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THE FINANCIAL CRISIS OF 2008–2013: STARKLY DIFFERENT ECONOMIC, SOCIAL AND POLITICAL SCENARIOS IN THE USA AND EUROPE. WHY? AND WHAT LESSONS CAN BE DRAWN?

Рассматриваются экономические, социальные и политические последствия глобального финансового кризиса 2008–2013 гг. в США и Европейском Союзе. Анализируется влияние глобального экономического кризиса на стабильность и жизнеспособность хозяйственной системы ЕС. Рассматривается разница в восприятии этих последствий политической элитой США и ЕС и в сценариях осуществления экономической политики выхода из кризиса.

Ключевые слова:
европейский федерализм, неолиберализм, политика остерити (финансовый аскетизм), секвестрация, экономическая реструктуризация.

The financial shock wave which came out of Wall Street in September 2008 following the bankruptcy of Lehman Brothers and the seizing up of credit markets moved like the «perfect storm» across the world, setting off economic, social and political crises that, at least in the case of the European Union, have not significantly abated five years later. The continued viability of the Eurozone, indeed of the entire European experiment of supranational integration, has been called into question.

Meanwhile in the USA itself, following a couple of years of steep recession with high unemployment and comparatively high social unrest, the ship of state righted itself. There have been two years of modest but significant growth in GDP. Social unrest succumbed rather easily to police methods of control after making little traction in the media. The public mood may be described as cautiously optimistic.

In this interpretive essay, I will make the argument that despite commonality of prevailing neoliberal ideology on both continents, the different political structures, and the difference in perception of the gravity of the crisis coming from financial markets to the real economy at its onset explain the very different scenarios that played out on both sides of the Atlantic.

I will present first an overview of the situation in the EU and in the USA today. Next we will go back to 2008 and follow how the crisis was perceived and what responses were made by the state authorities in the EU and in the USA over the course of the five years to today. And we will conclude with thoughts on possible lessons to draw from these sharply differentiated scenarios.

USA today

The official U.S. State Department message disseminated by ambassadors abroad is that the country recovered from the recession and began enjoying strong GDP growth (now moderated to 2,4%, Q1 2013) nearly three years ago, with steadily falling unemployment (currently 7,5%) [7; 12]. Because of the weighting of house ownership in family net equity, attention is directed in particular to the rise in real estate values from the depths to which they sank in the midst of the sub-prime mortgage crisis that preceded the crash of 2008.

The official account of the present day U.S. economy highlights the increased competitiveness of U.S. manufacturing industry arising from the restructuring of whole indus-

trial sectors, first and foremost, automobile production, early in the recession under state direction. The second leg of the recovery and the factor deemed most promising for repatriation of manufacturing industry from foreign shores is the commercial scale arrival of shale gas onto the domestic market at prices well below world levels. The boom in production of nontraditional gas provides not only cheap energy, but cheap feedstock for petrochemicals used across industries [10]. Moreover, in 2012 there was a shift from import substitution, itself a major contribution to improving the U.S. commercial balance of payments, towards prospective export of LNG to Europe and other welcoming markets.

Politically, the 2012 elections confirmed stability and stasis at the national level arising from a Republican dominated House of Representatives and a Senate where the Democrats hold a narrow majority. And while Americans as a whole today express very unfavorable views of Congress, radical populism represented by the Tea Party suffered significant setbacks in the election, which reconfirmed mainstream politicians of both parties. Meanwhile radical protest embodied by the Occupy Wall Street movement is now a distant memory.

Europe today

Europe is presently at the crescendo of a succession of separate but interrelated crises which find expression firstly in the ongoing financial bail-out of southern and peripheral states of the Union — Ireland, Spain, Portugal and Greece. The evening television news brings reports every few days on the resistance in the streets, at the ballot box and in national legislatures to the severe austerity programs instituted in these countries at the order of the so-called troika of European Commission, IMF and European Central Bank in exchange forhundreds of billions of euros in assistance packages which these countries' diminished tax receipts and inability to tap bond funding without ECB intervention forces upon them.

The austerity medicine prescribed by Dr. Europe has a number of dimensions with great social impact. The governments affected are being downsized through curtailment of social services including healthcare and education. In parallel, cash benefits are reduced and beneficiary participation in costs of services is raised.

Then there is the implementation of economic restructuring, the complementary recommendation to austerity on the short list of troika prescriptions. In simple English this entails changes to labor legislation in the target countries, in particular, raising the retirement age, making it less cumbersome and costly for employers to lay off workers and removing restrictions on entry into a variety of professions. In a word, the crisis is being used as cover for readjusting the social compact of the welfare state, with a lot of new pain dealt to the majority of the population otherwise deeply affected by the current high tide of unemployment in both private and public sectors simultaneously.

It is no exaggeration to say that the level of unemployment being experienced across the European Union today, at roughly 12%, is unprecedented [6]. In several of the aforementioned weakest states, the overall level is in excess of 25% and, most alarming, the level of youth unemployment (those under 25) is above 50%. Euronews, the BBC and print media provide a stream of depressing coverage of the plight of university graduates who are leaving their home countries, migrating to Germany if not overseas to destinations in Latin America (for the Spanish speaking) or still further afield in the expectation of finding relevant employment after years of discouragement at home. The brain drain is a much-debated issue [11; 13; 16].

Mass demonstrations in Athens, Madrid and other European capitals over cutbacks in public services, over forced pay and benefit reductions appear on television weekly [9]. The Indignados and related protest movements similar in social demands to Occupy are still gathering substantial followings. In the domain of electoral politics, populist parties, some embodying xenophobic and other extremist views, have claimed significant shares of the electorate in Italy and Greece during 2012 local balloting as the electorate expresses its non-confidence in the mainstream parties to defend its interests.

Public opinion polls in many European Union member states show remarkable negativity towards the Union and its central organs in Brussels, which are deemed to have abandoned the principle of solidarity that was a pillar of the integration principle from the beginning in the 1950s [14]. The idea of raising all of Europe gradually to the standard of living of the most advanced has, in the view of the broad European public, been replaced by focus on balancing budgets, fiscal conservatism and reducing exposure to the perceived extravagances and folly of the weakest members.

The public is treated to the spectacle of never-ending consultations between the member states in the European Council at ad hoc summits that have a fire-fighting character. The Union seems to be constantly too late with too little to stay ahead of the market and put in place the instruments of coordination needed to protect its currency against mas-

sive speculative attacks that globalization has empowered. Alone among the world's reserve currencies, the euro is not backed by a nation-state and, as has become painfully clear in the 5 year long crisis, lacks common fiscal policy, lacks a banking union, to protect its interests. Meanwhile the perception has emerged of a leadership crisis, a lack of vision, and a deficit of democracy in Brussels [8].

The EU institutions have for many decades been the whipping boy of national leaderships of the Member States which have jealously guarded their prerogatives against what is described as a bureaucratic Commission and a weak-tea legislature in the European Parliament which lacks the right of initiative and, most importantly, has no power to raise taxes. Indeed, at its present state of evolution the European 'government' has almost no direct tie-in with the peoples of Europe and no balance of powers internally. This is not a new development but only now are all of these defects in the public view daily because of the wrangling over how best to address the crises facing the continent for which the EU institutions lack the proper instruments to take charge. Moreover, the perception that Brussels represents mandarins responsible to no one rather than representative democracy has assumed a new dimension as EU officials took a hand in the replacement of popularly elected prime ministers in Greece and in Italy by technocrats chosen for their likely good relations with the markets, as guarantors of the faithful implementation of the austerity and restructuring programs.

The issue of the EU's viability today has become so acute that the minority of federalist minded politicians with continent-wide ambitions has mounted a campaign to use the crisis and force the pace of integration so as to reach a federal union following the 2014 elections. In a recently published book entitled Forward Europe, Liberal bloc chairman in the European Parliament Guy Verhofstadt and Greens leader Daniel Bendit-Cohn are promoting federalism as the only answer to the crisis [15]. Germany's most powerful think tank and patron of right-of-center causes, the Bertelsmann Stiftung, is supporting this effort.

As of this writing, in July 2013, Europe is mired in a 'second dip' recession. Meanwhile there are the first signs of a crack in the predominance of austeritythinking within the European Council, with the latest EU summit in the final days of June having approved a 6 billion euro appropriation of assistance to alleviate youth unemployment. This marks the success of an initiative introduced by the French Socialist government following its electoral victory a year ago to balance austerity with measures to encourage economic growth. At the same time, a growing assault on the stewardship of the European Commission under Jose Manuel Barroso has become public. While Barroso's lack of leadership generally over the past 6 years is easy to document, the fact that his post had been reduced to one of public relations was the conscious choice of those who installed him and reappointed him two years ago, the better to protect the prerogatives of the Member States. Thus, what is essentially a structural failure of the EU to face up to the systemic crisis which began in 2008 is trivialized as an issue of personalities.

USA, crisis scenario from 2008

The previous major worldwide crisis in 1997-98, dubbed the «Asian Flu», had its origins at the periphery of international financial system. Its outstanding feature was to demonstrate the potency of globalization and open capital markets in sweeping the world and wreaking devastation along weak links as funds were swiftly drawn out of speculative developing nations in a flight to safety in the money centers. Russia's financial default in 1998 was a case in point. The 2008 crisis, by contrast was Made in America, spreading out from the world's financial center, Wall Street.

And it was the direct consequence of the exuberant application of the Anglo-Saxon financial and political model of minimal government regulation of markets which had become the mantra in New York and London since the 1980s, and had spawned trading in fiendishly complex derivatives. This was a model taken up with enthusiasm by New Europein the 1990s and grudgingly by Old Europe in the new millennium, where it replaced dirigisme as the consensus view.

Attenuation of risk through its distribution among many market participants has been at the core of modern banking since its invention in Renaissance Italy. However, as quickly became apparent during 2008, there were novel problems in the new age, as the supposed self-regulating nature of markets failed to occur. First there was dereliction of duty by credit rating agencies with respect to fixed income securities representing bundled mortgage loansthat were nominally «subprime» and de facto uncollectible. Second, it developed that the sophistication of new instruments such as credit default swapsnot onlyevaded regulators but also escaped the comprehension of most bankers trading in them. The discovery after nearly a year of denial that major U.S. banks were carrying on

their books illiquid, 'toxic assets' led to a succession of near bank failures among some of America's largest institutions in 2008. In traditional fashion these pending insolvencies of institutions deemed 'too big to fail' without engendering a systemic failure threatening the real economy were resolved through U.S. Treasury directed takeovers by strong banks.

The step too far in an already fragile market environment was the decision of Secretary of the Treasury Hank Paulson, himself a former CEO of the competitor investment bank Goldman Sachs, to allow one of the oldest and best known institutions, Lehman Brothers, go under. In the years since, that decision has been examined from many angles, but one thing is clear: such a decision was totally in line with the highest principle of the American model of capitalism: to reinforce 'moral hazard' and ensure that those responsible for bad management and/or bad financial decisions paid the price of their errors. Indeed it responded well to the criticism that Paulson and the Bush Administration had received for saving the scoundrels running other banks 'too big to fail' in the preceding year.

The impact of the Lehman bankruptcy was a devastating shock to the U.S. financial community and its foreign counterparties. Interbank credit shut down. Banks refused the traditional overnight lending to one another, not to mention to the public. Between 15 and 19 September, the US stock markets were in free fall. The Dow Jones index lost 30% of its value.

In short, the decision immediately revealed itself to be a blunder of colossal proportions that threatened to set off a new Great Depression. This was understood both by Paulson and his team at the Treasury and by Ben Bernanke, the head of the Federal Reserve, who just happened to be an academic scholar on the Depression. What followed in a matter of weeks was a set of programs of massive proportions intended to prop up the American banking system and its partners abroad.

Paulson rushed legislation through Congress providing the Treasury with $700 billion to stabilize the financial system. The first step of an evolving process already became law on 3 October 2008. The Troubled Assets Relief Program, or TARP, was aimed primarily at relieving banks of their subprime mortgage papers and other illiquid holdings. For the recipients, it came at the price of a federal stake in their equity and a detailed set of requirements on executive pay, reopening of credits to other banks and to the public.

The programs amounted to nothing short of a public recanting by a Republican administration of the entire economic and political philosophy it wore on its sleeve. Big government was stepping in to save Wall Streetand the banking system in a manner totally incompatible with 'moral hazard.' A white flag was being raised by the authors and defenders of neoliberal ideology.

All that was left for the incoming Obama administration to do upon coming to power in January 2009 was to move on to saving elements of the real economy and to practice the Keynesian solution of pump priming to combat the unfolding recession and prevent its further descent into depression. This passed Congress swiftly in the form of the American Recovery and Reinvestment Act of 2009 which took effect already on 17 February. The overall value of the stimulus package was a huge $787 billion. Among the points covered were spending on infrastructure, education, health and energy; federal tax incentives, and expanded unemployment benefits and social welfare provisions (for a brief overview of the various federal programs put in place see [4]).

A noteworthy follow-on intervention of the federal government to combat the recession was Quantitative Easing, the purchase of debt instruments by the Federal Reserve to influence interest rates and encourage business investment. This began in 2008 with the Fed's purchase of mortgage backed securities, nominally QE1. However, it became a new and important lever on the economy in 2010, which is spoken of as QE2, and yet another follow-on beginning in 2012, called QE3. The effect of these novel measures was to keep credit cheap, encourage inflation, prevent deflation and rouse the economy. The value was roughly $600 billion per year.

Without going into details, the obvious point is that the US federal government, led by the Treasury Secretary and Federal Reserve Chairman, was able to react with blinding speed to the crisis which began in September 2008 and continued to apply heavy state intervention in the economy and Keynesian methods to reflate and stimulate the economy.

In parallel, it bears mention that from the very start of his presidency Barack Obama made his personal cause the expansion of America's threadbare social protection network in a major domain that would touch the entire population: his proposal to extend health insurance to the millions of citizens without coverage. For more than two years this issue became a focus of public debate and political maneuvering. While the end result was passed by Congress only through the application of political stratagems not consensus and fell well short of the opening objectives, nonetheless, in the midst of one

of the sharpest economic downturns in living memory and the threat of a new Great Depression, the American government was expanding rather than contracting its social protection for citizens.

The word austerity was absent from the American political lexicon during the whole of 5 years from the onset of the economic crisis. The stimulus programs were financed by record budgetary deficits and massive increases to the national debt. Political deadlock prevented any solution to the deficits which Democrats proposed to end by curtailing tax breaks dating from the Bush administration, meaning raising taxes for the wealthy; and Republicans insisted as determinedly on achieving by cutting 'entitlement programs,' meaning social security, healthcare and social benefits to the poor. In 2011, in one of the periodic standoffs over Congressional authorization of an increased level of national debt, it was decided to impose automatic spending cutbacks in the future should the sides fail to agree on the federal budget. And so, notwithstanding the threat of taking down GDP by 1% and harming the still unsteady recovery, in 2013 the long awaited… and feared «sequestration» took effect. Of course, against the background of a very real recovery and in the context of the vast stimulus programs that preceded it, the austerity effect of present sequestration has turned out to be minimal.

If one were to plot the level of organized social unrest in the USA with the cycle of the recession's onset and development it would be clear that midway in the past 5 years, the bottom was hit, recovery began and the background propitious to unrest faded. In this way, beginning at around 2010 police actions to remove Occupy positions in public space became effective and the back of the movement was broken.

Crisis scenario, Europe from 2008

The unfolding calamity facing the world financial community following the collapse of Lehman Brothers hit Europe immediately, but unevenly. The underlying issue of American 'toxic assets' from securities representing bundled subprime mortgages was a threat first and foremost to those countries which had traditionally been most heavily embedded in the American economy. Thus, Britain and the Netherlands were directly in harm's way. In Britain, the crisis immediately endangered several major banks, starting with the Royal Bank of Scotland, which required UK government intervention amounting to nationalization within weeks of the start of the crisis. To its credit and in consideration that the City of London alone accounts for 10% of British GDP, the UK government was quick and resolute in tackling the problem with taxpayer money. In the Netherlands, the depth of the rot emerged in the midst of the world's largest banking merger at the time, which in 2007 saw one of the country's leading banks, ABN-Amro, acquired and divided up between Royal Bank of Scotland, Bank of Santander (Spain) and Fortis (Belgium). The financing package for the mammoth deal was undone by the worldwide credit freeze while the value of the acquisition was destroyed as the extent of toxic assets ABN had on its books gradually became apparent. The consequence was the shattering of Belgium's largest bank, Fortis, which was saved from collapse only by state intervention and its takeover by BNP Paribas.

Apart from these near disasters in a very few EU member states in which the American connection was readily evident, the rest of the European banking system did not seem under threat in the autumn of 2008 and no heroic efforts were sought or undertaken. Indeed, the European response was directed mainly at the economic threat from the impending American recession. An EU wide stimulus package was passed in December 2008, but at a rather low level of 200 billion euros [3].

The second wave of problems which would hit Europe was a sovereign debt crisis which began rather inconspicuously at the very end of 2008 as Greece began to experience sharply rising market rates to refinance state debt. The issue assumed alarming proportions only after the October 2009 elections in Greece when revelations about the gravity of fiscal shortfall and budget deficits shook the markets [1]. It soon thereafter became apparent that Greece would require 100 billion euros or more (eventually several hundred billion) of EU assistance to bring its finances and refinancing under control. At this point bondholders of Greek sovereign debt, namely German and French and other major Member State banks,experienced sharp write-downs on their holdings, putting those banks in jeopardy. In this way, a small EU country accounting for no more than 2% of the GDP of the 27, initiated the loss of confidence in EU sovereign debt that has rumbled on across the Community seeking a systemic solution in terms of consolidation and mutualization across the Euro Zone that, till now, has not actually occurred [5].

Starting with Greece, the sovereign debt crisis moved out to ensnare Spain, Portugal and Italy. Whereas the prospect of Greece

abandoning the euro may have been supportable, the departure of Spain, not to mention Italy, would be fatal to the currency and to the whole EU project.

From this point, the issue taking top of mind at European summits was financial rather than economic: how to stave off total disaster by putting in place, or at least agreeing to put in place within fixed deadlines, the banking union, the fiscal union and possibly the mutualization of debt that had not been done when the Euro was first agreed as an objective of the EU Member States in 1992 and launched in 2000. The primary question was how much each state would have to put up to build the fire wall to protect the currency against speculative raids.

In this situation, the EU's strongest economy and biggest likely contributor to all bailout funds, Germany, acquired a decisive say in all decisions. And Germany had some well-defined thoughts on the issues coming out of its financial orthodoxy and experience with austerity, which was put in place already by the predecessors to Merkel's CDU, Helmut Schroeder and his socialist government (SPD) as the medicine to cure debt overhang from the post-reunification spending of the 1990s. Austerity had proven its worth in Germany in the new millennium, creating a favorable credit environment for the Mittelstand, driving down labor costs in line with curbed inflation and generally improving the competitiveness of German industry, a very weighty consideration given the export-driven character of the economy.

For these reasons, the Germans urged, nay insisted that their colleagues in the EU impose austerity on all applicant countries for EU bailouts. Unfortunately, in the midst of general subservience to the German prescriptions, EU Members ignored the fact that most of the weak nations struggling with steep recession had economies of an entirely different structure from Germany and were not major exporters, while the direct effect of austerity was to worsen and not improve their budgetary balances given that tax revenues were in decline and social benefits (unemployment compensation) had to be augmented. Indeed, it has been persuasively argued that austerity only aggravated the crisis in Europe while spreading negativity towards the EU as enforcer [2].

In the end, relatively little new money was actually put up by the Member States to assist the weaker states. Instead the main artillery in the battle to prop up the weaker states and bring interest on sovereign debt back down from ruinous levels has been the European Central Bank and its debt purchase program. With the approval of the States, and most critically, with German approval, a program of large scale intervention in the bond markets has been implemented to bring down the cost of borrowing to supportable levels for Spain, Italy and the other countries in most desperate situation, calming the financial markets. In this sense, the ECB acted in similar manner to the Federal Reserve but without a Treasury in tandem.

Conclusion

Over the course of its half century evolution, the project now known as the European Union has passed through numerous economic cycles of prosperity and recession, often wearing the hair shirt of penitence in the down periods and resolving to make structural reforms necessary to remain relevant and competitive in the world. Muddling through was a way of life over decades. The objectives of forming a European consciousness and pride based on the legal and economic acquis and its implicit convergence proceeded in good times and bad.

However, the crisis which began in 2008 in America and spread in a succession of waves across Europe found the continent unprepared intellectually and institutionally to cope. The simple solution of the past, namely to devalue currency to restore competitiveness and maintain tax revenues and employment, was no longer available under the conditions of the Single Currency. The rapid expansion of the EU from 13 to 27 had stretched resources and the will of the wealthier nations to show solidarity towards the weaker. And the absence of a common fiscal and budgetary policy, the absence of a federal European government, made itself felt in the most painful way.

In one of his memorable quips, Henry Kissinger once complained about the EU that if he urgently needed to consult with them on foreign policy, he didn't know whom to call. The crises of 2008 to 2013 have demonstrated that the same problem applies for the phone number of the European Treasurer manquant.

It was precisely the concentration of power in the USA in the hands of several key managers in the Treasury and in the Federal Reserve which made it possible to formulate measures of unprecedented scope to deal with a threat at least as great as what precipitated the Great Depression. And it was precisely the absence of such persons and powers that has made the European pa ssage through 5 years of crisis so dramatic, uncertain and, ultimately, destructive.

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