# From the Subprime to the Sovereign Crisis. Why Keynesianism does not work?

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## The menace of sovereign crisis

The deepening fiscal crisis of the states or the sovereign crisis now threatens governments and economic life of the majority of people in many capitalist countries.

It is serious especially in EU, starting from Greece, the motherland of democracy. In the Fall 2009, just after a change in administration, the Greek government revealed that the actual rate of deficit of the state budget against GDP was 13.6%, far beyond around 4% announced by the previous government, or a regulation rate requested by EU. The market price of Greek state bonds had to decline and the budget crisis of the state was accelerated. In May 2010, ECB (European Central Bank) and IMF cooperated to set up a rescue loan programme up to €110 billion in three years. In October 2011, 17 countries in Euro area requested banks and other financial institutions to cut off 50% of the face value of Greek state bonds as an additional rescue operation in order to avoid Greece's default and the resultant financial crisis.

Such a severe fiscal crisis of the Greek state caused difficulties in issuing additional state bonds in the face of shortage of budget revenue, and enforced resignation by Prime Minister G. A. Papandreou in November 2011. Just 5 days later a similar fiscal crisis in Italy soon enforced resignation of Prime Minister S. Berlusconi too. In Spain, Portugal, and Ireland, the fiscal crisis of the state is also deepening as shown in falling prices of state bonds in a market, making the budget operation harder and harder.

Those EU countries in a sovereign crisis had to ask for support to EU mainly led by Germany and France, so as to get financial loan or aid in the form of support buying of state bonds from ECB. Such loan or aid is often given in exchange with severe demand to cut down the fiscal deficit of the state within 0.5% of GDP, following German 'basic law' for fiscal discipline. This austere rule is called a project of Germanization of Europe. The countries which are demanded to follow the rule have to cut widely the state budget by dismissing many of public servants and reducing their wages. State expenditures for social security services and education have also to be cut down.

> *In such a process of passing the crisis around the world, the return to the renewed Keynesianism and social democratic welfare policies could not be carried through, but has been rather pushed back toward neo-liberal austerity policies in many countries under the pressure of deepening debt crisis of the state, against expectation among common people.*

Strikes, demonstrations and other forms of workers' and citizen's movement against such austerity policies are spreading from Greece and Italy to many European countries. Among social movements in peripheral countries in Euro area, opinions as follows tend to prevail. Within the area, the unified currency functions, just like the fixed exchange rate international monetary system, advantageously to Germany where productivity can easily rise in advanced manufacturing industries so as to increase surplus in trade balance, and disadvantageously to peripheral countries where productivity is hard to rise in their main industries like agriculture, sightseeing, and small-sized manufacturing. Given such international division of labour, Germany naturally ought to help peripheral countries in international financial crisis. It is unrealistic and unfair to demand Germanization of fiscal discipline in exchange for international financial aids within EU. Is it not better rather to leave the strait-jacket in EU, so as to restore the national autonomy of fiscal and monetary control, after cancelling international debt by default? If such political option is actually taken by Greece and some other peripheral countries, it would cause a disruption of unification of EU and Euro, as well as a heavy damage to banks and other financial institutions through a huge amount of default of state bonds.

Already in October 2011 a giant Belgian-French commercial bank, Dexia, was bankrupted due to capital loss mainly on its holdings of Greek and other government bonds in the process of falling market prices of those bonds. The fiscal crisis of the states is thus rebounding on the financial crisis, and the major rating companies reduced down the ranking grades of European mega banks in following December. Those banks and other financial institutions are striving for restructuring by cutting down their employment.

In the deepening economic crisis of EU, the credibility of its common currency Euro has been fallen down. Euro's exchange rate against a dollar has fallen from around 1.6 dollars in 2008 to 1.31 dollars, about 20%, and against yen from 160 yen to 100 yen, about 38%. This tendency makes it harder to sell European state bonds in a world market, promotes a fall in their market prices, as well as a rise in their rate of interest, and thus deepens the burden of state debt, so as to damage the credibility of Euro further, forming a vicious circle.

The menace of fiscal crisis of the state is not limited to European countries. In addition to the deepening US fiscal crisis in local (states and cities') government


which has enforced cuts of civil servants and social services after the subprime crisis, President B. Obama faced also a severe shortage of budget revenue for the US central government in Summer 2011, and had to compromise with the Republican Party to implement more austere economic policies, so as to get permission in the Parliaments to issue more of state bonds. The international credibility of dollar was shaken, causing a fall in exchange rate of dollar. It has been combined with heavy loss by the security market due to European crisis among others, and worsened US mega banks and other financial institutions also. The ratings of US banks have been pulled down and they are striving to cut employment and to restructure like their European colleagues.

In the meanwhile, among advanced countries, the menace of fiscal crisis of the state or the sovereign crisis is not yet so acute in Japan. Japanese yen has rather appreciated conspicuously since Summer 2011, as the exchange rates of dollar and Euro have declined. Japanese long-term (for ten years) state bonds are still being issued with an extremely low rate of interest under 1%. This seems a paradoxical riddle. As J. Attali (2010) points out, 'Japanese public debt, having reached 200% against GDP, is worst among advanced countries'. While the proportions of public debt against GDP were 80% in total EU, 135% in Greece, nearly 100% in UK, and 54% in USA, an acute sovereign crisis attacked these area or countries. Why can Japan with the worst proportion of public debt still escape from a similar sovereign crisis despite of her heaviest decline of real GDP among the major advanced economies in 2008-09 and the subsequent economic damage by the great earthquake in March 2011?

The riddle may be deciphered from the fact that the Japanese state bonds, unlike those of countries falling in sovereign crisis, are mostly being purchased domestically, by depending upon the high rate of household saving to have accumulated about 1500 trillion yen, three times of GDP, of individual financial asset. However, the amount of Japanese individual financial asset has become stagnant and has not increased but a little in the recent decade, as a tendency toward an aging society has intensified. Therefore, if financial demand for loanable capital is recovered in private sector in addition to the increasing public debt, a rise in the rate of interest must be inevitable. It would cause a fall in market price of Japanese state bonds with very low coupon, thus would give a huge amount of capital loss to Japanese banks and other financial institutions, and must surely make the burden of interest on public debt more destructive to the state budget. From this view, Attali's warning that Japanese huge public debt will become uncontrollable seems persuasive in pointing out an existing latent menace of sovereign crisis also in Japan.

## The Structured Debt Crisis

Capitalist economies in our age among advanced countries after the period of high economic growth until the beginning of 1970s, hypertrophied the roles of financial market and financial institutions, and became characterized as financialised capitalism (Lapavitsas, 2009). As A. Glyn (2006) states, the proportion of total profit of financial companies against that of non-financial companies in the USA, for example, used to be one fifth in the 1970s and 80s, but it rose to one half in 2000, and in some years went over 70%. The major source of such financial profit has shifted from the traditional lending interest revenue to commissions and margins in trading various kinds of securities, shares, foreign currencies, and derivatives in financial markets. The current sovereign crisis clearly proceeds through the shocks of falling prices of state bonds in the financial markets after swelling issue of state bonds in the process to cope with the subprime world economic crisis as a function of such financialised capitalism. The financial market in financialised capitalism now deeply involves states and seems to have power directly to rule over democracy and governments as was shown by enforced resignation of Prime Minister both in Greece and Italy last November.

The current sovereign crisis has causal and structural relationship with the subprime crisis, originating from financialisation and debt crisis of labour-power and the resultant debt crisis of financial institutions. In such three-structured total debt crisis among labour-power, financial corporations and the states, the sovereign crisis today is historically specific in contrast to the repeated past experiences of sovereign crises in the history of capitalism.

The USA was the epicentre of the subprime crisis. The US housing boom, which was promoted by housing loan, continued for a decade, and played a central role as a locomotive to lead the economic recovery especially during 2002 and 06 after the collapse of New Economy boom until 2001. At the end of 2006, the total amount of US housing loan reached 13 trillion dollars, about the same as annual GDP. The amount of subprime loan to households with lower credibility occupied 1.7 trillion dollars in it. As a typical subprime housing loan was 200 thousand dollars per household, and the other housing loan may be 300 thousand dollars in average, the number of households which purchased their new houses by such long-term housing loan must amount to 8.5 million in the subprime class, and to 43.3 million as a whole within about 100 million US households in total (Itoh, 2010). A large proportion of wage workers were thus induced to owe a heavy debt, at least several times as much as their annual wage revenue, with a promise to pay both interest and principal monthly typically so long as for 30 years.

Banks and other financial institutions in advanced countries began to expand consumer credit including housing loan, after the post-World War II high economic growth period, as non-financial big businesses tended to be self-financed by restraining investment into plant and equipment. In the history of capitalist development, traditional main business of modern banks and financial market used to be lending to capitalist firms, not to consumers, unlike the moneylenders or usurers in pre-capitalist societies. In financialised capitalism in our age, big banks and other financial institutions re-extended housing loan and other consumer credit anew by organizing specialized mortgage loan companies as subsidiaries. In addition to exploitation of surplus labour at workplaces, mass of workers are incorporated into financial relations to be further exploited in the forms of interest, commissions and insurance payment for consumer credit including housing loan, while substantial portions of their wage revenue are gathered into financial institutions in the forms of deposit, pension and insurance funds. Under financialised capitalism, financialisation of labour-power has clearly deepened.

Being promoted by such financialisation of labour-power, the speculative boom of US housing market could not continue endless. After it pushed up the average price

Table 1 Annual change in real growth rate (%) 2007-2012

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 |
|---|---|---|---|---|---|---|
| World | 5.4 | 2.8 | -0.7 | 5.1 | 4 | 4 |
| Advanced economies | 2.8 | 0.1 | -3.7 | 3.1 | 1.6 | 1.9 |
| USA | 1.9 | -0.3 | -3.5 | 3 | 1.5 | 1.8 |
| Euro Area | 3 | 0.4 | -4.3 | 1.8 | 1.6 | 1.1 |
| Japan | 2.4 | -1.2 | -6.3 | 4 | -0.5 | 2.3 |
| Emerging and Developing Economies | 8.9 | 6 | 2.8 | 7.3 | 6.4 | 6.1 |
| Developing Asia | 11.5 | 7.7 | 7.2 | 9.5 | 8.2 | 8 |
| China | 14.2 | 9.6 | 9.2 | 10.3 | 9.5 | 9 |
| India | 10 | 6.2 | 6.8 | 10.1 | 7.8 | 7.5 |

IMF World Economic Outlook, Sept. 2011.

of US houses twice and a half in a decade, it could no more sustain the elevated prices, not to mention upward trend of them, as the burden of paying both principal and interest for new housing loan against wage revenue became so excessive. Especially when the initial teaser loan period for two or three years was over, the so-called repayment shock to face a wide increase of monthly payment of principal and interest for debtors often caused real disappointment not being able to reset the mortgage debt advantageously by obtaining expected capital gain for a rise of house price, but rather making capital loss in the fall of house price in mortgage. From the subprime mortgage debtors with such repayment shock increased the number of persons who could not manage to continue monthly payment for housing loan, and were driven out of their houses due to foreclosures, just as the first scene of Michael Moore's film 'Capitalism'. By 2008 the number of foreclosures in the US housing market went over 200 million, and in June 480 million, or 8.8% of total number of housing loan in the US were reported either in being unpaid or in the process for foreclosure. Thus, the debt crisis of labour-power spread at the basis of subprime crisis, together with a terrible function of expropriation of dwellings. Even for households which managed to escape foreclosures, a huge capital loss by a fall of market prices of houses more than 30% in average remains, and enforces the continuous burden of monthly repayment including for the loss for long years to come. This functions also as a form of financial expropriation, and must depress down the consumer demand.

During the housing boom, the necessary fund to expand housing loan was globally obtained through selling mortgage backed securities (MBS) and other forms of securities which bundled quite a number of individual mortgage loans together in the world market. A theory in computational finance, that even individually risky loans such as subprime loans would be turned into safer prime loan securities when combined together, was generally believed true. The theory seemed adequate only so far as the prices of houses in mortgage were going up, but could not hold when the debt crisis of working people spread from the subprime class along with falling prices in the housing market. As the number of defaults in housing loan increased, market prices of multi-layered securities like MBS fell down, and brought about massive capital loss to hedge-funds, banks and other financial companies. The debt crisis of labour-power was thus turned into the severe crisis of financial institutions. The failure of fourth biggest US invest bank, Lehman Brothers, in September 2008 symbolized a peak of financial distress and broadened the crisis in the world financial market.

The financial crisis destructed the US housing boom and the related consumption boom, and depressed down the real economy, as we saw in the bankruptcy of big three US automobile makers in Spring 2009. According to IMF statistics (Table 1), the real economic growth in the USA thus declined 0.3% in 2008, and further 3.5% in 09, in total 3.8% in two years, by increasing the rate of unemployment to around 9%.

The subprime crisis which originated from the USA gave a serious blow especially to European financial institutions too. Because European banks and other financial corporations purchased a large proportion of US MBS and other securities related to housing loan including the subprime. In addition, in several countries in Europe like UK, Spain, and Ireland, a similar speculative bubble swelled in the real estate market simultaneously just as in the USA, and burst similarly following the US crisis. Many European countries including Germany also suffered from the depressed export to the USA and global market after the crisis. Thus the real growth rate in the Euro area declined by 4.3% in 2009, more widely than a fall in the US economy (Table 1).

Contrastingly Japanese banks and other financial institutions were relatively immune from the subprime financial crisis. Most of them had become more prudent to avoid risky speculative trading of subprime related securities, by reflecting their bitter experience to cope with bad loans so many years after the burst of huge domestic bubble at the end of 1980s. Their managerial bases had also been re-strengthened through mergers and restructuring through the 'lost decade' of 1990s. Despite of relative stability in the financial system, the Japanese economy experienced a wider decline in real economic growth rate beyond declines in the USA and the Euro area, 1.2% in 2008, and 6.3% in 09, in total 7.5% (Table 1). Why? The reason must be attributed to the character of Japanese economic recovery, which depended totally on increase in export to the US and other foreign markets, without resolving structural domestic weaknesses in consumer demand due to continuously depressed wages, as well as to a rapid transition to an aging society with anxiously cumulative state debt.

## Return to neo-liberal austerity policies; or Why Keynesianism does not work

The subprime global crisis deeply shook credibility of neo-liberalism which served as a dominant policy trend in the advanced capitalist economies since the 1980s. Neo-liberalism was based upon neoclassical micro-economics, and argued that the most rational and efficient economic order must be realized only through competitive free market by reducing the role of the state intervention. It was not just a reaction to the failure of Keynesianism and welfare state policies to prevent or solve the inflationary crisis in the 1970s, but was also given an appropriate economic basis in restructuring of contemporary capitalism to promote multi-nationalization of firms utilizing more and more cheaper irregular labourers flexibly both domestically and globally in competitive free markets upon the ground of newly developed information technologies (IT) (Itoh, 1990). In the process of such neo-liberal globalization, capitalism in advanced countries continuously tended to oppress down real wages by weakening trade unions, intensified financialisation of labour-power, and began to repeat speculative asset bubbles and their bursts unstably by mobilizing idle monetary funds which became excessive for stagnant industrial investment. The subprime crisis occurred finally through such repetitive collapses of bubbles, not externally but internally from within the US financial system which promoted neo-liberal globalization as a leading and central model. It evidently revealed anew that the market principle recommended by neo-liberalism cannot guarantee really rational and efficient economic order, and also that capitalist market economy unleashed from social regulations inevitably causes unstable self-destruction


with disastrous economic loss and social costs in vein (Itoh, 2010).

As a result, neo-liberalism and its theoretical foundation became broadly cast into doubt and reexamination. In 2009, changes of government were realized in the USA and Japan, as the majority of people voted for Democratic Party. Those people clearly wanted to end neo-liberal economic policies, and expected the government to stabilize their economic life by means of renewed Keynesianism and social democratic measures, such as green recovery strategies including the eco-point system, child allowance, and improvement of public health insurance plan. Prior to these, emergency economic policies containing rescue operation for banks and other financial institutions by public money were already being practiced in international coordination among advanced countries so as to mitigate the financial crisis, though inconsistently against neo-liberal market principles. The renewed Keynesian and social democratic policies by President B. Obama were called new New Deal in the USA, led similar changes of economic policies in Japan and Europe, and worked effectively in addition to emergency economic policies so as to restore consumer demand and economic recovery to certain extent. The real economic growth rates recovered from 2009 to 2010, by 6.5% to 3.0% in the USA, by 10.3% to 4.0% in Japan, and by 6.8% to 3.1% in total advanced economies (Table 1). This economic recovery, however, was rather short-lived and could not last long.

As the cumulative budget crisis deepened through the subprime crisis together with the subsequent emergency economic policies, the newly implemented reflation policies like the eco-point system had to end with the initially planned expiration dates toward the end of 2010, and accordingly a reactionary setback of economic growth was foreseen as inevitable for 2011 among the advanced economies. The predicted setback occurred more severely as the menace of acute sovereign crisis intensified. IMF reported sharp falls in growth rates in advanced economies in 2011 in September (Table 1), and the slowdown must become harder by now. The debt crisis of the state, originating from the subprime crisis of labour-power and financial institutions, is involving the international monetary and financial crisis spirally anew as we have seen. Capitalism in our age seems thus deeply in trouble in solving the self-destructive crisis, and just moving it around spaciously from one part of the world to another, as well as from one kind of problem to another, as D. Harvey (2011, p. 262) appropriately points out.

Even Japan, where the sovereign and financial crisis is not yet so acute, is experiencing a deep trouble in economic recovery with a renewed fall in growth rate (Table 1). In addition to the damage due to the great earthquake with giant tsunami and the resultant accident of Fukushima atomic power plant in March 2011, the difficulty of the Japanese economy has been repeated by declines of export demand due to the subprime and sovereign crisis, and further intensified also by appreciation of yen as the repercussion of sovereign crisis of Euro and dollar. The crisis of advanced economies is thus tossed around to Japan in a paradoxical way.

In such a process of passing the crisis around the world, the return to the renewed Keynesianism and social democratic welfare policies could not be carried through, but has been rather pushed back toward neo-liberal austerity policies in many countries under the pressure of deepening debt crisis of the state, against expectation among common people. Keynesian reflationary employment policies or subsidiary redistribution to promote consumer demand for eco-conscious appliances became so soon restrained, and instead cuts of number and wages of civil servants, privatization of welfare services, lowering pension levels in various ways, as well as increases in taxes and public dues, tend to be implemented. Obama administration being faced difficulties in recovery of employment by means of domestic fiscal policies, began to emphasize anew a policy to increase export twice in five years in order to restore employment, by promoting free trade through TPP (Trans-Pacific Partnership Agreement). Although the US government strongly requests Japan to join the agreement, it is causing a hot political debate in Japan, as it must work destructively on Japanese agriculture and may demand transformation of public health insurance system into the notorious US private health insurance market system. This issue also exemplifies the recent trend back toward neo-liberal globalization.

Why, then, Keynesianism and social democratic welfare policies are so difficult to revive and carry through in our age? Three interrelated factors must be worth consideration on this problem.

Firstly, the framework of regime of accumulation of financialized capitalism on the basis of multinational corporations to have promoted neo-liberalist globalization since 1980s has not essentially been destructed, and rather maintained through the global economic crisis, which was caused internally from within this framework. Resultantly, functions of nation states to secure and extend ecological, welfare, and employment policies tend to be severely restricted by international competitive pressures among business circles. Economic interest of multinational capitalist firms especially in the financial business tends to be unleashed from public control and then protected in case of need competitively across nations, whereas the economic burden of crisis tends to be shifted to the working people under the competitive pressure from the lower wages in the global market. In fact, the tendentious increase in income and asset gap between wealthy persons and common working people in advanced economies under neo-liberal globalization became so difficult to mitigate and reverse, and rather accentuated through rescue operations to supply public money for financial institutions and some other big businesses like big three US automobile makers in the subprime crisis, in contrast to the relatively small scale of rescue operation for workers' economic distress due to debt crisis and unemployment.

Secondly, both Obama administration and the Japanese Democratic Party government failed to implement policies to re-strengthen trade unions and other non-government civil organizations as their secure supporters for new New Deal of Keynesian employment policies and social democratic welfare policies. In this regard, they did not follow an important aspect in the classical New Deal strategy since the 1930s, and could not reconstruct organizational supporters to promote the progressive policies for the working people. This weakness must have worked as an important factor why the Obama Democrat administration has gradually intensified its character just as one of 'Parties of Wall Street', not much different from Republican Party, as symbolized by appointing T. F. Gaithner, the former president of NY Federal Reserve Bank, as the Secretary of the Treasury. This is surely related also to the restriction for economic policies upon the ground of globalization of multinational business activities under financialized capitalism, where the social rolls of trade unions tend to be competitively oppressed down in advanced economies.

Thirdly, after the collapse of the Soviet type of societies, socialism became generally regarded as an undemocratic past idea, not attractive for the future. Although Marx's theoretical insight into the fundamental contradictions and instability of capitalist market economy inevitably to cause crises has been re-appreciated broadly even in mass media, in parallel with Keynesian theories, Marxist social and political movements for socialism have not yet reunified and revived as a promoting progressive driving momentum strongly enough to lead workers and citizens dissatisfaction for a more promising future among the advanced countries. In retrospect, Keynesianism and social democratic welfare policies after the New Deal era actually got momentum competitively (both internationally and domestically) from the growth and diffusion of Soviet model of economies commonly conceived as socialism. In contrast, a hidden factor behind the difficulty of continuous powerful restoration of Keynesianism and welfare policies in our age must lie in the failure of socialist movements to revive after the collapse of Soviet model of societies. Thus, restoration of socialist movements based upon Marxian theories and ideas to present alternatives to capitalist global order must be desirable even so as to revitalize Keynesianism and welfare policies.

Actually Marxian theory inquiring into contradictory working of capitalist market economy repeatedly to cause self-destructive crises has broadly been re-appreciated in the process from the subprime to the sovereign world crisis, in parallel with, or even beyond Keynesian theory. At the same time, a social sense that 'another world is possible' has been continuously spread also world-wide from the anti-globalization movements, often including anti-capitalist tendencies. In such social movements, spontaneous grass-roots participation of citizens has become more and more conspicuous by utilizing facebook and other recent information media. As Harvey (2011) suggests, the historical split between Marxism and anarchism must now be overcome for the future. For instance, citizens' street occupation campaign in New York and other US cities against widening economic disparities with a slogan 'we are 99%', the waves of massive demonstration and strikes against the austerity economic policies in EU countries, and citizens' anti-nuclear power generation meetings, demonstration and sleep-in tents in front of METI (Ministry of Economy, Trade and Industry) for several months in Japan, all these recent people's movements in advanced countries seem to contain germs of revival of stronger anti-capitalist social movements so as to re-unify Marxism and anarchism.

Anyway, the chaotic confusion of economic policies in the capitalist advanced countries, in the process of from the subprime to the sovereign crisis, starting from revealing the failure of neo-liberalism, via tentative revival of Keynesianism and social democratic welfare policies, coming back to neo-liberal austerity policies in spiral should not be regarded as the dead end of history. This deep crisis in our age must also be opening up an opportunity for reviving Marxian theories critically to analyze the workings of capitalist market system to cause chaotic crises, and upon the ground of such theories Marxian social thoughts and movements anew so as to overcome the internal contradictions of capitalism for alternative future by working people.

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