# Global Financial Meltdown and the Demise of Neoliberalism

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The idea of economic liberalism has been a controversial subject in political economy for more than a century and recent evidence has shown that neoliberalism is not a viable theory. This article reviews the financial crisis that has occurred in few momentous weeks in September and October of 2008 in the United States and around the world and it attempts to understand the root causes of the crisis as have unraveled. It is argued here that this crisis heralds the demise of neoliberalism.

## What Happened in a Few Momentous Weeks?

The citadel of the US financial market was suddenly shaken as five major investment banks could not function without a lifeline of depositors' money. One had to file for bankruptcy, two were rescued by the depositors' money, and the other two were converted to commercial banks so that they could borrow money from the Federal Reserve Bank and could open deposit accounts. Lehman Brothers filed for bankruptcy, Merrill Lynch had to be sold to Bank of America, Washington Mutual had to be seized by FDIC and its deposits were sold to J. P. Morgan Chase, and Wachovia was sold to Wells Fargo. These happened in a matter of a few weeks in September, constituting the largest financial failure in the US since the great depression. Earlier in March, with financial backing of the government, Bear Stearns was sold to J. P. Morgan Chase. Furthermore the US government seized several major financial institutions in September 2008. Two financial titans Fannie Mae and Freddie Mac, and the largest insurance company in the world, American Insurance Group (AIG), had to be bailed out by the US tax payers. Also across the Atlantic, the British had the same problem after depositors ran on Northern Rock in September 2007 and the troubled mortgage lender HBOS agreed to be acquired by Lloyds TSB, and Bradford and Bingley a mid-size mortgage lender, was taken over by the British government in September 2008. No one could have predicted that the Anglo-Saxon financial meltdown could happen so fast. The following table is the summery of what has happened so far to some major financial institutions in a number of countries.

## The Unfolding of the Global Financial Crisis

| Date | Country | Financial Institution Failed | Rescue Plan |
|---|---|---|---|
| Sept 2007 | UK | Northern Rock | Rescued by the British Treasury and Bank Of England |
| Jan. 2008 | US | Countrywide | Sold to Bank of America in stock |
| March 16 | US | Bear Stearns | I P Morgan Chase took over, the FED guaranteed $29 billion |
| July 11, | US | Indymac | FDIC took over |
| July 14 | Spain | Alliance & Leicester | Bought by Santaner |
| Sept. 7 | US | Fannie mea and Freddie Mac | US government gave $100 billion each and guaranteed about 5.3 trillion of their debts |
| Sept. 8 | UK | Derbyshire and Cheshire Building Societies | Nationwide took over both banks |
| Sept. 15 | US | Lehman Brothers | Filed for bankruptcy |
| Sept. 15 | US | Merrill Lynch | Sold to Bank of America in stock |
| Sept. 17 | UK | HBOS | Sold to Lloyds TSB for 12 bl. pounds |
| Sept 17 | US | AIG | US government gave $85 bl. in exchange for 80% public ownership. Later received $37 bl. more. |
| Sept. 21 | US | Goldman Sachs and Morgan Stanly | Got approval to become regulated bank holding companies |
| Sept. 25 | US | Washington Mutual | Took over by FDIC, J P Morgan bough its deposits for $1.90 |
| Sept. 28 | UK | Bradford and Bingley | rescued by UK Treasury |
| Sept. 29 | US | Wachovia | Initially Citigroup wanted to buy Wachovia's banking operation for $2. Later Wells Fargo bought it for $15.1 bl. |
| Sept. 29 | Belgium | Fortis | BNP Paribas bought 75% and Governments of Belgium, Netherland, and Luxemburg threw 11 bl. euro lifeline to the bank |
| Sept. 29 | Germany | Hypo Real Estate | Rescued by Germen Government |
| Sept. 29 | Denmark | Roskilde Bank | Bailed out by Danish Central Bank |
| Sept. 30 | France | Dexia | Bailed out by French government for 6.4 b. euro |
| Oct. 3 | US | Various banks | House and Senate voted on $700 b. for purchase of banks' bad debts by the US treasury |
| Oct. 4 | Italy | UniCredit SpA | Needed to increase capital, No plan yet |
| Oct. 8 | Iceland | Kaupthing, LandsbBanki and Glitnir | Government of Iceland took over the banks |
| Oct. 9 | Ireland | Anglo Irish Bank | In process of being taken over. |
| Oct .10 | Japan | Yamato Life Insurance | Filed for Bankruptcy |

**Source: Compiled by the Author.**

The previous two major financial crises of neoliberalism, one in Latin America in early 1980s and the other in some part of Asia in late 1990s, happened in the capitalist periphery. This crisis however hit the capitalist center at both sides of the Atlantic at the same time and then spread to other countries. The

death knell of economic liberalism was heard when the governments had to act decisively to save the system. The neoliberalism ideology was suddenly cursed throughout the world. The same groups of liberalists, who believed government should not regulate and intervene in the market, helplessly turned to government for help in the midst of the crisis. They asked a life boat to be created by the Federal government to save them. Having already accumulated about S9 trillion national debts, the Bush administration initially did not want to intervene. This year it had already committed $29 billion to bailout the takeover of the investment bank Bear Stearns in March, $85 billion to bail out AIG, and $200 billion for Fannie and Freddie plus guaranteeing their $5 trillion debts in September. As a result, the US Treasury was in a weak financial position to bail out the rest. The solution was to force the investment banks to merge with commercial banks, a rescue strategy that put more risk on the shoulder of commercial banks and in turn on their depositors' money.

The takeover of Merrill Lynch by Bank of America immediately raised eyebrows in the financial market. It was a bailout that was disguised as a takeover. Bank of America will be responsible for all Merrill Losses of the distress securities, and thus increases risk to its own depositors. As it was reported in the Financial Times on Sept 15, John Thain, Merrill Lynch Chief Executive had called Ken Lewis Chief Executive of Bank of America a day earlier and they began talking about this opportunity over the phone and few hours later in person. Mr. Lewis said later "It didn't take but about two seconds to see the positive implications." Pressed on why his company offered $29 per share for Merrill after the stock had closed at $17.05 on the previous day, Mr. Lewis responded there was "always the possibility of someone else making a strategic investment". Offering 70% premium for a struggling company that could go into the single digit range a few days later was amazing; the stock later fell to about $12 a share. This kind of

mergers normally require months of due diligent investigations. How was it possible to do this in two seconds?

The Glass Steagall Act created the Federal Deposit Insurance Corporation (FDIC) in 1933 and banking reforms to prevent bank holding companies from owning other financial institutions in order to curb conflicts of interest. However, the Act was repealed in 1999. The Glass-Steagall Act would have forbidden the merger of Bear Stearns with J P Morgan Chase & CO and the merger of Merrill Lynch with Bank of America if it had not been repealed. Now, after 75 years of separation, the commercial and investment banks have become common entities again. The mergers significantly increased the size of each entity. As it was reported by the Wall Street Journal, on September 30, at the end of 2007, the three largest banks, namely Bank of America Corp., J.P. Morgan Chase & Co. and Citigroup Inc. -- collectively held 21.4% of all U.S. deposits. After the new mergers the combined assets of the Big Three increased to close to 30% of total U.S. deposits. In brief, these mergers amplified the formation of financial oligopolies.

Realizing the crisis as critical, in late September, Treasury Secretary Henry Paulson urgently asked for $700 billion more of the tax payers' money to purchase bad debts from the banks that were close to fail. Also FDIC insurance limit was raised to $250,000 maximum. When the House of Representatives initially rejected the package on Monday September 29, the stock markets nosedived from the center to periphery. All major indexes declined sharply, the Dow Jones by about 6.98%, S&P 8.8%, and NASDAQ 9.14%. The Dow had the largest percentage decline since October 1987 and S& P the largest in 21 years. The market regained half of its loss on the following day. Finally, the bailout package was approved on October 3, 2008, but it did not help to recover the market losses. The plan that is referred to as Economic Stabilization Act is similar to the Resolution Trust Corporation that was set up to take care of

the saving and loan crisis in 1989. The amount of $700 billion of public fund was devoted to remove distressed debt securities from the balance sheet of the US banks. Neel Kashkari, a 35 year old MBA was appointed to oversee the fund. The appointment of such a person with very little relevant experience immediately raised eyebrows in the financial market. The plan did not stop the financial turmoil; the stock markets continued to fall worldwide on October 6. The decline continued in big percentages in the following days, despite of a coordinated interest rate cut by the Federal Reserve, European Central Bank, and some central banks on October 8.

## What Precipitated the Financial Meltdown?

Following the dot-com boom bubble burst and the stock market crash in 2000, the US economy went to recession in 2001. The tragic event of September 11, 2001 precipitated the market decline. As a result, Allen Greenspan, the former Chairman of Federal Reserve, opened the money spigot by reducing Federal Fund rate to stimulate demand so that the severity of economic recession could be prevented. His predecessor Paul Volcker had warned about consequences of such monetary expansion. The lower interest rates increased demand for housing and big ticket items. It also made possible for the banks to give low interest loans to home buyers who mostly borrowed money on adjustable rates. The lower interest rates also increased speculations in the financial markets.

In 2006, the Fed raised short-term interest rates to prevent inflation. That led some financially weak individuals to default on their mortgage payments. As a result, the banks started to foreclose on the mortgage-defaulted homes. That caused home prices to fall as the number of unsold homes in the

market rose sharply. Most foreclosed homes were worth less than their loans' balances when their prices fell; for that reason the banks had to short sell them. That means the banks sold the houses for less than their loans' principals and took the losses. That eventually caused some banks to lose money and become insolvent. The investment banks that had high leverage positions in mortgage back securities lost the most. Some had borrowed money short term with low interest rates and had issued or purchased Collateral Mortgage Obligations (CMOs) in high multiples of their own capital. For example, Lehman Brothers had asset to equity leverage of about 30 that means only 3.3% decline on its securities holding would wipe out its entire capital and make it insolvent.

The decline in real estate prices caused weakness in the US financial market in August 2007, at which time the FED started to reduce the discount rate. Eventually, defaults on subprime loan payments led to decline of mortgage back securities and that caused stocks of financial institutions that had issued and purchased such securities to fall. That was followed by sharp decline of home building stocks and also junk bonds. Finally there was a domino effect on the entire US and the other countries' stock markets.

In the US financial market, stocks are mostly sold to mutual funds, the individual investors and petty traders. The less risky debt securities are mostly held by institutional investors and large investors. Lower interest rates lured in the petty investors to speculative stocks that do not pay dividends and do not have much tangible value. The financial institutions and large investors earn interests on bonds and debts such as CMOs that are loans to individuals for purchasing homes.

The advances in information technology have been extremely favorable to operation of the financial market. Financial securities trading have been completely computerized, which makes it possible for the general public to easily participate in speculative trading of securities. The technological advances have

increased transaction volumes and reduced trade execution time. As a result, the size of financial services industry has increased tremendously both in asset size and professional staff despite not being much productive in real economic sense. Information in Wall Street is asymmetric that means experts in financial institutions have privileged information that can result in financial gains as compared to uninformed general public on Main Street. Insider trading is alive and well despite of government measures to prevent it. This can be seen when price of stocks often change largely some time *before* news become public information rather than after. General public investment in Stock Market in short term is a Zero-Sum game, and the losers are the less financially savvy individuals versus Wall Street gurus who gain. Even on the long run the stocks are not certain to reward gains. Individuals' retirement funds are mostly invested in securities market. Some individuals invest their retirement funds in stocks through mutual funds or invest directly in stocks themselves and most of them lose good portions of their pensions when the market declines. It is not safe to invest peoples' pensions in stocks. Despite of this, President Bush in the beginning of his second term had proposed to privatize Social Security's Funds which meant putting funds in the risky securities market.

Thousands of financial professionals are engaged in speculative paper trades that can be hardly considered a productive work. Despite of their unproductive work, they mostly make good money. The young new college graduates have learned to make money by clicking on their computer screen and engaging in speculative trading of financial instruments and commodities. Young brokers, investment bankers, traders working in Wall Street, make huge amounts of money starting from 7 digit annual salaries and up and the managers and executives' compensations in Wall Street run up to 8 digits annually plus a "golden parachute" of getting a fortune in case of dismissal.

Financial professionals who work in Wall Street have privileged information about the financial status of companies. When the market weakened in summer 2008, they sold short stocks of financially weak companies. That drove stock prices further down and was followed by the decline in "junk bonds" market. The debt instruments are not as liquid as stocks and when there is possibility of default nobody wants to buy them. Hedge funds are normally engaged in such short selling in large volumes. They buy back the shares later when their prices decline to realize profits. At the same time, investment banks have been engaged in too much speculation by holding securities as much as 35 times of their equity capitals and engaged in trading risky financial derivatives such as options, futures, and credit default swaps. As mortgage back securities could not be liquidated the financial market went out of kilter and spread to investment banks and bond insurance companies.

On Sept. 19, 2008, SEC ruled to stop short selling practice for certain stocks temporarily to prop up the market. As a result the short sellers such as hedge funds started to close their short positions and that helped to temporarily rebound the market for a day or so. Richard Fuld, the former Chief Executive of Lehman Brothers blamed the short sellers for his company's failure.[1] Who else other than those who had privileged information about the status of the company could have sold short. People on Main Street don't have knowledge and ability to engage in short selling.

The Fed had reduced the Federal Fund Rate step by step from 5.25% on Sept. 18 to 2% on April 30th, 2008. But cutting the interest rate did little to calm the market as stocks continued to fall. Finally after the worldwide market collapsed in early October, the Fed cut the rate further in coordination with some other central banks to 1.5% on October 8 but that did not affect the market slide.

[1] Testimony before the House Committee on Oversight and Government Reform, on October 06, 2008. http://oversight.house.gov/story.asp?ID=2208

## Economic Liberalism Theory

A brief review of the major political economists' ideas about market liberalism is important to understand the root of the worst global economic crisis since 1929. Market liberalism or Laissez-faire is an economic doctrine that opposes government intervention in commerce and industry and advocates free enterprise system to operate on its own. This idea is originally attributed to Sir William Petty, a British political economist in the seventeen century.[2] The functioning of Laissez-faire capitalism was later systematically examined by Adam Smith in his famous book *the Wealth of Nations* in the eighteenth century. Smith introduced the concept of "invisible hand" that is continuously guiding the market economy along with "competition" as its controlling mechanism. Jean-Baptiste Say, who was an enthusiast of Smith, contended supply always provides the income to purchase what is produced. [3] What is saved will be invested; therefore there cannot be lack of purchasing power. However, Karl Marx considered Say's argument an "absurd dogma".[4] In his book *Das Kapital*, Marx argued anarchy of production in market economy results in overproduction and lack of consumers' purchasing power at times that are the key causes of periodic economic crises. During the nineteenth century, there were some departures from laissez- faire as the US government imposed some restrictions on the banking and interstate commerce and devised antitrust legislations. When the great depression hit the United States in 1929, major trend occurred away from laissez-faire in the Federal government policies. John Maynard Keynes' theories helped to bring US economy out of the depression. Keynes disagreed with Say's Law and argued there could be lack of purchasing power in the economy due to not having full

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[2] Petty, Sir William, *Discourses on Political Arithmetic*, London, 1690, http://socserv2.socsci.mcmaster.ca/~econ/ugcm/3ll3/petty/poliarith.html

[3] Say, Jean-Baptiste, *A Treatise on Political Economy*, Clement Biddle, Philadelphia, 1851.

[4] Marx, Karl, *Capital: A Critique of Political Economy*, Volume III, Progress Publisher, Moscow, 1978, P.841.

employment.[5] In his book *The General Theory*, he prescribed temporary deficit spending by the government to cure economic stagnation and mass unemployment. A decade later, Joseph A. Schumpeter in his book *Capitalism, Socialism, and Democracy* asked "Can capitalism survive"? He bluntly said "No I do not think it can."[6] Schumpeter believed capitalism would implode by democratic process when entrepreneurs' activities were restricted so that no longer the system could have incentive to function. He believed capitalism would eventually be replaced by socialism.

Nonetheless, capitalism continued to work as government took more roles in the economy by social spending and in regulations by measures such as the Glass steagall act and Anti-trust laws. In 1940s Karl Polanyi criticized the market system for its cruel social consequences such as unemployment. In his book *The Great Transformation,* he argued that the self-adjusting market institution is an impractical idea that "could not exist for any length of time without annihilating the human and natural substance of society; it would have physically destroyed man and transformed his surroundings into wilderness."[7] Since then, there have been periodic economic recessions during 1953-54, 1973-74,1990-1991, 2001-2002, and now a more sever one is happening. The free market has created social miseries in the past and some economists agreed with Polanyi's contention and continued to be pessimistic about the ability of free market system to manage the modern economy.

Neoliberalism is the brain child of economist Milton Friedman. In early 1970s, he argued laissez-faire capitalism could be revived by tax cuts, reducing public spending, deregulations, and privatization of

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[5] Keynes, John Maynard, *The General Theory of Employment, interest, and Money*, Harcourt, Brace & World, New York, P. 26.
[6] Schumpeter, Joseph, *Capitalism, Socialism, and Democracy,* Harper & Row Publishers, New York, 1950, P. 61.
[7] Polanyi, Karl, *The Great Transformation: The Political and Economic Origins of Our Time*, Beacon Press, Boston, 2001, P.3.

government-owned enterprises.[8] Based on this theory, under such condition the free market can perfectly function on its own to manage the economy. That is known as the underpinning ideology of economic liberalization or neoliberalism strategy.[9] That was the ideology of Friedman and some of his colleagues at the University of Chicago who are known as "Chicago Boys". After CIA backed Pinochet's coup in Chile brought down the democratically elected government of Salvador Allende, the Chicago Boys put Friedman's idea to work to reconstruct the Chilean economy. However, the outcome was economic misery as real wages declined; unemployment soared, and the rich accumulated wealth at the expense of the working class. Nonetheless, in late 1970s, neoliberalism became the favorite economic policy of the Republican Party in the US and the Conservative Party in Britain. Consequently, Neoliberal reforms were adopted by three emerging world leaders; Deng Xiaoping gradually adopted the idea in China in 1978, Prime Minister Margaret Thatcher adopted it in Britain in 1979, and President Ronald Reagan did the same in the US in 1981. After implementing neoliberal strategy in the US and Britain, the idea was widely prescribed for the Third world counties and for the former Soviet bloc by the World Bank, International Monetary Fund, and the World Trade Organization.

## Failure of Neoliberalism

Keynesian economic policies help stabilize the economy because peoples' lack of purchasing power can be cured by government investments, which in turn creates employment and income. Neoliberal economics minimize the role of government interventions. In the absence of government spending, the free market can only work if under-consumptions can be cured by banks' credits to low-income strata to

[8] Friedman, Milton, *Free to Choose: A Personal Statement*, Harcourt Brace Jovanovich, New York, 1979
[9] Harvey, David, *A Brief History of Neoliberalism*, Oxford University Press, New York, 2005, P.2.

keep consumption going. The economy works temporarily by spending on credit and the unsold goods are cleared by the market. But when people cannot afford to pay back the money they have borrowed, the economy runs to crisis. In this situation, lowering interest rates is unable to revive the economy, because it will create the problem of "liquidity trap" that is called in Keynesian economics. This happens when the banks would not lend money to financially weak individuals due to risk of default. In this situation monetary authorities would lose control over interest rates.[10] At present, the global economy is in such a situation. Consumer credit in August fell by $7.9 billion to $2.58 trillion, the largest since 1943. This means consumers' ability to borrow has deteriorated. Consumer spending is the largest part of the US economy. The banks hoard money to prevent defaults. Therefore relying on neoliberal economic policy is doomed to fail. Relying on free market practically has failed in the past and now central banks set interest rates and make monetary policy. However cutting interest rates in this situation is not effective to prevent further crisis. Also, the current policy of $700 billion bailout does not resolve the crisis because the root cause of the problem is worsening income inequality, which the bail-out does not change and therefore under-consumption remains.

The neoliberal idea of "trickle-down" economics does not have any logical ground. It basically means the free market economy generates income for the owner of capital and the resulted profits eventually would drip down to the bottom strata of the society. Three decades of neoliberal economic policy has led to widest gap between rich and poor in America as compared to other industrialized nations. During this period, income inequality has deteriorated significantly as is measured by the Gini coefficient. Currently the top 20% of population in America receive about 50% of income, while the lowest 20% get merely 3.4% of the income, and the top 1% own 40% of the wealth.[11] At the same time, real wages have

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[10] Keynes, John Maynard, *The General Theory*, P. 207.
[11] U.S. Census Bureau, *Income, Poverty, and Health Insurance Coverage in the United States: 2007, August 2008. PP. 40-41.*

stagnated or declined. Also accumulation of wealth at the top stratum has resulted in domination of political power by the wealthy to rule over the impoverished. The corporate media attracts voters by window dressing of good economic news while it is quiet on the crucial issues, such as income distribution and poverty.

John Kenneth Galbraith, in his book *the Great Crash of 1929*, counts several key causes for the stock market crash in 1929. Some of the causes he describes resemble the problems that have precipitated the present US financial meltdown.[12] These problems are: worsening of distribution of income, balance of foreign trades' problems, and lax regulations of banking and financial institutions. The neoliberal economic policies have caused all of these problems. Neoliberal policies increase income inequality by mounting wealth at the top stratum at the expense of the lower-income strata. The free trade policy has caused the US to develop growing trade deficits in the past three decades. The US has now the worst trade deficit as compared to any other advanced industrial nation. In the same period, deregulations have contributed to formation of large corporate oligopolies. The neoliberal ideology of free market has transferred the more productive manufacturing jobs from the capitalist center to the Third World periphery in order to take advantage of low- wage labor power and thus increase the rate of profit. The manufacturing blue color jobs have been substituted by some unproductive middleman services jobs.

Neoliberalism has continuously enlarged corporations by mergers/acquisitions and has reduced competition that is necessary to control the market prices. Examples of juggernaut corporate formations are re-emerging of the new AT & T as a giant communication conglomerate, Exxon Mobil the world second largest corporation , and the consolidations of large financial institutions as is happening now.

[12] Galbraith, John Kenneth, *The Great Crash 1929*, Houghton Muffin Company, Boston, 1961, PP. 182-191.

Neoliberalism has failed in allocation of health care services, housing, and other basic needs. The health care industry is widely inefficient, which has resulted in excessive cost and thus it is not affordable to almost 40% of the population. The profitable health insurance for the younger and middle aged individuals is privatized and the money losing elderly health care is socialized. While thousands of foreclosed houses remain empty in the market, a multitude of individuals do not have adequate housing to live in. Therefore, the neoliberalism key principle rules have failed to work properly in practice.

Although interest rates and inflation have fallen under liberalism but that has been at the expense of higher unemployment, cutback on social welfare, reducing infrastructural expenses, increasing inequality, and worsening standard of living for many.

Finally the free market failure to deal with externalities and provide public goods is a well known concept in economics. For example, market cannot adequately curb air pollution and does not have the ability to produce “public goods” such as mass transits and some social needs. The results are evident as the United Sates produces 25% of the world air pollution while it has only 5% of the world population. Also, the US has not developed essential mass transit system as compared to other advanced countries.

At the beginning of this decade, the Republican Party, the main proponent of laissez faire capitalism, had everything it wanted at its disposal. The Glass- Steagall Act had been repealed, the Federal Budget had slight surplus, the party had majority in both houses of the Congress, and it had occupied the White House in January 2001 by the Supreme Court’s 5 to 4 ruling. Furthermore, it had the support of the Democrats for its economic policies. The new administration had the free hand to further promote economic liberalism that had been initiated by the Reagan administration in 1980s and had been followed by the Clinton Administration.

However, the vital signs of economic liberalism started to weaken as the Bush Administration came to office. Economic globalization and geoeconomics competition could no longer go in favor of the United States. The era of importing inexpensive raw materials, especially oil, had passed and the US trade deficits started to deteriorate as almost half of it was due to imported oil. Neoliberalism could not be promoted further by normal rule of the market. Therefore, the Bush administration wanted to use military force to open the Third World market to the US products. At this time, the tragic event of September 11, 2001, provided a pretext for the neoconservatives in the Bush administration to pursue their military venture to control the oil resources in the Persian Gulf and Central Asia regions. Under the cover of weapons of mass destruction and the so called "war on terror" the neocons started their mission by invading Afghanistan in 2001 to protect the oil pipeline routes of Central Asia and later occupied Iraq in 2003 to control the vast oil resources in that country. Their next mission would have been Iran on the pretext of preventing nuclear proliferation if they had succeeded in implementing their mission in those countries.[13] The neocons hoped by occupying Iraq, they could control the oil market and satisfy the US economy's thirst for inexpensive crude oil. But that could not be achieved; the strong demand from the emerging economies of India and China pushed the oil prices higher. This was further precipitated by the weakness of US dollar. Despite of its sharp decline from $147 per barrel price peak, crude oil price is currently at about 4 times its $20 price range in 2001.

In 2006, the American people were mostly disenchanted with the Bush administration "war on terror" outside of the US borders and tilted towards the Democratic Party in the congressional elections. Americans hoped the Democrats in the new Congress could stop the war. But the result was exactly the opposite of the public expectation. The new Congress was not able to halt the war and instead voted for

[13] Harvey, David, *The New Imperialism*, Oxford University Press, New York, (2003) pp. 1-25.

the so called “troop surge“. The newly elected members of the Congress acted contrary to what the majority of Americans wanted. The continuations of the so called “pre-emptive” war increased public debt as the deficit spending for the war mushroomed. So far the estimated cost of the wars in Iraq and Afghanistan has reached 3 trillion dollar and the neocons have not yet completed their mission as they intended.

The Bush military spending for the war in the Persian Gulf region created huge budget deficits. The wasteful spending of the tax payers’ money benefited the American companies who were supplying the logistics for the war, the arms manufacturers, Halliburton, and the private security firm Black water. Public debt has now further increased to more than $10 trillion.

## Conclusion

In conclusion, economic liberalism has encountered many problems in recent years and does not appear to be a workable economic system. The US should make a U-turn from the market liberal economic policies that have caused the highest budget and trade deficits in history, increased income inequality, and rendered the health care system inadequate. For now, to revive the economy and prevent a major recession, more government involvement in the economy is essential. Giving public money to banks in exchange for toxic debt is not a good policy. Using the same amount of money to nationalize the banks that have liquidity problem is a much better policy. As it was discussed in this paper, the US financial market has entered a situation of “liquidity trap”. Therefore, further monetary stimulus is not warranted. Instead, massive government investments in public infrastructures and mass transit are needed. A progressive income and wealth tax must be imposed on the upper income stratum to redistribute income to underprivileged strata. Also, a universal national health care program is needed

to cut cost and make health care affordable for all. The United States perhaps should adopt a variant of the European social model such as those that exist in the Scandinavian countries. Furthermore, the unpopular war in the Persian Gulf region has to stop. The United States has now reached a position of financial distress and can no longer afford to engage in major military conflicts for economic conquests.

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