THREE

From financial crisis to fiscal crisis

Ian Gough

The financial crash of 2008 and the ensuing global recession have been widely recognised as the most decisive capitalist crisis since the Great Depression of the 1930s. The scale of the crash, the speed in which the circuits of finance capital unravelled, its origins within the heartlands of Anglo-American capital, the synchronised global slump in output and the gigantic scale of government reactions, marked it apart from all other post-war financial crises. Take just one authoritative real-time commentator, Martin Wolf (2009) of the *Financial Times*, and just one of his many interventions on the transformation in capitalism that will surely result:

> [T]he glory days of financial capital are behind it for decades, the hegemonic model of the market economy is past, globalisation may be fatally destabilised by present and future global imbalances, and the prestige of the US is damaged. The state has been strengthened, and decisive action by policymakers has staved off a severe global depression, but in the process states are becoming bankrupt. Moreover, there are major uncertainties, 'things we cannot know': how far unprecedented levels of indebtedness and falling net worth will permanently depress Western consumption spending; how long current fiscal deficits can continue before interest rates must rise; can central banks engineer a non-inflationary exit from the bank and financial rescues they have implemented?

This list indicates a systemic crisis of capitalism, and even this does not touch on the subsequent recession in the global economy – the most serious since the Second World War.

This chapter explores the consequences of the financial crisis and its aftermaths for the role of welfare states and fiscal regimes – the ways in which the financial crisis has been transformed into a fiscal crisis of the welfare state. It begins in the first section by providing a theoretical sketch, offering an endogenous explanation of the crisis in terms of the inner contradictions of the previous phase of capitalism rather than simply in terms of an exogenous shock or of such factors as 'irrational exuberance'. The second section details the reactions of and impacts on governments and public finances. The third section briefly describes the subsequent reactions of governments to fears of rising public debts, the switch to fiscal tightening and the targeting of welfare expenditures. In the fourth section some alternative policies for a sustainable and just economy and welfare system are sketched. The final section concludes the chapter.

The theoretical framework adopted is a modified version of the political economy perspective previously developed in 1979 (Gough, 1979). According to Caporaso and Levine (1992) and Gamble (1995), historically rooted political economy (not the public choice model so popular in economics) is characterised by two assumptions. The first is that political and economic processes, although analytically distinct under capitalism, are interlinked and should be studied as a complex and interrelated whole. The second is that the economy, the sphere of 'material provisioning', has a special weight in explaining and properly understanding polity and politics.

The chapter covers only the advanced capitalist countries and does not pretend to cover the rest of the world. Within this it focuses on the United Kingdom (UK), one of the hardest hit by the crisis and, not unrelated to this, having the second most powerful, and one of the most lightly regulated, financial centres in the world – the City of London. The 2008 crisis was unique in the post-war period in originating in the heartlands of financialised capitalism and in reflecting many features of Anglo-American capitalism. Its impacts then rippled or rushed around the world affecting countries exhibiting different varieties of capitalism. This is not a comparative essay on the crisis, although I do draw on cross-national data in places, mainly from the International Monetary Fund (IMF). My focus on the UK is in recognition of its central role in fostering the crisis, with the result that it is the major Western country most threatened by its aftermath.

On crises, conjunctures and contradictions: the political economy of financialised capitalism

Taking history seriously entails the idea of conjunctures – of interactions between distinct causal sequences that become joined at particular points in time. These conjunctures may initiate rare periods of *systemic* change, when institutions and regimes are shunted on to new tracks. Such transformative moments are commonly described as *crises*. But this word has been much overused and abused in the social sciences, so conceptual clarification is essential (Moran, 1988). One definition stems from the medical meaning of crisis: a stage in the course of a disease when the patient is expected to recover or die: 'The concept of crisis was familiar to us from its medical usage. In that context it refers to the phase of an illness in which it is decided whether or not the organism's self-healing powers are sufficient for recovery' (Habermas, 1975, p 1).

From this stem related definitions applied at the social scale: a crucial or decisive situation; a turning point; an unstable situation in political, social, economic or military affairs, especially one involving an impending abrupt change (www.thefreedictionary.com/crisis).

However, this does not sufficiently discriminate between an external blow, such as 9/11, and a more deep-seated *contradiction* within social and economic systems, which eventually blows up into a crisis. The latter points to 'underlying causes and conflicts which even in periods of relative calm … have not gone away': a crisis 'of' capitalism, not just a crisis 'in' capitalism, of which there have been several in the past two decades (Gamble, 2009, p 40). Using Lockwood's (1964) seminal article, two forms of contradiction can be distinguished – a failure of system integration or of social integration. The former refers to the clash between incompatible features of social subsystems; the latter to conflicts between social actors pursuing incompatible goals (Lockwood, 1964; Gough and Olafsson, 1999; Rustin, 2009).

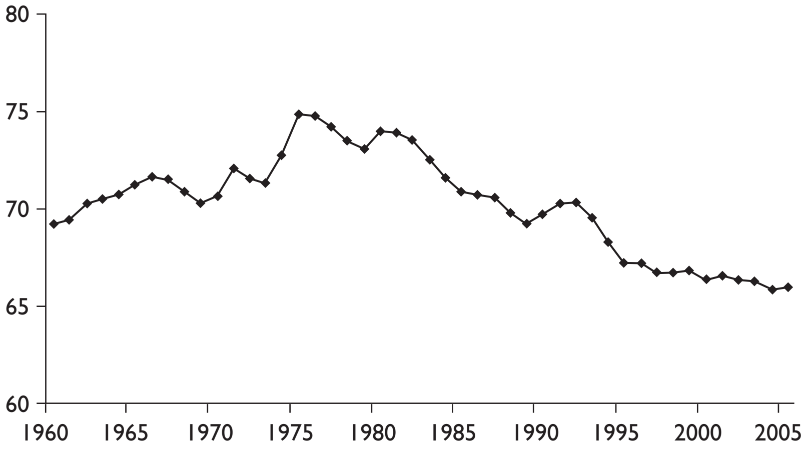
The idea of a system contradiction might suggest a return to a form of functionalist thinking, where objective 'problems' 'require' new solutions and policy responses. But, if this were ever an adequate stance, it is no longer so. Since the 1930s, governments have intervened to moderate the 'automatic' processes of capitalism in significant ways. Ever since Keynes, crises within capitalism have become intensely political events, influenced by the balance of social forces and dominant ideologies. This means that each is a singular event, in part decided by the resolution of the previous crisis (Gamble, 2009). Crisis resolution is a path of learning and collective action through historical time.

I turn now to interpret the crisis of 2008 in these terms, following the work of Glynn (2006) **[please supply reference]**. His work is relevant – and rather unusual – for paying attention to the key driver of accumulation and growth in the capitalist world – profitability – and the basic class divisions within capitalism. The underlying explanation of the crisis for him is the imbalance of factor incomes – the shares of total profits and wages in national income. Figure 3.1 shows that the share of wages and salaries in total incomes rose across the Organisation for Economic Co-operation and Development (OECD) world from 1960 to 1975 by six percentage points; since then it has fallen by almost 10 percentage points (Glynn, 2006) **[as above]**. This is confirmed by another time series of the ratio of equity prices to average wages, which exhibits an inverse pattern. There is clear evidence here of a generational reversal in the distribution of factor incomes (Atkinson, 2009).

The trend since 1980 has been compounded by a surge in inequality of incomes, notably in the Anglo-American forms of capitalism (Lansley, 2009). Between 1978 and 2008, real median earnings in the UK rose 56%, those of the poorest 10th by 27%, while those of the richest 10th rose by more than 100%. By the end of the decade to 2008, the top 10th of earners received £20 billion more, purely due to the increase in their income share, of which £12 billion went to workers in the financial sector (almost all of which was bonus payments) (Bell and van Reenen, 2010).

This fundamental division of income exerts a contradictory effect on the dynamics of capitalism. In brief, profits drive capital accumulation and production but wages and income from employment are the major drivers of consumption expenditure, which is the largest component of aggregate demand. In Marxist terminology, profit-driven enterprise boosts the production of surplus value, but wage consumption is necessary to 'realise' the surplus thus created. It is possible to conceive, as did Robinson (1961, pp 93-9), a 'golden path' of capitalist development

Figure 3.1: Trends in Labour's share of GDP, 1960-2005; average of 17 OECD countries (%)



Source: Glyn (2007, p 191)

wherein these two aggregates grow in step. However, as we have seen, the pattern since the Second World War has been of two great waves: first of rising labour shares and then, after the counter-revolution of monetarism and neoliberalism, of rising profit shares. The latter trend over the past three decades, plus the surge in inequality, has threatened aggregate domestic demand in the OECD world.

The solution to this dilemma that emerged was the rise and rise of consumer indebtedness, notably again in the Anglo-American economies. The ratio of total household debt to income in the UK rose dramatically from 45% in 1980 to 155% in 2007. By 2008, the credit outstanding of consumers in the United States (US) exceeded US$25 billion. **[have assumed all $ in this chapter to be US$ ~ ok?]** These trends permitted the growth of domestic demand to more than match the growth in domestic output, despite the falling shares of labour in national income.[1] They also provided a huge and growing market for mortgages, credit lines, hire purchase and numerous other financial products. This contributed to the explosive growth of the financial sector and further enhanced its profitability. And this in turn fed a speculative frenzy among the new rich wealth holders. The resulting unbalanced economic structure can be labelled 'financialised capitalism'. But of course these trends were not sustainable indefinitely. On the basis of these trends, and the underlying contradictions they reveal, Minsky, Glynn and others **[references?]** predicted a bursting of the bubble, which duly arrived in 2007-08. As Keynes recognised in an earlier era, it was soaring inequality that generated the unbalanced economies of the 1920s and the crash at the end of the decade.

To provide a background for what follows, Table 3.1 reproduces Gamble's (2009) short chronology of the unwinding crisis.

From financial crisis to fiscal crisis

How has the financial crisis and ensuing recession impacted on the public finances? There are four distinct routes.

First, the scale and nature of the crisis required massive government interventions to stave off runaway banking collapses and a catastrophic loss of confidence in financial institutions. These programmes divide into those undertaken by governments and those undertaken by banks. The former consist of capital injections and Treasury lending and purchases of assets. The latter comprise loan guarantees and other central bank support and amounted to some US$6,000 billion (that is, US$6 trillion) in the advanced capitalist world by the end of 2009. But for our purposes it is the former, government assistance that

Table 3.1: Chronology of the crisis, July 2007-April 2009

2007	
July	Bear Stearns announces major losses on hedge funds
August	Severe tightening in wholesale money markets
	Federal Reserve cuts lending rate to 4.75%
September	Run on Northern Rock
Sept-Dec	Federal Reserve cuts lending rate to 4.25%
	Major international banks announce losses
	Credit ratings of bond insurers is reduced
December	Federal Reserve announces major loan package to banks
2008	
January	Major falls in stock markets
	House prices start to fall
February	Federal Reserve cuts lending rate to 3%
March	Northern Rock is nationalised
April	Bear Stearns is taken over by JP Morgan Chase
July	IMF predicts financial losses will be $1 trillion
September	Collapse of IndyMac
	Bailout for Freddie Mac and Fannie Mae
	Collapse of Lehman Brothers
	Merrill Lynch is taken over by Bank of America
	HBOS is taken over by Lloyds TSB
	Numerous bank rescues, bailouts, nationalisations
	$700 billion bailout rejected by US Congress
October	Wall Street collapse
	Further falls in stock markets
	Further bailouts and rescue packages
	Further reductions in interest rates
	G7 proposes five-point action plan
November	Steve Forbes declares the worst is over
December	European Central Bank reduces lending rate to 3.25%
	IMF announces rescue package for Iceland
	Federal Reserve reduces lending rate to 0-0.25%
	US announces rescue package for Ford, GM and Chrysler
2009	
January	IMF predicts worst recession for advanced economies since 1945
February	Bank of England reduces lending rate to 1%
March	Bank of England reduces interest rate to 0.5%
April	G20 Summit in London

Source: Gamble (2009, p 23)

is more relevant – see Table 3.2. This shows that the total amount pledged by advanced country treasuries by end-2009 amounted to nearly $2 trillion, of which $1.1 trillion was actually utilised, equivalent to 3.5% of Gross Domestic Product (GDP). Part of the outlays will

Table 3.2: Direct government support for financial sector

	Direct support		
% 2009 GDP	**Pledged**	**Utilised**	**Net direct cost**
UK	11.9	6.6	5.4
US	7.4	4.9	3.6
Advanced economies	6.2	3.5	2.7
In $ **[[US$?]]** billion	1,976	1,100	882

Source: IMF (2010b, tables 4 and 5)

be recovered, but the IMF calculates that by end-2009, $882 billion remained outstanding. Interesting here is the exposure of the UK government, which exceeds that of any other by a wide margin. The British **[should this be UK?]** government directly pledged assistance to the banking and financial sector of almost 12% of GDP, of which just over half had been committed by mid-2010'. The maximum theoretical exposure of the Treasury and Bank of England combined is about one half of 2009 GDP (ONS, 2009).

Second, all states implemented large discretionary fiscal stimuli to prevent a major depression in the real economy; in the entire G20 these measures amounted to 2.0% of GDP in 2009 and 1.5% in 2010. Here the UK was not out of line and interestingly was the only major government to plan to cut back this fiscal stimulus to zero in 2010. This will switch to negative from 2011 onwards.

Third, several non-discretionary factors have impacted on public finances. The 'automatic stabilisers' of increased spending on unemployment and other social benefits plus reduced tax receipts cushion the recession, but will widen the fiscal gap by more than 2% of GDP in many OECD countries in 2009 **[bring sentence up to date or reword?]**. In addition, the 2008 financial crisis has entailed a sharp fall in equity, housing and other asset prices plus a decline in financial sector profits, all of which further reduce tax receipts.

Fourth, the worldwide crisis continues to drive down projected future growth rates, which, *ceteris paribus*, reduces tax revenues still further and expands expenditures. In July 2010, the IMF predicted a lower global growth rate for 2011 compared with 2010: down from 4.6% to 4.3% (IMF, 2010c). But forecast growth in the advanced economies is lower (2.6% and 2.4%) and for the UK much lower (2.1% in 2010, falling to 1.2% in 2011). This compares with a prediction of 3-3.5% growth in the 2010 Budget statement of the outgoing Labour government just three months earlier.

Yet, these growth forecasts may be optimistic. The IMF (2010c, p 1) went on to warn that 'recent turbulence in financial markets—reflecting a drop in confidence about fiscal sustainability, policy responses, and future growth prospects—has cast a cloud over the outlook'. A Bank for International Settlements report in March 2010 stated:

> In many countries, employment and growth are unlikely to return to their pre-crisis levels in the foreseeable future. As a result, unemployment and other benefits will need to be paid for several years, and high levels of public investment might also have to be maintained. The permanent loss of potential output caused by the crisis also means that government revenues may have to be permanently lower in many countries. (BIS, 2010, p **[page of quote?]**)

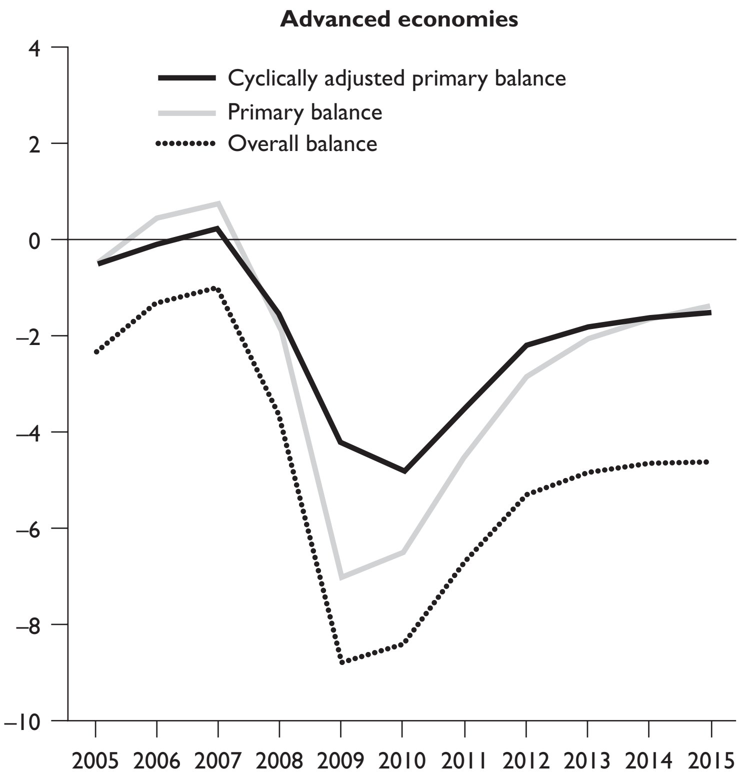
The result of these factors was a surge in government deficits and in accumulated public debt. Figure 3.2 shows the dramatic deterioration of fiscal balances in 2007-09 in the advanced economies. The primary balance, which excludes interest payments, fell to –7% of combined GDP and the total to –9%. After cyclical adjustments, the primary balance fell to –5%. These are now projected to improve, although the overall balance is predicted to remain at around –6% through 2015.

These continuing deficits are driving up the stock of government debt and the debt:GDP ratio. As a share of GDP, average gross government debt in advanced economies rose by 20% of GDP from 2007 to 2009 and is now predicted to rise by another 20 percentage points up to 2015, reaching an average of 110% GDP by then. However, the predicted debt in the UK by then is lower than this – some 88% – since it started off from a low debt ratio prior to the crisis.

According to the IMF (2010b), the debt surge in advanced G20 economies is driven mostly by the last of the four elements above – the output collapse and the related revenue loss. Of the almost 39 percentage points of GDP increase in the debt ratio, about *two thirds* are explained by revenue weakness and the fall in GDP during 2008-09. The emergency fiscal stimulus – assuming it is withdrawn as expected – would account for about 11% of the debt surge and banking bailouts for about 8%.

In the UK, the combined fiscal impact of the financial crisis and economic recession is more severe than in any other major country. My own rough estimate **[state the following: based on IMF (2010b, 2010c)?]** for the impact of the above four factors in 2009 is presented in Table 3.3. These are rough calculations, but they show that the crisis cost the Exchequer over 10% of GDP in 2009 in the form of escalating

Figure 3.2: Evolution of fiscal balances, 2005-15 (% of GDP)



Source: IMF (2010b, figure 1)

Table 3.3: Financial interventions (%)

Financial interventions: bank nationalisations, bailouts and other pledged supports to financial sector less amounts recovered (table 2)[a]	5.4
New fiscal stimuli	1.6
Fall in taxation; rise in compensatory social benefits[b]	3.0
Structural deficit in PS accounts due to lower growth[c]	1.8
Total	11.8

Notes:

[a] net direct costs to the Treasury = *utilised direct* supports to financial sector – amounts recovered.

[b] estimated automatic stabilisers = general government primary balance – cyclically adjusted primary balance.

[c] net expenditure on interest payments = general government balance – general government primary balance.

Sources: IMF (2010b, table 5, appendix table 1, statistical tables 1-3; 2010c, table 1)

[[What does PS stand for? Please spell out in full instead]]

expenditures and falling revenues, and it will continue to weigh heavily on public finances for many years to come.

Thus, a 'fiscal crisis of the state', much discussed in the 1970s, has returned as a central political issue in the UK and abroad. This is a direct result of the financial crisis of capitalism, the subsequent global recession and the (on the whole relatively successful) actions of governments to rescue the former and arrest the latter. It is most threatening in the UK because of the scale and economic centrality of the City of London.

From fiscal crisis to welfare crisis

The direct impact of these developments on the welfare state and on the welfare of citizens is affected by three things:

- the extent to and speed with which governments commit to reducing debt levels;
- the balance between spending cuts and tax increases in achieving this;
- the extent to which cuts fall on welfare state spending.

First, there is an ongoing debate about the need to reduce the size of planned government debts in the advanced capitalist world. This raises macroeconomic issues there is not space to cover here. What is an acceptable public sector debt:GDP ratio? Why is 60% of GDP the target accepted by the IMF? Will not a precipitate squeeze on fiscal balances threaten renewed recession? Why not accept a permanently higher post-crisis level of public debt?

Against these arguments, the IMF asserts, first, that with the US and other large economies moving beyond 100% debt levels (although not the UK), the world is moving into uncharted territory. Second, that 'the current crisis involves truly novel features compared with historical episodes: in particular it involves large contingent liabilities associated with guarantees of financial sector obligations; and it takes place, in many countries, in a context where pension and health care systems will give rise to large future spending increases' (IMF, 2010 **[a, b, c, d or e?]**: 34). Third, that future growth assumptions are uncertain. Fourth, that this might raise interest rates and risk premiums on bonds and thus debt service costs, although at present interest rates are at an historic post-war low.

Despite the numerous uncertainties involved in judging these issues, the British Labour government proposed a substantial debt reduction strategy to reduce the deficit over the lifetime of two Parliaments. The incoming coalition government adopted deeper and faster cuts in the emergency Budget in June 2010 and the October Comprehensive Spending Review. Furthermore, the new government proposed that the bulk of the fiscal rebalancing should fall on spending, not tax increases:

> Tough decisions need to be taken in order to reduce the unprecedented deficit. The Government is committed to achieving the bulk of this through reductions in Government spending, rather than tax increases, while protecting the quality of key frontline services. This Spending Review is not just about cutting spending and setting budgets. It will be a *complete re-evaluation* of the Government's role in providing public services. (**[source of quote?]**, emphasis added)

The 2010 cuts are summarised in Table 3.4, distinguishing between the three rounds.

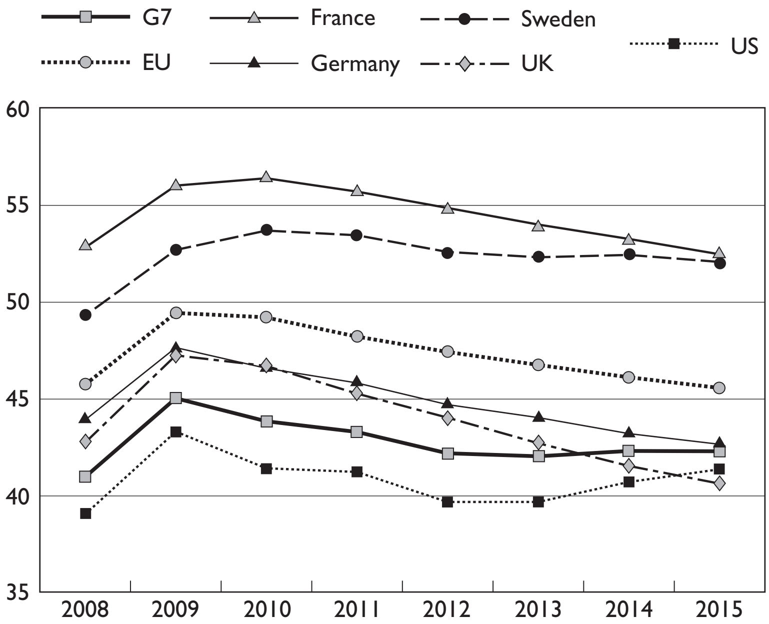
The total fiscal tightening planned for 2014/15 amounts to £110 billion, equivalent to around one fifth of the total budget in 2010. The goal is to reduce the deficit to manageable levels in five rather than 10 years. The share to come from spending cuts rather than taxation has increased to 73%. The contribution of public services has risen, and that of welfare benefits has escalated from zero to £28 billion. These are unprecedented measures in the UK's post-war history. Figure 3.3 shows how this marks a qualitative shift, which will pull the size of the public sector below even that in the US by 2015, according to Taylor-Gooby and Stoker (2010) **[please supply reference]**. In their

Table 3.4: Fiscal retrenchment in the UK, 2010

	Composition of the tightening in 2014–15		
£ billion	**March 2010 Budget**	**June 2010 Budget**	**October 2010 Spending Review**
Tax	21.5	29.8	29.8
Spending	50.9	82.8	80.5
Investment spending	17.2	19.3	17.0
Current spending	33.7	63.5	63.5
Of which:			
Debt interest	7	10	10
Benefits	–0.3	10.7	17.7
Public services	27.0	42.8	35.7
Total tightening	72.4	112.6	110.3
% spending	70	74	73
% tax	30	26	27

Source: **[[please state source]]**

Figure 3.3: Public spending trends, selected advanced economies, 2008-15 (% GDP)



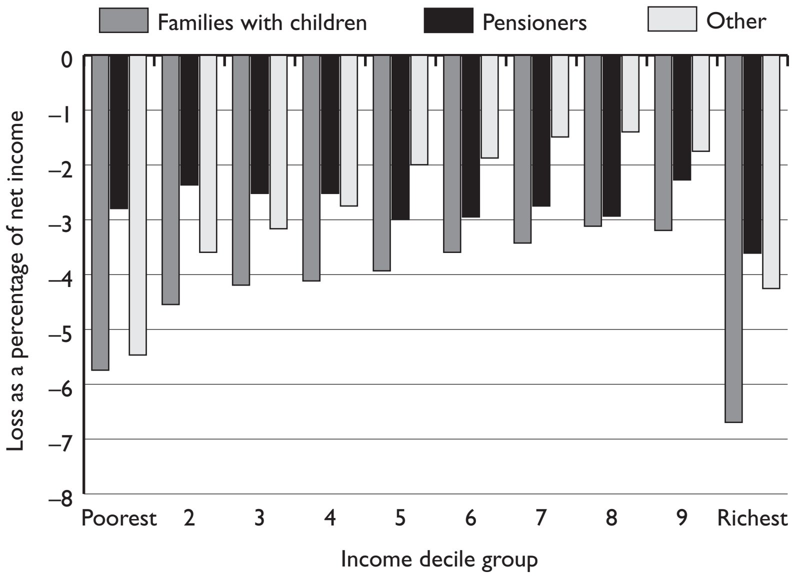
Source: Taylor-Gooby and Stoker (2010) **[[please supply reference]]**

words, 'The UK abandons Europe and joins Team America' (2010, p **[page of quote?]**).

Although the taxation of higher-income groups initiated by the outgoing Labour government has been retained, the overall impact of the 2010 fiscal retrenchment will be regressive – see Figure 3.4 for the estimates of the Institute for Fiscal Studies. Apart from the richest decile, the cuts in social benefits and social services will reduce the living standards of the poorest and of children and women the most.

The upshot is that a crisis originating in the financial sector in which the City of London is deeply implicated will be rescued by a savage attack on the living standards of the majority of UK citizens, notably those with the lowest and least secure incomes. The Bank for International Settlements recently argued that the fiscal capacity of a country depends on 'how far the government can raise tax revenues without causing the tax base to shrink, and how far it can cut public expenses without causing major social and political disruptions' (BIS, 2010, p 20). The evidence from Europe suggests that major cuts in benefits especially in pensions can call forth substantial and coordinated opposition, which can topple governments. Will the current UK

Figure 3.4: The effect of all tax and benefit reforms to be introduced between June 2010 and April 2014, by income decile group and household type



Source: Crawford (2010) **[[please supply reference]]**

government's radical strategy generate new oppositional movements? As I write, the British public shows few signs of challenging this unprecedented attack, although prolonged student demonstrations in late 2010 may provide the seeds of a counter-movement.

Conceiving alternative futures and policies

There *are* alternatives. Some elements are as follows, although I restrict my attention solely to the UK in what follows.

First, the need to drastically cut the state deficit should be challenged (see also Farnsworth, this volume). This is not the place to discuss or even summarise the ongoing debate between expansionists and restrainers. And since this chapter is written in the autumn of 2010, the objective situation and the contemporary strategies may have changed wholly by the time this book is published. But this central debate is unlikely to go away. The government and its supporters, such as Niall Ferguson and economist Kenneth Rogoff, argue that higher debt ratios are unsustainable. They consider higher unemployment and lower growth a price worth paying. Those who argue against rapid cuts, such as economists Paul Krugman, Joseph Stiglitz and Martin Wolf, want to cut the deficit later when the economy is stronger. They recognise that such a policy would lead to a higher debt ratio but argue that the benefits to employment and growth now are so substantial that they outweigh this risk. The evidence from Ireland is that it is self-defeating to cut public expenditure in the middle of a deep recession.

Second, even if the expansionist view is challenged, the current desire to correct the fiscal imbalance via cuts rather than tax increases can be questioned. The political consequences of raising taxes on the mass of the population in a time of recession or stagnant growth are equally dire. But there is an alternative agenda of *fair taxation*. There is a strong case to tax the financial sector to at least cover the costs of the bailouts and other rescue operations by the state. A leaked IMF report argued that this would require new taxes equivalent to no less than 4% of GDP in the UK (IMF Direct, 2010). A report by the Institute for Public Policy Research (IPPR, 2010) showed how part of this might be achieved. UK financial profits and bonuses in 2011 are likely to total £90 billion (5% of GDP), of which c£20 billion will be paid in tax. The report shows that another £20 billion *per annum* could be raised by tackling tax avoidance, introducing a levy on financial institutions, taxing profits and bonuses on a permanent basis and introducing a financial transactions tax at a rate of 0.01%. The overall impact of this would be very progressive whether the burden ultimately falls on traders or their customers. In addition, the Green New Deal Group (2010) estimates that up to £70 billion per annum could be raised by clamping down on illegal tax evasion. If correct, these sums are large enough to render unnecessary all the extra cuts of the coalition government and most of those of the previous Labour government.

Third, there is a strong case to shift the role of public and social expenditure further from *compensation* to *investment*. Since the 2000 Lisbon Agenda and the New Labour Third Way strategy, the 'social investment' paradigm has prioritised policies such as investment in human capital from early childhood to continuing education, and removing obstacles to participating in paid work (IFS, 2009). The challenge of climate change is pushing governments into new investments in sustainable energy and lifestyles, although at a snail's pace in most countries. This could be radically extended to encompass investment in mass retrofitting of dwellings, transforming transport, redesigning urban and living spaces and 'eco-system maintenance', as argued in the Green New Deal (nef, 2008a, 2008b). There is also a strong case to use public control of the nationalised banks to invest in sustainable and socially just projects, as proposed by the World Development Movement (WDM, 2010). For example, transforming the

Royal Bank of Scotland into a Green Investment Bank could release very large sums of money to kick-start the green energy revolution. It could bring an estimated 50,000 new green jobs a year, boost the UK economy, reduce the UK's carbon emissions and improve international competitiveness (although it may slow down deficit reduction slightly if green loans are made below market rates). At present the British public has incurred the costs of bank nationalisations with few of the benefits.

But to make these policies coherent requires new thinking and a new model of a sustainable social economy that would challenge both neoliberal and neo-Keynesian thinking. This would recognise the productive and reproductive role of much of the welfare state and of the emerging 'eco-state' to tackle climate change (Gough, 1979, chapter 6; 2010). To take one example relevant to this chapter, government and IMF calculations of public sector debt are typically of *gross* debt, not even subtracting financial assets let alone real public assets such as buildings and infrastructure. A first step to understanding that not all public debt is bad would be to create an integrated balance sheet of the public sector, as Hills (1989) proposes. Going further, we need to discriminate, as Jackson (2009, appendix 2) does, between types of public investment, building up public and public-guaranteed investment expenditures in human capital, climate adaptation and 'eco-system maintenance'. This will require a new conception of 'value' and new ways of calculating the social return on investment (nef, 2008a, 2008b; HM Treasury, 2009 **[please supply reference]**).

The implication is that we need new economic-social-ecological models to comprehend these distinctions and to enable new priorities to be legitimised. The current crisis provides an opportunity to switch tracks towards an eco-welfare state. Past rates of growth are very unlikely to be restored, and they may well be undesirable anyway due to planetary constraints (Gough, 2009 **[please supply reference]**). Since the traditional welfare state has depended on the 'growth state' for its finance, a sustainable welfare state will have to be radically transformative. This is a major challenge in developing an alternative.

Conclusion

The 2008 world financial crisis resulted in large part from the soaring inequality generated since 1980 by the new phase of financialised capitalism, which fuelled consumer debt and unbalanced economies. The international capitalist system was saved by timely action by the major states, but these bailouts and the ensuing recession transformed the crisis during 2009 into a fiscal or sovereign debt crisis. The policy reaction to this in 2010 in much but not all of the advanced capitalist world was sharp fiscal tightening and welfare cuts.

The UK played a leading role in all three years. The City of London was one of the two epicentres of the crisis, and the finance-dependent British economy evinced both historic levels of debt and inequality. The fiscal situation of the British government remains peculiarly exposed and the speed, ruthlessness and regressivity of the cuts and restructuring of the welfare state are unmatched among the large economies.

Thus far, a crisis of financialised capitalism has not fostered an alternative economic and social strategy. Rather, it has resulted in its opposite – a renewed ideological onslaught on the welfare state and mass living standards and a redoubled effort to widen class inequalities. If this crisis marks a switching point, and if the above analysis of the link between inequality and crisis holds, this strategy is likely to fail. What follows will depend on ideas, politics and citizen involvement.

Note

[1] This was not the only mechanism at work. Real consumption in the West was also boosted by the growing import of very cheap commodities from low-wage countries, primarily China. Indeed, the other fundamental cause of the crisis has been the growing global imbalances, notably between the US and China. It is notable that Sir Howard Davies (2010), when surveying the still-unsolved causes of the crisis, put at the top of his list global imbalances and growing inequality.