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FPIF Interview

Chomsky: Understanding the Crisis — Markets, the State and Hypocrisy

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FEEDBACK

Sameer Dossani | February 10, 2009

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Noam Chomsky is a noted linguist, author, and foreign policy expert. Sameer Dossani interviewed him about the global economic crisis and its roots. His first interview with Chomsky can be found [here](#).

SAMEER DOSSANI: In any first year economics class, we are taught that markets have their ups and downs, so the current recession is perhaps nothing out of the ordinary. But this particular downturn is interesting for two reasons: First, market deregulation in the 1980s and 1990s made the boom periods artificially high, so the bust period will be deeper than it would otherwise. Secondly, despite an economy that's boomed since 1980, the majority of working class U.S. residents have seen their incomes stagnate — while the rich have done well most of the country hasn't moved forward at all. Given the situation, my guess is that economic planners are likely to go back to some form of Keynesianism, perhaps not unlike the Bretton Woods system that was in place from 1948-1971. What are your thoughts?

NOAM CHOMSKY: Well I basically agree with your picture. In my view, the breakdown of the Bretton Woods system in the early 1970s is probably *the* major international event since 1945, much more significant in its implications than the collapse of the Soviet Union.

From roughly 1950 until the early 1970s there was a period of unprecedented economic growth and egalitarian economic growth. So the lowest quintile did as well — in fact they even did a little bit better — than the highest quintile. It was also a period of some limited but real form of benefits for the population. And in fact social indicators, measurements of the health of society, they very closely tracked growth. As growth went up social indicators went up, as you'd expect. Many economists called it the golden age of modern capitalism — they should call it state capitalism because government spending was a major engine of growth and development.

In the mid 1970s that changed. Bretton Woods restrictions on finance were dismantled, finance was freed, speculation boomed, huge amounts of capital started going into speculation against currencies and other paper manipulations, and the entire economy became financialized. The power of the economy shifted to the financial institutions, away from manufacturing. And since then, the majority of the population has had a very tough time; in fact it may be a unique period in American history. There's no other period where real wages — wages adjusted for inflation — have more or less stagnated for so long for a majority of the population and where living standards have stagnated or declined. If you look at social indicators, they track growth pretty closely until 1975, and at that point they started to decline, so much so that now we're pretty much back to the level of 1960. There was growth, but it was highly inequalitarian — it went into a very small number of pockets. There have been brief periods in which this shifted, so during the tech bubble, which was a bubble in the late Clinton years, wages improved and unemployment went down, but these are slight deviations in a steady tendency of stagnation and decline for the majority of the population.

Financial crises have increased during this period, as predicted by a number of international economists. Once financial markets were freed up, there was expected to be an increase in financial crises, and that's happened. This crisis happens to be exploding in the rich countries, so people are talking about it, but it's been happening regularly around the world — some of them very serious — and not only are they increasing in frequency but they're getting deeper. And it's been predicted and discussed and there are good reasons for it.

About 10 years ago there was an important book called *Global Finance at Risk*, by two well-known economists John Eatwell and Lance Taylor. In it they refer to the well-known fact that there are basic inefficiencies intrinsic to markets. In the case of financial markets, they under-price risk. They don't count in systemic risk — general social costs. So for example if you sell me a car, you and I may make a good bargain, but we don't count in the costs to the society — pollution, congestion and so on. In financial markets, this means that risks are under-priced, so there are more risks taken than would happen in an efficient system. And that of course leads to crashes. If you had adequate regulation, you could control and prevent market inefficiencies. If you deregulate, you're going to maximize market inefficiency.

This is pretty elementary economics. They happen to discuss it in this book; others have discussed it too. And that's what's happening. Risks were under-priced, therefore more risks were taken than should have been, and sooner or later it was going to crash. Nobody predicted exactly when, and the depth of the crash is a little surprising. That's in part because of the creation of exotic financial instruments which were deregulated, meaning that nobody really knew who owed what to whom. It was all split up in crazy ways. So the depth of the crisis is pretty severe — we're not to the bottom yet — and the architects of this are the people who are now designing Obama's economic policies.

Dean Baker, one of the few economists who saw what was coming all along, pointed out that it's almost like appointing Osama bin Laden to run the so-called war on terror. Robert Rubin and Lawrence Summers, Clinton's treasury secretaries, are among the main architects of the crisis. Summers intervened strongly to prevent any regulation of derivatives and other exotic instruments. Rubin, who preceded him, was right in the lead of undermining the Glass-Steagall act, all of which is pretty ironic. The Glass-Steagall Act protected commercial banks from risky investment firms, insurance firms, and so on, which kind of protected the core of the economy. That was broken up in 1999 largely under Rubin's influence. He immediately left the treasury department and became a director of Citigroup, which benefited from the breakdown of Glass-Steagall by expanding and becoming a "financial supermarket" as they called it. Just to increase the irony (or the tragedy if you like) Citigroup is now getting huge taxpayer subsidies to try to keep it together and just in the last few weeks announced that it's breaking up. It's going back to trying to protect its commercial banking from risky side investments. Rubin resigned in disgrace — he's largely responsible for this. But he's one of Obama's major economic advisors, Summers is another one; Summer's protégé Tim Geithner is the Treasury Secretary.

None of this is really unanticipated. There were very good economists like say David Felix, an international economist who's been writing about this for years. And the reasons are known: markets are inefficient; they under-price social costs. And financial institutions underprice systemic risk. So say you're a CEO of Goldman Sachs. If you're doing your job correctly, when you make a loan you ensure that the risk to you is low. So if it collapses, you'll be able to handle it. You do care about the risk to yourself, you price that in. But you don't price in systemic risk, the risk that the whole financial system will erode. That's not part of your calculation.

Well that's intrinsic to markets — they're inefficient. Robin Hahnel had a couple of very good articles about this recently in economics journals. But this is first year economics course stuff — markets are inefficient; these are some of their inefficiencies; there are many others. They can be controlled by some degree of regulation, but that was dismantled under religious fanaticism about efficient markets, which lacked empirical support and theoretical basis; it was just based on religious fanaticism. So now it's collapsing.

People talk about a return to Keynesianism, but that's because of a systematic refusal to pay attention to the way the economy works. There's a lot of wailing now about "socializing" the economy by bailing out financial institutions. Yeah, in a way we are, but that's icing on the cake. The whole economy's been socialized since — well actually forever, but certainly since the Second World War. This mythology that the economy is based on entrepreneurial initiative and consumer choice, well ok, to an extent it is. For example at the marketing end, you can choose one electronic device and not another. But the core of the economy relies very heavily on the state sector, and transparently so. So for example to take the last economic boom which was based on information technology — where did that come from? Computers and the Internet. Computers and the Internet were almost entirely within the state system for about 30 years — research, development, procurement, other devices — before they were finally handed over to private enterprise for profit-making. It wasn't an instantaneous switch, but that's roughly the picture. And that's the picture pretty much for the core of the economy.

The state sector is innovative and dynamic. It's true across the board from electronics to pharmaceuticals to the new biology-based industries. The idea is that the public is supposed to pay the costs and take the risks, and ultimately if there is any profit, you hand it over to private tyrannies, corporations. If you had to encapsulate the economy in one sentence, that would be the main theme. When you look at the details of course it's a more complex picture, but that's the major theme. So yes, socialization of risk and cost (but not profit) is partially new for the financial institutions, but it's just added on to what's been happening all along.

Double Standard

DOSSANI: As we consider the picture of the collapse of some of these major financial institutions we would do well to remember that some of these same market fundamentalist policies have already been exported around the globe. Specifically, the International Monetary Fund has forced an export-oriented growth model onto many countries, meaning that the current slowdown in U.S. consumption is going to have major impacts in other countries. At the same time, some regions of the world, particularly the Southern Cone region of South America, are working to repudiate the IMF's market fundamentalist policies and build up alternatives. Can you talk a little about the international implications of the financial crisis? And how is it that some of the institutions responsible for this mess, like the IMF, are using this as an opportunity to regain credibility on the world stage?

CHOMSKY: It's rather striking to notice that the consensus on how to deal with the crisis in the rich countries is almost the opposite of the consensus on how the poor countries should deal with similar economic crises. So when so-called developing countries have a financial crisis, the IMF rules are: raise interest rates, cut down economic growth, tighten the belt, pay off your debts (to us), privatize, and so on. That's the opposite of what's prescribed here. What's prescribed here is lower interest rates, pour government money into stimulating the economy, nationalize (but don't use the word), and so on. So yes, there's one set of rules for the weak and a different set of rules for the powerful. There's nothing novel about that.

As for the IMF, it is not an independent institution. It's pretty much a branch of the U.S. Treasury Department — not officially, but that's pretty much the way it functions. The IMF was accurately described by a U.S. Executive Director as "the credit community's enforcer." If a loan or an investment from a rich country to a poor country goes bad, the IMF makes sure that the lenders will not suffer. If you had a capitalist system, which of course the wealthy and their protectors don't want, it wouldn't work like that.

For example, suppose I lend you money, and I know that you may not be able to pay it back. Therefore I impose very high interest rates, so that at least I'll get that in case you crash. Then suppose at some point you can't pay the debt. Well in a capitalist system it would be my problem. I made a risky loan, I made a lot of money from it by high interest rates and now you can't pay it back? Ok, tough for me. That's a capitalist system. But that's not the way our system works. If investors make risky loans to say Argentina and get high interest rates and then Argentina can't pay it back, well that's when the IMF steps in, the credit community's enforcer, and says that the people of Argentina, they have to pay it back. Now if you can't pay back a loan to me, I don't say that your neighbors have to pay it back. But that's what the IMF says. The IMF says the people of the country have to pay back the debt which they had nothing to do with, it was usually given to dictators, or rich elites, who sent it off to Switzerland or someplace, but you guys, the poor folks living in the country, you have to pay it back. And furthermore, if I lend money to you and you can't pay it back, in a capitalist system I can't ask my neighbors to pay me, but the IMF does, namely the US taxpayer. They help make sure that the lenders and investors are protected. So yes it's the credit community's enforcer. It's a radical attack on basic capitalist principles, just as the whole functioning of the economy based on the state sector is, but that doesn't change the rhetoric. It's kind of hidden in the woodwork.

What you said about the Southern Cone is exactly right. For the last several years they've been trying to extricate themselves from this whole neoliberal disaster. One of the ways was, for example Argentina simply didn't pay back its debts, or rather restructured them and bought some of it back. And folks like the President of Argentina said that "we're going to rid ourselves of the IMF" through these measures. Well, what was happening to the IMF? The IMF was in trouble. It was losing capital and losing borrowers, and therefore losing its ability to function as the credit community's enforcer. But this crisis is being used to restructure it and revitalize it.

It's also true that countries are driven to commodity export; that's the mode of development that's designed for them. Then they will be in trouble if commodity prices fall. It's not 100% the case, but in the Southern Cone, the countries that have been doing reasonably well do rely very heavily on commodity export, actually raw material export. That's even true of the most successful of them, Chile, which is considered the darling. The Chilean economy has been based very heavily on copper exports. The biggest copper company in the world is CODELCO, the nationalized copper company — nationalized by President Salvador Allende and nobody has tried to privatize it fully since because it's such a cash cow. It has been undermined, so it controls less of the copper export than it has in the past, but it still provides a large part of the tax base of the Chilean economy and is also a large income producer. It's an efficiently run nationalized copper company. But reliance on copper export means you're vulnerable to a decline in the price of commodities. The other Chilean exports like say, fruit and vegetables which are adapted to the U.S. market because of the seasonal differences — that's also vulnerable. And they haven't really done much in developing the economy beyond reliance on raw materials exports — a little, but not much. The same can be said for the other currently successful countries. You look at growth rates in Peru and Brazil, they're heavily dependent on soy



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and other agricultural exports or minerals; it's not a solid base for an economy.

One major exception to this is South Korea and Taiwan. They were very poor countries. South Korea in the late 1950s was probably about the level of Ghana today. But they developed by following the Japanese model – violating all the rules of the IMF and Western economists and developing pretty much the way the Western countries had developed, by substantial direction and involvement of the state sector. So South Korea, for example built a major steel industry, one of the most efficient in the world, by flatly violating the advice of the IMF and the World Bank, who said it was impossible. But they did it through state intervention, directing of resources, and also by restricting capital flight. Capital flight is a major problem for a developing country, and also for democracy. Capital flight could be controlled under Bretton Woods rules, but it was opened up in the last 30 years. In South Korea, you could get the death penalty for capital flight. So yes, they developed a pretty solid economy, as did Taiwan. China is a separate story, but they also radically violated the rules, and it's a complex story of how it's ending up. But these are major phenomena in the international economy.

Government Investment

DOSSANI: Do you think the current crisis will offer other countries the opportunity to follow the example of South Korean and Taiwan?

CHOMSKY: Well, you could say the example of the United States. During its major period of growth – late 19th century and early 20th century – the United States was probably the most protectionist country in the world. We had very high protective barriers, and it drew in investment, but private investment played only a supporting role. Take the steel industry. Andrew Carnegie built the first billion-dollar corporation by feeding off the state sector — building naval vessels and so on — this is Carnegie the great pacifist. The sharpest period of economic growth in U.S. history was during the Second World War, which was basically a semi-command economy and industrial production more than tripled. That model pulled us out of the depression, after which we became far and away the major economy in the world. After the Second World War, the substantial period of economic growth which I mentioned (1948-1971) was very largely based on the dynamic state sector and that remains true.

Let's take my own institution, MIT. I've been here since the 1950s, and you can see it first hand. In the 1950s and 1960s, MIT was largely financed by the Pentagon. There were labs that did classified war work, but the campus itself wasn't doing war work. It was developing the basis of the modern electronic economy: computers, the Internet, microelectronics, and so on. It was all developed under a Pentagon cover. IBM was here learning how to shift from punch-cards to electronic computers. It did get to a point by the 1960s that IBM was able to produce its own computers, but they were so expensive that nobody could buy them so therefore the government bought them. In fact, procurement is a major form of government intervention in the economy to develop the fundamental structure that will ultimately lead to profit. There have been good technical studies on this. From the 1970s until today, the funding of MIT has been shifting away from the Pentagon and toward the National Institute of Health and related government institutions. Why? Because the cutting edge of the economy is shifting from an electronics base to a biology base. So now the public has to pay the costs of the next phase of the economy through other state institutions. Now again, this is not the whole story, but it's a substantial part.

There will be a shift towards more regulation because of the current catastrophe, and how long they can maintain the paying off banks and financial institutions is not very clear. There will be more infrastructure spending, surely, because no matter where you are in the economic spectrum you realize that it's absolutely necessary. There will have to be some adjustment in the trade deficit, which is dramatic, meaning less consumption here, more export, and less borrowing.

And there's going to have to be some way to deal with the elephant in the closet, one of the major threats to the American economy, the increase in healthcare costs. That's often masked as "entitlements" so that they can wrap in Social Security, as part of an effort to undermine Social Security. But in fact Social Security is pretty sound; probably as sound as its ever been, and what problems there are could probably be addressed with small fixes. But Medicare is huge, and its costs are going way up, and that's primarily because of the privatized healthcare system which is highly inefficient. It's very costly and it has very poor outcomes. The U.S. has twice the per capita costs of other industrialized countries and it has some of the worst outcomes. The major difference between the U.S. system and others is that this one is so heavily privatized, leading to huge administrative costs, bureaucratization, surveillance costs and so on. Now that's going to have to be dealt with somehow because it's a growing burden on the economy and its huge; it'll dwarf the federal budget if current tendencies persist.

South America

DOSSANI: Will the current crisis open up space for other countries to follow more meaningful development goals?

CHOMSKY: Well, it's been happening. One of the most exciting areas of the world is South America. For the last 10 years there have been quite interesting and significant moves towards independence, for the first time since the Spanish and Portuguese conquests. That includes steps towards unification, which is crucially important, and also beginning to address their huge internal problems. There's a new Bank of the South, based in Caracas, which hasn't really taken off yet, but it has prospects and is supported by other countries as well. MERCOSUR is a trading zone of the Southern cone. Just recently, six or eight months ago, a new integrated organization has developed, UNASUR, the Union of South American Republics, and it's already been effective. So effective that it's not reported in the United States, presumably because it's too dangerous.

So when the U.S. and the traditional ruling elites in Bolivia started moving towards a kind of secessionist movement to try to undermine the democratic revolution that's taken place there, and when it turned violent, as it did, there was a meeting of UNASUR last September in Santiago, where it issued a strong statement defending the elected president, Evo Morales, and condemning the violence and the efforts to undermine the democratic system. Morales responded thanking them for their support and also saying that this is the first time in 500 years that South America's beginning to take its fate into its own hands. That's significant; so significant that I don't even think it was reported here. Just how far these developments can go, both dealing with the internal problems and also the problems of unification and integration, we don't know, but the developments are taking place. There are also South-South relations developing, for example between Brazil and South Africa. This again breaks the imperial monopoly, the monopoly of U.S. and Western domination. China's a new element on the scene. Trade and investment are increasing, and this gives more options and possibilities to South America. The current financial crisis might offer opportunities for increasing this, but also it might go the other way. The financial crisis is of course harming — it must harm — the poor in the weaker countries and it may reduce their options. These are really matters which will depend on whether popular movements can take control of their own fate, to borrow Morales' phrase. If they can, yes there are opportunities.

Sameer Dossani, a [Foreign Policy In Focus](#) contributor, is the director of [50 Years is Enough](#) and blogs at shirinandsameer.blogspot.com.

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Name: Judy Davidson **Date:** Feb 10, 2009
Welcome to the USSA - this is what Noam Chomsky dreams of!

Name: Starman Skye **Date:** Feb 17, 2009
"Welcome to the USSA - this is what Noam Chomsky dreams of!"

This comment makes absolutely NO sense. It's completely contradictory. Obviously, Chomsky's deep insights about how the corrupt US system works is wasted on those whose sense of unquestioning devotion to a perverted ideal of patriotism precludes the duty to be a well-informed citizen, or else replaces critical analysis. Perhaps that's the payoff, a mistaken notion of loyalty that excuses intellectual sloth. The basis of America's foreign economic policy is nothing if NOT extremely hypocritical, as even a reasonably astute child could readily see. Chomsky's apparently inexcusable 'sin' is to point-out the hypocrisy, fraud, corruption, barbarism, thinly-hidden agendas and criminal intent behind much of the US's actions re: the third world. What a shallow and immature worldview that cops such an unreasoning attitude of disdain toward someone who makes explicit uncomfortable and awkward but vital truths. This pose unfortunately gives credence to the ugly stereotype of American sheeple that can't bear to acknowledge their nation has been hijacked by globalist elites and their thuggish cohorts -- and so they just don't. This is the most obnoxious form of treason, a betrayal of noble ideals for the sake of comfort, ease and convenience.

Great article BTW; Plenty here for those on the so-called left as well as the right to find thought-provoking and insightful, if only their assumptions don't get in the way or they abandon understanding as too hard. The US people today are having the same kind of neo-colonial snowjob being done on them that the Economic Hitmen have been doing to the 3rd world for the past 60 years. We may finally get the chance to feel what it's like to be an indentured serf to a global combine -- unless Americans wake-up to and throw-off tyranny sold as 'solution' to the problems the elites created.

Name: steven waldbaum **Date:** Feb 20, 2009
Chomsky refers to the 70's as the watershed for the Western economies in terms of finance overpowering industrial capital. I was wondering what also in the 70's caused the Soviet Union and the Eastern block economies which used to grow at full speed and seemingly ready to catch up with the US economy to slow down and decay?
Thank you

Name: Jane Curtis **Date:** Feb 25, 2009
This was one of the most thought-provoking articles I have read on global and US economics. Could you recommend further materials? I would appreciate material that could be understood by someone without a background in economics, though I am willing to work hard to try to understand anything relevant. Thank you!

Name: Calvin Miner **Date:** Mar 06, 2009
Steven, I'm no expert on the USSR, but this is what I can gather. What affected the industrial output were reforms that were supposed to increase production, but did the opposite. The Khrushchev decided to relinquish some of the Kremlin's central planning powers and give them to the regional councils, the Sovnarkhoz. This led to inefficiency. Gorbachev would continue with decentralization, which destroyed the old producer-supplier relationships without providing new ones. This created huge bottle-necks in the economy.

Name: Steve Athearn **Date:** Mar 24, 2009

Reading this interview, I am repeatedly struck by the absence of any evidence of awareness of the fundamental dependence of the "economy", "growth," "development," etc. on the non-repeatable drawdown of "phantom carrying capacity" (paraphrasing William Catton) - i.e. the enormous dependence on fossil fuels. This is probably the single most significant blind spot of the global culture that has emerged over the past 150 years, so in a way it is not surprising that Chomsky shares it. But it is unfortunate that an undisputably great rationalist of Chomsky's stature allows this particular curtain of irrationality - notably promoted also by the "good" economists that he cites - to hang undisturbed.

In this regard, we may note that the breakdown of Bretton Woods, which Chomsky characterizes with some justice as "probably _the_ major international event since 1945," also coincides with the peaking of U.S. oil production and the related shifts in its balance of payments, etc.

What Chomsky says about the state sector - whether in the U.S. or South Korea - is also true but misleading. Dynamic state sectors were basically means of making more efficient the run down of an enormous temporary energy windfall. "Successes" included, for example, the further development of U.S. based financial power after 1970 as well as South Korea's development of a manufacturing base, which in somewhat different ways allowed both countries to live beyond their means in terms of the ability to access energy imports. But the idea that either of them has reached a "level of development" (from which the ladder for others can be kicked away, unfairly) is pretty clearly false. Remove the non-sustainable energy supplies (for which there are no scalable alternatives), and they are faced with untold calamity. If, such calamity can be mitigated, we've got to have clearer thinking about this basic predicament than we have been seeing.

Name: bben **Date:** Apr 04, 2009

It is our very nature that is being revealed through the (now) fully integral world system. To solve the problem, and prevent future crisis we must understand that every action we make will have some effect on the collective (that might be considered a definition of globalization...). By understanding our interconnection and interdependence we will learn the best actions for the individual are not mutually exclusive to the interests of the collective. Michael Laitman is on the forefront of explaining our new integral reality and providing a framework for the future. We are at the point of evolve or die.

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