# Lecture Notes: The Neoliberal Turn

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## I. Failing to Clear a Very High Bar

### A. The Thirty Glorious Years

The Thirty Glorious Years that had followed World War II were so good for the global economy that they made it impossible for any reversion to anything more like normal post-1870 growth to seem satisfactory.

With incomes relatively equally distributed (for white guys at least), doubling in a generation, and with economic uncertainty very low with respect to either employment or prices—except on the upside—the bar was very high. It mattered that the only ideas on the menu were from the right. Really-existing socialism had proven a bust. Thus there was nothing as far as economic policy was concerned on the left side of the menu.

Governments in the 1970s failed to clear that high bar. And when they failed to clear that bar, calls for institutional reform of the social democracy that had guided the global north from 1945 became louder and louder.

## B. The Productivity Growth Slowdown

Since 1973 output-per-worker growth as measured by standard statistics in the global north has averaged not the 3% per year of 1938-1973 but rather 1.5% per year. In long-term historical perspective this is still great: it is equal to the growth rate over 1870-1913, that "economic El Dorado" that economists after 1918 desperately wished that they could get back to. But it came after expectations had been revolutionized in an upward direction by 1945-1973. Moreover, the wedge between average and typical was larger after 1973 than before 1914. Income distribution did widen in the first Gilded Age before 1914, yes, but it did not widen by that much: while mean income growth was 1.5% per year, median income growth was 1.0% per year. By contrast, after 1973 median income growth was, at best, 0.5% per year as conventionally measured. Income inequality started rising, and rising rapidly, just as productivity growth slowed.

It is still not clear why in the 1970s the growth rate of output per worker in the global north slowed so much and stayed so low relative to its 3% per year of 1938-1973. In Western Europe and in Japan the easy days of post-WWII "catchup", when simply applying to production technologies already deployed in the United States yielded enormous dividends, were over. In the United States and also in Western Europe the post-WWII baby boom generation entered the workforce, and making the members of this rat-in-the-snake of the age distribution fully productive was a difficult task, and the failure to fully accomplish it was one source of drag.

All over the global north attention turned to pollution control, and so a great deal of investment and socio-economic progress took the form of the public good of a cleaner environment rather than higher private incomes—and that cleaner environment was often overlooked.

Plus increasing uncertainty required increasing flexibility: businesses had to make investments to enable them to operate when oil prices were high and when oil prices were low, when the value of the domestic currency was high and when the value of the domestic currency was low. And money spent increasing flexibility is not spent increasing productivity.

And then there is the argument that true economic productivity growth did not slow down at all. The mass distribution of communications, computation, and video and audio entertainment technologies would have been worth a great deal to previous generations—yet they have now become simply part of our expected background. Perhaps our standard price and income measures confuse a rise in the and a decline in the ability to acquire traditional indicia of stable middle-class status for a stagnation in real standards of living.

Economists still do not, after 45 years, understand the post-1973 productivity slowdown at any useful level. Nor do they truly understand the mid-1990s speedup. Nor do they understand the late-2000s renewed slowdown.

## C. The Perceived Failure in the 1970s of Social Democracy

The bottom line: starting in 1973 people in the global north could no longer expect 3% productivity and real income growth in an average year. It became more like 1.5% and 0.5%. And people got mad. Social democracy had failed.

# II. Oil Shocks and Inflation

## A. Oil and OPEC

A second important cause leading to the perception of the economic failure of social democracy in the 1970s was the derangement of the oil market when Arab-Israeli war generated solidarity among Middle-Eastern oil producers and when their organization, OPEC, realized just how strong were the monopoly market muscles that it had to flex.

World oil prices were tripled in the fall of 1973.

This sent the world economy into a major recession, accompanied by rapid inflation. This pushed the world economy toward a much more energy-conserving pattern of production. This meant that a lot of people lost real incomes and jobs in ways that would not come back after the recession was over: the market was seeing signals that energy-intensive high-productivity manufacturing needed to change in an energy-efficient labor-intensive direction.

And this, too, became social democracy's fault.

It is possible that the tripling of world oil prices was an intended result not of U.S. foreign policy but of Richard Nixon and Henry Kissinger acting as geopolitical cowboys.

Kissinger, especially, sought to strengthen the then-Shah of Iran as a counterweight to Soviet influence in the middle east. With the oil price tripled, the shah was indeed immensely strengthened—at the price of enormous economic damage to both the industrial and the developing world. The economic repercussions of the oil price rise did come as a surprise. It is most likely that the oil price rise struck the administration as not worth its concern, and certainly as not worth trying to roll back—it did, after all, strengthen the shah, few had any conception of the economic damage it might do, and those few were not listened to by the U.S. government.

## B. Exchange Rates & the Collapse of Bretton Woods

As we have noted before, Richard Nixon was somewhat Trumpian. The Bretton Woods system posed an obstacle to Nixon's and Treasury Secretary John Connolly's plans in advance of the 1972 election to use price controls to reduce inflation while at the same time using expansionary monetary policy to reduce unemployment. With low tariffs and at a fixed exchange rate, the resulting trade deficit would undermine that policy.

Nixon's appointee as Chair of the Federal Reserve, Arthur Burns, "feared... with a passion" the breakdown of Bretton Woods. Paul Volcker reports an "interesting discussion with Arthur Burns" over lunch at the American embassy in Paris, at which "the Chairman of the Federal Reserve Board made one last appeal" not to break the system. Volcker reports that:

> To me, it simply seemed too late, and with some exasperation I said to him "Arthur, if you want a par value system, you better go home right away and tighten money." With a great sigh, he replied, "I would even do that..."

But he did not. At some level he did not want to joggle the elbow of his long-term political patron, Richard Nixon. At some level, he did not believe Congress would tolerate a Federal Reserve that looked like it was trying to generate another recession so soon after the recession of 1970, and he believed that the Federal Reserve needed above all to preserve its independence. But is the independence of a central bank that will not dare to cross either the executive or the legislature worth anything?

U.S. Treasury Secretary John Connolly claimed, with respect to the dollar, that “it’s our currency, but it’s your problem.” So the Bretton Woods fixed-parity system was abandoned, and the U.S. forced the move to the current system of largely-floating exchange rates. This meant that after 1973 every decision to engage in international trade by a business—and every decision by a worker to work in an export or an import-competing industry—became a speculation on the foreign exchanges. Some economists, most prominently Milton Friedman, did not fear this: rational markets would, after all, produce stability, and foreign exchange values would fluctuate slowly, gradually, and predictably in response only to the slow change of underlying fundamental comparative advantage. Milton Friedman, I think, understood neither finance nor foreign exchange markets. Foreign exchange markets capitalize all expected future interest rate differences between countries and load that capitalized value into the current value of the exchange rate. And financial markets regularly project large and persistent movements in interest rates, and then quickly and idiosyncratically revise their projections.

## C. The Inflation of the 1970s

And then there was the inflation of the 1970s, and its cure. The 1970s were the world’s only peacetime outburst of inflation in this century. The 1970s was the only era in which business enterprise and financing transactions were also “speculation[s] on the future of monetary policy”, and concern about inflation was an important factors in nearly all business decisions.

At a surface level, the United States had a burst of inflation in the 1970s because no one—until Paul Volcker took office as Chairman of the Federal Reserve—in a position to make anti-inflation policy placed a sufficiently high priority on stopping inflation. Other goals took precedence: people wanted to solve the energy crisis, or maintain a high-pressure economy, or make certain that the current recession did not get any worse. As a result, policy makers throughout the 1970s were willing to run some risk of non-declining or increasing inflation in order to achieve other goals. After the fact, most such policy makers believed that they had misjudged the risks: that they would have achieved more of their goals if they had spent more of their political capital and institutional capability trying to control inflation earlier.

At a somewhat deeper level, the United States had a burst of inflation in the 1970s because economic policymakers during the 1960s dealt their successors a very bad hand. Lyndon Johnson, Arthur Okun, and William McChesney Martin left Richard Nixon, Paul McCracken, and Arthur Burns nothing but painful dilemmas with no attractive choices. Bad luck coupled with bad cards coupled with a tendency to cut corners made the lack of success at inflation control in the 1970s worse than anyone had imagined ex ante that it could be.

And, in one sense, the truest cause of the 1970s inflation was the shadow of the Great Depression. The memory left by the Depression predisposed the left and center to think that any unemployment was too much, and eliminated any mandate the Federal Reserve might have had for controlling inflation by risking unemployment. Thus the memory of the Great Depression meant that the U.S. was highly likely to suffer an inflation like the 1970s in the post-World War II period— maybe not as long, and maybe not in that particular decade, but nevertheless an inflation of recognizably the same genus.

Sooner or later in post-World War II America random variation would have led the economy to fall off of the tightrope of full employment and low inflation on the over-expansionary side. Eventually some combination of shocks would produce a macroeconomy with strong excess demand. And once that happened—given the shadow cast by the Great Depression—there was no institution with enough authority, power, and will to quickly bring inflation back down again.

## D. The Volcker Disinflation

Hence inflation fluctuated between 5% and 10% per year for a decade, and then Paul Volcker as chair of the Federal Reserve brought down the hammer: 11% unemployment and interest rates as high as needed until no worker dared ask for a raise. And inflation dropped below 5%/year.

Many observers would say that the costs of the Volcker disinflation of the early 1980s were certainly worth paying. They compare the U.S. economy after 1984, an economy with relatively stable prices and—up until 2009—relatively moderate unemployment, with what they estimate to have been the likely consequence of business as usual: inflation slowly creeping upward from near ten toward twenty percent per year over the 1980s, higher unemployment as well as inflation deranged the functioning of the price mechanism.

Federal Reserve staff, especially, have to believe that that was true. For 1979-1984 was absolutely brutal interims of its macroeconomic distress.

Nevertheless, other observers believe that their ought to have been a better way: Perhaps inflation could have been brought under control more cheaply by a successful incomes policy, made up of a government-business-labor compact to restrain nominal wage growth (which certainly would have been in the AFL-CIO's interest, as it is harder to think of anything worse for that organization's long-term strength than the 1980s as they actually happened)? Perhaps inflation could have been brought under control more cheaply by a Federal Reserve that did a better job of communicating its expectations and targets? Perhaps "gradualism" rather than "shock therapy"?

1979-1984 was what it was, and that macroeconomic disaster was also laid at the feet of social democracy.

## III. Why the Collapse of Faith?

### A. The Shocks Appear Small

Yet all of these causes, even together, do not look big enough to derange a political-economic system that had worked for a generation better than anything else the global north had ever seen.

So what else contributed? The rigid ideology of the right-wing remnant gathered around the Mont Pelerin society? The "astroturf" of right-wing plutocrats seeking to create the appearance of a mass movement?

### B. Paul Krugman's Theory: Inflation's Salience

Paul Krugman is sure that it was the inflation of the 1970s that did it: that it had a grossly outsized effect. People saw their rising wages and profits as the just reward to their skill rather than as the necessary flip side of rising prices. But they saw the rising prices as stealing their wealth from them because of the incompetence of the BIG DAMN GOVERNMENT. And inflation, more than anything else, rubs people's noses into the fact that the market economy is not delivering things to those who deserve them and respecting Polanyian rights, but rather rewarding the lucky—and those who can see how to cheat their way into a better place in the system. Plus a government that cannot keep there from being annoying inflation is almost surely incompetent along other dimensions.

### C. Other Theories

Thomas Piketty believes that social democracy is unstable—that in the end wealth will tell in politics, and in the end a capitalist economy will produce concentrated wealthy, who will then have the power and levers to rearrange politics to their liking.

And then there is the “pure chance” explanation: Reagan and Thatcher were lucky enough to win election at about the same time, and then win reelection, and they and their advisors left their mark.

There is the belief that social democracy had vastly overreached—too much bureaucracy, too much money to unionized workers who did not work hard enough, too much government sticking its nose in and telling people what to do. The Nixon-Ford-Carter oil regulation policy was an absolute disaster. Alfred Kahn’s taking the baton Jimmy Carter gave him for regulatory reform, and his producing enormous benefits to consumers and entrepreneurs alike with the dismantling of the ICC’s restrictions on trucking and the FAA’s restrictions on air travel. Corrupt private-sector mobbed-up union bosses like the U.S.’s Teamsters. Public sector unions whose strikes seemed calculated to inconvenience the public as large as much as possible.

There were disappointments in emerging markets as well: hopes for social democracy turned into anti-social undemocractic kleptocracies—and those were laid at the feet of those who had tried to make government do too much

## D. The Breadth and Depth of Disappointment

Add all of these up, and a belief that governing less might be governing better—and that Reagan and Thatcher were the people to make it happen—had remarkably wide sway at the start of the 1980s.

Consider Eric Hobsbawm, lifelong Communist, at the end of his life eager to defend the Soviet collectivization of agriculture in the 1930s:

> In a period in which, as you might imagine, mass murder and mass suffering are absolutely universal, the chance of a new world being born in great suffering would still have been worth backing. Now the point is, looking back as an historian, I would say that the sacrifices made by the Russian people were probably only marginally worthwhile. The sacrifices were enormous; they were excessive by almost any standard and excessively great. But I'm looking back at it now and I'm saying that because it turns out that the Soviet Union was not the beginning of the world revolution…

Yet this Eric Hobsbawm could also write of:

> the rigidities, inefficiencies, and economic wastages so often sheltering under Golden Age government policies once these were no longer kept afloat by the ever-rising tide of Golden Age prosperity, employment and government revenues. There was considerable scope for applying the neo-liberal cleansing-agent to the encrusted hull of many a good ship 'Mixed Economy' with beneficial results. Even the British Left was eventually to admit that some of the ruthless shocks imposed on the British economy by Mrs Thatcher had probably been necessary…

## IV. The Intellectual Right Picks Up the Pieces

The right-wing critique of social democracy as it developed in the 1970s in the global north had several parts, owing, respectively, to: racism and more generally treating equally people who ought to be unequal, low and ineffective social discipline; perceived flaws; and bad luck.

### A. The Salience of Racism

First came the racism—and the decision in America by Barry Goldwater, then backed by Richard Nixon, that the Republican Party was going to clean up by abandoning its Lincoln roots and catering to voters who thought that the evolving center-left Democratic Party was no longer treating African-Americans badly enough.

To a great many white Americans, African-Americans were unequals to be treated unequally: that was the point.

In a broader sense, many thought that social democracy was flawed because it treated unequals equally. This was a version of the Polanyian backlash problem—the fact that social democracy appeared to be unfair and unjust because it did not validate rights. And one of those rights was to maintain appropriate hierarchies. So social democracy treated those who ought to be kept unequal as if they were equals. And this rubbed many people very much the wrong way when those treated equally by social democracy were American Blacks.

Consider University of Chicago professor, future economics Nobel Prize winner George Stigler, writing in 1962—before the Civil Rights Act, before the Voting Rights Act, before affirmative action—about “The Problem of the Negro”. What, for Stigler in 1962, was “the problem of the Negro”? It was: “the stream of demonstrations, growing in size and in insolence” that was “approved or at least tolerated by the political, intellectual, and religious leaders of the nation...

Why was this a problem? Because it taught “a semi-literate Negro teenager in a slum... that evil prejudice of the white man was the fundamental cause of his low estate”. That, Stigler wrote, “must lead to hatred, and hatred to violence, and violence to the retardation of the mounting compassion and assistance of the white man”.

There is a story that the late Johnny Cash is supposed to have told, of him giving his concert at Folsom State Prison in California, notional site of his song “Folsom Prison Blues”. “Now Mr. Cash”, said the warden, “please don’t do anything to remind the convicts that they are in prison”. “You mean they’ve forgotten?”

Generally, declarations that the oppressed should not be reminded of oppression are either (a) demands by oppressors not to have their bad consciences brought to the foreground, or (b) demonstrations by oppressors that they control not just what others do but what others can say—that telling the truth is itself too revolutionary an act to be tolerated.

Stigler went on: the American negro:

> lacks a desire to improve himself... lacks a willingness to discipline himself to this end. The task... [is] to make the Negro discontented with himself.... Love of knowledge and the willingness to work hard and achieve it are the product of cultural evolution. The Negro leaders should be helping the emergence of this cultural tradition, when instead they are diverting Negro energies from better school buildings....
>
> The Negro boy... excluded from many occupations by... prejudice. ... But he is excluded from more... by his own inferiority... lacking education, lacking a tenacity of purpose, lacking a willingness to work hard....
>
> The Negro as a neighbor... is frequently repelled and avoided by the white man... because the Negro family is, on average, a loose, morally lax, group, and brings with its presence a rapid rise in crime and vandalism. No statutes, no sermons, no demonstrations, will obtain for the Negro the liking and respect that sober virtues commend.... It is not easy or popular to place the Negro's discontent upon himself...

Social democracy encouraged people in genral to think of themselves as equals. And that, for many, was a very unfair thing for a system to do.

## B. The Importance of Social Discipline

Second, social democracy was flawed because it led people to expect that there would be full employment, and that they could easily get a job. But people should not think that they had a right to a job, or that getting a job would be easy. People needed to be kept on their toes. Social democracy meant that meant both that workers would be insufficiently differential—that social order would suffer— and that workers would be able to demand too-high wages. The government and Federal Reserve needed to focus on price stability, and then let the unemployment rate go wherever it needed to go.

Government couldn't be a "nanny state" offering everybody a bottle when they cried. Monetary policy needed to be turned over to strongly anti-inflationary policymakers—as Jimmy Carter had already, wittingly or unwittingly, turned it over to Federal Reserve chairman Paul Volcker.

The third flaw was that government had gotten too big and tried to do too many things. Too much of what social democracy attempted was technocratically stupid, and unsuccessful. As Reagan's future chief economist Martin Feldstein put it:

> Expansionary policies... adopted in the hope of lowering... unemployment... [produced] inflation.... Retirement benefits were increased without considering the subsequent impact on investment and saving. Regulations were imposed to protect health and safety without evaluating the reduction in productivity.... Unemployment benefits would encourage layoffs.... Welfare programs to help [the] poor... weaken family structures...

## C. True Flaws in Social Democracy

The perception that there were substantial flaws in the fabric of the social insurance state as implemented—in really-existing social democracy—was not wrong. Why, in Britain, did social democratic education policy turn out to give children of doctors and lawyers the right to go to Oxford without paying for it? The system was flawed when social democratic industry policy used the nationalized "commanding heights" of the economy not to accelerate technological progress and keep employment high, but rather to retard the shift of labor out of "sunset" industries.

## D. Bad Luck for Social Democracy

Perhaps social democracy might have muddled through. But union-side wage demands in Britain and strikes—especially public-sector strikes—pushed the center of the electorate toward thinking that union power needed to be curbed, and only the Conservatives could do so. The Volcker disinflation raised unemployment throughout the North Atlantic: social democracy could not even keep its own commitment to full employment.

And then the Carter administration attempt to rescue American diplomatic hostages from Iran failed. And then the Argentine generals decided that they could win popularity by conquering the Falkland Islands from Britain, and Margaret Thatcher responded by winning a splendid little war. Reagan and Thatcher were in power for much of the 1980s

## E. Sticking It to the Moochers

Alberto Alesina and his co-authors see the neoliberal turn as in large part the result of a successful political message aimed at a fault line of social democratic society. A step away from rationality in assessing public programs and instead focusing on making sure that the taxpayers and the job creators were not being exploited by the moochers. And the moochers did not really have to be doing the exploiting—simply a fear that they were out there, of the wrong ethnicity or with the wrong values or of the wrong religion, could do the job.

We saw this in the age of Reagan. Reagan loved to talk about "welfare queens". Here is his principal half-fictional half reality-based example:

> She used 80 names, 30 addresses, 15 telephone numbers to collect food stamps, Social Security, veterans' benefits for four nonexistent deceased veteran husbands, as well as welfare. Her tax-free cash income alone has been running $150,000 a year…

The lesson was that no money should be spent on a program that was vulnerable to frauds like this. And the harm done by cutting back social insurance on those who were not fraudsters? No harm was done—as long as the cutbacks were applied to programs for those of the poor thought of as undeserving. Cutting back welfare and food stamps, yes. Cutting back veterans' benefits or Social Security? Unthinkable.

And

We see this in the age of Trump:

> Ezekiel Moreno, 35, a Navy veteran… accepted in WorkAdvance.… That training led him to a job at M&M Manufacturing, which makes aerospace parts, and to steady pay increases. 'We've moved out of an apartment and into a house,. My daughter is taking violin lessons, and my other daughter has a math tutor.' Moreno was sitting at a table with his boss, Rocky Payton.…
>
> All said they had voted for Trump… were bewildered that he wanted to cut funds that channel people into good manufacturing jobs. 'There's a lot of wasteful spending, so cut other places,' Moreno said. Payton suggested that if the government wants to cut budgets, it should target 'Obama phones' provided to low-income Americans. (In fact, the program predates President Barack Obama and is financed by telecom companies rather than by taxpayers.)…
>
> I was struck by how loyal they remain to Trump…

Ezekiel Moreno voted for Trump to stick it to the moochers—and the liberals. Yet it never occurred to him that Trump would view him as one of the chief moochers—would say "he's Mexican", and see no difference between a government-funded program that provides him with skilled blue-collar training, and the arm-twisting George W. Bush and Obama applied to telecom companies to make them offer cell phones on a sliding price scale.

## V. Types of Neoliberalism

And so the North Atlantic global north made the neoliberal turn in the 1980s. And with the encouragement of and under the whip of the IMF and the World Bank, the emerging market economies of the global south made the neoliberal turn as well.

I am one who thinks that this is another butterfly-wing-flap historical crux in the history of the long 20th century. Reagan and Thatcher were elected and reelected by luck. Yet they and their advisors pushed on intellectual and policy fault lines, and so changed not just policies but how people thought about policies.

### A. Outside, Hard, and Soft

Let us distinguish between three types of "neoliberalism”, three directions of reform in response to the perceived failures of social democracy in the 1970s:

First, there is “outside” neoliberalism: that social democracy is fine for us, but that you cannot handle it—your politics are too corrupt, too riddled with rent-seeking, and even where your bureaucrats are motivated and allowed by their political masters to try to do good, they are too incompetent to succeed.

Hence neoliberalism as a counsel of despair applied to other people: For you, it is truly the case that that government governs best that governs least. Therefore we will take every step we can to push you to shrink or outsource your government. And maybe in a couple of generations you will be able to make another try at social democracy.

This, in a nutshell, is a great deal of what was the “Washington consensus” applied to issues of economic development from the mid-1970s to, well, today: it is still a live doctrine and an active policy.

Second, there is “hard” neoliberalism: the view that social democracy was basically misguided, and that people need to be confronted with hard incentives or else they will misbehave. These hard incentives take the form of strict penalties for attempting to undermine inherited status and wealth hierarchies. These hard incentives take the form of making the rich richer, to incentivize them to work harder and become "job creators”. And these hard incentives take the form of making the poor poorer, to incentivize them to work harder and to not be “moochers”.

Then, third, there is “soft” neoliberalism. Soft neoliberalism holds itself out as social democracy by other, and better, means. Government provision and central direction are often overly bureaucratic and highly inefficient. Would it not be better to crowd source solutions to social problems? To use taxes on activities with negative and bounties on activities with positive externalities, and to rely on the market to incentivize the entire population rather than a few planners to come up with grassroots solutions to societal problems—wouldn’t this better? Think globally in imposing Pigovian taxes and subsidies. Act locally by using market incentives and market processes to push the decisions about how global problems will be solved down to the action level of society, where the information is.

Soft neoliberalism is thus a better, spiffier, more effective means to achieving social democratic ends.

## B. Keynes as the First “Soft” Neoliberal

We saw this in chapter 24 of John Maynard Keynes’s *General Theory*. Central government direction, planning, and management of the market was necessary in order to achieve a good society. You need:

> the enlargement of the functions of government, involved in the task of adjusting to one another the propensity to consume and the inducement to invest…

plus, on the microeconomic level:

> the modern classical theory has itself called attention to various conditions in which the free play of economic forces may need to be curbed or guided…

But:

> If the State is able to determine the aggregate amount of resources devoted to augmenting the instruments and the basic rate of reward to those who own them, it will have accomplished all that is necessary…

And then Keynes flies his neoliberal freak flag proudly:

> the traditional advantages of individualism will still hold good… advantages of efficiency… decentralisation and of the play of self-interest… and of individual responsibility… even greater, perhaps, than the nineteenth century supposed…. But, above all, individualism… the best safeguard of personal liberty… widens the field for the exercise of personal choice… best safeguard of the variety of life… [which] preserves the traditions which embody the most secure and successful choices of former generations; it colours the present with the diversification of its fancy; and, being the handmaid of experiment as well as of tradition and of fancy, it is the most powerful instrument to better the future…

## C. "Outside" Neoliberalism

And so the North Atlantic global north made the neoliberal turn in the 1980s. And with the encouragement of and under the whip of the IMF and the World Bank, the emerging market economies of the global south made the neoliberal turn as well.

In the global south, among the underdeveloped economies or the developing economies or the emerging markets, the half-generation before 1980 had come as a substantial shock. Some had thought the poor countries of the world had been kept down by colonialism. With the end of colonialism, rapid growth would begin. Others had thought that the poor countries of the world had been kept down by an absence of development aid, especially in technology transfer and assistance with managing the demographic transition. With the rise of the development aid community and the commitment of funds to global development via the World Bank, rapid growth should begin. Yet it turned out that rapid growth was an exception in the global south. The globe continued to become more unequal. And many poor countries became stunningly undemocratic, kleptocratic, and bureaucratically incompetent and inept.

Something had gone wrong. And the solution was proposed that, while the global north might manage fine with social democracy, the global south needed the cold douche of neoliberalism.

This was the Washington Consensus: the view that, for poor countries, the task was growth now. Redistribution to make the growth equitable—social democracy—was a task for a generation from now—or for at least a generation from now.

This Washington Consensus—strong elements of which were applied to the global north as well—was complex. I see it as having not seven but twelve pillars:

1. Emerging market economies should not choose their own policies—they should be dictated to (and developed economies should adopt these policies too);
2. Fiscal policy discipline—no Keynesian stimulus, for big budget deficits were bad (monetary policy can substitute whenever it is desirable);

3. Redirection of public spending from subsidies (especially “indiscriminate subsidies") toward broad-based provision of key pro-growth, pro-poor services like primary education, primary health care ,and infrastructure investment;
4. On taxes, broaden the base and lower the rates;
5. No financial repression—let interest rates find their relative market levels, rather than the government forcing some to lend and keeping others from borrowing;
6. No exchange rate manipulation—let exchange rates find their free market levels as well;
7. Trade liberalization, with particular emphasis on elimination of licensing;
8. Liberalization of FDI—multinationals should be allowed to run as much of your economy as they want to;
9. Privatization—even of monopolies;
10. Deregulation: abolition of regulations that impede market entry or restrict competition
11. Greater respect for property rights.
12. Independent inflation-focused central banks—to produce what was to be called the “Great Moderation” of the global business cycle, and viewed as a great success up until 2010.

## D. “Hard” Right Neoliberalism

Lower taxes for the rich and offering slight regard to benefits for the poor truly became the conventional wisdom—that income inequality under social democracy had been too low, and that respect for elders, traditions, and authority figures had been unduly eroded. It was never clear whether this was an “incentives” argument or a “moral worth” argument. Would society produce greater good for a greater number if single mothers’ status as people who had bad luck and were doing a very valuable job for society was eroded? If they were regarded instead as moochers popping out babies so that they did not have to “work”?

It changed the gradient along which even technocrats evaluated policies. All government regulation was presumed guilty—and this was not a very rebuttable presumption. There was maximum friendliness toward financial deregulation—deregulated financiers made lots of money, and so that had to be good. And the spheres of government "regulation" that were bad included antitrust policy. Hard right neoliberalism saw the abandonment of the competitive market as an ideal, for a monopoly position meant that you had done something right and productive in order to obtain it—superior innovation or superior science or superior business judgment—and your monopoly profits were a suitable reward, on both the moral and the efficient economy incentive levels, for your previous good acts.

We can see the frame of mind of this hard right neoliberalism in a speech that 2012 Republican presidential candidate Mitt Romney gave to a dinner of donors in Florida. It leaked out, because the plutocrats attending and Romney himself did not think that the caterers at the event had both agency and smart phones. In his talk, Romney focused on the "47%"—47% of Americans who, he thought and saw, were in many senses profoundly unAmerican, and because they were so large a minority were on the point of becoming a majority that would seize permanent political power and so destroy what Romney saw as the positive exceptionalism of America.

The speech was tuned high and shrill because Romney wanted and needed the guests to open their wallets. Nevertheless it is at some level what he thinks.

From my perspective, the most interesting thing is how much of Romney's thought is hung on this "47%" number—a number dangerously close to a majority.

In Romney's mind:

- 47% is the share of the Democratic party base in the presidential electiorate: Romney thus has to round up at least 50% plus 1 of the 53% of the presidential electorate that is gettable for a Republican. To do that, he needs the dollars of the donor class. That was supposed to be Romney's pitch.

- 47% is the share of the population that pays no income tax. They are thus taught, every year, that government programs are a free lunch: they vote for them, and good things happen, and other people pay the costs for them.

- 47% is the share of Americans who have been taught that they are oppressed victims—minorities, feminists, and so forth—and that rather than taking personal responsibility for their lives, they can sit back and let the government do it.

The most interesting thing, listening to Romney, is that he thinks all three of these 47%'s are exactly the same people.

That is why he gets diverted from what was supposed to be his pitch—I have, arithmetically, a very difficult task and need all your money to do it—to his rant about how "they" do not contribute to society, think that they are victims of an oppressive society, and are a lost cause who will never take personal responsibility or care for their lives.

I do not know where Romney got the "47% think they are victims" number.

But that group, however large it may really be—for the overwhelming majority of minorities and feminists and so forth whom I know are very, very strong on taking personal responsibility, not only for how your life goes but for changing the world (the arc of justice, they say, will not bend itself)—is very different from the 47% who paid no income taxes.

The people who paid no income taxes are by and large Romney's elderly base who were living off of their retirement saving, plus the poor who had next to no income to pay taxes on. And both of these groups paid substantial amounts in sales taxes relative to their incomes. And the elderly pay high amounts of property taxes. It is simply not the case that the 47% who paid no income taxes do not feel the costs of government.

And both of those groups are different from the 47% of people who vote in presidential elections who reliably pull the lever for the Democratic candidate.

Yes, these groups overlap.

But they are noy a monstrous unified regiment of feminists and minority moochers who believe they are victimized and do not contribute to the government—that is so only in the head of Mitt Romney, and other hard right neoliberals. Yet that is how he sees them: a single monstrous unified regiment. And a lost cause: "I'll never convince them that they should take personal responsibility and care for their lives…"

And while we are at it, let me dunk on Ann Romney as well. I believe she would've made a truly excellent first lady. But there is a very strong sense that exhibits hard right neoliberals that they are not lucky but had to worked instead themselves disadvantaged. They had to struggle for success—and then other people should have to struggle too.

Listen to her, talking about life as a graduate student, back when her life was not easy:

> They were not easy years… a $62-a-month basement apartment…. I didn't have money to carpet the floor. But you can get remnants,

> samples, so I glued them together, all different colors. It looked awful, but it was carpeting…. Mitt had enough of an investment from stock that we could sell off a little at a time…. Mitt and I walked to class together, shared housekeeping, had a lot of pasta and tuna fishand learned hard lessons…

Former (Democratic) Texas Governor Ann Richards hit the nail on the head in assessing this kind of rhetoric, when she spoke of future President George W. Bush: “Born on third base, and thinks he hit a triple…”

The implication is that struggle and adversity build character—so that where social democracy went wrong was when it tried to steal from the poor and the working class their very precious opportunity to confront adversity and to struggle.

Now it should be obvious that I do not think this makes much sense. And it should be obvious what kind of neoliberal I am.

## E. “Soft” Left Neoliberalism

I have already noted how social democracy’s flaws and inefficiencies were supposed to be corrected by "soft" neoliberalism as not so much a kinder and gentler as rather a spiffier, more technocratic, more effective, market friendly, less bureaucracy-worshipping set of means to lead to the successful accomplishment of social democratic ends. The argument was that the market was one of the most powerful tools for human societal organization that we had managed to chance upon. And that, since it was very friendly to individual initiative and to freedom, the real social democrats would make as much use of it as possible.

The left neoliberals thus rejected John Kenneth Galbraith's aphorism that any attempt to step away from social democracy to the right was a surrender to the perennial goal of conservative thought: "the search for a higher moral justification for selfishness". Neoliberals might, in their quest to improve social democracy, find that it was prudent to make political alliances with those whose basic moral principle was "what I have, I keep". Neoliberals might, in their quest to improve social democracy, find that it was prudent to make political alliances with those who pretended that "what I have, I keep" was always and everywhere the best way to express a general unparticularised love for all sentient things. And they rejected these assessments of neoliberalism for a good reason: it is a fact that we have not yet discovered a better form of social organisation than private property and market incentives for solving several important classes of optimisation problems—and social democratic ends require that those problems be solved.

And soft neoliberalism—left neoliberalism—did have many successes. Was the Federal Aviation Administration as it existed before 1980 in the business of protecting airline passengers and the integrity of the air travel system or of protecting the profits of airlines whose executives rotated between government and the private sector? Was the interstate commerce commission as it existed before 1980 in the business of protecting farmers from price gouging railroads, or of protecting railroads' profits from competition from truckers? The set of policies that Presidents Nixon, Ford, and Carter had devised to try to provide incentives for oil exploration without allowing the market to boost the cost for oil consumers and the profits for oil producers massively all across-the-board. That created a rat's nest of price controls on old oil from which nre oil was exempted and lead to annoying and pointless lines for gasoline. Bill Clinton and Tony Blair and Jimmy Carter pursued policies that were good for the general welfare, and managed to do so to a considerable degree without succumbing to ideological blinders.

Nevertheless, soft or left neoliberalism's view of itself was definitely through rose colored glasses…

Let me give the mic to Nicholas Lemann, one of the pioneering ideologues who argued for soft neoliberalism at the little magazine that was the Washington Monthly back in the 1970s, before the neoliberal turn:

> The prospect of replacing interest group liberalism with something… better targeted… and also more effective, was deeply alluring…. Deregulating industries, using the power of markets… embracing technology, targeting… programs on people who really needed them, helping consumers rather than politically connected businesses, taking down trade barriers…. Reducing the power of the Democratic Party establishment and the labor unions, orienting government toward the public interest rather than toward interest groups...

But:

> Our scorn for interest group liberalism led us to undervalue the process of people organizing themselves and pushing the political system…. Eliminating all those structures that struck us as outdated... [wound] up working to the advantage of elites more than of the ordinary people… It's a cruel irony... that our preferred label for ourselves, neoliberal, has come to denote political regimes maximally friendly to the financial markets…

Concluding:

> I've come to see the merits of the liberal structures I scorned in my younger days…

Growth and stability now—repair of the distribution later. Regulation guilty unless proven innocent. Abandon fiscal policy, and turn macroeconomic management over to "technocrats". Soft neoliberalism as well as hard was greatly flawed.

# VI. Neoliberalism in Power

## A. Hard Neoliberalism

The right-wing governments of the 1980s were not terribly successful in their policies. Inflation did come down. But unemployment rose. Productivity growth did not speed up. The income distribution became more unequal.

Their belief had been that a tax cut was the pressure point to accomplish hard right neoliberal reform. But things did not turn out as expected…

They sought to reduce the size of the government. The chosen instrument to use to enforce a reduction in the size of the government was a tax cut. Tax cuts are always popular.

A new tax cut enacted by a new president would be very popular and, politicians and strategists calculated, would greatly weaken opposition to subsequent spending cuts: for the alternative proposed by those who wished to maintain spending would then necessarily include large budget deficits as a consequence.

Moreover the tax cut would have the added benefit of tilting the distribution of income in favor of the rich. Social democracy's problem was that it did not treat unequals sufficiently unequally. Industry should be rewarded, and sloth punished. The rich were industrious. Moreover, the rich saved and invested, thus enriching everyone in the future. The third principle, therefore, was to tilt the distribution of income in favor of the rich by cutting their taxes most.

Yet things did not work out well.

## B. “Supply Side” Economics

For one thing, in the short run of the early 1980's, the Reagan administration planned a massive buildup of the armed forces, and thus an expansion-not a contraction-of the size of the government. For another, there was a great unwillingness on the part of both Reagan and Thatcher to identify in advance which programs and subsidies would be cut in the shrinking of the government that the administration to be had planned. To reduce anxiety, politicians looked benignly on and encouraged the growth of the story that no spending cuts at all would be required: the tax cut alone and the lifting of the hand of regulation from the economy would create such a spur of economic growth that even domestic programs could be expanded, not contracted.

No one with a quantitative grasp of the government's budget and its pattern of change ever meant this story to be taken seriously. But administration policymakers welcomed its dissemination. Policy elites assured each other that their candidate would say a lot of silly things before the election, but that the candidate and his principal advisors understood the important issue. Tax cuts were to be followed by a ruthless attack against "weak claims" on the federal budget: programs like farm subsidies, subsidized student loans for the relatively rich, the exemption from taxation of social security income, the subsidization of the southwest's water projects, and so forth would themselves slashed in order to balance the budget after the tax cut. "Weak claimants"-people for whom government subsidies and assistance truly served as a "safety net"-would be protected, while "weak claims" would be reduced.

But too many of the Reagan administration's allies and supporters claimed, after the election, that they had taken this story seriously. They would not support spending cuts, for they were the "weak claims" whose subsidies and programs were to be targeted for reduction. These two factors-the expansion of the military budget and the claim by key legislators and influence peddlers that the Republican trip they had purchased was not for a tax cut and spending cut, but just for a tax cut-left the United States with large and only gradually controlled budget deficits throughout the 1980's.

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## C. Reaganomics Slowed Growth

Previous decades had seen one or perhaps two years of large budget deficits in recessions. Previously, large budget deficits had been seen only in years of deep recession. But the 1980's saw budget deficits, very large by the standards of the post-World War II era, persist throughout years of prosperity and low unemployment as well.

Large budget deficits threatened to become a drag on the American economy. Funds saved might not now be invested-they might be borrowed by the government and used for current spending. The large budget deficits of the 1980s reduced the rate at which the United States' capital stock grew. They reduced economic growth by half a percentage or so.

This was bitter for those who had worked very hard to elect a Republican administration because they thought that Democratic administrations were pursuing policies that reduced investment in and thus impoverished America's future because "the long-run benefits" of investment "apparently lie beyond the political horizon"-beyond, that is, the Democrats' political horizon. They had hoped to elect an administration committed to increasing savings and investment-to lowering taxes on those who did save and invest-in order to empower America's future. Yet the Reagan deficits threatened to be an order of magnitude more destructive of America's economic future than any of the inflationary, redistributive, or regulatory policies pushed by Democrats had been.

But for Republican influencers and influence peddlers, for Republican intellectuals as opposed to technocrats, the fact that the policies were pro-rich pleased the audience that mattered

## D. Reaganomics Created the Rustbelt as We Know It

The deficits also did substantial indirect harm: for more than half of the 1980's the U.S. dollar was substantially overvalued as the U.S. budget deficit sucked in capital from outside and raised the exchange rate. When a domestic industry's costs are greater than the prices at which foreign firms can sell, the market is sending the domestic industry a signal that it should shrink: foreigners are producing with more relative efficiently, and the resources used in the domestic industry should be transferred to some sector where domestic producers have more of a comparative advantage.

This was the signal that the market system sent to all U.S. manufacturing industries in the 1980's: that they should cut back on investment and shrink. In this case, it was a false signal, sent not by the market's interpretation of the logic of comparative advantage but by the extraordinary short-run demand of cash to borrow from the U.S. government. But firms responded to this signal even so. The U.S. sectors producing tradeable goods shrank. And some of the ground lost would never be recovered.

## D. The Return of the Financial Crisis Cycle

And the finance-driven business cycle returned. Why? Because full employment was no longer a priority.

Thus the business cycle was back. And as the 1980s turned into the 1990s, it became increasingly clear that serious dangers were produced by the freedom of international trade and international investment that had followed the collapse of Bretton Woods in the 1970s and the rollback of regulation in the 1980s.

The 1980s saw one major international financial crisis: the third world debt crisis that followed 1982.

The 1990s saw three major international financial crises happen one after the other, approximately 2.5 years apart: the collapse of the European Monetary System in 1992, the Mexican peso crisis of 1994-1995, the East Asian financial crisis of 1997-1998, and all that have followed since.

The reaction to the first such crisis—the debt crisis that followed 1982—was that it had been due to borrower fecklessness. Borrowers in the third world had willingly borrowed large sums at relatively low floating interest rates, thus taking on themselves and their countries the risk that monetary policy might tighten and the prices of their exports fall. The prices of their exports fell, and monetary policy worldwide was tightened as a result of Paul Volcker's decision to fight inflation first, a decision echoed by other industrial-core central banks. Much of the borrowed money turned out to have been used not for productive investment but to finance government deficits, or support elite consumption.

The second financial crisis, the collapse of the western European system of fixed exchange rates in 1992, also provoked few thoughts of systemic failure. The conservative government of Britain—and governments of other countries that had effectively pegged their currency to the German mark—had claimed that their commitment to their exchange rate peg was near-absolute: that they would accept a considerable domestic recession rather than abandon the peg.

When conflict between the German government and the Bundesbank over the financing of the absorption of East Germany into West Germany led to a substantial rise in interest rates, the governments of Italy, Britain, Sweden, and others were faced with the choice between severe domestic recession and abandoning their peg to the mark. Markets judged the commitment to the peg unbelievable, and placed heavy one-way bets on devaluation. And markets were right. And so the pattern was set

Yet, somehow, the belief that there needed to be institutional reforms to keep financial disorder from deranging the global economy did not gain purchase. And so pressures that would lead to the near-repeat of the Great Depression in 2008-2010 built.

## VII. Why the Disappointments?

### A. False Idols

The root problem was that the world just did not seem to work out as expected—or, at least, as those advocating for the neoliberal turn had confidently expected.

Back in 1979, a year before Reagan's election, Milton and Rose Director Friedman wrote their classic *Free to Choose: A Personal Statement* trying to set out and justify their brand of small-government libertarianism. In the book, they made three powerful factual claims—claims that seemed true or maybe true or at least arguably true at the time, but that now seem to be pretty clearly false. And their case for small-government libertarianism rested largely on those claims.

The first claim was that macroeconomic distress is caused by the government, not by the unstable private market. The form of macroeconomic regulation required to produce economic stability is straightforward and easily achieved, and it is only because the government tries to do too much that we have large business cycles.

The second claim was that externalities were relatively small, or at least that they were better dealt with via contract and tort law than through government regulation.

The third, and most important, claim was that, in the absence of government-mandated discrimination, the market economy would produce a sufficiently egalitarian distribution of income. The Friedmans argued that a minimal safety net for those whom bad luck or a lack of prudence had rendered destitute, and elimination of all legal barriers to equality of opportunity, would lead to a more equitable outcome than would social-democratic monkeying with taxes and subsidies, because those would fall prey to rent-seekers with power and wealth.

Alas, it all turned out to be wrong.

Ben Bernanke during the Great Recession followed the Friedmans' playback for how a government should manage the business cycle to the letter, and the Great Recession still came.

Whatever you think of the role of externalities in the economy of the 1970s, in the high-tech information-age write-once run-everywhere economy of the 1990s, externalities are omnipresent.

And the Gilded Age demonstrates that slimming government and regulation can produce an astonishingly unequal distribution of income and wealth.

## B. A Neoliberalism Balance Sheet

When we try to draw a balance sheet on the value of the neoliberal turn in the global north, the overwhelming factor is that it looked very approvingly on the rise in income inequality that has produced our second Gilded Age. That alone has to make the balance sheet overwhelmingly negative. Practically any socio-economic regime that took effective steps to stop or retard the growth in wealth and income inequality would have been a better system for the global north over the past 40 years.

Otherwise?: well, we have to assess it as a zero—or a negative—for growth in the Global North. Neoliberalism was supposed to revive the pace of economic growth that was being retarded by sclerotic social democracy. It was supposed to do so by lifting the dead hand of regulation. It was supposed to do so by incentivizing the entrepreneurs, the innovators, and the job creators. It

It appears to have done none of those things.

And it appears to have created a politically powerful upper class dead set on maintaining and expanding its growth-retarding monopolies and on slowing economic change in order to avoid being creatively destroyed.

Look, for example, at the fight Koch Industries has waged against any shifts in policies that might retard global warming. Why? Because global warming would reduce the value of their oil in the ground. Never mind that a company with substantial expertise across a lot of the energy business is ideally placed to profit from the economic change that will be the move out of carbon energy. Today's plutocrats have already made their money, and they seek to preserve it. So economic growth and change are things they regard as their enemies.

Plus neoliberalism was a huge minus in the vulnerability created by financial deregulation. Plus neoliberalism hobbled the response to the financial crisis of 2007-8, and turned it into the Great Recession. Much too much of: “the market giveth, the market taketh away, blessed be the name of the market”. Much too little of: “the market was made for man, not man for the market”

One big benefit of the neoliberal turn for the world’s poor economies was supposed to be that slimming-down the state and opening up the world economy to finance was supposed to make it easier for poor economies to raise the capital needed to relax binding growth constraints. That, indeed, was a reason why so many of those working in economic development were willing in the 1990s to make the neoliberal bet: international capital mobility would come to the rescue by relaxing capital constraints where they were binding, and by reducing the scope for corruption and rent-seeking, which was often a more significant binding growth constraint.

The hope was that, like the pre-1913 era of British overseas investment, which financed a huge amount of industrialization in the resource-rich, temperate periphery of the world economy, net capital outflows from the industrial core would finance much late twentieth and twenty-first century industrialization.

But that was not the outcome: while international capital flows soared after 1980, the large net flow of capital from rich to poor countries simply never materialized. In fact, the principal outcome was an enormous flow of capital from the periphery to the rich core. For most of the past generation, and looking into the future, the message of the market is that the benefits of international capital mobility do not include a relaxation of the capital constraint, and thus an acceleration of growth in the global periphery.

The reason is that investments in the global north economic core—especially the United States —offer a form of protection for capital against unanticipated political disturbances.

Yet the balance sheet on neoliberalism in the global south has to be not negative but positive, especially if one includes China's reform as part of the great neoliberal wave. Overwhelmingly, the greatest things for world welfare over the past 40 years have been China's move away from Maoimm to market fuel prosperity and India's move away from the forms of social democracy practiced by the early rulers of the Nehru dynasty to a more neoliberal configuration. Those were huge pluses for the global south and for humanity as a whole.

Are there benefits for the global south other than China and India? Well, the first response to that is that India alone is more than enough. And the role played by neoliberals in assisting China's finding a very profitable and productive place in the world economy and thus enabling it to grow as fast as it did not only weigh in the balance, they break the scales. Isn't that more than enough?

Plus we can attribute a lot of the successful growth of the manufacturing exporters to neoliberalism. This is not so true for the east Asian five: Japan Singapore Hong Kong Korea and Taiwan. But India Indonesia Thailand and Poland? And those countries that have had some success at leveraging resources into broader-based growth in a neoliberal age: Brazil, Nigeria, Australia, Mexico, and Turkey? The Washington consensus may well not have worked – it's poster boy, after all, was Argentina. But the coming of neoliberalism to the global south looks, even from today's perspective, like more of a plus than a minus.

## C. The Persistence of Neoliberalism

The story as I have told it is of a social-democratic system of governance that ran into bad luck in the 1970s, as its flaws and chance led it to lose support, in part because of a very high bar. The right-wingers then got their chance. But their policies were no more successful—save in reducing inflation. Rapid growth did not resume. Indeed, median incomes performed significantly worse under Reagan and Thatcher, as what productivity growth there was was funneled into the pockets of the rich, and a Second Gilded Age drew near.

Yet even though the policies of rolling back social democracy had not surpassed the high bar—or even a low bar—the neoliberal turn became accepted, conventional wisdom. It was not that policies became "neoliberal" everywhere. But that was where the energy was. Social democracy was under pressure. Market was preferred to government. Hard incentives were preferred to more lavish benefits. The need for fiscal balance always required spending austerity (but rarely required higher taxes). It was not Ronald Reagan but Bill Clinton who announced, in one of his state of the union speeches, that "the era of big government is over". It was not Margaret Thatcher but Barack Obama who called for austerity when the unemployment rate was above 9%: "Families across the country are tightening their belts and making tough decisions. The federal government should do the same".

What gives?

After World War II, there had been high and largely justified hopes for social democracy both in the global north and the global south. Strong redistributive social insurance states would severely reduce the income and wealth inequalities that had been characteristic of Bismarckian Germany or the Gilded Age United States. Public investment would build physical infrastructure, spend money like water on education, and use Keynesian policies to make sure that growth was free of the recessions and depressions that had characterized the 1800s and the first half of the 1900s.

But everything had not gone according to plan.

Nationalization of the monopolistic commanding heights of the economy did not go well. Nationalizatiop of more went badly. The nationalized commanding heights of the economy turned out more often than not to become employment bureaus for the politically well-connected: under Juan Peron in Argentina the number of employees of the (newly nationalized) Argentinian railroad system close to tripled, while the number of trains and the volume of goods carried fell. The state was simply not very good as a bank, or as a stock exchange, or as a nursery for inefficient enterprises.

Milton Friedman-style neoliberals had tried to draw a line. They argued that you needed government, but not all that much government. The government needed to guarantee full employment (and low inflation) via activist monetary policy. But, they go on, attempts by the government to do more than simply maintain full employment and price stability would inevitably come to grief. Government policies would be turned to enrich the politically powerful rather than to enhance social welfare, and so almost always do more harm than good. (Why he thought that activist monetary policy was different—-why Milton Friedman believed government could be successful there while it could not be successful anywhere else—-was never something that he could explain very well.)

Hence the first meaning of neoliberalism: at the margin, get the state's nose out of the economy as much as possible. When the state is neither an instrument of positive redistribution nor an instrument of growth-boosting investment, its interventions in the economy are likely to go awry. Reducing such—substituting market means for public means to attain social-democratic ends where market means would be effective—seems and seemed worth trying.

And there was supposed to be a second meaning of neoliberalism: use the government where the government works: North America, northern Europe, southern Europe, and East Asia provide powerful examples of government interventions and policies that appear to be powerful boosters of growth: the centrality of education (especially female secondary education) in accelerating the demographic transition, the importance of making it easy for domestic producers to acquire industrial core technology (embodied in capital goods or not), administrative simplicity and transparency, transportation and communications infrastructure that only the government can provide. Public investment plus market support were supposed to attract a broad center to a durable governing coalition. Call that "left-neoliberalism".

But there was also a third meaning: "right-neoliberalism", preached by the revived and restored classical liberals, via the Mont Pelerin society and a plutocrat-funded network of astroturf interest groups and think tanks. The claim that social democracy was one huge mistake–that it created a North Atlantic of takers who mooched off the makers. It held that if we got rid of social democracy, we would have a utopia because the makers wouldn't have to carry the takers on their backs and the takers would shape up–or if the takers did not shape up, serve them right! The moochers would then wallow in their much deserved squalor and misery. And the makers would not have to, as they do now, suffer the pain of watching the moochers live tolerable lives.

Within the neoliberal community, the argument for the left- rather than the right-wing version was that neoliberalism needed to support rather than replace social democracy, because social democracy was the only political system that could in the long run stably underpin a market economy that preserves a space for private property and private enterprise. Therefore the right had better shut up and try to make social democracy work, or else.

But what if the right were to go into dismantle-social-democracy mode. And once the right was committed to dismantling social democracy, the ability to construct and maintain the proper regulations needed to make market mechanisms tools to achieve social democratic ends fell apart as well.

## VIII. The Second Gilded Age

### A. Policy Biases of Neoliberalism

Inside the economies and polities of the global north, the neoliberal turn had more than one major effect in addition to bringing on the Second Gilded Age.

It did also shift the balance of biases in the government. Perhaps under social democracy before 1980 there had been a bias toward extending the government when equities were balanced, and a bias toward command-and-control mechanisms. Certainly after 1980 there was a bias toward tax cuts—and hence toward expanded government deficits and reduced investment in the future—a bias toward market mechanisms, and a bias toward allowing monopoly to grow and entrench itself. Whether this was a net plus or minus was hard to say at any time with any confidence out of any source other than one's prior political beliefs. Certainly it meant that government had fewer resources when challenges did arise, and that mobilizing government to cope with new problems was next to impossible. Would a Second Marshall Plan have been a good thing to launch in 1990 in the aftermath of the collapse of really-existing socialism? Probably. But the neoliberal air made it impossible to contemplate. Should government have taken on a powerful role in prepping to fight global warming starting in 1990? Yes—but it never happened, for Reagan had declared that “the government was the problem”.

## B. Cementing Support Among the Power Elite

The rise in inequality, however, was powerful and long-lasting. And the rise in income inequality cemented support for neoliberalism among the power elite, the upper class, the influencers…

## C. Piketty’s Logic of the Second Gilded Age

French economist Thomas Piketty popularized the striking differences between how the economy in the global north had functioned in the Gilded Age that preceded World War I, and how it had functioned in the decades following World War II. In the First Gilded Age, wealth was predominantly inherited, the rich dominated politics, and economic (as well as race and gender) inequality was extreme. After the upheaval of WWII, everything had changed. Income growth accelerated, wealth was predominantly earned (justly or unjustly), politics became dominated by the middle class, and economic inequality was modest (even if race and gender equity remained a long way off). The West seemed to have entered a new era.

And then things shifted back.

Piketty’s central point was that we shouldn’t have been surprised by this.

n a capitalist economy it is normal for a large proportion of the wealth to be inherited. It is normal for its distribution to be highly unequal. It is normal for a plutocratic elite, once it has formed, to use its political power to shape the economy in a way that enables its members to capture a large chunk of a society’s income. And it is normal for this to put a drag on economic growth. Rapid growth like 1945-1973, after all, requires creative destruction; and, because what would be destroyed would be the plutocrats' wealth, they are unlikely to encourage it.

Conclusion: In Piketty's view, we are likely to see oscillations between periods like 1870-1914, 1914-1945, and 1980-2020. The 1945-1980 social democratic era was a freak anomaly.

Is he right? I do not know. It is something to think about…

## D. Financialization and the Great Recession

And as inequality grew, the global north and even more so the American economy became financialized. The post-WWII social-democratic age had seen finance consume about 3% of America's national income in order to carry out its intermediary role. But today, at the height of the Second Gilded Age, that percentage is more like 8%. Is the U.S. getting good value from the extra 5% of national income now going into the pockets of financiers?

It seems unlikely. At a typical 5% annual real interest rate for risky cash flows, diverting that large a share of resources away from goods and services directly useful this year is a good bargain only if it boosts overall annual economic growth by 0.3%—or 6% per 25-year generation.

But there are no signs that the US economy today would be 6% less productive if it had had the finance-insurance system of 1950.

A well-functioning financial system provides insurance by diversifying and thus dissipating some risks, and otherwises matching those who fear risk with those who can comfortably bear it; matches large, illiquid investment projects with the relatively small pools of money contributed by individual savers; improves opportunities to borrow and lend to allow one to spend more when one is poor and save more when one is rich;

improves the ease of transactions; and improves corporate governance. The ease of transactions is greatly improved in our current financial system relative to the past. But the rest?

It is very hard to see what a 3% of national income finance system like the one of the 1950s failed to do that is worthwhile.

Why has the devotion of a great deal of skill and enterprise to finance and insurance sector not paid obvious economic dividends? There are two sustainable ways to make money in finance: find people with risks that need to be carried and match them with people with unused risk-bearing capacity, or find people with such risks and match them with people who are clueless but who have money. It seems likely that most of the growth in finance stems from a rising share of financial professionals who undertake the latter.

One consequence in America of the coming of the Second Gilded Age was that, when the Great Recession came along, and when recovery from the Great Recession was delayed and hesitant, the government and the political system barely seemed to care. A good part of the reason was that the rich dominated public discourse to an extent that they had not in previous decades. And, with the growing inequality of the Second Gilded Age, for the rich there was no crisis. Those who fell into the top strata regarded themselves as doing well in the US economy of the early 2010s. And indeed they were.

But, for everyone else—roughly 90% of the US population—there has been no jump in income share relative to ten or 20 years ago to offset what now looks to be a permanent lost decade. On the contrary, the bottom 90% has continued to lose ground.

## D. Economic Anxiety and the Fascist Revival

With the increased turn in America toward animosity on the political right toward people who are not white or whose grandparents were not born in the United States, it is conventional in many circles to make fun of those who blame the Tea Party of the early 2010s and the current state of American conservatism on “economic anxiety”. This is, I think, short-sighted. For many people the economy since 2007 has proved gravely disappointing. And they seek an explanation, and something to change. That they lack onto weaknesses in their own upbringing and irrationality in their thinking does not mean that they have not been disturbed by something very real.

## Notes, etc.

Presentation file: <https://github.com/braddelong/public-files/blob/master/econ-115-lecture-15.pptx>