Hoping for Hegemony: Why Obama Changed Direction on Financial Reform and Embraced Retro-Liberalism

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In January 2010, the US president presented a financial reform plan that was more aggressive than anything he had previously offered. Instead of seeking to shore up the banking industry, he seemed eager to shake it up. How should we understand this shift? Most explanations have focused on domestic politics, suggesting that Obama began listening to a different faction in the White House or tried to ride a tide of populist anger among voters. But evidence suggests the president's new proposal was aimed as much at an international as at a national audience. It was designed to not only bolster his domestic base, but also to reclaim for the US a domination position in the global political economy. In other words, Obama was trying to win back hegemony. In doing so, the president abandoned neo-liberalism, an approach that had become discredited among allies in Europe and Japan. Instead, he adopted "retro-liberalism."

On a cold day in January 2010, the US President Barack Obama surprised the world by unveiling a relatively strong package of proposals to regulate the financial services industry. The announcement came as a shock because, until then, the president had shown far more interest in shoring up that industry than in reforming it. What changed?

The conventional explanations, repeated in a variety of media reports, focus on domestic politics. Some observers have suggested that a more reform-minded faction of presidential advisers had elbowed aside a more status quo-minded faction. Others went beyond this narrative of White House infighting to assert that the president was trying to bolster his political ratings. More specifically, they said he was cynically trying to halt or slow down a rising tide of public anger over unpopular policies, such as the nearly $1 tn bank and automobile bailout plan, that suggested an unholy alliance between Washington and Wall Street.

One cannot wholly reject such explanations. Like all politicians, the president pays close attention to public opinion polls—especially those that take the form of elections. But Obama could have tickled the grassroots merely by engaging in more explicitly populist, anti-Wall Street rhetoric (which he did), or by taking political aim at the exorbitantly generous compensation packages that so upset the public (which he also did). He did not need to also promote an ambitious set of reforms designed to rollback a long wave of deregulation.

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I argue that the president's policy shift was aimed as much at an international as a national audience. While the reform program was clearly designed to bolster domestic political support for a beleaguered president, it also had a larger and yet still self-interested mission: to try to reclaim for the US and its business elites a dominant position, a "righteous" position of leadership, in the global political economy.

For the US, and especially its dominant social forces, the financial meltdown of 2008-09 was more than a domestic economic crisis; it also represented an international political crisis. Coming just five years after the widely criticized decision to invade Iraq, the meltdown created a new and perhaps even more intractable challenge to US hegemony in the international system. Critics all over the globe quickly pointed fingers of blame at risk-happy financial institutions, AWOL regulators, and the ideology of neoliberalism, all of which have been centered if not exclusively concentrated in the US. Obama, who became president as this crisis deepened, belatedly pushed a program to revamp regulatory policies and remake international institutions, a program that adds up to something I call "retro-liberalism."

This paper maps the president's response to the financial meltdown, pinpointing its meaning in the overlapping context of domestic and global politics. In the process, I suggest that the Obama administration resolved to try to regain US hegemony in the global political economy by winning back newly skeptical states in Asia and Europe. I begin by defining hegemony, and by describing two previous and distinct moments of US domination over the global political economy following World War II (WWII). I then describe the increasing financialization of the US economy over the past three decades, a trend that led inexorably to the near-collapse of Wall Street in the fall of 2008. After highlighting the backlash outside the US, I focus on the effort inside Washington to restore confidence in financial markets and rebuild support for a renewed process of global integration led by US political and economic elites.

Defining Hegemony

Mainstream scholars of international relations have long used the term "hegemony" to describe a condition in which one state, due to a preponderance of hard and/or soft power, exercises leadership in all or part of the world. Thus, realists and liberals alike have spoken of "Pax Brittanica," the period in the 19th century when the United Kingdom, with its strong economy and powerful Navy, led a multi-polar world, and "Pax Americana," the period between 1945 and the mid-1970s, when the US enjoyed supremacy due to its economic and military strength. Unlike realists, who focused more on the use of raw power (material capabilities) by leaders to compel weaker states to follow,[1] liberals often emphasized what they viewed as the distinctively benevolent and thus seductive character of the hegemon, especially the

[1] See, for example, Stephen Krasner (1976), "State Power and the Structure of International Trade", *World Politics*, Vol. 28, No. 3, pp. 317-347.

US after WWII. Ikenberry[2], for example, praised the US for exercising "strategic restraint" by enmeshing itself in a web of global institutions like the United Nations, and thereby persuading smaller but rising states in the capitalist world to bandwagon with rather than balance against it.

The mainstream characterization of hegemony as leadership is useful, but only up to a point. It falls short because it ignores the social underpinnings of the state and because it misunderstands the relational, inter-subjective dimension of power. Fortunately, a Gramscian perspective helps overcome these shortcomings.

On the first point, Gramsci[3] recognized that the state is not merely the constellation of politicians and bureaucrats who make up the government but also includes the dominant social forces in what Western scholars have come to call "civil society." For example, the fascist state that imprisoned Gramsci in the early 20th century obviously included Mussolini and his henchmen, but also the industrial and rural elites who ushered him into power and helped sustain him there. Other collaborating forces in society, such as conservative intellectuals and Catholic bishops, also helped form the Italian state of that time. If Gramsci were writing today, his analysis of the US state would not stop at a Democratic administration and a divided Congress, but would also undoubtedly incorporate the dominant forces (the military-industrial-financial complex, as well as the leading institutions of political thought, such as the Heritage Foundation and the Brookings Institution and the Council on Foreign Relations) in contemporary American society.

On the second, and perhaps more critical point, Gramsci[4] understood that power is a dynamic reality that combines coercion and consent. Hegemony is never secured through the use of brutal force alone, or through merely a show of goodwill. It is secured through strategic concessions that are not *required* for rule, but that are made begrudgingly to co-opt weaker social forces. And it is secured through the framing of particular or historically contingent social relationships and modes of production as universal and appropriate—as, in other words, "common sense." In this way, acquiescence begins to appear voluntary and natural.

Combining these two insights, Cox[5] (p. 171) argues that hegemony begins at home as dominant socioeconomic forces inside an "advanced" or powerful state capture the hearts and minds of other weaker forces inside that state. They do this by offering concessions, and by presenting the new domestic order as an inevitability, a given. This order then expands, or becomes globalized, as dominant forces link arms to

[2] G John Ikenberry (2000), *After Victory: Institutions, Strategic Restraint, and the Rebuilding of Order After Major Wars*, Princeton University Press, New Jersey, USA.

[3] Antonio Gramsci (1976), *Selections from the Prison Notebooks*, pp. 206-276, International Publishers Co., New York.

[4] Gramsci, *op. cit.*, pp. 58, 160, 244.

[5] Robert W Cox (1983), "Gramsci, Hegemony and International Relations: An Essay in Method", *Millennium: Journal of International Studies*, Vol. 12, No. 2, pp. 162-175.

form a transnational civil society of acceptable domination. International institutions like the UN, the GATT/WTO, the IMF, and the World Economic Forum reproduce this order.

Cox[6] does a fine job of summarizing the neo-Gramscian definition of hegemony in international relations:

> ... to become hegemonic, a state would have to found and protect a world order which is universal in conception, i.e., not an order in which one state directly exploits others but an order in which most other states (or at least those within reach of hegemony) could find compatible with their interests. Such an order would hardly be conceived in inter-state terms alone, for this would likely bring to the fore oppositions of state interests. It would most likely give prominence to opportunities for the forces of civil society to operate on the world scale (or on the scale of the sphere within which hegemony prevails). The hegemonic concept of world order is founded not only upon the regulation of inter-state conflict but also upon a globally conceived civil society, i.e., a mode of production of global extent which brings about links among social classes of the countries encompassed by it.

Two Periods of US Hegemony

In 1944, US and British officials convened an international conference in the bucolic resort town of Bretton Woods, New Hampshire. The result was a fixed exchange rate regime and a new set of intergovernmental institutions—all designed to maintain stability in both developed and developing markets, and thereby reinvigorate global capitalism. Under the so-called Bretton Woods regime, US allies pegged their currencies to the dollar, which was backed by gold stored in a grand vault in Fort Knox, Kentucky. The International Monetary Fund (IMF) was one of two new institutions born from that meeting. It was set up to supervise the new regime and help members cope with balance of payment crises that threatened the financial health of individual economies and the liberal international economic order as a whole.

The US, which emerged from WWII with by far the strongest military and richest economy on earth, was the leader of this new, pro-capitalist regime. More importantly, it was—in the Gramscian sense—the hegemon. Pushed by capital-owning forces, it invested heavily in the IMF, and thus earned the right to direct its fate. (The US acquired sufficient "quotas," which translated into votes, on the IMF's Board of Governors to enjoy veto power over the most important decisions.) The US allies like West Germany and Japan eagerly agreed to participate in the new regime—not only because participation was the coercive price of regaining their sovereignty in the 1950s, but also because it offered the potentially lucrative opportunity to quickly

[6] Cox, *op. cit.*, p. 171.

rebuild their ravaged economies through a reliable, reasonably safe system of international trade and investment. Even as the system began to weaken in the early 1970s, when a US trade deficit undermined trust in the embattled hegemon's ability to pay its creditors, allies benefited from massive dollar-based liquidity.

Historians generally agree that the financial instability of the 1930s contributed to the naked militarism in Europe and Asia that led to WWII. But that instability also led to new thinking by economists like Harry White and John Maynard Keynes, the brains behind Bretton Woods. Instead of allowing markets to run wild, they called on national governments to expand their authority by more carefully managing their own economies and by collaborating with one another on a new and more stable international regime. Borrowing Ruggie's[7] useful terminology, the postwar system was one of "embedded liberalism"—a system of constrained or bridled capitalism.

But the hegemonic bargain—stable growth for consent—could not hold. In 1971, President Richard Nixon came to the rescue of US exporters by announcing that the dollar would no longer be valued at an artificially high level. It would, henceforth, float. This announcement was the deathknell for Bretton Woods; by the end of the decade, most developed country currencies were floating and international financial markets were roiled anew.

In the 1970s, the US entered a period characterized by IR theorists as "hegemonic decline." Inflation rose, but—in defiance of the well-known Phillips Curve—unemployment did not fall commensurately. The US investors were rattled, and productivity growth slowed down. In one industry after another, from automobiles to machine tools, from consumer electronics to supercomputers, US producers fell behind rivals in other countries, especially in Japan. Pundits began to forecast the emergence of "Pax Nipponica," a new world led by the new economic superpower in East Asia. Eventually, other scholars, such as Thurow[8] hedged their bets, suggesting either Japan or the increasingly unified European Union could challenge the US.

Even as the US economy struggled to regain its footing, dominant social forces in the US worked overtime to reproduce a strong commitment to the "free enterprise system" at home. In 1971, Lewis Powell, Jr., then a corporate lawyer, a member of the board of Phillip Morris and several other large corporations, and soon to be a Nixon appointee to the Supreme Court, sent a confidential memo to the US Chamber of Commerce. He argued that criticism of capitalism had gone too far, and called on the chamber to lead a counter-attack, an intellectual assault on critics inside academia, the media, and the courts. "The time has come—indeed, it is long overdue—for the wisdom, ingenuity and resources of American business to be marshaled against those who would destroy it."[9] What was necessary, he wrote, was a concerted, well-coordinated attack. "Strength lies in organization, in careful long-range planning and implementation, in consistency of action over an indefinite period of years, in the scale of financing available only through joint effort, and in the political power available only through united action and national organizations."

Powell himself may not have been the primary inspiration, but a counter-attack did indeed unfold. As Harvey[10] tells the story, the chamber quadrupled its membership over the ensuing decade, and joined forces with the National Association of Manufacturers to build a huge war chest for lobbying Congress as well as newspaper editors and other opinion-makers about the virtues of capitalism. The Business Roundtable, a collection of CEOs "committed to the aggressive pursuit of political power for the corporation," emerged in 1972 as a new and powerful voice for "free enterprise." And large corporations helped create a plethora of think tanks—from the Heritage Foundation to the American Enterprise Institute—to promote a new and more radical approach to capitalism.

In a coherent and aggressive manner not seen since the 1920s, US business interests began to act collectively—as a social class. And as a result, they began to win battles in national and local political arenas. A journalist and political observer, Thomas Edsall[11], described the turn of events this way: "Rather than individual companies seeking only special favors ... the dominant theme in the political strategy of business became a shared interest in the defeat of bills such as consumer protection and labor law reform, and in the enactment of favorable tax, regulatory and antitrust legislation."

In place of embedded liberalism, business interests and their intellectual allies in academia and the media pushed for a new system that critics referred to as "neoliberalism". While the former tried to protect capitalism from itself by embedding markets in a social system of stable rules and regulations, as well as a modest level of income distribution, the latter sought to remove these constraints, to unleash capitalism. It is probably a misnomer to call this a new form of liberalism for it actually represents a return to the past, a time before labor unions, before government 'interference' in the marketplace, before Keynesian macroeconomic policy. Capitalism, according to Itoh[12], "seems to be running the film of history backwards by 'melting down' the sustained trend of a century, and returning to an older stage of liberalism."

[7] John Gerard Ruggie (1982), "International Regimes, Transactions, and Change: Embedded Liberalism in the Postwar Economic Order", *International Organization*, Vol. 36, No. 2, pp. 379-415.

[8] Lester Thurow (1993), *Head to Head: The Coming Economic Battle Among Japan, Europe, and America*, Warner, New York.

[9] The confidential memo has been reproduced by ReclaimDemocracy.org at http://reclaimdemocracy.org/corporate_accountability/powell_memo_lewis.html

[10] David Harvey (2005), *A Brief History of Neoliberalism*, pp. 43-44, Oxford University Press, New York.

[11] Thomas Byrne Edsall (1985), *The New Politics of Inequality*, p. 128, W W Norton, New York.

[12] Makoto Itoh (1990), *The World Economic Crisis and Japanese Capitalism*, p. 14, St. Martin's Press, New York.

In 1980, US advocates of neoliberal policies won a watershed victory with the election of Ronald Reagan. The new president, the leader of a longstanding, insurgent movement, soon declared that government "is not a solution to our problem; government *is* the problem." He wasted no time in challenging labor unions (notably PATCO, which bargained on behalf of air traffic controllers), rolling back federal regulations, and slashing income taxes. By 1986, inflation was down and the US economy was up.

This was the beginning of a neoliberal hegemony in the US But it must be recalled that Reagan was only able to build a social foundation for this new philosophy by resorting to three tactics: (1) casting white working-class voters as victims of a government-dominated Great Society that privileged racial minorities; (2) portraying Americans in general as a threatened species in a dangerous world; and (3) engaging in military Keynesianism. Let me address these tactics one by one.

First, in 1976, during his unsuccessful campaign for the GOP nomination, Reagan rallied his base by telling the story of a "welfare queen" from Chicago's South Side: "She has eighty names, thirty addresses, twelve Social Security cards, and is collecting veteran's benefits on four non-existing deceased husbands. And she is collecting Social Security on her cards. She's got Medicaid, getting food stamps, and she is collecting welfare under each of her names."[13] It did not matter that the story was exaggerated, if not completely apocryphal; it hit a deep chord among hard-pressed, frustrated and resentful taxpayers—especially white men. Four years later, Reagan gave his first speech after winning the GOP nomination in Philadelphia, Mississippi, the town associated with the brutal murder in 1964 of three civil rights activists by local Ku Klux Klansmen. He criticized the federal government for trampling "states' rights," and promised to "restore to states and local governments the power that properly belongs to them." This carefully coded message, too, resonated with white, Southern voters.

Second, Reagan appealed to national pride by painting the US as an exceptional, even messianic state ("a land of hope, a light unto nations, a shining city on a hill") imperiled by Communism. He issued a call to arms – both morally and militarily, targeting the Soviet Union as an "evil empire" that had to be righteously confronted in places like Central America, the Caribbean, and even Outer Space.

Finally, although he trumpeted a "supply side" economic philosophy of small government, Reagan actually implemented Keynesian policies of massive deficit spending unlike anything seen in the US since FDR and WWII. Indeed, it was his dramatic increase in military spending, combined with deep tax cuts, that helped kick-start a stagnant economy.

[13] *The New York Times*, "'Welfare Queen' Becomes Issue in Reagan Campaign", February 15, 1976, p. 15.

Inside the US, then, Reagan inspired popular and nationalist support. Outside the US, however, he inspired fear and suspicion. Granted: the new administration had close political allies in London (Thatcher), Ottawa (Mulroney) and Tokyo (Nakasone), as well as fawning fans in corporate boardrooms throughout the world. But ordinary people in Europe and Japan viewed this new administration as dangerously hawkish and unilateral. This was most evident on military matters like the Strategic Defense Initiative (which critics lambasted as "Star Wars"), but could be witnessed as well on economic policy. In 1985, for example, Reagan's treasury secretary (James Baker) called his French, British, German, and Japanese counterparts to the Plaza Hotel in New York City and persuaded (coerced?) them to take concerted action to "raise the value of non-dollar currencies"—the second time in a decade and a half that a US president had aggressively intervened in global markets on behalf of domestic exporters.

In the 1980s, then, dominant social forces acquired hegemony over weaker forces in the US, but they were unable to globalize that condition. It took another decade —and two different presidential administrations—before the US-led neoliberalism became an internationally embraced or hegemonic norm.

Compared to Reagan, his successor, George H W Bush, was less frightening to the rest of the world. Even in his most bellicose moment, the first Gulf War of 1990, he went through international channels, securing the blessing of the U.N. Security Council before putting boots on the ground to extricate the forces of Saddam Hussein from Kuwait. A former diplomat, he spoke of a "new world order," and—though he continued to press Japan, unilaterally and aggressively, to open its markets for more US goods and services—he generally collaborated with other allies in the liberal international economic order. For example, G H W Bush forged the initial agreement with Canada and Mexico to build a North American Free Trade Area (NAFTA).

It was under William Jefferson Clinton, however, that the US and its dominant social forces finally regained hegemony in the world. Clinton was a "new Democrat," a neoliberal like his predecessors who hired Wall Street insider Robert Rubin as his treasury secretary and who pushed for free trade, reduced government spending on programs like welfare, and less regulation of industry. But he also was an "internationalist," a strong supporter of intergovernmental institutions. Between 1993 and 2000, the US organized humanitarian missions to unsettled places like Somalia and Haiti, Cambodia and East Timor—all with the backing of the UN. It organized a NATO-led intervention in the Balkans, bombing Serbia into submission at the Dayton Peace Accords. On the economic front, the US helped negotiate an end to the Uruguay Round of the GATT, revised NAFTA, and reinvigorated APEC. It also organized IMF bailouts in Latin America in 1994 and East Asia in 1997-98.

By the end of the decade, those who had breathlessly anticipated the coming of Pax Nipponica were conspicuously quiet. Japanese land and stock prices tumbled in the early 1990s, leaving banks from Hokkaido to Kyushu saddled with a bulging bag of non-performing loans. The Japanese economy grew more slowly in the 1990s than any other industrialized economy in the world. The US economy, by contrast, enjoyed a dramatic rebound and appeared ascendant again. Investment expanded, corporate profits grew, and national income rose. Although it faced some volatility in the late 1990s and the early years of the new millennium, the US economy nonetheless continued to impress the rest of the world—at least until the collapse of 2008.

Behind the Bounce: Financialization

On January 24, 2007, the economics editor of the *Financial Times* used his column to crow like a rooster greeting the sun: "Rarely has the world had it so good." He went on to describe the prospects for continued growth in both advanced and emerging markets: "Such a sustained run of good news has not been seen since the early 1970s."

That was just one year before the bottom fell out of the US and then the global economy. But before we ridicule Chris Giles or anyone else, we should be honest and acknowledge that very few of us (and certainly not me) saw it coming until quite late. Using the twisted phrase popular in the US today, we had "drunk the Kool-Aid." Most of us had come to embrace the conventional wisdom that US economic growth was sustainable because it relied on "financial innovation" encouraged by free markets.

That innovation came in the form of new instruments—unregulated derivatives such as Collateralized Debt Obligations (CDOs), and Credit Default Swaps (CDS), which allowed lenders to socialize their risk far wider and deeper than before. It may be useful here to offer brief definitions of each of these:

- A CDO is a complex financial product made up of individual or corporate loans that are bundled together and then sold as a package on the secondary market. Investors acquire cash flow that is collateralized; it is, in other words, backed by commercial paper or mortgages, including perhaps subprime mortgages.
- A CDS is a form of debt insurance in which the buyer pays a periodic premium in exchange for a promise from the seller to provide a cash payout in the event of default.

The first CDO was sold in the late 1980s. By 2000, however, the global market for this instrument had surpassed $200 bn and by 2006, it had expanded to nearly $2 tn.[14] Likewise, the first CDS (a bet on Exxon's debt, which the European Bank for Reconstruction and Development made with JP Morgan Chase) was made in 1997. By the end of 2007, the nominal value of such debt had climbed to more than $62 tn.[15] To fuel the expansion of such derivatives, financial institutions became leveraged to an unprecedented level. While commercial banks were required to maintain a debt equity ratio of 10:1 ($10 in debt for every $1 in equity), the growing number of unregulated operations were leveraged to the tune of 30:1 or sometimes even 35:1. In fiscal year 2007, the top five investment banks in the US had debt obligations of $4.1 tn.[16]

The US real estate sector, characterized by rapidly rising prices, became the cash cow for much of this financial activity. A vast industry of predatory or unscrupulous intermediaries and lenders emerged to induce consumers to refinance their homes, or buy new ones, and thereby collect billions of dollars in fees and commissions. These brokers used complex or just plain crooked instruments such as adjustable rate mortgages offering low "teaser" interest rates, which would jump after a short introductory period. In many cases, they advertised "low doc" or "no doc" loans that allowed applicants to forego ordinary requirements to document income and assets. In some cases, they even pushed so-called "ninja" loans to prospective buyers with "neither income nor job and assets." In the rush to tap into this super-hot market, the US home mortgage debt as a share of GDP climbed from about 46% in the 1990s to 73% in 2008; in absolute terms, it reached $10.5 tn.[17]

While this narrative accurately describes the rise of the housing bubble, it ignores a deeper, underlying phenomenon: the growing financialization of advanced capitalist economies, especially the US Over the past half century, one sector—Finance, Insurance and Real Estate (FIRE)—has played a bigger and bigger role in the process of capital accumulation in the US. Financial profits as a share of total domestic profits in the US rose from about 17% in 1960 to 32% in 2005.[18] A remarkably steep rise began in 1985, but—after an adjustment in the mid-1990s—the trend became even more dramatic after 1998. Speculative investment was overwhelming productive investment—a fact that has been noted by a range of observers, from Marxist political economists like John Bellamy Foster[19] to Republican critics like Kevin Phillips.[20]

[14] Axel Pierron (2005), "Collateralized Debt Obligations Market", A Technical Report for Celent (October 31), available at http://www.celent.com/reports/collateralized-debt-obligations-market

[15] *The New York Times*, "Out of the Shadows and into the Harsh Light", September 27, 2008, p. C3.

[16] Winston Chang (2011), "Financial Crisis of 2007-2010", available at http://ssrn.com/abstract=1738486

[17] See *Fortune*, "The $4 tn Housing Headache", May 27, 2009, available at http://money.cnn.com/2009/05/27/news/mortgage.overhang.fortune/index.htm

[18] See "Corporate Profits by Industry, 1959-2007", Table B-91, from Economic Report of the President, 2008, available at http://www.gpoaccess.gov/eop/tables08.html#erp7

[19] John Bellamy Foster (2007), "The Financialization of Capitalism", *Monthly Review*, Vol. 58, No. 11.

[20] Kevin Phillips (2008), *Bad Money: Reckless Finance, Failed Politics, and the Global Crisis of American Capitalism*, Viking Press, New York.

Three critical developments drove this trend toward the increasing financialization of advanced capitalist economies. The first was a seismic shift in thinking about what a corporation stands for, and how it should be governed. In the 1980s and 1990s, large, publicly traded corporations came to embrace the idea of "shareholder value," the idea that their fundamental goal must be increasing the wealth of stockholders —either by paying higher dividends or by boosting the stock price—not maintaining stable growth over time. The second development was the accelerating pace of financial deregulation. This includes the decision by President Clinton and the US Congress in 1999 to gut Glass-Steagall, the landmark bill enacted in 1933 to curb speculation by establishing a firewall between commercial and investment banking. It also includes the 2004 decision by the Securities and Exchange Commission to exempt the brokerage units of large investment banks from a longstanding rule requiring them to maintain a pot of cash to protect against losses. The third, final, and perhaps most important development was a long-run decline in the cost of capital for investors, especially in the US This has been caused in part by the reduced real tax burden on capital, which in turn was propelled by the increased competition between states for mobile investors in a globalized economy. The corporate tax rate in OECD countries fell from an average of 40% in 1982 to 29% in 2001, according to the Institute for Fiscal Studies via Glyn.[21] The decline in the cost of capital also has been caused by the aggressive recycling of cash from oil-producing countries throughout the world and exporting economies in Asia, such as Japan and increasingly China, which have experienced extraordinarily high levels of saving. Flush with cash from such foreign sources, the US Federal Reserve was able to repeatedly depress interest rates and thereby expand credit.

What were the effects of financialization? First, on the ground, where most of us live, it contributed to an alarming trend: widening income inequality. Between 1979 and 2002, the net income of the poorest 20% of US taxpayers grew slowly (4.5%), while the net income of the richest 20% grew fast (48.2%). If we restrict ourselves to the richest 1% of US taxpayers, we find staggering income growth of 111.3%.[22] And if we broaden our lens beyond income to look at wealth, the numbers are even more stunning. Using census data, the Pew Research Center[23] found that the real median net worth of upper-income Americans increased 123% between 1983 and 2004, while the net worth of middle-income Americans and lower-income Americans rose only 29% and 24%, respectively.[24]

[21] Andrew Glyn (2006), *Capitalism Unleashed: Finance, Globalization and Welfare*, p. 165, Oxford University Press, New York.

[22] John Grahl (2009), "Measuring World Disorders", *New Left Review*, Vol. 60 (November-December), pp. 133-144.

[23] Pew Research Center (Social and Demographic Trends) (2008), "Inside the Middle Class: Bad Times Hit the Good Life", April 9, available at http://pewsocialtrends.org/pubs/706/middle-class-poll

[24] Pew defines "middle income" as 75-150% of median household income, which in 2006 was $44,620-$89,241 (adjusted for 2008 dollars).

In addition, financialization led to the growing fragility of the global economy. Although economists such as Stock and Watson[25] are correct to highlight the reduced volatility in aggregate growth among advanced capitalist economies in the decade between 1994 and 2003, they often have failed to notice the increased volatility of output at the firm level.[26] Macroeconomic policy, especially interest rate policy, helped stabilize economies exposed to frequent shocks created by product market competition. But as I showed earlier, macroeconomic policy increasingly led to overconfidence and risk-taking. The Great Recession of 2008-09 showed just how vulnerable we all had become.

The Crash

In 2007, a sharp decline in US home prices signaled an end to the buoyant financial bubble. Banks in Europe showed the first signs of distress; depositors scrambled to reclaim funds from Sachsen LB in Germany, Northern Rock in the UK, and then UBS in Switzerland. By March 2008, US investment bank Bear Stearns was forced to accept a buyout from JP Morgan Chase, backed by a $30 bn loan from the Fed. Three months later, Spain's largest property developer, Martisa-Fadesa, declared it was insolvent. In September, the US treasury announced it would take over failing mortgage giants Fannie Mae and Freddie Mac. Then, in perhaps the most dramatic move, Lehman Brothers broke under the weight of its $600 bn debt. The federal government soon seized Washington Mutual, the largest bank failure in the US history. By the end of the year, the government of Iceland moved to rescue its tottering banking industry, nationalizing all of its major institutions.

Within a year, then, a house of cards that had taken years to construct had collapsed. The effects were devastating: By the middle of 2009, $50 tn in global wealth had been destroyed; 15 million jobs had been lost internationally.[27] And by early 2010, governments around the world had run up massive budget deficits trying to stimulate their slumping economies.

The Backlash

While global capitalists and their invited allies in the media, academia, and politics gathered in Davos, Switzerland in January 2009 for the annual World Economic Forum, labor leaders, environmental activists and South American leaders gathered in an alternative venue for the World Social Forum. The mood in Belem, Brazil was defiantly righteous. Rafael Correa, the president of Ecuador, told fellow leftists that

[25] James H Stock and Mark W Watson (2003), "Understanding Changes in International Business Cycle Dynamics", NBER Working Paper (May 31), available at http://www.crei.cat/activities/sc_conferences/18/stock.pdf

[26] See, for example, Diego Comin and Thomas Philippon (2005), "The Rise in Firm-Level Volatility: Causes and Consequences", paper for NBER Conference (July 29), available at http://pages.stern.nyu.edu/~tphilipp/papers/diego.pdf

[27] In the US alone, households lost an estimated $10 tn in wealth and employers cut as many as 8.4 million jobs by January 2010 (Dow Jones Newswire, February 5, 2010).

the advocates of neoliberalism had nearly bankrupted the world: "They are the ones responsible for the crisis. They are not the ones to give us lessons."[28]

All in all, this was a predictable response from a group that has positioned itself as a counter-hegemonic force, an ideological alternative to neoliberalism: since 1999, Venezuelan President Hugo Chavez has tried to rally his people, as well as the rest of South America, against the US and its economic policies; and in 2003, Argentine President Nestor Kirchner and Brazilian President Lula da Silva forged the "Buenos Aires Consensus," a set of social welfare principles meant to stand in stark contrast to the so-called "Washington Consensus," a set of free market policies designed by the IMF, World Bank, and US Treasury Department for crisis-ridden developing countries.

But in the wake of the global financial meltdown, leftists in South America suddenly found themselves in good company. Longtime allies of the United States were just as quick to blame the crisis on the profligacy of US financial institutions and the passivity of US regulators. In Europe, political leaders called for a new global financial architecture that does not privilege economic markets over social communities. French president Nicolas Sarkozy spoke to supporters in Toulon in September 2008, calling for an end to a capitalist order based on greed and speculation, and the creation of a new order based on "ethics and hard work ... Self-regulation as a way of solving all problems is finished. Laissez-faire is finished. The all-powerful market that always knows best is finished."[29] Likewise, in April 2009, UK Prime Minister Gordon Brown declared in London that "the old Washington Consensus is over." He called for a new global order of coordinated regulation by cooperating states.[30]

In Berlin, meanwhile, German finance minister Peer Steinbrück criticized the US for failing to effectively police its financial markets and allowing unfettered risk-taking to infect the global economy. The US, he predicted, "will lose its status as the superpower of the world financial system. This world will become multipolar," with rival centers in Europe and Asia. "The world will never be as it was before the crisis."[31]

Asian leaders, too, joined the angry chorus. Newly triumphant, the Chinese party-state blasted US policies and practices; one official blamed the financial crisis on Washington's "warped conception" of prudential regulation,[32] while Chinese Premier

[28] *Guardian*, "World Social Forum message to Davos: We Told You So", January 30, 2009, available at http://www.guardian.co.uk/business/2009/jan/30/world-social-forum-latin-america

[29] *Le Monde*, "Le discours de Nicolas Sarkozy à Toulon", September 25, 2008, available at http://www.lemonde.fr/politique/article/2008/09/25/le-discours-de-nicolas-sarkozy-a-toulon_1099795_823448_1.html

[30] *Sky News*, "PM: G20 Pledge $1 tn for Economy", April 3, 2009, available at http://news.sky.com/home/politics/article/15254629

[31] *The Sunday Times*, "Peer Steinbrück, German Finance Minister, says US is to Blame for Turmoil", September 26, 2008, available at http://business.timesonline.co.uk/tol/business/economics/article4828377.ece

[32] *The New York Times*, "Booming, China Faults US Policy on the Economy", June 17, 2008, available at http://www.nytimes.com/2008/06/17/world/asia/17china.html?th&emc=th

Wen Jiabao criticized "an unsustainable model of development characterized by prolonged low savings and high consumption.[33]

Even the new government in Japan, traditionally one of the most vocal cheerleaders for US hegemony, began to openly express dissent. In August 2009, on the eve of the dramatic victory by his Democratic Party of Japan (DPJ) in lower house elections, Prime Minister-to-be Hatoyama Yukio wrote an op-ed column that called for an end to "unrestrained market fundamentalism and financial capitalism that are devoid of morals or moderation."[34] The financial crisis, he argued, "resulted from a way of thinking based on the idea that American-style free-market economics represents a universal and ideal economic order, and that all countries should modify the traditions and regulations governing their economies in line with global (or rather American) standards." The Liberal Democratic Party, which governed Japan virtually uninterrupted for more than a half century until Hatoyama's DPJ swept into power, mistakenly followed that line of thought, he argued.

Although no other country is yet strong enough to dominate, the current period of US hegemony is coming to an end, Hatoyama argued. A multipolar world is unfolding. Rather than resist such a trend by continuing to follow American-led globalization or globalism, Hatoyama called on Japan to embrace *yuai* or "fraternity" —a moderating force that allows for social order both at national and regional levels. The DPJ leader was especially keen on promoting the latter, and envisioned an EU-like "East Asian Community" emerging in the future with its own currency and even a collective security pact. This was a rather pointed rejection of the US-led status quo.

Throughout the world, then, neoliberalism as a hegemonic norm came under attack; US leadership in the international system was challenged. "The rules have changed," according to Jentleson and Weber[35], "and the biggest and most basic questions of world politics are open for debate once again."

Obama's Response: Retro-Liberalism

Although he heard the challenge, and indicated a desire to meet it, the new president of the US was divided. This was not a psychological problem; it was a political one. Barack Obama campaigned in the Democratic primaries as a quasi-populist, an insurgent who would bring "change we can believe in" to Washington. To win the November 2008 election, however, he had to rely heavily on the same social forces —finance capitalists—that have come to dominate the US political economy.

[33] *New York Times*, "China's Premier Seeks Guarantee from US on Debt", March 14, 2009, p. A1.

[34] The column was printed in the August 26, 2009 edition of the *New York Times*. An unabridged version of the piece was published later in the September 2009 issue of *Voice*, a Japanese journal. That version is available at http://voiceplus-php.jp/archive/detail.jsp?id=197

[35] Bruce W Jentleson and Steven Weber (2008), "America's Hard Sell", *Foreign Policy*, November-December.

During his long campaign, Obama received $39.5 mn in campaign contributions from individuals and groups in the FIRE sector, thereby breaking the previous record ($33.8 mn) held by his predecessor, Republican president George W. Bush, in 2004, according to the Center for Responsive Politics.[36] To compare, one should note that his GOP opponent in 2008, John McCain, received $28.9 mn from the FIRE sector—about 25% less than the Democrat received). Obama's second largest contributor to his campaign was Goldman Sachs ($995,000); #6 was Citigroup ($701,000 and #7 was JP Morgan Chase ($695,000). (Obama's leading contributor was the University of California, or rather, employees spread throughout the UCal network.)

In assembling his economic team, the president's ambivalence was evident. He hired Christina Romer, a Berkeley economist known as a "New Keynesian," to chair his council of economic advisers. And he routinely consulted Paul Volcker, the former chairman of the Federal Reserve who has emerged as one of the strongest critics of the US financial industry. At the same time, however, the president also turned to longstanding Wall Street insiders. The director of the president's National Economic Council was Lawrence Summers, deputy secretary and then secretary of the treasury under former president Bill Clinton, before becoming president of Harvard and then managing partner of a New York-based hedge fund. In 2008 alone, Summers earned $5 mn from that hedge fund, DW Shaw, and another $2.7 mn in speaking fees from Wall Street firms that received bailout funds from US taxpayers.[37] Obama's treasury secretary is Timothy Geithner, who was the president of the Federal Reserve of New York. While Geithner was still in charge, the New York Fed negotiated a deal with fallen insurance giant AIG, authorizing it to pass on more than $62 bn of the $170 bn it ultimately received in government bailout funds to several large investment banks that had engaged in credit default swaps. The banks received face value for those contracts, even though the market value had fallen steeply. Then, in January 2010, it was revealed that the New York Fed had urged AIG not to disclose details of its payments to the banks.[38]

In his first major initiative, the president seemed to follow Romer's lead by pushing a stimulus plan based on an old (or "new") Keynesian philosophy of pump-priming. But many economists, as well as liberal Democrats in Congress, complained that the $787 bn package was too small, and that it relied too heavily on tax cuts and not enough on government spending for construction, especially roads, mass transit and other infrastructure projects. US Rep. Peter DeFazio of Oregon blamed the legislation's outcome on Summers, whom he called "anti-infrastructure."[39]

[36] The Center for Responsive Politics maintains a useful website on election financing, with a variety of search mechanisms. For these data, see http://www.opensecrets.org/pres08/sectorallc.php?cycle=2008

[37] *The New York Times*, "Financial Industry Paid Millions to Obama Aide", April 4, 2009, p. A10.

[38] *Bloomberg*, "Geithner's Fed Told AIG to Limit Swaps Disclosure," January 7, 2010.

[39] *MSNBC*, "Rachel Maddow Show," January 23, 2009.

For a year, the Summers-Geithner wing dominated White House economic policy. Obama approached the crisis cautiously, more as a nurse trying to stop the bleeding than a surgeon trying to remove the cancer. On regulatory policy, he told the *New York Times*, "What I've been searching for is a ruthless pragmatism ..."[40] Although he called for better regulation of financial institutions, including more stringent capital requirements and greater oversight of the banking industry (through a new Consumer Financial Protection Agency), the president initially opposed calls by many of his European counterparts, as well as Volcker, who chaired the president's Economic Recovery Advisory Board, for measures to aggressively curb speculative activities and limit the size of financial institutions. This was most evident in the June 14, 2009 white paper ("Financial Regulatory Reform: A New Foundation") in which the White House distanced itself from Gordon Brown's proposal for a global tax, administered by the IMF, on risky financial transactions, and declined to endorse any effort to recreate Glass Steagall's firewall between commercial and investment banking. In short, Obama's approach at that time was profoundly modest.

Indeed, the treasury secretary was maintaining policies implemented by his predecessor, Henry Paulson (the Goldman Sachs executive appointed by Bush), that were designed to restore confidence in Wall Street, not reform it. Geithner's $2 tn financial stability plan, first unveiled in February 2009, included a measure to encourage private investors, including big hedge funds, to buy the hard-to-sell assets that had come to weigh down some banks. In addition, it included a new round of capital injections for banks that withstood a "stress test," and thus seemed able to withstand the ongoing crisis. One thing it clearly *excluded* was a cap on executive compensation at financial institutions. The White House did order companies receiving massive government bailouts to reduce salaries for their highest paid executives; but that came after Geithner and Summers generated controversy by insisting on a provision in the Troubled Asset Relief Program (TARP) that exempted bonus contracts signed before February 2009 from any pay limits for companies receiving funds from TARP. As a result, AIG was able to make $218 mn in bonus payments to employees of its financial services division.[41]

The paradoxical result of Geithner's financial stability plan was to increase the moral hazard embedded in the political economy of US finance. That is, the president bailed out banks that had become "too big to fail," and thus patched up the shredded safety net for the coterie of financial engineers who created the crisis in the first place. Rather than trying to contain financialization, Obama—like Bush—encouraged a process that led to even greater consolidation of market power in the financial industry. In the first quarter of 2008, the four biggest banks—Citibank, Bank of America, JP Morgan Chase, and Wells Fargo—controlled 32% of all deposits in FDIC-insured institutions; by the third quarter of 2009, after a series of bailouts and

[40] David Leonhardt (2009), "After the Great Recession", *The New York Times Magazine*, May 3.

[41] *The Wall Street Journal*, "Bankers Face Strict New Pay Cap", February 14, 2009.

mergers, they controlled 39%.[42] And those statistics cover only the commercial banking sector; they do not address the sweeping consolidation that has taken place in the investment banking sector (which has lost two of its previous competitors—Bear Stearns and Lehman Brothers). According to a 2009 survey by Fitch, five mega-banks—JP Morgan Chase, Bank of America, Goldman Sachs, Citigroup and Morgan Stanley—came to control 80% of the derivative assets and liabilities in the US market, and 96% of the exposure to credit derivatives.[43]

For many, these trends were a cause for alarm. In an interview, Neil Barofsky, inspector-general for TARP, declared: "I think we may be in a far more dangerous place today than we were a year ago."[44]

On January 21, 2010, however, Obama changed his tune and rolled out a much more aggressive plan to shake up the financial industry. This was, according to Simon Johnson, an MIT economist, "a complete change of policy—a fundamental shift."[45] The president's new approach was based on many of the reform proposals floated in January 2009 by the Group of 30's Financial Services Working Group, a Volcker-led team of economists from all over the world. First, Obama called for a tax on the unfunded balance sheet of the biggest banks. Then, in a stunning about-face, he embraced two key elements of the Volcker plan he previously had rejected: (1) Banks would be prevented from owning, sponsoring or investing in a hedge fund or private equity fund; and (2) Banks would be restricted from becoming "too big to fail" by limits on the growth in the market share of their liabilities.

In July 2010, after six months of strenuous lobbying by Wall Street, Congress passed a significantly watered-down version of the president's plan. The Dodd-Frank measure represents a blueprint for change, but leaves critical details up to the rule-making process. Others have done a nice job of explaining this legislative outcome.[46] What remains unexplained is the more perplexing question posed at the outset: Why did the president suddenly decide to get tough? One hypothesis is that he finally lost faith in the orthodoxy advanced by Geithner and Summers. The new tact, according to this view, represented an internal putsch by the reformist wing led by Volcker.[47] Another hypothesis is that Obama was scared into more resolute action by the political mood of the country. Only two days earlier, Republican newcomer Scott Brown pulled off a shocking upset by winning Ted Kennedy's Senate seat in

[42] Rolfe Winkler (2009), "Break up the Big Banks", *Reuters*, September 15.

[43] David Katz (2009), "Five Firms Hold 80 per cent of Derivatives Risk, Fitch Report Finds", *CFO.com*, July 24.

[44] *Huffington Post*, September 25, 2009, available at http://www.huffingtonpost.com/2009/09/25/neil-barofsky-tarp-inspec_n_300178.html

[45] Matt Taibbi (2010), "Wall Street's Big Win", *Rolling Stone*, August 19, p. 59.

[46] See, especially, Daniel Carpenter (2010), "Institutional Strangulation: Bureaucratic Politics and Financial Reform in the Obama Administration", *Perspectives on Politics*, Vol. 8, No. 3, pp. 825-846.

[47] See, for example, the January 22, 2010 article by David Cho and Binyamin Appelbaum in *The Washington Post*: "Obama's 'Volcker Rule' Shifts Power Away from Geithner".

Massachusetts, thereby depriving Democrats of their 60-vote, filibuster-proof supermajority.[48] Even a fellow Democrat, Senate Banking Committee Chairman Christopher Dodd, acknowledged that Obama's timing could appear "transparently political and not substantive."[49]

No one can deny that the president faced mounting pressure at home in early 2010. With wages flat or falling and unemployment rising to 10%, populist outrage —from Left and Right—boiled over. These fires were stoked in some measure by reports that Wall Street firms were once again raking in huge profits and doling out generous bonuses only months after receiving taxpayer aid.

So one can assume that Obama, armed with feisty rhetoric, offered his new plan at least in part to win support from grumpy US citizens. But one must also recognize that his pitch was aimed at the rest of the world, too. It sought to reassure foreign policy-makers and global investors that the US was finally prepared to move beyond confidence-building measures and begin to create meaningful rules for its otherwise unruly financial industry. "We're on the verge of legislating sweeping reforms .... recognizing that those failures in the United States were very consequential to the world as a whole," the US treasury secretary told reporters on the eve of an overseas trip to meet with G-20 finance ministers.[50]

The US was signaling to its international partners that it was finally ready to try and rescue not just capitalists, but capitalism. The timing of the president's actions helps reveal the global nature of his mission. In the weeks leading up to a G-20 summit in Canada, Obama leaned hard on members of a House-Senate conference committee to come up with a compromise plan. They complied, working overtime—day and night—to complete the chore. On 25 June 2010, as Obama traveled to this international summit, he hailed the congressional breakthrough in rhetoric aimed at his international counterparts. The message to the world on the White House website was triumphant: "The bill puts the US at the forefront of global financial reform, and advances the agenda to strengthen the international financial system."[51] More than a year later, the administration was still tooting its horn to global elites: "US leadership has played a transformational role by engaging others in a 'race to the top' to raise the quality of regulation and level the playing field across major and emerging financial centers."[52]

[48] Taibbi, *op. cit.*

[49] *Bloomberg*, "Obama's 'Volcker Rule' May Not Survive Congressional Skepticism", February 5, 2010, available at http://www.bloomberg.com/apps/news?pid=newsarchive&sid=apVODe60IKQ4

[50] *The New York Times*, June 6, 2010.

[51] See White House press secretary, "The G-20 Summit in Toronto: US Financial Reform and the G-20 Leaders' Agenda", June 27, 2010, available at http://www.whitehouse.gov/the-press-office/g-20-summit-toronto-us-financial-reform-and-g-20-leaders-agenda

[52] White House press secretary: "The G-20 Fact Sheet on US Financial Reform and the G-20 Leaders' Agenda", November 4, 2011, available at http://www.whitehouse.gov/the-press-office/2011/11/04/g-20-fact-sheet-us-financial-reform-and-g-20-leaders-agenda

State rule-makers and market players around the world had been pining audibly for such leadership. While US policy may have caused the crisis, only US action, they seemed to be saying, could now fix it. In the interregnum between Bush and Obama, other governments had proved unable to forge a unified response to the deepening malaise. In Europe, France favored and the UK opposed a new and stronger international regulatory regime. Germany expressed concern about any scheme that would require it to revive financially anemic neighbors like Portugal, Italy, Greece and Spain. In Asia, Japan was immobilized by its own public sector debt (200% of GDP). China, which seemed to hold all the cards with $2 tn in foreign exchange reserves, was focused narrowly on domestic concerns. Instead of proposing any changes to the international financial architecture, Beijing pursued a massive ($586 bn) stimulus package to prop up the Chinese economy.

The global impasse heightened both economic uncertainty and political frustration. Just a few weeks after the Lehman financial collapse and a few days after the Obama election victory, Nigel Sheinwald, British ambassador to the US, sounded breathless with anticipation: "We know it's an awkward time for the United States, but we feel these issues are too important to wait."[53] On the same day, the new president officially assumed office, Martin Wolf, chief economics correspondent for the *Financial Times*, London, wrote that "Mr. Obama must take the lead." Nothing less than a "re-creation of the global economic system" is required. "It is a challenge he has to take up."[54]

When at last it did surface, the president's more aggressive plan was panned by the big Wall Street banks and the US Chamber of Commerce, but lauded by a number of corporate executives in the US—including old-fashioned investors. These included John Bogle, the founder of the Vanguard Group; John Reed, a former chairman of Citigroup; Nicholas Brady, a former investment banker who became George H W Bush's treasury secretary; and William Donaldson, a scion of Wall Street who became chairman of George W. Bush's Securities and Exchange Commission.[55] Recall that none other than Warren Buffett, the highly respected sage of US finance, had called derivatives trading a "financial weapon of mass destruction."

Although it gained significant support inside the US, Obama's plan won even more praise from "outsiders" looking for a more stable international financial order. Western allies were especially enthusiastic. They viewed the revised proposal as bold but also familiar. One EU source called it "back to the future." The source told Reuters:

[53] *The New York Times*, "Nations to Talk Finance, as Pillars of Power Shift", November 14, 2008, p. B4.

[54] http://www.ft.com/intl/cms/s/0/dd14a46e-e72f-11dd-aef2-0000779fd2ac.html#axzz1Yz78H35i

[55] *The New York Times*, "Elders of Wall Street Favor More Regulation", February 17, 2010, p. B1. Obama's plan also won the support of a coalition of small business owners, "Business for Shared Prosperity". Frank Knapp, Jr., head of the South Carolina Small Business Chamber of Commerce, emerged as a spokesman for the coalition on this issue.

"These sorts of plans were implemented after the Great Depression and then taken away in the 1960s. He is sort of reinstating the same plans to deal with this crisis."[56]

Indeed, the president's new agenda marked a limited return to an earlier period of bridled capitalism, and thus represented what I call "retro-liberalism." It was a solid repudiation of the neoliberal view, which until recently had been the orthodoxy, the hegemonic position, that markets are automatically self-correcting.[57] At the same time, the president's new approach was designed to transform the global financial architecture.

Obama called for a "broader, more inclusive engagement" with the world, using the G-20 (which includes Australia, Argentina, Brazil, China, India, Indonesia, Mexico, Saudi Arabia, South Africa, South Korea, and Turkey, as well as the European Union), rather than the G-8, as the appropriate vehicle for negotiating a new global framework.[58] Under the president's new vision, states would work to harmonize if not coordinate their regulatory schemes. And Obama pushed for a significant shift in the allocation of votes on the IMF's Board of Governors, a 5% shift from advanced capitalist countries to emerging economic powers like China, India and Brazil. Under the current system, the US is the only state enjoying veto power in the IMF; it controls 17% of the votes on the board, where an 85% supermajority is required to approve a "critical" resolution. But small European states would end up losing even more than the US Currently, the "Benelux" trio—Belgium, the Netherlands, and Luxembourg, which represent 28 million people and $1.4 tn in GDP—collectively controls more votes on the Board of Governors than China, India, and Brazil, which represent 2.7 billion people and $11.5 tn in GDP.

Obama foreshadowed this initiative in June 2009, when he promised that the US would "use our leadership in the international community to promote a [global] initiative compatible with the domestic regulatory reforms."[59] Specifically, he signaled a commitment to reshape and thereby strengthen international institutions such as the Financial Stability Board and the Basel Committee on Banking Supervision.

Both pieces—the plan to shake up the US banking industry, and the proposal to change the global financial architecture—are new and yet old. They represent a break from the recent policies of unbridled capitalism led by what one economist (Jagdish N Bhagwati)[60] has derisively called "the Wall Street-Treasury complex." And

[56] *Reuters*, "Europe Welcomes Obama Bank Plan, Won't Imitate It", January 22, 2010; available at http://uk.reuters.com/article/2010/01/22/uk-obama-financials-idUKTRE60K6JF20100122

[57] In the academic subfield of finance economics, Robert E Lucas (1978) ["Asset Prices in an Exchange Economy", *Econometrica*, Vol. 46, pp. 1429-1445] staked out this position by advancing Fama's "efficient markets" hypothesis, which suggests that prices on traded assets reflect all available information, and instantly change to accommodate new information.

[58] See Obama's November 13, 2009 speech in Tokyo.

[59] US Department of Treasury (2009), "Financial Regulatory Reform: A New Foundation", June 14, p. 8.

[60] Jagdish N Bhagwati (1998), "The Capital Myth: The Difference Between Trade in Widgets and Dollars", *Foreign Affairs*, Vol. 77, No. 3.

they represent a partial return to an earlier set of norms, the norms of bridled capitalism reflected in the 1944 Bretton Woods agreement.

Conclusion

Although it is not drawn as sharply as it used to be, an academic line still divides the study of comparative (including American) politics from the study of international politics. This line often is indefensible, inviting transgressive inquiry that shows the often vast overlap between these subfields in political science. The case study presented here is but one example. I have tried to show the way in which a global condition—the threat to US hegemony in the international system—helped spur the Obama administration to belatedly turn against an important constituent (the investment banking industry) and pursue an aggressive plan for domestic financial reform. Obama was acting on behalf of the US economy, but also on behalf of dominant social forces here and elsewhere that feared the demise of US-led capitalism. While private investors and their public allies around the world immediately blamed the US for a crisis that threatened to undermine the international financial system, they ultimately came to realize that the new regime in Washington represented the best hope for rescuing that system. Obama responded to a domestic and international call for leadership, for a dramatic plan to stabilize the capitalist order dominated by the US.

I hope this case study also demonstrates the usefulness of historical analysis in addressing nettlesome political questions. The 2008-09 financial crisis was the product of a long series of political and economic actions and inactions that began in the 1970s, and Obama's response was the result of global and domestic conditions dating back to 1944. To truly understand the administration's otherwise surprising policy initiative in January 2010, we had to understand the rise of US hegemony in the global political economy after WWII, its decline in the 1970s and 1980s, its reassertion in the 1990s, and its damaged condition following the global financial crisis of 2008-09. Context matters.

Finally, the preceding analysis attempts to complicate and enrich our understanding of both "states" and "power." As realists suggest, states are indeed the primary actors in the international system. But a Gramscian perspective wisely shows that states are not unitary; they act on behalf of dominant social forces that can change over time. In addition, it shows that states do not always rely on material resources ("capabilities")—or the coercive use of such resources—to acquire and maintain influence. A dominant state can induce other states to go along with its agenda by granting concessions and by resorting to broad, universal-sounding appeals to "common sense." In this way, it may secure consent. This is how the US came to dominate the global political economy in the years after WWII and in the 1990s.

It is too early to say that, by embracing retro-liberalism, Obama has been successful in rescuing capitalism and reviving US hegemony. We know that hard economic times continue to generate deep skepticism about capitalism throughout much of the world. The Pew Research Center[61] asked citizens in 21 different countries whether they agreed with the proposition that "most people are better off in a free market economy." Sixty percent in Japan and Mexico did not agree; on the other hand, 52% in Spain, 50% in Poland, 46% in the Czech Republic, and 43% in France did not agree to the preposition of free market.

We also know that the reputation of the US as an economic juggernaut continues to falter. In another "global attitudes" survey, Pew[62] asked citizens in those 21 different countries to identify the world's leading economic power. Solid majorities in several European countries named China: 62% in Germany, 58% in Great Britain; 57% in France and Spain. Even in Japan, where anti-Chinese sentiment is high, 43% picked China as the world's leading economic power.

Of course, this does not lead ineluctably to the conclusion that the US has lost its hegemonic position in the world. As discussed earlier, hegemony has as much to do with dominating the normative field (getting others to want what you want) as it has to do with controlling—or even appearing to control—material resources. But the bitter conflict among US domestic elites surely threatens American hegemony in the world. Some friendly "outsiders" fret that the ideological division between Republicans and Democrats (or, on the ground, between representatives of two "social movements"—the Tea Party and Occupy Wall Street), is distracting the foreign policy establishment in Washington DC. In a commentary that reads more like a public pleading, one Japanese academic[63] writes: "What worries us is that the two movements could be seen as a symptom of America turning inward."

There are other, more tangible and immediate consequences of intra-elite discord in the US. For example, in August 2011, after a protracted congressional battle over a proposal to raise the national debt ceiling, Standard & Poor's, one of the major credit rating agencies, decided to downgrade US treasuries for the very first time. This move, along with a sovereign debt crisis in several countries, roiled markets again and raised new questions about American leadership. Rising powers, especially China and Russia, seized the opportunity to scold the US for failing to put its fiscal house

[61] Pew Research Center (Global Attitudes Project) (2012a), "Pervasive Gloom About the World Economy: Faith in Hard Work, Capitalism Falter But Emerging Markets Upbeat", July 12, pp. 48-50, available at http://www.pewglobal.org/2012/07/12/pervasive-gloom-about-the-world-economy

[62] Pew Research Center (Global Attitudes Project) (2012b), "Global Opinion of Obama Slips, International Policies Faulted: Drone Strikes Widely Opposed", June 13, available at http://www.pewglobal.org/2012/06/13/global-opinion-of-obama-slips-international-policies-faulted

[63] Nakayama Toshihiro (2012), "Polarized America and Two Social Movements", AJISS-Commentary (#157), for the Association of Japanese Institutes of Strategic Studies, September 11.

in order; Vladimir Putin was most colorful, accusing Americans of "living like parasites off the global economy."[64]

But even longtime allies expressed concern about the political fallout from the downgrade. Simon Tilford, chief economist at the Centre for European Reform in London, said that, given the congressional impasse and the limited policy tools available to the White House and the Fed, "there's real fear that ... this could only weaken US influence and the US role in the world."[65] Larry Elliott of the UK's *Guardian* newspaper, was more dramatic: "Whatever it means for financial markets this week, August 5, will be remembered as the day when US hegemony was lost."[66]

If Elliott's statement proves correct, and the US ultimately does lose its privileged position in global economic affairs, it won't be due to political passivity on the part of Obama. As I have argued here, the president made a concerted effort on January 21, 2010 to forestall this fate. ▼

Reference # 55J-2013-10-02-01

[64] *Reuters*, "Putin Says US is 'Parasite' on Global Economy", August 1, 2011, available at http://www.reuters.com/article/2011/08/01/us-russia-putin-usa-idUSTRE77052R20110801

[65] NPR, "Debt Downgrade Weakens US Stature Abroad", August 8, 2011, available at http://www.npr.org/2011/08/09/139118677/debt-downgrade-weakens-u-s-stature-abroad

[66] *Guardian*, "Global Financial Crisis: Five Key Stages 2007-2011", August 7, 2011, available at http://www.guardian.co.uk/business/2011/aug/07/global-financial-crisis-key-stages

The Battle for Hearts and Minds: Religious Peacebuilding as an Alternative Solution to Boko Haram Terrorist Threat

Babajimi Oladipo Faseke*

Today, religiously-motivated terrorist attacks are one of the biggest challenges to national and international security. The likes of al-Qaeda, al-Shabaab, Taliban and similar groups have, in recent times, disrupted domestic and international peace. The Boko Haram is an emergent Islamist sect that sprang up in the Muslim-dominated northern part of Nigeria, that, among other things, questions the secularity of the Nigerian state and seeks to enforce Political Islam through violence. The Nigerian government has responded to the situation through the use of force and plans of dialog. This paper proposes an alternative measure, suggesting that in the quest for a durable solution, religious peacebuilding—which involves a reorientation of people on the role religion plays in the crisis as well as a more nuanced response from religious actors—represents the best chance of success.

Introduction

In recent decades, there have been increased religiously-motivated terrorist attacks. The 9/11 attacks, which al-Qaeda claimed responsibility for, that led to unquantifiable losses and casualties, have drawn attention to this trend. Afghanistan's Taliban, Somalia's al-Shabaab and, now, Nigeria's Boko Haram (BH) are just a number of religious terrorist groups that have replicated al-Qaeda's model on the domestic front, while having links internationally. The increasing presence of such terrorist threats on the domestic front suggests that a solely global approach to quell terrorism might be grossly inadequate; this calls for such threats being stemmed before having the capacity to escalate and serving as a threat to international security.

Terrorist threat in Nigeria holds immense global implications, given that Nigeria holds the world's 10th largest proven reserves as a result of being Africa's biggest oil exporter, coupled with the fact that it is the most populous country in the continent. Terrorist control of Nigeria implies having a hold on Africa's most populous nation and America's biggest trading partner in sub-Saharan Africa. This strategic position makes it attractive to global jihadists who struggle for political space in their battle against the West. Osama bin Laden had in 2003 singled out Nigeria as an area of special interest for al-Qaeda's agenda, while in more recent times the BH hierarchy

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Focus

During the past six decades, India and Pakistan were involved in four major wars, including the low intensity Kargil war. Even after 66 years of independence, the two countries are at loggerheads with each other on various political issues and still have many unresolved territorial disputes. The Kashmir dispute is the major bone of contention and still occupies a predominant role in the relations between the two countries. The element of third factor like China has also played a key role in defining the relations between the two countries.

China has long been the most important player in the India-Pakistan relationship. It overtly supported Pakistan during the 1965 and 1971 Indo-Pak wars. It has supported Pakistan's claims over Kashmir and provided nuclear and missile technology, and also made heavy strategic and economic investments in that country. India's major apprehension is with regard to China's strategic partnership and grand alliance with Pakistan. Of late, military incursions into Indian territory by the Chinese forces have become a major irritant to Sino-India relations.

B N Mehrish, in the paper, "China as a Factor in India and Pakistan Relations", analyzes Indo-Pak relations with particular reference to the China factor. The author provides a brief historical background of India-Pakistan relations. The conflicting national interests and ideologies, the perception of each other, the various territorial disputes, including Kashmir, the 1971 war, and the role of external factors are seen as the major reasons for the conflict and distrust in India-Pakistan relations. The author examines China factor in Indo-Pak relations and allay's India's concerns about China's close economic, political, military and strategic alliance with Pakistan. China's support to Pakistan over Kashmir issue and recent Chinese military incursions into India are the major irritants to Sino-India relations.

On January 21, 2010, the US President Barack Obama unveiled a relatively strong reform plan to regulate the financial services industry. Walter Hatch, in the paper, "Hoping for Hegemony: Why Obama Changed Direction on Financial Reform and Embraced Retro-Liberalism", argues that the aggressive reform plan was designed to bolster his domestic political base and also to reclaim the US' dominant position in the global political economy. In doing so, the president abandoned neoliberalism, an approach that had become discredited among allies in Europe and Japan. Instead, he adopted 'retro-liberalism'. The author concludes by stating that it is too early to say whether Obama will be successful in rescuing capitalism and reviving US hegemony with his retro-liberalism approach.

Religiously motivated terrorist attacks are one of the biggest challenges to national and international security today. Babajimi Oladipo Faseke, in the paper, "The Battle