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## One Ring to Bind Them All:

# American Power and Neoliberal Capitalism

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In 2007, the United States government will spend more on its armed forces than all other countries combined. This fact, plus U.S. operations in Afghanistan and Iraq, tensions with Iran, and the “war on terror,” all make it easy to forget that American power is *not* based solely on its military might. At a time when pundits and policy makers alike speak of the “unipolar moment” or a new age of “empire,” it should make us pause to consider what such power is *also* based upon.

<sup>i</sup> Unlike the dark lord Sauron of *The Lord of the Rings*, the United States does not rule the world through the cruelty of a great army of Orcs. Like most successful great powers, military power is only part of the story. But like the dark lord Sauron, to stretch the analogy to its fullest, the power of the United States rests not merely on military might, but on “binding” men together with a conception of, if not what is “right,” then at least

what is desirable. As the political scientist Joe Nye argues, as well as applying force, a state can “obtain desired outcomes in world politics because other countries want to follow it, admiring its values, emulating its example, aspiring to its level of prosperity and openness.”<sup>ii</sup>

Consider, by way of contrast, the late Chairman Mao’s statement that “that power comes from the barrel of a gun.” This is undeniable. But what Nye is suggesting is that power also resides in the ability to make others want what you want so that you don’t have to stick a gun in their face in the first place. This has been, I argue, the more subtle, but just as vital, basis of American power: getting other states to want what you want.

In this chapter, I discuss how developing and deploying ideas about “the way the economic world works” has facilitated American power, enabling it to shape other states’ conceptions of their self-interest – that is, convincing other advanced industrial states through the ideas that the United States promotes, as well as the institutions that the United States sets up and the outcomes they deliver, that what the United States wants is good for them too. None of this suggests that “material” factors such as the postwar strategic balance or the sheer size of the U.S. economy do not matter. Rather, this chapter focuses on a less remarked upon aspect of U.S. power: the attractiveness of U.S. ideas.

The ideas that made the United States strong from the 1940s until the 1980s – multilateralism, consultative diplomacy, and an expansionary and redistributionary macroeconomic policy – have given way today to a new set of ideas based around unilateralism, indicative diplomacy, and a restrictive and regressive macroeconomic policy. Key to this transformation post-1975 has been the rise of so-called neoliberal economic ideas as the touchstone of “sound” economic governance. The adoption of

these ideas by the U.S. governing elite has led U.S. policy down a path that sees the supply side of the economy as dominant, wages as a cost to be minimized, and government as the cause of, rather than the solution to, economic problems. Being the proverbial three hundred pound gorilla in the room, the embrace of these ideas by the United States has had massive consequences for Europe, as Steven Teles and Daniel Kenney will show in the next chapter of this book.

As the U.S. business press frequently puts it, Europe's bloated welfare states are no longer viable in this new "globalized" environment. High taxes states must lose to low tax states; redistributionary states must give way to "competition" states; and labor protections must give way to "flexibility." In short, European states must accept "the way the world now works" according to the United States, and accept the policies these new ideas demand. Given the ferocity with which such claims were trumpeted during the 1980s and 1990s, many observers saw European states as inevitably falling into in an increasingly pernicious race to the bottom, with widening inequality the cost to be paid. To paraphrase Margaret Thatcher, "there [was] no alternative," or as Lord Sauron would have it, neoliberalism was the new "One-Ring that binds them all."

Indeed, during the 1980s and 1990s it seemed that Europe was following the United States in liberalizing their economies. Large-scale privatizations of public assets and institutional reforms unthinkable a generation ago were undertaken across all of Europe, culminating in European Monetary Union. Once again it seemed that what the United States wanted, Europe wanted too. After all, if these new ideas delivered the prosperity they promised, who would not want to be bound by the new "One-Ring"?

Things are often not what they seem, however, and once European governments became aware of the very real political and economic costs of “wanting what the United States now wants,” they balked, and the power of the new “One-Ring” began to fail. This has resulted in a growing divergence between the type of political economy many European governments still want (equalitarian and compensatory) versus that now sought by the United States (inegalitarian and nonaccommodating); and such divergence constitutes part of why the United States and Europe are growing apart today.

To make this case, the first part of this chapter sketches out the ideas that underpinned U.S. power between 1945 and 1975. This order was based on a specific version of “the way the economic world works” born in the Great Depression. The global acceptance of these ideas made American power in this period extremely robust since it successfully portrayed the particular interests of the United States as being the general interest of Europe. The next part of this chapter details why some groups in the United States found this order to be not in their best interests, and discusses how they overturned it, as detailed by Teles and Kenny (in Chapter 5), using neoliberal ideas. I then discuss how these ideas came to Europe, and detail the transformations they wrought during the 1980s and the 1990s.

The next part of the chapter argues that although the construction of common interests by the United States was possible in both periods, the neoliberal ideas underlying the current order make for a much more fragile compact – one that many European governments are unwilling to join. To substantiate these claims, comparisons are made between the United States and Europe in the areas of economic performance, welfare policies, and inequality. We find that there is indeed increasing divergence

between the United States and Europe in terms of economic policies and outcomes, and I question the extent to which Europe is really “going neoliberal.”

Although European leaders were willing to embrace the first compact given the positive-sum nature of the outcomes they offered, the more that the economic and social costs generated by the current order became apparent, the less they were willing to adhere to the second neoliberal compact. Consequently, what we increasingly see is European governments “talking a good game” regarding neoliberal policies while in fact doing something quite different in practice. If U.S. strength were based merely on brute force, this incongruence would be of little consequence, but it is not. To return to the dark lord Sauron, deprived of the ability to bind men together with a common conception of “what we all want,” what could be termed “Mao’s revenge” may begin to affect U.S. interests – that is, “if you can’t make someone want what you want, you may have to stick a gun in their face.”<sup>iii</sup> The costs of doing so, however, may ultimately prove to be very high indeed.

## A-Head Economic Ideas and the Foundations of American Power

### B-Head From Interference to Intervention

The basis of American power lies in the military victories of World War II. Yet acknowledging the importance of these military victories is just one aspect of a full understanding how the United States was able to shape the postwar world. What was also

critical was the conception of what government should do in the economy, both locally and globally, *after* the war. Basically, government intervention into the economy became respectable. Building on the successes of the New Deal period, those planning for the postwar world sought to build, as political scientist John Ruggie has described it, a new form of capitalism that combined the welfare-enhancing aspects of free trade with domestic institutions designed to avoid the instability and unemployment characteristic of the 1930s.<sup>iv</sup>

The need for such a new form of capitalism was as much political as it was economic. On the economic front, postwar planners believed that the reason fascism came to power in Europe in the 1930s was that when the world economy deflated in the Great Depression, the costs of deflation (falling prices) were borne for over a decade mainly by labor in the form of declining wages and higher unemployment. This was allowed to occur since, according to the economic ideas of the 1920s and 1930s, deflation was a series of shocks to the global economy that would ride themselves out through the adjustment of wages and prices; if the price mechanism was allowed to operate without the well-meaning but ultimately harmful interference of government. If there was unemployment, it had to be the result of labor bargaining for too high a wage; to restore balance, wages had to fall to match prices. Cushioning adjustment would simply pile on the pain and delay the inevitable.

There were unfortunately two problems with such a view. First, if it was correct, adjustment costs were still shouldered by labor, and what the 1930s seemed to show was that labor, wherever it was located, did not respond well to precipitous drops in the real wage.<sup>v</sup> Second, such a theory simply could not explain why between 1924 and 1931

millions of people across the world seemed to decide that the prevailing wage in their job was too low and that an extended unpaid vacation was in order. Indeed, the poverty and upheaval caused by the Great Depression made the claim that unemployment was voluntary seem quite absurd. As far as the postwar world was concerned, then, a simple return to the status quo ante, where the external financial balance automatically governed internal wages, prices, and employment levels, was not going to suffice.

## **B-Head** Rethinking the Way the World Works

In terms of governing ideas, the critical lesson learned from the Great Depression was that unemployment persisted not because people were unwilling to work at the prevailing wage, but because there was no work to be had; unemployment could be involuntary. These new ideas stressed that the reason economic depressions were so difficult to get out of was that investors were depressed – in a very specific sense. The new idea was that although investors and investment (the supply side of the economy) ultimately create jobs and growth, investors tended to have rather short-sighted expectations regarding the future.<sup>vi</sup> If investors think that the past three months were bad, and the three months before that were bad, then regardless of the preceding twenty months of bliss, they will probably think that the next three months will also be bad. The result is that, quite rationally but perversely, individual investors are unwilling to invest, with the consequence that economic activity as a whole declines, despite this being the very outcome that everyone wants to avoid.

To cap it all off, if the distribution of income and wealth is highly unequal (as it was in most countries during the 1930s), then investors do not need to invest to survive

given the disproportionate amount of income and wealth they already hold. Labor, on the other hand, cannot have wages without investment, and without wages fascism and communism lay just around the corner. Seen in this way, something had to be done to give a shock to the system and stimulate investment. That something was government. These new ideas proposed that boosting demand through spending would raise consumption, signaling to investors that prices were rising, thereby encouraging investment: Interference became intervention.<sup>vii</sup>

Some investors, suspicious of the government, argued that this was government trickery, since any spending now would be paid for in the form of higher interest rates (or taxes) in the future due to the government squandering available investment; or it would ruin business confidence, the very thing that government was trying to encourage. However, if investors' expectations were indeed "front-loaded," then raising prices through government spending would create a situation where investors *could* make money. All investors would then be faced with a choice: Hold out in principled opposition to government policy, or make money (since clearly someone else could), thus expanding the economy and reversing the self-fulfilling dynamic of investor expectations through the raising of prices.<sup>viii</sup>

## B-Head Changing the Way the World Works – and Augmenting

### American Power

Investors chose the latter option, and after 1945 government took on a role hitherto unprecedented: the active steering of the economy, both domestically *and* internationally. In addition to the New Deal institutions, the United States designed the new international

order of the period: the Bretton Woods exchange rate system (designed to stabilize world trade by fixing exchange rates), the International Monetary Fund (designed to help states avoid internal deflations by providing financing for balance of payments problems), and the International Bank for Reconstruction and Development (encouraging state-led development outside the developed world). Despite domestic opposition to such “socialistic” policies, the political costs of not pursuing them seemed simply too high given the experience of the 1930s.<sup>ix</sup> And there was another good reason for doing so: the credible alternative posed by the Soviet Union.

Although it is hard to imagine today, the USSR was widely seen in the postwar era as a viable alternative road to prosperity. With large (and popular) communist parties in many European states, especially France and Italy, capitalizing on the wartime success of the USSR, and the fear of a return to mass unemployment after the war, both American and European political elites saw the need to stabilize Europe. Although the Marshall Plan may be the most famous example of this commitment, equally important was the U.S. response to the Soviet alternative. Containment was one part of the strategy, but another part was the construction of redistributionary welfare states throughout Europe, all supported by the Bretton Woods order.

In this period of common interests and positive sum politics, where one state’s growth was not seen as another state’s loss, Western Europe voluntarily aligned itself with an American-designed form of capitalism that guarded the real wage of labor, sponsored interclass mobility through publicly funded education and, crucially, taught Western European leaders of all political stripes that it was good to be bound to the “One Ring” of the United States. After all, nothing succeeds like success, and in this period

Western European incomes in many cases tripled in less than twenty years. Such ideas and the policies they necessitated clearly served American interests, but did so in such a way as to make Western European political elites' interests parallel to those of the United States. There was no need to stick a gun in somebody's face.

## **A-Head** Does Anyone Have a Problem with This?

### **B-Head** Upsetting the Orthodox

Figuring out the answer to this question is hardly rocket science. Under the prior model of “the way the world works,” investors and entrepreneurs were the heroes. As liberal theorists from Adam Smith onward argued, savings led to investment, which led to wages to buy the products made by the workers themselves, which led to profits reinvested in the firm. In short, investment led to income, which led to investment – a virtuous circle. But in the 1930s, the virtuous circle broke down and the new ideas previously discussed came to prominence. But what is not often noted in discussions of the rise of these new ideas was the distributionary politics that they necessarily enshrined.

As discussed previously, these new ideas deemed that the key to encouraging investment was rising prices, and saw the government as being able to raise prices via spending. But in the long run such a position suggests something quite political: that consumption drives investment, not the opposite. Under these new ideas, the demand side, not the supply side, is seen as dominant. In such a world, consumers become heroes – not investors – and in making this change, political power becomes redistributed.

In this world, consumers' demands determine investors' supply schedules. So if one wanted to improve the economy, who should get the tax cut? Not the investor, but those most likely to consume – labor. No longer is Adam Smith's "parsimonious Scot" the hero. Now the heroes are millions of "average Joes" whose joint consumption decisions determine the supply of investment. This fact, plus mass democracy (another post-1945 invention for most of the developed world), threatened to lead to what John Maynard Keynes called "the euthanasia of the rentier" – the end of the world in which investors ruled the roost. That such groups recoiled at such ideas is hardly a surprise.

### B-Head Taxing Times Ahead

Although investors were not euthanized under the new regime, they certainly had to share the wealth a little more. Economists Claudia Goldin and Robert A. Margo call this period -"The Great Compression."<sup>x</sup> After the Great Depression, the wage structure of the United States compressed considerably. The differentials between workers at the top and bottom of the income scale narrowed, while the real wages of all groups (who received wages) increased. *This had never happened before.* This redistribution of income and wealth was further aided by the new institutions of the postwar world that acted as a tax on investors' earnings by making some practices either more difficult, or in some cases, downright illegal – financial speculation, for example. Similarly, a policy of cheap money and reflationary countercyclical fiscal policies aided those at the bottom of the income distribution far more than those at the top. And to pay for all this, investors as a class actually had to pay more in taxes, with the tax burden proportionately shifting towards upper-income earners *for the first time in history.*<sup>xi</sup> Taking the top 1 percent of U.S.

households as the core of the investor class, this group's marketable wealth declined from 44 percent of the gross domestic product (GDP) in 1930 to around 20 percent by 1970. In the United Kingdom, the redistribution was just as drastic, with the top 1 percent's net worth declining from 55 percent in 1930 to 28 percent in 1970. In Sweden, it fell from 38 percent to 18 percent over the same period.<sup>xiii</sup>

Clearly, something had to be done about this. It was bad enough to go from being the heroes of the system to being seen as the shortsighted adjuncts of the consumption decisions of the *profane vulgar*. But when this new system actually redistributed income and wealth from the top to the bottom, those who benefited from it had to be convinced that despite all this growth and income going their way, such a system was actually not really in their best interests. Yet thirty-plus years of higher taxes and bigger government, had produced *more wealth* for the bottom four-fifths of the income distribution in the United States than at any other time in history. Clearly, if there were going to be some new ideas that would make the majority of people believe that this system was not in their interest, they would have to be very creative, and also have more than a bit of luck on their side.

## B-Head The Return to Orthodoxy

The upsetting victory of these ideas was not uncontested; there were holdouts. Seen during the 1950s and 1960s as little more than old-fashioned conservatives confined to the so-called Freshwater schools of Chicago, Carnegie Mellon, and Wisconsin, these intellectual stalwarts of the old order bided their time, offering alternative ideas to the status quo. They waited, preparing to take the offensive when the opportunity presented

itself. As Teles and Kenney put it, “taking advantage [of a] window of opportunity ... turns largely on the transmission of ideas.”<sup>xiii</sup> As if realizing this, the poster child of this movement, Milton Friedman, once argued that the point of his work was

[ext] to keep options open until circumstances make change necessary. 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.<sup>xiv</sup>

Friedman’s contributions to neoliberal economics were legion, but one stands out for its elegance (it seemed to fit the facts) and its timing (it did so at the right time). Beginning in the late 1960s, Friedman began to question something that the “new economists” (the pro-government economists of the 1960s) such as James Tobin and Paul Samuelson had popularized: the Phillips curve.<sup>xv</sup>

The idea behind the Phillips curve was that there existed a trade-off between the rate of change in wages and the general level of prices (more prosaically, unemployment versus inflation). This curve seemed to offer policy makers a menu of choice between the two outcomes, trading one off against the other, which was nice; but it also had some rather unsettling distributional implications. For example, if the party that benefited most from these new ideas (that which represented the majority of the income distribution, the Democrats) preferred to trade off a little more inflation against a little more unemployment, then to the extent that inflation is a tax on time-deferred investment incomes, that tax would be paid by the Republican Party’s most powerful constituency –

the investor class. Friedman helped to portray this as a disaster waiting to happen, not just for the investor class, but for everyone.

## B-Head Neoliberal Lesson #1: Activism Is Harmful to Your Health

To turn this particular redistribution into a general disaster, Friedman made four assumptions that today form (with some modification; two were added later) the core of contemporary neoliberal thinking:

1. There is a “natural” rate of unemployment beyond which the economy cannot be pushed.
2. Job seekers and investors have “adaptive” rather than shortsighted expectations.
3. In the long run, there is no trade-off between employment and inflation.
4. Unemployment is voluntary.<sup>xvi</sup>

These assumptions enabled Friedman to tell the following story.

Imagine you live in an economy with a level of unemployment that is seen as “too high” and a government that wants to do something about it. According to the Phillips curve, it can do so by spending money to increase prices, signaling investment, and tightening labor markets, all of which would be reflected in higher wages that would encourage the unemployed to return to work (since their current unemployment is voluntary – assumption 4). This would trigger still higher prices, as the Phillips curve predicted, which would bring forth new growth. The problem, Friedman insisted, was that this trade-off between unemployment and inflation is an illusion, since workers had “adaptive” and not shortsighted expectations (assumption 2).

Unemployed workers would take the new job at the seemingly higher wage, only to discover that prices have also risen. Therefore, although their money wage had increased, their real wage (money wage minus the price level) would not have risen at all. Workers would then withdraw their labor (assumption 4) such that unemployment returns to its “natural rate” (assumption 1). If the government tries to do this again, it does so from a higher baseline of inflation (assumption 2), and once the price increases filter through the economy, workers again withdraw their labor and unemployment rises, and all that the state is left with is higher and higher inflation and the same rate of unemployment (assumption 1). The take-home message is clear: Government causes inflation – not greater employment.

Despite resting upon some rather heroic assumptions, the timing of this argument was perfect. Coming on the heels of Vietnam War expenditures, the 1960s’ welfare expansion, rising deficits, and the November 1973 oil shock, the Phillips curve broke down with unemployment and inflation rising together to produce “Stagflation.” Although this phenomenon was actually quite explicable in terms of Keynesian ideas, Friedman’s ideas gained much currency and, as detailed by Teles and Kenny in the next chapter, were promoted with vigor by business-funded think tanks and Republican policy makers. It also spawned a political variant of the same lineage that was even more damning.

B-Head Neoliberal Lesson #2: You Can’t Trust the Government with Your Money

If there were more workers/consumers than capitalists/investors, then Democratic Party administrations, those that nominally served the worker/consumer constituency, could effectively lock in their electoral advantage. By meshing the electoral cycle to the business cycle, such governments, it was argued, could cynically manipulate the economy to boom when an election was coming and bust it once it was won. But given that the unemployment/inflation trade-off that such manipulation would be based on was unstable (as shown by Friedman), rather than just soaking the rich, such behavior would produce lower growth and higher inflation for all. So even if you were in the constituency of the “many,” in the end you would get hurt too.<sup>xvii</sup>

Like Friedman’s version of events, this “political business cycle” theory saw government not as the stabilizer of the economy, but as the cause of inflation, recession, and unemployment. Governments were now seen as cynically causing inflation to enhance their electoral prospects, while federal bureaucrats were seen to expand their budgets relentlessly to swallow more and more of national product and investment. Such ideas found particular resonance in the context of large budget deficits and swollen tax receipts due to inflationary “bracket creep” during the economic slowdown of the mid-1970s. The tide was turning.

### B-Head Neoliberal Lesson #3: Government Is Pointless – or Toxic – or Both

Two more ideas were important for the full development of neoliberal thinking. First of all, why assume that people have adaptive expectations? If being wrong is expensive, then we would expect people to invest in being correct. We know people in fact do this

because if we assume that markets are efficient (assumption 5), then consistently wrong choices (and thus choosers) would be eliminated from the market. Therefore, those agents in the market at any given point must be those people who use the available information efficiently since they are not dead yet. Such agents must have “rational,” not adaptive, expectations (assumption 6).<sup>xviii</sup>

If this is the case, and these agents know that in the past the government has expressed a preference for lower unemployment, then they can reasonably expect the government to spend money to lower unemployment. But if spending now means either higher interest rates or higher taxes later on, then such “rational” investors will alter their budgets to compensate before the policy comes into effect, thereby nullifying the its effect on real variables. In other words, policy becomes futile. However, knowing that investors would do this, the government could try and spend unexpectedly, in an effort to get around the anticipated reactions of investors. Doing so would interfere with the otherwise efficient price signals of markets, thus causing confusion and thereby bringing about a recession. Government was therefore toxic, or pointless, or both.

The final nail in the coffin of the new economics was supply-side tax theory, a reinvention and reinstatement of the classical view that investment drives income, and not the other way around.<sup>xix</sup> This “supply-side revolution” was also very effective bribery. As Americans have shown in the past two decades, when faced with a choice between a tax cut and “any other policy,” the tax cut wins every time, despite the redistribution being rather obviously skewed toward the top earners. Add all this together, and fund it with lavish press campaigns, television programs, and research grants to sympathetic economists, and the result was to turn the world (neo-) liberal again.

## A-Head America and Europe, Skin-Deep Neoliberalism, and the Waning of American Power

### B-Head As Goes America? The U.K. Goes Neoliberal

Prior to Ronald Reagan implementing many of these ideas in 1981 and 1982, thereby causing a deep recession that decimated those U.S. industries traditionally aligned with the Democratic Party, such ideas had another champion, Margaret Thatcher. Coming to power in 1979, one early act of Thatcher's chancellor of the exchequer, Nigel Lawson, was to abolish U.K. exchange controls, remnants of the Bretton Woods system. The collapse of the Bretton Woods system of fixed exchange rates from 1971 to 1973 presented private financial interests in the United States and the United Kingdom with the opportunity to make billions by picking up the new market in currency risk. The abolition of exchange controls opened up London to such flows and abandoned any buffer between domestic and world prices.<sup>xx</sup> Such a policy change served two goals. First, it rewarded investors by opening up new markets. Second, it weakened the bargaining power of domestic labor by, once again, making wages adjust to external prices.

Building on this, the Thatcher government embarked upon a Friedmanesque policy of targeting the money supply to reduce inflation, which had the effect of precipitously raising real interest rates, but did so with a less obvious mechanism. This policy constricted the economy, caused massive unemployment, and, combined with a series of legislative assaults on trade unions, further weakened the bargaining power of

labor. It also increased further the value of paper assets by lowering inflation and further boosting the profitability of the financial sector.

Having succeeded in these tasks, the British government next pursued a series of privatizations that included the further deregulation of finance, thereby encouraging the growth of the service sector and unorganized white-collar labor. Capping all this off were supply-side tax cuts that redistributed even more wealth back to investors.<sup>xxi</sup> The United Kingdom and the United States, by embracing neoliberal ideas, both as a critique of existing institutions and as a guide for their replacement, reorganized their economies in such a way as to redistribute back from bottom to top, weaken the power of labor, and delegitimize state interventionism. This was neoliberalism in practice.

## B-Head As Goes America? Europe Goes Neoliberal

Such policies, emanating from two of the largest economies in the world, had effects elsewhere. With the end of fixed exchange rates and abolition of exchange controls by the two largest financial centers, an era of global capital flows began that shifted the cost of adjustment back onto domestic labor everywhere. From the point of view of other European states, when the United States and the United Kingdom opened up their markets, deregulated finance, and encouraged inward flows of capital, the costs of maintaining controls became ever more expensive. It became rational for the remaining states to abolish controls and bandwagon with the liberalizing states (and get some of the action) rather than hold out against the tide. What turned many European states in this direction this was what happened to France in the early 1980s.<sup>xxii</sup>

Coming to power in 1981, the Socialist government of François Mitterrand attempted to reflate its way out of the recession that had spread from the United States and Britain to continental Europe. Relying on methods of nationalization, controls, and fiscal stimulus, at a time when everyone else was deflating, Mitterrand's policies produced massive capital flight out of the Franc, which seemed to prove that controls did not work, and a massive appreciation of interest rates that caused the economy to slow even further. After a year of holding out, the French government executed a famous policy U-Turn and gave up trying to control the franc, the domestic rate of interest, and aggregate demand. Having "learned" from this, even Sweden, that paragon of social democracy, saw the writing on the wall and in 1987 deregulated its domestic credit markets and abolished exchange controls shortly thereafter.

By the time that the Berlin Wall came down, it seemed that there was indeed "no alternative." This was confirmed further in the 1990s, when right-wing governments lost power and putatively left-wing parties were returned throughout Europe with large majorities. However, as the cases of Tony Blair, Gerhard Schröder, Wim Kok, and Romano Prodi demonstrated, redistribution, higher taxes, and demand-side economics were conspicuous by their absence. In their place these, "left" governments created independent central banks and currency unions. To update Richard Nixon, it seems that "we are all neoliberals now." Appearances, however, can be deceptive. As the costs of pursuing such policies have become more obvious over time, the less European states are willing to bear them. Europe increasingly "talks a good game" about deep neoliberal reform, but in fact does something quite different in practice.

B-Head Comparing Europe and the United States

To make the case that the appearance and reality of a neoliberal Europe are actually quite different things, we must first have a benchmark as to what a neoliberal state looks like. Appropriately, the United States suffices. Having began the period as the most liberal of developed states, it embraced neoliberalism with gusto and underwent a more profound transformation than any other country except the United Kingdom. A quick examination of what happened to the United States since 1980 in terms of macroeconomic policy, welfare policies, and inequality serves as the basis for our contrast with contemporary Europe.

In contrast to what occurred in the United States during the Great Compression, during the 1980s 37 percent of the total income gains of that decade went to the top 1 percent of households. Meanwhile, the bottom 80 percent of the distribution received only 24 percent of the gains.<sup>xxiii</sup> During the 1990s, these trends continued despite redistributionary programs such as the Earned Income Tax Credit. In 2004, 37 million Americans lived below the poverty line, up from below 25 million in the 1973, and despite the growth in real GDP since the 1970s, the poverty rate has remained virtually unchanged.<sup>xxiv</sup> This is a complete reversal of the patterns of the previous thirty years.

The figures for wealth are even more illustrative than the figures for income. From 1945 to 1976, the share of marketable wealth controlled by the top 1 percent of households fell by 10 percent. Between 1983 and 1989, it rose by 39 percent. Nearly everyone else, the bottom 80 percent of the income distribution, saw their wealth holdings fall by nearly a fifth over the same period. By 1989, the top 1 percent of households owned 48 percent of total marketable wealth (stock, bonds, and real estate).<sup>xxv</sup>

To use a summary measure of inequality, the Gini coefficient, which gauges between 0

(perfect equality) and 1 (perfect inequality), the United States went from a Gini of 0.301 in 1979 to a Gini of 0.372 in 1997, a 24 percent increase.<sup>xxvi</sup> Among developed states, only the United Kingdom bests the United States in achieving a greater growth in inequality over the same period.<sup>xxvii</sup>

Such outcomes are not simply the result of partisan tax policies. The overall macroeconomic framework developed since the 1980s aided in this upward redistribution. Beginning in 1978, the Federal Reserve pushed up interest rates in an effort to control inflation. By the 1980s, interest rates reached double figures, which had two effects. First of all, it provided a bonanza for bond holders, who received unprecedented returns on their investments. Second, it caused a massive contraction of the nonfinancial economy and created unemployment in traditionally highly paid jobs, thus lowering the real wage, weakening labor, and increasing corporate profits.

On top of these changes, not only are more Americans poor and without adequate health care and fewer benefits, more of them are working, and they are working longer hours too. “In 1960 employed Americans worked 35 hours a year less than their counterparts in the Netherlands, but by 2000 were on the job 342 hours more.”<sup>xxviii</sup> More broadly,

Liberal countries [the United States and the U.K.] experienced ten years of declining hours into the 1980s ... [but] ... by 2000 liberal regime hours per working age person were 13 percent more than the social democratic countries [Denmark, Norway, and Sweden], and 30 percent more than the Christian Democratic countries [France, Germany, and Italy].<sup>xxix</sup>

It is worth noting that a high employment participation rate and long working hours are often noted as being a good outcome. This is strange, however, when one considers that according to (even neoliberal) economic theory, the richer a country gets, the less it is supposed to work. This is called the labor/leisure trade-off, which the United States seems determined to ignore. This might also explain why U.S. productivity is held to be so much better than that of Europe – Americans simply work longer. But does that make the United States more efficient, hence making neoliberal outcomes unavoidable? We often hear that it does, or at least that the United States is more productive than the rest of the world, and that Europe needs to catch up. However, in actual fact, this may not be the case either.

Taking 1992 as a baseline year (index 100) and comparing the classic productivity measure – output per employed person in manufacturing – the United States posts impressive productivity figures, from an index of 100 to 192.3 in 2005. Countries that beat this include that social democratic laggard Sweden (261.0), with the rest of Europe averaging about 30-40 points behind the United States.<sup>xxx</sup> However, as noted previously, if U.S. workers work on average 30 percent more than French workers, then the fact that the French productivity index is approximately 30 points lower than the United States's figure (163.8 compared to 192.3 in 2005) indicates that French workers are just as productive as their U.S. counterparts – it's just that they actually do trade off leisure against labor. This is a political choice, not an economic failing.

In sum, neoliberalism in the United States has meant an upward redistribution of wealth, increased labor market “flexibility” (growth in low-paid jobs without benefits and with rapid turnover), and longer hours. The end result has been a profound alteration of

the political economy of the United States. The question is, have we seen changes of such magnitude in Europe? Has Europe really “gone neoliberal”?

## B-Head Europe and the Politics of “Skin Deep” Neoliberalism

Let us take each of the previously discussed areas – macroeconomic policy, welfare policies, and inequality – and judge the degree to which Europe has indeed “gone neoliberal.” Macroeconomic policy may be the place where the greatest convergence has taken place, with a common concern for stability being pronounced since the 1980s. But the key to consider here is, what is Europe in this context? Although West Virginia and California are vastly different places, they at least have common currencies, fiscal policies, monetary policies, and national governments. Despite the Euro, the states of Europe do not share such commonalities. As political scientist Jonathan Hopkin puts it:

ext [I]n much of the policy debate, the non-English speaking advanced industrial countries tend to be lumped together as market-averse welfare states, with sluggish growth and high unemployment brought about by well-meaning but wrongheaded equality-focused systems of social protection. Sweden’s generous social benefits, Italy’s state pension liabilities, Germany’s restricted shopping hours, and France’s insistence on “national champions” are mixed together in the same Eurosclerotic bag. This “continental corporatist” model is then contrasted with the “Anglo-American” market-based model: a “capitalist culture-clash” in which the latter is usually tipped as the winner.<sup>xxx</sup>

But is this Europe a plausible entity to compare with the United States? Consider that modern Europe contains oil-rich Norwegians, poor Italian peasants, and unemployable postcommunist East Germans. The United Kingdom was deregulating its financial sector at the same time as Spain and Ireland were shedding agricultural labor. It

is little wonder, then, that neoliberal ideas would be adopted to varying degrees throughout Europe. Certainly, some states embraced neoliberalism with gusto, the United Kingdom being chief among them, but it was already liberal from the start.<sup>xxxii</sup> Such “neoliberalization” may be only skin deep, however.

Income inequality figures are illustrative in this regard. Whereas the United States and the United Kingdom have seen large increases in income inequality, much of Europe has not. France, for example, actually reduced inequality from a Gini of 0.298 to 0.293 from 1979 to 1994. Germany likewise reduced its Gini from 0.271 to 0.264 between 1973 and 2000, as did the Netherlands, which went from 0.260 to 0.248 between 1983 and 1999. Even Ireland, often lumped in with the neoliberal states in many studies and which had a high degree of inequality to begin with, decreased inequality from 0.328 to 0.323 between 1987 and 2000.<sup>xxxiii</sup> To be sure, inequality has increased in some countries, but for a variety of country-specific reasons. If one of the main corollaries of neoliberalism is increased income inequality, then there are, at the very least, some interesting (and large) exceptions out there.

Wealth inequality tells a similar story. Despite an enormous increase in wealth inequality occurring in the United States, redistribution has not been as dramatic in Europe. Rather than seeing an abrupt reversal in the downward trend of wealth concentration beginning in the late 1970s, the top 1 percent of households in the United Kingdom today continue to hold less, rather than more, of total marketable wealth. Although there was an upward redistribution, it did not all go to the very top.<sup>xxxiv</sup> The story is similar in France.<sup>xxxv</sup> And although wealth inequality has increased in countries such as Sweden, it has done so from such a low baseline that such states are still far more

equalitarian today than the United States was at the end of the 1970s. Despite twenty years of neoliberalism, the concentration of wealth in the United States looks like prewar Europe, whereas contemporary Europe looks more like the postwar United States.<sup>xxxvi</sup> Indeed, focusing on Sweden is especially illustrative of “talking the talk while not walking the walk,” as a quick look at what has actually happened there over the past fifteen years reveals.

### **B-Head** Exceptions Don’t Prove Rules: Sweden’s Neoliberal Moment

When Swedish real GDP declined by 5 percent and unemployment reached 12 percent between 1990 and 1993, analysts were quick to proclaim the end of the “Swedish model.” And when the Swedish Social Democrats Party (SAP) returned to power in 1994, far from repudiating the avowedly “neoliberal” policy stances of the prior liberal government, the SAP sought to further such policies in the areas of pensions, labor markets, social welfare provision, and macroeconomic policy. Neoliberalism, it seemed, was very much alive and well in Sweden in the early 1990s.

Weakened public finances in the mid-1990s led to reductions in public employment, and the government began a program of deregulation and privatization that eventually encompassed postal services, telecommunications, domestic aviation, electricity, and the rail network. Further microeconomic reforms aimed at increasing flexibility and part-time work were made throughout the decade. Macroeconomically, the neoliberal objective of price stability rather than full employment was enshrined as the number one goal of economic policy, while the Riksbank acted as the guardian of the currency without regard to domestic economic conditions. The state similarly tied its

hands by adopting a target of a 2 percent budget surplus to be achieved over the business cycle while reducing marginal tax rates. These reforms suggest a profound neoliberalization of the Swedish political economy. Indeed, the results of these reforms on Swedish business, and the overall macroeconomy, have been dramatic, but not at all neoliberal.

From 1993 to 2000, “industrial production rose by about 60 percent, equivalent to annual growth of about seven percent.”<sup>xxxvii</sup> The services sector grew from 48 to 60 percent of the economy from 1990 to 2000, and as noted previously, Sweden more than doubled its labor productivity over the decade 1997-2007 to an index value of 261.0.<sup>xxxviii</sup> Moreover, unit labor costs in Swedish manufacturing from 1992-2005 plummeted by nearly 50 percent in real terms over the same decade (from 100 to 53.5) in comparison with the United States decline of a mere 13 percent over the same period (100-87).<sup>xxxix</sup> Given these transformations, one must conclude that the Swedish model, and the equality associated with it, has gone out the window. Yet to conclude this would be a mistake.

First of all, as noted previously, in comparison with the United States and the United Kingdom, Sweden’s Gini coefficient has hardly moved in the past three decades. Second, the adoption of neoliberal reforms in countries such as Sweden is in fact much more complicated than the simple “reform -> inequality” equation would allow. Regarding pensions and unemployment benefits, although changes were made overall, “the generosity of Swedish social security was on average the same in 1998 as in 1980.”<sup>xl</sup> In fact, “the unemployment benefit was [even] more generous [than formerly].”<sup>xli</sup> Spending on private health and retirement certainly has increased, as has means-tested benefits, which implies more markets and less equality. However, this too is misleading,

since the proportion of the population covered by such benefits has actually increased, largely due to immigration.<sup>xlii</sup> Finally, although taxes were cut in the early 1990s, they were raised again in the latter half of the decade when the regressive nature of such changes became apparent.<sup>xliii</sup> Once Sweden recovered from the collapse of the early 1990s and began to run a budget surplus in 1998, as well as paying down the national debt, the government increased spending on child support and other benefits. As Prime Minister Goran Persson said, “healthcare, social services and schooling come before tax cuts,”<sup>xliv</sup> and indeed they did, consistently. In sum, although there has certainly been economic reform in Sweden, it is simply not the case that such transformations lead inevitably down the same path as the United States. Despite seemingly neoliberal measures being implemented from early 1990s on, Sweden remains a social democracy with a large public sector, generous social benefits, public services, and low levels of inequality. But perhaps Sweden is both lucky and unrepresentative. After all, aren’t the Germans and the French, much larger European economies, doing terribly in comparison with the United States and the United Kingdom? Hasn’t globalization simply left these states with no alternative but to go neoliberal? Is the world not, as Thomas Friedman put it, flat?

## B-Head The World Is Not Flat: Globalization and the Myth of European Sclerosis

As Thomas Friedman and others have argued, the changes previously detailed are the result of structural and “globalizing” forces beyond the control of any one state. As a consequence, the world is “flat,” and unless states adopt neoliberal policies, they will

become mired in low growth and unemployment, as evidenced by the larger continental economies, especially Germany and France. Ideas don't matter; economic forces manifest in "the unstoppable freedom and technology train" do.

Although appealing, such a logic, popular though it is, is actually quite overwhelmed by the available evidence. Such an analysis suffers two key failings. First of all, the timing is off. That is, although global forces may be strong today in 2006, they were not when such claims were being made the most, in the 1980s and 1990s. Quite simply, the numbers don't back up the story, even today. The quantitative effect of such forces leads us to a rather curious "tail wagging the dog" scenario. Second, although France and especially Germany do have real economic problems, such problems are self-inflicted wounds that have little to do with not adhering to neoliberal ideas. Indeed, it can be shown that when Germany has adhered to such ideas, the result has been to worsen its economic problems.

The issue of timing is important since if the claim is that "globalization made me do it" historically, then the quantitative data simply do not support the argument. One such claim is that competition from East Asia lowered costs and so impacted European labor markets during the 1980s that mass unemployment was the result since strong unions would not allow the necessary wage reductions to compensate. However, as Robert Wade has shown, exports from East Asia to the United States and Europe in the period 1980 to 1990 peaked at 5.5 percent of *world* trade, which is a case of the tail wagging the dog.<sup>xlv</sup>

In the early 1990s, a similar claim was made so often by presidential candidate Bill Clinton during the 1992 election that "the new global economy" had changed

everything, despite the fact that the United States was then, and still is, apart from Japan, the least globalized economy in the world. Taking a standard measure of an economy's openness – that is, one that measures how much consumption GDP is generated by imports and exports – the U.S. openness figures are 20.75 for 1980, 20.54 for 1990, and 25.44 for 2006, a mere 6 percent increase over twenty years.<sup>xlvi</sup> Moreover, to show what part of the U.S. economy is globalized, one has to divide these numbers in half to ascertain the sectors of the economy competing with imports. Do this, and once again the tail wags the dog, with just over 10 percent of the U.S. economy in 1990 (or 12 percent today) dictating the other 80 percent or so.

The same story is true of Europe, which has under the auspices of the EU been steadily *deglobalizing* its trade with the rest of the world while trading more internally. As Vivien Schmidt has shown, the argument that European states must compete for footloose global foreign direct investment (FDI) or suffer the consequences is likewise well short on the available evidence. In 1998, Germany's inward FDI as a percentage of GDP was 0.9 percent. France's figure was 2 percent. Indeed, both states exported more capital than they imported – 2.8 percent and 2 percent of GDP, respectively.<sup>xlvii</sup> Again, the tail was wagging the dog.

Turning to the second objection, Germany and France in particular do have very real problems with unemployment and slow growth, but this has very little to do with flexibility of labor markets and a lot to do with internal policy choices. Take the case of Germany, the unemployment showcase of Europe. From the mid-1990s until today, its unemployment performance was certainly worse than that of the United States, but it had also just bought, at a hopelessly inflated price, a **redundant** country of 17 million people

(East Germany). It then integrated these workers into the West German economy on preferential terms, mortgaging the costs of doing so all over the rest of Europe via high interest rates that flattened continental growth.<sup>xlvi</sup>

Add into this the further contractions caused by Germany's adherence to the sado-monetarist Economic and Monetary Union (EMU) convergence criteria, the establishment of a central bank for all of Europe determined to fight an inflation that died fifteen years previously, then cap it off with a restrictionary "Stability and Growth pact," and these policies will produce low growth.<sup>xlix</sup> Now compound this further with the world's most successful exporters shedding labor at an alarming rate in the context of sustained low domestic growth, and unemployment will result.<sup>1</sup> Indeed, when neoliberal reforms were made in the German labor market, unemployment went up, not down, on four successive occasions under the so-called Hartz reforms.<sup>li</sup>

Germany is not Europe, however, and should not be confused with it. Not only have the Scandinavian countries all posted solid growth performances over the past several years, but many of the new accession states have done likewise, even states replete with supposedly sclerotic institutions, such as Spain, have posted impressive growth rates. Moreover, there are recent signs that Germany has indeed turned the corner, proving that despite its "wrongheaded" policy choices, the world is neither flat nor is it necessarily neoliberal.<sup>lii</sup> Nor does the recent election of Nicolas Sarkozy in France signal the triumph of American ideas. While the election of Sarkozy was seen by many observers outside of France as a move to make France more 'Anglo' it is interesting to note how Sarkozy won. Royal, the socialist candidate, won a majority of the 19-59 year old vote. Where Sarkozy won however, and what won him the election, was among the

sixty and seventy year old voters (61 percent and 68 percent respectively). Interestingly, these are exactly those people who will be institutionally protected from exactly those reforms the younger voters voted against. Moreover, that Sarkozy, a classic French rightist really wants to turn France into 'Les Rosbifs' remains to be seen.<sup>liii</sup> America's ideas about the way the economic world works are no longer, it seems, the same as Europe's. States still have room to make choices, and when they do, the result is an inevitable growing apart.

## A-Head Conclusions: Growing Apart and the Diminution of American Power

I argued at the beginning of this chapter that power comes from getting someone else to want what you want, as well as from forcing them to do so by the barrel of a gun. In the period 1945 to 1975, the United States constructed “the way the world works” in a manner that led to positive-sum outcomes for both the United States and Europe. Indeed, because of this beneficent macroeconomic framework, European mass publics were able to enjoy a transformation of their life chances within a single generation. However, an important part of American society never cared much for this settlement and set about undermining it at the first possible opportunity. The fact that it took these dissenters twenty years and millions of dollars spreading alternative economic ideas speaks to the power of the ideas generating this order.

It also speaks to what such ideas enabled America do to. By improving the life chances of the vast majority of its population, the American project found it easy to

persuade European elites to sign on to it. Alliances were built on “common interests” that were instantiated in real gains for all sections of society. Support for this order, and thus for America, was strong. This is why the United States was able to count on its allies in Europe, by and large, pulling in the same direction. To get things done, one did not need to separate “ungrateful old Europe” from the “bribeable new Europe.” And when those allies disagreed – for example, over Vietnam – the “ties that bound” were strong enough to withstand such strains.

The new order constructed in the 1970s and 1980s clearly had some admirers in Europe, chief among them being the United Kingdom. And in that respect, the devotion to the United States (and the anti-Europeanism) shown by both Thatcher and Blair should perhaps be less surprising. Indeed, in the context of the recession of the early 1980s and the prolonged slump of the 1990s (for some states in Europe), the ideas of neoliberalism as “the only way” gained much credence among European elites. The problem was the outcomes that this policy shift produced. When these became clear, much of Europe balked.

Given their common history, European mass publics are simply not willing to tolerate policies that produce the type of economic outcomes characteristic of the contemporary United States. Equality is not simply a value, it is deemed a political necessity in an environment where instability and inequality have in the past caused untold strife. As scholars as diverse as John Ruggie and Robert Kagan have noted, Europe’s all-too-recent history of economic instability and political polarization has made inequality something to be abhorred, not something to be celebrated as an “incentive” for individual effort.<sup>liv</sup> This is why in Europe, when micro- and macroeconomic reforms are

made, they are made with built-in compensatory payments. When they are not built in, such reforms are challenged. This is not to argue that all Americans want inequality and all Europeans want higher taxes. But it is to claim that such policies are far more sustainable in the United States than they are in Europe. This suggests a growing division between countries over the very type of society deemed desirable. It is worth noting that in French political discourse, for example, the words *mondialisation* (globalization) and *Americanisation* are held as synonyms. Yet if globalization is Americanization, then “being American” is something that many Europeans no longer want. This is something profoundly new for the relationship between Europe and America.

As political scientist Riccardo Pellizo has shown, in opinion poll after opinion poll, European mass publics want more, not less, government-produced goods. When European parties’ political offers fail to match voters demands, parties see their votes drop.<sup>lv</sup> Neoliberalism has been tried in Europe, its “pure form” has been seen in the United States, and it is not widely embraced, as the failure of the European constitution and the blowback over economic rule making by the EU Commission clearly shows. Sauron’s ring circa 1945–75 might have been powerful, but his new adornment has proven to be less binding.

This is one of the many ways that Europe and the United States have increasingly grown apart. Europeans view “neoliberalism American-style” as not being in their best interests, and no amount of claims that neoliberalism, or globalization, is inevitable can make it so. As the struggles over the implementation of the Hartz labor market reforms in Germany from 2002 to 2005 and the French labor market reforms of 2006 clearly show, European mass publics simply do not accept that “neoliberalism is good for you.”

Lacking such common interests, as the United States goes further down a path to a society that Europe increasingly neither wants nor understands (which includes aspects of religion, guns, criminal justice, and foreign policy, as well as economics). In such a context, growing apart is inevitable, but why should the Americans care? I argue that the United States should care since much of what the United States got out of its binding to Europe, it risks losing now.

Due to these policies and the outcomes they produce, the United States increasingly relies upon unilateral action, military strength, and indicative diplomacy to get its way. As such, it cannot easily count on Europe to support the United States in its foreign and domestic policy goals given that other “ties that bind” no longer bind quite as well. If Europe is discussed at all in American policy circles, it tends to be seen as a bunch of “cheese-eating surrender monkeys” who tax themselves to death, are drowning in a sea of joblessness, and who simply need to be “more like us.”<sup>vi</sup> Yet where is economic weakness really to be found when you consider the following?

With a few exceptional years in the late 1990s notwithstanding, the United States has been running massive trade and budget deficits for over thirty years. It has also been consuming far beyond its ability to pay for the past twenty. The costs of such policies are huge interest repayments and an almost negative savings rate. To pay for this, the United States needs to maintain above-average growth and import approximately \$2.2 billion in other peoples’ savings per day to pay its bills. Add on to this military expenditures larger than half the members of the UN’s budgets and a debt “ceiling” of \$9 trillion, and it is not clear that this model is actually the sustainable one, particularly with the levels of inequality that it generates.

Such sentiment is already commonplace. As a consequence of its insatiable demand for imports, China and other East Asian states hold over a U.S. \$1 trillion in their foreign exchange holdings. Yet the value of that debt is declining. The dollar fell against the Euro by over 30 percent (2003-2007) Meanwhile, the U.S. response to this is to tell China to revalue its exchange rate, which is a little like a crack addict asking the dealer to raise the price so that he can get off drugs.

In the former era (1945–75), when the goals of the United States and Europe were congruent, other solutions were possible. Coordinated reflations and depreciations would have been seen as in the general interest of all states, rather than as special pleading by the United States (even if the United States would have been the primary beneficiary). Disciplinary mechanisms such as the World Trade Organization’s Disputes Committee would have been used as a last resort rather than a first resort. And a rumor that the South Korean Central Bank was considering dumping its dollars for Euros in February 2005 would not have caused a panic on the exchanges. In the current era, in a “lean-and-mean,” go-it-alone world, such solutions are no longer viable. In a neoliberal world, you can’t count on your friends.

The take-home lesson is this: When you have all the other countries on your side because they want what you want, you can do (almost) anything you like at very low cost. However, when the version of “the way the world works” that you are promoting no longer fits the ambitions of your main allies, and there are credible exit options, power can no longer be generated in this way. Like electricity from oil, U.S. power is simply going to cost more to produce. As Iraq clearly shows, when the “One Ring” of common

economic ideas fails, it is not clear that military power alone can suffice if the economic base supporting it is itself less than convincing.

This is why neoliberal ideas and policies have made the United States and Europe grow further apart. When seen on a broader canvas, such policies may have weakened rather than strengthened the United States domestically. They have certainly made its allies rethink what they themselves want. The grand bargain between labor and the state and business that underlay the “Great Compression” is, by political necessity, alive and well in Europe. In the United States, it is as dead as a dodo. And here lies the problem: With two separate visions of society, economy, and politics emerging, the very idea of the United States and Europe constituting “the West” is under strain. Abraham Lincoln once noted that “a house divided against itself cannot stand.” Although the United States and Europe may not come to blows, when each side spurns the other’s version of “who we are and what we do,” growing apart becomes inevitable.

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## Notes, ch. 4

<sup>i</sup> On unipolarity, see Charles Krauthammer, “The Unipolar Moment,” available online at <http://www.foreignaffairs.org/19910201faessay6067/charles-krauthammer/the-unipolar-moment.html>; on America as empire, see Niall Ferguson, *Colossus: The Rise and Fall of the American Empire* (New York: Penguin, 2004).

<sup>ii</sup> Joseph Nye, “Hard and Soft Power in a Global Information Age,” in Mark Leonard, ed., *Reordering the World: The Long-Term Implications of September*

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*11th* (London: Foreign Policy Centre, 2002, pp. 4–5). Available online at <http://fpc.org.uk/fsblob/36.pdf>, accessed December 12, 2006, 2:17 P.M.

<sup>iii</sup> This is not to say that coercion doesn't work – it does – but it also suffers diminishing returns.

<sup>iv</sup> Ruggie termed this an “embedded” liberalism, in contrast to the “classical” liberalism of the previous prewar era, where trade in things that produced jobs was encouraged, but financial speculation that did not was ruled out. See John Gerald Ruggie, “International Regimes, Transactions, and Change: Embedded Liberalism in the Post-war Economic Order,” *International Organization* vol. 36, no. 2, Spring 1982, pp. 379-415

<sup>v</sup> See Karl Polanyi, *The Great Transformation: the Political and Economic Origins of Our Time* (Boston: Beacon Press, 1944), passim.

<sup>vi</sup> See John Maynard Keynes, *The General Theory of Employment, Interest and Money* (New York: Harcourt Brace, 1964), chapters 10–12.

<sup>vii</sup> Mark Blyth, *Great Transformations: Economic Ideas and Institutional Change in the Twentieth Century* (Cambridge: Cambridge University Press 2002), chapters 3, 4.

<sup>viii</sup> This is why Friedman's argument that Keynes needs to “fool” people into investing is mistaken. One can know it's a government trick, but you can still make money out of it. So if you go for it, are you being fooled or simply selling out?

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<sup>ix</sup> Eric Helleiner, *States and the Reemergence of Global Finance* (Ithaca: Cornell University Press, 1994).

<sup>x</sup> Claudia Goldin and Robert A. Margo, “The Great Compression: The Wage Structure in the United States at Mid-Century,” National Bureau of Economic Research (NBER) Working Paper 3817, August 1991.

<sup>xi</sup> See, among other sources, Edward N. Wolff, *Top Heavy: A Study of Increasing Inequality in of Wealth in America* (New York: Century Fund Press 1995).

<sup>xii</sup> *Ibid.*, pp. 22–3.

<sup>xiii</sup> Steven Teles and Daniel Kenney, “Spreading the Word: The Diffusion of American Conservatism in Europe and Beyond,” chapter 5 in this book.

<sup>xiv</sup> Milton Friedman and Rose Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1982/1962), p. vii.

<sup>xv</sup> A. W. Phillips. “The Relation between Unemployment and the Rate of Change of Money Wages in the United Kingdom, 1861–1957,” *Economica*, vol. 25, no. 100, November 1958, pp. 283-299

<sup>xvi</sup> For an accessible summary, see Milton Friedman, “Inflation and Unemployment: the New Dimensions of Politics,” in Milton Friedman, *Monetarist Economics* (London: Institute of Economic Affairs, 1991); *idem*, “The Role of Monetary Policy,” *American Economic Review*, vol. 58, no. 1, March 1968, pp. 1-17

<sup>xvii</sup> The classic contributions to this literature are William D. Nordhaus, “The Political Business Cycle,” *Review of Economic Studies*, vol. 42, no. 2, April 1975; 169-190. C. Duncan MacRae, “A Political Model of the Business Cycle,” *Journal*

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of *Political Economy*, no. 85, vol. 2 April 1977; 239-263. Assar Lindbeck, “Stabilization Policy in Open Economies with Endogenous Politicians,” *American Economic Review*, no. 66, vol. 2, May 1976: 1-19

<sup>xviii</sup> For a nontechnical introduction, see Mark H. Willes, “Rational Expectations as a Counterrevolution,” in Daniel Bell and Irving Kristol, eds., *The Crisis in Economic Theory* (New York: Basic Books, 1981).

<sup>xix</sup> For an excellent discussion of supply-side and rational expectations theories, see Paul Krugman, *Peddling Prosperity: Economic Sense and Nonsense in the Age of Diminished Expectations* (New York: W. W. Norton, 1994), pp. 82–103.

<sup>xx</sup> See Nigel Lawson, *The View From No. 11: Memoirs of a Tory Radical* (London: Corgi Books, 1993), pp. 38–43.

<sup>xxi</sup> For an overview of the Thatcher period, see Andrew Gamble, *The Free Economy and the Strong State*, 2<sup>nd</sup> edition (Durham: Duke University Press 1994).

<sup>xxii</sup> See the sections on France and its U-Turn in Peter A. Hall, *Governing the Economy: The Politics of State Intervention in Britain and France* (Cambridge: Cambridge University Press 1988); Kathleen McNamara *The Currency of Ideas* (Ithaca: Cornell University Press 1998).

<sup>xxiii</sup> Wolff, *Top Heavy*, p. 7.

<sup>xxiv</sup> Carmen DeNavas Walt et al., *Income, Poverty and Health Insurance Coverage in the United States 2004* (Washington: U.S. Census Bureau, 2004), p. 16.

<sup>xxv</sup> Wolff, *Top Heavy*, p. 10.

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<sup>xxvi</sup> Data are available in extensive and summary form at the Luxembourg Income Study (LIS) website: <http://www.lisproject.org>. Summary country Ginis are available online at <http://www.lisproject.org/keyfigures/ineqtable.htm>.

<sup>xxvii</sup> Ibid.

<sup>xxviii</sup> Brian Burgoon and Phineas Baxandall, “Three Worlds of Working Time: The Partisan Politics of Work Hours in Industrialized Countries,” *Politics and Society* vol. 32, no. 4, December 2004, p. 443.

<sup>xxix</sup> Ibid., p. 452.

<sup>xxx</sup> U.S. Department of Labor, Bureau of Labor Statistics, available online at <ftp://ftp.bls.gov/pub/special.requests/ForeignLabor/prodsuppt02.txt>, accessed May 29<sup>th</sup> 2007, 4:36pm

<sup>xxxi</sup> Jonathan Hopkin and Mark Blyth, “Equality versus Efficiency? Structural Reform, Inequality, and Economic Performance in Western Europe,” unpublished manuscript, 2005, p. 6.

<sup>xxxii</sup> This supports Teles and Kenny’s finding that the adoption of libertarian (neoliberal) ideas in the developed world has ultimately been rather uneven at best.

<sup>xxxiii</sup> Data are available online at <http://www.lisproject.org/keyfigures/ineqtable.htm>.

<sup>xxxiv</sup> Wolff, *Top Heavy*, p. 22.

<sup>xxxv</sup> Ibid.

<sup>xxxvi</sup> This is a paraphrase from Wolff, *Top Heavy*, p. 24.

<sup>xxxvii</sup> Swedish Institute, “Fact Sheets on Sweden, FS 1 ab Qad,” May 2001, p. 2.

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<sup>xxxviii</sup> U.S. Department of Labor, Bureau of Labor Statistics, available online at <ftp://ftp.bls.gov/pub/special.requests/ForeignLabor/prodsuppt02.txt>, accessed April 27, 2006, at 12:50 P.M.

<sup>xxxix</sup> U.S. Department of Labor, Bureau of Labor Statistics, available online at <ftp://ftp.bls.gov/pub/special.requests/ForeignLabor/prodsuppt10.txt>, accessed May 29, 2007, 4:52pm.

<sup>xl</sup> Anders Lindbom, “Dismantling the Social Democratic Welfare Model- Has the Swedish Welfare State Lost its Defining Characteristics?” *Scandinavian Political Studies*, vol. 26, no. 2, 2003, p. 178.

<sup>xli</sup> *Ibid.*

<sup>xlii</sup> *Ibid.*, p. 182.

<sup>xliii</sup> Sven Steinmo, “Bucking the Trend? The Welfare State and the Global Economy: The Swedish Case Up Close. *New Political Economy* Volume 8, Number 1, March 2003, pp. 31-48.

<sup>xliv</sup> Quoted in Keesings Record of World Events, available online at <http://keesings.gvpi.net/keesings/lpext.dll/KRWE/krwe-23594/krwe-24472/krwe-24706/krwe-24798/krwe-24799>, accessed August 17, 2004.

<sup>xlv</sup> Robert Wade, “Globalization and Its Limits: Reports of the Death of the National Economy Are Greatly Exaggerated,” in Suzanne Berger and Ronald Dore, eds., *National Diversity and Global Capitalism* (Ithaca: Cornell University Press 1996), p. 69.

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<sup>xlvi</sup> Penn world tables; openness current prices, historical data, available at [http://pwt.econ.upenn.edu/php\\_site/pwt62/pwt62\\_form.php](http://pwt.econ.upenn.edu/php_site/pwt62/pwt62_form.php), accessed December 12, 2006, at 3:48 P.M.

<sup>xlvii</sup> Vivien Schmidt, *The Futures of European Capitalism* (Oxford: Oxford University Press, 2002), table 3.3, p. 120.

<sup>xlviii</sup> See

[http://www.bundesbank.de/statistik/statistik\\_zeitreihen.en.php?func=row&tr=su0113](http://www.bundesbank.de/statistik/statistik_zeitreihen.en.php?func=row&tr=su0113), accessed December 12, 2006, at 4:03 P.M.

<sup>xlix</sup> Known by some inside the European Commission (such as Prodi) as the “stupidity pact.”

<sup>l</sup> See

<http://search.ft.com/searchArticle?page=3&queryText=german+exporters&y=0&javascriptEnabled=true&id=060518008194&x=0>, accessed December 12, 2006, at 4:12 P.M.

<sup>li</sup> See Federal Statistical Office of Germany, available online at <http://www.destatis.de/indicators/e/arb210ae.htm>, accessed May 29, 2007, at 5:05P.M. The decrease in German unemployment from 12.1 percent in January 2006 to 9.5 percent in April 2007 is to be applauded. The extent to which its attributable to Chinese demand for German exports rather than labor market reforms is open at this point. See the article by Benoit (below).

<sup>lii</sup> See Bertrand Benoit, “The Sick Man of Europe Is Now a Picture of Health,” *Financial Times*, December 11, 2006. Available online at

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<http://www.ft.com/cms/s/3ab6ff88-88bc-11db-b485-0000779e2340.html>,

accessed December 12, 2006, at 4:21 P.M.

<sup>liii</sup> See <http://news.independent.co.uk/europe/article2521658.ece> accessed June 13, 2007 12:30pm

<sup>liv</sup> John Gerald Ruggie, “International Regimes”; Robert Kagan, *Of Paradise and Power: America and Europe in the New World Order* (New York: Knopf, 2003).

<sup>lv</sup> Riccardo Pelizzo, “Cartel Parties and Cartel Party Systems,” unpublished Ph.D. dissertation, Department of Political Science, Johns Hopkins University, 2003.

<sup>lvi</sup> For a particularly good example of this phenomenon, see John Tierny, “Who Moved My Fromage,” originally published in the opinion section of the *New York Times*, March 28, 2006, available online at

[http://www.denverpost.com/opinion/ci\\_3648311](http://www.denverpost.com/opinion/ci_3648311).

