Greece and Iceland – Could it Happen Here and How Would we Respond?*

In June last year I was at a conference in Iceland entitled 'Crisis and Renewal in Welfare States'. The speakers took us on an exposure tour of the hot spots in Europe's deepening crisis: Ireland, Spain, Greece and, of course, Iceland. Occupy Wall St was just gaining momentum and turning the media spotlight on rampant inequalities of wealth and power that the global financial crisis had laid bare. No one doubted that neoliberalism had failed and that people were demanding structural change. Despite that, the neoliberal paradigm remains deeply embedded. In particular, national, regional and global institutions of power have deemed survival of the discredited financial edifice more important than addressing its devastating impacts on the daily lives of individuals, families, communities and nations.

We have been largely cocooned from that reality in Aotearoa. We were fortunate that our banks were owned by Australia's, whose practices left them minimally exposed to the latest crisis. It would have been very different if they had been owned by Citigroup or the Bank of Scotland, as could well have happened.

Although we escaped the direct impact of that particular crisis, I will argue that the underlying conditions are much the same. Social and economic indicators show a society that is deeply under stress. Our government, the economy and ordinary households are in thrall to the so-called FIRE economy – finance, insurance and real estate – that has been the principle source of wealth creation in the past three decades. Real production, real jobs, real wages have been replaced by a giant ponzi scheme that our guts, and some of our analysts, tell us must fail. But it seems easier to think it will be all right in the end or just to drift along knowing that something is wrong but not doing anything about it, because we don't really know how to deflate the current model and what else to do.

There is a large literature, ranging from Fredrick von Hayek and Roger Douglas to Karl Polanyi and Naomi Klein, which shows how moments of crisis

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can be used to transform a paradigm. The people of Christchurch know that only too well. But that strategy to neoliberalism, and our dependence on finance capital, can be easily romanticised, without clearly understanding the barriers to that transformation and the pre-conditions for it to occur – let alone what it might look like.

It is interesting to reflect on Iceland's experience. A number of analysts had predicted the meltdown and I asked them how they prepared for that event and the opportunity it would provide for them to seed alternatives. They said they didn't have those conversations. They had analysed the problem, predicted the crisis, and said 'we told you so'.

Iceland was fortunate, because the government that sponsored the illusory gold rush was replaced by a coalition that rejected an IMF bailout and gave priority to protecting the most vulnerable. As a consequence, the impacts on ordinary people have been much less severe than in countries like Ireland, Greece, Spain and Portugal where austerity measures designed by the troika of the European Commission, the European Central Bank and the IMF were imposed, against popular protests but with government consent. The predictable consequences of those pro-cyclical policies are deepening recession, chronic unemployment, and worsening government deficits as tax takes fall and demands on dwindling social support systems multiply.

The particular circumstances of these countries are related to the pressures on them as part of the Euro-zone, which did not constrain Iceland's options (although ironically, it is considering membership. However, they share the same underlying contradictions that triggered the crisis – their dependence on the seemingly omnipotent forces of international finance capital. Despite the title of the lecture, I do not want to go into detail about their situation – rather to reflect on how we might deal with a similar situation here.

As I noted, Iceland's alternative pathway was due more to good luck that the political forces that prevailed at the time were progressive than it was to forward thinking by the critics of neoliberalism. Given the past three decades of neoliberal consensus between the major political parties, whether in government or opposition, it is hard to see a similar outcome here, at least for now. There is an embryonic discussion within Labour, and stronger dissent from the Greens, New Zealand First and Mana, as evidenced recently by the current debate over monetary policy. But these are small and tentative moves that fall far short of the systemic critique that is essential if the paradigm itself is to change.

I am not going to pretend I have the answers, but I have been thinking hard about the questions we need to ask. So let me get a bit more concrete. I see four main contributors to the malaise:

1) material dependency on credit that is sourced from a highly unstable and irresponsible international financial industry;
2) realignment of government that has institutionalised an intimate corporate and finance nexus;
3) constraints on government's policy and regulatory options under a straightjacket of meta-regulation; and
4) socio-cultural expectations and conditions.

This schema fits within a more complex theoretical framework that I do not have time to explore tonight.

1) Our material dependency on finance

My starting point is the shift in the centre of gravity of the capitalist economy away from production to finance, including insurance and real estate, which has become the principal source of wealth creation in advanced capitalist countries since the 1970s. This shift is commonly referred to as 'financialisation'. Governments came to rely on capital markets to finance their own deficits and the private sector's debt, and to provide credit that maintained the purchasing power and standards of living for households whose real wages had declined. As a result, highly leveraged economies like New Zealand have become especially vulnerable to financial volatility and the spillover effects when capital becomes scarce in financial crises.

Debt is integrated into the fabric of our daily lives in a way it never used to be. Sustaining economic activity, jobs and standards of living depends on access to easy credit. Despite the political rhetoric about public debt, that is not New Zealand's problem. While the Rogernomics model almost eliminated government debt in the 1990s and 2000s, private debt ballooned. In June this year was still a modest 24% of GDP, even after the recession, limited stimulus packages and finance company bailouts, and corporate debt was still 102% of GDP. The Australian-owned banking system remains reliant on rollover credit in offshore financial markets, despite moves to reduce that exposure. There is little prospect of a dramatic decline in this level of dependency under current conditions. As the IMF observed in its 2012 update, New Zealand is highly vulnerable to financial and credit crises offshore.

It is not just the economy and government that are structurally locked into financialisation. Ordinary people and households are too. Real household incomes of lower and middle-income groups dropped dramatically between 1985 and 1995 through a combination of falling real wages and benefits. There was some real income growth for middle classes after 1995, but that only produced a slight decrease in overall income inequality.

Real wages in New Zealand fell by a quarter from their peak in 1982 to the mid-1990s and never recovered, despite significant increases in productivity. Skilled workers, who migrated to higher-wage economies, were replaced by low wage immigrants, which kept wages suppressed. Severe cuts to social welfare benefits, especially in 1991, were compounded by a punitive differentiation between beneficiary households and those in low-paid work that denied the former access to the child tax credit and income support through 'working for families'.

At the same time an unprecedented income gap has opened between workers and management. Since 1985 the distribution of earnings has widened much more than the OECD average. Income inequality in New Zealand is now among the highest in the OECD, despite having plateaued in the 2000s.

Today, lower income households maintain their living standards and consumption by borrowing - sometimes to generate wealth from the property market but often just to pay their bills. Outstanding total household debt increased more than six-fold in dollar terms since 1990, peaking at 180% of households' disposable income in 2008. To reinforce my point about the FIRE economy, over 90% of household debt was housing debt. The level has fallen slightly as interest rates dropped, but debt servicing is still a huge demand on family incomes. Many poor households are prey to loan sharks that successive governments have been reluctant to regulate. Under the Credit Contracts and

Consumer Finance Amendment Bill the government required registration of largely unregulated credit providers, but did not to cap their interest rates. Higher income earners are also over-exposed to excessively leveraged finance. Added to mortgage and consumer credit are new forms of debt associated with privatised education and purchase of private pensions.

There are many other impacts of financialisation, including speculation on the dollar and its impact on the exchange rate; the growth of secondary markets in food commodities, oil, fisheries quotas or emissions trading rights; and the grip that highly leveraged private equity firms who are driven by maximising short term returns have over our media, infrastructure, aged care facilities and the financing arms of public private partnership consortia.

This partial snapshot illustrates the structural dependence of New Zealand's domestic economy and quality of life on the survival of financialisation, and the unsustainability of that model for a significant section of New Zealand society whose socio-economic wellbeing has suffered a relentless long-term decline.

Various options are being canvassed to rein in the finance sector, including capital gains taxes, financial transaction taxes and other forms of capital controls. There is a slow recognition that these measures may be essential, alongside positive moves to revitalise a productive economy, but there are powerful barriers to stop that happening. I want to mention three of these now.

2) The Government-Corporate-Finance Nexus

The standard narrative of neoliberalism, with its prescription of deregulation, privatisation and liberalisation, talks of 'rolling back the state'; indeed, that was the title of an early book of mine in 1993. We argued that Rogernomics, Thatcherism and World Bank structural adjustment programmes displaced the Keynesian interventionism of the mid-20th century with the laissez-faire ideal of self-regulating markets. But this misrepresented reality. The state did not abdicate its power or retreat in favour of self-regulation. Power was realigned, as the state actively constructed a different kind of capitalism, driven by credit, with a different redistribution of wealth.

This is obvious in the finance sector. Wall St and the City of London competed to construct a regime of light-touch and self-regulation and make that the default regime for a globally integrated financial system. It was bolstered by the liberation of capital flows, private debt financing of governments, businesses and households, and the concentration of power in a handful of global financial institutions. Their patron states constructed a globally integrated economic system whose blood supply is the abundant, highly leveraged and opaque real of international finance. Its nervous system is the system of instantaneous communications and data flows that have become possible under new telecommunications technologies and whose. Neither can be permitted to collapse. The consequences are evident in the post-2007 financial meltdown and the preoccupation of states and international institutions with resuscitating, rather than dismantling, that system.

In New Zealand intimacy between business, especially finance, and government has become a normalised part of government – symbolised in the identities of the current Prime Minister and his predecessor. But this is not new. Successive governments privatised all our state-owned banks, removed restrictions on foreign investment in the finance sector, and fully liberalised capital flows. The creation of state-owned Kiwibank in 2001 was a reluctant response to social failure of the foreign banks to provide access to banking for the poor and rural communities - remember that Treasury opposed the move and Labour only supported it as a condition of a coalition agreement with the Alliance Party.

From 2000 the Labour government made limited moves to shed New Zealand's reputation as the 'wild west' of financial markets by moving towards the OECD regulatory norm; yet finance companies remained effectively unregulated. Following the finance company collapses, unrelated to the GFC, an 'industry-led' Capital Markets Development Taskforce was established to 'develop a blueprint for New Zealand's capital markets'. Its members were almost all leaders of the financial and legal industry. Their 60 recommendations involved minimal re-regulation; even a proposed full-time super-regulator to replace the inadequate Securities Commission was later downgraded to a part-time position. One of the Taskforce's most perplexing proposals, given the lessons that might have been learned from the global financial crisis, was for New Zealand to develop a regulatory and tax regime to provide a back office hub for the financial services industry in the Asia Pacific region - which the Prime Minister applauded.

In other developments, the no-fault Accident Compensation scheme was partly privatised in the 1990s, partly re-nationalised under Labour government in 2002 and is again slated for privatisation through competitive tendering of its operations. The Kiwi-saver pension scheme was introduced to complement the universal pension and is operated by approved private firms, although its future remains uncertain.

How did this occur? In part it resulted from the capture of core government agencies, the Treasury and Reserve Bank, now joined by the Ministry of Business, Innovation and Employment, and the fluid exchange of players among the state sector, private business and international economic agencies.

Policy was outsourced to 'experts' selected for their ideological predisposition, or at the least disciplinary or sectoral alignment. There has been a systematic programme to import private sector 'expertise' into government in the name of efficiency, neutrality and expertise. Early examples included the corporatisation and preparation for sale of state enterprises under private sector boards from 1987, recruitment of private sector chief executives to state sector leadership positions from 1988, and the statutory independence of the Reserve Bank Governor and Board from 1989. Entities that were renationalised after failed privatisations, including Air New Zealand and the railways, are still governed by private sector boards. The process continues to invade the core of government: in 2010 three non-executive members from the private sector were appointed to the New Zealand Treasury board.

Other central players in financialisation have also gained strong footholds. I mentioned the growing influence of private equity firms, especially from Australia, who have no commitment to the activity they run. Ironbridge, an over-leveraged company that controls the major private media networks, was given an extended 5-year period to pay its license fees in March 2011, reportedly in a reversal of a Cabinet decision after a private conversation between the CEO and the Prime Minister. Another finance firm is on the process of taking it over. The Australian private equity Red Group, which owned the dominant book chains Whitcoulls and Borders, collapsed the same year. There is justifiable concern that private equity firms also dominate the aged care industry. In 2010 the National-ACT government also (belatedly) conceded to pressure from the Council for Infrastructure Development, until recently chaired by a former National Party Prime Minister, to use public private partnerships for prisons, roads, schools and hospitals, with the added benefit of shifting its infrastructure expenditure off balance sheet.

It has also become routine to delegate policy and administrative reviews and the design of regulatory schemes to ad hoc taskforces, 'expert' advisory groups and consultants. The former head of the Treasury during the crucial period from 1986 to 1993, Graham Scott, has performed a dazzling array of advisory roles for the current government, most of which remain under the radar. Those roles included chairing the overtly ideological Regulatory Responsibility Taskforce. That taskforce resulted from the 2008 coalition agreement between ACT and National, as did the '2025 Taskforce', headed by the Hayekian former Reserve Bank Governor and National Party leader, Don Brash, who recently executed a coup to take control of the ACT party. Another of the Taskforce's recommendations was the establishment of a Productivity Commission, which has Scott as one of the three commissioners alongside former Treasury, Reserve Bank and World Bank official Murray Sherwin – who also chairs the Canterbury Earthquake Recovery Commission.

There are plenty of other examples. The government appointed a Welfare Working Group that was predestined to produce extreme recommendations. While the government initially dismissed the most politically contentious, it later cited the 'fiscal and debt blowout' resulting from earthquake reconstruction and finance company bailouts as justification for adopting them in the 2011 budget. Former ACT president Catherine Isaacs chairs the taskforce on charter schools. It seems ironic that political ideologues who are opposed to an activist state have used confidence and supply agreements under MMP to deeply politicise policy and legislation, and strengthened both the government-corporate and government-finance nexus.

It may be tempting to think that a government of a different hue could achieve similar results by playing the same game. That would ignore the systemic leverage that finance and corporations exercise over New Zealand governments. No one should under-estimate their potential to generate a crisis of investor and business confidence that sees the international agencies, credit raters and other 'authorised voices' of neoliberal orthodoxy ring the fire alarms to bring the government back into line.

3. The Straitjacket of Meta-regulation

That brings me to a more subtle set of institutions and regulatory instruments that have been designed to embed neoliberalism. The architects of New Zealand's experiment revelled in the kudos of being world leaders in devising such arrangements, notably:

- The Reserve Bank Act, with its independent central bank and exclusive inflation target, which was a world first.
- The State Sector Act redesigned the public service and state agencies on private sector lines and mandated ongoing reviews.
- The Public Finance Act harnessed funding to short-term instrumental targets that could easily be outsourced and were so technical that few politicians could understand.
- Regulatory Impact Statements, now embedded within a Cabinet Directive on Better Regulation, Less Regulation, require cost-benefit analyses that give preference to light handed regulatory regimes and subordinate social and quantitative considerations in the policy equation.
- Moves driven by ACT and the Business Roundtable to impose stricter disciplines, including protection of private property rights from the impacts of regulation, went too far even for National, but the Regulatory Standards Bill is still on the parliamentary agenda as part of the 2011 coalition deal.

- The Fiscal Responsibility Act imposed constraints on public finance, to be tested against disclosure of short, medium and long-term Treasury forecasts. That Act was later incorporated within the Public Finance Act.
- State-owned Enterprises Act, and recently the Mixed-Ownership Model Bill, which requires commercial behaviour that disqualifies non-commercial social considerations and prepared entities for full privatisation.
- ACT's Spending Cap (People's Veto) Bill, which would have tied increased government spending to the rate of inflation and required a referendum to exceed it, will not be passed, but the government plan to legislate limits on the growth of core Crown operating spending. Similar constraints are occuring through the Local Government Amendment Bill.
- The World Trade Organisation agreements, New Zealand's seven free trade and investment agreements, the raft of closer economic integration agreements with Australia, and the proposed Trans-Pacific Partnership Agreement impose the most far-reaching constraints on government policy and regulation. All are enforceable by the other states that are party to the agreement, and many by foreign investors from those countries.

Although each element has its internal contradictions, these and other legal mechanisms represent an ideologically consistent and integrated regime to constrain governments. They are described as 'quasi-constitutional', because they pre-commit governments to maintain normative principles in the long term. According to their architects, governments voluntarily emulate Ulysses by tying themselves to the mast to escape the siren calls of pressure groups.

All these instruments, aside from the secretly negotiated trade and investment agreements, are ordinary laws that can be amended or repealed by a simple majority vote in the Parliament and there is no legal penalty for non-compliance. Yet individually and cumulatively they enjoy a protected status. Ideologically loaded terms of fiscal and regulatory responsibility, price stability, and free trade, and requirements that governments confess their non-compliance to Parliament or WTO committees, impose powerful disciplines. Undoing one law, as with the current debate on monetary policy, will leave the regime itself intact.

Socio-cultural barriers

While there are economic, institutional and legal bulwarks that defend the neoliberal regime, a change of paradigm also faces socio-cultural barriers. Psychology plays an especially important role in maintaining financialisation. New Zealanders have an expectation that they will enjoy a first world standard of living, with instant access to consumer items. The poor struggle to achieve it, but the aspiration is still there.

To some extent our practices of consumption and the expectation of high standards of living were created during the era of full employment, free public services and state welfare. But they have heightened at a time when they are less affordable. Individuals are consumers of debt. Easy wealth through property speculation has held the key. People have treated the wealth effect of the real estate bubble as real, because it let them borrow money; but that incurred real debt servicing obligations to be met even when property values decline. Again, Christchurch knows that only too well.

Who wants to think in advance about these downsides, especially when wages are not enough to fill the gap? While people's life options now depend on access to affordable finance, especially the very poor, it is not realistic to expect them to give that up voluntarily.

Can we blame people for thinking this way? To the extent that people engage with economic questions their understanding is shaped by the reification of economics and the 'expertise' of self-interested commentators. We are surrounded by powerful statistical illusions, rankings and ratings, and assessment of value. They are presented as objective, a-social and intrinsically valid. Every night on TV we see charts that track the price movements of shares and exchange rates. Self-interested analysts from financial institutions interpret these economic and commercial developments for us. The Reserve Bank's economic and inflation forecasts and interest rate settings go uncontested, as do Treasury's projections of economic growth rates, despite their constant ex poste revisions. Surveys on consumer sentiment and business confidence are reported as if they tell us something meaningful. All these statistics are built on illusions. But they are also real – they shape the decisions that affect our daily lives.

Again, these developments reveal the depth of the state-finance nexus. The void of critical debate is a success story for neoliberal ideology and its proponents. As in Iceland, independent economic think tanks were deliberately destroyed and critical academics marginalised and discredited. The renewed assault by the National government on public media and the ascendancy of tabloid journalism narrows that space even more, making new media even more important but likely to be accessed only by niche audiences. Universities are already under siege from external and internal commercial imperatives that marginalise critique; that will intensify if National succeeds in proposals to impose government-appointed boards councils. Unions have been heavily undermined, although some are leading a revival.

An optimistic conclusion

There *will* be another major financial crisis within the next decade, possibly the next 5 years. We are unlikely to fare as well as last time. When (not if) that crisis comes, we seem destined to face another rounds of the austerity regime that is already deployed in the name of the GFC and the Christchurch earthquakes. The recent cuts to the public sector, safety nets and government expenditures, and opportunistic policies, such as privatisation of public goods through public private partnership hospitals, 'educational renewal' and charter schools, would intensify ten-fold. Unless we can develop a coherent critical analysis of the problems we confront, and seed some proposals for a genuine paradigm shift that confronts our dependence on foreign finance capital, we might hope at best for a confused mishmash of pragmatism and piecemeal adjustments that do not address the underlying conditions.

Despite all my negativity I feel confident. There is a new energy and willingness to critique, and public intellectuals are creating new techniques and opportunities to engage on specific issues. However, we need to approach this project strategically. During the early years of Rogernomics people instinctively contrasted the radical neoliberal programme with an idealised version of Keynesian welfarism as key platforms of post-war corporatism were undermined. Following the financial crisis, most critics were still appealing for a restoration of some form of economic interventionism and centralised welfare state; sometimes this was a strategic choice, rather than a preferred position, to maintain some semblance of credibility under a comprehensive neoliberal hegemony. We need to look past simplistic solutions to identify the barriers that have to be overcome. Many different layers of neoliberalism have been carefully installed and will need to be peeled back, neutralised, and eventually replaced.

Understanding this anatomy has implications for how we strategise, intellectually and politically, for a different future. People in Christchurch are already confronting that challenge. I would love to hear what you see as possible and how we might get there.