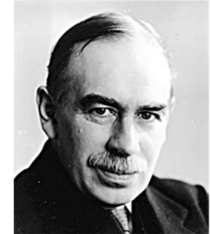
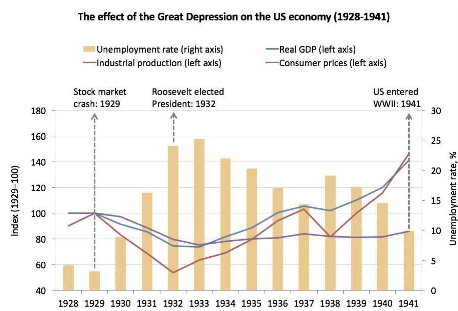
Opkomst en val van het egalitair kapitalisme

Keynesianisme: Overzicht

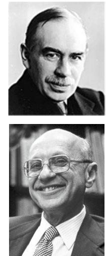
- J.M. Keynes (1936):
  - *"The outstanding faults of the economic society in which we live are its failure to provide for full employment and its arbitrary and inequitable distribution of wealth and incomes."*
- Pijlers van Keynesiaanse welvaartstaat
  - Contra-cyclisch macro-economisch beleid
  - Sociale zekerheid
  - Sociaal overleg
- 3 "i's" in CPE/IPE
  - *Interests*: belangen werknemers en industrieel kapitaal)
  - *Ideas*: opkomst Keynesiaanse gedachtegoed)
  - *Institutions*: institutionele verschillen in sociaal overleg en electorale systemen)

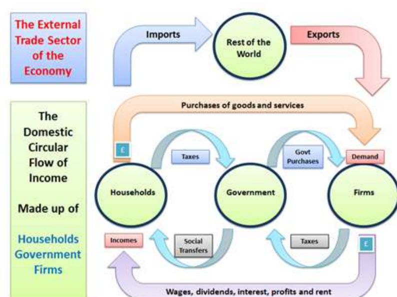




Paradigmaverschuiving als ideeënstrijd?

- *"Practical men who believe themselves to be quite exempt from any intellectual influence, are usually the **slaves of some defunct economist**."*
- *"There is enormous inertia—a tyranny of the status quo—in private and especially governmental arrangements. **Only a crisis—actual or perceived—produces real change**. When that crisis occurs, the actions that are taken depend on the ideas that are lying around. That, I believe, is **our basic function: to develop alternatives to existing policies, to keep them alive and available until the politically impossible becomes politically inevitable**"*



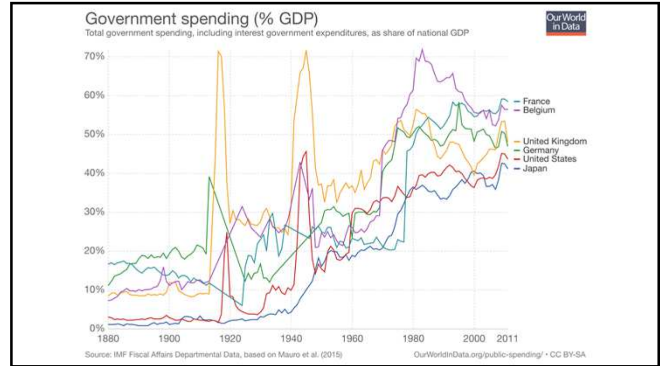


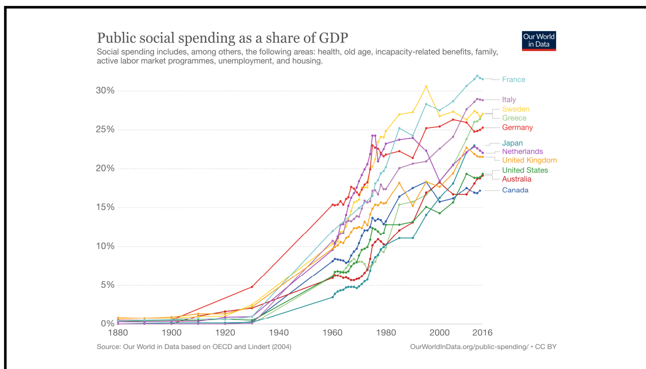
Klassiek-liberaal vs. Keynesiaans model

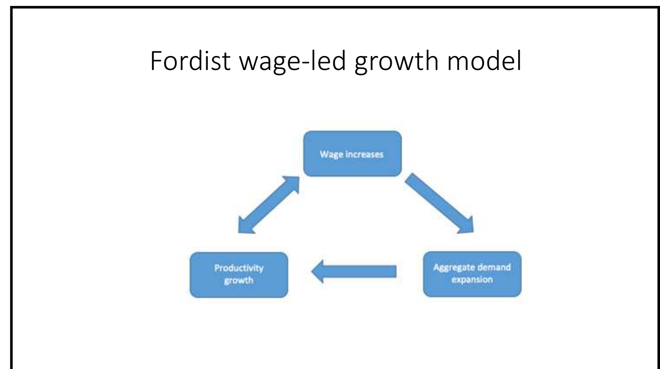
- Klassiek-liberaal model van de economie
  - Wet van Say: "Aanbod creëert eigen vraag"
  - Belang van prijs- en loonflexibiliteit
  - Zelfcorrigerende capaciteit van de vrije markt
- Keynesiaans model van de economie: "*In the long run, we're all dead*"
  - Persistente werkloosheid kan wijzen op tekort in geaggregeerde vraag → aanbod wordt bepaald door de geaggregeerde vraag: Y = C + I + (G – T) + (X – M)
  - Tijdens economische recessie daalt de private consumptie en investeringen vanwege een gebrek aan vertrouwen in de toekomst ("*animal spirits*")
    - Neerwaartse loonrigiditeit (geen slechte zaak!)
  - Staatsinterventie ("*deficit spending*") noodzakelijk om geaggregeerde vraag te ondersteunen en vertrouwen te herstellen!

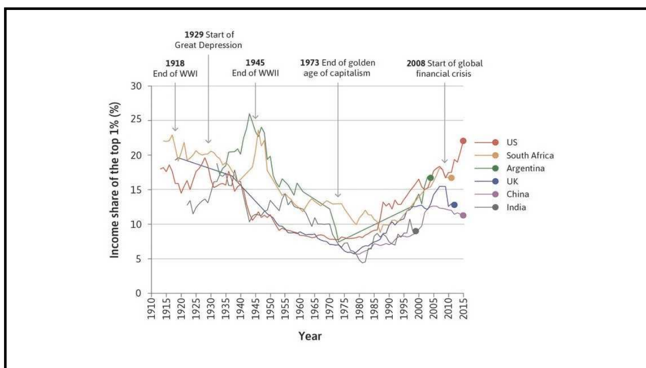
Pijlers van de Keynesiaanse welvaartstaat

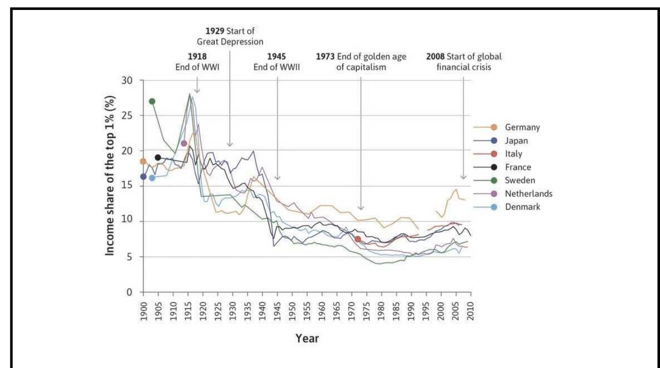
- Macro-economisch beleid gericht op "volledige tewerkstelling"
  - Stabilisering van de geaggregeerde vraag via contra-cyclisch monetair en budgettair beleid
  - Vb. New Deal van president Franklin D. Roosevelt in de VSA
- Sociale zekerheid
  - Vb. Social Security Act in de VSA (1935)
  - Sociale uitgaven als "automatische stabilisatoren"
- Fordisme
  - Sociaal overleg
  - Koppeling loon- en productiviteitstijging om afzetmarkt te verzekeren

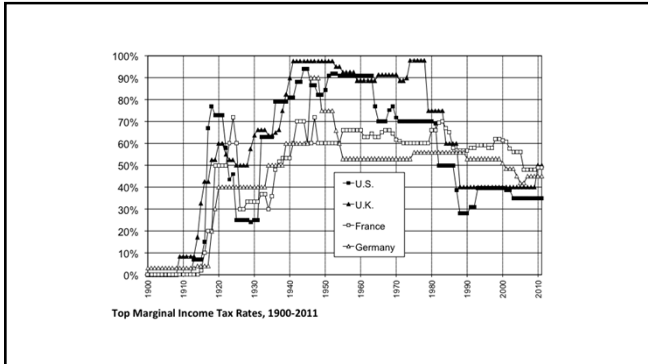


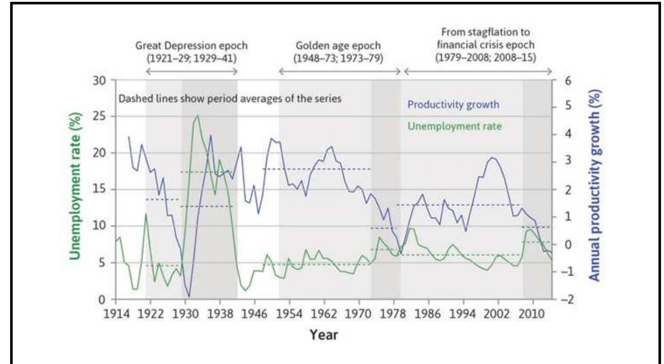






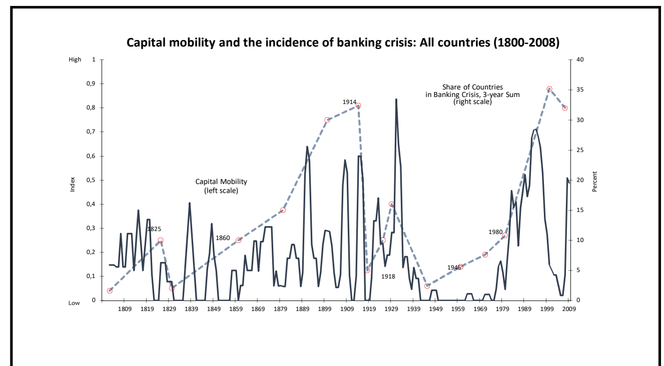






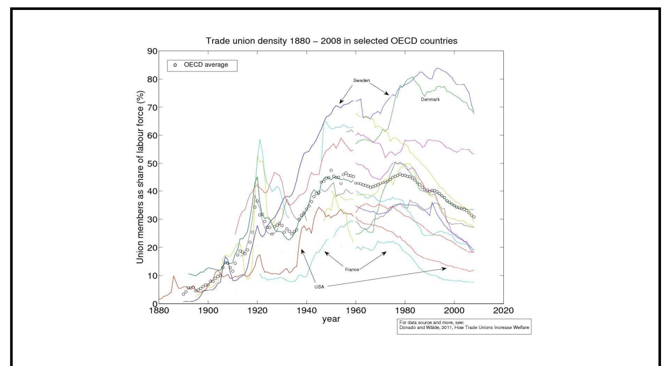
Keynesianisme en het Bretton Woods regime

- "*Embedded liberalism*"
  - Internationale economische integratie verzoenen met Keynesiaanse welvaartstaat
  - John G. Ruggie (1982): "*Unlike the economic nationalism of the thirties, it would be multilateral in character; unlike the liberalism of the [19th century] gold standard and free trade, its multilateralism would be predicated upon domestic interventionism*"
- Belangrijkste kenmerken Bretton Woods:
  - Beperkingen op internationale financiële kapitaalstromen ("kapitaalcontroles")
    - J.M. Keynes: "*Ideas, knowledge, science, hospitality, travel – these are the things which should of their nature be international. But let goods be homespun whenever it is reasonably and conveniently possible, and, above all, **let finance be primarily national**.*"
  - International Monetair Fonds en Wereldbank
  - Aanpasbare vaste wisselkoersen
  - Multilaterale liberalisering van handel via *General Agreements on Trade and Tariffs* (GATT)

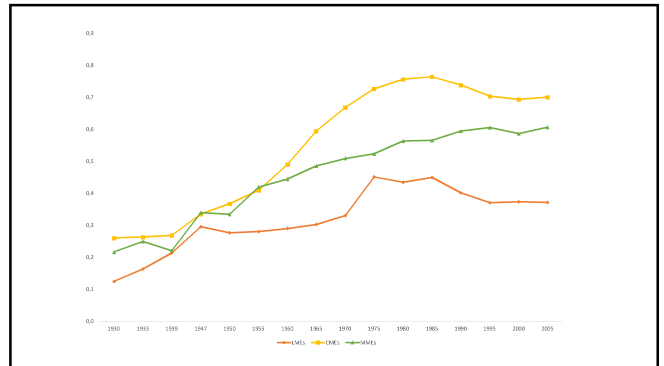


Opkomst van KWS: Belangen

- Verdeling van "power resources" tussen arbeid en kapitaal
  - Walter Korpi (1983): "*Through its political and union organizations, the working class can decrease its disadvantage in power resources in relation to capital.*"
- Ondersteuning KWS door bedrijven uit de industriële sectoren
- Ondergeschiktheid van de financiële sector
  - Eric Helleiner (1994): "*Discredited by the crises, the private and central bankers who had dominated financial politics before the 1930s were increasingly replaced at the levers of financial power by a new class of professional economists and state managers whose social base was among labour and national industrial leaders.*"
- Historisch klassencompromis tussen arbeid en industrieel kapitaal
  - Walter Korpi (1983): "*They would co-operate in 'making the pie larger in order that there would be more to divide'. Through control of the government, the labour movement could influence the distribution of economic growth. Business enjoyed favourable conditions for investment and expansion.*"



	Left percentage of valid votes		
	Before World War I	Interbellum	1945-80
Australia	37.0	45.0	48.5
Austria	23.0	41.0	48.0
Canada	0.0	3.0	15.0
Denmark	26.0	39.0	45.5
Finland	40.0	39.0	47.0
France	13.0	32.0	42.0
Germany	31.0	40.0	37.5
Italy	18.0	26.0	38.0
Ireland	-	32.0	42.0
Japan	-	-	36.5
Netherlands	13.0	25.0	34.5
New Zealand	5.0	35.0	46.0
Norway	15.0	36.0	51.0
Sweden	13.0	46.0	51.5
United Kingdom	5.0	33.0	46.5
United States	4.0	5.0	0.5



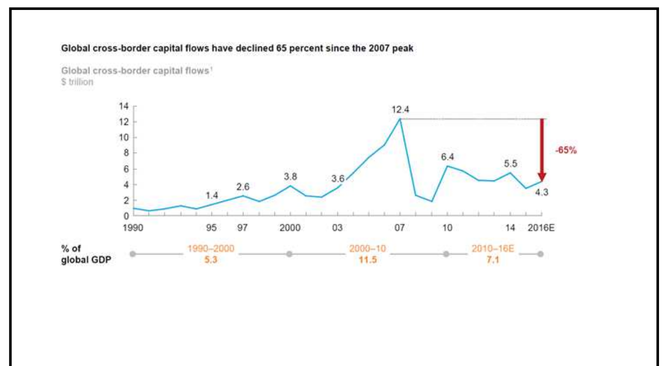
Opkomst van de KWS: Instellingen

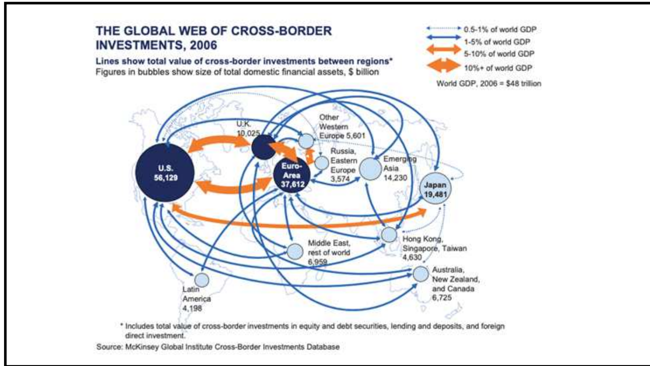
- Verschillen in instellingen voor sociaal overleg
  - Scandinavische "gecoördineerde markteconomieën" (CMEs): nationaal-gecentraliseerde vakbonden en werkgeversorganisaties
  - Andere CMEs: sectoraal georganiseerde vakbonden en werkgeversorganisaties (DE, AT) en/of confessioneel georganiseerd (NL, BE)
  - Angelsaksische "liberale markteconomieën" (LMEs): ambachtelijk georganiseerde vakbonden
- Verschillen in electorale instellingen
  - Proportionele kiesstelsels in CMEs
  - Meerderheidsstelsels in LMEs

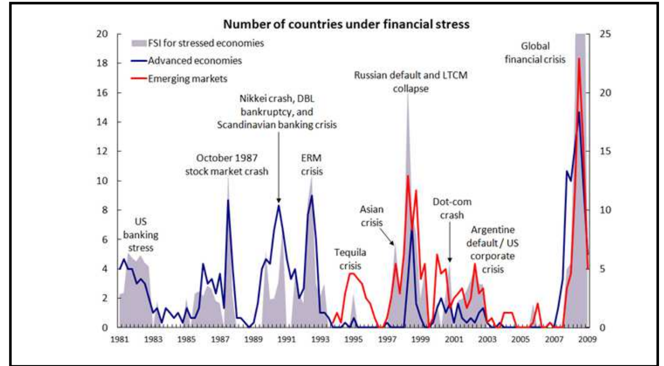
Country	Characteristics of Cabinet Composition	Electoral Model	Average Cabinet Shares (%) from 1945 to 1990			Average Votes (%) between 1945 and 1990		
			Left	*Conf.*	*SCR*	Left	Conf.	SCR
Austria	Confessionals in coalition with left or secular center-right parties	PR	61	38	2	47	43	10
Belgium		PR	28	52	20	36	37	27
Germany		PR	25	50	25	38	45	18
Netherlands		PR	20	61	18	35	42	23
Switzerland		PR	22	30	47	28	23	49
Denmark	Left dominance or left-right balance	PR	49	1	50	47	1	52
Finland		PR	41	0	59	45	2	54
Norway		PR	74	4	21	49	9	42
Sweden		PR	82	0	18	51	1	48
Italy	Confessional dominance	PR	20	70	10	44	39	17
Ireland	Center-right dominance	PR	11	22	67	14	29	57
France		M/P	22	9	69	44	9	47
Australia	High left votes without long-term left cabinet presence	M/P	34	0	66	47	0	54
Britain		M/P	39	0	47	42	0	58
Japan		M/P	2	0	98	34	0	66
New Zealand		M/P	38	0	62	45	0	55
Canada	Secular center-right dominance	M/P	0	0	100	16	0	85
USA		M/P	0	0	100	0	0	100

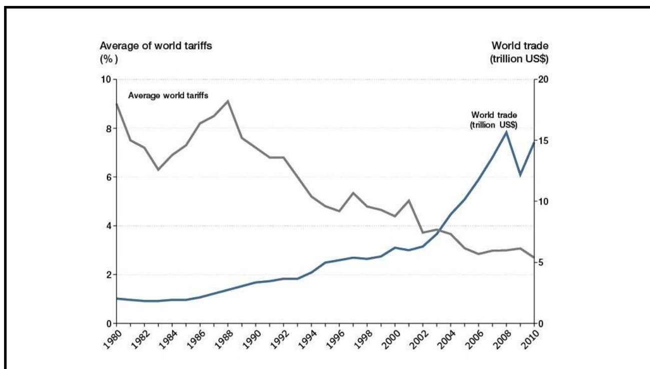
Neoliberale globalisering

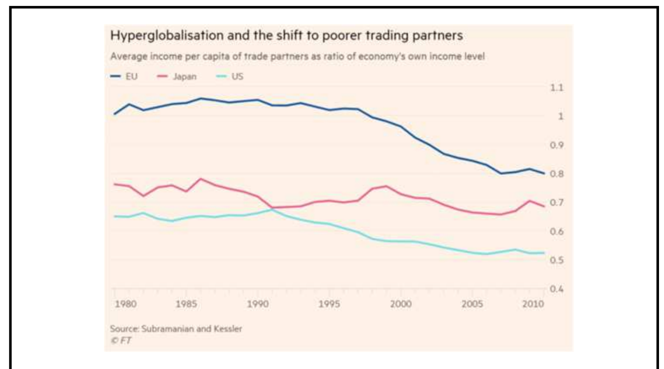
- Internationale context
  - Stagflatiecrisis tijdens jaren 1970 (zie volgende week)
  - Val van Bretton Woods 1971-73
- Financiële liberalisering
  - Belangrijkste munten kregen flexibele wisselkoers
  - Ontmanteling van kapitaalcontroles en transitie naar vrij kapitaalverkeer
- Handelsliberalisering
  - Verdere handelsliberalisering via GATT, uitmondend in oprichting van *World Trade Organization* (1995)
  - Facilitering van internationale handel door daling transportkosten
    - Belang van "containerisering": https://www.youtube.com/watch?v=F-ZskaqBshs
- Transnationalisering van productie
  - Groei van multinationale ondernemingen en "global value chains"











Gevolgen van neoliberale globalisering?

- Macro-economisch beleid
  - Universele transitie van "volledige tewerkstelling"-regime naar anti-inflatieregime ("sound money")
- Sociaal beleid
  - Flexibilisering/decentralisering van arbeidsmark en gedeeltelijke ontmanteling van sociale zekerheid
- Corporate governance
  - Opkomst van het aandeelhoudersmodel en transitie van "*retain-and-reinvest*"-business strategieën naar "*downsize-and-distribute*"
- Financial policy
  - Transitie naar "*market-based banking*"
  - Regime van "geprivatiseerd Keynesianisme", waarbij huishoudelijke schulden en "*deficit spending*" door gezinnen de geaggregeerde vraag moeten ondersteunen (vooral in Angelsaksische landen)

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Chapter 2 –

The rise and fall of egalitarian capitalism

In the previous chapter we have seen that the era between the 1930s and the 1970s was the most egalitarian period in the history of democratic capitalism: income inequality fell in the entire industrialized world. In this chapter we zoom in on the rise and fall of egalitarian capitalism, providing an overview of different theoretical perspectives in CPE/IPE on the ascent and subsequent demise of what became known in the literature as the Fordist accumulation regime of the Keynesian welfare state (KWS). The KWS arose in the wake of the Great Depression, which devastated the world economy and undermined the legitimacy of the classical-liberal normative pillars on which the institutional organization of capitalist economies had been based. Faced with soaring levels of unemployment and a sharp contraction of economic activity, governments abandoned their *laissez-faire* beliefs and started to experiment with new forms of state intervention informed and legitimized by new economic ideas and theories that are now identified as "Keynesianism". The KWS had the following three features. First, there was a cross-party political consensus that actively managing aggregate demand and bringing the economy towards its full potential and towards full employment had become a central responsibility of the state. Second, the KWS was oriented towards the expansion of welfare rights through steady growth in social spending and the advancement of collective bargaining in ways that ensured wages grew in line with average productivity. Finally, it was supported internationally by the Bretton Woods regime, which set out rules for managing international financial relations and provided a conducive external environment for domestic state intervention.

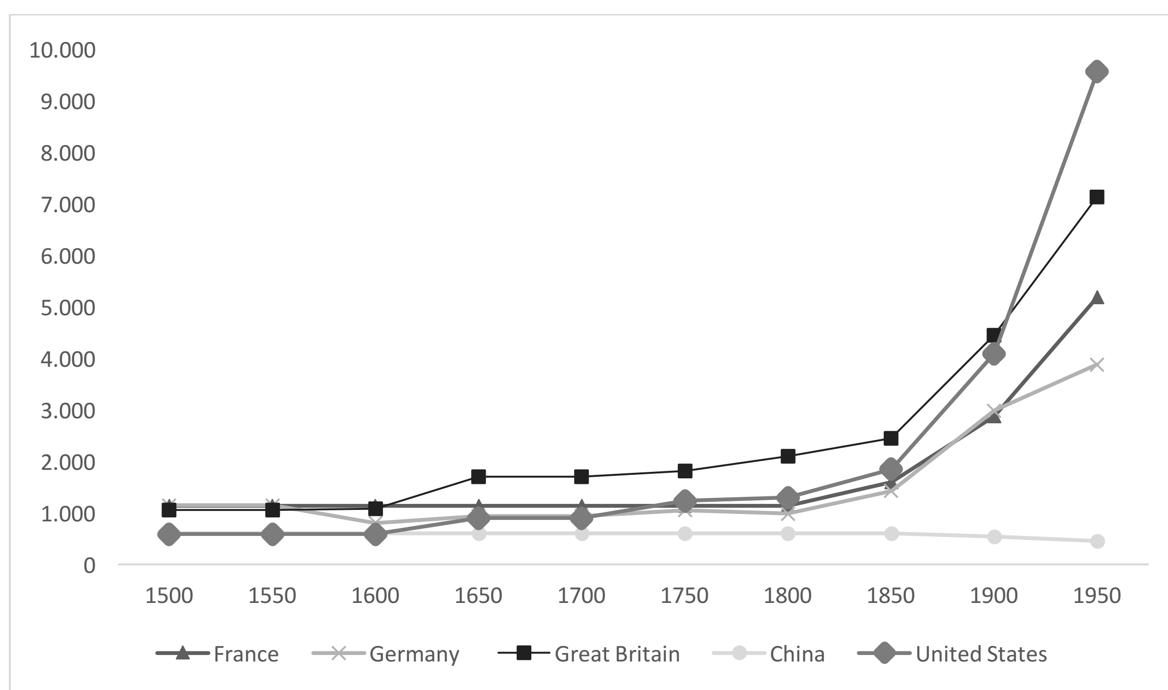
The rise of the KWS was both cause and effect of the post-war economic expansion, which lasted until the recession of 1973-75 and became known as the "Golden Age" of capitalism. Its expansion came to a halt in the wake of the breakdown of the Bretton Woods regime and the first oil shock of 1973, which precipitated a stagflation crisis that undermined the legitimacy of the Keynesian paradigm and set the stage for the rise of neoliberalism as a new framework for economic policymaking in the advanced capitalist world. In this chapter we sketch out how three core theoretical approaches in CPE/IPE account for the rise and fall of the KWS: (1) interest-based approaches identify material preferences of producer group coalitions and electoral politics as prime drivers of economic policymaking; (2) institutional approaches maintain that organisational structures of national political economies are the key causal factors behind the variation of economic policymaking over time and across countries; (3) ideational approaches highlight the role of economic ideas, norms and cultures in driving stability and change in economic policy regimes.

2.1. The rise of the Keynesian welfare state

2.1.1. The Great Depression: From laissez-faire to state intervention

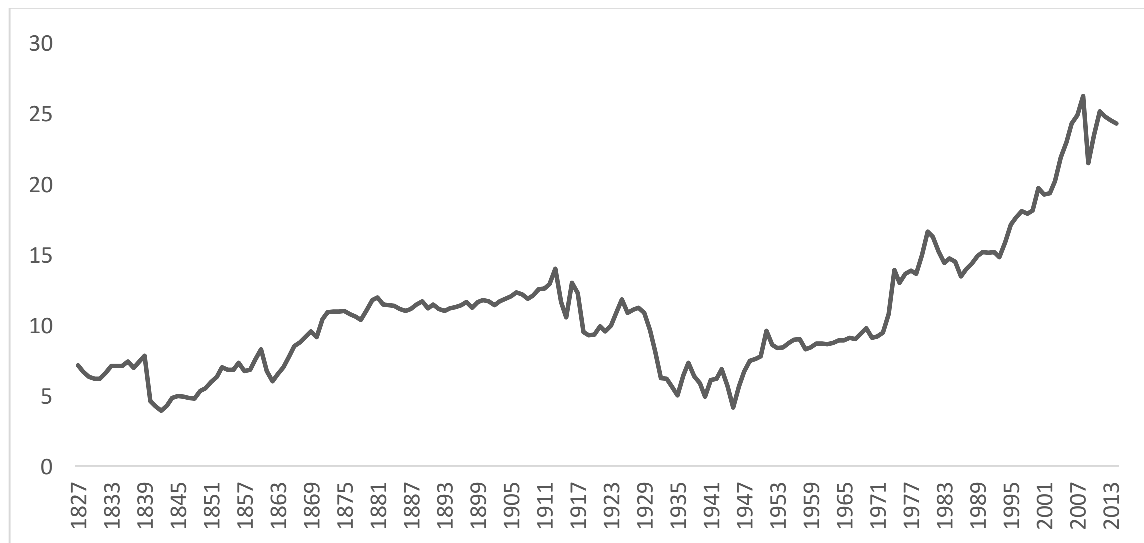
The 19th century witnessed an unprecedented expansion of material prosperity, as GDP per capacity – which measures the average income earns per year in a particular country – increased exponentially in Western Europe and America (Figure 2.1). From a classical-liberal perspective, economic growth was made possible by entrepreneurs and capitalists searching for new products and production methods in a context of increasing market liberalization, leading to an extraordinary growth in technological innovation and labour productivity. Many important inventions, scientific discoveries and applications revolutionized the way products were manufactured: the use of new machines and the construction of new industrial factories increasingly mechanized the production of goods like cotton and textiles. There were also important innovations in transportation (e.g. the steam train, steamship, the automobile and airplane) and communication (e.g. telegraph and radio) due to which the world economy became integrated like never before (Figure 2.2). International trade and investment was also promoted by the sharp reduction in tariffs on imports. The UK was the first country to liberalize trade, but other European countries soon followed. By the 1870s most industrializing countries had joined the gold standard: they promised to exchange their currency for gold at a pre-established rate. This bolstered international commerce and investment by effectively establishing an international system of fixed exchange rates and avoiding disruptive currency fluctuations.[1]

Figure 2.1 Growth in real GDP per capita selected economies (in international dollars)



Source: Maddison Project

Figure 2.2 World exports as a percentage of world GDP



Source: Ourworldindata.org

By the end of the 19th century political elites in the Western World had fully embraced the principles of classical liberalism. These principles prescribed a very restricted role for the state in the economy: governments reduced their involvement in the economy by introducing market mechanisms for the allocation of resources. The principle purpose of the state was to maintain the public order in order to ensure a proper functioning of the free market system and supply "public goods" – non-rival and non-excludable goods that remained underprovided by the market system, e.g. national security, public roads and infrastructure. Especially state protection of property rights was absolutely essential: without the ability to transfer and exchange property and enter into contracts, there could be no markets and hence no market economy; the right to own physical capital and land, and therefore to capture the value of what is produced using that capital and land was of fundamental importance to the expansion of markets and the accumulation of capital. The state also enabled the commodification of labour and the creation of "free" labour markets by organizing repressive actions against worker revolts. In this sense, the liberal doctrine of *laissez-faire* in practice was at least as much about the state *imposing* and *creating* free markets as it was about abolishing restrictions to markets – as Polanyi argued in *The Great Transformation*: "There was nothing natural about *laissez-faire*: free markets could never have come into being merely by allowing things to take their course … The road to the free market was opened and kept open by an enormous increase in continuous, centrally organized and controlled interventionism."[2] For Polanyi, the ultimate manifestation of this was the making of the gold standard, which forced governments to privilege international commitments to exchange rate stability over domestic demands and often imposed austerity and wage cuts onto the working classes (BOX 2.1).

Box 2.1. The gold standard and the macroeconomic adjustment process

As Fred Block notes in his introduction to *The Great Transformation*, Polanyi believed that the gold standard was a major intellectual achievement: “it was an institutional innovation that put the theory of self-regulating markets into practice, and once in place it had the power to make self-regulating markets appear to be natural.”[3] The gold standard gave market participants of different countries using different currencies the opportunity to freely engage in transactions with each other. The gold standard was based on the following three principles: (1) each country would set the value of its currency in relation to a fixed amount of gold and would convert freely between domestic money and gold at that price; (2) each country would back national banknotes and coinage with earmarked gold reserves and condition long-run growth in the money supply on the availability of general gold reserves; (3) each country would abstain from imposing restrictions on the export or import of gold and capital by private citizens. Based on these three rules, national governments and central banks had to subordinate their macroeconomic policy instruments – i.e. tools to support domestic demand and employment (see below) – to the convertibility of their currency into gold, which could be highly painful for countries running trade deficits. Because residents in these countries spent more on international trade than they earned from it, central banks had to raise interest rates while the government had to cut public spending to prevent outflows of gold and restore gold convertibility. These restrictive macroeconomic policies increased the level of unemployment and depressed wages of the working classes, who typically had to bear the bulk of the burden of the adjustment process.[4]

One of the key lessons of the gold standard is that countries can face a potential trade-off between their desire to reap the benefits from market integration and their need for societal protection against the vagaries of unfettered markets. The only reason why the gold standard was politically sustainable was the lack of democratic representation of working classes and other groups (like small farmer) most affected by its harsh adjustment mechanism. Since the commitment to the gold standard advanced the interests of creditors and harmed those of debtors, the gold standard could only work well when the electoral voting rights were limited to wealthy (white) men. Polanyi saw the spread of universal suffrage and the rise of the labour movement as a reaction against the tyranny of the market forces unleashed by the gold standard. The spread of democracy and the ensuing politicization of economic policymaking destroyed the political viability of the gold standard and gave rise to a new era of state intervention, as the Great Depression would show (see below).[5]

Economic liberals saw the creation of national wealth during the 19th century as the ultimate reflection of the benefits of free markets and globalization, but the sharp growth in per capita

GDP displayed in Figure 2.1 did not say anything about the distribution of national wealth. National wealth was distributed extremely unequally already at the beginning of the 19th century, yet wealth inequality grew even further and reached record levels at the beginning of the 20th century: the share of the top 1 percent and top 10 percent in national wealth reached, respectively, 45 and 81 percent in the USA on the eve of World War I and in Europe even 64 and 90 percent.[6] This *Belle Epoque* of patrimonial capitalism ended with World War I, when the rise in public debt to fund war expenditures destroyed the real value of financial wealth by fuelling inflation (see Chapter 3 for an analysis of the distributional implications of low versus high inflation). Political elites attempted to restore the liberal economic order during the 1920s but their efforts eventually culminated in the Great Depression of the 1930s, which started in the US economy after the October 1929 Wall Street Crash and rapidly spread to Europe and the rest of the world. Just like any other major financial and economic crisis, the Great Depression had a mixture of causes: (1) the collapse of the stock market bubble, fuelled by financial speculation and excessive borrowing, undermined the confidence of households and firms and brought about a sharp decline in private consumption and investment; (2) banks had taken too much risk by lending an excessive amount of money to households and firms that eventually could not be paid back, leading to series of banking failures that further depressed consumption and investment.[7]

The Great Depression had a devastating impact on the US economy: real GDP fell for four consecutive years and unemployment reached more than 25 percent in 1933 when Franklin D. Roosevelt was elected for US president. The persistent downfall in economic activity discredited the belief of political elites in the self-adjusting capacity of markets, whereby the price mechanism would automatically restore the market equilibrium and allow the economy to return to its full potential (see below). During the first years of the Great Depression governments resorted to the usual recipes of the classical-liberal policy paradigm, sticking to the gold standard and its straightjacket of tight money and balanced budgets. When it became increasingly clear that these policies exacerbated rather than mitigated the crisis, governments began to experiment with less orthodox forms of state intervention based on increased public spending, expansion of social rights and reforms of the banking system. The first country to do so was Sweden, where the political conditions for state intervention were favourable: unions were powerful and the government was led by the Social-Democratic Party. In the United States the government led by Democratic president Franklin D. Roosevelt enacted a "New Deal" to revive the US economy, consisting of banking reforms, spending programs and new social insurance and labour rights. The banking crisis was contained by bank bailouts and the 1933 Banking Act,

which divided deposit banks from those that invested on Wall Street and established the Federal Deposit Insurance Corporation to protect the savings of ordinary Americans. In March 1935 Congress approved its largest peacetime allocation ever, putting millions people back to work to build roads, airports other infrastructural projects. A few months later the US Congress passed the Social Security Act, the country's first national social insurance system.[8] Other industrialized countries implemented a similar mixture of banking reforms, spending programs and and expanding social security rights.

2.1.2. "Embedded liberalism": The Keynesian welfare state after World War II

While these new forms of state intervention were crucial to revive the economy by restoring aggregate demand, countries increasingly turned inward: governments erected trade barriers and all kinds of restrictions to international capital movements – called "capital controls" – that led to a disintegrated world economy and exacerbated the fallout of the Great Depression. After World War II the allied forces aimed to rebuild an open international economic order that would leave national governments room for state intervention and enable them to protect their citizens from market instabilities. At the time, it was clear that the United States would emerge from the war as the dominant economic power: US policymakers were determined to play a leadership role in building and sustaining a more open and multilateral international economic order than the one that had existed during the 1930s. But rather than returning to the classical-liberal order of the pre-1930s, they hoped to find a way to reconcile liberal multilateralism with the new domestically orientated priorities to combat unemployment and promote social welfare that had emerged with the New Deal. John G. Ruggie famously termed this compromise as embedded liberalism. "Unlike the economic nationalism of the thirties, it would be multilateral in character; unlike the liberalism of the gold standard and free trade, its multilateralism would be predicated upon domestic interventionism."[9] The Bretton Woods system, which established governing rules for post-war international economic relations, reflected this compromise of embedded liberalism.[10] It had the following features:

- Signatories to the Bretton Woods agreement agreed to fix ("peg") the value of their currency in relation to the US dollar, which was the only currency to be freely convertible into gold at a fixed price of $35 per ounce. The Bretton Woods architects aimed to re-establish a world of international currency stability without returning to the rigidity of the gold standard. Countries were given the option of adjusting their countries' par value whenever their country was in "fundamental disequilibrium". As such, the Bretton Woods system was a kind of "adjustable peg" system, in which countries could devalue their exchange-rate when they experienced sustained deficits on their trade balance. Currency realignments of up to

10 percent could be approved automatically, but larger ones required the permission of the newly created International Monetary Fund (IMF). In short, it was a discretionary exchange rate regime that allowed for internationally negotiated state intervention in currency markets.

- Countries were given the right to control international capital movements by means of a variety of restrictions to move money in or out of the country. This provision was not intended to stop all private international capital movements: those that were de-signed for long-term *productive* investment – e.g. foreign direct investments to build factories – were still welcomed. But governments were actively encouraged to restrict short-term capital flows – especially those with purely speculative motives. It was generally accepted that unrestricted capital mobility would not only destabilize exchange rates – and disrupt international trade – but also undermine the autonomy of national governments to fight economic recessions and develop the welfare state. The regulation of international capital movements via capital controls became the prevailing orthodoxy: the right of members of the IMF, European Community (EC), and Organization for Economic Cooperation and Development (OECD) to regulate and control movements of capital was protected by the IMF's Articles of Agreement (1945), the EC's Treaty of Rome (1957), and the OECD's Code of Liberalization of Capital Movements (1961). BOX 2.2 summarises the main characteristics of capital controls.
- The Bretton Woods architects also established two public international financial institutions: the International Bank for Reconstruction and Development (IBR, later renamed as the World Bank) and the IMF. At a broad level, these institutions were given the task of promoting international economic co-operation. The IBRD was designed to provide long-term loans for re construction and development after the war. The IMF was to provide short-term loans to help countries with international payment difficulties – a function that was designed explicitly to reinforce those countries' policy autonomy and challenge the kind of external discipline that private international financial flows had imposed before the 1930s.
- The Bretton Woods system promoted the gradual liberalization of trade, which took place through the General Agreement on Tariffs and Trade (GATT). In April 1947 participating countries agreed to cut trade tariffs by greater than one-third on average and agreed not to discriminate among countries. This was enshrined in the principle of unconditional most-favoured-nation treatment: any reduction in trade barriers between two GATT signatories was automatically offered to all GATT members; countries could not discriminate against

the products of one member in favour of the products of another. The result was a gradual international liberalization of trade, which grew exponentially after 1950.

BOX 2.2. Capital controls

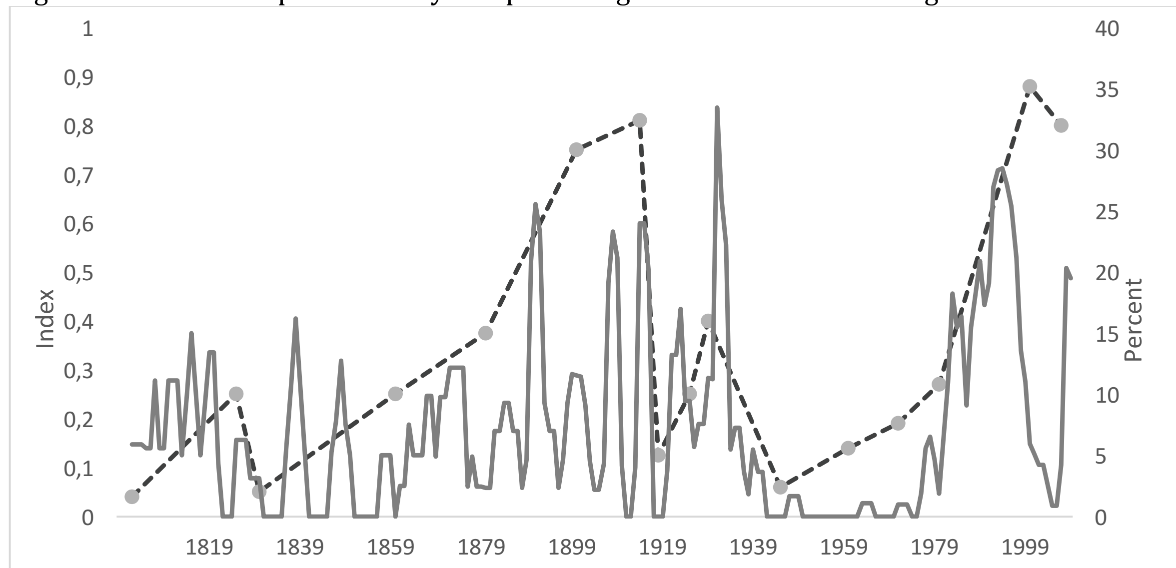
Since many recent financial crises have been triggered by large reversals in international capital flows, maintaining the stability of the financial system is a big policy challenge of our time. Targeted at certain capital flows that exacerbate systemic risks, capital controls can be useful policy tools in preventing or mitigating financial crises of various kinds. Capital controls are regulations that restrict or prohibit the movement of capital across national borders. The regulatory measures include restrictions on the movement of capital flows into or out of a country. Capital controls can regulate a wide range of cross-border transactions carried out by non-residents and residents in a country. These transactions may include money transfers, direct investment, portfolio investment, bank loans, and other financial assets. For example, a tax applicable only on non-residents' investments in domestic bonds or equities is a capital control. Similarly, caps on foreign equity investment in specific sectors (such as banking and defence) or limits on overseas investments by residents are classified as capital controls because these measures regulate the inflow and outflow of capital in a country.

Capital controls come in several varieties and can be broadly classified into two categories: quantity-based and price-based. Quantity-based controls involve explicit limits or prohibitions on capital account transactions. Such quantity-based measures on inflows may include a ban on investment in money market instruments; limits on short-term borrowing; and restrictions on certain types of securities that can be owned. The quantity-based controls on inflows are often used to limit the foreign ownership of domestic financial assets and to insulate the domestic market from international developments. On outflows, quantity-based controls can take the form of an explicit moratorium. Price-based controls seek to alter the volume of capital transactions by altering their cost, with the intention of discouraging a particular class of flows and encouraging another set of flows. Price-based controls on inflows can take the form of a tax on stock market purchases and certain foreign exchange transactions; or imposition of unremunerated reserve requirements on certain types of capital inflows.

Arguably, the most significant feature of the Bretton Woods system – the one that most clearly reflected the compromise of embedded liberalism – was its explicit endorsement of the use of capital controls. As Figure 1.10 shows, there seems to be clear correlation between the degree of cross-border capital mobility in the world – measured by an index that captures all the restrictions on international short-term capital flows and ranges from zero ("no capital mobility") to one ("perfect capital mobility") – and the share of countries experiencing a banking crisis (3-

year moving averages): the Bretton Woods era, which features capital controls and very low cross-border capital mobility, was the most financially stable period over the last two centuries.

Figure 2.3 Index of capital mobility and percentage of countries in banking crisis



Source: Rogoff & Reinhart (2009)
Note: Dashed line is the index of capital mobility

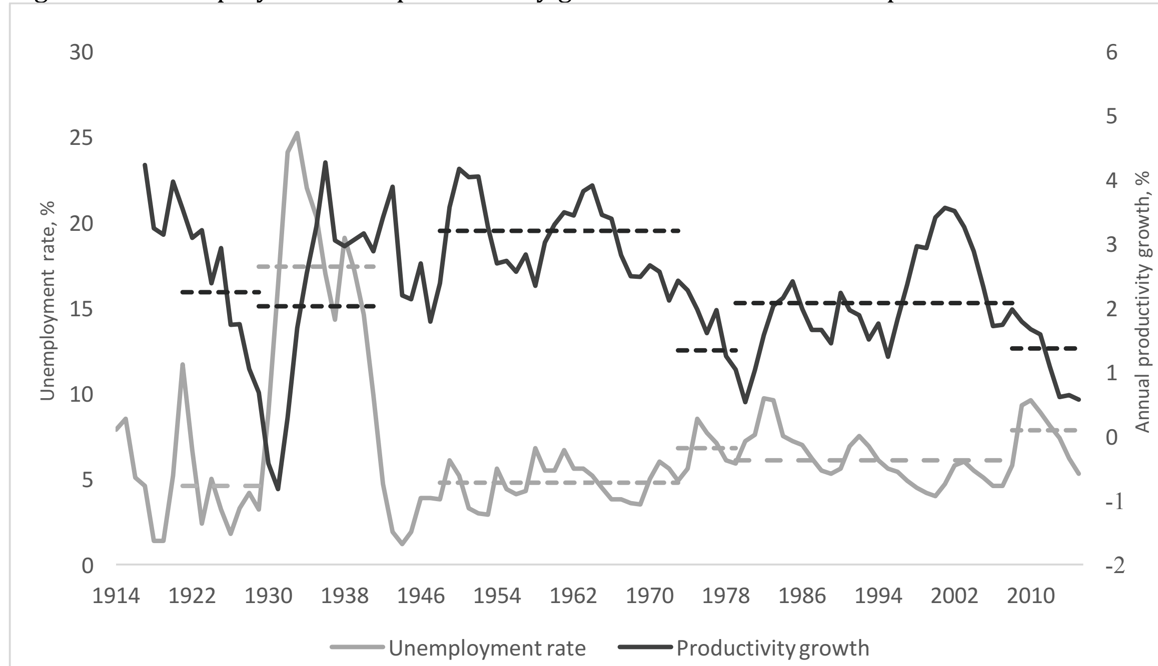
Financial stability concerns were not the prime reason for installing capital controls, however. Restrictions to the international mobility of financial capital particularly aimed to preserve the autonomy of governments to build a KWS based on (1) countercyclical macroeconomic policy-making and (2) higher taxes to fund social spending. A key dimension of the welfare state was that the government had to adopt expansionary fiscal and monetary policies geared towards the attainment of "full employment" in the economy: during economic recessions higher public spending and lower interest rates needed to boost household consumption and corporate investment until enough jobs were had for the working classes. The problem was that these expansionary fiscal and monetary policies could lead to higher inflation, potentially eroding the returns of private investors that would have every incentive to move their capital to higher-yielding countries (see Chapter 3). Indeed, as Keynes argued, "'the whole management of the domestic economy depends on being free to have the appropriate rate of interest without reference to the rate prevailing elsewhere in the world."[11] In short, capital controls were required to avoid "capital flight" from undermining the effectiveness of Keynesian macroeconomic policies oriented towards full employment. But the containment of capital flight was also needed to assist the expansion of the welfare state, which entailed higher levels of taxation (of both capital and labour) to fund the increasingly generous social security system: the architects of Bretton Woods sought to shield governments from capital flight that was initiated with the goal of evading domestic taxes or the "burdens of social legislation."[12]

Another key dimension of the KWS was the expansion of collective bargaining rights: an increasing amount of workers became represented by labour unions who negotiated with employer organizations over the setting of wages, working hours and other working conditions. For several reasons, collective bargaining contributed to a more equal income distribution. First, it facilitated the reduction of inter-firm and inter-sectoral wage differentials by including different firms and sectors into a single wage agreement: workers doing similar jobs would be paid similar wages across different firms and sectors (i.e. the "equal pay for equal work" principle). Second, collective bargaining also ensured that the *annual growth of wages* would be similar for workers and employees across different firms and sectors: national-level and sectoral-level agreements aligned nominal wage growth with respectively nation-wide and sector-wide average real productivity growth; as a result, workers in firms and sectors with below-average productivity received the same annual pay rises as workers in firms and sectors with above-average productivity (see Chapter 3 for more details). As such, national industrial relations systems characterized by strong trade unions and collective bargaining provided "crucial institutional mechanisms ensuring the transfer of productivity gains into real wages and household consumption", allowing "aggregate demand to expand in lockstep with the expansion of the productive potential of the economy for some time." Together with Keynesian macroeconomic policymaking, it gave rise to a *Fordist accumulation regime* based on assembly-line mass production methods and mass consumption: named after the founder of the Ford Motor Company, it consisted of a range of policies and institutions to support the accumulation of wealth by ensuring that there would be sufficient and stable demand for the standardized consumer goods produced by the system, with high wage growth acting as the engine of economic growth.

In the previous chapter we have seen that the rise of the KWS was associated with a more equal distribution of income and wealth than the pre-1930s and post-1970s eras. It also contributed to the Golden Age of capitalism: Figure 2.4 shows that the period between 1945 and 1973 is also of extraordinarily high productivity growth – a key determinant of long-term economic growth – and low levels of unemployment.[13] Nevertheless, there were substantial cross-national differences in terms of growth performance. In North America, growth rose to just over 2 percent between 1950 and 1970 and slowed down to less than 1.5 percent between 1990 and 2012. British growth adhered closely to the North American pattern. In continental Europe, per capita output leapt ahead to more than 4 percent from 1950 to 1970, before falling sharply to just slightly above US levels (a little more than 2 percent) in the period 1970–1990 and to barely 1.5 percent between 1990 and 2012.The Golden Age ended in the 1970s with the stagflation crisis, which caused a decline in firms' profitability and labour productivity and neoliberal shift in economic policymaking away from the role of aggregate demand toward supply-side issues.

Before giving a brief overview of the neoliberal shift in the final section of this chapter, we will review the three dominant theoretical approaches in CPE/IPE and discuss how they account for the rise of the KWS.

Figure 2.4 Unemployment and productivity growth in the advanced capitalist world



Source: CORE project
Note: Dashed lines refer to moving averages

2.2. Theoretical perspectives: Interests, ideas and institutions

For evident reasons, scholars in CPE/IPE have devoted a huge amount of attention to the collapse of the classical-liberal economic order and the subsequent development of the KWS in an international context of embedded liberalism. Cataclysmic events like the Great Depression typically act as "critical junctures" that lead to a fundamental revision and transformation of existing economic policy paradigms and its underlying institutions. How can we explain the shift from the classical-liberal paradigm based on free international capital mobility and the straightjacket of the gold standard towards the Keynesian policy paradigm based on capital controls, "full employment" macroeconomic policies and collective bargaining? In the literature, three theoretical approaches can be distinguished to account for such instances of institutional transformation: interest-based, ideas-oriented and institutional approaches. The three "I's"– interest, ideas and institutions – should not necessarily be seen as separable ways to explain outcomes in CPE/IPE; rather, they "represent different but not mutually exclusive ways to focus attention in explaining political economy".[14] Below we discuss the key elements of these three approaches, whose insights will help us understand not only the rise of the KWS out of the ashes of the Great Depression but also its subsequent demise since the 1970s.

2.2.1. Interest-based approaches

Political economy approaches that draw attention to the role of material interests in driving change in economic policymaking typically start their analysis with asking the following question: who benefits? It is based on the assumption that the government's economic policies and the country's institutions reflect the material preferences of the principle actors in the economy. A first perspective looks at the preferences of "producer group coalitions" and suggest that "we can explain the trajectory of economic policy … by tracing the way in which material interests of producer groups change so as to dissolve the support coalitions of past patters of policy and to make possible the formation of more powerful coalitions in support of new patterns of policy."[15] A second perspective looks at the role of electoral politics and links developments in political economy to competition between different political parties aiming to take control over the executive and shape government policies.

Marxism is a class-oriented interest-based approach to political economy: Marxists point to inherent conflict between capitalists and workers as a key driving force behind changes in the economy. The capitalist class (the bourgeoisie) and the working class (the proletariat) derive their respective interests from their position within the relations of production: the capitalist's interest is to extract more surplus value from workers; the worker's interest is to increase wages. Since they control the means of production, capitalists are believed to be the most powerful class in the sense that they are able to determine the outcome of the wage bargaining process as well as to shape the government's economic policies. Indeed, Marx saw the executive of the modern state as "a committee for managing the common affairs of the whole bourgeoisie", taking a functionalist view on the state "as an instrument in the hands of the ruling class for enforcing and guaranteeing the stability oft the class structure itself."[16] Based upon the asymmetrical relations of power between the two classes and the notion of the state as an instrument of capital, it is difficult to understand the shift towards a more egalitarian form of capitalism in the 1930s. This necessitates an analysis of how the working class was able to strengthen its power vis-à-vis the capitalist class, as advocates of the "power resources" approach have argued: "through its political and union organizations, the working class can decrease its disadvantage in power resources in relation to capital."[17] Thus, the core contention of the power resources approach is that the working class can improve its bargaining position and living standards by collectively mobilizing in the form of labour unions and left-wing political parties.[18]

By the end of the 19th century the growing labour movement represented an increasing challenge to the established liberal economic order: its demands particularly clashed with the liberal system's reliance on flexible wages and minimal government intervention. Industrial workers increasingly organized into labour unions that had become the largest occupational group

in most advanced countries. In a first stage particularly skilled workers united themselves, but unskilled workers were also drawn to the labour movement as large-scale factory production expanded. Table 2.1 presents some historical data on the evolution of union membership in 16 OECD countries: it shows the averages for three different periods of time: from the turn of the century to the outbreak of World War I, the interwar years, and the Golden Age (1945-75). The level of unionization doubled during the interwar years and increased further during the post-war period. The Great Depression increased the appeal of labour unions that served to protect the interests of the working class through collective mobilization. Rising unionization also strengthened the ability of the working class to organize strikes and push through labour demands. From a power resources perspective, the rise of the KWS is intrinsically linked to the intensification of social conflict during this period. This might clarify why the KWS developed the soonest in Sweden, which had the highest level of strikes and lockouts measured in terms of the number of working days per worker from the turn of the century to the early 1930s.[19]

Table 2.1 Union membership as a percentage of non-agricultural workers

	Before World War I	**Interbellum**	**1945-75**
Australia	19.7	40.3	50.9
Austria	6.0	42.2	62.0
Canada	4.7	8.9	27.7
Denmark	15.3	33.6	59.3
Finland	5.0	8.0	38.5
France	7.0	11.5	22.0
Germany	16.0	35.9	34.3
Italy	11.0	19.0	32.5
Ireland	-	15.0	36.5
Japan	-	20.0	34.5
Netherlands	16.9	30.6	38.8
New Zealand	17.0	25.0	41.5
Norway	5.5	19.4	58.0
Sweden	6.0	34.3	69.1
United Kingdom	13.2	29.6	42.2
United States	6.8	14.0	29.8

Source: Donaldo & Wälde (2011); Korpi (1983)

Moreover, the working class mustered power resources in the political arena by pushing through universal suffrage and engaging in partisan politics. As Geoffrey Garrett observed, “the short-term nature of democratic politics creates a bias in favour of distributional strategies:

Governments cannot afford to do what is good for the economy in the long run if this immediately hurts their core electoral constituencies."[20] In this regard, "the most important distributional cleavage in the industrial democracies has long been between those who support the market allocation of wealth and risk – the natural constituency of right-wing parties – and those who favour government efforts to alter market outcomes – the left's core base of support."[21] From a partisan politics perspective, the rise of the KWS is linked to the rise of left-wing political parties. Table 2.2 shows the increasing popularity of left-wing parties – defined here as social democratic parties and the parties to their left – among the electorates in most industrialised societies. During the interwar years, the strongest social-democratic parties were found in the Nordic countries. They were reformist parties based on the principle that "those who do not own instruments of production [e.g. workers] consent to the institution of the private ownership of the capital stock, while those who own productive instruments consent to political institutions [e.g. free elections with universal suffrage, right of workers to organize in labour unions, etc.] that permit other groups to effectively press their claims to the allocation of resources and the distribution of output."[22] Socialist parties were also strong in Austria, Belgium and Germany. After World War II the left percentage of valid votes peaked. Only in Northern American, the socialist parties never achieved a foothold.

Table 2.2 Left percentage of valid votes

	Before World War I	**Interbellum**	**1945-80**
Australia	37.0	45.0	48.5
Austria	23.0	41.0	48.0
Canada	0.0	3.0	15.0
Denmark	26.0	39.0	45.5
Finland	40.0	39.0	47.0
France	13.0	32.0	42.0
Germany	31.0	40.0	37.5
Italy	18.0	26.0	38.0
Ireland	-	32.0	42.0
Japan	-	-	36.5
Netherlands	13.0	25.0	34.5
New Zealand	5.0	35.0	46.0
Norway	15.0	36.0	51.0
Sweden	13.0	46.0	51.5
United Kingdom	5.0	33.0	46.5
United States	4.0	5.0	0.5

Source: Korpi (1983)

One potential shortcoming of interest-based approaches linking the development of the KWS to democratic class struggle is that they overlook the role of capital (businesses) in shaping the rise and trajectory of the KWS. While a united working class was a necessary precondition to the promotion of social-democratic reforms, a divided capitalist class was also critical: "A singular feature of the 1930s was the prominence of corporate backers of the macroeconomic, social, and labour reforms associated with social democracy."[23] First of all, capitalists saw the benefits in giving the government more responsibilities in terms of macroeconomic management, as the Great Depression undermined their profits by destroying demand for their goods. Many capitalist employers also favoured an expansion of state-provided social insurance.[24] This argument, which clarifies the rise of the KWS in countries like the United States that lacked a powerful labour movement, is particularly associated with the work of Peter Swenson. In his book *Capitalists Against Markets* Swenson made the case that the KWS was actively promoted by business leaders for various pragmatic reasons.[25] Capitalists recognized that the impact of expanding social security on their profits and competitive position would be minimal if all firms were required to contribute to unemployment and pension programs. In some sectors employers already paid out out higher wages and provided in-house unemployment and pension benefits as a way to attract skilled workers. This explains why capitalist support for social insurance was particularly strong in capital-intensive industries – e.g. automobiles and consumer electronics – where there was more need for a skilled workforce and where labour costs were a relatively small part of total production costs (see Chapter 4 for a more elaborate discussion of corporate interests in collective bargaining and social insurance).

While support from some fractions of the capitalist class were likely needed for the development of the KWS, it is much less clear that it benefited the entire capitalist class. Indeed, as Colin Hay rightly notes, "The interests of (generally, organized) business with respect to the labour market are treated by Swenson as synonymous with the interests of capital in general. This is clearly problematic, effectively precluding any consideration of the interests of, say, finance capital with respect to the creation and expansion of the welfare state."[26] The financial sector was obviously disadvantaged by the KWS, particularly by the restrictive financial regulations that underpinned its development. As Eric Helleiner has argued, the widespread enthusiasm for restricting the mobility of financial capital via capital controls reflected a "structural break" with how financial affairs were managed before the 1930s: "Discredited by the crises, the private and central bankers who had dominated financial politics before the 1930s were increasingly replaced at the levers of financial power by a new class of professional economists and state managers whose social base was among labour and national industrial leaders."[27] These

new producer group coalitions favoured interventionist policies that made finance the "servant" and not the "master" of the economy. As we have seen above, restrictions to international capital mobility were necessary for strengthening the autonomy of national governments to build and expand the KWS. Wall Street bankers vehemently opposed the endorsement of permanent capital controls in the Bretton Woods system, which in their view were a reminiscent of the "Hitlerian monetary system" and a mere instrument to pursue "unsound" inflationary macroeconomic policies. As we will discuss in Chapter 3, bankers have a natural tendency to oppose high inflation for hollowing out the real value of their financial investments and eroding their profits.

In sum, interest-based approaches point towards the formation of a "historical compromise" between the working class and the industrial fractions of the capitalist class as the key political underpinning of the KWS. This compromise rested on "the mutual contributions of the parties to increase economic growth": "They would co-operate in 'making the pie larger in order that there would be more to divide'. Through control of the government, the labour movement could influence the distribution of economic growth. Business enjoyed favourable conditions for investment and expansion."[28] There are, however, several issues that are left under-explained. Was the historical compromise merely the outcome of distributional struggles and altered power relations across and within different classes or where these struggles mediated by ideas and institutions? How and why did business leaders in the industrial sectors of the economy become convinced that the key tenets of the KWS would advance their interests? Why was there a cross-party consensus about the desirability of macroeconomic management and welfare expansion? And how can we explain the formation of different institutional variations of the KWS? Ideational and institutional approaches offer illuminating answers to these questions.

2.2.2. Ideas-oriented approaches

Ideational approaches in CPE/IPE appeal to economic ideas as causal variables in shaping stability and change in economic policy paradigms. Such approaches can be distinguished in terms of the ontological status they attach to ideas. Critical approaches mostly associated with neo-Gramscian IPE take an instrumentalist view on ideas, emphasising the role of ideas and ideologies in legitimizing economic policy choices and creating consent – especially among subordinated social groups.[29] As one neo-Gramscian scholar puts it, "ideas do not float in an endless universe of meaning, but are produced by human agency in a context of social power relations, and as such are also linked to the strategic actions of social actors." From this perspective, a key function of ideas is to allow the dominant social groups to establish a" hegemonic bloc", which involves "the *institutionalisation* of a set of ideational practices … not only by representing the narrow interest of then dominant class *as the general interest* but by genuinely incorporating

incorporating opposing interests in its discourse, although in such a manner that they are subordinated to the interests as specified by the original class ideology of the hegemonic group."[30] Constructivists go further by arguing that dominant economic and political elites need and use economic ideas to *define* their interests, especially in a context of uncertainty created by severe economic crises such as the Great Depression.[31] From a constructivist perspective, "economic ideas provide agents with an *interpretative* framework, which describes and accounts for the workings of the economy by defining its constitutive elements and 'proper' (and therefore 'improper) interrelations."[32] Accordingly, actors' preferences do not follow from their material circumstances but are a reflection of their particular *perception* and *interpretation* of these circumstances.[33]

Ideas-oriented approaches draw attention to the role of Keynesian ideas either in shaping powerful actors' preferences regarding the KWS or in legitimizing new forms of state intervention. The prolonged downfall in economic activity and persistently high levels of unemployment during the 1930s undermined the legitimacy of the classical-liberal policy paradigm, leading to a profound loss of confidence in *laissez-faire*: "The Great Depression politicized economic issues and ideas, and demonstrated the dire adverse consequences of the kinds of untrammelled free markets that the liberal creed advocated. It also illustrated more eloquently than any other academic treatise could that the underlying assumptions of neo-classical economics … do not obtain in the real world, certainly not in the short run."[34] One of these assumptions is that free markets tend towards equilibrium at full employment – a principle known as Say's Law, named after the 19th century French classical economist Jean-Baptiste Say. Say's Law postulates that "supply creates its own demand" as in the process of producing output businesses also create enough income for workers and the owners of capital to ensure that all the output will be sold. While Say's Law only works in the short-term when workers and capital owners consume their entire income, classical-liberal economists assumed that adjustments in wages and prices allow the economy to return to full employment in the medium and long term even if they desired to save their money. Whenever there is a downfall in aggregate demand for their goods and services, firms could reduce their prices to convince consumers to buy their products. But this also meant that workers' wages would need to decline, otherwise firms' profits would shrink. So as long as workers were unwilling to accept lower wages in the face of falling demand for their labour, there could only be *voluntary* unemployment from a classical-liberal perspective.[35]

Because classical economists assumed that supply created its own demand, they did not believe that it was possible to have a *general* oversupply of goods and services throughout the economy. The classical theorists' belief in the economy's ability to maintain full employment through its own internal mechanisms caused them to favour a policy of *laissez-faire*. The classical-liberal

doctrine and its *laissez-faire* policy prescriptions were almost universally accepted by economists and policymakers until the Great Depression, which shattered the classical belief that any unemployment would be moderate and short-lived. The most forceful critic of Say's Law – and the entire classical-liberal model of the economy – was John Maynard Keynes. In his view, firms base their production decisions on the level of *expected* aggregate demand: the more that consumers, investors, and others plan to spend, the more output businesses will expect to sell and the more they will produce. In other words, supply (or output) responds to demand – not the converse, as the classical economists suggested. Most importantly, Keynes argued that the level of total spending in the economy could be inadequate to provide full employment and that the classical economists were wrong in believing that wage/price flexibility would prevent unemployment. As Keynes did not believe that a market economy could be relied on to automatically preserve full employment, he argued that the central government had to *manage the level of aggregate demand* to achieve those objectives. He developed the following arguments for government intervention and management of the business cycle in his magnum opus *The General Theory of Employment, Interest and Money*:[36]

- In trying to explain the depth of the Great Depression, Keynes argued that economies could fall in a slump for long periods if there was a *collapse in confidence* among consumers and firms chose to save and hold on to their money (rather than consume and invest) until they perceived that the economy was improving. Moreover, Keynes argued that the classical assumption of highly flexible wages and prices was not consistent with the real world: a variety of forces prevent prices and wages from adjusting quickly, particularly in a downward direction. Markets are less competitive than the classical theory assumed: Keynes saw that many product markets were monopolistic or oligopolistic. When sellers in these markets noted that demand was declining, they often chose to reduce output rather than lower prices. Even more importantly, workers tend to resist wage cuts, especially in labour markets dominated by strong labour unions. As a consequence, wages and prices do not adjust quickly; they tend to be rigid or "sticky" (see chapter 3 and 4). Keynes also pointed out that sticky wages are not necessarily a bad thing, as a *general* fall in wages would likely cause an eventual decline in the demand for goods and services that workers buy.
- He argued that an economic crisis is usually a consequence of inadequate spending in all the key sectors of the economy. Economic downturns were most likely to originate from a decline in firms' purchases of capital goods, because investment expenditures are mostly determined by confidence in the future state of the economy. When a lack of confidence leads firms to reduce their spending on buildings and equipment, firms and workers who had been supplying these products before would be out of jobs and income. As a result, the

effects of their declining spending would spill over into the consumption sector, causing a decline there as well. Given this view of how the *aggregate* economy could quickly slide into a recession, the solution seemed obvious to Keynes: as investment and consumption spending fell, the government should take up the slack in demand by reducing interest rates to encourage spending in other sectors of the economy – i.e. through an expansionary "*monetary policy*" – and/or by borrowing money to increase its own expenditures – i.e. through an expansionary "*fiscal policy*". For reasons explained in the next chapter, Keynes believed especially in the effectiveness of fiscal policy based on increased government spending to revive the economy and reduce unemployment during a deep economic recession. As public spending works its way through the economy, it would ultimately produce a better outlook for businesses, which would restore their confidence and lead them to spend and invest more. This would start the whole process moving back upward to recovery and economic growth, since it would lead to more demand for for workers, higher wages and increased consumption.

During the 1930s the Swedish government was the first to apply Keynes' proposed solution to fight the depression even *The General Theory* was published in 1936. Swedish unions demanded their government to do more to put the jobless to work: between 1933 and 1935 the Social Democrats implemented public works that employed an average of sixty thousand workers and gave another thirty-five thousand cash assistance. According to constructivist political economists, these policies were shaped by new ideas developed by economists of the the *Stockholm School of Economics*, which also advocated reflationary macroeconomic policies during recessions to mitigate shortfalls in aggregate demand: "this new body of economic thought … gave Swedish social democracy the alternative economic ideas it needed to narrate the crisis in a new way, build a coalition, and restructure institutions accordingly."[37] More generally, Keynesian ideas legitimized and offered intellectual support to social-democratic parties' desire to build a KWS: "Social democrats everywhere soon discovered in Keynes' ideas, particularly after the appearance of his *General Theory*, something they urgently needed: a distinct policy for administering capitalist economies. The Keynesian revolution – and this is what it was – provided social democrats with a goal and hence the justification of their governmental role and simultaneously transformed the ideological significance of distributive policies that favoured the working class."[38] In West-European countries Keynesianism gave social-democratic politicians not only "a reason to be in office"; it also enabled them to forge a cross-party consensus about the benefits of the KWS and the appeal of macroeconomic demand management.

Keynesian ideas also informed Anglo-American experts during negotiations about the key features of the Bretton Woods system. Discussion about international financial affairs typically

take place in a technocratic context in which ideas carry weight by giving considerable clout to experts working out the details of the agreement. Expert representatives of the United States and the United Kingdom – lead by Harry Dexter White and John Maynard Keynes, respectively – formed a "primitive epistemic community", as John G. Ikenberry has argued: they were "a collection of professional economists and policy specialists who shared a set of general and technical views which concerned the proper functioning of the world economy and distilled contemporary economic thought and lessons of recent economic history."[39] The experts shared a common "governing philosophy of post-war economic order" – i.e. "the philosophy that it should be a managed multilateral order, with monetary and trade practices subject to international agreement, and that the overall system would work to facilitate Keynesian economic policy and social welfare goals."[40] In other words, Keynesianism underpinned the compromise of "embedded liberalism" on which the post-war economic order was based.

2.2.3. Institutional approaches

Institutionalist approaches attribute the evolution of capitalism and economic policymaking to the organizational structures of national political economies. While these organizational structures are by themselves shaped by distribution of power resources or prevailing ideas and norms as interest-based and ideational approaches have argued, institutionalist scholars maintain that these structures usually exert an enduring causal influence by generating "positive feedback effects".[41] So even if a national institution was shaped by a historically evolved distribution of power resources, "once an institution exists … it constitutes a power resource in its own right and in this capacity may affect the very distribution of power on which it was originally based."[42] Similarly, institutional structures both reflect and shape the ideational assumptions and norms of dominant social groups, as "institutional arrangements once established give rise to and shape the collective identity of social groups, exercising a formative impact on the interests such groups perceive to be theirs."[43] Institutionalist approaches argue that these feedback effects create *path dependencies*, as initial institutional choices have a lasting impact by shaping both the strategies and goals by political actors: "Once established, patterns of political mobilization, the institutional 'rules of the game,' and even citizens' basic ways of thinking about the political world will often generate self-reinforcing dynamics. Once actors have ventured far down a particular path, *they may find it very difficult to reverse course*. Political alternatives that were once quite possible may be irretrievably lost."[44]

For these reasons, institutionalist approaches are well-equipped to account for persistent – and sometimes growing – institutional divergences between national models of capitalism. In this regard, it is important to emphasise that the rise of egalitarian capitalism since the 1930s ma-

terialised into different *national varieties of the KWS* with different degrees of collective bargaining and welfare state expansion. An important source of differentiation was the organisational capacity of labour and capital and the resulting model of coordination.[45] In the Nordic countries workers organised in "peak-level" labour unions representing wage earners with different skill profiles (low-skilled; medium-skilled; high-skilled) and working in different sectors (high-productivity vs. low-productivity sectors; domestically-focused vs. export-oriented sectors). Moreover, these countries developed national business associations, encompassing a large share of the potential membership and enabling employers to cooperate with each other as well as with representatives from labour unions and government. The Nordic countries adopted a *macro-corporatist* model of coordination: workers and employers organized into hierarchically ordered groups that negotiated with each other and the state over diverse labour market and social issues in order to come to broad political agreements through collective bargaining and tripartite policy-making committees. In countries with *sectoral* coordination, such as Germany, employers and labour unions wield power largely at the industry level: given that the encompassing peak organizations were much weaker, employer organisations with specific industries engaged in collective bargaining with corresponding labour unions – largely without any state involvement. In *pluralist* countries, such as the United States and the United Kingdom, unions organized along the crafts and skill sets of their members and employers were represented "by a panoply of conflicting groups, with many purporting to aggregate business interests and with none having much policy-making authority."

National varieties of the KWS were also shaped by divergences in political institutions, which are relevant for election outcomes and affect the number of effective political parties, types of cabinets as well as the relative strength of different types of parties. In this context the key distinction goes between *proportional* and *majoritarian* electoral systems: while proportional systems generate multi-party competition and coalition cabinets, majoritarian/plurality systems tend to have two major parties alternating in cabinets.[46] Majoritarian political regimes created an environment of intense competition between political and economic actors and subsequent policy instability throughout the political economy. This in turn made credible commitment to collective bargaining and a generous welfare regime more difficult. Proportional systems, on the other hand, created a political environment favourable to cooperation between political and economic actors. A great numbers of political and economic actors are veto-players with access to the political and policy process, leading to a more stable and consensus-oriented policy constellation that facilitates commitment to collective bargaining and welfare expansion. Moreover, proportional systems have bias towards centre-left governments, as centrist parties are

more likely to form coalitions with left-wing parties and it is often more difficult to form majorities without participation of left-wing parties.[47] Table 3.3 provides information on electoral systems found in 18 countries between 1945 and 1990. Countries are crudely categorized according to patterns of coalition cabinets and relative cabinet strength of confessional and left parties. Austria, Belgium, Germany, the Netherlands and Switzerland had dominant centrist-confessional (Christian-democratic) parties that faced intense competition from left-wing socialist parties who often participated in government. In the Nordic countries social-democratic parties were dominant. Only Ireland and Italy had proportional systems without extensive left-wing participation in government, given that these countries lacked credible left-wing government parties during this period.

Table 3.3. Electoral model and partisan dominance in selected countries (1945-1990)

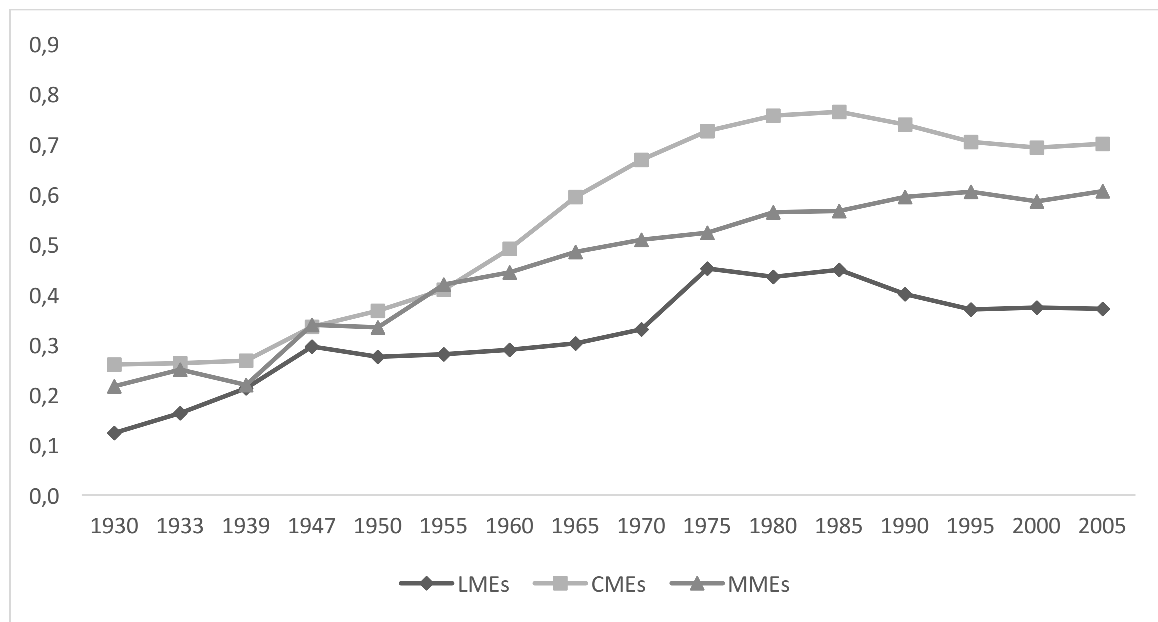
Country	Characteristics of cabinet composition	Electoral model	Average cabinet shares (%)			Average votes (%)		
			Left	***Conf.***	***SCR***	***Left***	***Conf.***	***SCR***
Austria	Confessionals in coalition with left or secular centre-right parties	PR	61	38	2	47	43	10
Belgium		PR	28	52	20	36	37	27
Germany		PR	25	50	25	38	45	18
Netherlands		PR	20	61	18	35	42	23
Denmark	Left dominance or left-right balance	PR	49	1	50	47	1	52
Finland		PR	41	0	59	45	2	54
Norway		PR	74	4	21	49	9	42
Sweden		PR	82	0	18	51	1	48
Italy	Confessional dominance	PR	20	70	10	44	39	17
Ireland	Centre-right dominance	PR	11	22	67	14	29	57
France		M/P	22	9	69	44	9	47
Australia	High left votes without long-term left cabinet presence	M/P	34	0	66	47	0	54
Britain		M/P	39	0	47	42	0	58
Japan		M/P	2	0	98	34	0	66
New Zealand		M/P	38	0	62	45	0	55
Canada	Secular centre-right dominance	M/P	0	0	100	16	0	85
USA		M/P	0	0	100	0	0	100

Source: Korpi (2006)

These differences in collective bargaining institutions and electoral systems gave rise to national varieties of capitalism that adopted different forms of the KWS. While all industrialised countries witnessed a significant increase in social spending during the Golden Age of capitalism, there were substantial differences in terms of the *generosity* of social benefits between groups of countries that would later be identified as "coordinated market economies" (CMEs), "liberal market economies" (LMEs) and "mixed market economies" (MMEs) (see Chapter 3 for more details). Figure 2.4 shows the evolution in average replacement rates – i.e. the proportion

of the income that is paid out via social transfers – for public pensions, unemployment and sickness benefits: replacement rates were similar between these models of capitalism until 1950 but Northwestern European CMEs began to develop increasingly more generous systems of social transfers than the Anglo-Saxon LMEs. The generosity of social transfers in the Mediterranean MMEs lied somewhere in between the other two models during this period. There is a strong connection between relatively high generosity of the social security systems of the CMEs and their high levels of centralisation in collective bargaining, as the neo-corporatist literature has argued. In the Nordic "social-democratic" CMEs peak-level labour unions agreed to pursue "wage restraint" to make sure that average wage growth did not exceed average productivity growth in the economy, allowing private firms to contain labour costs. In exchange, peak-level employer organisations accepted an expansion of welfare programs, while the government could adopt demand-supporting macroeconomic policies oriented towards full employment without unleashing excessive inflationary pressures in the economy. "Conservative-corporatist" CMEs like Germany established industry-level patterns of collective bargaining, whereby "from the employers' standpoint, welfare expansion was viewed less critically as long as it helped moderate unions' wage demands."[48]

Figure 2.4 Average replacement rates for pension, unemployment and sickness



Source: Social Citizenship Indicator Program (SCIP) 1930-2005 (Korpi & Palme 2008)

Anglo-Saxon economies had no similar legacy of neocorporatism and, hence, adopted a more pluralist form of the KWS. In the United States and the United Kingdom, "[t]he relationship between unions and employers is fraught and has been historically characterised by a terse and antagonistic climate, at times even openly violent confrontation."[49] As result, they lacked the collective bargaining structures that enabled governments to link wage restraint to social policy

reform. For instance, in the United Kingdom the Labour government led by Clement Attlee (1945-1951) tried to establish "explicit links between the willingness of government to use welfare measures to safeguard living standards and the willingness of the unions to control wage bargaining", but such links "were extremely tentative and were abandoned by the Conservatives."[50] In Japan, labour union were only powerful at the company level in the core sectors of the economy, where they "acted more as junior coalition partners than sources of confrontation" and where industrial conglomerates (*Keiretsu*) "offered a host offered amiable conditions that made the somewhat lower pay at the junior level, including company-specific training, the guarantee of lifelong employment [in the company], and relatively early retirement."[51] Finally, MMEs like France and Italy developed a tradition of state intervention and heavy labour market regulation: unions remained divided along ideological lines and suffered from internal lack of cohesion, so the state partially compensated for union weaknesses by implementing a series of labour-friendly policies.[52]

In sum, institutional approaches link different forms of the KWS to persistent differences in the organisational structures of national varieties of capitalism. As we will see in the following chapters, these organisational structures continued to exert causal influence after the demise of the KWS by shaping the responses of governments, unions and employers to stagflation crisis of the 1970s and subsequent deepening of economic globalisation.

2.3. The fall of egalitarian capitalism

The rise of the KWS came to a halt in the 1970s, when a number of challenges constrained its further expansion. First of all, the decision of the US government led by Richard Nixon to devalue the exchange rate of the US dollar in 1971 and "close the gold window" – i.e. suspend the convertibility US dollars into gold at the fixed price of US$35 per ounce – marked the end of the Bretton Woods system, ushering in a new era of international monetary disorder (see BOX 2.3 for the causes of the demise of the Bretton Woods system).[53] As a result of the "Nixon shock", the world's major currencies – the US dollar, the Japanese yen, the Deutschmark and British pound – became *flexible* currencies whose value would be determined by market forces rather than by state intervention. This transition towards a floating exchange rate regime was triggered partially by the growing size of speculative international financial flows, which complicated efforts of governments to defend their currency pegs. In 1974 the US government was also the first to remove its remaining capital controls, which played a central role in the Bretton Woods system by supporting the autonomy of national governments to develop a KWS. The United Kingdom dismantled its capital control regime 1979; other industrialised countries soon followed in the 1980s. As cross-border financial flows grew dramatically, exchange rates were often subject to considerable short-term volatility. For this reason, a number of member states

of the European Economic Community (EEC) decided to establish a new regime of fixed exchange rates, which they believed was necessary to promote deeper regional economic integration. The less stable international monetary environment made a commitment to Keynesian macroeconomic management of aggregate demand more difficult (see Chapter 3).[54]

BOX 2.3 The demise of the Bretton Woods system

The Bretton Woods system collapsed during the early 1970s, when the US government the gold convertibility of the US dollar and the adjustable-peg exchange-rate system broke down. This breakdown had in fact been predicted as far back as 1960, when the Belgian economist Robert Triffin (1960) had highlighted the inherent instability of the dollar-gold standard. In a system where the dollar was the central reserve currency, he argued that international liquidity could be expanded only when the United States provided the world with more dollars by running a deficit on its balance-of-payments – i.e. the record of all financial and trade transactions between the residents of a country and the rest of the world. But the more the US economy ran balance-of-payment deficits, the more it risked undermining confidence in the dollar's convertibility into gold. During the 1960s, and in particular after the mid-1960s, Triffin's predictions were increasingly borne out. US currency abroad did grow considerably larger than the amount of gold the US government held to back it up. In one sense, the situation was beneficial to the United States: the country was able to finance growing external deficits associated with the Vietnam War and its domestic Great Society programme (which produced rising imports) simply by printing dollars. In another sense, however, the country was becoming increasingly vulnerable to a confidence crisis. If all holders of dollars suddenly decided to demand their convertibility into gold, the United States would not be able to meet the demand. Another cost to the United States was the fact that the dollar's fixed value in gold was undermining the international competitiveness of US-based firms. If other countries had been willing to revalue their currencies, this competitiveness problem could have been addressed, but foreign governments resisted adjusting the value of their currencies in this way. Declining confidence in the gold convertibility of the US dollar and concerns about the effects of the US dollar's overvaluation on the competitiveness of US firms eventually pushed the US government to close the gold window and devalue the US dollar.

Second, the stagflation crisis of the 1970s damaged the legitimacy of the KWS. In fall 1973, members of the Oil and Petroleum Exporting Countries (OPEC) raised the price for oil from US$2.5 to nearly US$12 per barrel, thereby massively increasing the energy cost of oil-importing industrialised countries. Given the lack of alternative energy sources, rising oil prices translated into a general increase in the price level of goods and services. The second oil price shock

in 1979, OPEC decreed a near tripling of oil prices to US$33 a barrel, reinforced these inflationary pressures. However, rising inflation was also endogenously connected to the workings of the KWS: governments' commitment to full employment had strengthened the bargaining power of labour to such an extent that the wage demands of workers started to exceed productivity growth by the end of the 1960s. Faced with falling profit margins, private firms increasingly embarked on "investment strikes" by curtailing their spending on new capital goods and diminishing their production capacities. As such, the post-war accord between capital and labour and its Fordist rationale of enlarging the "overall economic pie" gave way to return of distributional struggles over the size of the slice each group could seize. The resulting stagflation crisis undermined the credibility of the Keynesian macroeconomic policy paradigm, as expansionary monetary and fiscal policies fuelled inflation instead of reducing unemployment. Rising unemployment and falling economic growth also increased the fiscal burden of the KWS, leading to rising public deficits since the second half the 1970s. In short, "[t]he mid-1970s brought much slower growth rates in the OECD as a whole, combined with high inflation, squeezed profits, industrial strife, high government deficits, unstable exchange rates, weak investment, and very low levels of employer confidence."[55]

It is worth noting that during intellectual debates of the 1970s and 1980s both neoliberal critics on the right and Marxist scholars on the left agreed on the basic diagnose that the KWS was being overburdened by conflictive demands from capitalist employers and their workers. From a Marxist perspective, "the institutionalisation of the Keynesian class compromise imposed rises in wages and increases in public expenditure that increased the pressure on profits," thus "undermining the attempt of the state to stimulate investment by encouraging optimistic expectations of profitability on the part of capitalists." By attempting to reconcile the conflicting aspirations of capital and the working class, the KWS "appeared increasingly as a barrier to both capital, in institutionalising the resistance of the working class, and the working class, in seeking to confine its aspirations within the limits of capital."[56] Marxist critics argued that the expansion of the KWS had always been "highly dependent upon the prosperity and continued profitability of the economy", so economic stagnation and falling profits were bound to create problems – not the least of which was the proclaimed fiscal crisis of the welfare state.[57] From a neoliberal perspective, the stagflation crisis and the growth in public debt were clear manifestations of the inefficiencies of the KWS and its lack of responsiveness to market exigencies. Neoliberal solutions to the perceived ills of the KWS became increasingly attractive for right-wing conservative parties in the 1980s and even for left-wing social-democratic parties in the 1990s. Indeed, as David Harvey notes in his *A Brief History of Neoliberalism*, "almost all states… have embraced, sometimes voluntarily and in other instances in response to coercive pressures,

some version of neoliberal theory and adjusted at least some policies and practices accordingly."[58] A central dimension in this respect was the pursuit of neoliberal globalization, the key features of which can be summarized as follows:

- Trade liberalization: Further liberalization of tariffs and non-tariff barriers to international trade at the global level were accompanied by efforts for even deeper regional integration. In different rounds GATT negotiations led new agreements that extended trade liberalization to new issues and drew in new and future members from the developing and formerly Communist nations. The Uruguay Round in 1994 also created a new institution, the World Trade Organization (WTO), to replace the GATT. The WTO is a permanent organization with powers of its own, largely to mediate trade disputes. Its founding consolidated the open trading system. At the regional level, members of the European Union approved the Single European Act in 1986 and put it in place gradually between then and 1992. The United States and Canada had long-standing investment and trade ties, and in 1987 they signed a free trade agreement. This started them on the road to a European-style single market, albeit without the concomitant political and foreign policy implications. Five years later Mexico joined in, and in 1994 the North American Free Trade Agreement (NAFTA) went into effect. Trade liberalization brought a huge expansion of world trade.

  Combined with the innovations in information and communication technologies (ICT) and transportation (especially the great breakthrough of containerisation, which revolutionized shipping by putting traded goods into standardised containers), the liberalisation of trade enabled a transnational organisation of production by multinational enterprises (MNEs): finished products increasingly result from manufacturing and assembly in multiple countries, with each step in the process adding value to the end product and with growing participation of developing countries in these "global value chains" (GVCs). One of the most important aspects of these GVCs is that they rest on a continuously evolving international division of labour: "While the consumption of finished products remains concentrated in the West, the production of this increasing range of commodities is increasingly conducted by workers located across the far reaches of global capitalism … This division of labour incorporates a great number of diverse and spatially separated workforces who undertake specific compartmentalised tasks and who are connected to the larger process through various forms of social organisation – ranging from the bureaucratic control of multinational firms, to market exchanges, social networks of subcontracting firms, and intricate webs of financing – that facilitate complex flows of goods, money and information."[59]

- Financial liberalization: Since the early 1970s there has been a trend towards *globalization of private financial markets*. Recall that the Bretton Woods architects endorsed an international financial order in which governments could control cross-border private financial flows, and public international institutions would be assigned a key role in long-term credit at the international level. Today, this world appears to be turned upside down. Enormous sums of private capital move around the globe freely on a twenty-four-hour basis. And the size of these flows dwarfs the lending activities of the IMF and World Bank (whose loans have become focused exclusively on poor countries). The growth of the global telecommunication networks has enabled money to be moved around the world much more easily than in the past. A number of market developments have also been significant. The dramatic expansion of international trade and multinational corporate activity from the 1960s onwards generated a growing demand for private international financial services. Private firms and investors were also encouraged to diversify their assets internationally by the increasingly volatile currency environment after the breakdown of the Bretton Woods exchange-rate system in the early 1970s, when governments of the major industrialized countries allowed their currencies to float in value vis-à-vis one another (i.e. their exchange rate was to be determined by the law of supply and demand in international currency markets). While financial globalization brought more volatility in exchange rates and interest rates, the risks and costs of international financial activity were also lowered throughout this period by various market innovations such as the creation of currency futures, options, and swaps.

  Freedom of movement for capital became the new orthodoxy once again and can be seen as the key pillar of neoliberal globalization. Neoliberals were less sympathetic to the Bretton Woods idea that national policy autonomy needed to be protected. Where Keynes and White had endorsed the use of capital controls for this purpose, many neo-liberals have applauded the fact that international financial markets might impose an external discipline on governments pursuing policies that were not "sound" from a neoliberal standpoint. Neoliberals have also criticized the role that capital controls might play in interfering with market freedoms and preventing the efficient allocation of capital internationally. The liberalization of capital controls was also seen as a kind of competitive strategy of governments to attract mobile financial business and capital to their national territory. Instead of the unwritten rules of the first era of globalization, the new era hence promoted formal and codified rules that explicitly commanded financial liberalization and deregulation. The rules of the EEC and the OECD were rewritten to oblige members to allow virtually all cross-border financial flows and abolish all restrictions they had put in place to control international

movements of short-term capital. The IMF began informally to promote financial liberalization among its member states and some policymakers sought to amend its Articles of Agreement to oblige members to liberalize capital movements.[60]

Box 2.4. International financial crises since the fall of the Bretton Woods regime

- The downturn of 1981-1982 – Commodity prices plunged. US interest rates reached the highest levels since the Depression.
- The debt crisis of the 1980s – Widespread sovereign defaults, hyperinflation and currency devaluations primarily hurt developing African and Latin American nations.
- The Japanese crisis of 1991-1992 – Real estate and stock market bubbles burst in Japan and the Nordic nations, also affecting other European economies.
- Crisis of the European Exchange Rate Mechanism (ERM) crisis of 1992-1993 – Sharp currency devaluation of the British pound, followed by a series of devaluations in other member states of the ERM.
- The "tequila crisis" of 1994-1995 – The Mexican currency collapsed.
- The East Asian crisis of 1997-1998 – This crisis began in Southeast Asia and spread to emerging markets like Argentina, Brazil, Columbia, Russia, and the Ukraine.
- The global financial crisis of 2007-2008 – The bursting of the US real estate bubble triggered stock market crashes and banking crises in the United States and Europe.
- The Eurozone sovereign debt crisis 2010-2015 – Banks withdrew their money on a massive scale from the peripheral Eurozone countries in the wake of the global financial crisis, triggering a sovereign debt crisis in these countries.

What are the consequences of neoliberal globalization? For one thing, we can notice that the re-emergence of global finance went hand in hand with growing financial instability. International competition between private banks and financial institutions encouraged risk taking, urging them to make profits by lending money to households, firms and governments both at home and abroad. In turn, financial liberalization and the opening of financial markets made it much easier for households, firms and governments to borrow from foreign banks and financial institutions. The result of excessive international lending and borrowing has been a succession of financial crises since the 1980s (see Box 2.3 for an overview of the largest financial crises). As Figure 2.3 showed earlier, banking crises broke out as soon as the industrialized countries began to dismantle their capital controls and open up their banking and financial system in the

1970s and 1980s – financial liberalization policies that were eagerly adopted by many emerging economies in the 1990s. As discussed in the previous chapter, there are strong connections between growing financial instability and the rise in income inequality in the advanced capitalist world. In subsequent chapters, we will lay the building blocks to develop a more intricate understanding of these connections by examining varying degrees of neoliberalization in four core policy domains – macroeconomic policy, social policy, corporate governance and financial policy – as well as by exploring cross-national variations in these transitions.

Endnotes

[1] Frieden 2006; Eichengreen 2008: Chapter 2.
[2] Polanyi 1944.
[3] Fred Block, introduction to the 2001-edition of Polanyi (1944).
[4] Eichengreen 2008: Chapter 2.
[55] For classical accounts of the politics of the gold standards, see Eichengreen 1992 and Simmons 1997.
[6] Piketty 2014: Figure 10.6.
[7] For a classical account of the Wall Street crash and subsequent Great Depression, see Galbraith 1955.
[8] Hilitzik 2011; Rauchway 2007.
[9] Ruggie 1982.
[10] For scholarly works on the origins of the Bretton Woods system, see James 1996 and Steil 2014.
[11] Keynes quoted in Clift 2018: 18.
[12] Harry Dexter White, US representative at the Bretton Woods conference, quoted in Helleiner 1994: 34.
[13] For several classical accounts of the Golden Age of capitalism, see Amstrong et al. 1994 and Frieden 2006: Part III. It should be noted that not all scholars agree with this conventional account of the post-war boom. For a critical Marxist account, see Brenner 2006.
[14] Clift 2014: 124.
[15] Hall 1997: 176; Frieden 1991;
[16] Sweezy 1942: 243. See Hay 1999 for an overview of Marxist theories of the state.
[17] Korpi 1983.
[18] Korpi 1983; Esping-Andersen 1990; Huber & Stephens 2001; Stephens 1979.
[19] Korpi 1983.
[20] Garrett 1998: 7.
[21] Ibid.
[22] Przeworski 1986: 207. On the rise of social democracy, see Baldwin 1990; Berman 2006; Korpi 1983; Stephens 1979.
[23] Frieden 2006: 244.
[24] Mares 2003; Swenson2002.
[25] Swenson 2002; Swenson 2004.
[26] Hay 2004: x.
[27] Helleiner 1995.
[28] Korpi 1983.
[29] Cox 1987; Gill & Law 1989.
[30] Van Apeldoorn 2002: 19-20.
[31] Blyth 2002; Abdelal et al. 2010. Vivien Schmidt's "discursive institutionalism" shares with constructivism the rejection of interest-based interpretations of ideas; see Schmidt 2008 for an overview of discursive institutionalism and its relation to constructivism and sociological institutionalism.
[32] Blyth 2002: 11.
[33] Hay 2004: 209.
[34] Clift 2014: 161.
[35] Rohlf 2010; Heilboner 1999; Whapshott 2012.
[36] Keynes 1936; see Rohlf 2010; Heilboner 1999; Whapshott 2012 for an introduction to Keynesian economics.
[37] Blyth 2002: 108.
[38] Przeworski 1985: 36.
[39] Ikenberry 1992: 293.

[40] Ibid.
[41] Pierson 2000; Lynch & Rhodes 2016; Rueschemeyer & Skocpol 1995; Thelen 1999.
[42] Ebbinghaus & Manow 2001: xix.
[43] Ebbinghaus & Manow 2001: xix.
[44] Pierson & Skocpol 2002: 298.
[45] Martin & Swank 2010; Thelen 1994; Swenson 2002; Martin 2000; Mares 2003.
[46] Lijphart 1984; Lijphart 1994; Lijphart 1999.
[47] Iversen & Soskice 2006; Iversen & Sockice 2009; Cusack *et al.* 2009.
[48] Manow 2001: 42.
[49] Menz 2017: 104.
[50] Whiteside 1996.
[51] Menz 2017: 121.
[52] Baccaro & Howell 2017.
[53] Gowa 1983.
[54] James 1996; Eichengreen 1996.
[55] Glyn 2001: 7.
[56] Clark 1988: 299.
[57] Offe 1984: 150; see also O'Connor 1973. It is important to note that Marxist do not necessarily blame the welfare state for the downfall in economic growth and profitability of capital; rather, lower economic growth and profitability would make the welfare state increasingly incompatible with the demands from capital. Offe (1984: 200) invokes the "Thomas theorem" – which states that "what is real in the minds and perceptions of people will be real in its consequences" to make this point: "The structural power position of the owners, managers and associational representatives of capital in a capitalist society is exactly their power to define reality in a highly consequential way, so that what is perceived as 'real' by them is likely to have a very real impact for other classes and political actors."
[58] Ibid., pp. 2-3.
[59] Baldwin 2016. On the rise of global value chains, see Neilson et al. 2016; Gereffi 2016; Ponte at al. 2019.
[60] Abdelal 2007; see also Helleiner 1994.