From Embedded Liberalism to Neo-Liberalism

This lecture will present a picture of two very different phases of political-economic management of the world economy, each with a profound impact on nation-states' ability to manage their domestic economies and provide their citizens with economic and social rights.
Today’s Agenda

• Where we are: The achievement of governance over the international economy
• The reality of American Hegemony: The golden age of embedded liberalism
• Overtaken by those we helped!!!
• How did the world respond in the absence of embedded liberal Hegemony?
The International Story: A triumph for embedded liberalism
How did the U.S. exercise hegemonic leadership?

- the United States assumed primary responsibility for the management of the world monetary system partially under the disguise of the IMF.
- The dollar became the basis of the international monetary system.
- The US took in the world’s distressed goods and began to build a trade deficit.
Post-War International Economic governance: weak institutions and American Hegemony

It was the U.S. economy, not the IMF which provided liquidity for the system. It was the outflow of dollars which provided the liquidity that greased the wheels of commerce.

All other countries could easily change their currency values and they didn't actually become convertible till 1959. But the U.S. did not change the $ value.

So dollars were in demand; the dollar became the world's principal reserve currency.
The Dollar greases the wheels of the international liberal economy

• ↑ imports + ↓ exports → trade deficit → need to pay up → use $ as reserve and exchange currency → stable currency values.
Taking in the world’s distressed goods
The Cold War: Two models of political economy clash and become deadly

For our purposes, a war between real live versions of two models of political economy: the political economy of Freedom and the Political Economy of Community: Liberalism and Communism.

Remember how industry and labor in the U.S. did not want the U.S. to play the role of hegemon?

Everyone remembered how U.S. isolation had not helped world politics in the two decades before World War I.

Truman did not want to repeat Wilson's error and not persuade congress to be involved abroad.

The Soviet Union was now the new "aggressor" nation. The Soviets wanted more territory from Turkey, and the Greeks were fighting a civil war with Communist guerillas, supposedly controlled by Moscow.

On March 12, 1947, Truman made the address that became known as the "Truman Doctrine." This was a U.S. pledge to support free peoples who are resisting attempted subjugation by armed minorities or outside pressures.

The Soviet Union interpreted this as a "fresh intrusion of the USA into the affairs of other states."

And the Cold War began.

The U.S. began to station its troops around the world to prevent communism from spreading.

A British cartoon of June 1947 shows Truman and Stalin as two taxi-drivers trying to get customers. The 'customers' are labeled 'Turkey', 'Hungary', 'Bulgaria', 'Austria'.

A communist insurrection in Greece...
A contest of the two ideologies in Europe

- In France and Italy, 25% of the people had voted for the Communists, and communists held important positions in labor unions.

- Europe could not be written off; its combined population exceeded that of either of the superpowers, and even in ruins it possessed one of the world's leading industrial plants.

- One of the chief postwar questions was therefore the rescue of Europe, or, in practical politics, who Europe's "rescuer" would be.

- Only two candidates, the USSR and the US.

- Europeans did not want to be rescued by either.

- Not too many Europeans wanted Europe to be remodeled according to the economy and culture of the United States.

- Dependency, even on the benefactions of the U.S., they feared as a gamble; remembering the depression of 1929, and how all Europe had gone down after the cessation of American loans, they had no desire to be dependent upon American capitalism.

- Europe wanted to preserve its identity, but it was too weak to do so.

- But the weak condition of the European economies became a cause for concern, because it was believed that weak economies would make these countries more susceptible to communist takeovers.
So the US provided Military security and economic aid

- Aid for the development of European export industries: Marshall Plan
- Encouraged European cooperation in the European Community
- Why?
  - Military security
  - Financial backing
  - US as generous dad pulling the child teaching the child how to ride a bike
  - Took in Europe's distressed goods
European Cooperation
U.S. Capital Flows to Europe

- ↓ exports → trade deficit → need to pay up → use Marshall Plan Dollars + restrict imports from US + European integration → transaction costs + $ as reserve and exchange ble currency values → stable trade + world trade in $
What were the results of U.S. hegemony for the “liberal” international economy?

- The Welfare State was protected
- Decline in Trade Barriers $\rightarrow$ Economic Growth
- Comparative Advantage and Liberal model vindicated
The “international economy” was divided into two camps
But the contest was deadly.....
But the U.S. sacrificed to hold up the “free world”: The US Trade deficit: 1950-1973

But no problem....no one asked for payment!
But for the U.S.....Overtaken by those we helped

- Growth of Western Europe and Japan

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<th>Per Capita Income</th>
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<tr>
<td></td>
<td>1950</td>
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<tr>
<td>Western Europe</td>
<td>$3,700</td>
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<tr>
<td>U.S. and Canada</td>
<td>$5,257</td>
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<td>Japan</td>
<td>$1.926</td>
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If the U.S. lost relative wealth why play the role of hegemonic leader?

- It possessed the capabilities but why was it now willing?
Marxist explanations

- Overproduction and capitalist class control of the economy
- Need for U.S. export markets to relieve overproduction
- Bankers pushed U.S. leadership of the world economy

"After the war, our economic policy will be aimed at full employment and full utilization of a greatly enlarged industrial plant. These objectives, however, cannot be realized unless we find new outlets for products of farm and factory--outlets that will be steady and profitable after war demands have dropped off."

-- U.S. Treasury Department report to President Roosevelt in 1944:
Economic Nationalist explanations

- Hegemony is a source of wealth, power and security
  - Control over raw materials
  - Control over sources of capital
  - Control over markets
  - Competitive advantage in the production of highly valued goods: control over high technology
Liberal explanations: Free Trade leads to Peace and American Prosperity

- "peace is only possible if countries work together and prosper together. That is why the economic aspects are no less important than the political aspects of the peace."
How EMBEDDED Liberalism ended.....
In the USA...Deficit spending: War on Poverty

• The United States and Deficit Spending 1950-1973
• In the Keynes model, deficit spending is a key tool available to governments struggling out of a recession -- but the flip side is that in the long run, deficit spending is inflationary.

• national poverty rate of around nineteen percent. The War on Poverty speech led the United States Congress to pass the Economic Opportunity Act, a law that established the Office of Economic Opportunity (OEO) to administer the local application of federal funds targeted against poverty.

• As a part of the Great Society, Johnson's view of a federally directed application of resources to expand the government's role in social welfare programs from education to healthcare was a continuation of Franklin Delano Roosevelt's New Deal and Four Freedoms speech from the 1930s and 1940s.

• In an address also known as the Four Freedoms speech, FDR proposed four points as fundamental freedoms humans "everywhere in the world" ought to enjoy:
  • Freedom of speech and expression
  • Freedom of religion
  • Freedom from want
  • Freedom from fear
• His inclusion of the latter two freedoms went beyond the traditional American Constitutional values protected by the First Amendment, and endorsed a right to economic security and an internationalist view of foreign policy that have come to be central tenets of modern American liberalism. They also anticipated what would become known decades later as the "human security" paradigm in social science and economic development.
The United States entered the war to prevent a communist takeover of South Vietnam as part of their wider strategy of containment. Military advisors arrived beginning in 1950. Then came the massive escalation of the Vietnam war in the 1960s.

How was the war in Vietnam to be financed when there was a war on poverty at home?
Too many dollars

To finance the war, President Johnson printed more dollars rather than take money out of the economy in taxes or cut his domestic programs. American dollars flooded world financial markets. What happens when you print dollars? A decline in the value of the dollar. Because other countries were holding dollars in reserve, the U.S. was, in effect, exporting inflation.
Exporting Inflation

Because other countries were holding dollars in reserve, the U.S. was, in effect, exporting inflation.

By mid-1971, the dollar had become seriously out of line with other major currencies, and the differential rates of inflation between the U.S. and other market economies had produced a fundamental disequilibrium in exchange rates.

We don't really need to print money any more, to make more of it. The money supply is measured typically by four figures, known as M0, M1, M2, and M3. M0 is the total of all printed money. The others refer to certain amounts of money such as bank loans that are available to the economy but not as liquid.

The management of these various money supplies is the foundation of Keynesian economics, which is in conflict with other approaches circulating today and arguably in decline. In the Keynes model, deficit spending is a key tool available to governments struggling out of a recession -- but the flip side is that in the long run, deficit spending is inflationary.
Declining Confidence in the Dollar

US = ↑imports +↓exports → trade deficit → need to pay up → deplete reserves → ↓ confidence in currency value ↓ currency value → unstable trade (bad for trading system)
Abandoning the Dollar for Gold

The American govt. was under pressure to convert these billions of dollars into gold. In 1970 official claims on the dollar rose to $20 billion, while U.S. gold and other reserves amounted to only about $14 billion. There was a real threat of a run on the U.S. central bank, the federal reserve. There was not enough gold in Fort Knox to pay everyone off.

The Bretton Woods Gold Exchange began to break down, as Europe got on its feet economically and began to become a strong exporter by the mid-1960's. This growing economic strength in Western Europe coincided with soaring U.S. public deficits as Johnson escalated the tragic war in Vietnam.

All during the 1960's, France's De Gaulle began to take its dollar export earnings and demand gold from the U.S. Federal Reserve, legal under Bretton Woods at that time. By November 1967 the drain of gold from U.S. and Bank of England vaults had become critical.

Central banks increased their call for U.S. gold in exchange for their dollar reserves. They calculated with the soaring war deficits from Vietnam, it was only a matter of months before the United States itself would be forced to devalue against gold, so better to get their gold out at a high price.

By May 1971 the drain of U.S. Federal Reserve gold had become alarming, and even the Bank of England joined the French in demanding U.S. gold for their dollars.
That was the point where rather than risk a collapse of the gold reserves of the United States, the Nixon Administration opted to abandon gold entirely, going to a system of floating currencies in August 1971. The break with gold opened the door to an entirely new phase of the American Century. In this new phase, control over monetary policy was, in effect, privatized, with large international banks such as Citibank, Chase Manhattan or Barclays Bank assuming the role that central banks had in a gold system, but entirely without gold. Market forces now could determine the dollar. And they did with a vengeance.

So Nixon, who was president at that time, decided to 'close the gold window,' that is not convert any dollars into gold. August 15, 1971.
Dollar devaluation
The U.S. begins to borrow and plunges into debt

- Expenditures exceeded revenues
- U.S. borrowed from other countries (sold bonds to other countries)
- Why did others want to buy US debt?
  - Long term interest rates
  - US providing military security
  - Holders afraid to diversify because value would drop
- Capital inflow for the US but.....
- Long-term debt + overvalued $
The End of American Embedded Liberal Hegemony

So even though it won the Cold War, a lot of people wondered about both the capacity and willingness of the US to continue to act as a hegemon to maintain the various rules and institutions that supported free trade and international economic liberalism. If the US were either unwilling or incapable of providing global leadership, they asked, would the world economy fragment along national lines as it did in the 1930s—or perhaps in other ways?

Econ. Nationalist interpretation:
So the U.S. hegemonsmashed the Bretton Woods system in order to increase its own freedom of economic and political action. The growing power of Western Europe and Japan was threatening to place restraints on American state autonomy, because the vast holdings of dollars by Europeans and Japanese meant that if the dollar were to hold its value and the dollar-exchange system were to be preserved, American policy would have to conform to their wishes. Rather than see its autonomy curbed, the U.S. chose to abandon the system.

So, people faced a basic question: in an age that combined globalization and uncertainty about US global leadership, how do you organize the international political economy?
The Rise of Neoliberalism: A new “golden straightjacket”

Thomas Friedman: The Golden Straightjacket
http://www.socstudcphs.org/values.goldenstraightjacket.pdf
Review: The rise of a “casino” economy

- End of hegemony removes international “safety net”
- Need to compete in the global economy for economic growth and to remove BoP deficits
- Requirement for competitiveness: End of the welfare state
- International institutions that promote and protect a neo-liberal international economy
End of welfare state: The Triumph of classical liberal orthodoxy in the U.S.

• “the wisdom, ingenuity and resources of American business must be marshaled against those who would destroy it”

• What is Neo-liberalism?
  
  http://ser.oxfordjournals.org/cgi/content/full/mwn016
Decline of the Welfare state?

Table: Changes in the Breakdown of the Social Security-related Expenditure and in the Percentage the Expenditure Occupies in the General Account

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<tr>
<td>Expenditure for measures against unemployment</td>
<td>28.6</td>
<td>23.0</td>
<td>12.9</td>
<td>7.9</td>
<td>4.4</td>
<td>4.8</td>
<td>3.9</td>
<td>3.8</td>
<td>2.1</td>
<td>2.1</td>
</tr>
<tr>
<td>Expenditure for public health services</td>
<td>12.9</td>
<td>9.6</td>
<td>7.7</td>
<td>12.4</td>
<td>7.9</td>
<td>4.8</td>
<td>4.9</td>
<td>4.8</td>
<td>4.8</td>
<td>4.8</td>
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<tr>
<td>Expenditure for social insurance</td>
<td>31.2</td>
<td>35.7</td>
<td>45.6</td>
<td>61.3</td>
<td>55.6</td>
<td>62.2</td>
<td>55.1</td>
<td>51.5</td>
<td>46.3</td>
<td>45.0</td>
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<tr>
<td>Expenditure for social welfare</td>
<td>12.0</td>
<td>8.0</td>
<td>3.3</td>
<td>3.5</td>
<td>16.7</td>
<td>16.7</td>
<td>20.9</td>
<td>23.7</td>
<td>26.9</td>
<td>25.5</td>
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<tr>
<td>Expenditure for public assistance</td>
<td>34.4</td>
<td>28.7</td>
<td>20.6</td>
<td>10.1</td>
<td>12.6</td>
<td>17.6</td>
<td>11.3</td>
<td>8.6</td>
<td>7.8</td>
<td>7.2</td>
</tr>
<tr>
<td>Percentage in the General Account</td>
<td>10.2</td>
<td>11.5</td>
<td>14.1</td>
<td>14.5</td>
<td>15.4</td>
<td>18.0</td>
<td>10.2</td>
<td>17.6</td>
<td>15.6</td>
<td>15.7</td>
</tr>
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Source: "Economic Statistics" Ministry of Finance
Why a decline in the Welfare state?

• ↑imports +↓exports → trade deficit → need to pay up → *reduce government spending (health care, education, pensions, unemployment etc.) → ↑confidence in currency value ↑currency value → stable trade (good for trading system)

• *↑ govt. spending → ↑ demand for goods and services → ↑ price of goods and services → ↓reduction in purchasing power of currency = ↑inflation → ↓ confidence in currency value ↓ currency value → unstable currencies → unstable trade (bad for trading system)
Transformation of International Institutions
New Role for the IMF: spread liberalism to developing countries

- Balance of payments lending in exchange for liberal reforms: structural adjustment
- Washington Consensus: stabilize, privatize, liberalize: put on the “golden straightjacket”
- No chance for the welfare state
- Contributes to freedom of finance capital to roam the earth
- Contributes to freedom of multinational corporations to roam the earth
New Role for the World Bank: focus on fostering neo-liberal policies as condition of lending

- Moved from the task of financing reconstruction projects for Europe after WWII
- To the task of financing development projects in poor countries
- Imposed the same conditions on lending as the IMF
GATT becomes the WTO

• WTO is a binding treaty
• Becomes the LAW in its member states
• An arena for negotiating the conditions for trade liberalization
• Overseas implementation of multilateral free trade agreements and punishment for non-compliance
• **Goodbye embedded liberalism**: members not permitted to protect their populations
  
  – Goodbye child labor protections
  – Goodbye environmental protections
  – Goodbye health and safety protections
  – Hello Private actors: banks, multinational corporations

• **Hello Private Actors**: banks, multinational corporations
This institutional framework permits
The rise of Multinational corporations

• Given these new “global guardians” of the market, private actors have new powers
• Corporations sit on advisory boards of WTO, IMF, and World Bank
• Global FDI grew from $50 billion to $2.5 trillion in 30 years
...and the growth of unregulated global finance

- *International movements of money – both volume and speed*
- cross-border bank lending has grown about 10% annually.
- daily foreign exchange trades now exceed by a wide margin the combined reserves of all central banks.
The result: Increasing privatization

• Some say international institutions governing the global economy have been weakened
• Only those who prefer embedded liberalism say that
• The institutions have simply changed (and strengthened) to govern an international neo-liberal economy
• Privatization is the goal of neo-liberalism
From Embedded to neo-liberalism: The rise of a “casino” economy
So..... If the U.S. pursued economic nationalism after hegemony, how did we get a neo-liberal global economy?

• U.S. hegemony supported embedded liberalism
• Without a hegemon and with IFIs and WTO transformed to protect neo-liberalism, Private forces are unleashed and unregulated
• Many governments were then free to pursue economic nationalism
• Why didn’t the world devolve into the fragmentation of the 1930s?
Because of the U.S. market and the $

• First of all, freedom, not stability, is the goal
• The U.S. market still stimulates exports abroad because
  – Americans consume wildly
  – Demand met by imports
• The U.S. is also a magnet for foreign capital
  – Strong dollar
  – Low inflation rate
• But Financial crisis suggests instability
Maybe fragmentation will yet occur. Without embedded liberalism, economic nationalism can rear its head: indicators are PTAs and Subsidies

• What are PTAs?
  – Two or more parties with preferential access
  – Violates MFN obligation
  – End of 2004: 300 PTAs
  – 50% of global trade

• Rich countries give mammoth agricultural subsidies
INTERPRETATIONS
The WTO: A Distributive Justice Critique: neoliberalism creates growing inequality

• The rich get richer, the poor get poorer
• A “race to the bottom”
• “non-commercial values” cannot play a part in trade rules
• Property rights preferred to health and human lives: “right to profit” over “right to life”
And Institutions of economic neoliberalism undermine democracy

- Are these organizations a new source of global dominance, surveillance, and manipulation of the nation-state?
- Conditions of IMF and world bank loans not subject to domestic debate in borrowing countries
- WTO rules supersede domestic laws
The Economic Nationalist Critique

• Organizations undermine state sovereignty and make private actors more powerful than states
A Liberal rebuttal: Global Growth without a hegemon and with neo-liberalism

Gross World Product, 1950-2005

Source: IMF, Worldwatch