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BOOK REVIEW

Challenging the dance of bailout and austerity

Martijn Konings, *The Bailout State: Why Governments Rescue Banks, Not People*, Polity Books, 2024.

This is a book about what the author calls the 'dance of bailout and austerity' in the postwar American economy (xii). The central chapters of the book, Chapters 3–9, each treat a single decade of that experience, from the 1950s to the 2010s. In each decade, the precise mechanism of the bailout was different, as we shall see, and so too were the folks getting the bailout. In the early decades, the era of the 'welfare state', it was the unionized and largely white working class who were protected in downturns. But from the 1980s on, the welfare state morphed into what the author calls the bailout state. In Konings' telling, this later incarnation is a story of the state quite specifically and repeatedly bailing out the rich, and then imposing austerity on the poor.

It has taken a while for the precise outlines of the bailout state to become visible. In the 1990s, for example, the middle class that had been created by the welfare state benefited from bailout-induced rising asset prices through appreciation of their homes and pension savings. But the state response to the Global Financial Crisis of 2008–9 laid bare who the real beneficiaries of the new 'wealthfare state' were. Political turmoil ever since has its origin in the fateful decision to save the bankers and then use quantitative easing to goose asset prices, hoping for a repeat of the 1990s which never came. Instead, turmoil shifted into a higher gear once the state response to the Covid pandemic in 2020 showed the very real possibility of a different political settlement: 'a glimpse of what could happen if the democratic public were to get its hands on the machinery of the bailout state' (xiii). This book is an attempt to intervene in the politics of the present by opening up the possibility of what the author calls the 'democratization of banking'.

For all its twists and turns over the decades, the thread that runs through the postwar American story is the dance of bailout and austerity. And throughout that story, the important consequences of that economic dynamic have been twofold. First, inflation. Limiting the downside of contraction, but not the upside of expansion, has created a structural imbalance between aggregate supply and demand that results in a structural tendency to inflation. That's why we get austerity, which is the state's attempt to rebalance what its own intervention has imbalanced. Second, inequality. Bailouts have repeatedly targeted the privileged few while austerity has targeted the many poor. Decade after decade of this dance thus results in increasing disparity between the lived experience of the rich and the poor.

It didn't and doesn't have to be this way. For Konings, the state response to COVID-19 in 2020 shows a different way. For the first time, the bailout was general. Checks went to the poor, not just the rich. But now comes the austerity, as Powell's Fed has raised interest rates from essentially zero to 5 per cent. In Konings' telling, the present moment is a pivot point. Do we continue the familiar dance of bailout and austerity, or do we do something else? And if something else, then what exactly?

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The audience Konings is primarily trying to reach is other progressive political economists, who have adopted what he argues is an unhelpful frame within which it is difficult, even impossible, to see the contours of the bailout state. According to this unhelpful frame, the important political divide is between the Keynesians (who favor active state intervention) and the neoliberals (who do not). A particularly effective version of this leftist orthodoxy is Modern Monetary Theory (MMT). 'The idea that it is only ideological distortion and manipulation shackling us to a reality of bailouts from some and austerity for others is too simple. If we are to have any hope of re-seeing the present, we need to understand what happened in the first place' (23). Against this frame, Konings argues that the bailout state has its origins in the American Keynesian orthodoxy of the immediate postwar period, which is an orthodoxy that has persisted ever since.

Chapter 3, 'How Welfare Capitalism Worked', is therefore crucial to the book's argument. The immediate postwar social bargain did not so much favor the rich as a particular slice of the poor, the white working class. 'For a broad middle class, New Deal institutions made it possible to live a propertied life on the basis of wage labor' (63). Here 'propertied' means home ownership, and 'New Deal institutions' means the 30-year fully amortized mortgage funded by government-guaranteed bank deposits, i.e., mass entanglement with the world of finance. What made this social bargain possible was unionization and the 'living wage', and it was state-sponsored capitalization of the living wage that made homeownership possible. 'The postwar order did more to democratize rentiership than to euthanize it' (12). But, crucially, that deal was not offered to African Americans.

Here, in Konings' telling, is the origin of the American dance of bailout and austerity, bailout for me and austerity for you. He is, as I say, writing for a progressive audience who see the world through a Keynesian lens, and see themselves heroically combatting the evil of neoliberalism. To that audience, his message is that their Keynesian policies are not in fact the solution, but rather the origin of the problem. It is the Keynesian single-minded focus on stabilization, specifically of the price level, that has been driving the dance of bailout and austerity. The origin of the present problem is thus not neoliberal resistance to Keynesianism but rather Keynesianism itself. Hence Chapter 2, 'What Keynes Missed'.

This chapter is all about Minsky, whom Konings elevates to the status of a world-class social thinker, on a par with Marx, Weber, and Keynes. 'What Marx did with the commodity, Minsky did with the asset: use it as a lens to critically reconstruct our understanding of capitalist society' (186). It is on the foundation of Minsky, not on MMT, that Konings proposes to construct his own understanding. What Keynes missed, at least in the *General Theory* if not in the *Treatise*, and what his modern followers (Post Keynesians and Neo Keynesians alike) also miss, was the centrality of bank money, an institutional feature of the modern economy that Minsky puts front and center.

Standard economics – and also Lerner's chartalism (36) – adopts a 'village fair' concept of money, imagining money as a medium of exchange to facilitate the trade of commodities. By contrast, Minsky adopts a 'Wall Street' concept, viewing money as the creation of banks in the financing of production.

> By replacing heterogenous debts owed by a variety of parties with a debt owed by the bank, banks produce currency, a debt that circulates at par and in which other debts are denominated and settled ... Banks do not create credit on the basis of an existing [state] monetary standard: they *create* that standard in the first place by 'making a market' for their own debt. And they *re-create* that standard every single day. (37, emphasis in the original)

It is this conception of money that Konings brings to his understanding of the postwar American experience, and in particular to the dance of bailout and austerity. Minsky

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himself, in Konings' reading, showed the way. The pre-war New Deal settlement established state-sponsored bailout as response to the Great Depression, and in so doing created also the structural tendency toward inflation with which postwar economic managers have had to contend, first by means of austerity that hit mainly those unprotected by the New Deal settlement, and then by means of a more narrowly tailored bailout regime that rolled back the New Deal settlement.

> According to Minsky, then, deflationism is not a congenital defect of a basic version of capitalism. Instead, it is a policy to compensate for the inflationary pressures produced by other policies. It's a way to manage the pressures produced by an institutional framework guaranteeing a financial return on property. (40)

So, unlike much of the left political spectrum with which he identifies, Konings resists nostalgia for the immediate postwar settlement. His nostalgia is instead for the actual wartime settlement when society was united for a great cause. The state response to Covid was a reminder of that settlement, which is apparently still available, albeit in exceptional circumstances. Konings is not opposed to bailouts, he just wants a democratization of bailouts. On his own account, the inevitable result will be inflation, which he proposes to address with price control not austerity, on the model of wartime.

For an economist like myself, there are some problems with the story that Konings tells. The main one is with the concept of 'bailout'. What exactly is a bailout? Here are some descriptions: 'public guarantees for private balance sheets' (ix); 'enormous corporate tax breaks and financial market backstops' (x); 'risk socialization' (xi); 'government floor under asset markets' (16); 'web of subsidies and backstops' (16); 'drip-feed of liquidity support [that] stabilized expectations and sustained asset prices' (16). These are clearly quite different mechanisms.

If I read him correctly, Konings lumps them all together because he wants to deny the fiscal/monetary division that has worked during the postwar period to sideline monetary questions as merely technical. Abba Lerner, notwithstanding his other deficits, quite correctly urged 'a full rejection of the fiscal/monetary distinction' (33), and Konings, while rejecting Lerner's chartalism, wants to retain this rejection. 'In practice, the monetary/fiscal distinction, while entirely a human invention, has been all too real' (34). What is important to him is the bailout, not the precise mechanism of it, whether monetary or fiscal. For a political scientist maybe that makes sense, but not so much for an economist.

In this regard, one of the unfortunate consequences of conflating different kinds of bailout is to elide the crucial distinction between solvency and liquidity. If you think of money as primarily a means of payment for settling debts (as Konings proposes, following Minsky), then liquidity comes into central focus. Either you can meet your debt commitments as they come due with monetary reserves on hand, or you cannot; and if you cannot, then the question arises as to whether you can roll over the debt to a future date, and if so, on what terms. It is in this respect that I like to say that liquidity is a market fact, whereas solvency is merely an accounting fiction.

This is important for Konings' topic because of the potential role of central banks as lenders of last resort, substituting their own currency for mere bank currency. Konings realizes this but proceeds without adequately distinguishing between lender of last resort and, for example, a credit guarantee that derisks a private debt by adding the government's signature. Tax breaks and subsidies are even more direct fiscal supports of private enterprise by government. In practice, the Fed is very careful *not* to take on credit risk or to engage in any direct subsidy; that is the task of the Treasury (and the elected government), if anyone, but you would not know it from reading this book. Even Quantitative Easing, which involved Fed purchase of Mortgage Backed Securities, built on Treasury guarantees through Fannie Mae and Freddie Mac. Distinguishing between the role of the Fed and the role of the Treasury would enrich the story told here and hence also inform the range of options that we collectively face looking forward.

In the closing pages of the book, Konings invites the reader 'to decide whether my position is consistent with the MMT framework' (184). On the one hand, he makes it very clear that, for him, 'Minsky, not Lerner, is the best guide to capitalism's financial terrain – banks, not governments, are in the driver's seat' (184). In this regard, which is to say as a matter of economics, he clearly diverges from MMT. Indeed, his Minsky is quite definitely not the Minsky claimed by MMT as ancestry; for MMT the lineage from Lerner, as Konings emphasizes, is more correct.

On the other hand, which is to say as a matter of politics, Konings finds himself quite aligned with MMT.

> According to MMT, Americans live in a perverse reality, where a Keynesian state is fully operative but functions to advance the interests not of people but of banks and corporations. What prevents us from discerning this is the erroneous myth of free markets. *That assessment, I believe, is essentially correct*. But it is also incomplete. (22–23, my emphasis)

As a political scientist, Konings is concerned with the question of 'why governments rescue banks, not people' (the subtitle of the book). So too is MMT and hence they are fellow travelers with a similar political agenda.

Finally, as a sometime historian of economic thought, I have to say that Konings' reading of Lerner is a bit distorted by the lens of MMT. Lerner (1943) was not so much responding to Keynes as to Alvin Hansen (1941), who was crucial to the creation of a distinctively American Keynesianism, for better or worse. 'Bastard Keynesianism' to some, I have argued elsewhere that Hansenianism should in fact be understood as the quite legitimate offspring of American institutionalism, centrally involving advocacy for a postwar mixed economy (Mehrling, 1998: cited by Konings at 11, footnote 8). Lerner's 'functional finance', by contrast, is narrowly a defense of deficit spending, looking ahead during wartime to the problem of economic management in the peacetime to come. Government deficits can be covered by money issue or debt issue, and I suppose this is the sense in which Lerner rejects the monetary/fiscal distinction. But crucially, he realizes that wealth holders have to be willing to hold whatever mix the government issues, and anticipates that this will mean expanding money and debt more or less in line with each other.

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