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Finance-dominated Capitalism in Crisis – The Case for a Keynesian New Deal at the European and the Global Level*

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Abstract

We analyse the long-run imbalances of finance-dominated capitalism underlying the present crisis, which began in 2007, with a focus on developments in the USA, on the one hand, and in Germany and the Euro area, on the other hand. We argue that beyond inefficient regulation of the financial sector, the severity of the present crisis has been caused principally by increasing inequalities of income distribution and rising imbalances in the world economy as well as in the European economy associated with finance-dominated capitalism. From this it follows that in the near and not so near future, the USA will no longer be able to act as the driving force for world demand. In order to avoid a period of deflationary stagnation in major parts of the world economy and a disintegration of the Euro area, we finally propose the policy package of a Keynesian

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New Deal at the global and at the European level which should consist of: (i) the re-regulation of the financial sector; (ii) the re-orientation of macro-economic policies along (Post-)Keynesian lines; and (iii) the re-construction of international macroeconomic policy coordination, in particular in the Euro area, and a new world financial order.

Keywords: Finance-dominated capitalism, financial crisis, macro-economic policies, Keynesian New Deal

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1 Introduction

The world economy is still struggling with its most severe crisis since the Great Depression of the late 1920/early 1930s. On the one hand, the present crisis is a financial crisis which started with the collapse of the subprime mortgage market in the USA in summer 2007, which then gained momentum with the breakdown of Lehman Brothers in September 2008 and which reached another climax with the euro crisis in early/mid-2010. Under the conditions of deregulated and liberalised international financial markets the financial crisis has spread rapidly across the world. On the other hand, the present crisis is a real crisis, which started well before the financial crisis with an economic downswing in the USA. The financial crisis and the real crisis have reinforced each other, and the world economy has been hit by a decline in real GDP in 2009 – something not seen for generations. Major regions in the world are only slowly recovering from this decline, in particular the Euro area, the UK and Japan.¹

A complete breakdown of the world economy could be halted by monetary policy interventions providing liquidity on a massive scale to the money market, thus preventing a meltdown of the financial sector, and, in particular, by massive fiscal expenditure programmes. We will argue, however, that the present global crisis, with serious future deflationary risks, marks a structural break in the long-run development since the early 1980s. This development has been dominated by the neoliberal model of deregulated labour markets, reduction of government intervention and social policies, redistribution of income from (lower) wages to profits and high management salaries, and deregulated international financial markets. In the USA and the UK this model, in combination with expansive monetary and partly fiscal policies, has been able to generate sustained periods of high growth rates and low unemployment, and these economies performed far better than the Euro area and, in