IN DEFENSE OF NEOLIBERALISM

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ABSTRACT: For many the financial crisis illuminated neoliberal's fatal flaw – growth was built upon rising private debt. In this view, barring radical restructuring, Anglo-American economies will either stagnate or risk a new debt crisis. This paper contests this position and offers a defense of the neoliberal growth model. Long term, the macroeconomic record of neoliberal economies was quite positive, albeit with rapid periods of growth punctuated by financially-induced downturns – a two steps forward, one step back pattern. Nor is the evidence that neoliberal was just "debt-driven growth" particularly compelling, its persistence driven by a pervasive confirmation bias in analyzing the relevant data. Finally, it is overly simplistic to portray the crash as the inevitable product of neoliberal development. Neoliberalism is not an exhausted growth model, but one in need of reform. The key problems are: (1) deregulated financial markets tending to produce excessive credit; (2) widening income inequality; and (3) sluggish growth post-crash. A combination of macroprudential financial regulation, policies for improving "human capital", and continued supply-side inducements for investment and entrepreneurship can correct these failing. Reform rather than restructuring is the best and cheapest path to reviving the growth trajectories of Anglo-American economies.

INTRODUCTION – AND SOME STIPULATIONS

For many political economist, the global financial crisis (GFC) was the foreseeable outcome of a failed neoliberal growth model. For these critics, the economic expansion of neoliberal economies, mainly the United States and Great Britain, resulted not from structural reforms that improved productivity and growth. Rather, domestic consumption relied on rising private debt (Crouch, 2011; Hay, 2013; Gamble, 2014). When the debt bubble burst, consumption and output collapsed, and the Great Recession ensued. Despite the devastation of the crash, politics since then has largely reinforced rather than overturned the status quo, although the political tectonic plates may be about to shift dramatically. As critics see these faults as structural rather than cyclical, the net result will be either stagnation under continued austerity or a new bubble economy (Blyth, 2013; Hay and Payne, 2015). Therefore, neoliberalism must go. With the ascension of Labour's Jeremy Corbyn, we now have the leader of a major political party dedicated to that proposition.

This paper contests this portrayal and constructs a defense of neoliberalism based on three key points. First, for adherents of neoliberalism, the main selling point is superior economic performance. Critics counter that liberal market economies did not, in fact, perform any better than more organized market economies, to use the Hall and Soskice, 2001, nomenclature. An impartial assessment shows that the core neoliberal economies performed quite favorably compared to others since the early 1980s. At the same time, neoliberal economies have been more volatile, with periods of robust growth punctuated by sharp downturns eroding (but not eliminating) the gains made during expansions – a two steps forward, one step back pattern of development. Even taking this into account, the net performance of neoliberal economies has been quite positive. Critics further contend that neoliberal growth was fundamentally a mirage, with rising private debt rather improved productivity fueling rising output. Closer analysis indicates the evidence for debt-driven growth is not as compelling as its adherents claim. The ballooning of credit and debt were more of an infection that flared in the years immediately prior to the GFC rather than a cancer that grew in

malignancy over decades. Finally, the crash is frequently explained as market failure facilitated by excessive financial deregulation. That is certainly part of the story, but a complete narrative of the causes of the crash suggest that it is only part of the story, undermining the assertion that neoliberalism "caused" the global financial crisis. Taking this into account, neoliberalism is not an exhausted growth model, but one in need of reform, mainly in three areas: (1) the tendency of deregulated financial markets to produce excessive credit; (2) concerns regarding widening income inequality; and (3) managing the imperatives of post-crash deleveraging and reviving growth. This paper explores policies to ameliorate these problems, specifically macroprudential financial regulation, policies focused on improving "human capital", and continued supply-side inducements for investment and entrepreneurship. Reform rather than radical restructuring is the best way to revive the growth trajectory of Anglo-American economies.

To defend neoliberalism post-crash risks being relegated in with the flat earthers and climate change deniers. As such, a few stipulations are in order. The argument here is not that the global financial crisis was "just another downturn". This was a very different beast from previous recessions and we not likely to return to stable, long-term recovery simply by returning to the status quo ante. Quite the contrary. The argument here is for a *reformed* neoliberalism. Secondly, financial deregulation was not sufficient to explain the crash, but it was a necessary factor. To be sure, this crisis started in the American subprime mortgage market, a market heavily influenced by government intervention and regulation (Thompson, 2012; Calomiris and Haber, Chapter 8, 2014). Yet deregulation facilitated and encouraged the proliferation of mortgage-backed securities (MBS), the device through which a localized housing crash transformed into a global financial crisis. Third, Mark Blyth (2013) and others are correct: our problems began as a crisis of excessive debt within the private (financial) sector. It was only after the meltdown induced a Great Recession that it became a public sector debt problem (Thompson, 2013). Fiscal profligacy is not the root of our sorrows, although that does not mean it is not a burden to be managed. That said, the focus of this paper is not on the pros or cons of austerity policies – a short- to medium-term issue. The focus here is on the longer term, to understand the dynamics of the existing economy and how it can be reconfigured to

enhance prosperity over the long-term. What follows will hopefully contribute to our current debates and not be seen as merely as an apologia for status quo.

A CLEAR-EYED VIEW OF NEOLIBERALISM

The core question post-financial crisis is whether substantial economic reorganization is needed. Answering this requires clear, dispassionate analysis of the past performance and future potential of the existing neoliberal regime. Unfortunately, dispassionate analysis is in short supply. Neoliberalism is the go-to *bête noire* across the social sciences, used to explain just about any and all social ills.[1] Within this literature is an enormous amount of sloppy analysis, some of it pardonable ("neoliberalism" is an expansive and imprecise concept, after all), but much of it willful or inexcusably careless. For example, large, unregulated and, in this conception, unstable financial markets are considered integral to neoliberal growth. That the banking systems of Canada and Australia, both in the neoliberal camp, remained quite conservative and resilient during the financial crisis is ignored (Calomiris and Haber, Chapter 9, 2013). Rising household debt in the Anglo-American economies is, we are told, a necessary component of this growth model. That other countries, including Norway, the Netherlands, and Denmark, had higher household debt to disposable income ratios in 2007 than either the US or UK does not seem to dislodge this connection (Glick and Lansing, 2010).[2] The most egregious example is the persistent invocation of the repeal of the Glass-Steagall Act, ending the separation between commercial and investment banking, as a cause of the crisis. Commercial

[1] Colin Crouch (2015, p. 62) even pins "the health risks of many processed food products" on neoliberalism. The Institute for Economic Affairs (IEA), a key think-tank of the Thatcherite revolution, was founded by Antony Fisher, who made his fortune in bringing the factory farming of chickens to Britain. In a way, processed foods led to neoliberalism, not the other way around.

[2] One way around this for critics is to blur the idea of distinct neoliberal economies. A largely undiscussed fissure seems to be developing within comparative political economy between those who cling to some version "varieties of capitalism" as popularized by Hall and Soskice (2001) and those who see neoliberalism as more hegemonic, impacting all economies, and thus manifesting as generalized trait of 21st century advanced capitalism. In this vein Scandinavian household debt just as much a mark against the model as the same evidence from the UK. The contributors to Schmidt and Thatcher's (2013) anthology on the "resilience of liberalism in Europe" wander back and forth on this point, for example. The underlying assumption in this article is that the organization and operation of capitalist economies can still be meaningfully differentiated.

banks, such as Citibank and Bank of America, it is implied, gambled away depositors' money on subprime mortgage-backed securities. "Repeal of Glass-Steagall gave high risk traders access to the savings of millions of people..." (Crouch, 2011, p. 99). Except that there is no evidence of this happening.[3] (The real story is much worse; banks gambled with borrowed money.) The institutions that failed – Bear Stearns, Morgan Stanley, Lehman Brothers, Merrill Lynch, AIG, Fannie Mae and Freddie Mac – were not covered by Glass-Steagall restrictions. Those commercial banks that ran into trouble (Wachovia, Washington Mutual, and Bank of America)[4] did so because of their dealings in mortgage markets, which were allowed pre-repeal. JP Morgan and Wells Fargo, both deposit-bearing institutions involved in investment, weathered the crisis fairly well (Pearlstein, 2012). Other than as an example of deregulation, Glass-Steagall had no practical impact on the events producing the crisis. That has not stopped analysts and politicians from insisting that it did and acting accordingly, such as the "ring-fencing" of retail from investment banking in the UK's Financial Services (Banking Reform) Act of 2013. Fixing a non-problem does nothing to prevent future crises and may, in fact, make matters worse by creating the illusion of safety.[5]

Before we condemn neoliberalism, we need a clear-eyed assessment of the past. There are three areas of concern in how this model has been assessed: (1) the comparative economic performance of neoliberal economies; (2) the empirical validity of the "debt-driven growth" hypothesis; and (3) the role of liberalized financial markets in inducing the crash. What we shall see for each is that the case against neoliberalism is not nearly as straightforward as it is frequently portrayed.

A representative example of the argument that neoliberalism failed to improve macroeconomic performance is provided by Ken Coutts and Graham Gudgin (2015). They contend that British GDP has, in fact, slowed rather than increased since 1979. UK relative

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[3] Former President Bill Clinton in August 2015 stated, "Look at all the grief I got for signing the bill that ended Glass-Steagall. There's not a single, solitary example that it had anything to do with the financial crash." *The Hill* (Online Edition) 11 August 2015. Accessed 18 February 2016.

[4] Bank of America's troubles actually came from its purchase of the mortgage lender Countrywide Financial.

[5] Lehman Brothers's collapse triggered a crisis because if exponentially increased fears of counterparty risk, leading credit markets to freeze. Governments intervened to counter than, not so much to prevent depositors losses. Ring-fencing may reduce future bailout costs somewhat, but the "too big to fail" problem – if anything, even worse now than in 2008 – remains.

productivity has improved against European economies, but more because of a dramatic slowdown in their productivity growth rather than through improvements in British performance. To the extent that there was higher growth in the UK compared to other economies since 1979, it was solely the result of a build-up of household debt. Neoliberalism simply did not deliver the goods

A fairly simple and straightforward comparison of macroeconomic data belies this assessment. Table 1 compares the two dominant neoliberal economies, the US and UK, against the two major continental economies, France and Germany, on measures of output, productivity, unemployment and inflation. On output and productivity, the pattern is clear and consistent: France and Germany were the leaders in the postwar era; positions reversed in the neoliberal era. That British growth slowed post-1979 is irrelevant; this was true for every major economy following the end of the postwar boom. That the productivity record is more one of European failure than British success is also rather immaterial. The essence of political economic comparison is relative performance. We talk of "British economic decline" in the postwar period, when the growth rate was higher than today, because it was relatively worse than other countries. On unemployment (Table 1), neoliberal economies were worse off in the 1980s, then switched places with the continental economies in the 1990s and 2000s. Inflation was also worse earlier on, then more evenly spread in more recent decades, with all of these economies enjoying the benign environment of the "Great Moderation".

All of this translated into average incomes rising relatively in the Anglo-American economies relative to continental Europe (Figure 1). The British postwar experience was one of relative economic decline, as seen in Figure 2. The precipitous fall in per capita GDP relative to France is halted post-liberalization, though it was not a smooth process. Much of the income gains of the 1980s were wiped out in the recession of the 1990s, a pattern repeated in the GFC. Table 2 illustrates the volatility of growth in the neoliberal economies, experiencing both larger booms and deeper recessions -- very much been a two steps forward, one step back progression. The net result has been quite positive, though. Pre-liberalization, the UK and US generally performed worse compared to France and Germany; post-liberalization, better.

Of course, national averages can mask individual experience. Even if growing, the benefits, it is said, were concentrated at the top (Hay and Payne, 2015, p. 11). Conventional wisdom states that average incomes have stagnated since the seventies, a claim often grounded on the evidence of one particular study, Thomas Piketty and Emmanuel Saez's 2003 article on US income inequality. Neoliberal policies are to blame. Schmidt and Woll (2013, p. 115), for example, state, "Rising inequalities – in which the rich have only gotten richer while the working classes have seen little or no wage growth – can be directly traced to neo-liberal policy ideas focused on limiting state regulation, lowering taxes, and cutting welfare spending." The financial crisis itself clearly knocked a hole in most peoples' finances. US median household income was $4752 less in 2012 than 2007, a decline of 8.3%. However, as Figure 3 shows, "30 years of wage stagnation" misrepresents the record. US median household income stagnated in the 1970s, rose substantially in the 1980s and 1990s, and flatlined in the 2000s before plummeting after the GFC. A Pew Research Center study (2015) of the American middle class found that the percentage of the adult population in this income group has declined steadily since 1971[6] and a greater of aggregate income now goes to those in the upper brackets.[7] Nevertheless, their median household income, adjusted for family size, has increased 34% over the same period, with the largest gains coming in the 1980s and 1990s. This matches with the fact that US real personal consumption more than doubled since 1980.[8] How can this be if incomes did not rise at all for most people?

Opponents have an answer: it was all bought on credit. From this perspective the story of the last three decades was stagnant real wages and trimmed welfare states. Macroeconomic stagnation was only avoided because of rising private debt. The engine of growth within what Colin Hay calls the "Anglo-liberal model" of capitalism was "…the systemic build-up of debt

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[6] Pew defined "middle income as those with 67-200% of the median household income. In 1971, 61% of the adult population was middle income category, with 25% lower and 14% upper. In 2015, 50% of adults were middle, with 29% lower class and 21% upper income. While the trend is centrifugal, note that the larger percentage movement has been upward.

[7] In 1971, 63% of income went to those in the middle income bracket and 29% to those at the top. In 2015 those numbers were 43% and 49%, respectively.

[8] The Bureau of Economic Analysis' index of personal consumption expenditure (2009 = 100) was 40.53 in 1980; 108.66 in 2013. See NIPA Table 2.3.3. Real Personal Consumption Expenditures by Major Type of Product, Quantity Indexes at www.bea.gov. See also Alan Reynolds, "The Mumbo-Jumbo of 'Middle-Class Economics'" *Wall Street Journal* (Online Edition) 2 March 2015.

incurred principally to fuel consumption." (Hay, 2013, p. 2), facilitated by newly liberalized credit markets. The locus of demand management shifted from the public sector to private debt, rendering it a form of "privatized Keynesianism" (Crouch, 2009 and 2011). The fallacy of neoliberal growth was finally exposed as the credit bubble which sustained it exploded in 2008. With some variations on the theme, the debt-driven growth hypothesis has become the core rationale for the rejection of neoliberalism. Since inflating private debt is the only mechanism by which neoliberalism can revive growth, the future hold either continued stagnation or a new crash. Either way, "…the Anglo-liberal growth model is irretrievably and irreversibly compromised" (Hay, 2010, pp. 25-26.).

Is this hypothesis empirical valid? Sharply rising private debt in the years immediately before the crash is evidence enough for many. US household debt increased from 89% of disposable income to 125% from 2000 to 2007. UK debt skyrocketed from 106% to 150% in the same period (McKinsey, 2015). Yet the evidence of rising debt lends itself to two contrasting interpretations: (1) this was the inevitable culmination of systemic pathologies; or (2) it was an asset bubble/credit boom. How empirically do you distinguish a credit bubble from a systemic pathology? To use a medical analogy, how do you distinguish a flaring infection from a cancer? What are the empirical markers of such afflictions? I have explored the empirical validity of the debt-driven growth hypothesis in greater detail elsewhere (Casey, 2015); let me reiterate some of those arguments here. If that hypothesis is correct, we should see private debt rising with output as households divert a greater share of income to debt service (since wages are supposedly stagnant). Indeed, private debt/debt service should be a *leading* indicator to consumption and growth. To build up debt, one must first have access to credit, which for most people is secured against their largest asset – their house. House prices and the home equity therein thus hold a privileged proposition in the logic of this argument (Hay, 2009). We should see a close association between rising private debt, particularly in the form of mortgage equity withdraw, and economic output. Since this is supposed to be a systemic pathology rather than a short-term infection, seeing this in the years immediately preceding the crash is insufficient; there should be evidence across the entire neoliberal era. Figure 4 plots UK housing equity withdraw data against changes in GDP. Equity withdraw did indeed peak prior to the GFC, yet it

was down during the growth years of the 1990s. Figure 5 paints a similar picture for the US. Here the disjunction is even greater as mortgage equity withdraw only tracks with GDP immediately before the crash. In both countries, equity withdraw plummeted in the years since, evidence of deleveraging, despite a return to modest growth. This evidence is more consistent with an interpretation of the GFC as a bubble rather than a systemic pathology. The recovery has been too shallow to indicate in either direction the connection between private debt and growth. There are also some worrying indications of consumer debt again rising in the UK (Office for Budgetary Responsibility, 2015). However, the debt-driven growth hypothesis is correct, rising debt should be a leading, not lagging, indicator. This is not in evidence.

Such evidence is hardly sufficient to refute the debt-driven growth hypothesis (see more extensive discussion in Casey, 2015). It possesses a *prima facie* appeal and the logic[9] and evidence used to support it are plausible. As such, it truly can be said to be the heart of the critique against neoliberalism. The evidence, however, is insufficiently compelling to warrant its widespread acceptance as *the key dynamic* in the model. Across the literature there is an unfortunate confirmation bias, a tendency to downplay exculpatory evidence while trumpeting damning evidence. Key issues are thus under analyzed. The question returns – how to distinguish a credit bubble (requiring correction, but not radical political-economic alteration) from a systemic pathology (which can *only* be corrected by radical change)? Credit bubbles have a long, illustrious, and devastating history (Jorda, Schularick, and Taylor, 2011). They occur in economies at different levels of development (Dell'Ariccia, 2012), different political economy model (Drehmann, Borio, and Tsatsaronis, 20012, see especially Graph 2 on p. 16), and under different monetary regimes (Aikman, Haldane, and Nelson, 2010, see Chart 19 on p. 28). They are neither unique to the neoliberal era or to free market-oriented economies. The GFC was a particularly bad credit cycle, but it is not at all proven that it was a crisis resulting from debt-driven growth pathologies inherent in the neoliberal model.

[9] It assumes that consumers consistently choose to increase debt rather than decrease consumption in light of stagnant wages. Yet no sociological or psychological argument as to why marginal propensities to consume would be so consistently unaffected by declining real wages is offered. The (implicit) explanation is that financial deregulation made credit cheap, encouraging people to borrow. That the demand for credit would rise in this scenario if undeniable. That is must inevitably rise to unsustainable levels is not.

Critics hold a trump card: the crash itself. The unassailable fact is that a massive economic meltdown followed three decades of neoliberal dominance. The question is why? The dominant narrative is one of market failure. Going back to the Big Bang of the City, Anglo-American financial markets were steadily deregulated or, to use Gordon Brown's preferred phrase, managed with a "light touch". "Efficient market" principles assumed that financial markets released from political fetters would function better, punishing (through economic loss) those pursuing risky practices. Self-regulation obviated the need for government control (Wolf, p. 125). Financial markets were not so much deregulated as under-supervised (Wolf, 2014, p. 141; Calomoris and Haber, 2014, p. 265). In the midst of the "Great Moderation" of long-term low inflation and stable growth it seemed that the major macroeconomic challenges had been solved. Central bankers calmed the stormy economic seas and, having done so, were not attuned to probing for dangers beneath.

In this permissive environment, financed thrived. UK bank balances were around 200% of GDP in the late 1980s; in 2007 they were 500%. Competition drove product innovation, particularly in derivatives such as residential mortgage backed securities (MBSs), whose value rested on the booming US housing market. With US house prices skyrocketing, banks extend mortgage lending to riskier clients through subprime mortgages, often roping them in to adjustable rate commitments that only worked as long as house prices continued their vertiginous ascent. Banks did not care as they pursued an "originate and distribute" models, quickly selling off subprime mortgages, which were then repackaged as MBS, each divided and subdivided into increasingly risky chunks ('tranches'), aided by credit ratings agencies that slapped AAA ratings on the superior tranches.[10] MBS were part of the alphabet soup of new financial instruments, combined and recombined in endless variation and sold far and wide. Exactly what was contained in each was often unclear. With the good times rolling, few asked hard questions. Banks, searching for greater yield and ballooning executive bonuses, pursued riskier and riskier strategies, ratcheting up leverage ratios and financing trading through short-term loans – betting and borrowing to bet again. All was well as long as the bets keep winning.

[10] Ratings agencies (Moody's, Standard and Poor, Fitch's) used probability models which suggested that there would never be a nationwide drop in the housing market. They were very wrong.

When the US housing market collapsed and Lehman Brothers went under, the realization that lots of players held very risky hands (and no one quite knew who they were) led interbank lending to freeze until, of course, the banks were bailed out by the government. In this telling, free markets led to excessive deregulation, increased financial risk, and created crisis. Finance needs to be firmly leashed if not neutered.

There is much truth in this narrative. Left at that, though, you have a dangerously incomplete story. Global imbalances, producing a "savings glut" (Wolf, p. 4), played a substantial role. The export-led growth of Japan and China encouraged heavy investment in US securities to keep their exchange rates down and exports flowing. Other countries in East Asia responded to the 1997 crisis by building up surpluses to cushion against sudden capital flows (Rajan, 2010, p. 13). These countries all became net savers, shipping their savings off to the (wealthier) United States, fueling the credit boom. Additionally, two US government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, played a direct role in generating the subprime mortgage crisis. By lowering their standards to purchase subprime loans, they effectively lowered the standards of the entire US mortgage industry (Calomiris and Haber, 2014, p. 240). Aggressive purchasing of subprime MBSs by the GSEs, an indirect way to expand the subprime market, encouraged their growth throughout the private financial sector (Thompson, p. 404). The GSEs were driven not by free market ideology, but because the Clinton and G.W. Bush Administrations wanted more home ownership in poor and minority communities.[11] Market and state were working hand in hand (Thompson, 2012, p. 415). Finally, at the heart of the crisis was the purported fraudulence[12] of MBSs and other instruments. The

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[11] Attempts were made to constrain the GSEs, mainly from Republicans. Yet Fannie and Freddie had powerful allies on Capitol Hill in both parties, including Newt Gingrich, and a powerful lobbying machine. Calomiris and Haber further argue that the expansion of subprime lending was driven by a unique coalition of urban activist groups, such as ACORN, and major banks, such as Bank of America and Citibank. Banks looking to merge with smaller banks and expand needed to establish their "good citizenship" credentials with regulators. An easy way to do so was to expand Community Reinvestment Act (CRS) loans into poorer communities. Activist groups, realizing this, worked with banks to make commitments to expand CRA loans. It was a symbiotic partnership that expanded subprime lending to a grand total of $3.3 trillion from 2000 to 2007. (Calomiris and Haber, 2012, pp. 216-222).

[12] "Systemic fraud", frequently invoked to explain the crash, implies bankers knowingly bought worthless securities to turn a quick profit. Most banks only invested in AAA-rated MBS rather than much more lucrative triple-B rated asset-backed securities. The more plausible explanation is they were willing to accept the safety that the triple-A rating entailed without asking any hard questions as long as the profits flowed (Friedman and Kraus, 2011, p. 42). Proliferating subprime mortgages, creating complex derivatives, ratcheting up leverage ratios, all of these were bad business decisions, but they were neither illegal nor fraudulent (Wolf, p. 122).

crash was not the result of banks selling worthless securities to others; it happened because they bought loads of them themselves.[13] Why would they do that? The answer lies in capital adequacy requirements; the so-called Basel rules (Calomoris and Haber, 2014, p. 262). Banks must maintain capital cushions, generally 8% of assets. Basel I established cross-national capital minima based on "risk weights' for different classes of assets. Safe assets (gold, government bonds) were weighted at zero; business loans at 100%. Securities issued by government-sponsored entities, like Fannie Mae, were weighted at 20%. Thus for every $100 invested, a business loan required $8 in capital while a GSE-issued MBS required $1.60. Banks were thus encouraged to invest in MBS, deemed "safe" under capital adequacy requirements, to increase their leverage to enhance profits (Wolf, 2014, p.132). Capital requirements encourage banks to pursue the particular strategy of investing heavily in mortgage-backed securities, without which you do not (likely) get a crash. This was regulatory arbitrage, manipulating the rules to their advantage, to be sure. Still, it was not the failure of deregulation. Rather it was the unintended consequences of regulation (See Friedman and Kraus, 2011 for a detailed elaboration of this argument).[14]

For many, the global financial crisis is a simple morality tale of the dangers of unregulated financial markets. Like all good stories, truth is enhanced by embellishment and omission. A more accurate rendition highlights mistakes made by many institutions, both state and market.

A clear-eyed examination show that neoliberal economies have generally outperformed their competitors, albeit with more volatile growth (a two steps forward, one step back pattern). Private debt rose in the years prior to the crash, yet the evidence that this was indicative of a pathological dynamic in the neoliberal growth model is not compelling. Finally, an objective analysis of the global financial crisis highlights many factors that do not conform to the "free markets run amok" narrative. Taken together, the case that the neoliberal growth

[13] Freidman and Kraus make the point that it is the demand for, not the supply of, MBS that is the dependent variable to be explained in the GFC.
[14] Kraus and Friedman also place blame on the oligopoly of ratings agencies, itself a function of government regulation, and the mark-to-market rules that exacerbated a freezing of credit once the crisis hit.

model "…is irretrievably and irreversibly compromised" (Hay, 2010, pp. 25-26.) is far from proven. With reform, it is reparable.

REFORMING NEOLIBERALISM

The crash highlighted both macroeconomic and microeconomic dilemmas for neoliberalism. The major macroeconomic problem is the volatility of output. Deregulated financial markets produce booming economies while also rapidly expanding credit. When credit expands too rapidly, a quick reversal is often required, damaging the real economy in turn. This creates a "two steps forward, one step back" pattern of growth under neoliberalism. The optimal mechanism for curbing this volatility is through a through a system of *macroprudential financial regulation*. Beyond this, there are microeconomic concerns about the distribution of the fruits of growth. The rewards of growth, it is argued, now accrue only to those at the top while the rest of us are left to stagnate. Whether a fully accurate characterization of our times is a point of dispute. Still, many find themselves locked out of employment commensurate with a middle-class lifestyle. The optimal solution is not redistribution, but providing workers the skills and training needed to earn a good wage. Policies of *human capital formation* is the main mechanism for combatting inequality. Finally, digging out from under the wreckage of the crash and reinvigorating the economy requires *balanced deleveraging*, reducing the overhang of private and public debt without strangling the nascent recovery. Assuming these three problems can be resolved, the culmination should be a "non-reform" – reviving the sort of *supply-side encouragements to investment and entrepreneurship* with which neoliberalism succeeded in the past.

The crash of 2008 was the collapse a rather large *financial cycle* (for elaboration, see Casey, 2015). Speculative manias and crashes are the hardy perennials of capitalism (Kindleberger, 1989), each arising because "this time is different" (Reinhardt and Rogoff, 2009). Hyman Minsky (1986/2008 and 1992) long ago perceived that the likelihood of financial bubbles increases the longer the upswing because stability reduces the collective sense of risk,

promoting instability.[15] Continued prosperity not only deteriorates risk assessment, it synchronizes it, validated by the ongoing boom (Aikman, Haldane, and Nelson, 2009, p. 3). Individually rational strategies, when repeated and amplified across the entire financial sector, create systemic instabilities. These concepts have been used to develop an analysis of *financial cycles* (see especially the work of Claudio Borio of the Bank for International Settlements and Andy Haldane at the Bank of England), which highlights the *procyclical* nature of credit growth. Financial cycles undulate similarly to business cycles, although the two are not directly connected and financial cycles are longer -- 10-20 years (Aiken, Haldane, and Nelson, 2010, p. 14; Drehmann, Borio, and Tsatsaronis, 2012, p. 19). Financial cycles have been in evidence long before the neoliberal era (Jorda, et al., 2011) and are not, per se, the result of financial liberalization (Schularick and Taylor, 2009, p. 6), although the amplitude, length, and economic disruption of financial cycles have all increased because of the easier flow of credit (Drehmann, Borio and Tsatsaronis, 2012, p. 2). Neoliberalism did not create financial cycles, it just exacerbated the problem.

Financial cycles are best indicated by credit to GDP ratios and asset prices indices, particularly houses (Borio, 2011, p. 18). Figure 6 shows a composite index of house price data and credit to GDP ratios for the US and UK, contrasted against GDP growth.[16] The UK data (Figure 6a) shows the financial cycle at work, with credit spikes in the late 1980s and 2000s. The American data is similar, albeit with a smaller credit spike in the 1980s. These indicate financial expansion decoupled from GDP growth and preceding economic downturns; the basic dynamics of a financial cycle. Must financial growth always end in economic disaster? No, if it is managed through *macroprudential financial regulation (MPR).*

Defying simple definition, macroprudential financial regulation fills the space between monetary policy and the (microprudential) regulation of individual banks. Fundamentally, MPR aims to monitor and control systemic risk in the financial system, specifically by restraining excessive credit growth – a sort of “Keynesianism for the financial cycle”. As Keynesians advocate government spending to boost demand during downturns, MPR advocates that

[15] Cassandras like Minsky, however, predicted the end to be nigh decades before the “Minsky Moment” actually occurred, demonstrating little understanding of the timing of such events.
[16] Each is indexed to 1995 -- the midpoint of the neoliberal era – for comparability.

regulators dampen financial cycles before they inflate sufficiently to produce a crisis. Regulators prior to the GFC were focused the stability of individual banks, unheedful of systemic dangers. Macroprudential regulation aims to monitor systemic risk. In the United States this responsibility now resides with the Financial Stability Oversight Council within the Treasury, an offspring of the Dodd-Frank reforms. In Britain it rests with the Financial Policy Committee within the Bank of England, and Europe has created the European Systemic Risk Board. When risks are identified, authorities can deploy countercyclical credit controls, including increased capital ratios, time varying liquidity buffers, or maximum leverage ratios. The Bank for International Settlements has tried to address the "too big to fail" problem by identifying "systemically important financial institutions" (SIFIs) subject to additional capital requirements, another concept embodied in the Dodd-Frank Act in the US. The specifics of reforms vary from country to country.

MPR is in its early days and there remain numerous important issues to work out, not the least of which is how controlling credit growth interacts with monetary policies (see Casey, 2015, pp. 15-16; Wolf, 2014, Chapter 7). What is important is that MPR directly addresses a key shortcoming of the neoliberal growth model. The model delivered prosperity for decades, only to see many, but not all, of those gains dashed in the Great Recession. Neoliberalism's predicament, as noted above, is not a lack of growth, but its volatility, a problem stemming from financial instabilities that eat away at the gains made. Policies to tamper financial excesses can counter this macroeconomic failing.[17]

Greater attention is being paid to microeconomic questions of income inequality. Thomas Piketty's *Capital in the Twenty-First Century* (2014) became a surprise best seller, contending that the return on capital outpaces economic growth (r>g) leading to an inexorable rise in inherited wealth over time.[18] Deciphering the unvarnished facts about income inequality

[17] Many advocates of MPR see it more as a mechanism for fundamentally transforming neoliberalism, what might be called a "hard MPR" position. See especially Andrew Baker and Wesley Widmaier, 2015. The argument here is that the deployment of a "soft MPR" approach could serve to modify (and thus preserve) rather than overturn the model. I obviously differ from Baker and Widmaier on the desirability of this.

[18] Although Piketty himself qualifies this, noting, "…I do not view r>g to be the only or even the primary tool for considering changes in income and wealth in the twentieth century, or for forecasting the path of inequality in the twenty-first century. Institutional changes and political shocks – which to a large extent can be viewed as

drags one into the quagmire of statistical warfare. The oft-repeated claim of long-term wage stagnation, drawn largely from Piketty and Saez (2003), is countered by Burkhauser, Larrimore, and Simon (2011), who say that once post-tax transfers and benefits are added to the calculations, Picketty and Saez's piddling 3% rise in average middle class American family income turns into a 37% increase from 1979-2007. A Pew Research Center (2015) study decrying the decline of the middle class also notes that average income of those same middle class households rose 41% from 1970-2007, dipping to 33% accounting for post-crash income loss.[19] Bradbury and Katz (2009) find declining income mobility in the US in recent decades; Chetty, *et. al.* (2014) argue that intergenerational social mobility in the US remained stable since 1971, even as income inequality has risen. Wages, some argue, have lagged because they are becoming decoupled from productivity increases (see, for example, Mishel, 2012). For others, this is a statistical error derived by using hourly wages rather than total compensation, which have indeed kept pace with productivity increases (Anderson, 2007; Feldstein, 2008). Jaoa Paulo Passoa and John Van Reenan (2103) similarly find no evidence of a decoupling of wages and productivity in the UK. And, of course, Piketty's book has been picked over by many, most publicly by Chris Giles, the economics editor of the *Financial Times*, who suggested that Piketty's manipulation of the data overinflated the share of wealth at the top.

Adjudicating these disputes is not necessary here. Take it as a given that inequality has risen. The important question is why? Attributing this trend entirely to neoliberal economic policies is tenuous. In recent studies of the issue, the OECD (2011 and 2014) cites multiple causes for rising inequality. First, globalization increases wage competition by integrating several hundred million new laborers from China, India, and elsewhere into the market. Second, recent market trends, including a more active financial sector, have increased the returns of capital over labor, the benefit of which largely accrues to those in upper income brackets; Professor Piketty has something going there. Finally, technological change has

endogenous to the inequality and development process – played a major role in the past and it will probably be the same in the future." (Piketty, 2015, p. 48).

[19] Pew defined middle class as households with two-thirds to 200% of median household income. In 1970, 61% of US households fell into this category. By 2015 the number had shrunk to 50%. Not all movement was downward, though. Of the 11% who migrated out of the middle class, 7% rose to the upper middle and upper classes (pew, 2015, p. 7).

exacerbated inequalities of income by increasing skill premiums. The wage differential between skilled and unskilled workers is widening. It is also vital to recognize *income inequality is increasing across the developed world, not just in neoliberal states* (OECD, 2015; see Figure 1.3). Absolute levels of inequality are higher in neoliberal economies (US, UK, Canada, Australia, and New Zealand) compared to most continental European states. In terms of the *shifts* over the last 30 years, however, there is little difference. Indeed, the sharpest rise in inequality since the mid-1980s was seen in social democratic Sweden (OECD, 2015). Similarly, the GINI coefficients *before* taxes and transfers – market inequality, levels of inequality produced by the economic system prior to welfare adjustments -- are far more clustered together. The more egalitarian European economies are not, as such, any fairer up front, they just do a better job of correcting the inequities after the fact.[20] All of this suggests that global socio-economic trends – specifically, globalization and technological change -- are the primary drivers of increasing inequality rather than welfare policy (Besson, 2014, p. 77-78).

Former British Foreign Minister David Miliband sees the strains of globalization at the heart of right- and left-wing political revolts of the present. "The right has no good answer to the problem that globalization erodes people's identities. The left has no good answer to the problem that it exacerbates inequality"[21] (Washington Post, Online Edition, 25 February 2016). How best to combat these problems? The worst approach would be to reverse globalization, as the experience of the 1930s demonstrated. Global inequality, moreover, has been declining from the rise of the BRICs and other developing nations. Reversing globalization now would protect western wages at the expense of workers in less-developed countries. Alternately progressives favor aggressive redistribution, jacking up taxes on the rich to confiscatory rates (80% is favored by Piketty) and using the windfall to increase welfare spending. In an era of austerity, it is certainly reasonable to consider raising taxes on the wealthiest. It is important,

[20] An open question is the macroeconomic impact of inequality. The OECD (particularly 2015) and IMF (Ostry, Berg, and Tsangarides, 2014) have recently switched gears, favoring lowering inequality to enhance growth. Without doubt, extreme levels of inequality stifle growth. What we cannot say with any empirical certainty is whether the Swedish or American levels of egalitarianism are macroeconomically optimal.

[21] Miliband is right overall, but perhaps the responsibilities need to be reversed. The right, all in favor of free trade and free markets, needs and effective policy for managing inequality and the left, desiring open borders and inclusive societies, needs to deal an answer to the identity question.

though, to recognize the practical limitations. There is one pattern is common to pretty much every dataset on changes in inequality of the last century, including Piketty's (See Figure 1.1, p. 24): the concentrations of income built up in the 19th century declined precipitously in the first half of the 20th century, before the major policies and institutions of the postwar welfare state were established.[22] Those datasets equally show a rise in inequality since 1980, a change manifest in welfare states vast and paltry.[23] Economic redistribution can blunt underlying trends more than erase them. For welfare systems facing long-term problems of entitlement deficits, demographic shifts, and rising state debt, that seems like more heavy lifting than they can likely bear.

The focus should be on enhancing earning potential. Technological change, specifically the information technology revolution, increases the economic premium between skilled and unskilled workers, and in a particular way. Societies, argues Brink Lindsey, are increasingly complex, offering a rising payoff to those who can manage this complexity (Lindsey, 2013, p. 4). Computerization has led to a "hollowing out" of the middle. Highly skilled workers can use I.T. to make themselves more valuable. For many low skilled, manual laborers, computerization has not had much of an impact. It is those in the middle, those who undertake relatively complex but codifiable tasks (bank tellers, for example), who are under threat (Lindsey, 2014, p. 59). It is not just a question technical skills. Many of the jobs invulnerable to technological annihilation are those requiring interpersonal skills and non-cognitive abilities frequently lacking in those from underprivileged backgrounds (Lindsey, 2014, p. 35). James Bessen (2015) argues that the lag between the introduction of new technologies and the widespread dispersal of wage benefits to workers is neither new nor surprising. Every major technological change requires a great deal of social learning – "learning by doing" -- in order to maximize its economic benefit. The power looms introduced in the early 1800s did not translate into large numbers of good paying mill jobs until the late 1800s and early 1900s. He identifies a "paradox of technical knowledge": "…technology creates aggregate wealth for the nation because new ideas can be replicated at low cost, but technology creates wealth for the *people* of a nation by requiring

[22] The Great Depression and World Wars having the largest impact on undermining concentrations of wealth.
[23] Not all moved in tandem, of course. The UK saw a sharp jump in income inequality in the 1980s, Britain's GINI coefficient rising from 0.26 in the mid-1970s to just under 0.35 in 1990, where it has stabilized since.

new technological knowledge that cannot easily be replicated" (Bessen, 2015, p. 82). Institutional, organizational and labor market barriers get in the way of countering this paradox. The neoliberal "voluntarist" job training system leaves skills acquisition to individual workers, who perhaps cannot afford it, or to companies, who may be unwilling to train workers that may then take their talents elsewhere (Bessen, 2014, p. 126). The result is a pervasive skills mismatch. Information technologies exacerbate this challenge as they are synchronous, impacting every industry at once (Bessen, 2015, p. 3). Market failure thus hinders our ability collectively to combat inequality and revive growth. There are two stark realities of our current labor markets: (1) workers with the proper skills have not been left behind; they are in employment and doing well;[24] but (2) even during the depth of the recession, many jobs went unfilled for lack of workers with the proper skills. Technology is not, as some would suggest, replacing jobs (Gordon, 2016; Cowen, 2011) it is displacing workers into new areas (Bessen, 2014, p. 105). Yet our educational and labor market institutions have not adjusted. "The main forces for convergence [in equality] are the diffusion of knowledge and the investment of training and skills" (Piketty, 2014, p. 21). The development of human capital -- providing people with the skills they need to get well-paying jobs -- should be the focus of our efforts to combat inequality.

This is a monumental challenge. Recommendations to address this issue range from enhanced early childhood education, removing barriers to entrepreneurship, increasing funding for community colleges, reducing licensure requirements, improving job mobility, and preventing abusive patent litigation, among many other reforms (see Lindsey, Chapter 7; Bessen, p. 204). Many of these areas are politically sensitive, infested with special interests, and unlikely to show economic payoffs for some time. Managing 21st century complexity seems to require a broad liberal education coupled with specific STEM skills -- a world of mechanical engineers who can recite Shakespeare. Yet it is not as complicated as all that. According to the 2015 ManpowerGroup Talent Shortage Survey (ManpowerGroup, 2015), the main jobs unfilled in the US and UK include not only financial specialists and engineers, but skilled trades, drivers,

[24] The Pew study of the status of the middle class confirm this. "The economic status of those with a bachelor's degree changed little from 1971 to 2015…Those without a bachelor's degree tumbled down the income tiers…" (Pew Research Center, 2015, p. 11).

sales representatives, technicians, teachers, administrative support staff and nurses. Nearly a third of US business report difficulties filling these jobs. Reform would require compromises on both the right (more spending on educational and training programs) and the left (contemplating serious reform of public schools). We are far better off ensuring that workers are provided the skills allowing them to take advantage of the opportunities of the 21st century economy rather than correcting imbalances after the fact. Jobs are the best social welfare program.

Upgrading skills would also reinforce the next step: reinvigorating output and growth. To date that has been particularly challenging, with a recovery far slower than in past recessions. For some this is indicative of the incapacity of neoliberal economies to recover (Hay and Payne, 2015); for others that we are entering a period of "secular stagnation", the end of a long wave of growth (Cowen, 2011; Gordon, 2016). What we are experiencing, in fact, is the winding down of a major credit-debt cycle – a debt "supercycle" in Ken Rogoff's words (2015). Historical analysis of previous financial crashes shows that it is normal for it to take anywhere from five to seven years before growth (might) return to its previous trajectory (Reinhart and Rogoff, 2009; Chen, et. al., 2015). Even worse than a standard asset bubble (i.e., the dot-com crash), this was a "leveraged bubble", one supported by a massive expansion of credit, which render the following recession considerably more painful (Jorda, Schularick, and Taylor, 2015). In light of the nature and depth of the crash, the long-slow recovery is to be expected.

Deleveraging, therefore, is crucial to the long-term prospects of recovery. Many prominent authors disagree. Colin Hay has argued repeatedly that this is a crisis of growth rather than a crisis of debt (Hay, 2013a and 2013b; Hay and Payne, 2015). Mark Blyth (2013) similarly – and correctly – argues that our problems began with the debts of the private financial sector and have since been repackaged for political purposes as profligate government spending producing a sovereign debt crisis. Hay is equally correct that higher growth will hasten recovery. Both err, however, by implying that massive increases in government spending, financed by borrowing, can resolve this without any potential negative impact. In reality, both the composition and the overall amount of debt with which an economy is burdened matter. During an economic downturn, particularly a severe one, it makes sense for government to pick

up the slack in the economy, even allowing its debt to rise so as to facilitate greater deleveraging within the private sector. Over the long-term, though, *the net amount of debt needs to be reduced;* shifting that debt from the private to the public sector does not resolve the problem. If massive government spending was a quick, easy and costless path out of a financial disaster, then Japan would be thriving. Persistent low interest rates render government borrowing a more palatable near term option, yet loans still must be repaid. Heavy borrowing now represents an intergenerational transfer of debt, dependent upon rolling over debt in bond markets 20-30 years hence, the required yields of which are unknown. A more balance approach focusing on long-term debt reduction *across the entire economy* is warranted.

To a great extent this has happened in the US and UK. Table 3 examines the composition and changes in debt since the crash. Both economies have undertaken moderate deleveraging in the corporate and household sector, more so for US households, balanced by fairly significant increases in government debt. Deleveraging has gone further in the US financial sector while Britain's remains heavily indebted, although the numbers in Table 3 understate the extent of deleveraging as debts continued to rise after 2007. Debt to GDP in the financial sector has fallen by the equivalent of 36% of GDP since 2011 (using data from McKinsey, 2012). Private sector deleveraging was accompanied by public sector releveraging. Public debt to GDP rose substantially in both countries, up by 50% in the UK. Both states also undertook massive quantitative easing (QE) programs, pumping money into the banking sector and assets onto their balance sheets. The Federal Reserve's balance sheet, now heavily packed with mortgage backed securities, has ballooned to nearly $4.5 trillion dollars (about 25% of GDP).

The open question is whether all this is enough to reduce debt sufficiently to ward off a future crash. Deleveraging after a financial crisis is a delicate balance. Cut consumption too quickly and growth suffers, undermining both recovery and deleveraging. "Deleveraging and slower nominal growth are in many cases interacting in a vicious loop, with the latter making the deleveraging process harder and the former exacerbating the economic slowdown" (Buttiglione, et. al., p. 2). Arguably this describes the Eurozone at the present, with northern European creditors imposing growth-crushing austerity on the southern periphery. On the

other hand, allowing debts to rise unabated risks engendering a new crisis. Policymakers must walk a tightrope, with high potential for slippage. In comparative terms, the US and UK have managed these trade-offs reasonably well (Buttiglione, et. al., 2015). Even so, we are not clear of danger. Net global debt continues to rise, particularly in China and other developing states (McKinsey Global Institute, 2015; Buttiglione, et. al., 2015). There are also worrying concerns of revived household debt in the UK (Office for Budgetary Responsibility, 2015). That the US and UK may be somewhat less exposed to debt than in 2007 may mean little in the face of another global meltdown. Unfortunately, we will not know until the time comes.

Dropping the excess weight of debt will not alone render our economies fit and vigorous. We need to revive growth. On this front, I am not a reformist. Assuming we can continue to successfully deleverage, the best path to reviving productivity and output would be to return to supply-side encouragements to investment and entrepreneurship. Again, neoliberalism's flaw is not underinvestment, low growth, and low productivity, it is the tendency of that real growth to be reduced by financial crises. The record of the era is also frequently caricatured – neoliberalism as a relentless monster of deregulation and spending cuts. Both the size of the state and the extent of regulation increased during the Blair Government (Casey and Howard, 2009). According to KPMG, the EU average corporate tax rate of 24.8% pre-crash has dropped to 22.2% in 2015 while the "tax-cutting" US rate remains at 40%. Government spending rose in both states prior to the crash, and rose a good deal more thereafter. There have been a whole host of new regulations put in place by the Obama Administration, including all of the various new rules of the Dodd-Frank Act and the Affordable Care Act. By most measures, the US and UK are far less neoliberal than they were in the late 1990s. Some of these reforms, particularly post-GFC, are undoubtedly necessary. Some may prove a drag on growth.[25] We should certainly consider these regulations in the context of a pro-growth agenda. Collectively, our reaction to the trauma of the crash has been somewhat kneejerk. The crash was caused by deregulation; the solution is to start regulating everything

[25] For example, the Affordable Care Acts requirement that businesses employing more than 50 workers provide healthcare coverage may serve to stifle job creation.

(Hay and Payne, 2015, pp. 17-22). “Regulation good/deregulation bad” is just as silly and misguided as its libertarian cousin opposing any and all regulations.

There are, of course some specific difficulties in the present. One problem, not unique to neoliberal system yet rising in political salience at present, is the issue of “crony capitalism” – when business profitability relies upon political connections. It is hardly a new concept, Charles Lindbloom (1977) having long ago elaborated how the political imperatives of economic growth and job creation grants business a privileged position in democracies. And many of the concepts used to illuminate these relationships – rent seeking, regulatory capture, and interest group politics – are well studied and established within the social science literature (Holcombe, 2013, pp.543). The nature of the crash, the massive bank bailouts that followed, and the fact that both government and financial sector have grown while the rest of the economy falters has created a rising tide of populism on both sides of the Atlantic and both ends of the political spectrum. There is increasing disillusionment with a system that seems rigged in favor of elites and insiders, be they the 1%, the Washington Establishment, or bureaucrats in Brussels.

In this more skeptical political milieu, market liberals must face a hard fact. Neoliberalism in principle is pro-market, dedicated to maintaining a competitive economic environment, yet too often neoliberalism in practice was much more pro-business: “The subtle and important distinction between policies that support a market economy and those that support the interests of large firm was not fully appreciated by policymakers on either right or left” (Kay, 2011). Here we find the sharp disjuncture between neoliberal theory and “real existing neoliberalism”. Fundamentally law and public policy must renew the commitment to developing truly competitive markets, not just advancing the interest of politically favored corporations. How to do so is a large topic, but suffice it to say that since cronyism is best incubated in the shadows, sunshine is the best cure. Tax simplification, slicing through the jungles of the corporate tax code where special benefits hide, would reduce the opportunities and potential gains of rent-seeking behavior. Decades of campaign finance limits in the US have done little to stanch the flood of money into politics. Perhaps a system more focused more on transparency (who is financing whom and how much) and less on restrictions would be more effective. Most importantly, it must be reiterated that the larger the size of government and

the more extensive the regulation of the economy, the greater the opportunities for rent seeking behavior. That does not per se mean that only small budgets can stop cronyism. Holcombe makes the point that Scandinavian countries, despite having large welfare states, are not especially prone to this (Holcombe, 2013, p. 552). What is important is to reduce the flexibility of tax structures and subsidies that flow into industry, which means abandoning many of the favored policies of both left (i.e., green energy subsidies) and right (i.e., oil subsidies). All told, transparency is the best mechanism for combatting cronyism and market liberals who wish to reform the system need to be more vigilant in doing so.

Creating favorable conditions for investment does not, of course, guarantee investment. Both major corporations and major banks are sitting on mountains of cash (MacMillan, Prakash and Shoult, 2014; Craig and Koepke, 2015) yet corporate investment is down from its post-crash peak. Instead, corporations frequently pump these surpluses into stock buy-backs, artificially boosting share value without enhancing productive investment (Lazonick, 2014). Some of this is driven by a poor global economic outlook and might work itself out; a few more year of stable, even if sluggish, growth might encourage investors to be more proactive. If not, then perhaps it is time to revisit issues of corporate organization and principles of shareholder value. Encouraging investment and entrepreneurialism has been one of the great strengths of the neoliberal model. Assuming that we can pursue the other reforms outlined above and work toward enhancing the "human capital" of our economies, than otherwise the basic neoliberal growth formula is correct: creating stable macroeconomic conditions, provide a regulatory and tax environment that encourages entrepreneurship and innovation, and then let private market actors grow and innovate on their own. In this area we do not really need reform.

In sum, a reformed neoliberalism seeks to prevent future financial bubbles through macroprudential financial regulations; addresses issues of inequality through improving human capital; continues the deleveraging necessary to revive growth in a fiscally responsible and balanced manner; and focuses on supply-side policies to encourage investment and entrepreneurship. To be certain, this is all posed at a very high level, leaving a good deal of policy detail obscured. Nor are these necessarily the only reforms needed. Whatever the

totality of reforms needed, they are premised on the conception that the neoliberal model can and should be revived.

CONCLUDING THOUGHTS

In a post-crash assessment of Britain's economic futures, venerable political economist Andrew Gamble stated, "The financial growth model adopted in the 1980s, whose main drivers were financial services, retail, property and construction in the private sector, and education, health, and universities in the public sector achieved remarkable success for the UK economy in the 1990s and up to 2007". The question now is, "…whether this [neoliberal] growth model can be repaired and relaunched after some minor modifications, whether it needs a radical redesign, or whether a quite different growth model is required" (Gamble, 2011, p. 39). The reformist argument laid out above falls somewhere between "minor modifications" and "radical redesign". Gamble for his part calls for full replacement. Neoliberalism cannot overcome the contradiction between debt and growth. Doing nothing means decades of secular stagnation -- a "crisis without end" (Gamble, 2014). The view advanced here offers an optimistic contrast to Gamble's pessimism. To be sure, the crash was much more than just another downturn in the business cycle, and it revealed flaws in the neoliberal growth model. However, for the reasons argued above, these problems are not intractable.

It is worth recalling the last major political-economic transition. The Keynesian welfare state worked exceptionally well during the long postwar boom. The seventies revealed the political flaw at the heart of the model, though. Democratically elected politicians found true countercyclical spending – decreased during booms to maintain an overall balance -- hard to do, leading to an upward spending ratchet. As the postwar boom slowed and inflation kicked in, governments were faced with rising distributional demands and reduced resources. Politics become more zero-sum; analysts began to speak of democracies, especially the UK, as being "ungovernable". Keynesian pump-priming fed inflation without gaining the purported Philips Curve trade-off of higher growth and employment. Inflation increased wage demands,

outpacing productivity gains, which undermined competitiveness and profitability. Attempts in the UK to assert authority over (the Heath Government) or negotiate with (the Wilson/Callahan Governments) the unions to control wages came to naught. As the crisis dragged on, confidence in the model waned. Leaders turned to monetarism and the market, absolving themselves of responsibility for distributional decisions (Krippner, 2011). The result was Thatcher, Reagan, and neoliberalism.

Britain and America were unable to resolve the crisis of 1970s within the existing, Keynesian framework. Yet some countries were, opting instead for a neo-corporatist approach (Katzenstein, 1985). As the Anglo-American economies embraced the market, many European economies transformed rather than discarded the Keynesian welfare state. There *was* an alternative. But the political systems, social structures, and economic institutions of the UK and US were not well suited to a corporatist solution. Each adopted the policies more appropriate for their contexts.[26] The choice was contingent, albeit within political and institutional constraints.

We are again at a moment of choice. Is the optimal choice now to abandon neoliberalism? Major political and economic transitions are traumatic and costly. The establishment of the postwar welfare state was accompanied by balance of payments crises and rationing. Thatcher's neoliberal revolution saw mass unemployment and political unrest. Given the real existing political, social and economic constraints, does it make more sense to fundamentally remake our political economy anew or invest in attempting to reform existing institutions? It does if your position is that there is no possibility of neoliberal reform; if so, there is no alternative.[27] The argument above suggest that there is an alternative in reforming neoliberalism, which corresponds much more appropriately with the political and economic

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[26] Or, to put it in terms of Hall and Soskice's (2001) "varieties of capitalism", the "institutional complementarities" of the British and American systems were not particularly conducive to a neo-corporatist solution.

[27] For all of the polemics against neoliberal, there has been a dearth of fully articulated alternative growth models, and those that have been presented are questionable. Colin Crouch (2014) promises a "capitalism fit for society", but his argument is for nothing more than a more assertive version of postwar social democracy. Hay and Payne's (2014) model of "civic capitalism" is sweeping and ambitious in its scope, so much so that it would require a near complete transformation of markets, political institutions, social structures, and the political culture to work. The question then is: Change at what cost?

institutions, both domestically and internationally, already in place. That is our best hope and should be attempted before grasping at utopian alternatives.

TABLES:

Table 1: Comparative Economic Performance

	France	Germany	United Kingdom	United States
	GDP Growth (Average % Change)			
	France	Germany	United Kingdom	United States
1950-73	5.05	6.02	2.94	3.96
1980-07	2.11	1.82	2.47	3.00
	Real GDP per Capita (Average % Change)			
	France	Germany	United Kingdom	United States
1950-73	4.02	5.36	2.43	2.48
1980-07	1.56	1.63	2.15	1.93
	Productivity (GDP per Person Employed-Average % Change)			
	France	Germany	United Kingdom	United States
1950-73	4.54	4.98	2.39	2.32
1980-07	1.45	1.62	1.89	1.62
	Productivity (GDP per Hour Worked-Average % Change)			
	France	Germany	United Kingdom	United States
1950-73	5.31	6.14	2.82	2.58
1980-07	2.21	2.48	2.34	1.75
	Unemployment (Average %)			
	France	Germany	United Kingdom	United States
1980-91	8.06	6.75	9.63	7.10
1992-07	9.30	8.85	6.68	5.34
	Inflation (Average Annual %)			
	France	Germany	United Kingdom	United States
1980-91	6.68	2.93	7.03	5.43
1992-07	1.77	1.94	1.93	2.65

SOURCE: IMF World Economic Outlook Database April 2015; The Conference Board, Total Economy Database, May 2015.

Table 2: GDP Growth, France Germany versus US-UK			
	Average GDP Growth		
	(A) France & Germany	(B) US & UK	DIFFERENCE (B-A)
1970-79	3.4	2.8	-0.6
1980-81	0.9	-0.1	-1.0
1982-89	2.3	3.5	1.2
1990-92	2.6	0.8	-1.8
1992-99	1.7	3.3	1.5
2000-01	2.6	2.9	0.2
2001-07	1.6	2.7	1.0
2008-09	-1.8	-1.9	-0.1
2010-15	1.4	2.0	0.6

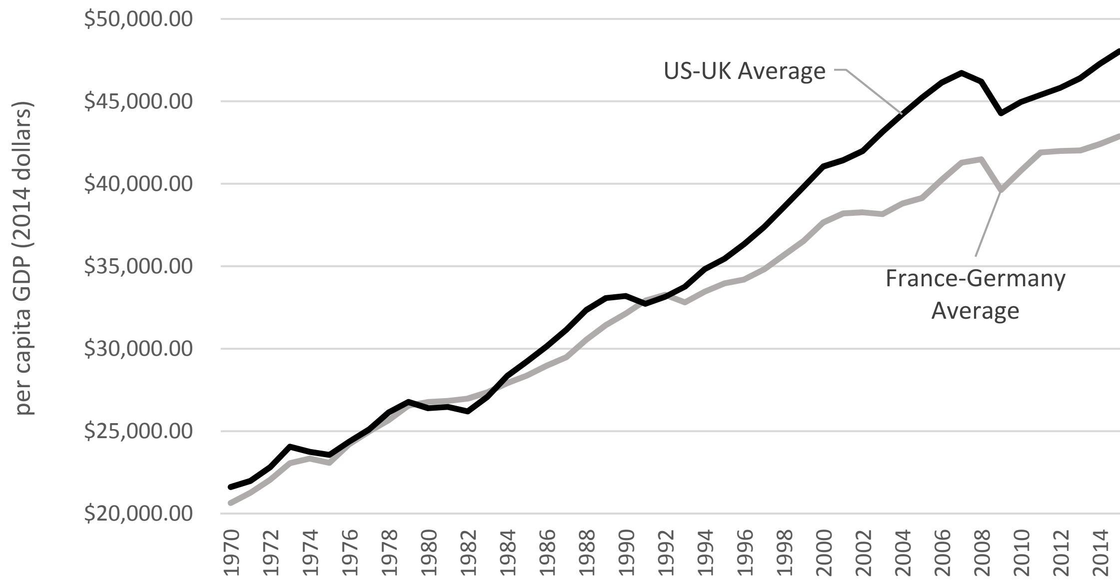
Recession years in grey; growth years in white.

Source: Conference Board, Total Economy Database. May 2015.

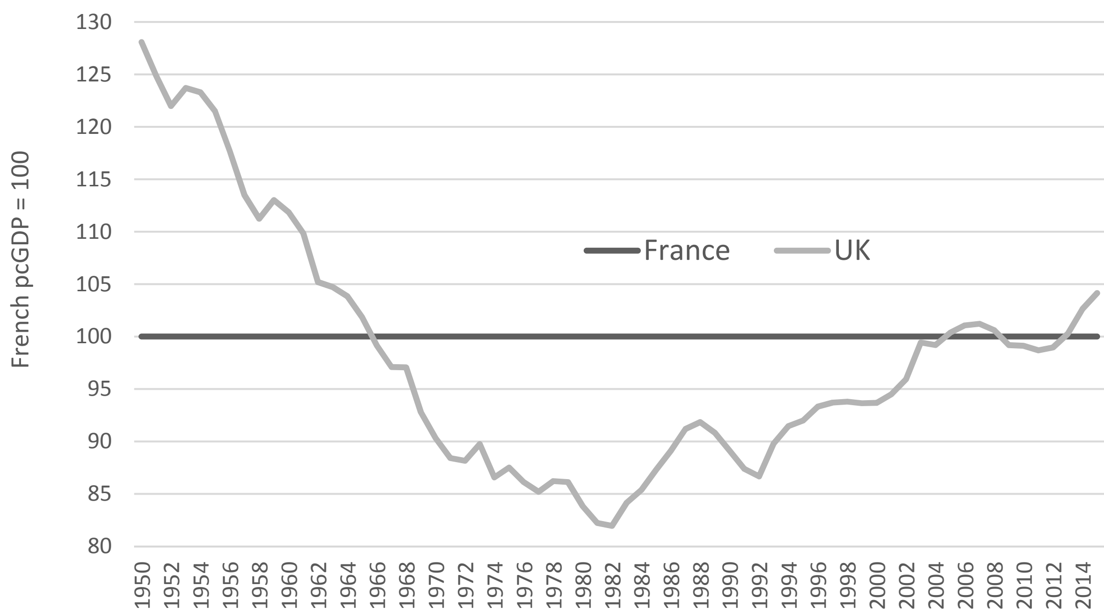
Table 3: Debt Composition and Changes in Debt to GDP Ratio, US and UK					
	Debt to GDP	Real Economy Debt to GDP Ratio			Financial Sector Debt to GDP
2014		Government	Corporate	Household	
United Kingdom	252	92	74	86	183
United States	233	89	67	77	36
Change 2007-14					
United Kingdom	+30	+50	-12	-8	+2
United States	+16	+35	-2	-18	-24

Source: McKinsey Global Institute, *Debt and (Not Much) Deleveraging*, February 2015, p. 14 and 106.
All numbers represent percentage GDP
Debt to GDP Column = Government + Corporate + Household Debt.

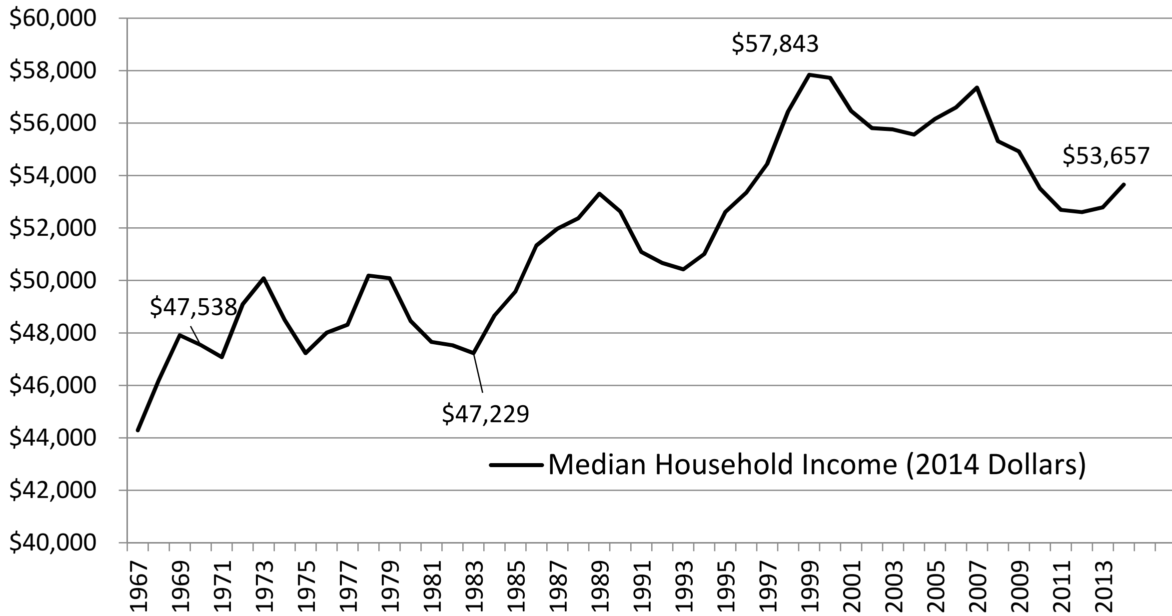
Figures:



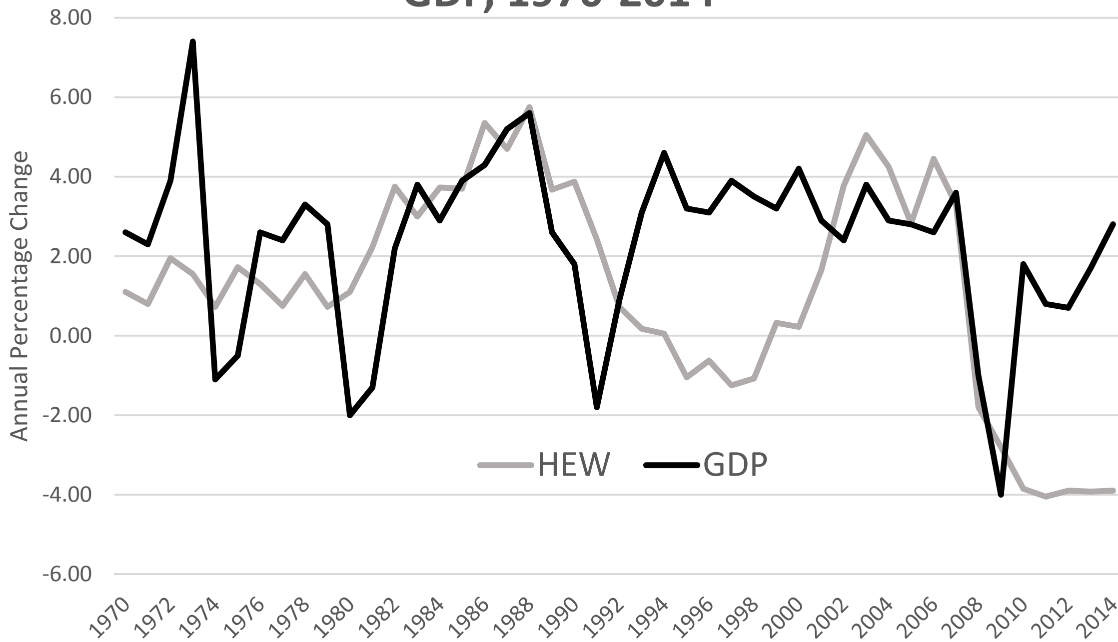
SOURCE: The Conference Board, Total Economy Database, May 2015.



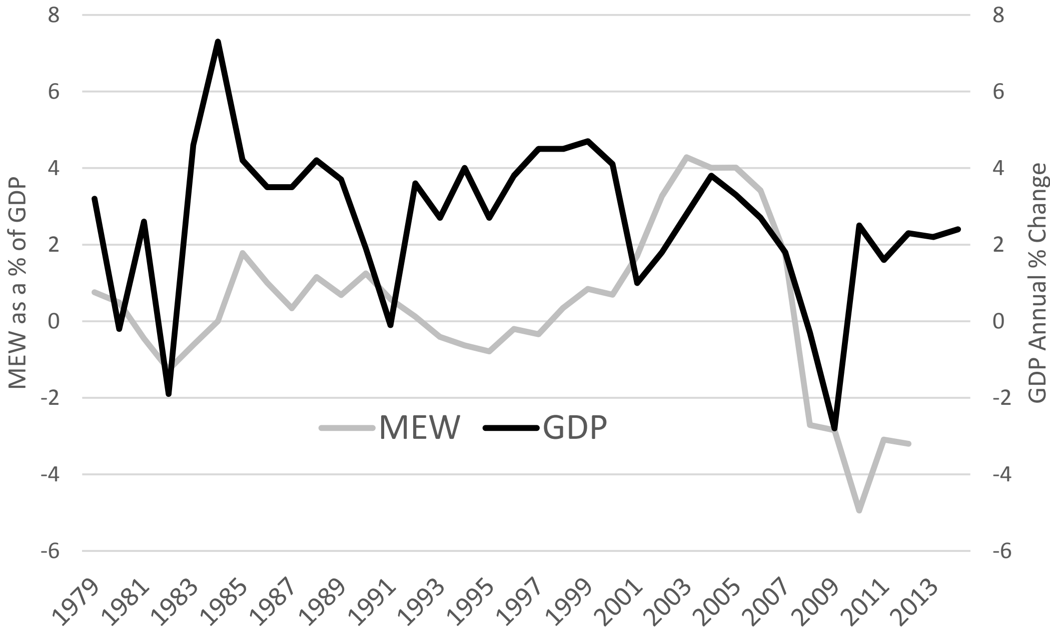
SOURCE: The Conference Board, Total Economy Database, May 2015



Source: US Census Bureau

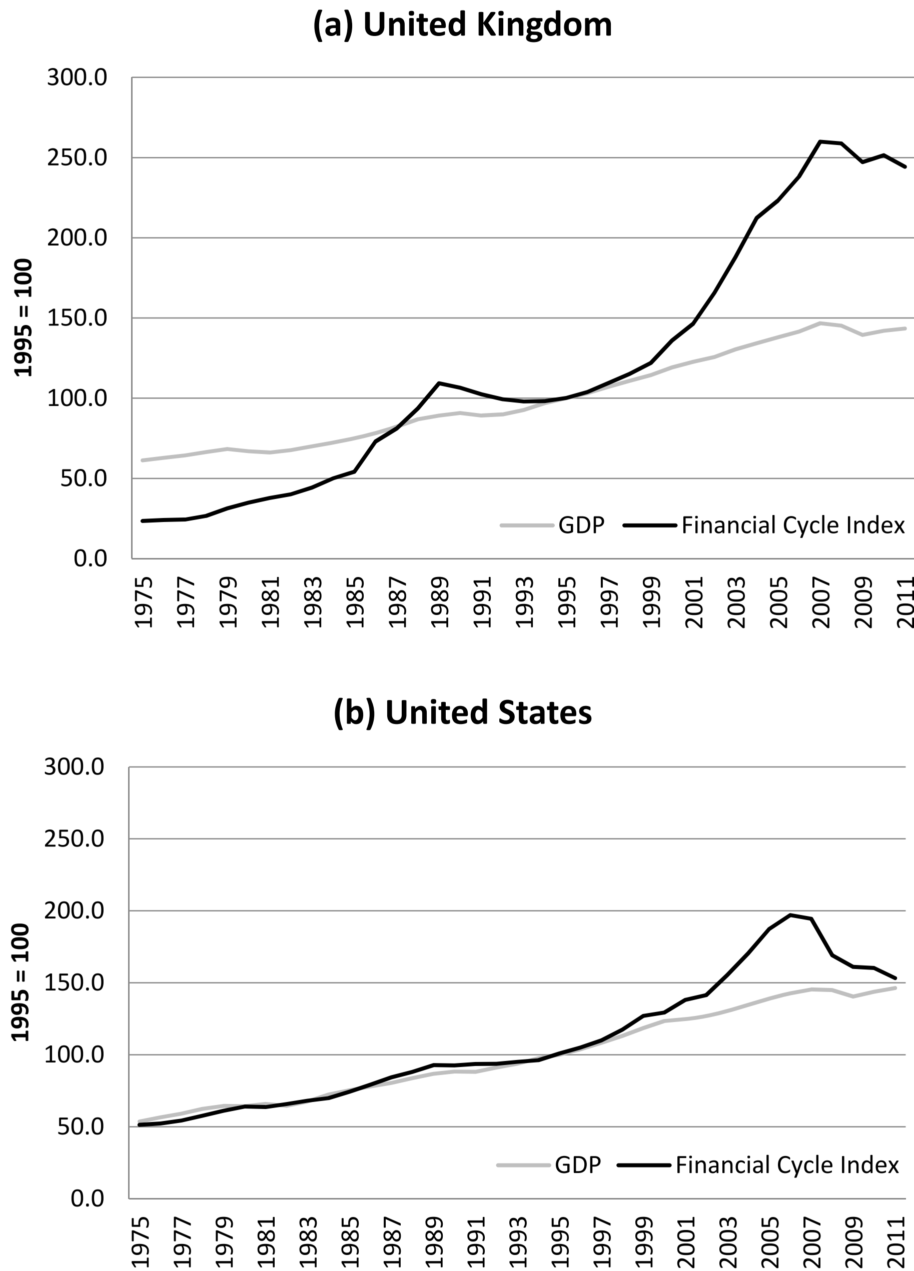


SOURCE: Bank of England; Office for National Statistics



SOURCE: GDP data from Bureau of Economic Analysis. MEW calculated, following the method of Bivens (2008), as the year-to-year change in mortgage debt (from the Federal Reserve Flow of Funds) minus 70% of private residential investment (from BEA).

Figure 6: UK and US Financial Cycles and GDP Growth, 1975-2011



SOURCE: Originally published as Figure 5 in Casey 2015. Financial Cycle Index is a composite of house price indices and credit to GDP ratio. UK housing data from Nationwide Housing Index. US housing data from Freddie Mac Housing Index (1975-86); Case-Shiller Housing Index (1987-2011). Credit to GDP data from the World Bank. GDP data from ONS and BEA.

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