Halt the Neo-Liberal Deformation of Europe
Jeremy Leaman

Abstract
The ‘neo-liberal deformation of Europe’, described by Jörg Hußschmid in a noteworthy commentary on the 50th anniversary of the Rome Treaties (Hußschmid 2007), can today be quantified, not simply in terms of the destruction of economic and social potential since 2008, but in the misallocation of social resources and dilution of economic potential before the crisis. The institutions and instruments of neo-liberal policy-making have proved incapable of ensuring sustainable and equitable socio-economic development in the region. Nevertheless, the political reality of the European Union – as an ‘historical bloc’ of interdependent but unequal elites – manifests a deeply embedded resistance to any significant shift away from ‘disciplinary neo-liberalism’ (Gill 1998). The ideological fixity of the key hegemonic agencies of the region (Commission, ECB, Bundesbank, German federal administration) has, in combination with seemingly immutable institutional arrangements, pre-programmed a set of policy responses which will continue the dilution of European welfare regimes and compound the trend towards increasing social inequalities. Against the background of a systemic crisis of European capitalism as critical as the 1930-45 crisis, the continuing political demonisation of state indebtedness (and by implication, of the state) represents a colossal obstacle to the politico-economic progress of the region as well as a fatal mis-diagnosis of the severity of the crisis. Neither the European Union nor the Eurozone can hope to progress towards a socially and environmentally just resolution of their collective problems without jettisoning the baggage of destructive ‘disciplinary neo-liberalism’ and replacing it with a new paradigm of policy-making which is collectively legitimized, adequately resourced and committed to the provision of public goods, to international cooperation and policy-coordination. This paper, in conclusion, asserts the centrality of harmonised regimes and cultures of taxation in Europe as preconditions for revitalised ‘courageous’ fiscal state, for regional cohesion and as a preventive cure for harmful fiscal and regulatory arbitrage.

ANALYSIS
Even before the Great Crash of 2008, Europe had managed to accumulate a very considerable number of problems for itself, problems which then increased the severity of that crisis and which have, in turn, been reinforced by the continuing effects of the multiple crises triggered by the cardiac arrest of financialised capitalism. What the political ‘management’ of Europe’s crises has revealed, above all, is that the intellectual/ideological paradigm that informed the thinking of both policy elites and their dutiful mainstream academic supporters in recent years is proving stubbornly resistant to critical self-reflection. The assumptions of neo-liberal thinking remain deeply embedded in the institutions and processes of European policy-making and the mind-set of those that preside over them. However dramatically the evidence of systemic collapse may reveal the political and intellectual follies of the neo-liberal ‘revolution’, their syllogisms continue to hold sway in the corridors of power, in the noisy wasps’ nest of the print and audio-visual media and – although increasingly interrupted by the voices of protest – within civil society. One of the most pernicious of those syllogisms concerns the nature of governance and the need to limit the role of collective action (state, government, public sector) to merely ensuring individual freedom and protecting life and property. While Hayek did not go as far as Mises (1951: 133) in denying the ‘strictly Liberal state’ an active role in economic affairs, the popularised logic of The Road to Serfdom (Hayek 1944) creates an artificial and dogmatic polarity, sanctifying the individual’s ‘liberty’ and demonising the state’s curtailment of individual action. Thus, the undeniable and observable deficiencies of state action on the part of Europe’s Keynesian administrations in the 1960s were often deployed as arguments to justify essentialist views which eschewed any attempt by states to intervene in capitalist markets, views that were popularised with the fundamentalist ‘efficient market hypothesis’, ‘crowding-in theory’ and the ‘quantity theory of money’. The lazy convenience of popular ideologies that employ a binary bad ‘other’ to justify its polar opposite ‘good’, has historically proven dangerously attractive as the intellectual cement of hierarchical, hegemonic arrangements; there are, as a result, many more bons mots that decry the fiscal state than are deployed in its defence; more tax collectors, by the same token, have been deemed scoundrels than heroes.
Neo-liberalism, however simple-minded its tenets, has proved and is still proving to be a tough and resilient cement for the ‘hegemonic bloc’ that established itself after the collapse of the Keynesian consensus in the 1970s; its ‘capture’ of both the political imagination of policy-makers and – more culpably – of Economics departments across the OECD, was reinforced by the paranoid idiocies of Stalinism and by the (US-assisted) collapse of European state-socialist economies. Since 1989, most Eur-
European states in both the established ‘West’ and the transformed ‘East’ have employed a conceptual framework and a set of institutions which conform to the binary model of Neo-Liberalism, critically influenced by German Ordo-Liberalism. This long-standing variant of market fundamentalism, rooted in the relatively obscure Freiburg School of economics under Walter Eucken, and popularised in the late 1940s by the newly formed Christian Democratic Union (CDU) under the appealing banner of the ‘social market economy’, identified just two key functions of the state, namely to ensure a stable monetary order and a stable competitive order. The CDU’s Düsseldorf Principles of 1949 encapsulate this minimalist view of state responsibilities which, rhetorically at least, set German post-war economic policy-making apart from the Keynesian orthodoxy emerging elsewhere in Europe:

‘The state is thus freed from the worry of central direction. There remains the task of making and protecting the law, of encouraging competition and organising monetary affairs’ (CDU 1949: 9).

Notwithstanding the consummate failure of West Germany’s ‘monopoly control’ (c.f. Hufschmid 1972: 150) and the clear evidence of extensive, activist state economic management at central and regional government level, the reputation of the Federal Republic’s austere and disciplined economic ‘order’ grew markedly in the ‘miracle’ years and, even more noticeably, in the stagflationary crises of the 70s and early 80s. The ostensible ‘object lesson in economic management’ (Zweig 1976) which was deemed to have generated less inflation and more growth in Germany than in its European partners, rapidly came to provide the institutional blueprint for the neo-liberal revolution at national and then, after 1989, at European level.

In place of the halfway co-ordinated macroeconomic orthodoxy of Keynesian policy-making (in its various national guises), west European states chose to adopt the asymmetrical German model of a (democratically unaccountable) autonomous central bank which fixed the policy parameters – borrowing costs and borrowing/ debt ceilings – of democratically accountable sovereign states and their regional/ local counterparts within the framework of the Maastricht Treaty (1992), the Stability and Growth Pact (1997/2005) and now the Treaty on Stability, Coordination and Governance in the Economic and Monetary Union (the ‘Fiscal Pact’, 2012). It is important to stress the path dependency of the particular way in which Europe managed to institutionalise neoliberalism, linked as it was to a politically inflexible model of central banking, compared to the US Federal Reserve and its obligation to consider cyclical fluctuations of growth and employment as well as price movements, and rendered effectively immutable by the unanimity principle in any reform of the ECB’s statutes (c.f. Arestis & Sawyer 2011). Equally important was the political dimension of the timing of European monetary integration and the fundamental objective of securing the loyalty of a newly united Germany to the European project within a reunited but volatile European political economy. The likely negative effect of German preferences on the conditions for membership, the institutions and the processes of EMU was prefigured by the Bundesbank’s mismanagement of the unification crisis 1990-93 and the absence of appropriate macro-economic mechanisms for ensuring the rapid convergence of the East with the productivity levels of the richer West after German currency union; this deficiency is grimly echoed by the mess currently afflicting the Eurozone. The fact 11 members of the then EU-12 nevertheless proceeded with the extreme monetarist conditions set by Finance Minister Waigel and the Bundesbank in 1991, is explicable only in terms of anxieties over ‘non-EMU’ – continued (informal) subordination to the arbitrary monetarism of the Bundesbank – and the collective blindness of Europe’s ‘epistemic community’ a) to the perils of severe current account disparities within any currency union, b) to the effective privatisation of money-creation by the ‘liquidity factories’ (Philips 2005) of financialised capitalism and c) to the havoc that decoupled monetary accumulation was wreaking and threatening to wreak in the real economies of Europe and the rest of the OECD (Altavater 1993).

What is now less explicable is the preparedness of the EU17 to submit themselves to an even tighter regime of ‘disciplinary neoliberalism’ (namely the Fiscal Pact) after the results of Maastricht and the Stability and Growth Pact became so apparent in the autumn of 2008, and the debris of the EU’s subsequent stabilisation measures littered the policy landscape. We are confronted by the ‘strange non-death of neo-liberalism’ (Crouch 2011) and threatened by the perverse ‘triumph of failed ideas’ (Lehndorff 2012; Krugman 2010).

Figure 1: The Non-Recovery of the European Economy
For Commission President Barroso to assert that economic recovery was ‘gathering pace’ in September 2010 (Reuters 7.9.2010) and more recently to inform us that we are ‘on the right track to recovery’ (United Nations 17.5.2012) requires more than a spoonful of bravado, when set against the evidence of the Eurostat diagram for Euro area and EU27 production above (Figure 1). If aggregate economic performance in Europe were not poor enough, the recovery rhetoric deserves hollow laughter when the real economic decline in Greece, Portugal, Spain and Italy is considered (see Table 1 below). Real economic output in the Euro area as a whole is set to reach 2007 levels only in 2013, according to the OECD, while six years of contraction in Greece will leave it producing almost a fifth less in 2013 than in 2007; Portugal and Italy will generate just 93% and 93.6% of 2007 output respectively, while Spain will still be well short of 2007 output with 96.2%. The calculable losses incurred already by five years of underutilised capacity indicate the worst slump in over 70 years, even before the compounding effects of continuing structural crises and mismanagement are considered.

Table 1: Real GDP in Selected European Countries 2007-2013 (2007 = 100)

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Source: OECD; * OECD Estimates in May 2012; **according to the IMF July update EU17 performance would be lower at 98.8 and 99.5 for 2012 and 2013 respectively

In contrast to Barroso’s wishful rhetoric, an occasional paper by staff at the Commission’s Directorate General for Economic and Financial Affairs (2009) strikes a more sober note of warning in its preliminary assessment of the long-term effects of the crisis, which presented both ‘optimistic’ and ‘pessimistic/realistic’ scenarios of losses in output and investment within the EU over twenty years. Both scenarios foresee permanent losses, of 0.5% in the optimistic variant and 4.5% annually in the pessimistic variant. The staff paper’s findings are in line with both specific studies of the 2008 crisis (Haldane 2010a) and the general conclusions of comparative studies of historical financial crises (Rogoff
& Reinhart 2009; Abiad et al. 2009); however, the DGEFA paper – for whatever reason – does not translate the warning into a set of prescriptive policy proposals, in contrast to Abiad et al. (2009: 27) who at least imply that countervailing fiscal measures reduce the deviation from trend growth!

Figure 2: Losses in Potential Output in EU27 2008-2027 (Estimated)

Without, at this stage, exploring Rogoff’s and Reinhart’s question of the ‘difference’ of the current crisis (see Box 1 below), the impact studies indicate at the very least that the scale of economic and social damage facing Europe is historically massive, not least because the crisis is regional if not global in nature, in contrast to the national nature of many comparator financial crises. Even if we limit our view to the cyclical crisis of output, the scale of the contraction is of an order which justifies an exceptional political response to mitigate the extensive reduction in overall welfare that current and future output losses will entail. There is no question that, in the view of EuroMemo and other heterodox economists, the policy response of the EU and its key member states – together with the policy advice of mainstream economists – has been entirely insufficient, merely at the level of anti-cyclical crisis management, of restoring national and regional patterns of economic activity to something approaching normality. However, the crisis amounts to much more than a cyclical disturbance of output, investment, consumption and employment. The very failure to manage even the cyclical crisis betokens a fundamental crisis of economic reasoning within the regional and global policy community. The trivialisation of economic discourse as a result of the neo-liberal revolution has generated its own path-dependency in the institutional arrangements, the operational principles and the policy processes – in a way which makes critical self-reflection seemingly very difficult.

Rather than admit that they’ve been wrong, European leaders seem determined to drive their economy — and their society — off a cliff. And the whole world will pay the price (Krugman, *New York Times*, April 15, 2012).

Box 1: Europe’s Multiple Crisis

There is strong evidence that the 2008-2012 global crisis represents a multiple crisis for European societies. Such a multiple crisis arguably entails the following:

1. A functional crisis of the global system of financial services; banking and related services have become incapable of ‘servicing’ the circuits of production, service-provision, investment and consumption;
2. A cyclical crisis of production, consumption, trade, investment and employment, which is threatening to become a regional ‘slump’ greater than that of the 1930s;
3. A structural crisis of ‘over-commitment’ to financial services as vehicle of growth; this in turn involves a fundamental crisis of capitalist commercial psychology, notably of the exaggerated profit-expectations underpinning Ponzi-capitalism; public and private pension funds, social insurance funds, private investment funds, private and corporate shareholders became fatally addicted to the unsustainably high rates of return, provided by hyper-leveraging and hyper-appreciation of financial assets;
4. A crisis of the ‘growth’ paradigm as policy vehicle for ensuring economic and social equilibrium, where the simple saturation of markets and increasing elasticity of demand renders the delivery of convenient incremental increases in output less feasible; the temporary illusion of growth and affluence provided by Ponzi-style circuits of fictitious capital can be seen as a desperate attempt to defy the reality of the increasingly limited growth potential of affluent societies;

5. A continuing crisis of the ‘growth’ paradigm as basis for planetary survival; the depletion of resources, bio-diversity, habitat-quality, along with the consequences of man-made global warming, pose colossal challenges to current generations in their efforts to bequeath a viable bio-sphere to future generations.

6. The first four crises above amount to a clear crisis of the neo-liberal paradigm; the bankruptcy of the ‘efficient market’ hypothesis and the illusions of ‘the’ market’s self-healing properties are evident and crass. However, the failure hitherto by ‘epistemic policy communities’ to acknowledge the intellectual bankruptcy of the paradigm betokens: >>

7. A continuing crisis of economic discourse, characterised by an institutionalised resistance to reflection and to holistic, interdisciplinary approaches to human social and economic relationships which acknowledge the profound (global and societal) interconnectedness of those relationships;

8. This in turn has revealed a deep crisis of economic management, characterised by a continuing paralysis of public authorities in the face of private interests, the nonsensical demonisation of the state as economic actor and the dominance of sovereign debt-consolidation as policy imperative.

9. The above thus betokens much more than a temporary cyclical or structural crisis of an otherwise secure mode of production, and rather an existential crisis of capitalism itself, unheeded by its corporate elites and its political ‘managers’ alike. It is thus very much ‘different this time’. The resultant recoveries from ‘the’ crisis are therefore unlikely to follow the patterns exhibited by states in earlier financial crises, as Rogoff and Reinhart (2009) suggest.

**Monetary Accumulation and the Destruction of Value**

The neo-liberal catastrophe is not confined to the recent bursting of financial asset-bubbles and its social and political aftermath. The process of value-destruction began almost simultaneously with the conversion of policy-makers and their wider community of academic and administrative advisers (their ‘epistemic’ community) to monetarism and Thatcherite supply-sidism. A recent study of the British economy by Martin Weale demonstrates in graphic form two major periods of value-dilution/destruction since the 1920s, the first beginning in 1930 through to the end of the Second World War, the second starting in 1980.

**Figure 3: Ratio of Produced Wealth to GDP in the UK 1920-2005**

Weale himself does not employ the concept of value-destruction but of the decline of the UK’s wealth-to-GDP ratio (Weale 2012: 62ff) – where wealth is defined as capital stock plus net foreign assets and net national saving. His analysis nevertheless provides an eloquent illustration of the similar effects of depression/war on the one hand and the neo-liberal paradigm on the other, inasmuch as the weakening of the overall wealth ratio between 1930 and 1945 was followed by a gradual recovery up until 1980, ‘after which it has declined sharply again’ (ibid.), reaching the historically low level of 1945 again between 2000 and 2005 (see Figure 3). Weale’s analysis in fact focuses on the significance of the current wealth ratio for the future sustainability of the macro-economy in terms of intergenerational equity; the inferred over-consumption of recent generations (i.e. of the neo-liberal period) is deemed to leave a less viable foundation for future welfare than the one inherited in 1980. However, Weale’s data also illustrate indirectly the allocatory diseconomies of the paradigm of ‘monetary accumulation’ as a function of poorer investment and saving between 1980 and 2005, weakening the long-term resilience of the UK economy, even before the further wealth-destruction during the 2008-9 crash. One can thus develop Weale’s model of unsustainable consumption further to include the diseconomies of functional and personal income distribution in the period.

The most striking and contradictory feature of distribution developments, in the UK and elsewhere in Europe, has been the rise in the profits ratio and (contrary to supply-side expectations) the decline in the investment ratio. We were assured by the proponents of the neo-liberal revolution that the higher profits, facilitated by tax relief measures, labour market reforms and capital market deregulation, would of necessity produce a greater preparedness on the part of enterprises to modernise and extend their capacity through increased investment; the associated enhancement of the enterprises’ competitive supply position would in turn, following Say’s Law, generate higher demand for the goods and services produced, and consequently create more job opportunities. However, the postulated virtuous circle, connecting higher rewards/profits for wealth-creating entrepreneurs on the one hand to increased employment for the mass of the population on the other, involved at best a colossal leap of faith, and at worst a dubious and counter-intuitive syllogism.

**Figure 4. Profits Ratio and Investment Ratio in Advanced Economies 1980-2005**

![Figure 4](image)

Source: IMF World Economic Outlook, April 2007, data from Charts 1.15 & 5.7; profits ratio defined as the share of income from capital in national income before tax and transfers; investment ratio is the proportion of gross fixed capital formation to GDP in any given year.

Even before one considers the strategic choices facing entrepreneurs regarding the particular vehicles for the valorisation of their increased reserves of capital at the end of a severe global stagflationary crisis in the early 1980s, one problem stands out: it is very difficult to take seriously the assertion that, by weakening the primary demand factor of a national/ regional economy – in the form of a lower
wages ratio and hence relatively lower household demand – and increasing the financial rewards of the primary agents of supply – in the form of an increased profits ratio – companies would be encouraged to increase capacity and employment through higher investments, when in fact there was no evident prospect of increased sales turnover in domestic markets and related OECD economies. Figure 4 above provides a fairly persuasive demonstration of the fallaciousness of the supply-side gamble; the rise in the gross profits ratio in advanced economies from 31.7 percent of national income in 1980 to 38.5 percent in 2005 (which corresponds to a mirror decline in the gross wages ratio from 68.3 percent to 61.5 percent) was accompanied by a decline in the average investment ratio of 2.8 percentage points from 19 to 16.2 percent of GDP.

Supply-side theory would expect a parallel rise in both ratios, rather than the divergence exhibited by Figure 4. However, apart from the naivety of supply-sidism in general and Say’s Law in particular, there were additional factors which contributed to the failure of the strategy:

- Neo-liberal reforms of the state included the extensive privatisation of state assets, many of them natural monopolies like the gas, power and water utilities or public transport networks and hubs (airports, ports). While telecommunications became increasingly subject to the competitive influence of cable and satellite technologies, most utilities remained natural monopolies, inaccessible to genuine market competition and its associated price efficiencies. The most popular solutions to the problem of the potential abuse of monopoly pricing in such utilities were the political regulation of rates of return (favoured in the US) or price/tariff changes (UK), with regular adjustments according to set formulae. Such regulatory systems operated on the assumption that there must be continuity of supply, provision for modernisation and long-term investment and (implicitly or explicitly) a guaranteed return on capital (c.f. Stern 2003: 22). It is unsurprising that the performance of such regulated monopolies has ensured higher returns on capital than applies to the SME sector (Candeias 2009); their revenues represent monopoly rents guaranteed for given contractual periods. Such privatisation programmes became core elements of state policy in advanced states and of the development policy of advanced states and supra-national institutions like the World Bank and the European Union.

- An extension of straightforward privatisation of state-owned assets was the introduction of ‘public-private-partnerships’, involving the private financing of public building and civil engineering projects and medium- to long-term leases granted to the companies, with guaranteed income streams from the public institutions (in education, health, transport etc.) operating their services from the facilities. A strong determinant motive in such schemes was the desire by state authorities to minimise the effect of such public sector projects on the state’s borrowing requirements in a period (1990 to date) dominated by the monetarist strictures of deflation and debt-consolidation. Such projects nevertheless also involved guaranteed monopoly rents within contracts that have been frequently criticized for their generosity towards the private partners. Recent official UK studies of the efficacy of the 700 or so PFI projects also cast serious doubt on the both their underlying principles and their viability (e.g. House of Commons 2011).

- Against this background of state policies helping to engineer higher than average rates of return on capital through guaranteed monopoly income streams, the investment options open to companies with growing capital reserves already militated against the risk of simply expanding and modernising capacity in traditional commercial sectors; more significantly the privatisation programmes raised expectations of rates of return that would become increasingly difficult for such traditional sectors to deliver (c.f. Haldane 2010b: 13). What then emerges from the parallel accumulation of corporate reserves in the MNCs of advanced states and the transfer of ‘petro-dollars’ from rich oil-producing states to the financial institutions of the North is a highly liquid global market for finance capital in search, not of secure but modest long-term returns on invested capital, but of increasingly high returns on capital that is committed for ever shorter periods of time (Hufschmid 2002).

1 The attractiveness of PFI/PPP schemes as vehicles for minimising state borrowing, as popularised in the UK, was responsible for the launching of a federal programme in Germany in 2008, aimed at increasing privately co-financed public infrastructure projects (motorways, schools, hospitals) to 15 percent of all state infrastructure investment; c.f. P-Newsletter, No.10, April 2008
In addition to these determinants of rising ROR expectations, in the early 1980s the monetary authorities of the advanced economies – led by the Federal Reserve – presided over a sudden increase in real interest rates which increased bond yields to historic highs; this was driven both by orthodox monetarist deflationary policies via higher central bank base rates, but also by the fairly unorthodox strategic military programmes of the Reagan administration and their heavy reliance on deficit-spending. Accordingly, US 10-Year real bond yields reached 14% in 1982. One commentator describes returns on bonds in recent decades as ‘super-sized’, noting that ‘real bond returns after inflation in both the US and UK have been on average 5.9% compound per annum – some three to four times the long term average respectively’ (Gillen 2012). Such returns on state guaranteed financial assets thus also contributed to increasing levels of expectation on the part of major investors, particularly in a period of low or negative growth, preparing the ground for the wholesale revolution in financial services that ensued (c.f. Huffschmid 2002; Mellor 2010; Phillips 2008; Tett 2008).

The important feature of the paradigm shift to financialised capitalism and monetary accumulation was that it was constructed on the illusion of enhanced wealth-creation, of the appreciation of paper assets which of themselves would produce ‘value’ and improve the welfare of citizens on a sustainable basis. Even a UK Treasury economist, like Andrew Haldane, demonstrates rather that the contribution of the financial sector to growth and ‘value’ was in large measure a ‘mirage’ (Haldane 2010b); the mirage of seemingly effortless value-appreciation through the operation of financial circuits nevertheless maintained an astonishing level of credibility among policy-elites, credit-rating-agencies and the academic community, defying the warning signs of the East Asian Crisis of 1997, the Enron debacle of 2001 and the ‘dotcom’-crisis of 2001-2, as well as the intuitive logic of observers who suggested it was difficult to create value out of ‘thin air’ (Mellor 2010 etc.). Nevertheless, the ‘fool’s gold’ paradigm (Tett 2008) was only revealed to be what it was to wider sections of global civil society when the affairs of Lehmann brothers, AIG etc. became public in the autumn of 2008. Haldane’s account of the ‘productivity miracle’ of financial services is persuasively simple, inasmuch as he uncovers the basic accountancy tricks of banks and other institutions which allowed them to create vast quantities of liquidity without altering the ‘health’ of their visible balance sheets or increasing their basic capital. They achieved this through a combination of hyper-leveraging (borrowing) and securitization (converting loans/ liabilities into securities/ assets based on future income streams). Far from suggesting a dilution of the asset-side of the balance sheet, such operations – often through so-called special-purpose-vehicles (SPVs) belonging to the same bank – the asset-side was seemingly increased by the on-going appreciation of the bonds (CDOs, ABSs etc) on secondary markets and the persistence of triple-A ratings delivered by compliant credit ratings agencies. The colossal liabilities represented by leverage ratios of ‘more than 50 times equity at the peak of the boom’ (Haldane 2010b: 15) were thus spirited off balance sheets in smoke-and-mirrors operations involving multi-layered ownership structures, shell companies and offshore secrecy jurisdictions.

The deployment of so much liquidity in the febrile capital markets of the 1990s and 2000s allowed a corresponding increase in the rate-of-return on equity (ROE): ‘the level of ROEs was consistently at or above 20% and on a rising trend up until the crisis. This is roughly double ROEs in the non-financial sector over the period’ (Haldane 2010b: 13). Moreover with the banks ‘engaged in a highly competitive ROE race’ (ibid.), the pressure to continue the leverage/securitization merry-go-round was very high, suppressing what remained of scepticism and prudence at the level of executive boards, investment analysts, credit ratings agencies and institutional investors. Such post hoc insights by a Treasury insider beg the question as to why there were so few warnings from the UK Treasury and the other policy elites of advanced states and of supra-national institutions, when financial ROEs were so clearly abnormal.

Figure 5: Ratio of Financial to Fixed Capital in Eurozone NFEs 1995-2005
The dilution of real wealth in the decades of the recent three decades of financialised capitalism is also evident in the changing shape of the asset holdings of ‘non-financial institutions’ (NFEs) or ‘non-banks’. Figures from the ECB (2007) covering the balance sheet composition of all NFEs in the Eurozone show that between 1995 and 2005, the ratio of their financial assets to tangible fixed assets more than doubled from an average of 0.53 to 1.18.

Most striking is the transformation of the balance sheets of manufacturing enterprises with financial assets in 2005 totalling 171 percent of physical assets (see Figure 5), a virtual doubling in just ten years. Figures for the individual branches of Germany’s dominant manufacturing sector show a marked trend towards the financialisation of their asset portfolios in the previous decade-and-a-half between 1980 and 1985, with motor manufacturers reaching an average financial asset ratio of 1.57, electro-technical corporations 1.76 and German chemical TNCs a ratio of 2.0 (c.f. Leaman 2009: 80f). The not infrequent references to Siemens and Daimler-Benz as banks with manufacturing subsidiaries find strong empirical support from such data.

A critical determinant of this historically unprecedented shift in the way in which industrial corporations valorised their capital, deriving increasing proportions of their operating profits from financial securities, rather than the sale of products and services, was the adoption of ‘shareholder-value’ as predominant measurement of commercial success. Lazonick (2011) identifies the particular role of stock (share) options in the remuneration packages of senior managers in driving this process in the United States. The option to be rewarded by extra tranches of a company’s stock distorted incentives, according to Lazonick, particularly within larger corporations, towards short-term commercial strategies designed to drive bull markets.

With average compensation in the Top 100 US corporations varying from ‘lows’ of $18.2 million (1994) and $103.7 million (2000), stock options accounted for well over two thirds in most years in the period 1992-2008 (Lazonick 2011: 8). One of the most potent vehicles for generating significant increases in corporate share values was in the (frequently hostile) takeover of other enterprises or the acquisition of majority holdings in other corporations. Figure 6 shows how dramatic the two waves of global takeovers were between 1990 and 2006, with record deal values of $4 trillion in both 2000 and 2006. The efficacy of M&A activity, as noted above, is strongly contested by a number of studies, one suggesting that 70 percent fail (Campbell et al. 2008), another that hostile takeovers have a generally worse record (Martynova et al. 2006); in the case of banks, Haldane cites research suggesting that economies of scale in banking are exhausted at relatively modest levels of assets, perhaps between $5–10 billion and that subsequently there ‘is no strong evidence of increased bank efficiency after a merger or acquisition’ (Haldane 2010a: 11).

**Figure 6: Global Mergers and Acquisitions 1990-2006**
Against the background of the ‘common knowledge’ that ‘most M&A activity is value-destroying’, as asserted by a mainstream economist (Haldane 2010b: 21; my emphasis) his subsequent assessment of the extraordinary degree of concentration in the banking sector, particular after the repeal of the Glass-Steagall Act in the US in 1999 (Haldane 2010a: 6 & 18) supports the view of the EuroMemo group and other heterodox economists that the ‘merger mania’ of the last two decades generated colossal gains for the minority of banking and other corporate executives involved in hyper-leveraged buyouts, but equally colossal risks for the compliant and complacent states and their respective citizens, risks that exploded in the autumn of 2008 and the costs of which have not even yet been remotely grasped by policy ‘elites’ at political or corporate level.

Austerity: The Persistence of Primitive Economics

In December 1899 George Washington developed a severe sore throat and temperature after a ride around his plantation; he insisted that – in line with common practice at the time – he should be bled to cure the infection; his doctors and his servant removed a total of 1.7 litres of blood from the sick man, roughly a third of his blood supply. Within 36 hours Washington had died. The primitive conviction that the human body was governed by humours, the periodic excess of which could be ‘cured’ by bleeding, can be equated with the primitive monetarist economics of today’s EU, most notably of its Fiscal Pact. By rendering public sector borrowing the primary enemy of economic recovery, an enemy which all member states must be statutorily committed to fight by means of pro-cyclical austerity, Europe’s policy elites are accelerating both the economic and democratic decline of the region through stubborn and naive adherence to a faith in the self-healing properties of ‘the’ market.

The unfortunate truth is that the damage inflicted on the circulatory mechanisms of advanced capitalism before and after 2008 had rendered it so weak and structurally so much less sustainable, that the reversal of the brief period of deficit-financed state reflation at the end of 2009 was absurdly premature and irresponsible. The Commission epitomised this absurdity by issuing ‘excessive deficit’ notices to 26 out the EU’s 27 member states in the worst year for the peacetime European economy since 1930. The implicit reduction of Europe’s remaining economic problem to a simple sovereign debt crisis and its effect on the confidence of financial investors has informed the stubborn adherence to the – in any case arbitrary – fiscal rules of the Stability and Growth Pact and the blind pursuit of fiscal austerity over the last three years. The belated and temporary resolution of the sovereign debt problems of the states in Europe’s southern periphery, in the European Financial Stabilisation Mechanism (EFSM) and its associated Stability Facility (EFSF) still operates according to the simplistic logic of ‘crowding-in’ private investment and growth by reducing the state’s demand for credit that dominated German and subsequently European central bank policy since the 1980s. Persisting with Germany’s fiscal
austerity preferences represents a collective irresponsibility that begging belief; its pro-cyclical nature – reinforcing the weakness of recovery in all states – was criticized by heterodox economists at an early stage in the crisis (EuroMemo Group 2009); since then the chorus of austerity-critics has expanded into the bastions of economic orthodoxy, at least in serious financial dailies (Wolfgang Münchau and Martin Wolf in the Financial Times, Thomas Fricke and Lukas Zeise in Financial Times Deutschland), as the evidence of the predicted counter-productive effects of premature fiscal austerity mounts. However, the irresponsibility continues.

In the Commission’s internal impact report (2009: 33) the ‘realistic’ scenario forecasts a ‘persistent decline in the capital stock’ as a result of chronically reduced investment, such that in 2028 capital stock in the EU27 will be 9.47 percentage points below pre-crisis levels. Incorrigibly, the working paper rejects ‘lax and unsustainable fiscal policies’ (44). The analysis confirms the extreme paradoxicality of Commission thinking. Firstly, neo-liberalism diluted Europe’s capital base, generating a decline in the investment ratio (Figure 4 above), and applying the German ‘austerity straitjacket’ of the Maastricht Treaty and the Stability and Growth Pact (Heise 2002); secondly, the global crisis since 2008 has destroyed real capital both through the chronic under-utilisation of capacity and the collapse of investment, with potential output losses of € Trillions; thirdly, fiscal austerity is compounding the destruction of physical capital by failing to compensate for the collapse of private investment and tolerating the colossal waste of ‘human capital’, represented by chronic levels of structural unemployment, most notably among Europe’s younger workforce. This threefold assault on the foundations of the future material and psychological well-being of European societies demands a vigorous response from all the peoples of this rich and still resourceful region.

End the Tyranny of Neo-Liberalism
In an interview with the German daily, Die Welt, the former president of the German Bundesbank, Helmut Schlesinger, suggested that the money issuance of the European Central Bank had reached ‘dimensions that are reminiscent of war-financing’ but unprecedented (and by implication unacceptable) in peacetime (Die Welt, March 13 2012); accordingly he warned of serious inflationary consequences for the German and European economies. The war analogy, designed by Schlesinger to ridicule the irresponsibility of the ECB and its departure from Bundesbank virtues, is in fact much more appropriate than he would ever be prepared to concede. The analysis above has attempted to demonstrate that the neo-liberal paradigm (deregulation, financialisation and monetary accumulation) generated a two-fold destruction of value, akin to the devastating effects of war, with neo-liberal austerity threatening a further period of destruction and depression. The dilution of social wealth since 1980 operated hand-in-hand with the most profound redistribution of income and wealth in modern times, generating serious diseconomies for current and future generations, even before 2008. Counterfactual estimates would suggest that the well-being of future generations could have been better ensured if the investment ratios and wages ratios of advanced states had remained at their 1980 levels, indeed that their maintenance would have been reciprocally strengthened with the parallel improvements of productivity, wages and consumption. The factual destruction of potential value in the processes of financialisation between 1980 and 2008 precedes and pre-programmes the factual and inevitable disaster of both the systemic collapse of monetary accumulation in the winter of 2008/ 2009 and the subsequent hapless attempts to manage the crisis.

The alarming estimates of potential permanent global output losses of up to $200 trillion – with current annual global GDP at around $78 trillion – do not actually begin to illustrate the challenges facing world policy-makers, particularly in the advanced economies. Recovery from the cataclysm of the Second World War involved arguably fewer strategic challenges than the current mess. For example, the evident need, after the War, to make good the colossal physical damage to commercial, domestic and public property, to urban infrastructures, to national and international transport networks, was combined with a state-welfarist policy consensus and a profound preparedness to cooperate within and between nations which allowed a rapid transition to growth and prosperity in the 1950s. This was reinforced by the emergence of both consumerism and the technical-managerial means (Fordism) to satisfy the burgeoning demand of increasingly affluent households. The 2008 crisis manifests none of these auspicious pre-conditions for recovery and reconstruction:

- There are no general physical signs of a catastrophe to be remedied;
• There is no shared acknowledgement of the unnecessary follies of the neo-liberal paradigm as there was of the need to reverse the (unavoidable) privations of war;
• There is no shared diagnosis of the causes and extent of the crisis; there have been no mass resignations from the Economics departments of OECD universities and research institutes; there is no self-evident replacement for a discredited system;
• There is significantly no overwhelming need for a marked increase in consumer goods provision – saturation of markets and unpredictable elasticities of demand predominate;
• There is no common view about the need for an increase in the provision of public goods, even if some progressive forces point to these consistently as vehicles for general human progress.

Policy Options
It is nevertheless undeniable that the civil societies of the advanced states of Europe are generating new debates about the nature of economic and social relations and in particular about the need for greater equity and ‘fairness’, and a central role for an active state. The continuing mobilisation of such forces and an intensification of public debate within and across borders is an urgent priority. A number of stark policy-options suggest themselves from the analysis above. These run counter to the policy preferences, currently being pursued by the European Union. The obsessive attachment of Brussels to the German ‘model’ of export-led growth and deflation on the one hand, together with its inexplicable thraldom to the wisdom of credit-ratings agencies and major banks, threatens to condemn Europe to an extended period of stagnation, protectionist nationalism and political fragmentation. The early signs of multi-lateral coordination within the G20 have all but evaporated, weakening one essential pre-condition for effective crisis management.

Figure 7. Sovereign Debt Ratios in Selected Countries 1930-2010

Public Control and Limitation of Banking: Given the dilution and destruction of value resulting from the irresponsible neo-liberal experiment with financialised capitalism and the equally hazardous roll-back of the state, there is an increasingly strong case for the (temporary) public control of the commanding heights of finance capital as a means of restoring a modicum of allocatory good sense to the reinvestment of social wealth as a real basis for sustainable human development, along with a much higher level of legitimacy. Political economies that seek to promote the welfare of all of their citizens simply cannot afford financial services that are predominantly self-serving, which divert corporate reserves into value-destroying Ponzi-style ‘financial investments’ away from value- and welfare-enhancing real invest-
ments. They cannot operate effectively with a sector whose total balance sheets, as in the case of the UK, grew from just 50 percent of GDP to 500 percent of GDP between 1970 and 2008. Financial services essentially need to be returned to the service function of collectively beneficial and controllable circuits of investment, production and consumption.

- **Fair Distribution:** Additionally, policy-makers in advanced economies need to address the critical disparities of distribution within the future context of far lower and far less predictable trend-growth; learning to cope with zero quantitative growth while allowing poorer economies to converge towards a sustainable level of qualitative growth is arguably the most critical task facing post-crisis societies.

- **Public Goods:** Within qualitative growth scenarios, likewise, the role of public goods in the broadest sense (health, education, legitimacy, social inclusion, distributional equity as public goods) will inevitably become more rather than less significant, in line with Wagner’s Law of state tax ratios rising with levels of civilization.

- **Realistic Rates of Return:** A further challenge to all participants in the recalibrated political economies of the OECD and of Europe is to overcome the structural addiction to unrealistic rates of return that have too long informed the investment strategies of the managers of sovereign wealth funds, pension funds and other investment funds and, by implication, generated the exaggerated management fees extracted from Ponzi-style investment vehicles. Above all, the current and future sustainability of retirement pensions will have to become increasingly the subject of general distributional debates within society concerning their intergenerational equity, rather than of intra-fund adjustments.

- **Deficit-Spending as Necessity:** The current contradictory trajectory of European states and their pro-cyclical strategy of growth through austerity (!), represents a public ‘bad’ which needs to be reversed as a matter of extreme urgency. The analysis above has attempted to demonstrate that the cumulative crises that have hit Europe since 2008 represent more intractable problems than those facing states in the reconstruction period after World War II. The levels of sovereign debt in Europe generated by the 2008 crisis are accordingly by no means extraordinary by historical comparison (See Figure 7). The UK’s sovereign debt in 1948 was 237 percent of GDP, that of the Netherlands and Belgium 223 and 118 percent respectively (Reinhart & Rogoff 2011: database). It took some 20 years before the debt of these states fell to Maastricht-compliant levels; expecting the EU17/ EU27 to achieve these levels by 2013 indicates monumental stupidity. Against the background of the critical asymmetries generated by the neo-liberal paradigm and the consequently greater challenges of promoting debt-reduction via growth, the case for tolerating higher levels of debt in the medium term to avoid even greater economic asymmetries and the collapse of the European project, is thus overwhelming.

Reconfiguring Economic Governance in Europe: Public Goods, Taxation and the State

In December 2008, it seemed as if at least one practical lesson had been learned by both policy-makers and civil society, namely that the role of the state was, contrary to the idiotic prejudices of the preceding 30 years, central to the survival of capitalism and the continuous management of its deficiencies. The deployment of colossal volumes of public resources to provide life-support to national financial institutions as well as international networks of banking and payments, should at least have laid to rest the delusion of ‘the’ markets’ self-healing properties. There were very few ‘experts’ within Europe’s ‘epistemic community’ of economists and economic policy-makers that would have trumpeted the virtues of ‘efficient markets’ for resolving the cataclysmic mess of casino capitalism in the winter of 2008-9. The call for decisive political action, for international cooperation and coordination was deafening; the response of EU, G7, G20, the Federal Reserve, the European Central Bank, Bank of England, the World Bank and the IMF was admirably urgent. National, international and supranational governance and re-regulation was seemingly acknowledged as pre-conditions for recovery. By the same token, the financing of salvage operations for banks and of counter-cyclical stimulus packages via budget deficits enjoyed at the very least the tacit support of the economic elites and the citizens of the advanced economies.
However, despite such auspicious beginnings, 2009 saw the rapid return to what Richard Murphy has recently coined ‘the cowardly state’ (Murphy 2011) with the re-assertion of the primacy of deflation and debt-consolidation among key EU states and at Commission level. This reversion to ‘failed ideas’ (Lehndorff 2012) was in part pre-figured by the contradictory persistence during 2008 and 2009 of the Commission’s ‘excessive deficit’ obsession in relation to new member states (Leaman 2012: 175ff), particularly when most CEECs had lower PSBRs and overall debt ratios than their counterparts in the EU15. This obsession was given ECB support at an early stage in 2009, as Europe was experiencing the worst recession in 80 years, with Jean-Claude Trichet asserting that states had reached the limit of indebtedness and would need to start reducing their borrowing in 2010 in order to reassure consumers and financial markets (quoted in The Guardian, 21 June 2009). In April 2010, Trichet surprised one questioner by asserting and, on request, repeating the conviction that ‘the market is always right, and has to be completely respected at all times’ (cited in: Lehndorff 2012: 7). Finally, and shortly before his departure as President of the European Central Bank in 2010, in a speech declaring the imminent restoration of full health to European capitalism, Trichet stated that all the ECB had to do was to accompany ‘the market as it progressively gets back to normal’ (Financial Times 9.9.2010). Trichet’s restatement of neoliberal orthodoxy has, over the last three years, been echoed by key figures within the policy community in Berlin, Frankfurt, Brussels, Amsterdam, Helsinki, London and Vienna. The opportunity to reflect on failure and alter course has thus been woefully squandered, raising the suspicion that a neo-liberal policy-elite is indeed using the opportunity to ‘finish the job’, to complete a pan-European neo-liberal strategy (Buckel et al. 2012: 30ff) and weaken European social provision even further as a supply-side inducement to retain the loyalty of capital (Lehndorff 2012: 24).

The ‘competitive state’ (Hirsch 1995) is the opposite of the activist state of New Deal Keynesianism; it is not even the ordo-liberal state, pursuing national mercantilist goals, but the subaltern set of institutions within an interdependent network, controlled by transnational capital as a hierarchized historical bloc. The capture of Europe’s advanced states by transnational capital epitomises Huffschmid’s notion of ‘deformation’. Replacing these deformed structures of governance Europe-wide with new institutions of collective, multi-level democratic control with strong commitments to harmonised principles of active and socially just fiscal policies is the fundamental challenge for this and future generations of European civil societies, as the EuroMemo Group and other organisations like Attac have repeatedly stressed. The obstacles in the way of both salvaging what is left of ‘social Europe’ are considerable and have been multiplying since the aggressive reassertion of pro-cyclical, neo-liberal debt-reduction programmes in 2009. What is also becoming increasingly evident is that the challenge is of a fundamental, socio-cultural nature, made particularly problematic by the capitulation of many established, social democratic parties to key tenets of the neo-liberal revolution; indeed the capture of these parties and of significant sections of both electorate and civil society by interest-driven media campaigns and their sanctification of consumerism and individualism helped to generate new waves of expectation in relation to lifestyle, income, expenditure, pensions which were critically dependent on Ponzi-style capitalism. These effects have survived the collapse of the latter and, at the very least, interfere with processes of reflecting on and recalibrating those lifestyles. The competition states of Europe have, through their collective powerlessness and their separate degrees of national failure, also contributed to a weakening of faith in conventional democratic politics, where resignation and cynicism would seem, as yet, to be stronger than reflective, dynamic opposition to the historical bloc, even if that opposition is growing.

The neo-liberal programme of crisis management is set to intensify the competition between member states as they dilute further their provision of public goods, services and social security; the ‘race to the bottom’ is accelerating (Genschel 2011). Hitherto, this ‘location competition’ has increased the disparities in the external balances of the EU, in particular within the Eurozone, with German current account surpluses growing in relation to most other member states (Lehndorff 2012: 92). The demand and supply asymmetries between Eurozone members are mirrored by the shift in demand structures in individual countries, with weak domestic demand in Germany offset by increasing dependence on export demand as a vehicle for growth. Further demand asymmetries have been generated by the growing disparities in income distribution.

Persisting with the German ‘model’ will exacerbate rather than alleviate these asymmetries. Rebalancing them is a precondition to European recovery. A precondition for altering course is the **refining and radicalising of politico-economic discourse in the civil societies of all member states**, for which the EuroMemo group provides one significant platform. This requires, at the very least, a coalition of
forces against neo-liberal orthodoxy and the influence of transnational capital. The initial primary focus of this coalition must arguably be the restoration/creation of the active fiscal state which redistributes social resources for the benefit of the overwhelming majority of its citizens – the 99% as the central banner of the Occupy movement suggests. Fiscal rebalancing has to be rooted in a European consensus about the very purpose of taxation. Annamaria Simonazzi summarizes the challenge correctly as an educational task:

‘The understanding of taxes has to be linked to the understanding of services: people have to learn again, that it is their health, that it is education, kindergartens and the care of the elderly, that they pay for’ (Simonazzi 2012: 201f).

Currently, the absence of a serious revenue dimension to fiscal harmonisation represents Europe’s greatest structural deficiency in policy-making; monetarist strictures about debt and expenditure predominate. One of the few successful initiatives in the direction of tax harmonisation – the European Savings Directive – has been fatally weakened by the bilateral tax deals between Switzerland and two of the EU’s major neo-liberal strongholds, the UK and Germany. A sensible point of departure for a broad, pan-European opposition to the destructive effects of such wilful beggar-thy-neighbour policies and the EU’s historical failure to promote tax harmonisation (Leaman 2012a) would include the elements outlined below:

Towards a New Fiscal Consensus in Europe

1. A Fiscal Union and Settlement Union of the EU17 based on the long-term commitment to eradicating poverty, unemployment and social exclusion; as a Settlement Union the Eurozone would deploy its resources collectively to ensure the relative convergence of external balances, of national and regional ratios of investment, private consumption and public consumption to GDP against the condition to outlaw fiscal free-riding with the abolition of tax and regulatory competition and a relative convergence of states with low tax ratios (c.f. Ireland, Greece, Portugal) to a higher average.
2. The Fiscal Union of the EU17 would allow deficit-spending for anti-cyclical purposes and for structural modernisation, without the imposition of arbitrary ceilings to deficits or overall debt (no Debt Brake!) and with mutually assured Eurobonds.
3. Fiscal harmonisation within the EU27 which ends tax competition, establishing minimum standards for direct and indirect taxation, maximising transparency, automatic information exchange and compliance-policing:
   - Agreed minimum rates of personal income tax (PIT) and corporation tax (CT);
   - Commitment to the principle of progressive income taxation (phasing-out of flat-tax regimes and relative convergence of scales of progression);
   - A Common Consolidated Corporate Tax Base;
   - Country-by-Country reporting/ Publish What You Pay;
   - Formulary Apportionment associated with CBCR;
   - Restriction of national variations of special allowances on both PIT and CT to the purposes of rectifying current account asymmetries and productivity disparities;
   - Outlawing of European tax havens/ secrecy jurisdictions;
   - Boycott of financial corporations and other companies operating ‘brass plate’ business in overseas tax havens;
   - Tax avoidance to be made as ethically unacceptable as human trafficking.

The restoration of a strong and well-resourced fiscal state represents a minimum consensus around which progressive forces in Europe could and should be mobilised. On these foundations, the obstacles to sustainable social development could be removed and the objectives of a courageous, activist state could be addressed. The removal of the legal, institutional and organisational pillars of neo-liberalism – as the historical means of social and economic ‘deformation’ – would be as radical as the original Thatcherite ‘revolution’:

- The public ownership of utilities as natural monopolies should be restored and other sources of monopoly rents (Private Finance Initiatives, e.g.) eliminated. The provision of water ser-
vices, public transport, power distribution, health, education and social welfare as public goods is the natural function of the public sector; the commodification of those services as a vehicle for the direct valorisation of capital is incompatible with a society committed to collective responsibility for the welfare of its citizens, based on solidarity, social justice and democratic legitimacy. The recent accelerated privatisation of public utility companies and service providers as a condition for EU assistance for states with temporary sovereign debt problems (Greece, Portugal) must be reversed; securing comfortable income-streams from monopoly franchise/ supply operations inflates rate-of-return expectations and reduces entrepreneurial incentives to invest in commercial activities that are subject to market pressures.

- The on-going paralysis of commercial investment in many EU countries is in part informed by the distortions in profit expectations generated by 30 years of neo-liberal privatisation. This paralysis furthermore demands a long-term role for the public sector in underpinning national and regional investment demand and has consequently informed a number of proposals by progressive economists for the establishment of state-owned investment banks to fill the void left by coy private banks (Murphy 2011: 274ff) and for the European Investment bank to fund infrastructure projects (EuroMemo 2010: 4, 40; EuroMemo 2011: 3, 34); state investment banks would be financed directly by central banks, by-passing the hitherto fruitless and dubious route involving liquidity injections into private banks.

- The third key function of the active state is to counteract the pernicious redistribution of income and wealth that has characterised the neo-liberal era; this cannot simply involve the secondary transfer of state resources to produce a less inequitable distribution of net incomes, but must also address the more critical and growing disparities of market incomes; the record of the UK Labour government (1997-2010) demonstrated the haplessness of an anti-poverty strategy that neglected the central function of market distribution, deploying colossal volumes of state transfers merely to prevent a further rise in an already high Gini coefficient. Fiscal transfers play an important but secondary role, compared to statutes of industrial and employment law which allow productivity increases and profit growth to be reflected in the growth of real wages.

Ending the destructive tyranny of neo-liberalism represents a colossal challenge, not just in the mechanical delivery of a radical new policy-mix, but above all as an intellectual and cultural learning process. Such change cannot be delivered by an insurrectionist vanguard in individual nation-states, but by a broadly-based, well-informed, dynamic coalition of progressive forces operating at a variety of levels – local, regional, national, global, virtual. The EuroMemo Group can play an important role in helping to mobilise and inform such a coalition, to ensure that we bequeath our grandchildren halfway adequate foundations for decency, justice, sustainability and coexistence.

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