

## **Structural Contradictions of the Global Neoliberal Regime**

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## I. Introduction.<sup>1</sup>

Post World War II economic history can be thought of as evolving within two distinct political-economic regimes. The high growth Golden Age was based on socially or politically 'embedded' domestic markets, government responsibility for aggregate demand growth, and state control over cross-border economic activity. It lasted until the early 1970s, to be replaced, after a decade of turbulence, by the Neoliberal Regime, built on deregulation, liberalization, privatization, and ever-tighter global integration. The Neoliberal Regime took root in the 1980s and consolidated in the 1990s. It has now been in place long enough to permit a preliminary analysis and evaluation of its economic performance.

Proponents of liberalization argued that once government distortions were removed from global markets and the benefits of the new information based technological revolution were free to flow around the globe, higher growth, accelerated productivity gains, and declining unemployment would follow. Financial liberalization would lead to lower interest rates and higher global investment, and money and technology would flow from the capital and knowledge rich advanced nations to the opportunity rich poorer countries, closing the economic gap that separated them.

Unfortunately, Neoliberalism's promised benefits have yet to materialize, at least not for the majority of the world's people. Global income growth has slowed, productivity growth has deteriorated, real wage growth has declined, inequality has risen in most countries, the less developed nations outside East Asia have fallen even further behind the advanced, and average unemployment is higher.

In this essay, I focus on world output growth. Real global GDP growth averaged

4.9% a year in the Golden Age years from 1950 through 1973, but dropped to 3.4% annually in the unstable period between 1974 and 1979. Dissatisfied with the instability, inflation, low profits and falling financial asset prices of the 1970s, advanced country elites pushed hard for a switch to a more business friendly political-economic system; global Neoliberalism was the result. World GDP growth averaged 3.3% a year in the early Neoliberal period of the 1980s, then slowed dramatically to 2.3% from 1990-99 as Neoliberalism strengthened, making the 1990s by far the slowest growth decade of the post war era.<sup>2</sup> The question addressed in this essay is: why do the structures and practices of Neoliberalism generate such slow global growth?

## **II. Why is Global Growth Stagnant?**

I argue that chronically weak aggregate demand is a fundamental characteristic of the global Neoliberal Regime, and that inadequate aggregate demand growth is the main cause of sluggish global growth rates. Slow demand growth, in turn, has intensified competitive pressures in key industries, leading to shifts in corporation strategies that exacerbate demand deficiency. This vicious Neoliberal circle constrains global growth.

### **A) The Neoliberal Regime generates chronically inadequate global aggregate demand growth.**

Six roots of sluggish global aggregate demand are identified that are deeply embedded in the Neoliberal Regime.

The most important demand constraint is the slow growth of wages and mass

consumption. Wages have been restrained by: high average unemployment; the decline of unions; weaker government regulation of collective bargaining; a worldwide slowdown in productivity growth; more intensive international competition, which caused many large firms to shift from high to low road labor relations; heightened job insecurity due to rising import competition, the increased mobility of physical capital, the 1990s merger and acquisition explosion, and chronic job “churning” (due to labor-saving technical change and new corporate strategies of downsizing and re-engineering)<sup>3</sup>; and a deterioration of workers’ ‘exit options’ due to a declining social wage. Moreover, increased global openness and improvements in technology have made it easier for multinational corporations to substitute low-wage Southern labor for higher-paid Northern labor -- which may contribute to lower global wage inequality, but reduces global labor income nonetheless.<sup>4</sup> One study of 19 developed countries (not including the US) found that after rising rapidly through the early 1970s, real compensation growth fell to 1.2% a year in 1979-89 and again to 0.7% in 1989-96. For the US, real compensation growth plummeted to -0.3% a year in the 1980s, and averaged only 0.1% a year from 1989-96. (Mishel, Bernstein and Schmitt 1999: 362) Finally, growth in workers’ disposable income has been retarded by a shift in the tax burden from mobile capital to immobile labor, rising household debt burdens, and, recently, a shrinking social safety net.

A second factor depressing global growth rates is the high real interest rates created by independent, conservative, and inflation-obsessed central banks after 1980. David Felix estimates that the real interest rate on 10 year G7 government bonds averaged 2.6% from 1959-70, 0.4% from 1971-82, and 4.9% from 1983-94 (1998: 184).

Central Bank predilections were reinforced by the spread of financial deregulation in the 1980s and 1990s, which increased the power of global financial interests. Rentiers were increasingly able to use capital flight to punish countries using macro policy to pursue growth and employment rather than low inflation. Moreover, the heightened instability of global financial markets, exacerbated by the increasing incidence of banking and currency crises, caused financial investors to demand larger risk premiums on loans.

A third factor is increasingly restrictive fiscal policy. Lower taxes on mobile capital and upper incomes, a less generous social safety net, and an abhorrence of fiscal deficits, are part of the Neoliberal revolution. The importance given to austere fiscal policy was recognized explicitly in the criteria established under the Maastricht Treaty and carried over to the Euro zone. Government social spending in Europe and North America is still large — representing a higher share of national income than even a decade ago. But there is no question that after rising significantly in response to slow growth and high unemployment rates in the 1980s, government spending as a share of income has peaked, and in many countries begun to decline, as conservative political forces become ever more powerful. For example, the structural budget deficit as a percent of GDP for the advanced countries exhibited a continuous fall from -3.3% in 1992 to -0.6% in 1998 ( IMF World Economic Outlook May 1998:167). It is expected to continue to decline.

A fourth factor is the level and character of global investment. The growth of investment spending has slowed in the Neoliberal era due to sluggish aggregate-demand growth -- low demand growth retards investment, which in turn further slows demand growth in an ongoing multiplier-accelerator process, high real interest rates,

and increased instability and uncertainty (though, as discussed below, it has held up surprisingly well in key manufacturing industries). According to World Bank data, the annual rate of growth of world real gross domestic investment was 7.0% from 1966 to 1973 at the end of the Golden Age. It then fell to 2.2% from 1974 to 79, rose modestly to 2.8% from 1980 to 1989, then fell slightly to 2.7% from 1990- through 1996, the last year for which data is available. Investment growth in the 1990s was especially sluggish in the developed world; high income OECD countries had an average annual growth of investment of only 2.1% from 1990 through 1996.<sup>5</sup> But beyond this, much investment has been labor-saving and labor-disempowering, undertaken in support of a shift from high road to anti-worker labor policies: thus, the increased aggregate demand it created has been counteracted to some degree by the job and wage losses associated with it.<sup>6</sup>

A fifth factor is the expanding role of international institutions such as the IMF and World Bank. As more developing countries experienced national insolvency over the past two decades, the Fund and the Bank have stepped in with ever larger loans -- the loan package put together for Korea was on the order of \$58 billion. But they have invariably mandated austerity macroeconomic policies plus Neoliberal restructuring in return for the money. The growth of Fund-Bank mandated austerity-plus-restructuring programs around the developing world has severely constrained global aggregate demand. It has been estimated that something like 40% of the world's population live in countries under IMF dictate.

Finally, the 1990s has witnessed the weakening, and perhaps even the death-knell, of the East Asian state-guided, late-development models, the only successful development models of the past two decades. Battered by increased liberalization of

trade, investment, and, especially, financial capital flows, by threats from the G7 nations, the IMF, the World Bank, and multinational firms and banks, and by ever stronger demands from domestic elites for freedom from government control, the traditional structures of state economic regulation across Asia are weakening. Under its indigenous development models, East and Southeast Asia was the only high growth area in the world in the Neoliberal era. “Of 119 countries studied by the World Bank over these decades [from the mid-1960s through the mid-1990s], seven achieved both high growth and low income inequality. All seven were in Asia” (Business Week December 13 1999: 120). About half of the growth in global GDP from 1989 through 1997 originated in East Asia. The collapse of these models would push average global growth rates even lower.

**B) The global Neoliberal Regime creates chronic excess aggregate supply, leading to destructive competition and increased demand constraints.<sup>7</sup>**

According to the business press, chronic excess capacity in many global industries is a fact of life in the Neoliberal era. Business Week noted that: “supply outpaces demand everywhere, sending prices lower, eroding corporate profits and increasing layoffs” (January 25 1999: ). GE Chairman Jack Welch claimed that “there is excess capacity in almost every industry” (New York Times November 16 1997: 3). The Wall Street Journal observed that “from cashmere to blue jeans, silver jewelry to aluminum cans, the world is in oversupply” (November 30 1998: A17). The Economist worries about “a malign deflation caused by excess capacity and weak demand,” speculating that the gap between sales and capacity is “at its widest since the 1930s” (February 20 1999: 15).

*Why hasn't global supply growth adapted to the reduced pace of global demand growth in the past two decades, creating sluggish but balanced growth?* The answer, in my view, is that in the Neoliberal Regime, demand problems have exacerbated destructive competitive processes, causing over-investment and excess capacity in much of global manufacturing.

During the Golden Age, many important Northern industries were characterized by what Schumpeter called “corespective competition,” inter-firm relations based on partial cooperation rather than all-out war. Under corespective competition, firms could be reasonably sure that rivals would not take actions intended to undercut industry demand growth or erode industry profitability. Of particular importance, firms avoided the predatory pricing and capital investment ‘wars’ that destroy profits and create large-scale industry excess capacity. By placing upper limits on capacity and lower limits on price, firms generated secure oligopoly rents, which were used in part to fund the high road labor relations that were the hallmark of the dominant firms of the era. High road labor relations, in turn, helped generate high productivity growth and rapidly rising real wages. Closing the circle, rising wages and low unemployment helped sustain strong private demand growth and financed much of the period’s demand-augmenting increase in social welfare expenditures. In this environment of contained uncertainty and assured high profits, firms in core oligopolies could engage in long-term planning, generously funding R&D, offering lifetime employment to most workers, and managing the introduction of new technologies to ensure that capital equipment did not become obsolete before its pay-back period was over. Moreover, profits were high enough to finance most investment internally, holding indebtedness within safe bounds.

In the Neoliberal era, technical change, increasingly open borders, and the end of governments' commitment to high growth have destroyed the conditions necessary for coresponsive behavior. We have witnessed an outbreak of what I have called "coercive competition" (Crotty 1993) in manufacturing and elsewhere, based on cut-throat pricing, the destruction of secure oligopoly rents, overinvestment relative to demand, (creating chronic excess capacity), and faced-paced technical innovation that often renders recently constructed capital goods prematurely obsolete -- and the debt that financed them unpayable.

With their survival threatened by fierce competition, much of it international in character, large firms in the industrialized North were forced to adopt shorter planning horizons. Semi-cooperative management-labor relations, though essential to the creation of high productivity growth in the Golden Age, were now considered unviable because firms believed they had to slash labor costs through downsizing and wage cuts to survive beyond the short-run. Conflict-driven labor relations policies became the order of the day.<sup>8</sup> Coercive competition quickly altered the strategies of US and British firms, which had the weakest institutional and legal commitment to the high road. They were the first to attack their unions, repudiate existing 'implicit contracts' with workers and suppliers, maximize outsourcing and the use of temporary workers, and adopt downsizing as a permanent policy. But coercive competition is inexorably deconstructing the traditional practices of European and even East Asian firms as well. Reliance on long-term planning horizons and high road labor policies are winning strategies given coresponsive competition and strong aggregate demand growth. But an extended bout of low demand growth and coercive competition will, at some point, make

these strategies unsustainable. The new Anglo-American firm is at its strongest under conditions of instability and adversity (and relatively weakest in stable, prosperous eras) because its emphasis on flexibility shifts the costs of adversity and instability from the firm and its shareholders to workers and governments. It would thus appear that strong demand growth, high road labor policies, and co-competitive competition are each necessary conditions for the others' existence.

*Why does coercive competition lead to chronic global excess capacity?* The modern global economy has a number of key manufacturing industries -- such as autos, airplanes, computers, semiconductors, electric appliances, steel, ship building, and machine tools -- that dominate international trade and investment. These industries are capital intensive, with large economies of scale. Therefore, unless profits are generous, firms must rely heavily on debt to finance capital investment. Firms have industry-specialized machinery, labor, and management; assets are thus substantially 'illiquid', not easily transferrable to other uses when average industry profits fall. Moreover, many of these industries are characterized by frequent advances in technological knowledge, which means that recurrent waves of investment might be required for survival if competitive pressure is not restrained, causing severe devaluation of existing capital assets and ever-rising debt burdens. The size of firms, their substantially industry-specific physical, human and organizational assets, and their vulnerability to rapid technical change and financial fragility, suggest that they would face excessive risk and inadequate profits under dog-eat-dog competition. They are thus "*natural oligopolies*"-- industries that require either self- or state regulation of competition to ensure reasonable profits, guard against the premature obsolescence of the capital stock, limit

the risk of bankruptcy, restrain investment to avoid chronic excess capacity, and permit efficient high road labor relations.

Under oligopolistic organization and adequate growth in the overall economy, these industries are highly profitable. Therefore, large multinational corporations from mature industrialized economies want to continue to dominate them. However, as the post-war period evolved, developing countries that wanted to move up the technology/productivity/value-added ladder, such as Japan, Korea and Taiwan, entered these industries. Each new wave of entrants, like the countries of South East Asia in recent decades, added to the potential for market over-crowding, making inter-firm cooperative relations increasingly difficult to maintain. Had global aggregate demand growth remained strong, the newcomers would have been easier to accommodate, and the breakdown of co-respective relations might have been postponed. In the Golden Age, fast growth and limited international competition allowed Northern oligopolies to maintain some degree of co-respective relations even as Japan and, later, Korea and Taiwan began their slow ascent up the export pecking order. But, as we have seen, global Neoliberalism severely constrained global demand growth. With sluggish demand, established players must quickly exit from the industry as new firms enter to avoid chronic excess supply, falling prices and low average profits. This did not happen.

*Why do new entrants keep coming and why don't established firms withdraw from these markets as profits deteriorate?* Emerging countries *have to* go pass through most of the rungs on the technology ladder if they are to accelerate economic development; they cannot go directly from labor intensive textile exports to auto and

semiconductor exports. And established firms have huge sunk physical, human and organizational costs which will largely be destroyed if they are forced to pull out of the industry. Fundamental uncertainty plays a big role in this process. If it were known in advance which firms would ultimately lose the struggle for survival in the industry, the losers would exit to cut their losses. And those who are demonstrably weaker than their opponents often do leave. But given the importance of many of these markets and the huge sunk costs required to enter and thrive in them, most competitors try to 'stay in the game' even as competition mounts, hoping to survive the current struggle so they can reap the secure, above average profits expected to emerge when the eventual winners are in a position to re-oligopolize the industry.

Consider, for example, the global auto industry. Business Week recently reported that at least three quarter of the globe's forty auto makers are "drowning in debt and glutted with factory capacity: the industry can make 20 million more cars and trucks a year than it can sell."<sup>9</sup> The global market is plagued "by cost pressures and cutthroat pricing on top of the overcapacity problems" (January 25 1999: 69). Yet firms continue to invest in the face of these seemingly disastrous industry conditions -- and largely because of, not in spite of, these problems.

I have elsewhere (Crotty 1993) labeled this phenomena "coerced investment." Price-profit pressures *force* firms that have decided to 'stay in the game' to build plants where labor and other costs are cheapest -- and Neoliberalism has offered them the whole world as potential cost-cutting sites. They invest to shed and more tightly control labor, to gain greater economies of scale, and to acquire best practice technology for both cost reduction and quality reasons; in markets such as autos, semiconductors and

airplanes, best-practice technology often requires huge investments. Finally, they invest to get inside the borders and on the ground floor of expected high growth developing markets, a designation that now rapidly shifts back and forth across geographical boundaries.

For example, Ford, GM and Daimler Chrysler are again investing heavily in Asia, even though sales are not expected to return to 1996 levels until 2004. “With the US and European markets maturing, the Big Three are counting on Asia for growth.” But since Japanese firms will not cede this market to them, Asia “has turned into a war of attrition, with the Big Three aiming to be among the winners” (Wall Street Journal December 8 1999: B1). The Wall Street Journal reports that GM is building new plants with huge capacity in Brazil in order to cut costs in a bad market, introduce new models, and produce inside the potentially large Brazilian market: “by containing losses now and pushing ahead with plans for investment in new products, GM hopes to be ready to cash in when the market recovers” (February 25 1999: 1). It observed that “many experts warn of vast overcapacity in Asia and South America if auto makers complete even a fraction of already announced plans for new plants,” yet adds that these experts “acknowledge the [competitive] advantage of being the first producers” in local markets (August 4 1999: 1). The Economist sees the cost cutting pressures associated with “globalization” as a key culprit behind the burst of new capacity; the “rush to build plants all over the place has merely added to the capacity mountain” (May 10 1997: 21).

This process of coerced investment appears to be irrational and, for this reason, it does not exist in the world of Neoclassical theory. And from the perspective of the economy or society as a whole, it *is* irrational. But it is not irrational for the affected

firms. Under their 'natural' oligopolistic organization, these industries are exceptionally profitable. Thus, every firm wants to be one of the survivors: "The survivors of overcapacity downturns often emerge as the big winners," The Wall Street Journal reminds us (November 30 1998: A17).

Of course, the most powerful firms are not content to let this process complete its destructive course. They are currently caught up in a global merger movement that is, in large part, a response to destructive competition. Companies are merging to "cut costs by shedding labor," and "trim capacity, reduce competition, and hike prices" (Business Week October 18 1999:234). Business Week argued that in a decade or so, there will be only six surviving super-firms in the global auto industry (January 25 1999: 68). Under prospective new corespective arrangements, the winners will have eliminated global excess capacity (by shutting down the losers's factories), and be in a position to regulate investment, control price, and restore good profit margins -- assuming that global demand growth does not slow down even further.

The point that must be stressed is that *sluggish aggregate demand growth and chronic excess aggregate supply reinforce one another in a vicious circle*. The more competitive pressures develop, the more they force firms to cut wages, smash unions, substitute low for high wage labor, and pressure governments to cut spending and generate budget surpluses. But these actions constrain global aggregate demand even more tightly, creating yet stronger competitive intensity, and so on.

This pattern, with the development of coercive competition followed by a merger wave, is being repeated in the financial sector. In the wake of continuing financial deregulation, large banks are moving into heightened competition both with investment

and brokerage firms and with one another.<sup>10</sup> Increasingly, high profits can be obtained in the financial sector only by creating new products or new markets -- which merely postpones the problem unless the temporary scarcity rents generated are solidified through oligopolization, or by taking on ever more leverage and ever greater risk. We have witnessed both processes unfold in the last two decades.

Keynes and Minsky, among others, taught us that unregulated financial markets are inherently speculative and volatile, subject to irregular cycles of over-optimism followed by excessive pessimism. But it is not just excessive optimism or belief in fairy tales about the “new economy” that has led large banks to write incredibly risky loan and derivative contracts or undertake dangerous off balance sheet commitments. Faced with the ongoing loss of their corporate loan business -- their main source of profit -- to other institutions, banks were forced to undertake greater risk, or decline in size and power. It should not come as a shock to find that they chose greater risk.

Global Neoliberal financial markets are thus *both highly speculative and coercively competitive*. It is therefore not surprising that banking and currency crises generated by risky and reckless lending and financial investment patterns break out with increasing frequency. “Financial crises seem now to happen with almost monotonous regularity,” The Economist recently observed (June 12 1999: 65). Only continuous IMF- Fed bailouts (at enormous taxpayer expense) have prevented the self-destruction of the global financial system, and sustained the profits of multinational financial enterprises. But both recurrent crises and subsequent ‘rescues’ erode global demand growth by creating deep, extended recessions in the crisis areas, adding high risk-premiums to interest rates, and forcing more and more countries to submit to the

austerity macro policies mandated by the IMF and World Bank.

### **III. Conclusion.**

I have argued that sluggish aggregate demand growth and chronic excess capacity are fundamental, deeply-rooted characteristics of the Neoliberal Regime. They have contributed significantly to the development of many of the ills we have come to associate with globalization, such as slow growth, high unemployment, low wages, rising inequality and relative poverty, unstable cross border financial flows, the frequent outbreak of banking and currency crises, and the breakdown of the world's most successful development models.

Take the recent Asian financial crisis as one example of this relation.<sup>11</sup> Slow growth and below average profits reduced the incentive to invest in physical capital in the developed world in the Neoliberal era, while rising incomes at the top of the income pyramid sustained the flow of funds seeking investment outlets. Financial deregulation, the removal of capital controls across the globe, and technical innovation made it possible for an increasing proportion of these funds to flow across national boundaries in search of high returns in the less developed world. The flow of short term portfolio investment and bank loans to developing nations accelerated sharply in the 1990s, especially to the 'miracle' economies of East Asia.

To prevent the sudden withdrawal of these short-term funds, recipient nations must avoid significant deterioration in their trade balance. To eventually repay the loans, they must be able to run substantial export surpluses for extended periods. *But, it is increasingly difficult for developing countries to maintain healthy trade balances*

*because slow global growth, especially in developed countries, constrains the total demand for exports, while fierce competition in global manufacturing markets constrains the market share any particular country can hope to maintain.* Consider the case of South Korea, a major recipient of short-term foreign bank loans, whose largest export earner is semiconductors. In 1996 excess supply and fierce competition drove semiconductor prices down by almost 80%, contributing to a sharp increase in the trade deficit (from 2% to 5% of GDP) that helped trigger the Korean financial crisis. Most of the area experienced a similar problem. South and East Asian export growth fell by two-thirds in 1996 from the rates achieved in 1994 and 1995 (United Nations Trade and Development Report, 1997: 5).

Thus, slow growth and low industrial profit rates in the North helped stimulate financial flows to Asia, but slow growth and coercive competition simultaneously made it almost impossible for the recipient countries to sustain the trade performance needed to maintain their loans and portfolio investments from the North. Having forsaken import regulation as part of the liberalization process, affected countries felt they had little choice once the crisis hit but to accept IMF intervention and the deep, import slashing, recessionary policies it brought. Paradoxically, the structural contradictions of the Neoliberal Regime ended up destroying, at least temporarily, the high growth and profit rates that attracted the funds to Asia in the first place.

In sum, the structures and practices of global Neoliberalism are fundamentally flawed. They cannot create an economic environment conducive to prosperity and security for the majority of people in the developed or the developing world. Unless and until new progressive structures and practices for national economies and for global

integration are implemented, we can expect to see an intensification of all the problems mentioned in this essay.

## ENDNOTES

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1. The general line of argument in this paper can also be found in Crotty and Dymski (1998) and Crotty, Epstein and Kelly (1998).
  2. The 1950 to 1973 growth rate is from Maddison (1995: 60). Post 1973 data are taken from various issues of the United Nations Conference on Trade and Development's Trade and Development Report.
  3. "Constant restructuring and consolidation by large corporations is driving layoffs to record highs" (Business Week December 27 1999: 55).
  4. Another factor depressing global wages was the entry of workers from China, the former Soviet Union, and India into the available global labor pool.
  5. World investment is for 210 countries for which a time series is available, and is taken from the World Bank's "1999 World Development Indicators CD- Rom", as is the data for high income OECD countries.
  6. The relation between labor saving investment, heightened competition, and shifting corporate strategies is discussed in Crotty (1993).
  7. The concepts and theory that inform this section are examined in detail in Crotty (1993), which discusses the causes and consequences of the shift in competitive regimes from the Golden Age to the Neoliberal era, and analyzes the implications of this shift on various aspects of economic activity. See also the interesting treatment of destructive international competition in Brenner (1998).
  8. An excellent discussion of the effect of changes in the competitive environment on the labor relations policies of US firms, and of rising wage inequality in general, can be found in Howell, Duncan and Harrison (1998).
  9. The big US auto companies have been profitable recently, but this is primarily due to the huge profit margins they receive on their popular suburban utility vehicles, and secondarily to profits made on their financial operations. SUVs represented 18% of US auto sales in 1999, up from 10% in 1994. "Profits from SUVs are huge," the Wall Street Journal reported, "while small car sales remain loss leaders" (12-8-99, A2). It seems inevitable that these abnormally high SUV profit margins will eventually evaporate as a result of more serious import competition, a decline in auto demand due to market saturation or recession, or both.

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10. See Dymski (1998) on this point.

11. Crotty and Dymski (1998) explain in more depth why sluggish global demand growth and coercive competition helped bring on the Asian crisis.

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