# The Dangerous Consequences of Misdiagnosing the European Crisis

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Commentaries about the global crisis that began in 2008 invariably include reference to its being the worst since the Second World War. What is far less common is any closer analogy of the present European ‘situation’ to that particular European crisis, and the subsequent period of post-crisis recovery. While it would be nonsense to suggest that the crises were similar in their determinants, their conduct and their physical consequences, they share some structural features which deserve closer examination, not least because they might help in correctly diagnosing the current crisis and in devising more appropriate ways of generating a sustainable recovery. A correct diagnosis would in turn allow a considerably more tolerant view of current levels of sovereign debt and a far less destructive policy-mix than currently being pursued by European policy-makers

The first observation involves the allocatory changes that were imposed upon the national and global political economies by what can loosely be described as paradigm-shifts: a) a paradigm shift from the peacetime to wartime organisation of economic activity and b) the shift from Fordist production and accumulation to neo-liberal financialisation and monetary accumulation (Altvater 1992). A common feature of these transitions was that they diverted resources away from ‘normal’ production and distribution arrangements to radically different circuits involving real and financial resources. In the case of war, these resources were diverted to support the production of armaments, to supply the armed forces with the means of warfare and survival and to maintain the basic provision of private and public goods on the home front; this, above all, involved significant sectoral shifts in employment – away from the mass production of consumer goods towards the mass production of weapons and ordnance – along with mobilisation/ redeployment of wide sections of the population to replace those fighting in the armed forces. The driving force of this war paradigm of organized capitalism was to prosecute and win a ‘just’ war and, in the case of Britain, it enjoyed cross-party unanimity and broad levels of popular legitimacy.

In the case of the monetary accumulation paradigm, which established itself in the 1980s, the diversion of resources was less explicit and less politically managed and legitimized, even if it was politically facilitated by a series of legal changes to the statutory arrangements for financial transactions and other features of the financial services sector: e.g. in relation to exchange controls, securities trading, bank reserve ratios etc. Nevertheless, the diversion from traditional primary and secondary industrial sectors to – in this case – the financial services sector was significant, driven by the increasingly wide gap between the rates of return on traditional sectors of production and distribution and those involved in the operations of financial services (c.f. Haldane 2010b). Haldane notes that since 2000 the level of returns on equity in financial services ‘was consistently at or above 20% and on a rising trend up until the crisis. This is roughly double the ROEs in the non-financial sector over the same period’ (p.13). The most important common feature of the two ‘diversion’- paradigms is, of course, that they (ultimately) involved the colossal destruction of capital, the one deliberate and largely justified by the ends (victory and peace), the other (largely) unintentional but culpable, and justified by no other logic than that of greed, power and complacent stupidity.

The assets that were destroyed in and since 2008 were not as visible as the bombed cities of 1945. The damage that their destruction involved nevertheless represents a colossal and long-term disruption to the life of most European states and their citizens. More tellingly, however, the repair of that damage may prove to be considerably more difficult than the economic and political rebuilding of Europe after 1945. Haldane, in a speech delivered in March 2010, provides a sobering estimate of the economic cost of the crisis and its implications for the banks as culprits (‘polluters’ in his parlance), the global political economy and the UK in particular. The result, assuming a trend growth rate of 3%, is:

 ‘an output loss equivalent to between $60 trillion and $200 trillion for the world economy and between £1.8 trillion and £7.4 trillion for the UK. As Nobel-prize winning physicist Richard Feynman observed, to call these numbers “astronomical” would be to do astronomy a disservice: there are only hundreds of billions of stars in the galaxy. “Economical” might be a better description’ (Haldane 2010a: 2).

Notwithstanding the problem of assuming a global trend growth rate and the need for developed economies to adjust to different measures of human progress, there are several reasons for erring on the side of greater pessimism. The first and most obvious reason is the absence of a half-way coherent diagnosis of the crisis on the part of Europe’s political and economic elites. While much rhetorical energy has been expended by several western leaders on the excesses of investment banks, hedge funds and other over-exuberant gamblers, the measures they have adopted to date (along with the non-decisions) suggest a chronic underestimation of the challenges represented by the collapse of financialised capitalism. Jean-Claude Trichet, shortly before his departure as President of the European Central Bank, reflected the uncomprehending optimism of Europe’s political elites when, in a speech declaring the imminent restoration of full health to European capitalism, he 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). The ‘normality’ invoked by Trichet, by his successor Draghi and the other authors of the great ‘growth through austerity’ plan in Brussels, Berlin, Paris and London, is arguably precisely the same market that generated mayhem in the decade preceding 2008. It is the normality of a political and corporate class that, on the one hand, constructs a colossal and disastrously inflexible monetarist architecture to combat the evil of price inflation, while encouraging the inflationary appreciation of other asset classes (property, equities, ‘asset-backed’ securities, credit default swaps etc.) the provenance and value of which is arguably less trustworthy than that of a tin of baked beans or a pound of tea. We are regularly invited to rejoice at the bull surges of share indices worldwide while we are simultaneously expected to gnash our teeth and beat our breasts over the failure of the Bank of England or the European Central Bank to keep the Retail Price Index or the Consumer Price Index below target levels. By the same token we are expected to applaud the entrepreneurial panache of private equity companies and their bank advisors as they mount courageous and highly leveraged takeover bids, promising huge scale efficiencies and enhanced shareholder ‘value’, when the logic of such acquisitions is, more often than not, the accumulation of a greater market share and the resulting monopoly rent, or the short-term extraction of value from the dismemberment of the takeover target.

**Figure 1: Ratio of Produced Wealth to GDP in the UK 1920-2005**

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Source: Weale (2012: 62)

Martin Weale’s examination 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 – provides a further illustration of the similarities of war and neo-liberal paradigms, inasmuch as the weakening of the overall wealth ratio between 1930 and 1945 was followed by a gradual recovery up until 1981, ‘after which it has declined sharply again’ (ibid.), reaching the poor levels of 1945 again between 2000 and 2005 (see Figure 1). Weale’s analysis focuses on the significance of the current wealth ratio for the future sustainability of the macro-economy and 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 the allocatory diseconomies of the paradigm of ‘monetary accumulation’ as a function of poorer investment and saving between 1980 and 2005, weakening the resilience of the UK economy, even before the further wealth-destruction during the 2008-9 crash. One can develop Weale’s model of un- sustainable consumption further by including the diseconomies of functional and personal distribution in the period.

The most striking and contradictory feature of distribution developments, in the UK and elsewhere in Europe, was 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. 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

**Figure 2. Profits Ratio and Investment Ratio in Advanced Economies 1980-2005**

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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.

faith, and at worst a dubious and counter-intuitive syllogism. 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. Figure 2 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 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 2. 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 solution to the problem of the potential abuse of monopoly pricing in such utilities was the political regulation of rates of return 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* a guaranteed return on capital. 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, administered by 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.
* 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 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. Andrew Haldane, a UK Treasury economist, 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 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.

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.

**Figure 3: Ratio of Financial to Fixed Capital in Eurozone NFEs 1995-2005**

Source: ECB 2007

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 3), 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 sizeable 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 skewed 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 4 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 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 4: Global Mergers and Acquisitions 1990-2006**

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Source: Dealogic

Against the background of the ‘common knowledge’ that ‘most M&A activity is *value-destroying’* (my emphasis; Haldane 2010b: 21) 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) allows a fairly robust conclusion 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.

**Wrong Diagnosis – Wrong Treatment**

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 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 arguably be equated with the primitive view of ECB President, Trichet, that health could be restored to Europe’s economic order by consolidating state budgets and ‘accompany(ing) the market as it progressively gets back to normal’ (*Financial Times* 9.9.2010). Without belabouring the metaphor too far, this fairly typical view among European political elites (particularly in the core states of the northern EU) reflects an ill-considered understanding of the anatomy of the crisis of European capitalism and a naïve faith in the self-healing properties of ‘the’ market and the limited role that the fiscal state should seek to play in the restoration of ‘normality’.

The unfortunate truth is that the damage inflicted on the circulatory mechanisms of advanced capitalism before and after 2008 rendered it so weak and structurally so unsustainable that the reversal of the brief period of deficit-financed state reflation at the end of 2009 was absurdly irresponsible. The Commission epitomised the 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) 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. It failed self-evidently, as demonstrated above (Figure 2), generating anaemic rates of growth – most notably in Germany! – and rendering European economies dangerously dependent on exports for what little growth there was. Persisting with Germany’s fiscal austerity preference represents a collective irresponsibility that beggars 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. It is remarkable that an awareness of the permanent damage done to Europe’s economies on the part of some Commission staff was evident at an early stage in the crisis in a 2009 publication entitled *Impact of the Current Economic and Financial Crisis on Potential Output* (European Commission 2009); here, a research team under Gert-Jan Koopman and István Szekély, postulate not simply permanent output losses from trend growth not recovering to meet the pre-crisis trend growth but a permanent weakening of the trend growth-rate, such that the ‘potential output loss increases over time’:

‘Given its global nature and its roots in the financial system, the current crisis is likely to have a large negative impact on potential output in the short-run, and there is a prospect of a prolonged period of slow growth as economies adjust to their post-crisis growth’ (European Commission 2009: 44).

In the ‘pessimistic/ realistic’ (sic) scenario there is a ‘persistent decline in the capital stock’ as a result of chronically reduced investment (ibid.: 33), such that in 2028, capital stock is estimated to be 9.47 percentage points below pre-crisis levels. Incorrigibly, the working paper rejects ‘lax and unsustainable fiscal policies’ (44), despite acknowledging that the basis of social production and future wealth-creation (the capital stock) is set to decline and fiscal consolidation itself weakens investment. The analysis confirms the utter paradoxicality of Commission thinking. Neo-liberalism diluted Europe’s capital base as a result of a falling investment ratio and the German ‘austerity straitjacket’ of the Stability and Growth Pact (Heise 2002); the global crisis since 2008 has destroyed real capital through the chronic under-utilisation of capacity and the collapse of investment with potential output losses of $trillions; 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 the 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.

**Conclusion: 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 be prepared to concede. The above analysis 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, evident in the UK’s declining wealth-to-GDP-ratio and the overall decline in the investment ratios of advanced states since 1980, operated hand-in-hand with the most profound redistribution of income and wealth in European and other advanced states in modern times, to generate serious *diseconomies* for current and future generations, even before 2008. Counterfactual estimates would arguably suggest that social wealth would have provided a better basis for the sustainable development of future generations 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 (c.f. Martin Weale’s analysis) precedes the factual and inevitable disaster of the systemic seizure of monetary accumulation in the winter of 2008/ 2009 and the subsequent 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*. The evident need 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 compounded 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 (necessary) privations of the war paradigm; there is no shared diagnosis of the causes and extent of the crisis, 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 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’. 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 acted out under the auspices of 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 5. Sovereign Debt Ratios in Selected Countries 1930-2010**

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Source: Reinhart & Rogoff 2011; <http://www.reinhartandrogoff.com/data/>

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 investments. 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. 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. 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.

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.

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 5). 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. 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 overwhelming.

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