A short history of neoliberalism (and how we can change it)

By Jason Hickel. Published in *New Left Project*, 2012.

As a university lecturer I often find that my students take today's dominant economic ideology – namely, neoliberalism – for granted as natural and inevitable. This is not surprising given that most of them were born in the early 1990s, for neoliberalism is all that they have known. In the 1980s, Margaret Thatcher had to *convince* people that there was "no alternative" to neoliberalism. But today this assumption comes ready-made; it's in the water, part of the common-sense furniture of everyday life, and generally accepted as given by the Right and Left alike. It has not always been this way, however. Neoliberalism has a specific history, and knowing that history is an important antidote to its hegemony, for it shows that the present order is *not* natural or inevitable, but rather that it is *new*, that it came from somewhere, and that it was designed by particular people with particular interests.

For most of the 20th century, the basic policies that comprise today's standard economic ideology would have been rejected as absurd. Similar policies had been tried before with disastrous effects, and most economists had moved on to embrace Keynesian thought or some form of social democracy. As Susan George has put it, "The idea that the market should be allowed to make major social and political decisions; the idea that the State should voluntarily reduce its role in the economy, or that corporations should be given total freedom, that trade unions should be curbed and citizens given less rather than more social protection – such ideas were utterly foreign to the spirit of the time."

So how did things change? Where did neoliberalism come from? In the following paragraphs I offer a simple sketch of the historical trajectory that got us to where we are today. I demonstrate that neoliberal policy is directly responsible for declining economic growth and rapidly increasing rates of social inequality – both in the West and internationally – and I make a few suggestions for how to tackle these problems.

Neoliberalism in the Western Context

The story begins with the Great Depression in the 1930s, which was a consequence of what economists call a "crisis of overproduction." Capitalism had been expanding by increasing productivity and decreasing wages, but this generated deep inequalities, gradually eroded people's ability to consume, and created a glut of goods that could not find a market. To solve this crisis and prevent it recurring in the future, economists of the time – led by John Maynard Keynes – suggested that the state should get involved in regulating capitalism. They argued that by lowering unemployment, raising wages, and increasing consumer demand for goods, the state could guarantee continued economic growth and social well-being – a sort of class compromise between capital and labor that would forestall further instability.

This economic model is known as "embedded liberalism" – it was a form of capitalism that was embedded in society, constrained by political concerns, and devoted to social welfare. It sought to exchange a decent family wage for a docile, productive, middle-class workforce that would have the means to consume a mass-produced set of basic commodities. These principles were widely applied after World War II in the United States and Europe. Policymakers believed that they could use Keynesian principles to ensure economic stability and social welfare around the world, and thus prevent another world war. They developed the Bretton Woods Institutions (which would later become the World Bank, the IMF, and the WTO) toward this end, in order to smooth out balance of payment problems and to foster reconstruction and development in war-torn Europe.

Embedded liberalism delivered high growth rates through the 1950s and 1960s – mostly in the industrialized West, but also in many postcolonial nations. By the early 1970s, however, embedded liberalism was beginning to face a crisis of "stagflation", which means a combination of high inflation and economic stagnation. In the US and Europe, inflation rates soared from about 3% in 1965 to about 12% ten years later.

Economists debate the reasons for stagflation during this period. Progressive scholars such as Paul Krugman point to two factors. First, the high cost of the Vietnam War left the US with a balance-of-payments deficit – the first of the 20th century – to the point where worried international investors began to offload their dollars, which set inflation rates rising. Nixon exacerbated inflation when, scrambling to pay for the spiraling costs of the war, he unpegged the dollar from the gold standard in 1971: the price of gold skyrocketed while the value of the dollar plummeted. Second, the oil crisis of 1973 drove prices up and caused production and economic growth to slow down, leading to stagnation. But conservative scholars reject these reasons. Instead, they hold to a narrative that sees stagflation as a consequence of onerous taxes on the wealthy and too much economic regulation, claiming that it represented the inevitable endpoint of embedded liberalism and justified scrapping the whole system.

At the time, the latter argument held a great deal of appeal for the wealthy, who – according to David Harvey[1] – were looking for a way to restore their class power in the wake of embedded liberalism. In the US, the share of national income that went to the top 1% of earners fell from 16% to 8% during the post-war decades. This didn't hurt them a great deal so long as economic growth remained strong, since they were getting a still-large share of a fast-growing pie. But when growth stalled and inflation exploded in the 1970s, their wealth began to collapse in a much more serious way. In response, they sought not only to reverse the effects of stagflation on their income, but also to leverage the crisis as an excuse to dismantle embedded liberalism itself.

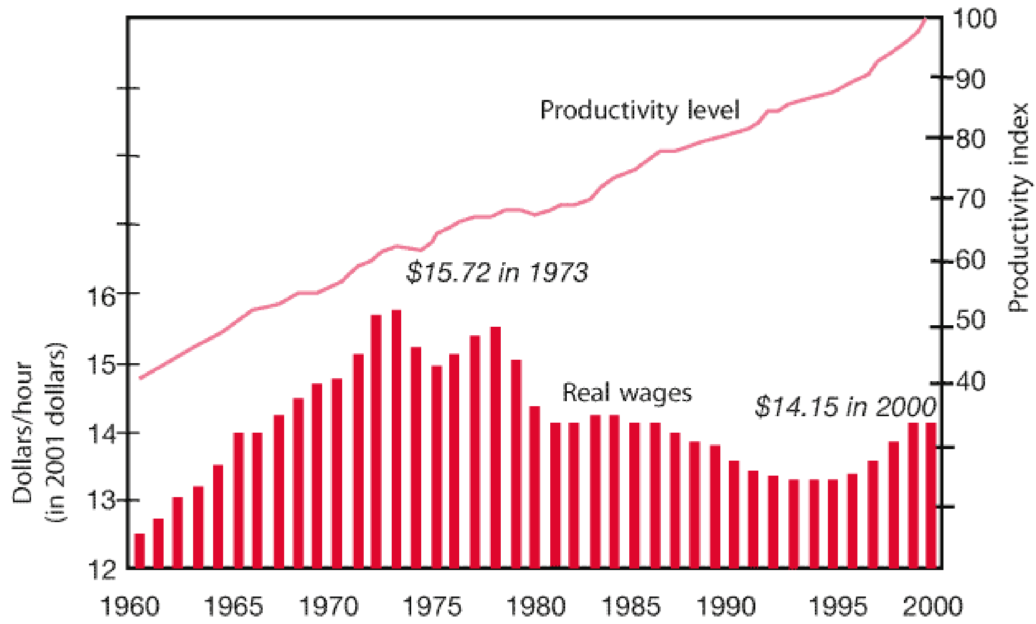
They got their solution in the form of the "Volcker Shock." Paul Volcker became the chairman of the US Federal Reserve in 1979, appointed by President Carter. Following the recommendations of Chicago School economists like Milton Friedman, Volcker argued that the only way to halt the crisis was to quell inflation by raising interest rates. The idea was to clamp down on the supply of money, incentivize savings, and thus increase the value of currency. When Reagan took office in 1981,

he reappointed Volcker to continue to jack interest rates up from the low single digits to as high as 20%. This caused a massive recession, led to unemployment rates of over 10%, and consequently decimated the power of organized labor, which – under embedded liberalism – had been the crucial counterbalance to the capitalist excess that had lead to the Great Depression. The Volcker Shock had devastating effects on the working class; but it cured inflation.

If tight monetarist policy (i.e., targeting low inflation) was the first component of neoliberalism to be put in place in the early 1980s, the second was supply-side economics. Reagan wanted to give more money to the already-rich as a way of stimulating economic growth, the assumption being that they would invest it in productive capacity and create a windfall that would gradually "trickle down" to the rest of society (which didn't work, as we will see). Toward this end, he cut the top marginal tax rate from 70% to 28%, and reduced the maximum capital gains tax to 20%, the lowest since the Great Depression. The lesser-known correlate of these cuts is that Reagan also *raised* payroll taxes on the working class, moving toward the Republican goal of an across-the-board "flat tax". A third component of Reagan's economic plan was to deregulate the financial sector. Because Volcker refused to support this policy, Reagan appointed Alan Greenspan to take his place in 1987. Greenspan – a monetarist who promoted tax cuts and the privatization of Social Security – was reappointed by a succession of both Republican *and* Democratic presidents until 2006. The deregulations he pushed eventually precipitated the global financial crisis of 2008, during which millions of people lost their homes to foreclosure.[2]

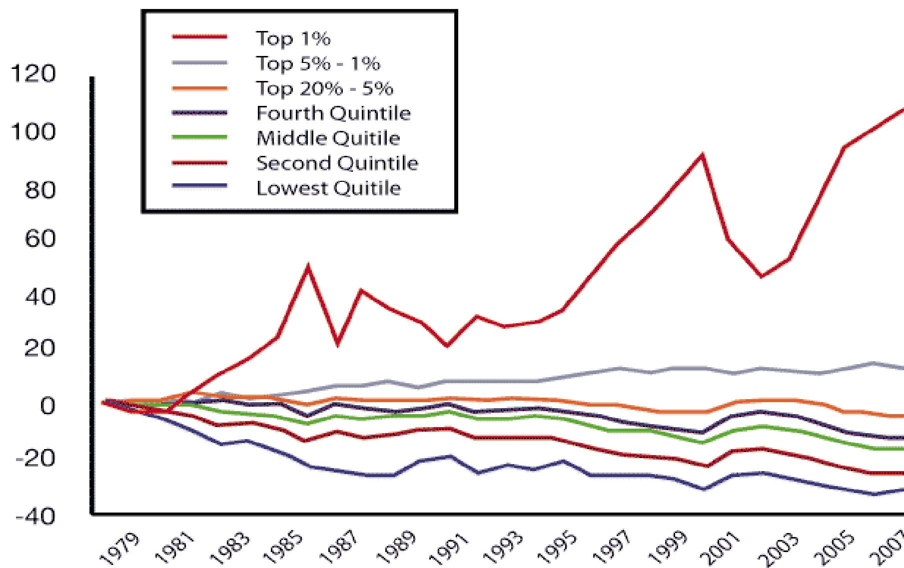
Together, these policies (which were mirrored by Margaret Thatcher in Britain during exactly the same period, in addition to rampant privatization) drove social inequality in the United States up at an unprecedented rate, as the following graphs illustrate. Graph 1 shows how productivity continued to increase steadily during this period while wages plummeted after the Volcker Shock in 1973, effectively shifting an increasing proportion of surplus value from workers to the owners of capital. Further illustrating this trend, CEO salaries increased by an average of 400% during the 1990s while workers' wages increased by less than 5% and the federal minimum wage *decreased* by more than 9%.[3] Graph 2 shows how the share of national income captured by the top strata of society has increased at an alarming rate: the portion going to the top 1% has more than doubled since 1980 from 8% to 18% (the same is true of Britain, with a jump from 6.5% to 13% during this period), restoring levels not seen since the Gilded Age. According to Census data, the top 5% of American households have seen their incomes increase by 72.7% since 1980, while median household incomes have stagnated and the bottom quintile have seen their incomes *fall* by 7.4%.[4]

Figure 1. The attack on labour: real wages and productivity in the US, 1960-2000



Source: R. Pollin, Contours of Descent (New York, Verso, 2005).

Figure 2. Share of national income, 1979-2007



Source: Mother Jones magazine, based on US Census data

So much for the trickle-down effect; as Cambridge economist Ha-Joon Chang has so aptly put it, “Making rich people richer doesn’t make the rest of us richer.” Nor does it stimulate economic growth, which is the sole justification for supply-side economics. In fact, quite the opposite is true: since the onset of neoliberalism, the industrialized world has seen average per capita growth rates *fall* from 3.2% to 2.1%.[5] As these numbers show, neoliberalism has completely failed as a tool for economic development, but it has worked brilliantly as a tool for restoring power to the wealthy elite.

If neoliberal policy has been so destructive to most of society, how have politicians managed to pass it off? Part of it has to do with the decimation of organized labor after the Volcker Shock, the demonization of unions as “stifling” and “bureaucratic,” attempts by the Left to distance itself from socialism after the collapse of the Soviet Union, and the rise of the “consumer” as the key figure of American citizenship. We might also point to the increasing influence of corporate lobbying in the U.S. political system, and the recently exposed conflicts of interest among academic economists bankrolled by Wall Street. But perhaps most importantly, on an ideological level, neoliberalism has been successfully marketed under the quintessential American value of “individual liberty.”[6] Conservative think tanks like the Mont Pelerin Society, the Heritage Foundation, and the Business Roundtable have devoted the past forty years to peddling the idea that individual liberty can only be properly achieved through market “freedom”. For them, any form of state intervention is liable to lead to totalitarianism. This position was given credence when the two icons of neoliberal theory – Frederich Von Hayek and Milton Friedman – each won the Sveriges Riksbank Prize in the 1970s, an award commonly referred to as the Nobel Prize in Economics even though it is granted by Swedish bankers instead of the Nobel Foundation.

Neoliberalism on the International Scene

While Western countries like the United States and Britain have experimented with neoliberalism in their own economies, they have also aggressively – and often violently – forced it on the postcolonial world, and in even more extreme measures.

The history of neoliberalism on the international scene begins in 1973. Responding to the OPEC oil embargo that year, the US threatened military action against the Arab states unless they agreed to circulate their excess petrodollars through Wall Street investment banks, which they did. The banks then had to figure out what to do with all of this cash and, since the domestic economy was stagnating, they decided to spend it abroad in the form of high-interest loans to developing countries that needed funds to ease the trauma of rising oil prices, particularly given the high inflation rates of the time. The banks thought this was a safe investment because they assumed that governments would be very unlikely to default.

They were wrong. Since the loans were made in US dollars, they were linked to fluctuations in US interest rates. When the Volcker Shock hit in the early 1980s and interest rates skyrocketed, vulnerable developing countries – beginning with Mexico – slid to the edge of default, setting off what is now known as the “third world debt crisis”. The debt crisis looked set to destroy Wall Street banks and thus undermine the entire international financial system. In order to prevent such a crisis, the United

States stepped in to make sure that Mexico and other countries could repay their loans. They did this by repurposing the IMF. In the past, the IMF had used its own money to assist countries in addressing balance of payments problems, but now the United States was going to use the IMF to ensure that third world countries would repay their loans to private investment banks. According to David Harvey, during this same period – beginning in 1982 – the Bretton Woods institutions were systematically "purged" of Keynesian influences and became mouthpieces of neoliberal ideology.

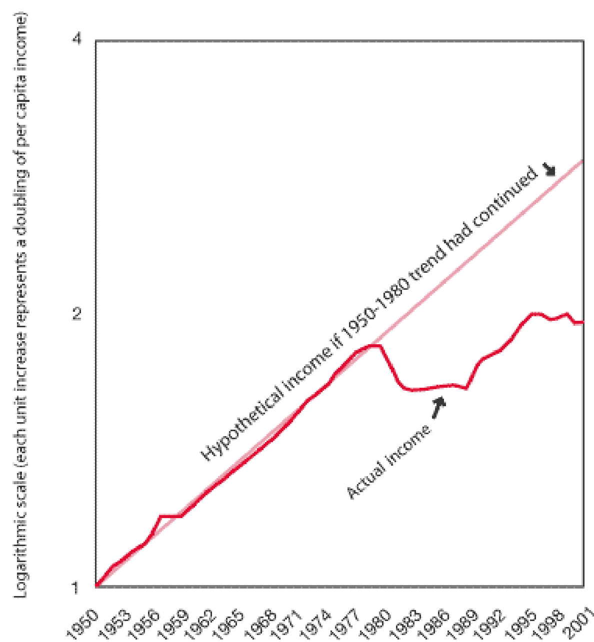
This is how the plan was supposed to work: the IMF offered to roll over the debts of developing countries on the condition that they would agree to a series of "structural adjustment programs". Structural adjustment programs promote radical market deregulation on the assumption that this will automatically enhance economic efficiency, increase economic growth, and thus enable debt repayment. They do this by cutting government subsidies for things like food, healthcare, and transportation, by privatizing the public sector, by curbing regulations on labor, resource use, and pollution, and by cutting trade tariffs in order to create "investment opportunities" and open new consumer markets. They also aim to keep inflation low so that the value of third-world debt to the IMF does not diminish, even though this reduces governments' ability to spur growth. Many of these policies are specifically designed to promote the interests of multinational corporations, which are often given the freedom to buy up public assets, bid on government contracts, and repatriate profits at will.

These same neoliberal principles are pushed on developing countries through the World Bank, which gives loans for development projects that come attached with economic "conditionalities" that entail forced market liberalization (this was particularly true during the 1980s). In other words, the IMF and World Bank leverage debt as a tool for manipulating the economies of sovereign states. The World Trade Organization – along with various bilateral Free Trade Agreements, such as NAFTA – also promotes neoliberalism by granting developing countries access to Western markets only in exchange for tariff reductions, which have the effect of undermining local industry in poor countries. None of these institutions are democratic. Voting power in the IMF and World Bank is apportioned according to each nation's share of financial ownership, just like in corporations. Major decisions require 85% of the vote, and the United States, which holds about 17% of the shares in both corporations, wields de facto veto power. At the WTO, market size determines bargaining power, so rich countries almost always get their way. If poor countries choose to disobey trade rules that hurt their economies, rich countries can retaliate with crushing sanctions.

The ultimate effect of this neoliberal phase of globalization has been a widespread race-to-the-bottom: since multinational corporations can rove the globe in search of the "best" investment conditions, developing countries have to compete with one another to offer the cheapest labor and resources, often to the point of granting extended tax holidays and free inputs to foreign investors. This has been fantastic for the profits of Western (and now Chinese) multinational corporations. But instead of *helping* poor countries, as they were supposedly designed to do, neoliberal structural adjustment policies have basically destroyed them. Prior to the 1980s, developing countries enjoyed a per capita growth rate of more than 3%. But during

the neoliberal era growth rates were cut in half, plunging to 1.7%.[7] Sub-Saharan Africa illustrates this downward trend well. During the 1960s and 70s, per capita income grew at a modest rate of 1.6%. But when neoliberal therapy was forcibly applied to the continent, beginning with Senegal in 1979, per capita income began to *fall* at a rate of 0.7% per year. The GNP of the average African country *shrank* by around 10% during the neoliberal period of structural adjustment.[8] As a result of this, the number of Africans living in basic poverty has more than doubled since 1980.[9] Graph 3 illustrates how the same thing has happened in Latin America. Former World Bank economist William Easterly has shown that the more structural adjustment loans a country receives, the more likely its economy is to collapse.[10]

Figure 3. Per capita income index in Latin America; actual and trend 1950-2003



Source: W. Easterly, The White Man's Burden (London, Penguin, 2006).

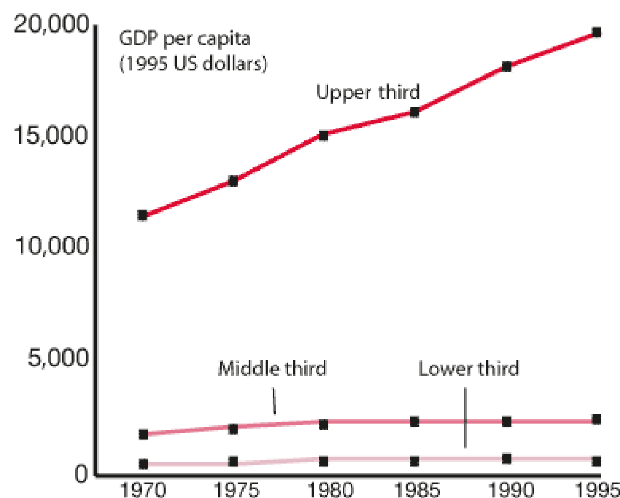
We shouldn't be surprised that this has happened. There is a flagrant double standard at play here: Western policymakers have been telling developing countries that they have to liberalize their economies in order to grow, but that's exactly what the West did *not* do during its own period of economic consolidation. As Ha-Joon Chang has shown, every one of today's rich countries developed their economies through *protectionist measures*. In fact, until recently, the United States and Britain were the two most aggressively protectionist countries in the world: they built their economic power using government subsidies, trade tariffs, restricted patents – everything that the neoliberal playbook denounces today. William Easterly notes that the non-Western countries that did *not* implement across-the-board free market principles managed to develop reasonably well, including Japan, China, India, Turkey, and the East Asian "Tigers".

The key point to be gleaned here is that neoliberalism is a *selective* use of free market principles in favor of powerful economic actors. For instance, US policymakers gladly embrace market freedom if it allows corporations to exploit cheap labor abroad and undermine domestic unions. But on the other hand they refuse to heed the WTO's demands that they abolish their massive agricultural

subsidies (which distort the competitive advantage of third world countries), because that would run against the interests of a powerful corporate lobby. The 2008 bank bailouts provide another prime example of this double standard. A true free market would have left the banks to pay for their own mistakes. Neoliberalism, however, often means state intervention for the rich and free markets for the poor. Indeed, many of the problems produced by neoliberalism could be mitigated by a more equitable application of market principles. In the case of the agriculture trade, for instance, poor countries would benefit hugely from *more* market liberalization. Another good example is Germany's system. Working on a theory known as *ordo*liberalism, Germany uses state intervention to prevent monopolies and encourage competition among small and medium-sized businesses.

As a result of neoliberal globalization, the income gap between the fifth of the world's people living in the richest countries and the fifth in the poorest has widened significantly, moving from 44:1 in 1980 to 74:1 in 1997.[11] Graph 4 illustrates this trend, which analyst Lant Pritchett has aptly described as "divergence, big time". Today, as a consequence of these policies, the richest 358 people on earth have the same wealth as the poorest 45% of the world's population, or 2.3 billion people. Even more shocking, the top 3 billionaires have the same wealth as all of the Lowest Developed Countries put together, or 600 million people.[12] These statistics flag a massive transfer of wealth and resources from poor countries to rich countries, and from poor individuals to rich individuals. Today, the wealthiest 1% of the world's population controls 40% of the world's wealth, the wealthiest 10% control 85% of the world's wealth, and the bottom 50% control a mere 1% of the world's wealth.[13]

Figure 4. Diverging incomes of rich and poor countries 1970-1995



Source: World Bank World Development Report 1999/2000.

If neoliberal policy has led to *worse* (and in many cases stagnant or declining) economic growth rates, then the rapid accumulation of wealth by rich people and rich countries has happened not only by appropriating what little growth *does* happen, but effectively by *stealing* it from poorer ones. For example, according to a recent article in the *Economist*, almost all of the gains from the post-crisis recovery in the United States have accrued to the top 1% of earners. Or consider the new study by

Global Financial Integrity that shows how multinational corporations have literally stolen as much as $1.17 trillion from Africa alone since 1970 through transfer pricing and other forms of tax evasion.

Another World is Possible

The key point to take away from this history is that the neoliberal model was made – intentionally – by specific people. And because it was made by people, then it can be undone by people. It is not a force of nature, and it is not inevitable; another world is in fact possible.

But how do we get there? In the United States, a first crucial step would be to amend the Constitution so as to preclude the possibility of corporate personhood. Following the recent Citizens United vs. FEC ruling, which allows corporations to spend unlimited amounts of money on political advertising as an exercise of "free speech", a number of campaigns have made headway toward this goal. A second step would be to strengthen the power of labor to act as a counterbalance against the excess power of capital. This could be done by keeping the federal minimum wage pegged to inflation, by passing the Employee Free Choice Act with a "card-check" provision that would allow workers to form unions without fear of employer intimidation, and by amending the Taft-Hartley Act to allow union shops and agency shops. A third step would be to re-regulate the financial sector by reinstating the Glass-Steagall Act, which – until its repeal in 1999 – moderated financial speculation and separated commercial from investment banking.

Popular resistance against neoliberalism has mounted since the financial crisis of 2008. Not only did the crisis expose the flaws of extreme deregulation, but conservative policymakers have sought to leverage the recession to justify unprecedented austerity measures in the name "deficit reduction", including deep cuts to healthcare, education, affordable housing, food stamps, and other social programs (while funnelling trillions of taxpayer dollars to private banks). In other words, policymakers hope to fix the crisis of neoliberal capitalism by prescribing yet more neoliberalism. This is true not only in the United States but across Europe as well. Not surprisingly, this naked power grab has spurred the rise of new social movements like Occupy Wall Street, the "indignados" in Spain and Greece, and in Britain the biggest spate of student protests and labor strikes for over fifty years.

On the international scene, the most common solution to the poverty crisis has been "development aid", which – after some forty years – has failed to make a meaningful impact. This is hardly surprising given the contradiction at the heart of the development model, which doles out aid *at the same time* as it mandates economic structural adjustments. As economist Robert Pollin has pointed out, even if the West met the recommendations of the UN Millennium Development Project and increased aid to developing countries to $105 billion per year (an improbable wish in the first place), this sum would still pale in comparison to how much developing countries have *lost* as a result of structural adjustment since the 1980s, which amounts to roughly $480 billion per year in potential GDP. Again, the absurdity of aid is that it usually gets used as a way of smuggling in the exact same economic policies that created the problem in the first place. Such is the hegemony of neoliberal ideology in today's economics.

Solutions that address the actual issues at stake might include the following: First, democratize the World Bank, the IMF, and the WTO to ensure that developing countries have the capacity to defend their economic interests. Joseph Stiglitz, who was fired from his post as Chief Economist of the World Bank for his critique of these institutions, has devoted his career to developing proposals toward this end. Second, forgive all third world debt – the rallying cry of the alter-globalization movement – so as to reduce the leverage that rich countries have over the economies of poor countries. Third, get rid of blanket structural adjustment conditions associated with foreign aid and development loans, recognizing that each country has unique needs. Fourth, instate an international minimum wage pegged to local costs of living as a way of putting a floor on the "race to the bottom." Fifth, allow poor countries to restore the levels of growth that they enjoyed prior to the neoliberal period by using strategic measures such as import tariffs, subsidies, marginal fiscal deficits, low interest rates, restrictions on transfer pricing, and state investment in infant industries.

Finally, and perhaps most importantly, we need to reclaim the idea of freedom. We have to reject the neoliberal version of freedom as market deregulation, which is really just license for the rich to accumulate and exploit, and license for the few to gain at the expense of the many. We have to assert that thoughtful regulation can in fact *promote* freedom, if by freedom we mean freedom from poverty and want, freedom to have the basic human dignity afforded by good education, housing, and healthcare, and freedom to earn a decent living wage from a hard day's work. Instead of accepting that freedom means unhinging the economy from the constraints of democratic society, we need to assert that true freedom entails harnessing the economy to help us achieve specific social goods that are democratically arrived at and collectively ratified.