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Structural Contradictions of the Global Neoliberal Regime

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ABSTRACT

The paper argues that global Neoliberalism creates both chronic sluggish aggregate demand growth and chronic excess aggregate supply, and that these tendencies reinforce one another in a vicious circle. Stagnant global demand has unleashed destructive competition in core global markets, creating low profits, financial fragility, and over investment. Over investment generates the excess industry supply that sustains competitive intensity. The greater the competitive intensity, the greater the pressure on firms to cut wages and employment, and lobby for less generous social welfare spending, which further constrains aggregate demand. And so on.

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1. Introduction[1]

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

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

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

In this essay, I focus on world output growth. Real global GDP growth averaged 4.9 percent a year in the Golden Age years from 1950 through 1973, but dropped to 3.4 percent annually in the unstable period between 1974 and 1979. It averaged 3.3 percent a year in the early Neoliberal period of the 1980s, then slowed dramatically to 2.3 percent from 1990–99 as Neoliberalism strengthened, making the 1990s by far the slowest growth decade of the postwar era.[2] The question addressed in this essay is: *why do the structures and practices of Neoliberalism generate such slow global growth?*

2. Why Is Global Growth Stagnant?

I argue that chronically weak aggregate demand is a fundamental characteristic of the global Neoliberal Regime, and that inadequate aggregate demand growth is the main cause of sluggish global growth rates. Slow demand growth, in turn, has intensified destructive

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[1] The general line of argument in this paper can also be found in Crotty and Dymski (1998) and Crotty, Epstein, and Kelly (1998).

[2] The 1950 to 1973 growth rate is from Maddison (1995: 60). Post 1973 data are taken from various issues of the United Nations Conference on Trade and Development's *Trade and Development Report*.

competitive pressures in key industries, leading to shifts in corporation strategies that exacerbate demand deficiency. This vicious Neoliberal circle constrains global growth.

1.1 The Neoliberal Regime Generates Chronically Inadequate Global Aggregate Demand Growth.

Space limitations do not permit a detailed discussion of the causes of sluggish aggregate demand growth.[3] Instead, I simply list six constraints on global demand that are deeply rooted in the structures and practices of Neoliberalism:

1. Slow growth of wages and mass consumption.
2. High real interest rates.
3. Increasingly restrictive national fiscal policy.
4. Slow growth in investment.[4]
5. The spread of IMF "austerity" programs and World Bank "structural adjustment" programs across the globe.
6. The weakening, and perhaps even the death knell, of the high-growth East Asian state-guided or "late-development" models, the only successful development models of the past two decades.

1.2 The Global Neoliberal Regime Creates Chronic Excess Aggregate Supply, Leading to Destructive Competition that Further Tightens Demand Constraints.[5]

According to the business press, chronic excess capacity in many global industries is a fact of life in the Neoliberal era. *Business Week* noted that: "supply outpaces demand everywhere, sending prices lower, eroding corporate profits and increasing layoffs" (January 25, 1999: 118). This raises the obvious question: *why hasn't global supply growth adapted to the reduced pace of global demand growth in the past two decades, creating sluggish but balanced growth?* My answer is that in the Neoliberal Regime, demand problems have exacerbated destructive competitive processes, causing over investment and excess capacity in much of global manufacturing.

During the Golden Age, many important Northern industries were characterized by what Schumpeter called "corespective competition," inter-firm relations based on partial cooperation rather than all-out war. Under corespective competition, firms could be reasonably sure that

[3] A longer version of this paper is available from the author.

[4] Important exceptions to this generalization are discussed below.

[5] The theory that informs this section is presented in detail in Crotty (1993), which discusses the causes and consequences of the shift in competitive regimes from the Golden Age to the Neoliberal era, and analyzes the implications of this shift on various aspects of economic activity. See also the interesting treatment of destructive international competition in Brenner (1998).

rivals would not take actions that eroded industry profitability. Of particular importance, firms avoided predatory pricing and capital investment "wars" that destroy profits and create excess capacity. By placing upper limits on capacity and lower limits on price, firms generated secure oligopoly rents, which were used in part to fund the high road labor relations adopted by the dominant firms of the era. High road labor relations, in turn, helped generate high productivity growth and rapidly rising real wages. Closing the circle, rising wages and low unemployment helped sustain strong private demand growth and financed much of the period's demand-augmenting increase in social welfare expenditures. In this environment of contained uncertainty and assured high profits, firms in core oligopolies could engage in long-term planning, generously fund R&D, offer lifetime employment to most workers, and manage the introduction of new technologies to ensure that capital equipment did not become obsolete prematurely. Moreover, profits were high enough to finance most investment internally, holding indebtedness within safe bounds.

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

With their survival threatened by fierce competition, much of it international in character, large firms in the industrialized North were forced to adopt shorter planning horizons. Semi-cooperative management-labor relations were now considered unviable because firms had to slash labor costs to survive beyond the short run. Conflict-driven labor relations became the order of the day. Coercive competition quickly altered the strategies of U.S. and British firms, which had the weakest commitment to the high road. They were the first to attack their unions, repudiate "implicit contracts" with workers and suppliers, maximize outsourcing and the use of temporary workers, and adopt downsizing as a permanent policy. But coercive competition is inexorably deconstructing the traditional practices of European and even East Asian firms as well. Reliance on long-term planning horizons and high road labor policies are winning strategies *given corespective competition and strong aggregate demand growth*. But an extended bout of low-demand growth and coercive competition will eventually make these strategies unsustainable. The new Anglo-American firm is at its strongest under conditions of instability and adversity because its emphasis on flexibility shifts the costs of adversity and instability from the firm and its shareholders to workers and governments. It would thus appear that strong demand growth, high road labor policies, and corespective competition are each necessary conditions for the others' existence.

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

Under oligopolistic organization and adequate growth in the overall economy, these industries are highly profitable. Therefore, large multinational corporations from mature industrialized economies want to continue to dominate them. However, developing countries must enter these industries if they want to move up the technological/productivity/value-added ladder. But each new wave of entrants—such as Japan, Korea, and Taiwan, followed by the South East Asian countries in the postwar period—adds to the potential for market overcrowding, making inter-firm cooperative relations increasingly difficult to maintain. Had global aggregate demand growth remained strong in the past two decades, the newcomers would have been easier to accommodate, and the breakdown of corespective relations might have been postponed. But with sluggish demand under Neoliberalism, either established players had to quickly exit from the industry as new firms entered, or entrance had to be restrained if chronic excess supply, falling prices, and low average profits were to be avoided.

Why did new entrants keep coming and why didn't established firms withdraw from these markets as profits deteriorated? Emerging countries *have to* pass through most of the rungs on the technology ladder if they are to accelerate economic development; they cannot go directly from labor intensive textile exports to auto and semiconductor exports. And established firms have huge sunk physical, human, and organizational costs which will largely be destroyed if they are forced to pull out of the industry. Fundamental uncertainty also plays a big role in this process. If it were known in advanced which firms would ultimately lose the struggle for survival, the losers would quickly exit to cut their losses. Those who are demonstrably weaker than their opponents often do leave. But given the importance of many of these markets and the huge sunk costs required to enter and thrive in them, most competitors try to "stay in the game" even as competition mounts, hoping to survive the current struggle and reap the secure, above average profits expected to emerge when the eventual winners reoligopolize the industry.

Consider, for example, the global auto industry. *Business Week* recently reported that at least three quarters of the globe's forty auto makers are "drowning in debt and glutted with factory capacity: the industry can make 20 million more cars and trucks a year than it can sell." The global market is plagued "by cost pressures and cutthroat pricing on top of the overcapacity problems" (January 25, 1999: 69). Yet firms continue to invest in the face of disastrous industry conditions.

I have elsewhere (Crotty 1993) labeled this phenomenon "coerced investment." Price-profit pressures *force* firms that have decided to "stay in the game" to build plants where labor and other costs are cheapest and market growth strongest—and Neoliberalism has offered them the whole world as potential investment sites. They invest to shed and more tightly control labor, to gain economies of scale, and to acquire best practice technology for both cost reduction and quality reasons. Finally, they invest to get inside the borders of expected high growth developing markets.

For example, Ford, General Motors, and Daimler Chrysler are again investing heavily in Asia, even though sales are not expected to return to 1996 levels until 2004. "With the U.S. and European markets maturing, the Big Three are counting on Asia for growth." But since Japanese firms will not cede this market to them, Asia "has turned into a war of attrition, with the Big Three aiming to be among the winners" (*Wall Street Journal*, December 8, 1999: B1). *The Wall Street Journal* reports that GM is building new plants with huge capacity in Brazil in order to cut costs in a bad market, introduce new models, and produce inside the potentially large Brazilian market: "by containing losses now and pushing ahead with plans for investment in new products, GM hopes to be ready to cash in when the market recovers" (February 25, 1999: 1). It observed that "many experts warn of vast overcapacity in Asia and South America if auto makers complete even a fraction of already announced plans for new plants" (August 4, 1999: 1).

This process of coerced investment appears to be irrational, and for this reason it does not exist in the world of Neoclassical theory. From the perspective of the economy or society as a whole, it *is* irrational. *But it is not irrational for the affected firms.* Under their "natural" oligopolistic organization, these industries are exceptionally profitable. Thus, every firm wants to be one of the survivors: "The survivors of overcapacity downturns often emerge as the big winners," *The Wall Street Journal* reminds us (November 30, 1998: A17).

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

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

This pattern, with the development of coercive competition followed by a merger wave, is being repeated in the financial sector. In the wake of continuing financial deregulation, large banks are moving into heightened competition both with investment and brokerage firms and with one another.[6] Increasingly, high profits can be obtained in the financial sector only by creating new products for new markets—which merely postpones the problem—or by taking on ever more leverage and ever greater risk. We have witnessed both processes unfold in the last two decades.

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

Global Neoliberal financial markets are thus *both highly speculative and coercively competitive*. It is therefore only to be expected that banking and currency crises generated by risky and reckless lending and financial investment patterns break out with increasing frequency. "Financial crises seem now to happen with almost monotonous regularity" (*The Economist*, June 12, 1999: 65). Only continuous IMF-Fed bailouts (at enormous taxpayer expense) have prevented self-destruction of the global financial system, and sustained the profits of multinational financial enterprises. But both recurrent crises and subsequent "rescues" erode global demand growth by creating deep, extended recessions in the crisis areas, adding high-risk premiums to interest rates, and forcing more and more countries to submit to austerity macro policies mandated by the IMF and World Bank.

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[6] See Dymski (1998) on this point.

3. Conclusion

Sluggish aggregate demand growth, destructive competition, and chronic excess capacity are fundamental, deeply-rooted characteristics of the Neoliberal Regime. They have contributed significantly to the development of many of the ills we have come to associate with globalization, such as slow growth, high unemployment, low wages, rising inequality and relative poverty, unstable cross border financial flows, the frequent outbreak of banking and currency crises, and the breakdown of the world's most successful development models.[7] The structures and practices of global Neoliberalism cannot create an economics environment conducive to prosperity and security for the majority of the people in the developed or the developing world. Unless and until new progressive structures and practices for national economies and for global integration are implemented, we can expect to see an intensification of all the problems mentioned in this essay.

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[7] See Crotty and Dymski (1998) for an analysis of how the structural contradictions of the global Neoliberal Regime helped cause the Asian crisis of 1997–98.