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THE DAILY STAR

Tuesday, October 21, 2008

'La Strada' on Wall Street and the end of neo-liberalism

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Commentary by

Apologists for neoliberalism assume not only that states should be run like companies, but also that, as far as possible, they should not intervene in the economy. The market, they insist, regulates itself. But, more than 50 years ago, the Nobel laureate Paul Samuelson contradicted this idealization of markets in graphic terms: Absolute freedom for the market will lead to Rockefeller's dog getting the milk that a poor child needs for healthy development, not because of market failure, but because "goods are placed in the hands of those who pay the most for them."

This distributional quandary lies at the heart of the capitalist system, which is one of never-ending competition fueled by the drive to maximize profits. In such a world, there is no room for a social conscience.

It is the state that, to a greater extent in some societies than in others, must fill the gap. The market economy is unsurpassed as a system for creating wealth, but only social compensation ensures that this wealth is distributed in a just manner. Europe's social-market economies, far more than the Anglo-Saxon neo-liberal model, regard mitigating the inequalities created by markets as the state's duty.

In fact, the market economy can function only if the state does intervene. The US financial crisis demonstrates what happens when markets are given free rein. Rather than regulate themselves, market players destroy themselves, however much they might be marveled at as golden calves.

Indeed, investment bankers transformed stock markets into a surreal circus. For the most part, they resembled high-wire artists juggling borrowed money without a safety net. They threatened to crash - until the state stepped in. In Fellini's film "La Strada," the circus artists lived on the margins of society; in the "Wall Street Circus," they lived like gods, making millions. That's over for a while. Wall Street has collapsed. The present crisis, the fall of Wall Street, is to neo-liberalism what the fall of the Berlin Wall in 1989 was to communism.

The global dimension of this crisis surprisingly also has a positive side. The international community is now charged with thinking about how to reorganize the financial sector and minimize the risk of similar catastrophe in the future. Until now, a major part of the problem was countries' unwillingness to cooperate. Previous demands for stricter regulations came to nothing because of financial sector opposition. When should this stance change if not now?

It is crucial that the European Union accepts the challenge of the financial crisis at the highest level, draws the appropriate conclusions, and takes the logical next steps.

So what lessons are to be learned from the failure of the neo-liberal economic model?

First, markets need clear rules. Stronger regulation means legally binding, globally applicable rules and standards. While important areas of economic policy are subject to rules that allow penal sanctions, the financial sector has a special status that is no longer acceptable.

Those areas of the financial sector that have suffered the most reputational damage are the ones least subject to regulation and supervision: the derivatives market, hedge funds and private equity funds, and the ratings agencies. Voluntary codes of good conduct have been a dismal failure. We urgently need globally applicable regulatory minimum standards similar to those, say, within the WTO.

We need a democratically legitimized world finance organization, equipped with the necessary regulatory instruments, which would supervise major global financial institutions. This organization should also have authority to create conditions for greater transparency, and to implement better early-warning systems and instruments for crisis management.

The newly created regulation need not apply to everyone. But only those financial institutions that subject themselves to these rules would be able to rely on the support of the public authorities in case of a crisis. This would ensure both fiscal stability and fiscal innovation - in contrast to the present situation, in which no one obeyed any rules and, when crisis erupted, taxpayers had to come to the rescue.

Second, welfare-state institutions should be strengthened. The crisis has made clear that the provision of people's elementary needs must not be made dependent on speculation and stock market curves. Expansion of public financing for pensions, nursing care, and health insurance is therefore crucial.

Finally, we need a European economic stimulus program - a "Big Bargain" - and we need it now. The crisis in international financial markets has had a noticeable impact on Europe's real economy. Some large EU countries are on the brink of recession. Japan in the early 1990s waited too long to act and missed the right opportunity to enact countermeasures, which is why Japan has still not recovered from its long stagnation.

Public investment in infrastructure (such as a massive expansion of the European railroad network), as well as climate protection and environmental technology, will be needed. To strengthen purchasing power and to stimulate consumption, tax cuts on low- and medium-income households are essential.

Of course, EU member states should determine the concrete form that such economic stabilization programs take for themselves. But that shouldn't stop European governments from working together closely. To be effective, any stimulus program will need Europe's nations to act in concert.

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