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The Political Consequences of the Crash

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The financial crash of 2008 precipitated a major recession. It shattered the financial growth model that had dominated the previous twenty years and plunged the international economy into a period of economic and political restructuring of uncertain duration. The immediate origins of the crash lay in the lending practices associated with the sub-prime mortgages in the United States which produced the credit crunch in 2007, but the wider causes were the unbalanced character of growth in the international economy and the particular role played by finance. The crisis has been explained in a number of different ways, focusing on the behaviour of the financial markets, the institutional and policy conditions that made the boom possible and then undermined it, longer-term economic and policy cycles and the nature of uncertainty and risk in complex social systems. The political impact of the crash and the recession has not been uniform; it has been highly uneven, depending on the position of particular states in the international economy. The rapid interventions by governments to stave off financial collapse at the end of 2008 were successful, but at the cost of creating serious problems of adjustment for the future. The political debate around what were the causes, who should be blamed and what should be done is only just beginning, and the way this crisis comes to be understood will play a major part in determining how it is eventually resolved and how far-reaching will be the changes to the international economy and to domestic politics.

The financial crash of 2008 and the worldwide recession that followed it brought to an end a period of sustained growth in which almost all parts of the world economy had participated. The impact of this crash was much greater than other recent financial crises, which have included the bursting of the dot-com bubble in 2000, the Asian financial crisis in 1997, the recession in 1990–2 and the stock market crash in 1987. The events in 2008 were recognised to be of a different order, and appeared to herald a time of economic and political trouble, whose duration was uncertain. There were some optimists who expected the effects to be short-lived, but they tended to be outnumbered by pessimists. The events that took place in 2007 and 2008 shattered the growth model that had been so successful for so long, and it was not clear in 2009 how quickly this growth model could be rebuilt, or whether it could be rebuilt at all. A lengthy period of restructuring of politics as well as economics, similar in its scale if not in its detail to what took place in the 1930s and the 1970s, appeared likely (Gamble, 2009).

Among the reasons for this judgement were both the scale of the events that erupted in 2007 and 2008 and the magnitude of the response of governments to them. Another reason was that this crisis erupted in the heartlands of Anglo-America, in the City of London and Wall Street, the financial nerve centres of the world economy, and prime movers in the creation and perpetuation of the economic boom. Both the United States and Britain were particularly hard hit by this crisis, and reacted accordingly to stave off a slump on the scale of 1929–32. But many other countries were also severely affected. As in all such recessions the impact was uneven, and the crisis was experienced as a series of national crises, with particular national political consequences.

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The Origins of the Crash

In the writing on the crash that has so far appeared there is widespread agreement on the main events that triggered it. During 2007 many financial institutions involved in the sub-prime housing markets in the United States began to experience increasing difficulties because the sharp rise in US interest rates meant increasing default by homeowners in this sector. At first it was assumed that all that was required was a little financial tightening to rectify the problem and make the balance sheets of the lending institutions healthy again. Instead the problems grew steadily worse in the summer of 2007, as financial institutions began to realise just how much bad debt they were potentially carrying. During that summer it became clear that many financial institutions were seriously overextended. This was demonstrated in September 2007 when Northern Rock, the former building society which had become one of the most aggressive and successful mortgage lenders in the UK, suddenly got into difficulties, sparking the first run on a British bank for more than a century. The queues of depositors waiting outside branches of Northern Rock to withdraw their savings, even after these savings had been guaranteed by the government, was the first sign that this was no ordinary crisis.

Nevertheless the collapse of Northern Rock was still thought to be exceptional, and this was reflected in the way in which the British government reacted. It was very unwilling to announce the nationalisation of the bank. It stepped in to rescue it and guarantee the deposits of investors, but spent many months trying to find a private sector solution to take the bank off the government's hands. This was consistent with its assumption that the financial crisis would be temporary and that nothing must be done to damage the authority and credibility of the City. But in the end the government had to admit defeat and nationalise Northern Rock, for which some politicians like Vince Cable had been calling from the start (Cable, 2009).

The severity of what became known as the credit crunch was more quickly recognised in the United States than in Britain, and from September 2007 the Federal Reserve began to cut interest rates aggressively to try to head off major financial defaults. But during 2008, instead of easing, the position grew steadily worse as a string of bank failures and rescues were announced. The collapse in April 2008 of Bear Stearns, a leading investment bank which had become heavily involved in sub-prime lending, was followed by assistance having to be given to the largest mortgage lenders in the United States, Fannie Mae and Freddie Mac. What was obvious by the summer of 2008 was that the financial crisis was no longer confined to sub-prime mortgages but was spreading inexorably to the whole financial system, because of the way in which debts had been securitised and sold on to other financial institutions. As in many financial bubbles before, leveraging had become widespread and a series of inverted credit pyramids had been created. A point had been reached where no-one knew the real value of the assets on their books, or had anything in reserve if the markets began to fall. The huge paper mountain of debt had been erected on very shaky foundations, and once those foundations were called into question, everything began to unravel.

The seriousness of the situation was widely understood by the summer of 2008, but it was still felt to be manageable. At the worst the world economy and the countries heavily dependent on financial services in particular would have to accept a period of tightness, austerity and slower growth to get the financial sector back into balance. Once this latest asset bubble was burst growth could resume again, and the financial markets could resume their upward march. What destroyed that mood was the series of extraordinary events in September 2008, starting with news of the collapse of Lehman Brothers, one of the world's leading investment banks. Because it was an investment bank rather than a retail bank, the US financial authorities decided not to bail it out with government funds but to allow it to fail. This decision set off a wave of panic selling which over the next few days threatened the stability of the entire financial system, not just a few financial institutions, and would have led to the collapse of some of the leading banks in both Britain and the United States if governments had not intervened. Allowing the financial system to have imploded in this way would have precipitated a major slump as well as a major political crisis, so instead the British and US governments stepped in to rescue the banks, nationalising or semi-nationalising several of them and providing a huge financial bail-out to shore them up and prevent them defaulting. The unusual sight of Hank Paulson, the US Treasury Secretary and a former chairman of Goldman Sachs, announcing the government takeover of a major part of the US banking system was too much for many Republicans in Congress, who threatened not to support the plans for bailing out the banks, arguing that it was better they be allowed to fail than for the government to endorse socialist solutions. Their action in withholding support for the bill precipitated a further dramatic collapse of the stock market, which persuaded enough Republicans to drop their opposition and allow the bill to pass.

These actions were accompanied by interest rates falling to zero, and the British and US governments both declaring that they would use 'quantitative easing' to increase the money supply and prevent the kind of deflationary slump that had followed the crash in 1929, when the US price level dropped by about one-third. In 2008 governments and central banks knew enough at least to prevent that. Ben Bernanke, the Chairman of the Federal Reserve, had researched and written about the Great Depression, and was determined that the mistakes that the Federal Reserve had made then in not countering deflation at the outset would not be repeated (Bernanke, 2000). This time there would be no contraction of demand, but on the contrary a big rise in liquidity, brought about by fiscal stimulus and quantitative easing. The financial authorities were aware of the example of the 1930s, but perhaps even more important was the recent experience of Japan. The collapse of the housing bubble in Japan at the end of the 1980s had led to a decade of very slow growth and a strong deflationary trend. After some hesitation the Japanese central bank had moved interest rates to zero, but by itself this had not provided enough stimulus for the economy.

What was clear in the first half of 2009 was that swift action, particularly by the US and British governments, had averted a slump on the scale of 1929, but the cost was a very large increase in public debt, which many forecasters predicted would constrain economic policy in these countries for a long time ahead. The strategy, particularly for Britain, depended on the fiscal stimulus sparking an early recovery; without it there were fears that such a high fiscal debt would not be sustainable and would precipitate either significant spending cuts and tax rises or a sterling crisis. Critics argued that the government had shored up the credibility of the banks, but in doing so had undermined its own credibility as a prudent manager of the public finances. The government argued that all the alternatives were worse and that only by intervening could it mitigate the effects of the crash and shorten the length of the recession.

Explaining the Crisis

How should this crisis be explained? When events as large and complex as this occur it is not easy to establish their causes or to assess their significance, in part because that is determined over time by the political responses to them. The events themselves are capable of being interpreted in many different ways, leading to different courses of action being proposed and different outcomes. The disturbing of the settled pattern of doing things creates the possibility of a new pattern emerging and a radical break with the past, but it does not guarantee it. The old pattern may simply reassert itself after an interval or continue in a new form.

The question of whether a crisis such as this leads to some fundamental changes is part of the dispute over whether these events should be labelled a crisis at all. In the narrow technical sense there has clearly been a crisis in the financial markets, with the failure of so many leading financial institutions and the exceptional measures that governments were required to take to stabilise the system. The causes of this crisis are fairly clear in retrospect, and many analysts had warned of the dangers of what was happening in the financial markets (Strange, 1998). Almost everyone agrees now that there was over-borrowing and under-saving both in the public and private sectors, and that the markets ran ahead much too far and too fast (Cable, 2009; Gowan, 2009; Peston, 2008; Soros, 2008; Tett, 2009; Turner, 2008). Financiers were ingenious at creating new financial instruments which prolonged the boom by allowing the great tide of lending to go on and the asset price bubbles to continue inflating. As has often been observed in previous booms, there is a particular psychology associated with the upswing (Kindleberger, 1978). At a certain point people come to believe that the boom will last indefinitely. Many people in the financial markets, including it seems Alan Greenspan, believed that the financial markets had become so sophisticated that they were able to price any risk, and adjust to any shock (Greenspan, 2008). The complexity of the system and the fact that no one mind could grasp it or understand what was going on was held to be a virtue, because it meant that the order created by the markets was spontaneous and unplanned and all the more robust because of it. The shock when these expectations of a continually rising market are disappointed is profound, but viewed in the long history of these episodes the breaking of the boom is entirely predictable, and is always anticipated by some players in the markets. From this perspective the financial crisis should be understood, in the long history of financial crises stretching back to the South Sea Bubble in 1720, as yet another episode of financial exuberance in markets (Kindleberger, 1978). The too-rapid boom creates the need for an adjustment and a contraction.

A second set of explanations looks at some of the institutional and policy factors that created the boom and the conditions of the crash. There has been a lively political argument as to whether the problem was caused by too little regulation or by ineffective regulation, and therefore whether bankers or regulators should be most blamed for the mess. Mistakes made by individual regulators who did not spot the danger to the whole financial system until it was too late have been highlighted. Other accounts direct attention to the new regulatory system for finance which was installed in stages from the 1980s onwards, and which involved the scrapping of many of the safeguards designed to prevent another Great Crash, some of them like the Glass-Steagall Act dating back to the 1930s. This Act, which had separated investment banking from retail banking, was repealed in 1999. Under the new rules different jurisdictions competed with one another to offer the least intrusive regulation on financial institutions in order to attract subsidiaries of the big international banks. Light-touch regulation was considered highly desirable. In Britain, for example, in the years before the crash the Labour government was regularly criticised by the Opposition when it proposed any measure that might damage the competitiveness of the City of London.

The argument that better regulation might have avoided or moderated the crisis has some force since there was nothing inevitable about the rush to deregulate. Several countries, including Canada and India, avoided deregulating their financial sectors, and as a result their financial sectors were much less affected by the crash. It was possible to maintain much stricter controls on bank lending and still prosper in the global economy. The reason why so many countries were prepared to abandon them was that the growth of the financial services sector was a key engine of the growth that was experienced in the 1990s. This financial growth model extended a lot further than just seeking to attract foreign banks to locate in the new financial centres that mushroomed from Reykjavik to Riga. It was allied to a set of policies that sought to promote the financialisation of citizens, encouraging all citizens to become more reliant on credit to fund themselves through the life cycle as well as paying for immediate consumption and major items of expenditure such as houses (Crouch, 2008; Langley, 2004; Seabrooke, 2007). A growing literature analyses how national economies have become increasingly reliant on policies that promote financialisation and on the provision of cheap credit. Re-regulating the financial markets in the wake of the crash may not be easy to accomplish if it is seen as substantially weakening one of the main contributors to the growth and prosperity of the last two decades. The financial growth model proved to be the way out of the last recession, and if it cannot be repaired, the question is what can take its place?

Another set of arguments analyses the particular bubbles that the world economy has experienced over the last twenty years, to ask why it was that certain bubbles like the dot-com bubble were successfully contained, while other bubbles, like the housing bubble, were not. There is a great deal still to be uncovered about the precise mechanisms by which risk was transferred through the securitisation and the use of financial instruments like credit default swaps (Mason, 2009). The financial authorities were not overly concerned about bubbles, since they believed that bubbles could be allowed to inflate and could then be burst without too many adverse effects. In the case of the dot-com bubble and the Asian financial crisis this proved to be true. The bubbles burst without spilling over into the whole financial system. But the housing bubble that had been building through the 1990s and 2000s could not be contained in this way and did spill over to infect the entire financial system. Whether this can be prevented in future and how has become a major focus of concern (Wolf, 2009).

Another explanation moves beyond finance to consider the other aspect of the boom, the huge imbalances that were created between different countries in the world economy, with some countries like the United States running large current account deficits, and others like Germany and China amassing large current account surpluses. The problem with such imbalances is not their existence but their persistence, and the lack of any corrective mechanism. Some countries are permanently in surplus and others permanently in deficit and there is no mechanism for correcting the deficits, only accommodating them through the willingness of the creditor nations to hold assets denominated in the currencies of the debtors. The boom lasted as long as it did because of the willingness of some of the creditor countries, in particular China, to modernise their economies through a strategy of exporting as much as they could to the West (Hutton, 2007).

This strategy was extraordinarily successful and it has transformed China, although it remains a developing country, with a large part of its population still on the land, and a long way to go before it rivals the developed Western economies (Breslin, 2007). One of the consequences of Chinese and Indian development in the 1990s was that inflation in the advanced capitalist countries fell to very low levels, because of the flood of cheap imports. So long as the financial system of the Western economies provided the credit to enable their citizens to buy these imports, the spending spree could continue unchecked. But even at the height of this boom there was concern that this pattern of growth was not sustainable in the long run. It was recognised that at some point there would have to be a major adjustment, a revaluation of the renminbi, an expansion of China's domestic market and a reduction in Western debt, which would allow a more balanced growth. The financial crash highlights the need for such an adjustment to be made. The difficulty of making it is political, since it requires the new pivotal position of the economies of China and India in the world economy to be acknowledged and accepted. The imbalances may not have been the immediate cause of the financial crash, but they were an underlying cause. Many observers have concluded that some resolution of the problem of the imbalances is now imperative for a lasting recovery (Wolf, 2009). The drastic falls in the value of so many of the assets amassed by the creditor countries are creating political difficulties and leading to demands by the surplus states for firmer guarantees and for international currency reform.

A fourth set of explanations examines the crisis in terms of theories of longer-term economic and policy cycles. Regular oscillations between boom and bust and between regulation and deregulation have long characterised the economic and political history of capitalism. Viewed from this perspective the drama and shock of recent events is tempered by a focus on the long-run determinants of economic progress, and fluctuations around trends. Over the last 200 years, despite the shocks provided by financial crises, depressions, world wars, radical regime changes and paradigm shifts, capitalism has proved remarkably resilient in adapting and surviving, and the world economy has continued to grow. The division of labour and the division of knowledge have progressively increased, and the latest boom has been particularly significant in creating new global players like India and China, which in the next few cycles could radically alter the pattern of the world economy and the distribution of power and wealth that became established in the twentieth century, eventually modifying the fixed hierarchy of twentieth-century capitalism (Arrighi, 1994).

Some of the most ambitious long-run theories in the past have been those that seek to detect long waves of economic activity, based around the introduction and dissemination of major new technologies. These are sometimes regarded as too technologically determinist, reducing everything to fundamental innovations such as steam power and electricity. The incorporation of science and technology as an indispensable part of the capitalist economic process has been a key driver of economic progress in the last 150 years, but has depended on the creation and sustaining of particular political, ideological and cultural frameworks. The progress of this system has been marked by periodic crises, which have both threatened its survival but have also been the means for its renewal. Despite setbacks, increasing challenges and doubts about its long-run sustainability, capitalism continues to set the terms of world politics.

Another very important perspective on the financial crisis is analytical rather than historical, and rests on the distinction between uncertainty and risk. The management of risk has become a central component of all modern economies and business enterprises, and a great deal of intellectual effort has gone into measuring risk, the better to control it and create stability and relative certainty. Given the complexity of modern societies it would be hard to see how they could function otherwise. The insurance industry is one obvious manifestation of this effort. The financial services industry more generally is another. Enormous effort has gone into managing risks and creating business models that would generate the highest returns in volatile markets. What the financial crash of 2008 demonstrated is that however sophisticated ways of measuring risk are, they do not take account of the radical uncertainty that lies at the heart of social systems, and which produces events that are often unexpected and can run completely counter to expectations. Every so often uncertainty does reassert itself, and throws into question all the assumptions that were taken for granted. Uncertainty cannot be planned for, only acknowledged as an ever-present reality in politics and economics. In Frank Knight's distinction, risk is randomness with knowable probabilities while uncertainty is randomness with unknowable probabilities (Knight, 1921). Social science, and economics in particular, has tended to concentrate on the former, but that does not make uncertainty go away, and in an event like this financial crisis we are forcibly reminded of it.

The Politics of Recession

The impact of the events of 2007 and 2008 on both domestic and international politics is still at an early stage. Certain consequences are immediately apparent but how they will work themselves out over a longer period remains unclear. The most immediate consequence of the crash has been the exposure of the fragility of the financial system. Few expected there could be such a dramatic collapse of trust in the banks and in the whole financial system. The decision by banks to stop lending to one another and the seizing up of the wholesale money markets made government intervention inevitable, and even then it has taken a long time for confidence to begin to return. Credit conditions remained very tight after the crash, and many businesses and individuals were no longer able to get access to it.

In the wake of the crash bankers became very unpopular for a time, particularly with the spotlight being placed on the bonus culture and the levels of remuneration bankers were receiving and continued to receive even after the crash. There was much talk of re-regulating the banking sector, reversing some of the deregulation that occurred in the 1980s and 1990s and restoring some of the tight controls that had been imposed in the 1930s. There was particular debate in 2009 on the issue of whether the banks had become too big, and therefore too big to fail, and whether this had removed financial discipline from the sector. There was some support for dividing investment banking from retail banking, and running the latter as a public utility, while allowing the former to take risks, but with no guarantee of public bail-outs in the event of failure. Many people in the banking sector, including some regulators, argued strongly against this approach, arguing that it would weaken any national financial sector that imposed it, to the advantage of those financial sectors that did not.

Pressure for a move back to more prudential banking seemed to be irresistible after the crash, but it was remarkable how successfully the financial sector in Britain managed to block certain proposals, and how quickly the bonus culture revived, even though such a large proportion of the industry was now publicly owned. The reluctance to introduce drastic reforms to the sector that had been at the heart of the growth model of the previous twenty years was strong. The power of the financial sector was indirect and structural rather than direct. Bankers had few political allies and little public trust, but their main advantage was that governments recognised the vital importance of a successful financial sector to economic performance, did not have an alternative growth model and so were wary of introducing reforms that could permanently damage the ability of the financial sector to recover. New regulatory reforms were proposed in both Britain and the United States, but they were often modest in scope.

The financial crash had been contained by the early months of 2009, and it was clear that governments had averted a major collapse. But governments were then left with the consequences, which included the most serious economic recession certainly since the 1970s, and possibly since the 1930s. The rising tide of bankruptcies and the sharp falls in output and employment were marked in the first six months of 2009, and the International Monetary Fund (IMF) had to revise down its forecasts for the world economy and for individual countries. What governments feared most at the end of 2008 was the possibility of a deflationary cycle taking hold, which might make the recession a very long one indeed. But the means of averting this created major new fiscal problems, and drastically limited the flexibility for responding to any further financial shocks. The impact of the crash and the government response on pensions, mortgages and savings was severe, and left governments with an unwelcome set of problems. First signs of recovery began in the middle of 2009, but how strong and sustained the recovery would be and how vulnerable to further shocks remained uncertain.

The political fallout was uneven across countries. Some incumbent governments suffered greatly, being blamed for not protecting their citizens and for not foreseeing the meltdown. Others, such as Germany and France, fared better. They argued that the crisis had its origins in the financial heartlands of the world economy, in the United States and in Britain. It was the fault of Anglo-Saxon finance and not of the economic policies they themselves had pursued. The complicity of the surplus economies in sustaining the boom and benefiting from the financial excesses that London and New York orchestrated was obscured, but it meant that blame could be shifted elsewhere. The falls in output and employment, however, in countries like Germany which had become so dependent on the ever rising consumer demand elsewhere in the world economy, was marked, and often more extreme than in the countries at the heart of the failed financial system.

The recession is producing a very varied pattern in terms of effects on particular governments and their policy and ideological responses. The other important political impact to register, which will take many years to unfold, is the impact on the global balance between states in the world economy. An event like the financial crash of 2008 draws attention to how the relative positions of some of the leading players – the US, the EU, China, India, Russia and Brazil – have altered. It enables moves by different states to change some of the rules to their advantage, and to have their new political and economic weight acknowledged. The existing institutions of the world economy have been thrown into question by the financial crisis, over whether and how they should be reformed. Getting agreement on the next steps is not easy when all the leading players have been affected differently by the financial crisis and by the recession, and all have different interests. There may be a common interest in ensuring that the institutions of the international economy are preserved, particularly as regards maintaining flows of goods and investment, but because domestic interests conflict, finding a workable compromise is extremely difficult. The rhetoric of world leaders is impeccable, but their actions are often different. At the 1933 World Economic Conference there was strong rhetorical support for maintaining openness and international trade, but in practice every nation imposed protectionist measures and capital controls, and world trade stagnated throughout the decade. In 2009 the political forces behind protectionism are weaker, but they are still present nonetheless and are likely to grow stronger the longer the recession lasts. In the first nine months since the crash many states quietly introduced measures of financial and industrial protectionism in response to domestic political pressures. These are likely to intensify.

The severity and extent of the political impact of the crash and the recession will be greatly influenced by how long the recession lasts and what kind of recession it turns out to be. There has been much discussion in the financial press as to whether the recession would have a V, W or L shape; whether in other words there would be an early and sharp recovery, whether there would be further setbacks or whether the economy would remain depressed and below its trend growth level for a considerable period. Optimists have pointed to the decisive, early action that the authorities took to prevent a deflationary spiral. The signs of recovery in several countries in early summer 2009 were taken as a vindication of the strategy that had been adopted. Pessimists argue that the remaining unsolved problems in the world economy, particularly the imbalances between surplus and deficit countries, and now the very difficult fiscal position in many countries, mean that the worst is not yet over, and full recovery a distant prospect.

The pessimists can point to the experience of the 1970s and the 1930s as evidence of how long it can take for stable growth to resume after there has been a major dislocation of the economic order. In these cases it was not just a question of restoring the economic conditions for growth, but of complex political and institutional changes that took time to emerge. Because each situation in these major downturns is unprecedented, the guides from the past available to policy makers are inevitably limited. There has to be a period of trial and experiment, of improvisation and compromise and often of conflict, before a workable new order can be established. The length of the recession will be determined by how quickly the financial system can be rebuilt and trust restored in it again, whether the openness of the world economy can be preserved and whether deflation can be avoided without creating the conditions for inflation. No-one yet knows the answer to any of these questions.

Political Debates

It is unlikely that there will be any quick return to normality and business as usual, however much incumbent governments may hope for it. After such a major setback as the 2008 crash it is likely that there will be a lengthy period of restructuring, and a series of aftershocks, political upheavals and some major shifts in power. What is different about this crisis compared to earlier ones is that there is no obvious alternative to the current order of the capitalist world. There are no major external challengers now that China and even Russia are embedded within it, and few domestic challengers either. There is little ideological polarisation as occurred in both the 1930s and 1970s. This has led some to doubt that this is truly a crisis at all, on the grounds that for there to be a crisis there needs to be not just the breakdown of one paradigm but the articulation of an alternative. There is no sign of a replacement for neo-liberalism in the way that neo-liberalism emerged as a replacement for Keynesianism in the 1970s. Aspects of neo-liberalism may have been discredited, but there are as yet few signs of a paradigm shift in the priorities of public policy (Hall, 1993). Announcements of the return of Keynes may be premature (Skidelsky, 2009).

The absence of such an alternative, however, does not mean that there will not be profound political changes. They may acquire a narrative only retrospectively, but in the first instance will be a product of improvisation and pragmatic adjustment, particular choices and particular conflicts. Roosevelt's New Deal was very much like this, and Keynes did not publish the *General Theory* until 1936 (Badger, 1989; Clarke, 2009). There are likely to be some lively political debates between different ways of responding to the crash and its aftermath. This has already been evident in the argument between those who favour letting the crisis take its course and those who advocate intervention. This argument splits the neo-liberal camp, because many neo-liberals in their distrust of state intervention are reluctant to see bail-outs and a major extension of the state. They argued that irresponsibility should be punished and that the private sector should not become dependent on the state. But the counter-argument that won the day, at least initially, is that deflation has to be prevented at all costs, and that therefore governments and central banks should do whatever it takes to shore up the system, increasing liquidity, reducing interest rates to zero, recapitalising the banks, getting the flow of credit started again to small businesses and home loans, and protecting jobs and incomes.

Beyond this is a deeper dispute about whether the broadly neo-liberal framework of the last 25 years should be replaced with something new or whether it just needs some patching. Those that argue for patching are numerous and powerful, and they intend to resist any radical moves aimed at recasting institutions either domestically or internationally. On the other side are those arguing for a new version of the New Deal, involving a re-regulation of banks and financial services, a redistribution of income and assets, investment in new infrastructure projects and new technologies, investment in education and skills and, to fund all this, a programme of austerity and lower consumption to reduce debt and free up resources for investment. They also want to see a new financial architecture and a change in the balance of international economic institutions, including the IMF, the World Bank and the World Trade Organisation (WTO). Adherents of this position argue that only new rules for a multilateral trading order and eventually a new international currency regime can lift the shadows of recession and establish the conditions for renewed economic growth.

There are more radical voices too, particularly in the green movement, where the crisis is seen as an opportunity for a much more far-reaching reconstruction of economies and societies. For greens the financial crash is a symptom of a much bigger problem, the problem of an economic system that is prone to excess and is not sustainable in the long run because of its increasingly damaging effects on the planet. Climate change is the most visible but only one of these effects. The green critique is fairly well developed, and has been making some progress, but as yet in its radical version it lacks real political weight or support, and there is unlikely to be substantial popular movement towards green positions during the recession; there is also increasing contestation, mainly by conservatives, of the evidence for global warming (Lawson, 2009). More likely is the rise of populist, nationalist groups advocating various kinds of protection and exclusion in response to the hardships that so many are already experiencing in the recession.

The political outcomes of this crisis are uncertain and not foreordained. Whether there is some fundamental change or whether the old order is restored will be determined politically. There are many obstacles to recovery and there are already signs of political upheaval in many countries. The responses of some of the leading players, and in particular the United States and China, are likely to be critical in determining whether a new order emerges relatively smoothly, or whether there will be a prolonged period of instability, with all its attendant risks and uncertainties.

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