

## NEW WORLD ORDER? THE AFTERMATH OF THE FINANCIAL CRISIS

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The crash of 2008 is already recognised as one of the largest financial crises to have hit the international capitalist economy in the last hundred years. The only two comparable events are the Great Crash in 1929-32, which led to the Great Depression and the final collapse of the old liberal international economy in the 1930s, and the Great Stagflation of the 1970s, which also precipitated a lengthy period of economic restructuring and intensified political and social conflict.

What is not yet clear is the scale of the political and social changes that are likely to ensue from the 2008 crash. One immediate effect of the crisis in the financial markets was a deep recession that has affected many, though by no means all, parts of the international economy. This downturn brought an end to a long period of sustained growth, but the swift action of the authorities in both North America and Europe has, thus far, succeeded in offsetting the threat of recession turning into a depression and a major deflation of the kind experienced in the 1930s. 2009 witnessed a gradual return to normality, and the first signs that some of the leading economies were coming out of recession. But confidence remains fragile.

Alan Greenspan, the former chairman of the Federal Reserve, described the 2008 financial crash as a once-in-a-century event. This crisis was certainly different in scale from other recent financial crises, such as the bursting of the dotcom bubble in 2000 or the Asian financial crash in 1997, but there has been disagreement among commentators over whether the worst is now over, or is still to come.

By the end of 2009 signs of recovery were visible: markets were improving and bankers' bonuses were on the rise again. Unemployment is expected to peak in many countries, including the UK, during 2010. But there are fears of aftershocks from the great financial earthquake of 2008. Confidence is still brittle, and the cost of the financial bail-outs and stimulus packages has been very high. In many countries the banking crisis has begotten a fiscal crisis, and in some of the worst affected states this fiscal crisis has threatened to become a sovereign debt crisis as well. Fears of a new financial collapse, leading to a double-dip recession, remain strong, particularly since many of the features of the international political economy that gave rise to the crisis in the first place have not been addressed. Guaranteed international agreements on reform of the global financial

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architecture have yet to be secured. Disaster was staved off at the end of 2008, but it is not yet clear that the groundwork has been laid for a sustained recovery.

### **How Big was this Crisis?**

The magnitude of the crisis can be measured in a number of ways. There is firstly the scale of the events themselves, particularly the number of major financial institutions that got into difficulties. This was not an isolated bank or even a group of banks; it was all the major players. The crisis struck in the heartlands of the financial system, not on its periphery, and it had ripple effects which meant that no state or region was entirely immune.

A second indicator is the response of governments. There was a blizzard of initiatives, which included bail-outs, nationalisations, fiscal stimulus packages, zero interest rates and quantitative easing. Neo-liberal orthodoxies were cast aside, and the state returned with a bang. As in previous crises there were dramatic interventions and policy innovations. The pressure of events forced responses that would have been dismissed as unthinkable a short time before. Doubtless Hank Paulson, the US treasury secretary and a former chairman of Goldman Sachs, would never have expected to stand up and announce the nationalisation of some of the United States' leading financial institutions.

As with previous crises of the international political economy, this crisis has some common, international features, but it is experienced primarily as a series of national crises, and has been defined through a variety of national debates, narratives and solutions.

In the United Kingdom, for example, the banking crisis of 2008 had been transformed into a fiscal crisis by the end of 2009. The very success of governments in intervening to prevent depression and a repeat of the 1930s meant that the worst was staved off, but only by saddling the taxpayer with a new and intractable set of problems. Governments are having to manage much higher levels of domestic and external debt, while at the same time trying to avoid jeopardising prospects for an early resumption of growth, because only if growth does resume will the debts incurred be bearable. How growth might resume and in what form are matters of concern in many countries. There is uncertainty over whether the growth model of the 1990s with the leading role it assigned to financial services can be resuscitated or whether it has been damaged beyond repair.

The final judgement on the scale of the crisis will be its political consequences. These are still unfolding. This is not an easy time for incumbents and already several countries have changed their government, including the United States, Japan, Iceland and Greece – others are certain to follow. More fundamentally, a crisis on this scale raises a basic question of politics – who gains and who loses – in an acute form. Struggles over distribution of resources, taxes and public spending are

likely to intensify. Some countries have not experienced much real pain yet, but that is sure to come in the next few years, and as in the 1930s and 1970s the conflicts that develop will be the source of new political movements and new policies. There are also likely to be lasting consequences for the international order as a result of the crisis.

Many observers are already predicting a significant shift in the balance of power between east and west, with the emerging economies of India and China becoming much stronger, and Europe weaker. The chosen forum for debating the crisis and possible solutions to it has not been the G7 but the G20, and some envisage the need in the future for a G2: China and the United States.

## **Scenarios**

In judging how big this crisis is and what its lasting effects might be there are two broad questions on which much discussion is focusing. The first is whether it will in fact change the geopolitical balance, and the second is whether it will change the policy framework. The question of the geopolitical balance can best be analysed by employing scenarios built around assumptions about what will happen firstly to the global economy and secondly to the international state system. In one set of scenarios economic growth resumes quite quickly. The recovery turns out to be V-shaped, and the recession short-lived. Successful government interventions to halt the slide into depression, combined with the explosive growth of India and China, which dipped but still continued at a high rate during 2009, are sufficient to pull the whole international economy out of recession. With the continuing fast pace of innovation in information technology and in biotechnology, the fundamentals of the international economy are seen as very favourable to growth, so long as major policy mistakes are not made. There may well be an adjustment of wealth and power between east and west, but this can be handled within an expanding economy.

This scenario is associated with two different alternatives for the international state system. In the first the ascendancy of the United States is restored. There is a new boom presided over by the United States; the dollar continues as the undisputed international currency; and US productivity and technological innovation continue to give the United States a competitive edge. The neo-liberal international economy is re-established and a further period of deepening globalisation ensues. The second alternative predicts that the United States is unable to restore its former hegemony, but accepts and in part leads a multilateral reordering of the international economy, resulting in successful deals on climate change, economic and financial regulation and nuclear proliferation.

The second scenario for the international political economy is much less benign. It assumes that there is no early resumption of growth, and that the recovery observed in 2009 falters. The recession turns out to be at best U-shaped, at worst W- or even L-shaped. It might even turn into a new

depression, meaning that growth remains below trend for an extended period. This could come about for a variety of reasons, including the re-emergence of new weaknesses in the financial markets, political victories for parties advocating fiscal rectitude and retrenchment in the United States and Europe, and decisions China makes or fails to make. China might, for example, be unable or unwilling to expand its domestic consumption fast enough, for example by revaluing the renminbi (the people's currency), which may be required if growth is to be sustained in the rest of the world.

In such a climate the reform of the institutions governing the international economy might stall, and creeping protectionism might take hold, as more and more countries seek to insulate themselves from the effects of the international downturn. In this scenario there are again two main alternatives for the international state system. The United States might remain the dominant power, but severely weakened, presiding over a series of deadlocks and increasing fragmentation of the international community. The second alternative is that at some stage the United States might seek to withdraw from its extended involvement in the international political economy, and this could lead to much higher levels of protectionism, regional blocs and resource wars.

## **Policy Frameworks**

The last two major crises of the international political economy, in the 1930s and 1970s, led eventually to the overthrow and discrediting of the established policy framework and the emergence of a new one. In the 1930s it was Keynesianism and ideas of an extended role for the state that triumphed; in the 1970s it was neo-liberalism and ideas of contracting the role of the state that came to dominate. Some observers expect that this crisis will lead to the rehabilitation of the state and the return of Keynes. But that is far from certain. There has been an initial move in that direction, but whether it is sustained will depend on the political battles that will be fought over the next few years.

Since 1929 the international political economy has passed through two cycles, one emphasising market failure, the other state failure. Both approaches have been tried and partially discredited, but there is no alternative idea at present as to how economies might be co-ordinated in a better fashion. There will be a period of experimentation with new policies and new ideas, as well as with many old ones, and the struggles around them will determine the shape of whatever order eventually emerges.

The first phase of these struggles to define what the crisis is and how best to resolve it has already seen a clash between market fundamentalists and market realists, the former arguing that the crisis should be allowed to take its course, with no bail-outs for banks or anyone else, allowing markets,

not governments, to make the necessary adjustments. Market realists have backed government intervention to prevent deflation and a slide into depression, and to protect jobs and income and restart bank lending. So far the market realists have prevailed.

A second clash is emerging between regulatory liberals, who seek new ways of governing finance, trade and currencies as well as more eco-friendly growth policies, and economic nationalists, who are suspicious of international agreements that limit their freedom of action to protect their own citizens and pursue their interests as they perceive them. More radical ideas for reforming and reorganising existing capitalist societies on both right and left have also begun to emerge, although so far only in a rather muted form. Much of the focus in the public debate at present is on how to go back to the international political economy that existed before the credit crunch. If these efforts are successful, then a patched-up version of the old order may well survive.

If there is another crisis, however, it will intensify the political struggle at all levels of the international political economy, and at that point more radical solutions may come to the fore.