1 Crisis, Austerity, and the Neoliberal Turn

Politics in the postfinancial crisis world is defined by the struggle over austerity. Like a tidal wave that follows an earthquake, financial collapse in U.S. credit markets in the fall of 2008 quickly spread to Western Europe, toppling economies that, once the dust settled, were revealed to also have been built on their own shaky financial footings. Even as the causes of the crisis are still being sorted out, government officials have faced a clear and distinct choice about how to move forward. On the one hand, they could walk the path carved by historical experience by trying to jump-start the stalled economic engine through the kind of strong fiscal measures that their predecessors had taken when faced with the Great Depression nearly a century ago. On the other hand, they could continue to walk the path of neoliberalism by restoring order and balance in credit markets and government finances in the hopes that market forces would work their magic. With few exceptions they chose the second path, simultaneously backstopping credit markets with emergency credit to the banking system and, even more dramatically, forcing state ledgers back into balance through harsh austerity measures.

First to stride down the path of austerity was the Papandreou government in Greece, which, despite having been elected on a left-wing and antineoliberal platform in 2009, called for €500 million in cuts to public spending, reduced holiday pay for pensioners and civil servants, and increased taxes on consumption in the spring of 2010. Later that year Prime Minister Brian

Cowan unveiled the National Recovery Plan for Ireland built on €10 billion in cuts to public spending, a 12 percent reduction in the minimum wage, reductions in public sector pay, and increased taxes on consumer goods. Over the course of the year the governments of Portugal, France, Spain, and Romania proposed similar measures.

In the United States, 2010 saw the rise of the political star of the Tea Party, a far-right political movement whose primary purpose is to shrink the size of the federal debt through massive cuts in public spending and social services. Yet, even though this particular movement can be written off as extremist, there is no denying that the commitment to austerity has seeped so deeply into the American political mainstream that politicians no longer debate whether budgets need to be balanced but only how to do it: raise taxes or reduce spending.

When governments announce the need for austerity measures, they couch them in the language of "shared sacrifice." Everyone needs to tighten his or her belt; politics must give way to sound economic principles. According to the proponents of austerity, these policies are the rational response, indeed the only reasonable response, that, however painful they may be, can repair a broken economy. Yet, despite the ubiquity of this narrative it takes only a moment's critical reflection to see that austerity, like the broader neoliberalization of the economy of which it is a part, is neither neutral nor natural. Beneath the universalist language of shared sacrifice lies a deeply political project.[1] In the eyes of the proponents of austerity, if government debt is too high it is because irresponsible politicians have used the national treasury to cater to every whim and desire of a caterwauling public—handing out unrealistic pensions, being too generous with health care, and letting public sector workers take home bloated paychecks. If the financial system has become nothing more than a flimsy house of cards, it is because consumers have failed to learn to live within their means and are too obsessed with big homes, fancy cars, and a continuous display of conspicuous consumption. To be sure, those who champion austerity will also level some blame for the nation's financial woes on lax banking regulation and overzealous financial speculators. But, at its core, the push for austerity is grounded in the belief that the reason that we all got into this mess and cannot pull ourselves out of it is because irresponsible, profligate governments, workers, and consumers have gotten in the way of the kind of healthy, sustained economic growth that comes only from robust private investment in a context of monetary and price stability. If governments

overspend they threaten the economy with ruinous inflation, and if they dare to tax corporations they stifle the business owner's will to invest. If workers and consumers push for a greater share of the economic pie, they threaten corporate profitability and competitiveness in the global economy.

While frustrating for those who would prefer that a different path be taken, the strength of the movement for austerity may seem unsurprising; just further confirmation of the continuing power of neoliberal social forces to shape policy agendas. Yet, when looked at in historical perspective, the fact that neoliberalism and its austere approach to crisis management have been so resilient in the face of the global economic collapse of 2008 is very puzzling. Crises tend to break up existing political coalitions and shake core understandings about the workings of the economy.[2] Or at least they did in the past. Classical liberalism and its laissez-faire ethos gave way to Keynesianism in the face of the global depression of the 1920s and 1930s. For decades the Keynesian principle that activist state intervention in the economy and a more equitable distribution of economic rewards was the surest way to sustained prosperity dominated both the field of professional economics and the halls of economic policy making but then fell victim to the global crisis of capitalism of the 1970s. Knocked from its high perch, Keynesianism was replaced by a new incarnation of economic liberalism, what scholars now generally recognize as a "neoliberal" turn in economic thinking and economic policy making. Like the economic paradigms that came before it, neoliberal doctrine has spread from its foundational centers and become truly global.

So although the proponents of austerity claim that their approach to economic management is simply common sense, it is in fact a fairly recent common sense or, to be more precise, the rebirth of an old common sense once discredited nearly a century ago. History shows that there is nothing natural or necessary about austerity. It is but one of several possible means of dealing with an economic crisis. Why, then, have the politics and policies of austerity proven so resilient in the face of crisis?

In this book, I address this question by drawing a historical arc from the era of the classical liberal era of the nineteenth-century gold standard to the politics of neoliberal austerity of the early twenty-first century. As already suggested, although economic liberalism has always had its adherents, it has not always been dominant. Rather, from the beginning of the First World War through the Bretton Woods era the proponents of economic liberalism struggled against the forces of "embedded liberalism"—the belief that economic

policy need not be subsumed to the abstract, universal "laws" of the market but rather needs to be attuned to the cultural and political particularities of each national context.

Within this larger story I conduct a detailed empirical investigation of the politics of growth in the 1960s, a critical turning point when nascent efforts to liberalize the global economy provoked an ongoing debate between policy makers across North America and Western Europe over the question of international economic cooperation in an increasingly interdependent global economy and, in doing so, raised larger questions about whether global capitalism would be defined by classical liberalism or embedded liberalism.

The core argument of this book is that the rise, consolidation, and resiliency of neoliberalism and its economics of austerity are tied to international institutional configurations that increase the influence of financial interests over national economic governments. Specifically, I show that the rise and consolidation of austerity as a dominant economic policy paradigm can be traced to what I am calling the transnationalization of monetary authority. By this I mean the increasing cohesion of state financial officials—central bankers and finance ministers—in transnational and intergovernmental institutions and the increased centrality of these institutions in the regulation of the international financial system.

Beginning in the early 1960s, central banks took on more and more of the responsibility of managing an international monetary system that had outgrown the institutional arrangements put in place at Bretton Woods in 1944. National governments saddled with substantial balance of payments deficits and facing speculative attacks against their currencies grew increasingly dependent on financing arranged through central banks who have long clung to the core tenets of classical liberalism: currency stability, fiscal balance, and economic restraint. It was from this position of having acquired significant international monetary power that state monetary authorities were able to coerce social democratic governments back onto the path of austerity.

These transformations in the institutions of international monetary management that took place in the 1960s were only the beginning of what would ultimately become a deeper consolidation of a transnational monetary authority in the post–Bretton Woods era. After the collapse of Bretton Woods in the 1970s, the management of an increasingly crisis-prone global economy was consolidated in the international forums of monetary cooperation: the Bank for International Settlements, the International Monetary Fund (IMF),

the meetings of the Group of Ten, and, in the 1990s, the European Central Bank. In the era of classical liberalism, individual financial institutions were strong, but true international cooperation was elusive. In the neoliberal era, the monetary authorities are cohesive and coordinated as organizational histories and national allegiances have given way to a shared understanding of the state's proper role in the economy. The strength and resiliency of neoliberalism and its policies of austerity derive from this international institutional architecture that has elevated the transnational monetary authority to the heights of global economic management.

This book builds on scholarship on the rise, diffusion, and resiliency of neoliberalism in two ways. First, while many scholars have already discussed the role that collapse of Bretton Woods played in the emergence of neoliberalism, much of this research focuses on the way in which the collapse of Bretton Woods unleashed private transnational capital to wreak havoc on a deregulated global economy, opening space for free market ideas.[3] I take a different tack, arguing that the resilience of austerity is rooted in the public, or quasi-public, institutions and organizations that have been center stage in the process of reregulating the post–Bretton Woods international monetary system under a "new international financial architecture." While this term is most often used to describe the vast and expanding system of international organizations regulating global finance, I argue that three aspects in particular have been critical for the institutionalization of neoliberalism and austerity as dominant economic policy paradigms: the widespread diffusion of inflation-targeting regimes, which brings with it increased policy-making autonomy for central banks; the adoption of market-based capital regulation through reserve requirements; and the consolidation of monetary authorities' role as lender of last resort during times of global financial crisis.

Second, in addition to offering new insight into the contemporary politics of austerity, the transnationalization of monetary authority is very much part of the story of the financialization of modern capitalism or the growing weight of financial activity and financial-sector profits in the process of capital accumulation. Krippner's recent account of the financialization of the U.S. economy shows how domestic politics, specifically the way in which state elites "stumbled on" finance as a solution to the deep economic crises of the 1970s and 1980s, laid the political and economic groundwork for the thorough financialization of economic activity that took hold in the 1990s and 2000s.[4] While not denying the importance of these domestic factors, this book links

these domestic developments to international institutional transformations that have supported and legitimated domestic processes of financialization.

Historical Lessons, Historical Antecedents: From Social Democracy to Austerity in the 1960s

This book addresses the global politics of the present through a historical investigation of the relationship between international monetary power and national economic policy making in North America and Western Europe in the late postwar period. In the first decade following the end of the Second World War, most North American and Western European countries pursued a moderate-to-conservative path to economic growth. In Western Europe, center-right political parties held off the socialists' and communists' demands for higher wages, nationalization of industry, and high levels of public spending. Instead, center-right governments channeled economic resources into private and public capital investment with the goal of becoming competitive in international export markets. Similarly, in the United States the Eisenhower administration followed a very moderate program of countercyclical Keynesianism, maintaining a very slow, but stable, rate of economic growth while keeping a watchful eye for any signs of price inflation that could not only hurt the trade balance but, even more importantly, weaken the international value of the dollar, the currency on which the postwar international monetary system rested.

By the early 1960s it appeared that this era of economic conservatism was coming to a close as liberal and social democratic political parties returned to power. Such was the case in three countries that form the core of this book's empirical analysis: the United States, the United Kingdom, and Italy. In the first two cases, liberal parties—the Democrats in 1961 in the United States and Labour in 1964 in the United Kingdom—returned to the head of government after having been out of power for close to a decade. In Italy the ruling party, the Christian Democratic Party, remained in power but drastically shifted its political strategy in 1962 by trying to forge for the first time in the postwar period a center-left governing coalition with the socialists.

Despite a domestic political climate conducive to left-wing economic policies, in all three cases social democratic projects were never fully realized or were quickly abandoned, replaced instead with policies that restricted, or even reduced, the share of national income going to workers and consumers. In the United States, the Kennedy growth agenda took the form of "commer-

cial Keynesianism," which was based primarily on supporting private investment through tax cuts for private corporations and the wealthy and which, in turn, required keeping government spending—particularly government social spending—in check. In the United Kingdom and Italy austerity measures were more direct and, because they came directly on the heels of real social democratic policy reforms, felt more harsh: Budgets were cut, access to consumer credit was sharply restricted, and wages were placed under control.

These sudden breaks with social democracy and the turn to austerity are the historical puzzles that drive the analysis in this book. As in other cases when governments have abandoned national growth experiments for market-friendly austerity measures, the pressure to do so in each case came from international political and economic forces. Specifically, when the United States, the United Kingdom, and Italy abandoned their growth experiments, they did so while facing massive balance of payments deficits that were generating financial market speculation against their currency. For many scholars of international political economy, this fact points to a rather simple explanation for the shift from social democracy to austerity: Facing a severe balance of payments deficit, national governments did what they necessarily had to do, constricting domestic economic growth to restore the balance of trade and reduce the outflow of foreign investment capital.

Yet it is precisely the obviousness of austerity as the appropriate policy response to a severe balance of payments deficit in these cases that demands critical investigation. Only in retrospect do the policy responses of state officials to a payments crisis, or any other crisis for that matter, appear obvious. Observing policy makers when these decisions were actually made, or at least observing them through the records of their decisions that they left behind, it becomes immediately clear that the causes, severity, and solutions to payments crises were clouded in uncertainty and deeply contested.

Today, researchers and policy officials are used to having immediate access to accurate data on a whole range of economic phenomenon. This was not the case in the 1960s. National accounting, let alone balance of payments accounting, was still new. Countries varied widely in how they defined, and calculated, their individual balance of payments positions.[5] Moreover, even if these technical problems could have been solved and agreement could have been reached that a balance of payments deficit had become so severe as to warrant some kind of compensating domestic policy response, the questions of how to respond, and which policy instruments to use, were open to a wide

range of views and interpretations. The balance of payments measures the economic transactions of a national economy with the rest of the world. It includes typical economic transactions like trade in goods and services, foreign direct investment, and financial investment. It also includes transactions such as military spending, foreign aid, and even the spending of tourists traveling overseas. To have a balance of payments surplus means that you export more than you import, you attract more capital and investment then you send out, you are host to a foreign military base, or perhaps you attract more foreign tourists. As such, the balance of payments is an index measure of a broad range of economic activities, each of which is determined by its own set of complex factors. Trade imbalances, for example, could arise from divergent exchange rates, divergent cost structures, or divergent regulatory policies. An imbalance, in other words, does not prescribe an obvious policy response.

What makes the cases of the American, British, and Italian turns to austerity so striking, when viewed side-by-side, is that despite all of these ways in which payments deficits lend themselves to a variety of possible policy responses, despite the fact that the underlying causes behind each country's payments deficit were different, and despite the fact that each was trying to manage its payments deficit while simultaneously grappling with domestic economic and political issues that were quite different in each case, the specific content of each response is nearly identical.

The question that needs to be answered, therefore, is: Why was austerity selected as the common policy response to a balance of payments crisis in each of these three cases? The answer lies with the weakening of the international institutions formed at Bretton Woods and the increasing international monetary power of the international financial community that resulted. Although the United States, the United Kingdom, and Italy all arrived at their payments deficits through different means, by the early 1960s resolving payments deficits, or at least papering over them to prevent a speculative run against their currencies, increasingly came to depend on the active cooperation of foreign central banks and other monetary authorities.

In the 1960s the Bretton Woods settlement came under severe stress. The governments in North America and Western Europe worked together to slowly but surely dismantle restrictions against transnational capital movements, resulting in a significant increase in short-term, cross-border capital transactions that overwhelmed the existing mechanisms of balance of payments financing. The critical consequence of this change in the global economic landscape was the creation of new mechanisms of balance of payments

financing that elevated national monetary authorities into the heights of the international monetary system.

One of the central arguments of this book is that it was not payments deficits per se that triggered a turn to austerity but rather the evolving mechanisms of balance of payments financing that made warding off currency speculation dependent on the cooperation and confidence of private international investors and public financial authorities. These shifting structures of dependency provided the mechanism through which foreign central banks and other international financial organizations could significantly influence the direction of other governments' national economic agendas. The policy ideas of the international financial community—policies of austerity—were selected into national policy-making processes not because they were technically superior but because they were given real, material weight by the changing distribution of international monetary power.

The prevailing accounts of the rise of neoliberalism and its global diffusion have yet to appreciate these important transformations in the institutional mechanisms of balance of payments financing, the effect that they had on restructuring relationships of financial dependency, and the way in which this empowered state monetary authorities to push for a return to a classically liberal understanding of the relationship between international economic stability and national economic growth. Investigating economic policy making during the critical decade of the 1960s thus provides analytical leverage on the broader question of how, and when, international monetary power shapes the course of national economic policy making.

Austerity and Neoliberalism

The concept of neoliberalism is most often used to describe an interrelated bundle of ideas and policies that mark a fundamental shift in modern democratic societies in the state's relationship to the economy and to its citizens. Neoliberalism is grounded in neoclassical economic theory, specifically neoclassical theory's belief in the technical and moral superiority of free markets over state direction of the economy. The growing weight of this market-centered ideological framework manifests as a transformation in state policies that, in general, have tried to undo the social-democratic Keynesian compromises of the postwar era through a process of marketization—lifting regulations on economic activity, privatizing state-owned enterprises, and subjecting more and more of the social world to the discipline of market competition.[6]