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WETENSCHAPPELIJKE RAAD VOOR HET REGERINGSBELEID

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AFTERSHOCKS

ECONOMIC CRISIS AND INSTITUTIONAL CHOICE

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AMSTERDAM UNIVERSITY PRESS

Aftershocks

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Economic Crisis
and
Institutional Choice

Anton Hemerijck
Ben Knapen
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(eds.)

Amsterdam University Press

Cover design: Maedium, Utrecht
Layout: Het Steen Typografie, Maarssen

ISBN 978 90 8964 192 2
e-ISBN 978 90 4851 185 3
NUR 754 / 781

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Preface

Is the current crisis simply too big to reflect upon? Do the sheer complexity and the dazzling dynamics of the financial and economic crisis impede the possibility of learning some lessons this early on? This book, I think, shows that the answer to these questions is negative. Indeed, some strategic lessons can and should be learned, even at this stage. Waiting until the crisis is over is simply not an option given ambition to prepare our societies for the world after the crisis.

Of course, as this book went to press, the severest economic crisis since the Great Depression was still underway. How to deal with the turmoil that it wrought, especially from a long-term perspective, remains an unanswered and highly debated question. Present and future economic stability is still highly uncertain. It is in this context that Anton Hemerijck, Ben Knapen (director and member of the Dutch Scientific Council for Government Policy, respectively) and Ellen van Doorne (member of the staff of the Prime Ministers' Office) set themselves a daunting task: to try to shed some light on the causes and ramifications of the crisis, even as the economic storm continued to rage.

The Scientific Council for Government Policy was not sure that it had a role to play at the front lines of combating the immediate consequences of that storm. Nor did it intend to publish a complete – let alone definitive – analysis of what went wrong and what exactly was going on. However, the council thought it would be important to encourage the editors of this special publication to seek expert opinions to explore the repertoire of policy choice and institutional design, on the basis of informed academic analysis and experiential observations and judgments of front line observers, as a first attempt to sketch the contours of a socio-economic order that could emerge out of the ruins of the crisis. If this crisis is also a chance for change, in what directions could that reconstructuring take us?

Twenty-four experts were selected from a broad range of fields and disciplines, on the basis of both their expertise in their given subject area as well as their institutional imagination and ability to think beyond the present circumstances. Aggregating their cumulative knowledge and insights, the editors have attempted to document the intellectual 'state of the art' in the midst of the crisis before hindsight can be given an opportunity to work its amnesiac magic. Interviewees were given time to consider the questions, and their responses are exceptionally well prepared and thought out. However, their final revisions to their contributions occurred in late September 2009. Thus, they were necessarily historically bound by the facts and information available to them at this time.

This book is therefore a special project, supported by the Dutch Scientific Council for Government Policy. The volume deviates from the kind of policy advice reports the council generally produces. The intellectual endeavour began as a series of workshops on the economic crisis, organised in conjunction with the network of the strategists of a number of Dutch ministries. At these events, it became apparent that there was a wide breadth of insight developing on this very new subject. As researching current events presents innumerable methodological and practical barriers, this somewhat unorthodox project of semi-structured interviews was proposed in order to explore and document the institutional features of these new debates. The volume covers a wide range of topics: from the need for a new European narrative that helps to position the European Union in a world order shaped by a new geopolitical and economic balance of power, to the need to reform the academic discipline of economics. All the topics invite further reflection with the intent to prepare a new agenda for the period following that of this current crisis. The volume clearly shows that we cannot and should not wish to return, either theoretically or institutionally, to the world that preceded the current crisis. There is a need for new paradigms, institutions, wisdom, and ideas. Political courage is imperative to pursue institutional change to prepare for a new age, in which, more than ever before, the social, ecological and economical agendas have to be discussed in a more integrated manner.

Since the onset of the crisis, the political and academic debates have begun to shift. Initially, the aftermath of the crisis was primarily concerned with immediate damage control and preventing a complete erosion of the economy's foundations. Recently, however, the debate has shifted, as people have begun to contextualise the crisis and wonder what this will mean for the future. More specifically, they wonder, what does this crisis mean for my pension? For my children? For my country? For the world's poor? For the structures of global institutions? To this end, this book is an attempt to illuminate – in real time – a cross-section of a vital debate.

The council is grateful to the editors who managed to involve some of the best brains of the world to come together in this book for what is, indeed, an interesting variety of some of the brightest economists, political scientists, historians and sociologists around today. On behalf of the Council, I would like to thank the editors (Anton Hemerijck, Ben Knapen and Ellen van Doorne) and the supporting editorial team for all the work they have done.

Wim van de Donk
Chairman of the Scientific Council for Government Policy

Acknowledgements

The aim of this volume is to explore the institutional impact, dimensions, and consequences of the global economic crisis of 2007. This volume is the result of a series of interviews held from May to September 2009 with various academics and experts across geographic, occupational, and disciplinary boundaries.

We asked our interviewees to think out loud, and the strength of this project is the result of their intellectual engagement, insightful ideas, comments, and constructive criticism offered throughout the entire process. Therefore, first and foremost we owe our thanks to these interviewees for being so generous, not only with their succinct and sharp analyses but also with their time. They were willing to look beyond their primary interests and sub-disciplines, to reflect on the causes, conditions, and consequences of the crisis, taking a dive into the unknown. Both individually and collectively, they expanded our understanding of the crisis and its possible aftershocks. We especially wish to thank them for their enthusiasm, their faith in this project and for their responsiveness to the demands of our speedy editorial process.

Meanwhile, it cannot be stressed enough how much an incredibly talented young team of research assistants contributed to this publication: Casper Thomas, Katherine Tennis, and Jessica Serraris. We are especially grateful to Casper Thomas, who operated in a dual capacity of co-interviewer and all-purpose editorial assistant. We also greatly appreciate the flawless editorial skills, writing assistance, and language improvements of Katherine Tennis and Jessica Serraris, turning all of our interviews into independent contributions, changing them from Q&A to essay format. With relentless vigour and sustained high quality, Casper, Katherine, and Jessica worked most of the summer of 2009 completing this project. We thank them most sincerely for their professionalism, commitment, and good spirits.

We would finally like to acknowledge the support of Wim van de Donk, Chairman of the WRR, whose encouragement was crucial to this venture. The many strengths of this volume are undoubtedly to the credit of our interviewees and our highly professional support and editorial team. Any remaining errors are our own.

Anton Hemerijck, Ben Knapen and Ellen van Doorne

INTRODUCTION

The Institutional Legacy of the Crisis of Global Capitalism

Anton Hemerijck

1. GREEN SHOOTS OR FALSE HOPES

Two years into the first economic crisis of 21st-century capitalism, policymakers everywhere are anxiously awaiting signals of whether or not we have passed the nadir of the global downturn. Is the economy finally gaining traction after the worst economic crisis since the Great Depression? Will the 'green shoots' observed in global trade and US and EU equity markets, Chinese investments in public infrastructure, and Brazilian exports prove to be harbingers of a sustained economic recovery? As this book went to press in September 2009, economists from the Organisation for Economic Co-operation and Development, the World Bank, and the International Monetary Fund had come to endorse the view that the global economy was indeed stabilising (OECD, 2009).

The cascade into the greatest economic crisis since the 1930s began in 2006, with falling US house prices and rising defaults on US subprime and Alt-A mortgage loans. In February 2007, the Federal Home Mortgage Corporation, Freddy Mac, announced that it would no longer buy risky subprime mortgages and mortgage related securities. Next, the New Century Financial Corporation, a leading subprime mortgage lender, filed for bankruptcy in April 2007. By the end of July, investment bank Bear Stearns had liquidated two hedge funds heavily involved in mortgage-backed securities, and in August 2007, BNP Paribas, France's largest bank, halted redemptions on three investment funds. After a retail run in the fall of 2007, Northern Rock, a large UK mortgage bank, was eventually nationalised in February 2008. On 7 September, the two large semi-public mortgage banks, Fannie Mae and Freddie Mac, were placed in government conservatorship. On 15 September 2008, the American authorities let the 158-year-old investment bank Lehman Brothers fall, apparently without realising the consequence of triggering a worldwide credit freeze. Nobody knew which financial institutions (in the US or elsewhere) had bought into the dangerous subprime mortgages, and as a result, a severe crisis of confidence erupted in the fall of 2008. Because finance had become so globalised, when the housing and asset price bubble burst, the near collapse of the financial system spread rapidly across the entire world economy. The ensuing credit downgrade of AIG, the world's largest insurer, which had become involved in the Credit Default Swap (CDS) market, set the scene for a severe liquidity strain. This time, on September 16, however, the US government did come to AIG's rescue, with 85 billion dollars. In the midst of this predicament, a complete seizure of interbank money markets broke out, exposing the micro flaws of the internationally deregulated financial system. Morgan Stanley and Goldman Sachs ceased to exist as independent investment banks. Across the Atlantic Ocean, the Belgian-Dutch Fortis group was nationalised on September 28, and the next day the German Hypo Real Estate was saved, under government pressure, by a 35 billion euro life support injection from other financial institutions, while the Icelandic government nationalized the Glitner savings bank. A massive credit crunch subsequently threw the global economy into the worst financial crisis and recession since the 1930s.

While financial conditions may have started to ease, the jury is still out on whether 2010 will indeed bring a 'V-shaped' upturn, with its much hoped-for swift return to pre-crisis levels of growth. But given the severity of the crisis, we could also be heading for the beginning of a longer, more drawn out, slow and weak 'L-shaped' recovery. For the advanced economies, this would be akin to the experience of Japan's 'lost decade' of the 1990s. Worse still is the horrific scenario of a 'W-shaped' economic nightmare, whereby an apparently swift recovery, paid for by ballooning budget deficits, triggers runaway inflation which in turn can only be reined in with an aggressive hike in interest rates by central banks, setting the stage for a second deep recession in the aftermath of the present crisis. There is a fear that the unprecedented supply of cheap money from public authorities is setting the stage for another bubble. With such uncertainty, is talk of 'green shoots' premature? Perhaps it is only a mirage, a temporary fluke improvement in an otherwise severely battered and highly vulnerable global economy?

There is every reason to remain cautious about forecasting economic improvement. In the years ahead, various aftershocks, caused by the momentous economic contraction of the global downturn, will have to be reckoned with.

First, there is the aftershock of the looming crisis of unemployment. Unemployment usually lags behind general economic activity by roughly a two- to three-quarter delay, so labour market conditions in the advanced industrial world are expected to worsen in the coming years, even as stock markets improve across the globe. US unemployment is currently just below 10%, while in Europe unemployment has already reached double digits in many countries. Most worrisome is the surge in youth employment: in Latvia, Italy, Greece, Sweden, Estonia, Hungary, Lithuania, France, Ireland, and Belgium, youth unemployment has crossed the 20% threshold, and in Spain it is over 30%.

Even a tepid economic recovery will be insufficient to compensate for the job losses incurred during the crisis. Increasing unemployment will result in mortgage defaults and rising insolvencies, which will have an adverse feedback effect on the already weakened banking system. Their reduced appetite for lending could, subsequently, trigger another contraction in the financial sector with another round of disrupting effects for the real economy.

Second, there is the aftershock of the pension crisis. The sharp fall in equity markets has severely affected the value of pension fund assets, jeopardising pensioners' incomes in countries with large private pension provisions. In many western economies – especially the US and the UK – public pensions have been retrenched over the past two decades. Instead, people have been given incentives to choose their own private pension arrangements. Many have used real estate as investment for old age savings, feeding into the growth of the financial industry, which now has collapsed, bringing their savings down with it. For Europe, the dual challenges of the economic crisis, combined with the expenditure pressures of the ageing population, mark a real stress test for public finances.

Third, there is the aftershock of a fiscal crisis of the state. Costly bank bailouts, tax cuts, and other stimulus measures have drained the public purse. In Europe, the automatic stabilisers of comprehensive social insurance could result in a double bind of rising social benefit expenditures combined with declining government revenues. Declining population levels have already resulted in a shrinking work force, which significantly reduces tax revenues, even independently of the crisis.

Finally, there may be all kinds of political aftershocks. Once the recession subsides, elevated public debt-to-GDP ratios will make fiscal consolidation imperative. This will require tight fiscal control and painful cuts in Europe's cherished welfare programs. Yet retrenchment of social expenditures will certainly be met with strong public opposition, so it is politically unrealistic to count on rebalancing the budget solely through reductions in expenditures. In addition, taxes will have to be raised in the final stage of fiscal consolidation in order to pay down public debt even, though this could negatively affect growth prospects and leave little room for addressing newly emerging social needs.

Because of these likely economic, social and political aftershocks in the labour market, banking system, pension system, public finance, and social spheres, there is a real danger of the crisis persisting for more than just a few bad years. Japan's 'lost decade' following the crisis in the early 1990s provides a worrisome antecedent (Koo, 2008). Nevertheless, according to the OECD, we should count our blessings; a complete collapse of the world economy has been prevented. It appears that we are through the deepest waters of the economic contraction, and a nascent recovery is underway. However, caution is still warranted: a self-sustaining recovery in the real economy will only begin when private economic actors are again ready and willing to take over.

2. THE POLITICS OF ECONOMICS

The full political implications of the economic crisis are impossible to discern at present. Yet there has been one obvious shift: public authorities – especially governments and central banks – have taken an unprecedented hyperactive role in response to the credit freeze panic. Suddenly, in mid-2007, the state (re-)emerged as a key strategic economic actor. Faced with an exceptionally deep crisis, most advanced economy governments showed little inhibition in pursuing bold strategies of crisis management, on a scale truly unthinkable only a few years ago. This happened despite the standing hegemony of neo-liberal doctrine, which proclaimed unequivocally that government was the problem and markets the solution. Since the crisis, most observers would agree that the public authorities' activist crisis management strategies have succeeded in forestalling a much darker scenario – a rerun of the Great Depression. It is no exaggeration to claim that the state – or rather the taxpayer – has saved modern capitalism from meltdown.

The initial measures of crisis management concentrated on stabilising the financial system, often by bailing out overly indebted systemic banks. Meanwhile, central banks turned to reducing interest rates to close to zero percent, while simultaneously pumping hundreds of billions of euros and dollars into the world's weakened banking systems through quantitative easing. As the credit crunch started to affect the real economy, fiscal authorities turned to dazzlingly aggressive stimulus packages and tax cuts in the hope of further stimulating consumer demand. Many governments – especially China – invested heavily in public infrastructure projects. In Europe, numerous states have introduced wage subsidies, expanded short-term unemployment benefits in order to preserve existing jobs, and enacted new training programs and other active labour market measures. At the time of writing, governments on both sides of the Atlantic were considering tougher remuneration rules for bankers, regulatory caps on bank bonuses and golden handshakes, as well as a new regulatory regime for hedge funds. The EU is hoping to be able to enact more systemic and intrusive regulation of European financial markets, including credit agencies. In sum, public authorities have left no interventionist stone unturned in the face of the first economic crisis of 21st-century capitalism.

The powerful and unexpected resurgence of state intervention has reinforced the truism that without the state, market economies would not be able to thrive. Without public authorities capable of exercising legitimate coercion, capitalism would be impossible. This is what the economic anthropologist Karl Polanyi has called the 'embeddedness' of economics. Effective market allocation depends, first and foremost, on the political protection of property rights and contract laws. In his *The Great Transformation*, Polanyi shows that public intervention and regulation have historically played a decisive role in the institutional separation of society into an economic and political sphere by providing a supportive framework in which markets can prosper (Polanyi, 1944; 1985). The notion of embeddedness underlines the fact that economic activity is created and shaped by political decisions, social conventions, and shared norms and understandings. Although free markets are often misperceived as natural, sovereign, self-contained, and self-regulating, a market economy cannot exist independently of the society and rules in which it is located.

Embedding markets is essentially a political activity of institution-building. Institutions are enduring rules for making important (economic) decisions. The most important economic institutions are, of course, property rights. Property rights are assigned, restricted, qualified, and regulated by political decisions. Modern capitalism not only requires regulatory systems at the micro level, but also effective macro institutions, both monetary and fiscal. Although redistributive institutions such as unemployment benefits, public pensions, education, and health care are provided for through non-market arrangements, they are nevertheless intimately connected to the private market economy, through which they are financed and for which they perform stabilising and productive functions. Thus, social protection, despite not being market-generated, does serve to embed mature capitalist economies. All of the above institutional features of advanced market economies have a significant impact on production, resource allocation, regulation, economic growth, levels of productivity and employment, and the distribution of goods, services, incomes, and wealth (Granovetter, 1985; Swedberg, 1987; Maier, 1987).

As politics defines and qualifies property rights, it demarcates boundaries between the political and the economic realms of society. For advanced capitalism, it is imperative that the state allows the market to function relatively autonomously. Today, that very requirement commits the state to more rather than less activism, forcing it into expensive and radical measures of crisis management. Yet even during the neo-liberal globalisation period, it would be a mistake to think that the state withdrew from the management of advanced market economies. Admittedly, in most cases the dominant trend was toward privatisation and deregulation, but it should be emphasized that economic liberalisation is also a form of politically sanctioned state activism. There is also plenty of evidence of public interventions beyond liberalisation (Levy, 2006). Many European governments have been able to reconfigure labour markets and to re-orient social spending towards measures to promote employment through active labour market policies, while at the same time, for example, stepping up support for childcare in an attempt to encourage more women to enter the workforce (Hemerijck and Eichhorst, 2008).

In times of crisis, politics and economics become inseparably linked, and the precipitous return of the state to economic affairs is surely not the result of an unchallenged or widely shared political consensus. Severe economic turmoil always polarises political debate and economic analysis. Different economic and political actors disagree over what kind or how much intervention is called for in these unconventional times. In the op-ed pages of financial journals, a truly fierce intellectual dispute has emerged between the Nobel Laureate in economics Paul Krugman and the popular economic historian Niall Ferguson (2008). Krugman (2008) advocates a drastic Keynesian fiscal stimulus response to the crisis, whereas Ferguson – making a case for fiscal conservatism – critiques aggressive Keynesianism as a recipe for hyper-inflation, spiralling US fiscal deficits, and the ultimate demise of the dollar (Lynn, 2009).

In addition to these intellectual debates, governments have also come under fierce attack by their citizens. Mass unemployment, rising poverty and inequality, cuts in public sector pay and services, and reduced pensions and social benefits bring enormous pressure to bear on elected politicians. Moreover, governments have used tax revenues to bail out banks, whose CEOs continue to rally against more intrusive regulation. This confronts elected leaders with the daunting political challenge of communicating these 'pro-business' interventions (which arguably do avert further economic distress) to citizens in the real economy whose jobs, savings, and pensions are at risk. When banks receiving taxpayer support continue paying huge bonuses out to top executives and traders, such a political predicament can potentially become explosive.

Such pressures can even lead to the overthrow of ruling parties. The recent government turnovers in Iceland, Latvia, Hungary, the Czech Republic, and Greece are the first political repercussions of the crisis. The 2008 election of Barack Obama as President of the United States of America can also partially be attributed to the crisis. Similarly, the significant gains of the far right, populist, anti-EU, nationalist parties in Denmark, Austria, Hungary, the Netherlands, and the UK in the June 2009 elections for the European parliament reveal how the crisis and fears of unemployment can fuel xenophobia and protectionist sentiments. Finally, the landslide victory of the centre-left Democratic Party of Japan over the long-standing Liberal Democratic Party in the August 2009 general elections is the most recent example of such punctuated political change.

In addition, the crisis has led to a fundamental debate about the role of central banks. The goal of inflation targeting has, for at least two decades, been the neutral *modus operandi* of central bankers. However, with the crisis, this has become highly politicised. German chancellor Angela Merkel attacked the loose monetary policy of the European Central Bank (ECB), whereas Mervyn King, governor of the Bank of England, has been equally unconventional in his open critique of the huge fiscal deficits accumulated by the UK Labour Government.

Political strife over crisis management also features in the international arena. After the bankruptcies of Landesbanki and Icesave, which triggered the downfall of the Icelandic krona in the fall of 2008, Iceland has applied for membership of the European Union in hopes of joining the stable euro. The Netherlands and the UK, however, have made Icelandic EU membership contingent on a 4 billion euro reimbursement of British and Dutch savings lost in Landesbanki and Icesave.

On the European continent, moreover, most leaders prefer tougher, more intrusive, and systemic financial sector regulation. The Brits, on the other hand, fear that an overly ambitious European framework of financial market regulation will stifle the City of London's future room for manoeuvre in the global economy. An unresolved outstanding issue is the extent to which national rescues of ailing industries is in accordance with EU single market legislation.

Then there remains the fundamental disagreement between the US and the EU over the necessary aggressiveness of fiscal stimulus packages. European leaders, such as Angela Merkel and Nicolas Sarkozy, worry about the disturbing lack of attention paid to the medium- and long-term consequences of Obama's 800 billion dollar stimulus program. To the extent that the crisis is a crisis of excessive debt, which in the US is already three times gross domestic product, Europeans maintain that it cannot be solved by incurring further debt. What exit strategy does the Obama administration have in mind to restore fiscal responsibility and sustainable economic growth?

In short, the global financial crisis, together with its economic and social aftershocks, is very likely to fundamentally shape the narrative of politics and, as such, the outlook for social and economic policy reform in the decades ahead. Communicating and explaining policy measures, as well as finding effective and fair solutions of crisis management that citizens consider legitimate, form a key political precondition for a sustainable economic recovery. The political management of the social, fiscal, and emotive aftershocks of the crisis is surely a tall order.

3. FROM 'EMBEDDED LIBERALISM' TO THE 'WASHINGTON CONSENSUS'

Deep economic crises are moments of political truth. They expose both the strengths and weaknesses of existing policy repertoires and institutional structures. As a consequence, they encourage fresh thinking about the institutional arrangements embedding contemporary market economies. In the aftermath of both the Great Depression of the 1930s as well as the crisis of stagflation (low growth and high inflation) in the 1970s, economic and social policy regimes were transformed in quite fundamental ways.

The Great Depression and the Second World War have had a profound impact on the institutional architecture of North America and Western Europe after 1945. The experience of the deflation in the 1930s as well as the foolish adherence to the gold standard led post-war policymakers to embrace Keynesian economic management (Temin, 1989). The extent of market regulation and social protection differed from one country to the next, but governments in all advanced democracies took an active and strategic role in the stabilisation of the economy and the distribution of post-war prosperity. The lessons of mass unemployment and debt deflation from the Great Depression were taken to heart. Social protection came to be firmly anchored in an explicit normative commitment to granting social rights to citizens, protected by the nation-state. An impressive set of welfare programs was developed: an expanded education system improved the equality of opportunity; a comprehensive health insurance system spread the benefits of health care to the population as a whole; and a full range of income transfer programs – unemployment insurance, workers' compensation, disability benefits, old age pensions, survivors' benefits, children's allowances, and social assistance – were introduced to protect citizens from the economic risks associated with modern industrialism. The mixed social and market economy was based on the axial principle of full employment for male breadwinners and promoted a growth-oriented industrial policy to achieve this end. The dominant consensus among policymakers was that governments, collective bargaining, and the welfare state had key roles in 'taming' the capitalist economy through Keynesian demand management and market regulation. In trying to understand what went wrong in the Great Depression, Keynes introduced a completely new brand of economics focusing on the study of the behaviour of the economic system as whole, rather than the behaviour of individual actors. If the Great Depression gave rise to Keynesian economics, the 1950s and 1960s vindicated Keynesian demand management as a standard tool of economic policy. Keynesian macroeconomists in academia and public office proclaimed that enduring recessions would be a thing of the past.

The objectives of full employment and welfare protection were supported at the level of the international political economy by what John Ruggie later described as a regime of 'embedded liberalism'. On the one hand, governments encouraged the liberalisation of the economy through successive rounds of GATT negotiations that slowly broke down the regulatory regimes and trade barriers put in place during the Depression and the Second World War. On the other hand, the expansion of social programs compensated for the risks inherent to economic liberalisation. Western governments embraced the change and dislocation that comes with liberalisation in exchange for containing and socialising the costs of adjustment (Ruggie, 1982). As a consequence, the constraints imposed on national economic policies by the classical gold standard were relaxed, and the pursuit of 'free trade' was replaced by the goal of non-discrimination. Against the backdrop of the Cold War, the goal of price stability was sacrificed when this was deemed necessary to maintain an open international economy (Maier, 2009). The Bretton Woods monetary system of stable exchange rates laid the groundwork for the regime of embedded liberalism, allowing national policymakers freedom to pursue relatively independent social and employment policies without undermining international economic stability. It should be emphasised that the compromise of embedded liberalism was tailored to a world in which international competition remained limited and foreign investment was conspicuously based on a regime of capital controls.

The era of embedded liberalism was an era of institution building. The post-war domestic and international communities were resolved to contain the economic and political instabilities of the 1930s and 1940s. At the international level, the United Nations, the World Bank, the International Monetary Fund (IMF), and the European Community were established. Together, the Bretton Woods institutions, the national welfare state, and the European Community were all launched with an eye on avoiding the crises of the early 20th century. During the Golden Age of economic growth between 1945 and the early 1970s, each of the advanced industrial societies developed their own country-specific brands of mixed economy and welfare capitalism. What came out of the post-war era was therefore an international system of national capitalisms, not a global economic system (Berger/Dore, 1996; Berger, 2005; Rodrik, 2007).

Despite the historically unprecedented achievements of the post-war mixed economies in promoting civil liberty, economic prosperity, social solidarity, and public well-being, there is, of course, no such thing as an institutional regime for all seasons. In the late 1960s, the post-war celebration of unprecedented growth and social solidarity through democratic politics was already giving way to doubts. Rising inflation as a result of wage explosion and the resurgence of worker militancy and social protest confronted the sober and consensual political economies of the post-war era with a new political context, reflecting the new levels of economic prosperity and social expectations. The era of embedded liberalism came to end in the mid-1970s as the two oil shocks revealed contradictions in the mixed economy and welfare-friendly regime of embedded liberalism; specifically, its inability to contain inflation under conditions of near-full employment. Furthermore, increased international competition and de-industrialisation came to undermine the effectiveness of domestic Keynesian demand management. This led to a massive surge in unemployment, not seen since the 1930s. As Keynesian economists continued to analyse macro-economic performance in terms of a trade-off between employment and inflation, they lost their intellectual edge. After the second oil shock in 1979 led to tightened fiscal and monetary policies in the early 1980s, the world economy entered its severest slump yet. High inflation, mass unemployment, and sluggish growth provided an opportunity for an intellectual and political break with 'embedded liberalism'.

The crisis of stagflation thus set the stage for a political return to more unfettered market economies, away from public ownership, excessive regulation, and generous levels of social protection. The election of Margaret Thatcher and Ronald Reagan in 1979 and 1980 respectively, brought the belief in the primacy of self-regulating markets and a minimal state back into the limelight. The state was identified as the source of the problem of stagflation, as it was believed to distort the natural workings of the market. Beginning in the 1980s and gathering momentum in the 1990s, neo-liberal doctrines of fiscal discipline, low inflation, financial liberalisation, labour market deregulation, privatisation, and the marketisation of welfare provision from regulatory constraints gained precedence in the management of advanced market economies. However, it should be remembered that neo-liberalism did not spell the waning of state activism, but instead the redeployment of government initiatives to the new mission of liberalisation, deregulation and privatisation. State authorities shifted from a market-steering orientation to a market-supporting orientation.

Neo-liberalism lasted until the onslaught of the current crisis. What neo-liberalism stands for exactly is far from unanimously accepted. This is because neo-liberalism, unlike the academic concept of 'embedded liberalism', is most often used to denote an ideological political position. At a very general level, I associate neo-liberalism (based on the ideas of Wolfgang Streeck and Kathy Thelen) with the secular expansion of market relations inside and across the borders of national political economies. The key goal of neo-liberalism was to free up markets, institutions, rules, and regulations, which under the post-war settlement of embedded liberalism were reserved for collective political decision-making. With due caution, it would therefore seem justified to characterise neo-liberalism as a broadly based process of 'institutional liberalisation' of the fairly organised forms of capitalism that emerged out of the era of embedded liberalism. If the era of embedded liberalism was a time of institution building, then the era of neo-liberalism is best understood as a time of institutional disembedding. Important qualifications notwithstanding, the neo-liberal transformation in the 1980s and 1990s made modern capitalism more market-driven and market-accommodationist, releasing ever more economic transactions from public-political control, and turning them over to private actors and contracts. Throughout the advanced world, price stability rather than full employment became the principle objective of macro-economic policy.

As the global economy started to pick up in the second half of the 1980s, European economies were behind the curve compared to the stronger rebound in countries like the US and Japan. The European Commission, under Jacques Delors, rose to the occasion by introducing the concept of the Single Market, promoting privatisation and deregulation in an attempt to open up national markets. The Single European Market Act of 1986 was negotiated at a time when neo-liberalism was riding high. Neo-liberalism's view of the welfare state system was well summarised in the OECD Jobs Strategy, published in 1994, which launched a critical attack on the 'dark side' of double-digit unemployment of many of its European OECD members (OECD, 1994). Unemployment rates in France, Germany, and Italy were twice as high as in the US, and the 'prospect for survival' of the mixed economies of Western Europe was recognised as poor. The OECD economists singled out the accumulation of perverse labour-market rigidities that impeded flexible adjustment, blocked technological innovation, and hampered employment and economic growth. Downward wage rigidity was once again seen as the principle obstacle to full employment. Moreover, strong 'insider-outsider' cleavages with unfavourable employment chances for young people, women, the elderly, and the unskilled prevented the rigid European labour markets from replicating the higher employment rates of the US, the UK, or New Zealand. The fundamental European dilemma was conceived of in terms of a trade-off between economic efficiency and equality, growth and redistribution, competitiveness and solidarity. The policy recommendations that followed this analysis included retrenchment, deregulation, decentralisation, and privatisation. To its credit, in strengthening competition, neo-liberalism did help to lower prices and sober up public finances. It permitted higher rates of non-inflationary growth, and thus promoted prosperity in the US and the EU.

Because of neo-liberalism's emphasis on capital mobility, it is closely associated with the process of globalisation. Indeed, it was not until the 1980s that the world economy returned to the same level of capital mobility, foreign direct in-