

# The Crisis of Neoliberalism and U.S. Hegemony

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## 1. Introduction

At the end of the 1970s, capitalism entered into a new phase, »neoliberal capitalism« or, for short, »neoliberalism«. After almost 30 years, in August 2007, a crisis struck the United States, the center of the neoliberal world. The crisis was originally denoted as the »subprime crisis« but it became rapidly clear that the U.S. financial sector was devastated. In October 2008, it appeared that the entire globe was affected, and the GDP of most countries entered into a period of contraction.

This crisis is certainly that of neoliberalism but, to this first characterization, one must add the reference to »U.S. hegemony«. A crucial feature of the three neoliberal decades has been the consolidation of the dominance of the United States. The United States assumed an unchallenged leadership among imperialist countries, within what had become a unipolar imperial world after the fall of the Soviet Union. Both neoliberalism and U.S. hegemony are now under threat. The world is entering into a new phase, beyond neoliberalism, and the diminution of U.S. hegemony is already a fact.

The following sections consider, successively, neoliberalism and U.S. hegemony, the crisis of neoliberalism and U.S. hegemony, and the new social and global order into which the world is entering.

## 2. Neoliberalism – Neo-imperialism

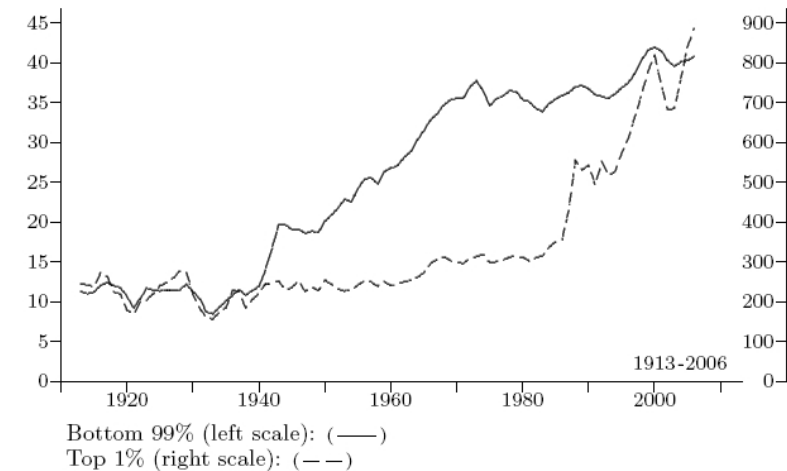
The structural crisis of the 1970s, a »profitability crisis«, created the economic conditions underlying the establishment of neoliberalism. The crisis of the late 2000s, which is not the expression of a decline of the profit rate but more of the nature of the Great Depression, marks its end.

Between the two crises, neoliberalism prevailed during about three decades, with significant differences between various countries or regions of the world. The dictatorships in Latin America (notably in Chile and Argentina) can be seen as »laboratories« of the new course of events, but full-fledged neoliberalism was first imposed in the United States and Europe and, then, exported to the rest of the world, often at the cost of severe crises as in Asia or Latin America. Japan joined lately other major countries. Many countries suffered tremendously of neoliberalism, as Africa and Latin America or, in a different context, Japan. China highly benefited from its integration into the new international division of labor, but without adjusting to the basic rules of neoliberal globalization.

Neoliberalism is a class phenomenon, a social order, a new »financial hegemony«. It is the result of the victorious struggle of upper capitalist and managerial classes (»upper classes«) against the classes of production workers and clerical-commercial

personnel (»popular classes«). The objective of this struggle was the quest for high income (*capital income*, that is, interest, dividends, and capital gains, and *high wages* including stock-options and bonuses). A »restoration« is implied here, since high incomes had been contained during the first decades after World War II.

**Figure 1: The purchasing power of two income fractiles of U.S. households**  
(thousands of dollars of 2006)



Source: Piketty/ Saez 2003.

The dramatic difference in the trends of purchasing powers among various social categories, between the first postwar decades and neoliberal decades, is illustrated in Figure 1 (based on income statements to the Internal Revenue Service). The first variable (—, measured on the left axis), is the average purchasing power (in 2006 dollars) of the income fractile 0–99 of U.S. households. The second line (---, measured on the right axis) describes the profile of the same variable for the fractile 99–100, that is, the top 1% of U.S. households in terms of income. The scale on the right axis is 20 times larger than the scale on the left axis, and this observation shows that, at the beginning as well as at the end of the period, the average purchasing power of the 99–100 fractile was 20 times larger than that of the 0–99 fractile. The figure strikingly contrasts the first postwar and neoliberal decades. It shows the advance of the purchasing power of the bulk of U.S. households from World War II to the 1970s, and its latter stagnation. Conversely, the purchasing power of the top 1% hardly grew between prewar years and the 1970s, before soaring during the following decades. (This shift of income patterns to the benefit of upper income brackets, here described for the United States, is actually a global phenomenon.) Thus, given its social objective, neoliberalism appears as a tremendous success.

Beginning the historical investigation at the end of the 19<sup>th</sup> and early 20<sup>th</sup> centuries in the United States, neoliberalism appears as the third such »social order«. A first »financial hegemony« prevailed from the beginning of the century, but it was destabilized during the Great Depression and the New Deal, a period of intense class struggle. The social order characteristic of the period that stretches from the New

Deal to the late 1980s can be denoted as »social democratic« or »Keynesian«, with significant differences among countries. Its main social feature was a »compromise« between managerial and popular classes, paralleling the containment of capitalist interests.

How neoliberalism was established historically lies beyond the limits of the present study. Conversely, the description of the methods used is rather straightforward. A new discipline was imposed on workers, with the control of their purchasing power, new labor conditions, and the decline of welfare. While, after World War II, a large percentage of profits were conserved within nonfinancial corporations to the end of investment, in neoliberalism, profits were lavishly distributed as dividends and, up to 2000s, a large fraction was paid out as interest. Policies aiming at price stability were substituted for macro policies tending to growth and employment. Financial regulations inherited from the Great Depression were gradually lifted. Restrictions to international trade were eliminated to the benefit of free trade, and the free international mobility of capital was imposed to most countries. Neoliberal »globalization« allowed for the deployment of transnational corporations worldwide.

The United States emerged from the two world wars as the leading international power. While other imperialist countries, as France or the United Kingdom, were still involved in the defense of their traditional empire, the United States abandoned the first attempts at the constitutions of such an empire at the end of the 19<sup>th</sup> century, to the benefit of the Wilsonian vision of the informal dominance of the most advanced among capitalist countries, with the gradual imposition of the dollar as international currency. The Great Depression did not destabilize this hegemony, which was dramatically consolidated by the victorious participation of the country in World War II. The United States never accepted the new rules of the Bretton Woods agreements limiting international trade and the international movements of capital, and the dollar was confirmed as a substitute for a truly international currency.

After World War II, the United States fought for the defense, in front of the Soviet Union, of the so-called »free world« and for their own dominance worldwide. Everywhere, corruption, subversion, and wars were used to these ends. The U.S. economy came to dominate the nonfinancial and financial world economy. The transnational corporations of the country were the most powerful, in particular financial institutions. In the 1970s, many analysts of global trends pointed, however, to a decline of U.S. hegemony and the formation of a »triad« (the United States, Europe, and Japan). Neoliberalism inverted these trends and strengthened the preeminence of the U.S. economy. As of the 2000s, the U.S. economy was presented to other major capitalist countries as a model to be emulated, and the United States as a leader to be followed.

### 3. The crisis of neoliberalism under U.S. hegemony

The contrast is sharp between the »success story« of *neoliberalism under U.S. hegemony* and the sudden and dramatic character of the crisis of the late 2000s. Not only were the unsustainable features of neoliberal trends revealed, but also the fragile basis of U.S. hegemony. The threat inherent in the progress of new challengers is now much more clearly assessed. One may wonder why there was so little consciousness of underlying trends. The historical precedent of the Great Depression shows that

such periods of euphoria may suddenly introduce to dramatic collapses, but this basic lesson from the past had, apparently, been forgotten.

There are two strands of determinants to the crisis of neoliberalism. A first set of factors refers to the »unchecked quest for high income« typical of neoliberalism. Besides the pressure placed on workers, regulations were lifted, notably financial regulations, and all barriers to globalization were suppressed. The consequence was the new configuration of financial-global mechanisms around the globe, a fragile and unwieldy structure. In this context, the quest for high income reached tremendous degrees. The appropriation of an increasingly »fictitious surplus« led to the payment of large and quite »real« flows of income: dividends to shareholders and very high »wages« to management, in particular within financial corporations, encroaching on their own funds. These trends underwent a sharp acceleration during the 2000s.

The second set of factors is typical of the U.S. economy. It is the unsustainable macro trajectory of this economy. Involved are the declining trend of capital accumulation within nonfinancial corporations, the rising consumption of households (notably on the part of high income brackets), the upward trend of the debt of households and Government (Government during the 1980s and early 1990s, and then households during the 2000s), the rising deficit of foreign trade, and the increasing financing of the U.S. economy by the rest of the world.

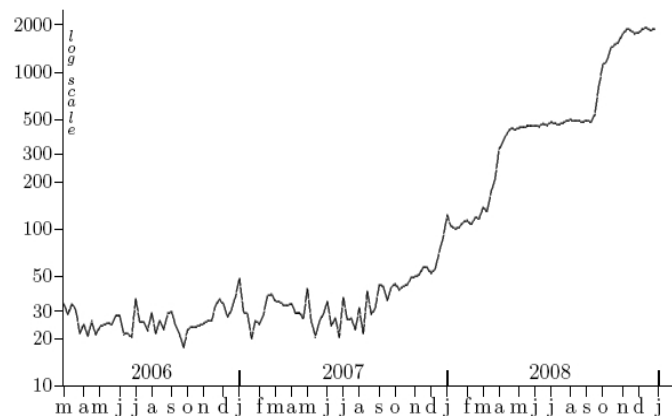
The two sets of determinants combined their effects, and this explains why the crisis began in the United States. Year after year, more loans had to be granted to domestic agents to support the use of productive capacity in the U.S. economy, while a growing fraction of the resulting demand was imported from the rest of the world. During the 2000s, mortgage loans to households were the main component of this rising indebtedness, financing residential investment and consumption in general. A fraction of households were enticed into perilous indebtedness. The debt was supported by the development of securitization (the issuance of Asset-Backed Securities, ABSs, and, in particular, Mortgage-Backed Securities, MBSs) and the purchase of a rising fraction of these securities by the rest of the world. These mechanisms culminated in innovative procedures such as Collateralized Debt Obligations (CDOs) in which large amounts of dubious assets were pooled and transformed into pseudo-AAA securities. These credit flows were insured against defaults by insurance companies and investment banks, leading to the expansion of Credit Default Swaps (CDSs), a highly speculative instrument on derivative markets. These mechanisms were only the central and, now, famous component of a broader financial structure. It is the collapse of this pillar of the financial edifice that triggered the crisis, a seismic wave that first provoked a liquidity crisis and, then, destabilized the entire construction, originally in the United States and, then, around the globe. The collapse of the financial structure provoked a dramatic contraction of credit, a »credit crunch«, without precedent. The consequence was the downturn of output in the United States and other countries, in turn adding to the financial turmoil.

An alternative outcome of these unsustainable developments could have been a crisis of the dollar, the expression of the growing financing of the U.S. economy by the rest of the world. To date, the crisis did not come to the world by this channel, but the threat is still pending.

The crisis developed in a stepwise fashion. Figure 2 shows the total loans of the Federal Reserve to U.S. financial institutions. The outburst of the financial crisis is

generally dated to August 9, 2007. Prior to this date, the variable describes the ups and downs of standard monetary policy, that is, the volume of »repurchase agreements«. The upward trend of the support by the Federal Reserve is then apparent. It paralleled the gradual decline of the Federal Fund rate, from 5.25% at the beginning of August 2007 to less than 0.25% in December 2008. After a first steady rise, a major step upward occurred at the end of 2007. The situation seemed to stabilize a first time, with a total support from the Federal Reserve reaching about \$110 billion. To this point, the disruption of financial mechanisms could be described as a »liquidity crisis«. But the crisis took new proportions in March 2008, and the difficulties of Bear Stearns, filing for bankruptcy, marked the entrance into a new phase. A second plateau was reached at about \$450 billion. During the summer of 2008, the difficulties of the GSEs, Fannie Mae and Freddy Mac, were revealed. The last step upward signals a period of panic, with a chain of major bankruptcies in the United States, the expansion of the financial crisis worldwide, and the beginning of what can be denoted as the »Great Contraction«. The last plateau in the figures was established at \$1,800 billion.

**Figure 2: Total loans of the Federal Reserve to financial institutions** (billions of dollars)



Source: Federal Reserve (n.d) Tables H.4.1.

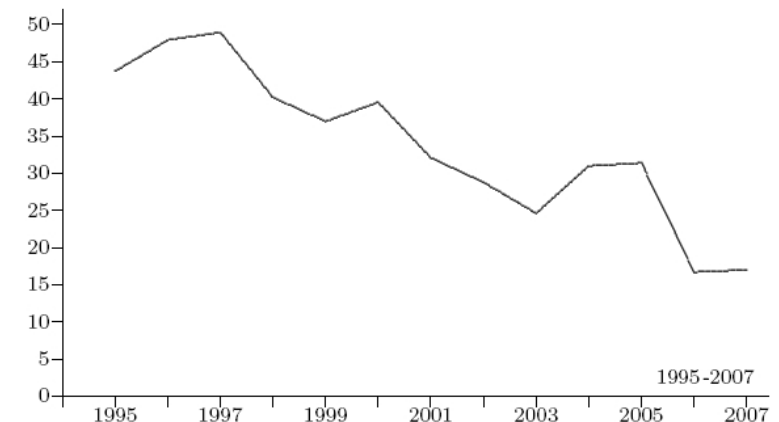
Beginning in December 2007 and with a major increase in September 2008, the variable also includes currency swaps to foreign central banks.

An examination of underlying trends stresses that the symptoms of the declining U.S. dominance remained rather limited to the mid-1990s. This explains probably why a major crisis was necessary to reveal to the world the threats posed on the continuation of U.S. hegemony, the expression of much longer tendencies. A first manifestation of these trends is the comparative rise of challengers: the progress of other economies worldwide. Globally, during the 2000s, the GDP (using purchasing power parity exchange rates and the classification of countries by the International Monetary Fund) of the broad group of »Developing and Emerging countries« (DECs) grew faster than the GDP of the major economies, later denoted as »Advanced Countries« (ACs). Between 1980 and 1999, the GDP of DECs fluctuated around about 59%

of the GDP of ACs. This constant percentage hid the comparative progress of China and India, and the decline of other DECs. But after 2000, all DECs grew faster than ACs. Only between 2000 and 2008, the GDP of DECs rose from 59% to 80% of the GDP of ACs. In 2008, the GDP of China amounts to about half of the GDP of the European Union, itself slightly ahead of the United States.

A second factor is the trajectory of »disaccumulation« proper to the U.S. economy (both intrinsically and in comparison to the rest of the world). Neoliberalism had a devastating impact on the investment of U.S. nonfinancial corporations, whose negative effects culminated during the second half of the 2000s in the massive buybacks of stock shares by corporations (that is, negative new issuances). Figure 3 provides a striking image of the comparative issuance of shares on the part of U.S. corporations as a percentage of total new capital raised by corporations worldwide. The percentage culminated at 48% in 1997, meaning that during the late 1990s almost half of the issuance of shares in the world was made by U.S. corporations. Then, a downward trend was asserted to 17% in 2006 and 2007!

**Figure 3: New capital raised by U.S. corporations**  
(percent of total such capital raised worldwide)



Source: World Federation of Exchanges.

Other indicators point to converging observations. Prior to the crisis, the financial hegemony of the United States was clearly established concerning the number and wealth of rich households, the number and size of large corporations, stock-market capitalization... The U.S. economy was leading concerning the most advanced financial institutions and instruments. A percentage as high as 42% of billionaires and more than a third of millionaires were U.S. citizens, and the largest financial and nonfinancial corporations were of the same nationality. Most CDOs had been established by U.S. institutions, although they were located within tax havens ... All variables point, however, to the dramatic rise of challengers during the most recent period. Considering the 500 largest corporations worldwide between only 2003 and 2008, the U.S. economy lost 65 corporations and the so-called BRIC countries (Brazil, Russia, India, and China) gained 50. In 2008, among the 25 wealthiest persons in the

world, 15 are from EDCs. In the overall classification of billionaires worldwide, China ranks fifth and third if Hongkong is included (though still at a considerable distance from the United States).

#### 4. New social and global orders

As contended earlier, the analysis of the determinants of the crisis of neoliberalism and U.S. hegemony points to two converging groups of factors: the quest for high income typical of neoliberalism and its implications in terms of financialization and globalization, on the one hand, and the trajectory of the U.S. economy (with the declining trend of accumulation, the rising domestic indebtedness, and external disequilibria), on the other hand.

In all of these respects, sharp corrections are urgently needed. At issue here are basic *economic requirements*, independently of their political feasibility. They radically contradict neoliberal objectives and methods. The most obvious requirement is financial regulation as a condition for the overall stability of the economy. The unchecked quest for high income, typical of neoliberalism, was naturally conducive to perilous financial expansion and innovation. Thus, besides the control of indebtedness, a new framework is required in which strict limits are posed to these ambitions. The correction of external imbalance is another basic requirement, necessary to the limitation of domestic debts. For mere accounting reasons, the deficit of trade provokes the growth of the financing of the domestic economy by the rest of the world (simplifying to some extent, an »external debt«). The net domestic debt and the net external debt are, however, the two sides of the same coin.

How to correct for the deficit of trade in a world of free-trade and free international movements of capital? How to ensure a »reterritorialization« of production? Not within the framework of neoliberal economics. This means a new corporate governance (in which interest, dividends, and high wages are limited to the benefit of investment in fixed capital), new policies targeted to growth and technical efficiency and, not only the regulation of financial mechanisms, but a financial sector to the service of productive investment.

Given the speed of the decline of the comparative GDP of the country with respect to the rest of the world, there is no future for U.S. international hegemony in the absence of a sharp correction. If the new trends apparent during the decade preceding the crisis are prolonged, the U.S. economy (and Europe) will lose their economic dominance, and the crisis itself will add to this comparative decline. There must be a way out, but it is narrow and at odds with neoliberal class objectives.

As in the case of the New Deal and the postwar economy, income and power hierarchies among classes are involved. The new social and economic path to be implemented, if the United States really want to slowdown the decline of their dominance, will hurt the interests of capitalist classes, but also the upper fractions of management, in particular, of a significant fractions of wage-earners within financial institutions. The experience of the New Deal suggests a new containment of financial interests under the leadership of managerial classes, obviously not those that benefited most from neoliberalism, with a prominent role played by government officials (in particular during the first stages of the establishment of the new social order). Whether this will be achieved in alliance with popular classes will depend on the pressure placed

by these latter classes on the forthcoming transformations and of the degree of the social confrontation among the fractions of upper classes. Whether a new alliance to the Left, or rather »Center-Left« in the case of the United States, is possible or not, remains undetermined. The history of the interwar years also teaches, however, that government official may seek the support of popular classes in a first phase, as was the case of the Roosevelt Administration, and a new, substantially distinct, compromise found at a later stage, as after World War II.

The formation of a new global order is already underway. One can surmise that there will be no substitute for U.S. hegemony during the coming decades, rather the establishment of a more »multipolar« world, with given centers in various regions of the world: Brazil in South America, various »poles« in Asia... In this context, strengthened international institutions are urgently needed, tending toward a form of global governance. (Obviously, these new forms of global government will remain at the image of international hierarchies, dominated by regional hegemonic powers, and subject to the class hierarchies and compromises in each countries or regions of the world.) The example of the Bretton Woods agreements is telling of the type of class and international patterns of power that might prevail in this context. As a »new New Deal« is on the agenda in each country, a »new Bretton Woods« is at issue internationally. Such a framework is required to guarantee a degree of coordination within a post-U.S. hegemonic global order.

The gradual establishment of a multipolar configuration worldwide opens; however, new opportunities for the emancipation of dominated countries, as had been asserted in the Bandung meeting in the context of the bipolar world of the first postwar decades. The contemporary crisis and the decline of U.S. hegemony are also creating conditions favorable to the emergence of a broad diversity of social orders in various countries.

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#### Notes

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