What is neoliberalism?

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The recent popularity of the concept of neoliberalism on the agenda of social sciences has been characterized by a surprising lack of precision in the use of the term.¹ The most notable definitional problem is that it is conflated either with selected schools of thought in economics (the spectrum varies from classical liberalism to the Austrian School), or with given policy templates (the Washington Consensus, Margaret Thatcher’s economic program etc.). While these do indeed represent various faces of neoliberalism, the relationships among them are not spelled out clearly and parsimoniously, with “ideas,” “policies” and “institutions” mixed in an unsystematic and sometimes haphazard fashion. Thus, according to Campbell and Pedersen (2001), neoliberalism is:

“[a] heterogenous set of institutions consisting of various ideas, social and economic policies, and ways of organizing political and economic activity[…] Ideally, it includes formal institutions, such as minimalist welfare state, taxation and business regulation programs; flexible labor markets and decentralized capital-labor relations unencumbered by strong unions and collective bargaining; and the absence to international capital mobility. It includes institutionalized normative principles favoring free-market solutions to economic problems, rather than bargaining or indicative planning, and a dedication to controlling inflation even at the expense of full employment. It includes institutionalized cognitive principles, notably a deep, taken for granted belief in neoclassical economics.”(Campbell and Pedersen 2001: 5).

I associate the neoliberal development program with the spectrum of ideas that grew out of neoclassical economics in the second half of the 20th century to include such intellectual innovations as monetarist, supply-side economics, public choice theory, New Public Management and New Consensus economics.² For example, neoliberals posit causal links between tax cuts and capital investment (rather than consumption) or between the rigidity of employment protection legislation and unemployment figures. Also, a litany of neoliberal policy templates (often identified with Williamson’s original Washington Consensus) can be derived from the neoliberal policy paradigms: reducing inflation and budget deficits (even at the cost of employment), privatization, the scrapping of industrial policy, lower marginal tax rates and reduced corporate income tax rates, deregulation of financial instruments, decentralization and flexibilization of labor protection and the use of market principles in public services (for an he overview of the neoliberal program see Heilbroner and Milberg, 1995).

The adoption of selected neoliberal programs could occur separately from conversion to the economic paradigm itself. The mere adoption of a privatization program by a government

¹ The search term “neoliberalism” rendered 65,800 hits on Google Scholar, relative to 32,300 for Keynesianism (Last search February 4, 2009).
² Institutionalist economics typically represents the chief foil of neoclassical economics in modern capitalist history (Heilbroner and Milberg 1995). Yet the neoliberal paradigm cannot be boiled down to these “technical schools.”
does not warrant the conclusion that that government was compelled by the wider neoliberal paradigm. It merely signals a crack in the old interventionist consensus. Also, economic doctrines associated with neoliberalism can be downgraded to the status of programs. For example, scholarship on the spread of neoliberalism to the UK, (Hay 2001: 209-14; Epstein and Schor 1990; Panitch and Leys 1997: 121-22) showed that between 1974 and 1979 the Labor government used monetarism as an instrument of economic management, rather than as an economic doctrine, having not abandoned during this period its commitment to full employment, the mixed economy, the comprehensive welfare state and other markers of the paradigm known as welfare Keynesianism.

The inclusion of historical narratives in the concept of neoliberalism may be controversial. Yet, it has been shown that the supporters of neoliberalism often give dramatized causal stories about the failure of developmentalism, such as the 1979 “winter of discontent” in Britain or about capital flight under globalization, as much weight as they give to, say, monetarism (Hay 1996; 1998; 1999). According to Colin Hay, this is because the ability of policy agents to assess the range of strategic options available is constrained by perceptions of what is feasible, possible and desirable and these perceptions are, in turn, likely to be shaped not only by policy paradigms and perceptions of institutional resources, but also by the historical lessons they draw from other contexts (Hay 2001: 199).

As a recent review of constructivist political economy scholarship put it, “[a] research focus on the construction of crises would allow analysis to better recognize the importance of expressive struggles over the “lessons of history,” as intensified debate over the meaning of contemporary events often fosters reinterpretations of past wars and crises.” (Widmeier et al 2007: 755). The example given by Widmeier et al (2007: 755) are the causal stories about the Great Depression: “[i]n the context of debates over the stagflation of the 1970s, the lessons of the Great Depression came under new discussion. Keynesian “market failure” constructions, which had dominated discourses from the 1930s onward with their stress on the endogenous instability of market expectations, increasingly yielded to more classical “state failure” constructions which cast macroeconomic expectations as inherently destabilizing” (Widmeier et al 2007: 755; see mainly Blyth 2002).

The Rise of Neoliberalism in the Capitalist Core

Keynesianism and Its Crisis

The Keynesian policy paradigm adopted by postwar governments departed from the assumption that the private sector was fundamentally unstable to emphasize the role of the government in influencing growth rates, employment and production through a combination of fiscal and monetary policies. This policy paradigm was based in an intellectual consensus shared by mainstream economists throughout Western Europe and North America, with the notable
exception of Germany, where ordoliberal views constrained the effects of the brief 1966-1973 Keynesian interlude (Hall 1989; Backhaus 1985). \(^3\)

The angular stone of the paradigm was Keynes’ *General Theory* (1936), an initially obscure book proposing a theory where involuntary unemployment\(^4\) was attributed to a deficiency in aggregate demand.\(^5\) After the Second World War, what was understood as “Keynesianism” was in fact a synthesis between neoclassical economics and the “orthodox” Keynes of the *General Theory* (Hall 1989; Backhouse 1998).

By contrast with “fundamentalist Keynesianism” (Coddington 1978: 1259), in the neo-Keynesian model the [neoclassical model](#) of Smith and Marshall was assumed to hold in the long-run while the Keynesian one was applicable in the short run and for situations when the economic situation was marked by sticky wages, liquidity traps and interest-insensitive investment.\(^6\) Neoclassical synthesizers like Paul Samuelson, Robert Solow, James Tobin, James Meade, J.R. Hicks and Franco Modigliani strived to fit Keynes’ insights into the neoclassical fold as well as to formalize them through econometrics.\(^7\)

Far from being a homogenous paradigm, neo-Keynesianism was a spectrum of ideas. The “right” of the spectrum stretched as far as the neo-Keynesians who embraced the so-called

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1. Juergen Backhaus’ survey of the adoption of Keynesian ideas in Germany concluded that in this country Keynesians “emphasized productivity, capital formation, fiscal conservatism and an entrepreneurial approach to the attainment of public purposes. It was not designed for intervention, but participation in the market.” (Beckhaus 1985: 243). On the 1966-1972 “Keynesian” interlude, one observer noted that “[t]he entry of the SPD into the government finally allowed Keynesians some access to the policy arena, and, as Economics Minister, Schiller was finally able to secure passage of a Stability and Growth Law in 1967, which officially recognized the government’s responsibility for employment and mandated macroeconomic measures to secure the goals of the “magic polygon”, consisting of price stability, economic growth, full employment, and balanced trade. However, the first and fourth goals outlined in this polygon received much more stress than did the second and third.” (Allen 1989: 16-19). During this time, the central bank placed strict monetary limits on deficit spending and continued its epistemic hegemony by employing over 1,000 economists, in sharp contrast with the 200 economists on the payroll of the German finance ministry.

2. Keynes defined involuntary unemployment as a situation when some people are willing to participate in the labor market at the given wage or even at a lower wage yet are unable to act on this choice. For a discussion of the Keynesian definition see Hahn (1986).

3. Keynes’ qualitative insights were formalized a year later by three economists (Meade 1937; Harrod 1937; Hicks 1937) who saw in the *General Theory* the opportunity to reconcile neoclassical orthodoxy with Keynes’ arguments. The basic infrastructure of ideas used by Spanish neoclassical synthesizers was the Samuelson-Kaldor-Hicks formalization of Keynes’ thought. The intellectual manifesto of Keynesians as a group took place in a 1953 special issue of the economics review *De Economica* on Keynesianism’s applicability to the Spanish context.

4. The basic formalization of the *General Theory* was achieved by John Hicks and Franco Modigliani in the infamous IS-LM model, a system of simultaneous equations meant to address short-run imperfections to achieve the long-run equilibria in all the markets of the economy expected by neoclassicals. IS/LM stands for Investment Saving / Liquidity preference Money supply. The IS-LM model allowed for the synthesis of the classical regime, where wages were assumed to be flexible and the Keynesian regime, where nominal wages were assumed to be relatively rigid (“sticky”).
“Pigou effect”, which stated that Keynes’ *General Theory* failed to specify a link from "real balances" to current consumption, and that the inclusion of such a "wealth effect" would make the economy more “self-correcting” to the drops in aggregate demand (and therefore in employment) than Keynes predicted. This entailed a decreased emphasis on using demand-side policies to achieve the Keynesian objective of full employment.

On the “left” of the Keynesian spectrum were those who concluded that the “Pigou effect” had to work on a narrow band of assets and that even if this effect existed, its power could be empirically ignored. Another mark of left-leaning Keynesianism was Abba Lerner’s (1949, 1951, 1952) “functional finance” argument that balancing the budget is not important in itself, and should be managed accordingly. Governments could act to end high inflation without risking a major depression only by balancing monetary and fiscal intervention through incomes policy and a “functional finance” policy that ensures the adequate demand levels that guarantee full employment (Colander 1982:552). Similarly, the income redistribution effect of Michal Kalecki (1939: Ch. 3; 1942) held that far from being stabilizing, the reduction in money wages in a situation of unemployment can lead to reductions in aggregate demand and thus more unemployment. “Functional finance” ideas became textbook Keynesianism and the basis for policy during the Western postwar expansion.

Pushing Keynesianism even further to the left were French economists like Pierre Masse who read in Keynes’ work an endorsement of the imperative of indicative planning (Estrin and Holmes 1985; Eichengreen 1984; Coddington 1984; Meade 1970), Austro-Keynesians (Gerlich et al 1985; Tichy 1984; 2007) and the more rebellious, yet less policy relevant post-Keynesians (King 2003).

Indicative planners argued that one of the functions of government should be the early identification of oversupply, bottlenecks and shortages so that state investment could be used on time and in concert with investors to preempt the occurrence of market disequilibria. By

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8 For a classical Keynesian critique of the Pigou effect see Kalecki (1944). Kalecki argued that the adjustment required by the Pigou effect would increase catastrophically the real value of debts which, in turn, would cause wholesale bankruptcy and a “confidence crisis.”

9 “What eventually became known as textbook Keynesian policies were in many ways Lerner’s interpretations of Keynes's policies, especially those expounded in The Economics of Control (1944) and later in The Economics of Employment (1951). . . . Textbook expositions of Keynesian policy naturally gravitated to the black and white 'Lernerian' policy of Functional Finance rather than the grayer Keynesian policies. Thus, the vision that monetary and fiscal policy should be used as a balance wheel, which forms a key element in the textbook policy revolution, deserves to be called Lernerian rather than Keynesian.” (Colander 1984, p. 1573)

10 The logic behind this was that if wages decline, then the mark-up between prices and wages would increase. This would result in a redistribution of income from wage-earner to profit-earners. But if profit-earners have a lower propensity to consume than wage-earners, then the average marginal propensity to consume in the economy declines and thus aggregate demand declines. This argument was further elaborated upon by Nicholas Kaldor (1956) and Joan Robinson (1962), Sidney Weintraub (1958, 1965), Kenneth Boulding (1950) and Frank Hahn (1950, 1951).

11 Estrin and Holmes (1985) saw indicative planning as an appropriate response to uncertainty based on Keynes’ 1926 *The End of Laissez-Faire* (1973, Vol. IX). This view was disputed by Coddington (1984). But even though that Keynes was less favorable toward planning of all sorts in the *General Theory*, it certainly is the case that French indicative planners such as Masse cited Keynes as the father of indicative planning. This may have been an act of “radicalization” of Keynes’ work, but what it matters is that French planners reproduced Masse’s reading of Keynes and so did their Spanish counterparts. John Meade (1970) provides a more general discussion of indicative planning within a broader Keynesian context. See Meade’s *Theory of Indicative Planning*. Manchester, UK: University of Manchester Press, 1970.

12 Inspired by Joan Robinson’s “Ely Lecture” at the AEA in 1971, Alfred Eichner, Jan Kregel and others organized what developed into the grouping known as Post Keynesian economics.
contrast with “standard” Keynesianism, Austro-Keynesians complemented counter-cyclical demand management with strong neocorporatist incomes and exchange rate policies.¹³

Beginning with the late 1970s, it became apparent that the post-Keynesian revolution of Joan Robinson was losing steam in the economics profession just as macroeconomics began to “de-Keynesianize” and cede more and more points to neoclassical orthodoxy (King 2003). Some leading Keynesian economists put up a fight.¹⁴ Speaking from his position as president of the American Economic Association in 1977, Franco Modigliani attacked the monetarist insurgency and defended countercyclical monetary and fiscal management policies as the adequate response to stagflation by arguing that the inflation of the 1970s was mostly the result of the oil shock of 1973, rather than the result of flawed government policies (Modigliani 1977). He argued that expansionary fiscal policies could either complement or offset monetary policy in the pursuit of either unemployment or anti-inflationary objectives. A few Keynesian macroeconomists set out to demonstrate that the embarrassing difficulty to predict stagflation could be overcome by incorporating exogenous supply shocks in the standard structural models based on the Phillips curve.

Other prominent neo-Keynesians, however, began to make major concessions or simply defected. In 1980, prominent Keynesian James Tobin, a scholar who defended a reflationary response to the crisis, ended up agreeing that “the price- and wage-setting institutions of the economy have an inflationary bias. Consequently, demand management cannot stabilize the price trend without chronic sacrifice of output and employment unless assisted, occasionally” (Tobin 1980: 64). Around the same time, Assar Lindbeck, the dominant figure of Scandinavian Keynesianism began to accept the basic assumptions of monetarism and rational expectations, leading to a paradigmatic shift to the right in the economics of the flagship of social-democracy (Blyth 2001: 16). In less than a decade, Keynesianism went from epistemic hegemony to defensive.

The Neoliberal Insurgency in Economics
At the heart of embedded liberalism was the idea that monetary policy alone could control inflation. Inflation was commonly believed to be driven primarily by factors other than monetary policy: fiscal deficits, commodity price shocks, inflation psychology, aggressive labor unions, or monopolistically competitive firms.¹⁵ Beginning with the early 1960s, monetarists attacked this consensus by making the twin contentions that an excessive supply in the quantity of money by the central bank is the most important cause of inflation, and that the vagaries of monetar policy are responsible for the cyclical fluctuations of the economy.¹⁶ This controversial argument that did away with neo-Keynesians’ complex accounts of the causes of inflation was built on the

¹³ According to Austro-Keynesians, “economic policy tried to stabilize the data most important for entrepreneurial decisions, especially wage increase, exchange rates and investment promotion. This lightened the burden of the traditional instruments of stabilization policy. In addition these instruments were assigned differently: Exchange rate policy was primarily used to stabilize prices in the short run, incomes policy to equilibrate the current account in the medium and longer run, fiscal policy to stabilize employment” (Tichy 2007).

¹⁴ For an overview of the Keynesian resistance see King (2003).

¹⁵ Even the head of the Federal Reserve from 1970 to 1978, Arthur Burns, shared this view (Burns, 1979; Hetzel, 1998).

¹⁶ The tenets of classic monetarism were laid out in a string of Milton Friedman classics: Essays in Positive Economics (1953), Studies in the Quantity Theory of Money (1956), A Program for Monetary Stability (1960) and “The Role of Monetary Policy” (1968).
classical assumption that governments may not know in advance what the real effects of monetary policy will be in the long term.\footnote{Monetarism rose as an anti-Keynesian restatement of the 18th century classical quantity of money theory. This emphasized the stability of the private sector and the insufficiency of monetary policy in controlling inflation, and it was built on the classic liberal faith that, in the long run, markets are more efficient and productive than government intervention. For the pre-history of modern monetarism in the 18th and 19th centuries see Leidler (2008).} According to Milton Friedman (1956; 1960; 1963; 1969), to forestall either deflation or inflation, the most important goal of the monetary policy should be a public commitment by the government to lock in low fixed rates of growth in the money supply (between 3 and 5 percent) plus all commercial bank deposits.\footnote{This policy was adopted by the US Fed on October 6, 1979 by lowering and steadying the growth in the money supply. This was achieved by varying the reserves available to the banking system through open-market operations.} Once accepted, this thesis eviscerated Keyensian counter-cyclical policies based on forecasting the rise in demand. It promoted the institutionalization of monetary targets via open market operations, changes in interest rates, budgetary spending cuts or quantitative controls of the increase in bank credit, all with a view to reduce the effective demand for goods and services (Mayer 1978; Leidler 1981; 2008; Hoover 1984; Kindleberger 2006).\footnote{The key policy implication of the monetarist thesis was that government should keep the money supply steady and expand it slightly each year in accordance with the natural rate of economic growth. In practice, this meant that central banks should establish binding inflation targets. If they did this, monetarists claimed, the normal market process would keep inflation and unemployment low, while avoiding the risk of recession (Kindleberger 2006). While Keynesians endorsed a complex mix of monetary and financial policies to forestall the formation of bubbles, modern monetarists prescribed the same simple money supply growth rule enforced by a strong central bank (Leidler 2008:66). These ideas gained more respectability once Edmund Phelps (1967) and colleagues (Phelps et al. 1970) showed how Friedman’s findings could be derived using better specified models, in which information was imperfect and agents made mistakes.} But the monetarists’ offensive did not end with monetary policy. They attacked government employment regulations by cutting the links between monetary policy and the dynamics of unemployment. Friedman postulated that there is a natural rate of unemployment whose levels can only be kept low artificially, through labor market rigidities (labor unions, minimum wage legislation, hire and fire costs). According to his theory, the natural rate of unemployment is unknowable. Therefore, the government’s attempts to lower it are doomed to generate either inflationary spirals if unemployment is set below the natural rate, or deflation if it is set above this rate. The most important implication of this argument is that there is no permanent trade-off between inflation and unemployment; there is only a temporary trade-off.

During the 1970s, the monetarist onslaught against Keynesianism was complemented by two new schools of thought: supply-side and new classical economics. Supply-side economics was the product of interactions between conservative media and a small group of maverick economists. It resuscitated the classical liberal thesis that supply creates its own demand (Say’s law),\footnote{The best-known supply-side economists were Arthur Laffer, Jude Wanniski, Paul Craig Roberts, Alan Reynolds, Karl Brunner and Robert Bartley. Some have degrees in economics but none have a strong record on scholarly work.} leading supply-siders to reject the possibility that economic recessions may be caused by a fall in demand (Wanniski, 1978; Canto et al 1982).
But, as Mark Blyth (2002) showed, supply-siders went beyond this classical thesis in two respects. First, they argued that pumping up demand would simply lead to higher inflation, if it were not done in conjunction with the improvement of markets through deregulation, liberalization, privatization or free trade. Given the assumption that unemployment is voluntary, the second monetarist intellectual contribution was that government policy may increase the labor supply (and thus both productivity and investment) by allowing participants in the labor market to keep more of their money (through tax cuts), and to more freely enter and exit the labor market (by scrapping minimum wage legislation and the deregulation of labor legislation).

Second, in addition to tax cuts and labor deregulation, supply-side ideas also entailed reductions in welfare benefits. This was not based on the monetarist idea that welfare spending can be inflationary, but on the supply-side discovery that the labor supply decreases when the unemployed are offered benefits that give them incentives not to work. Supply-siders cited no evidence for such theses. The fact that welfare state scholarship did not engage with large-N research on the “big welfare-reduced growth” thesis until the mid 1980s kept the supply-side argument sheltered from robust attacks precisely at a time when social-democrats began to doubt their commitment to the welfare state.

Finally, by importing microeconomic ideas into macroeconomics, monetarists also argued that regulation created perverse incentives and distorted resource allocation as much as it cured other problems. Because supply-siders assumed that efficiency was possible only in conditions of private ownership of assets and competitive markets, deregulation and privatization emerged as key policy recommendations.

According to the more academically-anchored new classical (or rational expectations) approach, real-world business fluctuations could not be explained away as market failures (the Keynesian approach), or strictly as the result of monetary disturbances (the monetarist foil). Instead, Robert Lucas, Thomas Sargent, Neil Wallace and other prominenti of this new tradition also stressed the causal role of supply-side shocks, such as technological revolutions, raw materials price spikes and radical changes in the organization of production. Employment, like output, would rise with favorable shocks and fall with unfavorable shocks.

21 The concern with the efficiency losses generated by taxation was first articulated in the postwar years by Arnold Harberger’s *Taxation and Welfare*, Boston: Little Brown and Co (1974). Working with the classical assumption that the added value created by growth trickled down in the form of employment-generating investment, the supply-siders emphasized that the tax cuts should be directed principally at high marginal income tax rates, a move to be conducted in conjunction with broadening the tax base (coded language for increasing taxation on a wider range of goods and services).

22 In their strong forms, supply-side ideas argued that tax cuts would generate such revenue growth that the resulting deficit would be completely financed by the cuts themselves (the Laffer curve) and would raise living standards to such a degree that welfare spending would be unnecessary.

23 Significantly, welfare state scholars found the supply-side argument devoid of empirical value. Both Korpi (1985) and Friedland & Sanders (1985) found that welfare states have a positive effect on growth rates. After disaggregating expenditure categories, Saunders (1985 1986) found that social transfers have a positive effect on growth, just as the Keynesian paradigm maintained.

24 For two key general accounts of new classical economics see Hoover (1988) and Sheffrin and Steven (1996), For more detailed descriptions and evaluations see Hartley et al (1998) and Lucas and Sargent (1981).
The new classicals argued that these disturbances could not be remedied by the government. On the contrary, echoing the earlier critiques of government intervention made by the Austrian School, they argued that interference could only worsen them. Where Friedman had argued that policy was destabilizing, Lucas and his colleagues used complex mathematical models to demonstrate that, if private agents were completely rational and if markets were competitive (two assumptions shared by the neo-Keynesian mainstream) it would be impossible for the government to stabilize the economy, simply because agents would adjust their inflationary expectations and “outsmart” the government. 25 Consequently, the government’s only policy option was to credibly commit itself to anti-inflationary policies, whose costs in terms of higher unemployment could be addressed by boosting the supply-side of the economy through tax cuts and labor market deregulation.

The radical attack against government intervention, which was instigated by rational expectations, was further strengthened during the 1970s by the indigenization of public choice theory in macroeconomics. 26 William Nordhaus’ (1975) work on the political business cycle, for example, legitimated the assumption that bureaucrats and politicians were not seeking to optimize a national welfare function, as Keynesians had assumed, but rather were motivated by their own strategic interests. Public policy, therefore, was riddled with inefficient rent seeking. The most important policy implication was that governments should delegate monetary policy to an independent central bank, whose vested interest (ensuring price stability) was by hypothesis a virtuous one. Other public choice economists (Choi 1983) went further in attacking a basic social-democratic thesis by trying to demonstrate that welfare states harm growth in the long term due to rent-seeking. However, as some reviewers noted, they “employed proxy variables for sclerosis (age of a nation or years of democracy) that assumed a fair amount of faith” (Esping-Andersen and van Kersbergen 1992: 199).

25 To make this argument, new classicals adopted John Muth’s rational expectations hypothesis: if the predictions of an economic model were correct and the agents’ expectations of the future were wrong, then the agents could use the model to remedy their expectations and avoid future errors. They applied this argument to a critique of the Keynesian assertion that there was a trade-off between unemployment and inflation, and they maintained that an expansion of the aggregate demand could lower unemployment only because the acceleration in prices was not anticipated. The companies that mistook higher market prices for higher real returns would be willing to increase output, while workers who mistook higher market wages for higher purchasing power would be willing to terminate their unemployment sooner. Yet these outcomes would not last, because neither the returns to firms nor the purchasing power of workers were really higher when adjusted to inflation. As soon as they realized that expansionary policy is not a stimulus to the economy, but is actually an early warning inflation, firms and workers would reduce production and increase the unemployment rate. What is more, having made the mistake once, they would not be easily fooled again by the same policy, thus depriving state intervention of the capacity to reach its goals in the long run.

26 Public choice theory dates back to the work of James Buchanan, Gordon Tullock, Mancur Olsen, and Anthony Downs around 1960. For a systematic overview see Amadae (2003).
The Neoliberal Revolution in Practice

**Insurgent Ideas for International Organizations**

Beginning with the mid 1970s, the neoliberal insurgency began to percolate in international organizations as well as in the political system of the advanced capitalist core. The embrace of these ideas by actors with influence in the world economy gave these ideas a greater weight relative to available alternatives such as, say, post-Keynesian or Austrian economics, because they provided policy makers puzzled by enduring stagflation with concrete and successful examples.

As neoliberal ideas were adopted by the European Commission, OECD, the IMF and by great economic powers, the pressures to adjust to the new reality increased on nation state elites elsewhere. Yet, as the following sections show, the endorsement of the neoliberal agenda did not reach a critical mass of center-left West European parties until the second half of the 1980s, well after PSOE decided its government program in 1982.

At the systemic level of analysis, the IMF’s tolerance of Keynesian demand management began to weaken just as the Bretton Woods system showed its first signs of crisis. As a recent study of IMF policy papers shows, during the late 1960s “a form of ‘monetarism’ was emerging in the counsels of the IMF, which involved not only a focus on monetary aggregates, but, perhaps even more importantly, a skepticism about governmental discretion in the conduct of economic policy and an enthusiasm for fixed, quantitative targets” (Clift and Tomlinson 2008: 565). But it was not until the mid 1970s that the neoliberal turn became evident. Scholars attribute this turn to the fact that key policymakers in United States began to push the IMF to embrace select neoliberal ideas such as conditional financing and financial deregulation (Vreeland 2003; Harmon 1997).

Simultaneously, monetarist arguments began to gain traction in the British and American financial press and central banks at a time when financial markets became increasingly hostile to the Labor government’s adoption of a neo-Keynesian crisis package in 1974 (Blyth 2002; Helleiner 1994; Wass 2008; Hay 2010). And since Britain was more vulnerable to financial interests than any other European country, she became the trial run of neoliberalism in 1976, when an IMF macroeconomic austerity package with financial deregulation clauses was forced on a British government trying to fight the collapse of the sterling. Historical contingency entered the scene in dramatic fashion, as the left faction of the Labor party was one vote away from rejecting the IMF package (Hickson 2005; Wass 2008). Neoliberal ideas thus scored their first victory at a critical juncture of European economic history.

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27 According to Eric Helleiner, Treasury Department Secretary Simon and Federal Reserve Chairman Burns and secretary of state William P. Rogers used their institutions’ influence in the IMF to force Britain in a macroeconomic stabilization package that contained crucial financial deregulation reforms (Helleiner 1994: 124-130). The matter appears to have been highly “securitized”, as National Security Adviser Brent Scowcroft is quotes saying “I spent more time on this matter [Britain’s financial crisis] during those weeks as anything else. It was considered by us to be the single greatest threat to the Western world” (Helleiner 1994: 128-129).

28 Testifying to the importance of this moment, US state Secretary William P. Rogers suggestively framed this moment as “a choice between Britain remaining in the liberal financial system of the West as opposed to a radical change of course, because we were concerned about Tony Benn precipitating a policy decision by Britain to turn its
Following the British crisis, the IMF further enlarged the list of policy areas subject to its newly-acquired neoliberal sensibility. Broome and Seabrooke’s (2007) systematic analysis of IMF policy documents concerning Western capitalist states evidenced that while the Fund expanded its advisory jurisdiction over the tax regime, labor regulations, welfare state and industrial policy issues during the late 1970s and early 1980s. After 1981, a similarly expanded package was served to developing countries (Polak 1984; Bierstecker 1990). The OECD followed a similar line in near-synchrony with the IMF. After 1977, OECD reports written for the EEC advocated a standard monetarist line plus an emphasis on fixed exchange rates. The most important of these was the McCracken report (1977), whose call for austerity policies to address the stagflation crisis was couched not only in the new set of neoliberal ideas discussed above but also in new political, sociological and psychological narratives about the “wealth paradox” that bolstered those ideas (Keohane 1978; McNamara 1998).

In Western Europe, the neoliberal revolution arrived first in the European Commission and in Germany. In 1973, even before the first oil shock hit, EEC’s Council of Ministers passed a resolution that in effect represented the first official endorsement of monetarist theses. The resolution called on member states to “progressively reduce the growth rate of the money supply until it equals that of the real GNP” (cited in Bernanke et al 44-45). Subsequently, the Commission’s finance “ministry” (the Directorate General for Economic and Financial Affairs) issued a report in 1975 that recommended monetary supply targets to lower inflationary expectations and create the foundations for a new fixed exchange rate regime. Known as the OPTICA reports (OPTimum Currency Area), these policy papers took issue with the then still reigning neo-Keynesian orthodoxy and turned low inflation and fixed exchange rates into top priorities of economic policy at the supranational level in Europe (Thygessen 1978). During the second half of the 1970s, German-style inflation targeting also became the new orthodoxy in the

back on the IMF. I think if that had happened, the whole system would have come apart...So we tended to see it in cosmic terms.” (Helleiner 1994: 128).

For example, in 1977, the Fund advised Denmark not only to cut its growing current account, which was part of its old neoclassical orthodoxy, but also to adopt neoliberal supply-side measures such as the raising of indirect taxation and the lowering of income taxes. Also, in 1981 the Fund basically told Sweden to shrink the welfare state, cut industrial subsidies, cut income taxes and control wage increases (Broome and Seabrooke 2007:592-593).

After the Latin American debt crisis in 1981, IMF policy advice went beyond deflationary, fiscal adjustment, wage restraint and revenue-increasing policy suggestions and began to advocate for more structural measures, such as privatization (public enterprise sales, sub-contracting or eliminating public sector services), labor market deregulation, tax incentives for private sector development, market restoring mechanisms (ending subsidies, interest rate increases and wage indexation, trade and payment liberalization) (Polak 1984; Bierstecker 1990).

These narratives used unexamined conservative values and assumptions to intimate that implied social-democracy and welfare systems were dead-enders, that government interventions are doomed by intrinsic inefficiencies and that high levels of long term unemployment were acceptable in the name of cementing incentives to invest. In the analytical framework of this influential report, the state-as-investor disappears, yet the “new” state is now the “minimal” state of the orthodox neoliberal line. In addition to the neoliberal disciplinarian function (through credible commitments to price stability), the state was expected to continue to facilitate social consensus through engineering wage and price level agreements with labor and capital, rather than act as the public arm of private capital (Keohane 1978: 119-125). OECD reports also began to attack generous welfare benefits and labor market regulations, rather than insufficient demand, as the cause of persisting high unemployment (OECD 1989; 1994).

Like American monetarists and rational expectations economists, the OPTICA experts also saw much futility in government interventions in wage and price formation and urged member states to adopt the inflation targeting monetary regime pioneered by Germany in December 1974.

Neoliberalism and European Political Economy

What gave the EEC policy recommendations greater weight in an otherwise underinstitutionalized Community was the fact that the monetarist regime had had a trial run in Germany beginning with 1974 (Scharpf 1984; McNamara 1998). While monetarist policies had been tried during the postwar years by the Netherlands and Belgium (Kurtzer 1993: 163; 228), the fact that Keynesian policies were associated with higher growth rates in France, Austria, Scandinavia or Italy weakened the case for its diffusion outside Germany and the small group of states that “shadowed” its macroeconomic policy.

This time it was different, however. Germany’s generous welfare state, employment figures and wage levels appeared to weather stagflation better than countries that pushed ambitious demand side policies during the second half of the 1970s. West Germany’s constitutionally-guaranteed commitment to price stability ensured through an independent central bank had been a mainstay of this country’s monetary policy during the postwar years (Kaltenthaler 2008; Holtfrerich 2008; Prasad 2006). Yet it was only in December 1974 that the central bank resorted to monetarist inflation targeting, or the use of pre-announced low growth targets (around 2 percent a year) for the money stock (M3) with the intent of lowering the public’s inflation expectations.

This policy move was enabled by the fact that the collapse of Bretton Woods relieved the Bundesbank of its most important external obligation (i.e. to intervene in the foreign exchange markets), yet the choice for a more rightward option was based in explicit monetarist arguments (Issing 1992; 1996). 33

Yet Germany-style monetarism was soon to be emulated across Western Europe was of a hybrid or “pragmatic” rather than of an ironclad or doctrinaire kind. In Germany not even the conservative Bundesbank economists wished to conceive of inflation targeting the first step in taking Germany’s embedded liberalism apart. Theirs was a “pragmatic monetarism” that acknowledged the limits of price stability for employment and economic growth outcomes while allowing for moderate and temporary accelerations of money growth to stimulate real growth (Bernanke 1999 et al 51; Issing 1997: 72; McNamara 2006; Kotz 2007; Neumann 2007). The central bank liked not only Modell Deutchland ‘ liberalized cross-border capital movements and deregulated domestic bank interest rates, but also Germany’s conservative universal banks, its privilege to coin Europe’s anchor currency and institutionalized skepticism towards financial innovations and (Issing 1994; 1995; Streeck and Yamamura 2001; 2003).

33 Although the targets were not met until 1979 (Issing 1995), Germany reduced inflation from 6 percent in 1975 to 2.7 percent in 1978, while not experiencing the stagflation drama of other advanced capitalist economies (Bernanke et al 2000: 43-54). As a former Bundesbank official argued, “[t]he choice of a monetary target in 1974 undoubtedly signaled a fundamental regime shift. Not only was it a clear break with the past but also a decision to discard alternative approaches to monetary policy.3 There were two main arguments in favor of providing a quantified guidepost for the future rate of monetary expansion. First, and foremost, was the intention of controlling inflation through the control of monetary expansion. Second, the Bundesbank tried to provide a guidance of agents’ (especially wage bargainers’) expectations through the announcement of a quantified objective for monetary growth. Therefore, with its new strategy, the Bundesbank clearly signaled its responsibility for the control of inflation.”(Issing 2005: 330).
Friedman’s idea that monetary policy should be consigned to fighting inflation found little support in the Deutschebank and its admirers throughout Europe (McNamara 1998; Bernanke and Mishkin 1997: 105). Moreover, inflation targeting as actually practiced by West European central bankers contained a considerable degree of policy discretion to allow responses to unemployment conditions, exchange rates and other short-term conditions (Bernanke and Mishkin 1997: 106).

The German policy success in weathering the stagflation crisis inspired other West European governments to do the same (McNamara 1997: 129-140). This was not only the case of Britain, where the right wing of the Labor party narrowly passed a neoliberal policy package in 1976 (Ludlam 2010; Hay 2010; Wass 2008; Rogers 2009; Hickson 2005; Harmon 1997; Hall 1993; Burk and Cairncross 1992).

As early as 1976, conservative governments in France and Italy also shifted from expansionary measures to reform plans centered around restrictive monetary policy through the adoption of inflation targets, currency stabilization, wage restraint and rejection of the notion of full employment. In so doing, they expressly modeled their restrictive policy packages on Modell Deutschland (McNamara 1998). The center-left governments of Benelux had “shadowed” Germany’s anti-inflation posture throughout the late 70s by pegging their currencies to the deutsche mark while defending deficit-financed countercyclical spending, corporatism and the welfare state.

Yet when Belgian and Dutch conservatives won the elections in 1982 and 1983 respectively, they not only maintained the D-mark peg, but also embarked on deflationary policies that suspended wage indexation, froze benefits, institutionalized work share agreements and deregulated part-time work (Smits 1983; Kurtzer 1998; Hemerijck and Visser 1997; 2000; Bastian 1994).