Rupture or Reform? In Defense of Neoliberalism

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Background paper for the Roundtable 3 – "Exploring Alternative Growth Models"

NOTE: *The impetus for this roundtable was to continue a dialogue initiated among some of the participants in a panel entitled "Toward a New European Growth Model: Exploring the Alternatives" at the 2015 Council for European Studies conference in Paris. Sensing that much more discussion was needed to properly "explore the alternatives", we put together this panel for the SPERI conference. Although we gather in a roundtable format, we thought a more useful dialogue would ensue if we shared some of the background material from our previous exchange. The following work is a revision of the paper I presented at the CES conference in 2015 and the PSA conference in 2016, with an additional discussion of the most salient political change since last summer – the rise of rightwing populism in the US and Europe. Taken together with David Coates' paper, "Riding the Tiger: Towards a New Growth Strategy for the Political Left", this should provide those interested with good sense of the issues to be discussed.*

ABSTRACT: The financial crisis and its aftermath has reinvigorated the contention that the neoliberalism model of political economy first established under Margaret Thatcher in the 1980s must be forcefully and finally rejected. This paper contests this position, arguing for a more dispassionately empirical analysis of the mechanisms of the current political-economic settlement before opting for radical alternatives. The macroeconomic record was in the net positive, albeit with periods of robust growth punctuated by downturns eroding the gains achieved during expansions – a two steps forward, one step back pattern. Nor was economic output merely "debt-driven growth", a malady more of the years immediately preceding the crash than the neoliberal era as a whole. As such, 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 problems of neoliberalism that must be countered are: (1) the tendency of deregulated financial markets to produce excessive credit; (2) widening income inequality; an outcome driven by technological change and financialization; and (3) reviving growth in the wake of the crash. Reforms to correct these include macroprudential financial regulation and policies focused on improving "human capital". Reforming existing structures is more likely to produce a positive cycle of growth at a lower cost in terms of economic and social disruption than a radical rupture with the past. Finally, questions of how best to advance these arguments given the populist backlash that has manifest on both sides of the Atlantic will be explored.

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For most political economists, the global financial crisis (GFC) was the outcome of a failed neoliberal growth model. Free market structural reforms actually did little to improve growth, which was only maintained through private debt-fueled consumption (Crouch 2011; Hay 2013; Gamble 2014).When the debt bubble burst, consumption and output collapsed, and the Great Recession ensued. Since the problems of the present are structural rather than cyclical, a new growth model is needed. Neoliberalism must go.

This article constructs a defense of neoliberalism,[2] highlighting both its strengths and weaknesses as a growth model, and advocating key reforms to address those failings. Critiques of neoliberalism first contend that free market policies did not, in fact, improve economic performance. However, an impartial comparison of macroeconomic performance shows that neoliberal economies did indeed outperform more organized market economies, to use the Hall and Soskice 2001 nomenclature. In fairness, though, neoliberal economies are more volatile, noted for periods of robust growth punctuated by sharp downturns eroding (but not eliminating) the gains made during expansions – a two steps forward, one step back

[1] Previous versions of this paper were presented at the Council for European Studies Conference, Paris in July 2015 and the Political Studies Association conference, Brighton, UK in March 2016. My thanks to Andrew Gamble and Colin Hay for comments on earlier drafts. Of course I alone am solely responsible for the arguments that follow.
[2] I've chosen to adopt the term neoliberalism even though the term is generally only used by critics of the model, advocates preferring free market policies or economic liberalism. Using neoliberalism is a self-conscious desire to 'own' the model, warts and all.

pattern of development. Critics further contend that neoliberal growth was a mirage built on rising private debt rather improved productivity. Closer analysis indicates the evidence for debt-driven growth is not nearly as compelling as its adherents claim. The ballooning of credit and debt were more of an infection that flared in the years 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 crash suggest that it is only part of the story, undermining the idea 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. Reforms that can ameliorate these shortcomings include macroprudential financial regulation, policies to improve '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 rapid relegation with the flat earthers and climate change deniers. As such, a few stipulations are in order. The argument here is not simply for a return 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, it started in the American subprime mortgage market, a market heavily influenced by government intervention and regulation (Thompson 2012; Calomiris and Haber 2014: Chapter 8). 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: the debt crisis began in the private (financial) sector and only morphed into a public sector debt problem after the fact (Thompson 2013). Fiscal profligacy is not the root of our sorrows, although it remains a burden to be managed. That said, the focus of this article 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 existing economic dynamics 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 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 – “the ideology at the root of all our problems” (Monbiot, 2016). Much of this analysis is sloppy, some inadvertently so (‘neoliberalism’ being an expansive and imprecise concept, after all), but some willfully inexact. Large, unregulated and inherently unstable financial structures are now portrayed as an integral component of the neoliberal model. That the banking systems of neoliberal Canada and Australia remained quite conservative in their structure and resilient during the financial crisis is ignored (Calomiris and Haber, Chapter 9, 2013). Levels of household debt are accentuated in Anglo-American economies we are told, the result of the debt-driven growth upon which this model depends. 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).

Perhaps 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 banks, such as Citibank and Bank of America, it is implied, gambled away depositors’ money on subprime mortgage-backed securities. Except that there is no evidence of this happening. (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. Commercial banks that ran into trouble -- Wachovia, Washington Mutual, and Bank of America[3]-- did so because of their mortgage dealings, which were allowed pre-repeal. JP Morgan and Wells Fargo, both deposit-bearing institutions involved in investment, weathered the crisis fairly well. Other than as a marker 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 heighten danger by creating the illusion of safety.[4]

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

[4] Lehman Brothers’ 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-

Before we condemn neoliberalism, then, 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 slowed rather than increased since 1979. UK relative productivity improved against European economies, but this was more an indication of a dramatic European slowdown than British improvements. 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 did not deliver the goods.

A 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 led in the post-war era; positions reversed in the neoliberal era. That British growth slowed post-1979 is irrelevant; this was true for every major economy with the end of the post-war boom. That productivity is more a case of European failure than British success is equally immaterial. The essence of political economy is comparative performance. 'British economic decline' in the post-war era, when the growth was higher than today, manifest because it was worse than competitor countries. Noting better performance now is analytically consistent. 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 evened out in more recent decades as part of the 'Great Moderation'.

The Anglo-American economies thus saw average incomes rise relative to continental Europe in the neoliberal era (Figure 1). The transformation of British fortunes is vividly illustrated in Figure 2. Three decades of precipitously falling per capita GDP relative to France is halted once the move to the market under Thatcher occurs. Growth post-liberalization was not a smooth process, though. 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. However you look at it, the

fencing may reduce future bailout costs somewhat, but the too big to fail problem – if anything, even worse now than in 2008 – remains.

change has been positive. 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: 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 clearly to blame. Schmidt and Woll (2013: 115) 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 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 the percentage of the adult population in this income group has declined steadily since 1971[5] and a greater aggregate of income now goes to those in the upper brackets.[6] Nevertheless, 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 the more than doubling of US real personal consumption since 1980.[7] How could consumption rise if incomes stagnated for most people?

Opponents have an answer: it was all bought on credit. 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 incurred principally to fuel consumption.' (Hay 2013b: 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

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

[6] 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.

[7] 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.

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. From 2000-07, US household debt increased from 89% of disposable income to 125%; the UK went from 106% and 150% in the same period (McKinsey 2015). However, this evidence lends itself to two contrasting interpretations: (1) this was the inevitable culmination of a systemic pathology; 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 access credit, which for most is secured against their largest asset – their home. 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 indeed peaked 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 exactly the connection between private debt and growth, and there are some worrying indications of consumer debt again rising in the UK (Office for Budgetary Responsibility 2015). However, if 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 (again, see the more thorough discussion in Casey 2015). It possesses a logical[8] appeal and the evidence used to support it is plausible. The evidence is insufficiently compelling to warrant its widespread acceptance as *the key dynamic* in the model, though. Across the literature there is an unfortunate yet consistent 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 et al. 2011). They occur in economies at different levels of development (Dell'Ariccia 2012), different political-economic models (Drehmann et al. 2012: Graph 2 on 16), and under different monetary regimes (Aikman et al. 2010: Chart 19 on 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.

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 unregulated financial markets would function better, punishing (through economic loss) risky practices. Self-regulation obviated the need for government control. Financial markets were not so much deregulated as under-supervised (Wolf 2014: 141; Calomoris and Haber 2014: 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 innovation, particularly in derivatives such as residential mortgage backed securities (MBSs), built on the booming US housing market. With US house prices skyrocketing, banks extended 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

[8] Although the logic is not without problems. It assumes consumers consistently choose to ratchet up 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 explains an increase demand for credit. It does not explain why debt must inevitably rise to unsustainable levels is not.

vertiginous ascent. Banks did not care as they pursued '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.[9] 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. 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 crisis. Finance needs to be firmly leashed if not neutered.

There is much truth in this narrative. Left at that, though, you have a very incomplete story. Global imbalances, producing a savings glut (Wolf 2014: 4), played a substantial role. The export-led growth models 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: 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 mortgages. By lowering their standards to purchase subprime loans, they effectively lowered the standards for the entire US mortgage industry (Calomiris and Haber 2014: 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 2012: 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.[10] Market and state were working hand in hand (Thompson 2012: 415). Finally,

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

[10] Attempts were made, mainly by Republicans, to constrain the GSEs. Yet they had powerful allies on Capitol Hill in both parties. 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. Big Banks looking to merge with smaller banks 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).

at the heart of the crisis was the purported fraudulence[11] of MBSs and other instruments. The crash was not the result of banks selling worthless securities to others, however. It happened because they bought loads of them themselves.[12] Why would they do that? To leverage the capital adequacy requirements embodied in the so-called Basel rules (Calomoris and Haber 2014: 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: 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, to be sure. Still, it was not a failure of deregulation. Rather it was the unintended consequences of regulation (See Friedman and Kraus 2011 for a detailed elaboration of this argument).[13]

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

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[11] '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).

[12] 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.

[13] 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.

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 often follows, 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 to promote *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.[14] Continued prosperity not only deteriorates risk assessment, it synchronizes it, validated by the ongoing boom (Aikman et al. 2009: 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 like business cycles, although the two are not directly connected and financial cycles are longer -- 10-20 years (Aiken et al. 2010: 14; Drehmann et al. 2012: 19). Financial cycles predate the neoliberal era (Jorda, et al., 2011) and are not, per se, the result of

[14] 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.

financial liberalization (Schularick and Taylor 2009: 6), although the amplitude, length, and economic disruption of financial cycles have all increased because of the easier flow of credit (Drehmann et al. 2012: 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: 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.[15] 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, MPR 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 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 policies to dampen financial cycles. To do so requires monitoring for signs of 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 resolve, not the least of which is how controlling credit growth interacts with monetary policies (see Casey 2015: 15-16; Wolf 2014: Chapter 7). MPR, nevertheless, directly addresses a key shortcoming of the neoliberal growth model. It 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.

[15] Each is indexed to 1995 -- the midpoint of the neoliberal era – for comparability.

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.[16] Deciphering the unvarnished facts about income inequality 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 et al. (2011), who say that Picketty and Saez's piddling 3% rise in average middle class American family income turns into a 37% increase from 1979-2007 once post-tax transfers and benefits are added in. 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% after post-crash income loss. 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. Wages, some argue, have become decoupled from productivity increases (see, for example, Mishel 2012). For others, this is a statistical error resulting from 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. Piketty's book, moreover, 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, as many critics do, is tenuous, however. In recent studies of the issue, the OECD (2011 and 2014) cites multiple causes for rising inequality. Globalization increases wage competition by integrating several hundred million new laborers from China, India, and elsewhere into the market. Recent market trends, including a more active financial sector, have increased the returns of capital over labor, the benefits of which largely accrues to those in upper income brackets; Professor Piketty has something going there. Finally, technological change exacerbates 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: Figure 1.3). Absolute levels of inequality are

[16] 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 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).

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.[17] 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: 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'[18] (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, though, to recognize the practical limitations. There is one pattern common to pretty much every dataset on changes in inequality of the last century, including Piketty's (Figure 1.1 on 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 of post-war redistribution were established.[19] Those datasets equally show a rise in inequality since 1980, a change manifest in welfare states vast and paltry. Economic redistribution blunts underlying trends more than erases 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.

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[17] 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.

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

[19] The Great Depression and World Wars having the largest impact on undermining concentrations of wealth.

The focus should be on enhancing earning potential. Technological change, specifically the information technology (IT) 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: 4). Computerization has led to a hollowing out of the middle. Highly skilled workers can use IT 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: 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: 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 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: 126). The result is a pervasive skills mismatch. Information technologies exacerbate this challenge as they are synchronous, impacting every industry at once (Bessen 2015: 3). Market failure thus hinders our ability collectively to combat inequality and revive growth. Current labor markets show two stark realities: (1) workers with the proper skills remain employed and properly compensated;[20] but (2) even during the depth of the recession, many jobs went unfilled for lack of skilled workers. Technology is not, as some would suggest, replacing jobs (Gordon 2016; Cowen 2011) it is displacing workers into new areas (Bessen 2014: 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: 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.

[20] 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).

This is a monumental challenge. Recommendations to address this 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 2013: Chapter 7; Bessen 2014: 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, sales representatives, technicians, teachers, administrative support staff and nurses. Reform would require compromises on both the right (more spending on education 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 (Gamble 2014; 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 et al. 2015). In light of the nature and depth of the crash, a long, slow recovery was to be expected.

Deleveraging, therefore, is crucial to the long-term prospects of recovery. 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), and higher growth will hasten recovery. Mark Blyth (2013) similarly 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. Both are partially correct in their analysis, yet both err by implying that massive increases in government spending, financed by borrowing, can resolve this without 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 shows the composition and changes in debt since the crash. Both economies undertook 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 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, creating a vicious negative cycle (Buttiglione, et. al. 2015: 2). Arguably this describes the Eurozone, 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, or 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 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.[21] 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 (Hay and Payne 2015: 17-22). 'Regulation good/deregulation bad' is just as silly and misguided as its libertarian cousin.

There are, of course some specific difficulties in the present. One problem, not unique to neoliberal system yet rising in political salience, is crony capitalism – when 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: 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.

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

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. 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 gains of rent-seekers. In general, 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: 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.

Creating favorable conditions for investment does not guarantee investment. Major corporations and banks continue to sit on mountains of cash (MacMillan et al. 2014) 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). A poor global economic outlook partly drives this and might work itself out with a few more year of stable, even if sluggish, growth. 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: 39). The reformist argument laid out above falls somewhere between minor modifications and radical redesign. Gamble for his part calls for a different growth model as, in his view, 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 post-war 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 post-war 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. 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 post-war 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. The argument above suggest that there is an alternative in reforming neoliberalism, which corresponds much more appropriately with the political and economic institutions, both domestically and internationally, already in place. That is our best hope and should be attempted before grasping at more radical alternatives.

Postscript (June 2016): The Rise of Right-Wing Populism

Anyone interested in shaping the future of the Anglo-American political economies must grapple with the sudden rise of populism. Latent for some time, these movements have surged to electoral success in the last year, most notably with Donald Trump securing Republican Party's nomination. Currently (June 2016) he is polling fairly even with his opponent, Hillary Clinton. In the UK, right-wing populism found its voice mainly in opposition to Brussels, with UKIP polling getting 13% of the vote in the 2015 General Election (netting but one seat, though) and the Leave campaign making the EU referendum (occurring after this writing) a close run thing. Right-wing populism is not confined to the Anglosphere. Freedom Party leader Norbert Hofer fell just a few votes short of the presidency in Austria in May 2016. Polls indicate that National Front leader Marine Le Pen is on track to make it to the second round of the 2017 French presidential election. In Poland, Hungary, even Sweden, votes for right-wing populist parties are increasing. Nor is this only a phenomenon of the right. Jeremy Corbyn's surprise victory as Labour Party leader and the insurgency candidacy of Bernie Sanders represent discontent among activists with mainstream left-wing parties that have governed quite moderately for many decades. Syriza in Greece and Podemos in Spain represent the more electorally successful left-wing variations on this theme.

Why is all this happening? What are the implications for the reform of the political economy? We are in the midst of transformation, so what follows is best read as tentative and preliminary. Each form of populism, moreover, has its own national accent and specific features. However, we might usefully focus on the rise of Trump in the US as a mechanism for getting at some of the commonalities. For even more so than in other countries, the rise of Donald Trump was a bolt from the blue, not foreseen by the Republican establishment or the general punditocracy. The important thing to be explained is not Trump himself; he is in many ways a very common form of demagogue. It is the millions and millions of people very ready to support Trump and all he stands for – a force that is unlikely to exit the political stage once The Donald does. That is a true systemic political shock.

To get a hold of this it should be noted that Trump, while in some respects a mirror image of the Sanders campaign, is also different in kind. Sanders is of course a progressive (rather than nativist) reaction to a disaffection with what he and his supporters see as the selling out of moderates within his own party. (The same could be said of Corbyn in the UK.) Yet Sanders is not really advancing new ideas. His platform is a more forceful, direct, full-throated recitation of ideas that have long been dear to progressives. The "Sanders Revolution" is less an attempt to transform the party and more one to recapture it for the McGovernite left. Hence his assaults on the Establishment within the Democratic coalition, represented in undiluted form by Hillary Clinton, remained somewhat subdued. It is a revolution that wishes nothing to leave no destruction when it is over.

Not so Trump. It cannot be over-emphasized: Trump supporters hate (and that is not too strong of a word) the GOP establishment. That said, Trump's platform (a slippery, shifting best, indeed) is most assuredly not a more forceful expression of the same right-wing rhetoric that has been kicking around for decades. That honor belong to adherents of the so-called Tea Party and Ted Cruz. Trump may align with the far right/Tea Party on immigration and to some degree tax policy, but little else. Trump is in and economic statist, categorically rejects the need for entitlement reform, and advocates a foreign policy that is oddly both isolationist (no more wars in the Middle East) and aggressive ("bombing the shit out of ISIS") at the same time. Above and beyond all else, his campaign is explicitly rejects ideology; it is about him. His core argument is that he is the ultimate dealmaker. America can be made great if he makes the deals. Donald Trump is thus ideologically and temperamentally apart from mainstream Republicans. Mainstream Democrat can counter Sander's populist rhetoric with pragmatism; the goals (single payer healthcare, free college) are lovely, but just not practical. The GOP Establishment was unable to counter Trump because his mass support does not represent the apotheosis of Reaganite Republicanism. It is its (partial) repudiation.

It is easy and intellectually comforting to dismiss Trump supporters as nothing more than racists and xenophobes. To be sure, there are indeed many of those among his supporters. Yet his support cuts across education, income, age, and religious conviction (Taub, 2016).[22] Trump's rhetoric is classic populism, convincing voters that all of their problems can be blamed on uncaring or incompetent elites or the threat posed by "the other", in this case, mainly Mexican immigrants and Islamic terrorists. He presents himself as the one strong leader who can right these wrongs. As such it is not only populist, it is authoritarian. In January 2016 political scientist Matthew MacWilliams reported a headline-grabbing result. The trait among that most effectively predicts whether one supports Donald Trump is not any demographic category; it is support for authoritarianism (MacWilliams, 2016).[23] Voters with this characteristic seek strong leaders to impose order when driven by a sense of fear, fear frequently directed at perceived outsiders. Seen through this lens the long-term trend of increasing partisanship is not the residual of gerrymandering and moneyed interests manipulating politics. Indeed, the disquiet caused by Trump's rise has masked the evidence that in the 2016 election cycle "big money" has proven to be rather impotent. It was the congregation of authoritarians in the Republican Party starting in the 1960s. The Democrats became the party of civil rights and social change; Republicans supporters of law and order and tradition. Authoritarianism is often dormant, lingering below the surface until "activated" in response to a sense of threat in the form of economic and social transformations. Add to this the potential for physical threat, especially terrorism, which can serve to drive those voters who are not particularly prone to authoritarianism in a more authoritarian direction. Therefore, "…if social change and physical threats coincided at the same time, it could awaken a potentially enormous population of American authoritarians, who would demand a

[22] Trump supporters may be predominantly white, but not poor, their average income according to FiveThirtyEight.com being $72,000, well above the national average (quoted in the *Washington Post,* online Edition, 7 June 2016).

[23] MacWilliams assesses authoritarianism based on responses to a series of questions related to child-rearing, a technique that has been used to measure authoritarian proclivities since the early 1990s.

strongman leader and extreme policies necessary, in their view, to meet the rising threats." (Taub, 2016). Enter Donald Trump, savior of the threatened.

Exactly how do these voters feel threatened? Part of it is unquestionably economic. The post-financial crisis recovery is real, but anemic. Employment is up but wages have lagged. Median household income remains $3700 lower than it was in 2007. Much of Trump's support comes from those who feel they have been "left behind" as a result of globalization. White working class voters, many of whom found employment commensurate with a middle class lifestyle in manufacturing for generations, face increasingly bleak economic prospects. Economists have long touted the net benefits of free trade for the US and other economies and assumed markets would adjust swiftly to negative disruptions, particularly in lost jobs. Political elites of both parties promised a brighter future for all, yet the economic pain came quicker than the body politic could correct. Given the size and speed that trade has grown, particularly with (less-developed) China, it appears that labor markets have not adjusted as swiftly as predicted and those industries most exposed to import competition have suffered the worst (Autor, Dorn, and Hanson, 2016). Even those in employment fear that they are going to lose their jobs or that their children will not be able to get good jobs. Economically, Trump is at the head of a revolt against globalization.

The most consequential policy shift encapsulated in this populist wave is the near collapse of support for free trade – a pillar of US foreign economic policy under both Democratic and Republican administrations since the Second World War. Trump and Sanders have adopted nearly identical anti-free trade positions; both have argued that NAFTA was an enormous mistake that they would, presumably, seek to reverse. Faced with this onslaught, even Hillary Clinton wavers on supporting new deals, such as the Trans-Pacific Partnership (TPP) and the Transatlantic Trade and Investment Partnership (TTIP). Notably, this is not exactly congruent with the mainstream critique of neoliberalism, which focuses on the instabilities of deregulated finance. That, after all, is the heart of Bernie Sander's stump speech – our problems are the result of the fraudulent behavior of Wall Street bankers and the perverse influence of "the 1%" on American economic and political life. In the end, the Democratic Party rejected this candidate in favor of one with close ties to Wall Street. Whether one supports their arguments or not, so far the Bernie Sanders-Elizabeth Warren wing of the Democratic Party has still not shown itself capable of winning on a national level. In the end, despite the many criticism of financial liberalization as the source of our current woes, it is actually international trade liberalization[24] that has garnered the greatest political opprobrium across the

[24] Capital mobility only enters in in the context of FDI and moving production overseas, not in the free movement of capital itself.

electorate. An element of neoliberalism to be sure, it is also the aspect of neoliberalism with the greatest cross-party consensus.

Those with more progressive leanings may gaze upon the internecine warfare of the GOP with an understandable sense of schadenfreude. The economic and political chickens seem to be coming home to roost. The populist tide can be seen as a revolt against neoliberal economics – a 21st century manifestation of Karl Polanyi's "double-movement", whereby society, threatened by the increasing marketization of life, rebels in an attempt to protect itself (Polanyi, 1944). In Polanyi's day the result was a fascist reaction and world war. One can but hope present trends end more favorably. Trump has also been portrayed as the Frankenstein's monster of Republican electoral strategies that constantly denigrated the role of government and pushed divisive cultural issues. Either way, in this reading it is all the Republicans fault. However, I would argue that this phenomenon is driven by larger trends that go beyond economic policy or electoral strategy and are not likely to recede after this election cycle regardless of the direction the GOP takes after the election. The populist wave only jostled the Democrats while smashing the Republicans this time. Perhaps not so in the future.

Much of the current discontent stems from a pervasive sense that the economic system is not working effectively for the average person. Parties of the right, including Republicans in the US, need to develop policies which serve to ameliorate these fears and reinforce economic stability for working families. If these parties are going to continue to advocate for the utility of market forces in everyday life, with all the volatility that implies, they would do well to incorporate some stabilizers. In other words, Anglo-American liberal parties would do well to adopt some of the German social market model. This means rethinking what has generally been the default positions of the right on taxation and spending (cut and cut) since the time of Reagan and Thatcher. It is likely time perhaps to make peace with the welfare state and the levels of taxation needed to support it. That does not preclude tax reform as a mechanism for enhancing growth; various mechanisms for tax simplification have much to speak for them. It suggests, however, that a continued obsession with fiscal retrenchment and entitlement reform is likely to continue to be an electoral non-starter.[25] Policies to more effectively adjust to the downsides of globalization, particularly for those not so highly skilled, are needed. I point back to the arguments detailed above about enhancing skills (human capital) which will, of course require resources channeled directly or indirectly

[25] Neoliberals have never really been able to cut the size of the welfare state. US federal spending as a percentage of GDP is almost exactly where it was in 1980 at around 20%. UK government spending (around 40% of GDP) is well down from its peak in the late 1970s-early 1980s (at 48%) and only slightly lower than it was in the early 1970s.

through the state. For those who wish to see relatively free markets maintained, this may be the cost of doing business.

The current populist wave does not represent a complete rejection of free market economics, nor does it manifest predominantly as support for the alternative. Trump supporters (or UKIP voters) may be clamoring for many things, but they are not looking for more socialism. As Bernie Sanders, Ed Miliband, and Jeremy Corbyn have learned to their peril, the progressive/democratic socialist coalition does not appear large enough to achieve an electoral breakthrough. This gets to a bigger point, and one to which the left should be attentive, which is that this populism is not driven solely by economics. Again, if populist supporters are those who feel threatened, part of that threat comes from an uncertain and dangerous international situation. Russia, having annexed the Crimea, is again a potential threat to European security. China, already a concern for many Americans due to is rapid economic rise, has taken to aggressively asserting its sovereignty over large swathes of the South China Sea. North Korea continues to develop nuclear weapons and the deal with Iran seems to have delayed, but not halted, theirs. And after a fifteen years of constant war in the Middle East, the region looks even more disrupted and dangerous, and Islamic terrorists are undertaking attacks of growing lethality in Paris and Brussels and closer to home in San Bernardino, CA. President Obama has prided himself on nuanced and measured foreign policy responses to these challenges; perhaps to a fault (Goldberg, 2016). His constant admonition to Americans that they are far more likely to be harmed by car crashes or slips in the tub than terrorism may be statistically correct, yet hardly reassuring. In a broader sense the Obama Administration seems to have adopted the frankly incredible position that this huge wave of discontent with politics and government that has come at the end of his tenure in office has really very little to do with him. It is all the fault of others. Perhaps in other areas of economic and social policy this is defensible. Far less so on foreign and security issues.

A greater part of the threat that Trump supporters feel is from the multitude of social changes. Norms surrounding issues of race, gender, sexual identity, etc. are changing and at a quite rapid pace in recent years. After all, same same-sex marriage – now the law of the land – was a policy *opposed* by both Barack Obama and Hillary Clinton when they ran in 2008. President Obama not only "evolved" on the issue, he had the White House lit up with rainbow colors to celebrate the Supreme Court decision. If authoritarian voters lay dormant until "activated" by a sense of threat, these social transformations are some of the key "activators" (Taub, 2016). This is the logical continuation of the identity politics that has been prevalent within the Democratic Party since the 1960s. It is a political approach explicitly committed (as embodied in the grand structure of affirmative action) to favoring certain groups to achieve larger goals of social justice.

It is the politics of cosmopolitan, well-educated white voters (the Sandernistas) and assorted minority groups. It is also a political framework that is alienating to many white working class voters. One can see why in a political environment where an unemployed white guy living in a trailer in rural Appalachia is deemed to have “white privilege” and an African-American student at an Ivy League school suffers from “systemic racism”. Nor is there any respite on offer. Andrew Sullivan writes:

> For the white working class, having had their morals roundly mocked, their religion deemed primitive, and their economic prospects decimated, now find their very gender and race, indeed the very way they talk about reality, described as a kind of problem for the nation to overcome…Much of the newly energized left has come to see white working class not as allies but primarily as bigots, misogynists, and homophobes, thereby condemning those often at the near-bottom rung of the economy to the bottom rung of culture as well. (Sullivan, 2016)

The Democratic Party especially has gone deep down the rabbit hole of identity politics, rendering it difficult for Democratic politicians to both satisfy the demands of the representatives of identity groups and reach out to a wider constituency at the same time. During an October 2015 CNN Democratic debate, for example, when faced with the question, “Do black lives matter or do all lives matter?”, Bernie Sanders unhesitatingly declared “black lives matter” and Hillary Clinton (unsurprisingly) weaved her way around the question. That the statement “all lives matter” should prove difficult and controversial in a Democratic debate highlights the political challenge that identity politics poses to expanding an electoral coalition. The default response of progressives to any opposition, indeed even any questioning, of these social changes has not been to try to persuade and convince, but, as Sullivan notes, to label and condemn. The language of identity politics is unbending, absolutist. One can see this on the current debate about transgender rights, a complicated issue at both a personal and social level worthy of serious social discussion and debate. Apparently not, though, for to even raise questions regarding the relationship between gender and sex, or how society should accommodate those who identify with a gender different from their sex, renders you a monumental bigot. The Obama Administration given legal power to that point through a Department of Education that dictates that all schools receiving federal funding (that is, *all* schools) must treat anyone identifying with particular identity as of that identity – fully, completely and without qualification.[26] Faced with a complicated social issue, one where perhaps nuance and consideration of a diversity of views is warranted, the message of Democrats to anyone outside of *bien-pensant* opinion is: shut up.

[26] Specifically, “The Departments interpret Title IX to require that when a student or the student’s parent or guardian, as appropriate, notifies the school administration that the student will assert a gender identity that differs from previous representations or records, the school will begin treating the student consistent with the student’s gender identity.” Department of Education Dear Colleague Letter on Transgender Students, 13 May 2016.

The point is not that progressive social changes need be reversed. Advocates for transgendered rights and those battling systemic racism are heartfelt in their convictions and believe they are working for a more just world. But it is time to consider the political tactics by which those ideas are advanced and how they serve to facilitate or inhibit the building of larger political coalitions that can effectuate economic changes. Some years back, progressive author Thomas Frank lamented, “What’s the matter with Kansas?” (Frank, 2005). He was trying to understand why so many poor people in his home state were motivated by conservative social issues (which he thought were wrong or unimportant) when they should be motivated by (liberal) economic positions. In essence his answer to socially conservative voters was: “Don’t be”. That is really not an answer for peoples’ concerns about the reshaping of society. Again, the point here is not about social morality, it is about political strategy and coalition building. The current take-it-or-leave-it political strategy adopted by the Democrats and the left in general on social issues is alienating a good segment of the electorate, not all of whom are racists, bigots, or homophobes.

The focus has been on the US but, again, we are seeing very similar patterns elsewhere. Perhaps no country has benefited more from free trade than Germany, yet German voters are increasingly turning against free trade (Fratzscher, 2016). Political scientist Will Jennings writes in *The Guardian* (4 June 2016) the following about the sorting of voters for the EU referendum:

> Research shows that in England especially, citizens are increasingly divided between those living in cosmopolitan areas of growth and those in areas of decline. Residents of cosmopolitan areas tend to be more global in outlook, liberal and more plural in their sense of identity. Those from shrinking backwaters are more likely to be inward-looking, relatively illiberal, negative about the EU and immigration, nostalgic, and more English in identity.

Domestic politics is looking similar on both sides of the Atlantic. Trump, the reality TV host turned politician, may be quintessentially American. The political forces that he symbolizes, are not.

Donald Trump is a classic demagogue, seducing the electorate with simple and brutal solutions. However, too quickly dismissing the motivations for those who are so seduced may lead us to fail to examine and understand the real and legitimate grievances of those attracted to his rhetoric in the first place. If we are to develop non-demagogic alternatives on both the left and right, we must understand and address those grievances. Part of the answer is of course straightforward resistance to the uglier elements of this movement – against race baiting, xenophobia, and economic nationalism. Economic liberals need to recover from the sting of rejection and continue to advocate for the benefits of limited government and free trade. Social liberals need to make the case for the benefits of an inclusive society. I come back to the

Ed Miliband quote about globalization (see p. 13 above). We live in a much more integrated and complex world. If the right continues to favor free markets and free trade, they need to come up with mechanism to ensure economic opportunity and stability. The left, desiring open, inclusive, tolerant societies, needs to come up with better ways to address social inequities while also inculcating common identities. In short, the right needs to develop policies to dismiss peoples' real economic fears; left wing their real social fears. And we must recognize that these are not just movements of a few cranks, but millions of voters disenchanted with the status quo. Economic liberals and progressives alike need to be willing to take a good, hard look at their own orthodoxies at least modify, if not abandon, some of the things that they hold dear. "The vital and valid lesson of the Trump phenomenon is that if elites cannot govern by compromise, someone outside will eventually try to govern by popular passion and brute force." (Sullivan, 2016)

TABLES:

Table 1: *Comparative Economic Performance*

	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.

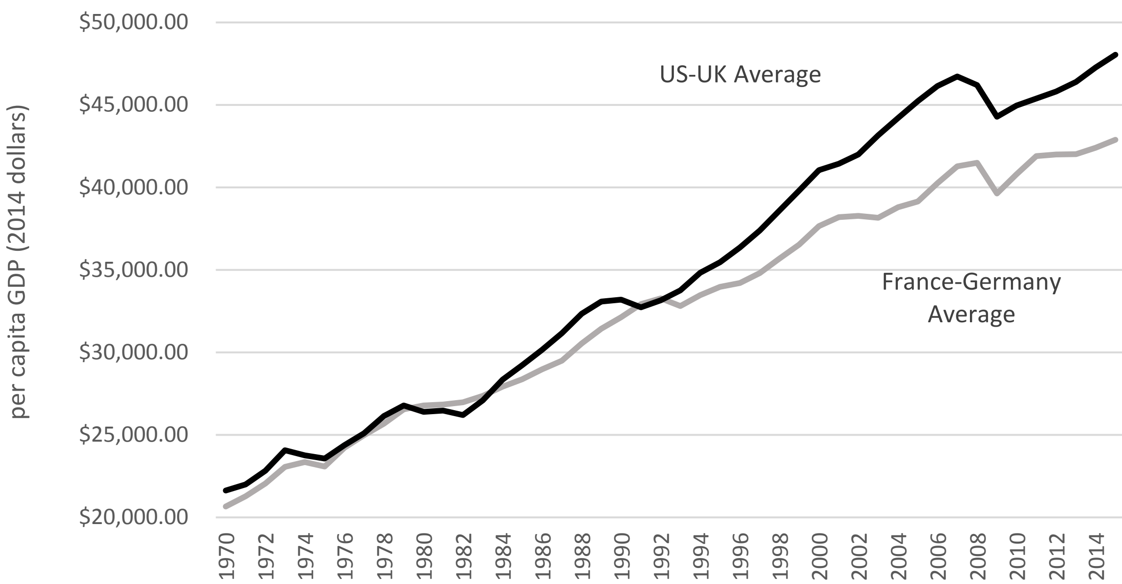
Table 3: *Debt Composition and Changes in Debt to GDP Ratio, US and UK*

	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.

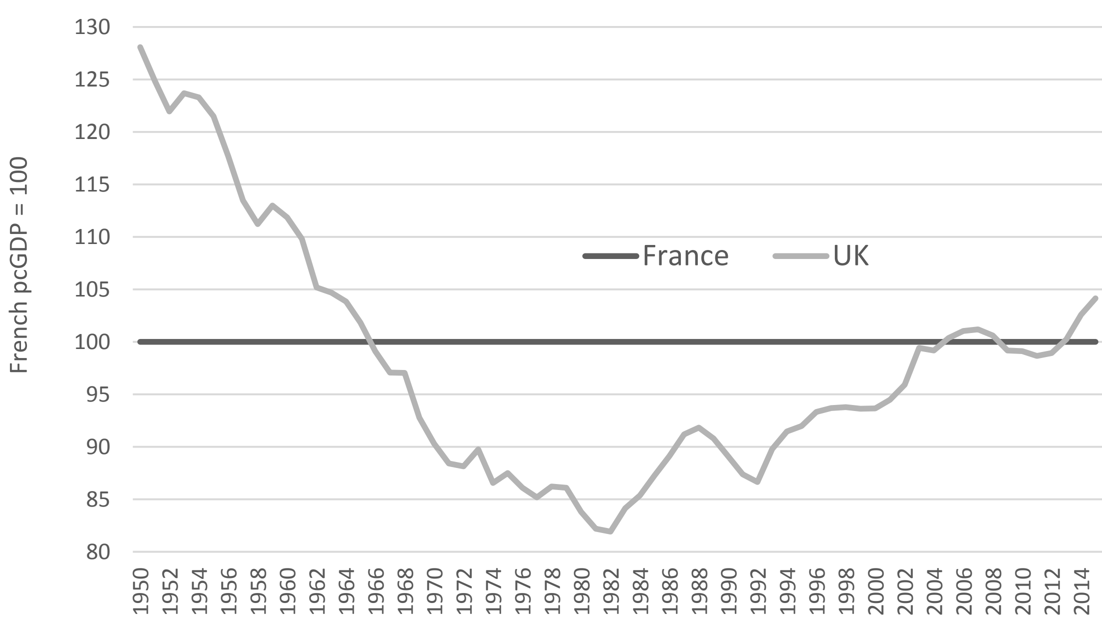
Figures:

Figure 1: Per Capita GDP, France-Germany versus US-UK

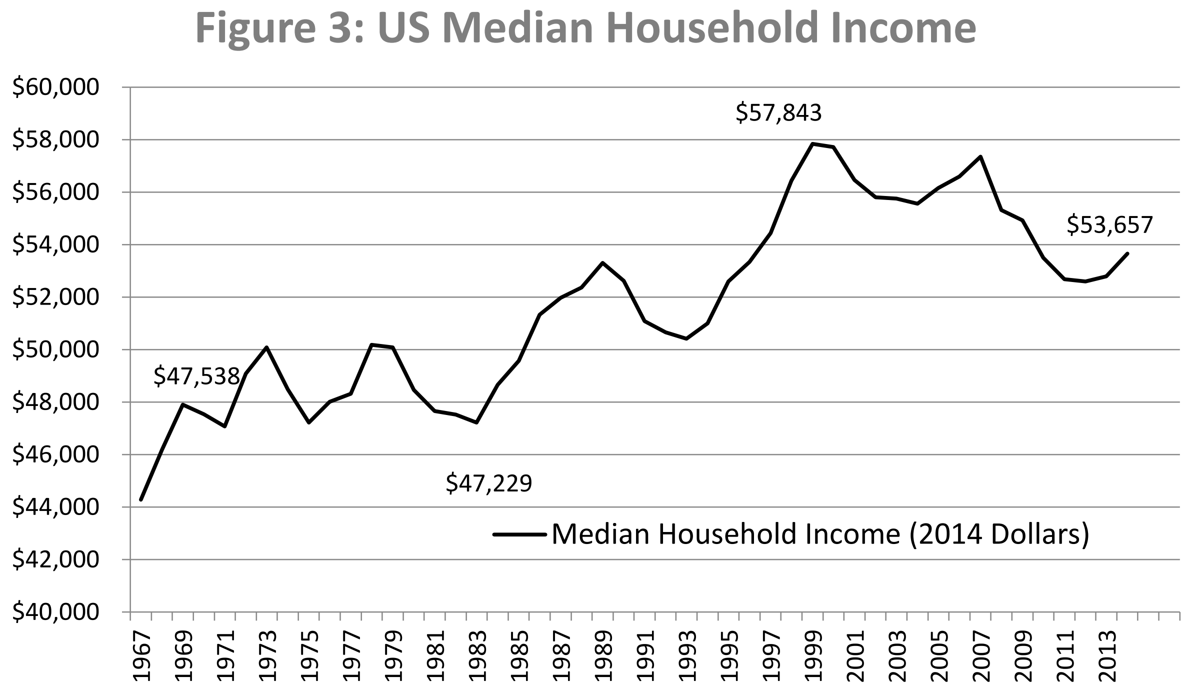


SOURCE: The Conference Board, Total Economy Database, May 2015.

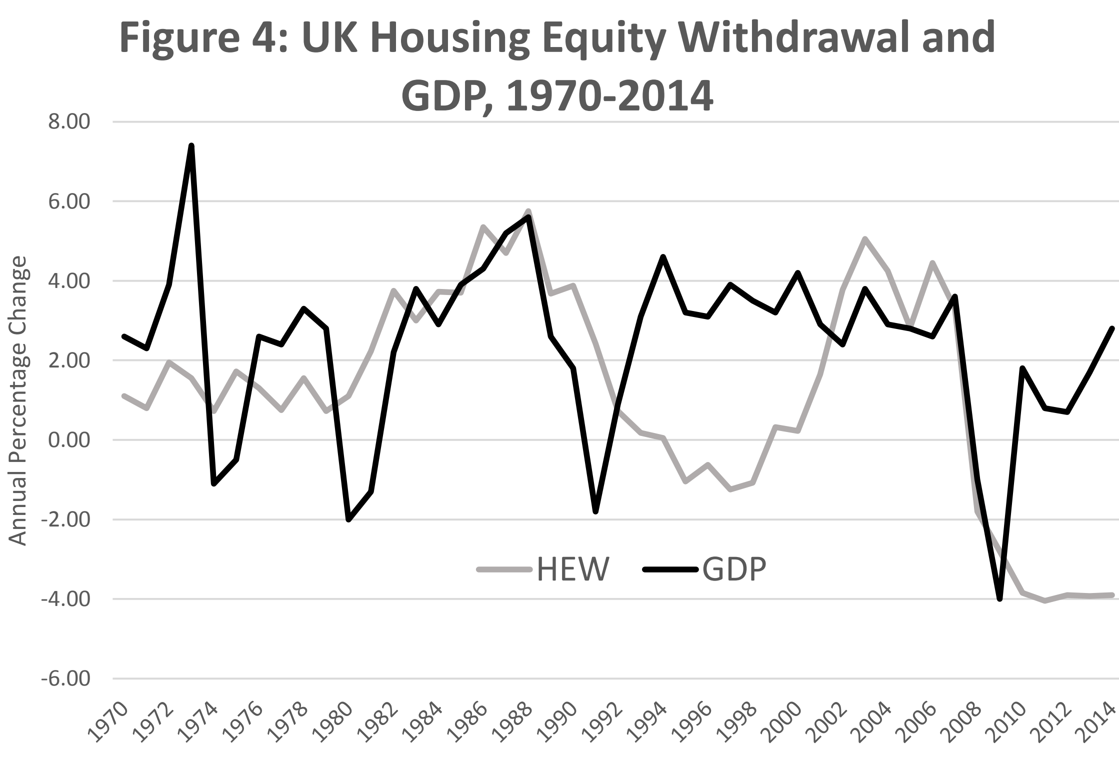
Figure 2: British v. French per capital GDP, 1950-2015



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

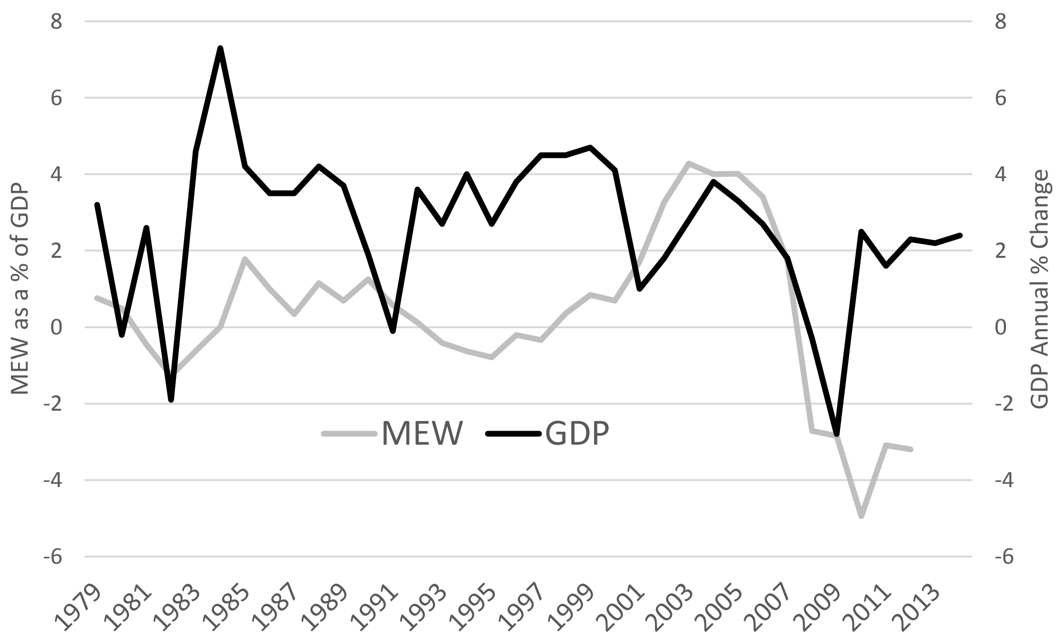


Source: US Census Bureau



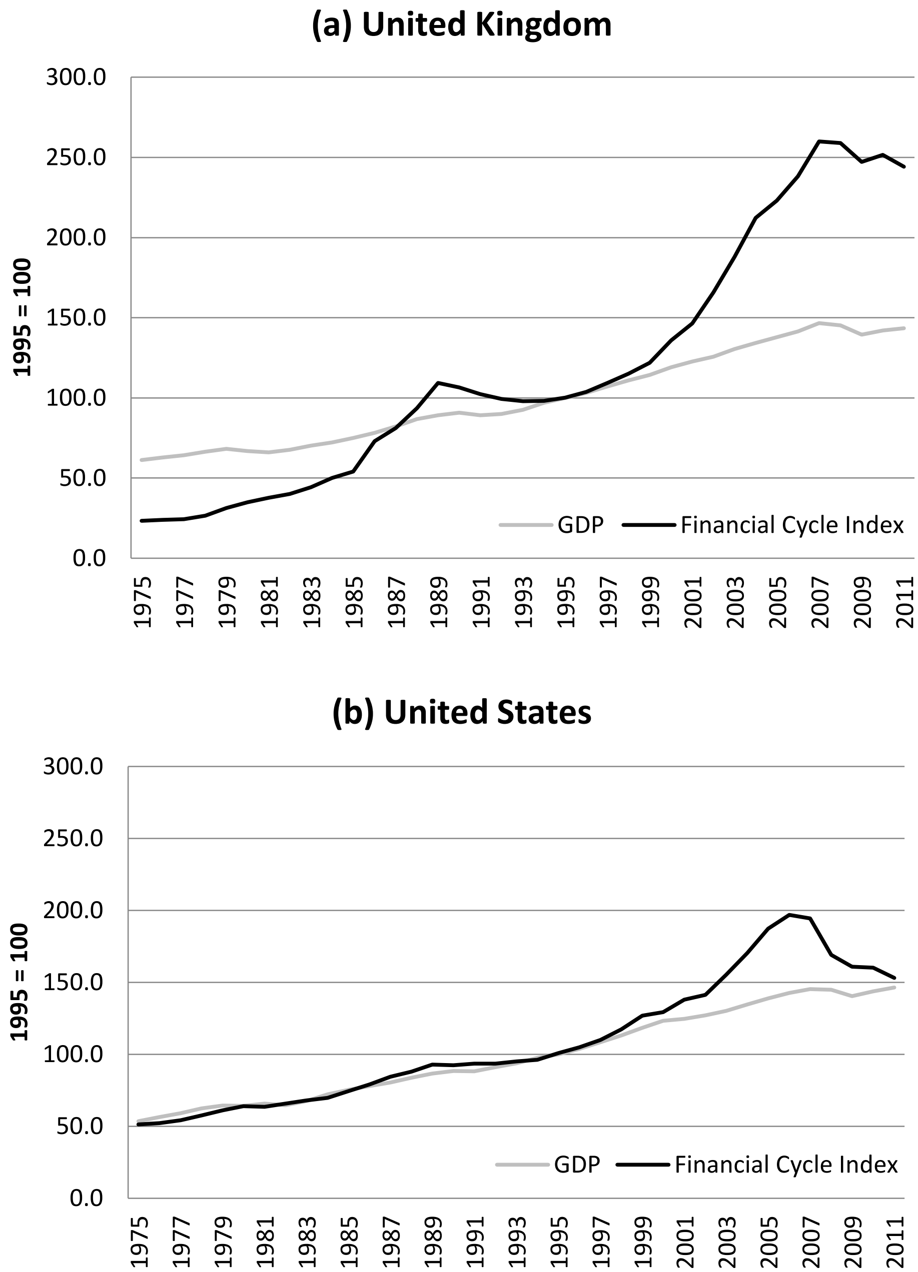
SOURCE: Bank of England; Office for National Statistics

Figure 5: US Mortgage Equity Withdrawal (MEW) and GDP, 1979-2014



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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