Developed economies are not suffering from the consequences of a financial crash, but from a structural crisis of neoliberal capitalism

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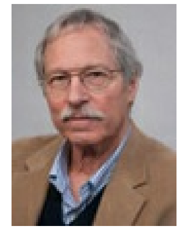
Several economies across the world, most notably in the Eurozone, continue to show only weak signs of recovery from the financial crisis which began in 2008. **David M. Kotz** *argues that developed economies are not merely suffering from the consequences of a financial crash or a severe recession, but from a structural crisis of 'neoliberal capitalism'. Drawing on 'social structure of accumulation' theory, he writes that similar crises have occurred at other points throughout modern history and that the only route to returning to growth is to facilitate the emergence of a new institutional form of capitalism.*



What explains the current malaise in developed economies across the world? In my book, *The Rise and Fall of Neoliberal Capitalism*, I analyse the roots of the economic crisis that began in 2008 and the free-market, or 'neoliberal', form of capitalism from which the crisis emerged. I argue that the stubborn stagnation afflicting many of the developed economies cannot be understood simply as the fallout of a severe financial crash or as an unusually severe 'Great Recession', but instead is a structural crisis of the neoliberal form of capitalism. This means that the continuing stagnation cannot be resolved by policy measures alone within the constraints of neoliberal capitalism. Rather, a resolution requires major institutional restructuring.

I also address the widespread concern with growing income inequality, a trend that was documented in Thomas Piketty's Capital in the Twenty-First Century. Piketty showed that large shifts in the direction of change in income inequality have occurred at certain points in history in a number of countries. I argue that the main determinant of the trend in income inequality is the institutional form of capitalism, which has changed periodically over time. The 'regulated capitalism' that was gradually constructed in the 1930s-40s in the developed countries reduced income inequality through the early 1970s. When that form of capitalism was rapidly replaced by the neoliberal form in the late 1970s to early 1980s in a number of developed countries, the trend in inequality reversed.

Recently a body of mainstream economics literature has appeared on a possible long-run stagnation problem in developed economies. Much of this literature points to such causes as population growth slowdown or absence of major growth-stimulating technological innovations. I argue instead that the cause is found in the breakdown of the institutional form of capitalism that has prevailed since around 1980.

My approach is a modified version of the social structure of accumulation (SSA) theory, which originated in the early 1980s. The SSA theory offers a framework for explaining the alternation between long periods of relatively stable economic growth and long periods of stagnation in capitalist economies. History shows that capitalism has taken a succession of particular institutional forms over time. The SSA theory posits that each institutional form, or SSA, initially promotes profit-making and stable economic expansion. However, eventually an SSA turns from a promoter of stable expansion into an obstacle to it, ushering in a long period of economic stagnation, referred to as a 'structural crisis' in this literature. The stagnation persists until a new institutional form of capitalism emerges. Such structural crises have occurred before in the developed capitalist economies, in the last decades of the nineteenth century, the 1930s, and the 1970s. Each was followed by major institutional restructuring, which gave rise to a long period of stable growth.

The book examines the reasons for the unexpected rise and triumph of neoliberal ideas and institutions around 1980. This came as a surprise, given the rejection of free-market ideas and the acceptance of Keynesian economics by the mainstream of the economics establishment after the Great Depression and World War II. I provide documentary evidence that in the course of the 1970s a critical mass of large corporations in the U.S. shifted from their previous informal coalition with organised labour in support of collective bargaining, Keynesian demand management, and a welfare state to promotion of deregulation, privatisation, a union-free environment, and cutbacks in the welfare state.

Canary Wharf, London, Credit: Graham Duerden (CC-BY-SA-3.0)

Focusing on the U.S., I explain the factors that motivated such a dramatic shift. The post-World War II system of regulated capitalism, after bringing some 25 years of rapid economic growth and widely shared prosperity, entered a crisis in the 1970s. A key factor in the 1970s crisis was a long decline in the rate of profit in the U.S. and the leading West European economies, starting in the mid-1960s and lasting until the early 1980s. Big business organisations concluded that falling profits stemmed from rising worker bargaining power in the regulated form of capitalism. They also increasingly chafed at the expanding environmental and other forms of regulation by the state in the 1970s. A decisive part of big business in the U.S., as well as in a number of European countries, found in neoliberalism the means to resolve the problems they had identified.

For several decades, neoliberal capitalism was able to bring a series of long economic expansions punctuated by relatively brief and mild recessions as well as a low rate of inflation. However, the programme of freeing markets and cutting taxes did not lead to a prosperity that trickled down to those in the middle and bottom. Rather than a rising tide that lifted all boats, neoliberal institutions brought stagnating or falling incomes for the majority and a remarkable upward income redistribution to the very rich.

Neoliberal transformation did not unleash the promised wave of investment, which has been sluggish compared to the era of post-war regulated capitalism, but the increasing inequality and rising profits it produced did stimulate initial economic expansion. However, a long economic expansion requires growing demand for output as well as profit incentives for expansion, and stagnating wages and state spending created a problem on the demand side. The demand problem was solved by two other features of neoliberal capitalism, large asset bubbles and a risk-seeking financial sector. Together those two features led to rising debt-fuelled consumer spending, which underpinned the long expansion of the 1990s and that of 2001-07 in the U.S.

However, under the surface the very same features that together promoted long expansions and low inflation — growing inequality, an increasingly risk-seeking financial sector, and a series of large asset bubbles – gave rise to trends that were unsustainable over the long run. In 2007-08 the unsustainable trends — growing household and financial sector debt, the spread of toxic financial assets, and increasing excess capacity in industry – interacted with the deflation of the U.S. real estate bubble to bring a financial panic and Great Recession, which quickly spread in various forms to the other developed countries.

Austerity policies in Europe and the U.S. can be interpreted as an effort to preserve the neoliberal form of capitalism. That form of capitalism has been very favourable for corporate profit and the income of the rich, and it is difficult for its beneficiaries to give it up. Austerity policies also follow logically from the dominant economic ideas of this era, which are difficult to dislodge despite the evidence that austerity only deepens the stagnation.

I argue that both theoretical considerations and historical precedents indicate that the neoliberal form of capitalism can no longer give rise to sustained economic growth. The stagnation will put increasing pressure on all the affected groups in society to find an alternative route to resuming normal economic growth. I suggest that a return to a statist economy is the likely outcome, although that can take different forms, ranging from a right-wing nationalist version to a new round of social democracy or even a shift away from capitalism toward socialism. While the neoliberal form of capitalism is unlikely to survive, which statist form will replace it cannot be predicted in advance and will depend on the outcome of economic and political battles among various groups and classes in the coming years.

The Rise and Fall of Neoliberal Capitalism, published by Harvard University Press, will be released in January 2015

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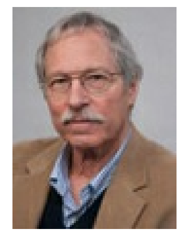
About the author

David M. Kotz – *University of Massachusetts Amherst*
David M. Kotz is Professor of Economics at the University of Massachusetts Amherst and Distinguished Professor in the School of Economics at the Shanghai University of Finance and Economics.



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