# The Oil Shock and Neo-Liberalism


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## 15th February 2022

At 9 pm EST, President Nixon interrupted the transmission of *Bonanza* to address the nation. He announced a New Economic Policy. He was making a fundamental change in American international economic policy by closing the 'gold window' and effectively ending the international monetary policy that had been agreed at Bretton Woods in 1944. We can take this speech as emblematic of the crisis of the global economy in the early 1970s.

## Crisis

### 1. The end of Bretton Woods

The Bretton Woods agreement laid down principles for international economic relations:

- The dollar was fixed at $35 an ounce, and this rate was not easily changed – it required Congressional approval.
- Other currencies were then pegged to the dollar with a margin of +/-1 per cent. The intention was to end the currency warfare of the 1930s and create stable exchange rates which would, it was believed, allow the recovery of trade.
- These other currencies could be devalued if they were in 'fundamental disequilibrium' – as did Britain in 1949 – so that exports would become more competitive and imports more expensive.
- To keep exchange rates stable, and to allow an active domestic monetary policy, capital controls were permitted: countries could reduce their interest rate to stimulate the economy without the risk of capital flight in search of higher interest elsewhere which would put pressure on the exchange rate.

The system was expected to become operational after a short transitional period but was only really adopted in 1958 when currencies became convertible on current account– and it soon experienced difficulties that culminated in Nixon's speech on 15 August 1971.

1. Liquidity issue or the Triffin dilemma. After the war, the dominance of the US economy meant there was a dollar gap: other countries wished to buy American goods but could not yet export their own goods, so dollars were sucked out of the global economy. By the 1960s, this turned to a dollar glut: as other countries recovered, they built up trade surpluses; and the United States trade position weakened as well as heavy overseas expenses for defence. As a result, dollars were pumped into the world economy to cover the US deficit. This was the dilemma identified by Robert Triffin: liquidity for the world economy depended on the US running deficits – but if those deficits ran for too long, there would be a loss of confidence in the dollar.
2. It was difficult for the US to improve its position by devaluing – it would mean a change in the price of gold which needed Congressional approval. Even if that were secured, would it work? Other currencies were pegged to the dollar, so they would follow it down without changing relative prices. And the countries which held large gold reserves were not the ones to which the US wished to give a windfall: South Africa, the Soviet Union, and France. In any case, it would only be a 'one shot increase' that did nothing to solve the longer-term problem. Changing the price of gold was ruled out by Kennedy in February 1961 as inflationary and immoral.
3. Surplus countries were under no obligation to revalue which led to American resentment, above all against West Germany and, by 1971, Japan. The Americans argued that undervaluation of their

currencies allowed these countries to export their goods and compete with the United States. Pressure on Bonn and Tokyo to revalue was backed by threats of troop withdrawals and demands for more payment. Just how realistic were these threats during the Cold War?

4. In turn, the Europeans accused the United States of weakness. Why did the United States have a deficit? Because it was failing to put its own economy in order by holding down prices and consumption. In February 1965, President De Gaulle complained of the 'exorbitant privilege' of the dollar: 'The fact that many States in principle accept dollars on the same basis as gold so as to offset, if need be, the deficits in their favor in the American balance of payments, leads the United States to indebt itself abroad at no cost…. This unilateral facility which is granted to America is serving to cloud the idea that the dollar is an important and international medium of exchange, when it is a means of credit belonging to one State'. It allowed a 'deficit without tears' and 'greenback imperialism'I buying up European companies. n 1970, Valerie Giscard de d'Estaing commented that 'A currency that aims to play an international role as an accounting unit must obviously be of a highly fixed nature, since the other currencies cannot be permanently determined in relation to a standard that is no longer fixed but variable. None of you would agree to set his watch by a clock that was out of order'. Germany was also aggrieved: speculators saw that the DM would have to appreciate and the dollar depreciate at some point, and dollars flooded into Germany which threatened inflation – something that was anathema to Germans.

This was the problem that faced Nixon when he took office in 1969. He was not really interested in these monetary issues – as one adviser remarked, Nixon 'may even have had an almost psychological block about economics' which he viewed 'somewhat like a little boy doing required lessons'. Nixon focussed on grand geopolitical strategy of detente with the Soviets and China; and he certainly had no intention of deflating the US economy which would threaten his chances of winning the mid-term Congressional elections and his own re-election.

What to do? The Nixon administration was divided.

1. George Shultz followed the line of his colleague at the University of Chicago, Milton Friedman: abandon pegged exchange rates and let markets set the rate. Pegged rates were 'congealing the blood of capitalism'. To keep exchange rates at the same level, it was necessary to have controls on trade, prices, and wages; if rates were flexible, they would not be needed. 'There is one and only one satisfactory solution: abolish governmental price fixing. Let exchange rates become free market prices determined primarily by private dealings. Let the government simply stay out of the picture'.
2. Pegged rates were defended by Arthur Burns at the Fed and by Paul Volcker at the Treasury who was responsible for international monetary policy. They preferred to realign rates and retain Bretton Woods, with a slightly wider margin of fluctuation – a policy of 'evolutionary change'.
3. Outcome: benign neglect. Wait for a crisis, close the gold window and then use it to force a realignment in exchange rates. That still left the question of what to do after the crisis.

The crisis hit in summer 1971. Nixon closed the gold window, and the New Economic Policy also imposed a 10 per cent import surcharge and introduced price and wages controls – just what Friedman did not want. Nixon saw political advantage in the overall package. Labour would not be concerned by closing the gold window, but 'they will sure as hell understand the border tax, the price freeze and the other actions that would stimulate employment'. He was hiding what might looked like a defeat for the dollar behind an assertive domestic policy.

But what to do? There was no plan. Volcker flew to London and told European finance ministers that 'the Administration had no specific programme or blue-print for reform in mind. Rather they had an objective which was that the United States must now be put back into a strong balance of payments position'. The Europeans were astonished at American abdication of responsibility – and even more by the hard-nosed aggression of the secretary of the Treasury, John Connally. Lyndon Johnson – no slouch in these matters – said he could leave more dead bodies in the field with less remorse than any politician I ever knew'. He was, as a British newspaper remarked, 'the Nixon administration's John Wayne'. Connally's approach to the international monetary system was summed up in his blunt words that 'My basic approach is the foreigners are out to screw us. Our job is to screw them first'. Nixon went along with Connally's aggressive approach, for 'this country wants to kick foreigners in the ass'. Even so, attitudes were shifting and in December, Nixon met President Pompidou on the Azores to broker a deal which was confirmed by other countries at the Smithsonian on 17 Dec 1971. The Bretton Woods regime was patched together: other countries agreed to revalue their currencies; the US accepted a change in the price of gold so that it devalued; margins were widened to +/-2.25 per cent.

Nixon welcomed the Smithsonian agreement as 'the most significant monetary agreement in the history of the world'. Volcker was more realistic when he remarked that 'I hope it lasts three months'

Nixon would not deflate the American economy to preserve the Smithsonian agreement, and by February 1972, Pompidou complained of 'uneasiness with regard to the evolution of the international monetary situation'. He pointed to 'certain shortcomings which risk weakening the correct implementation of our agreements as well as to my preoccupation over steps taken or of positions envisaged by your administration and which, at first glance, do not seem to me to be consistent with what we agreed.' Specifically, 'the combination of a large budgetary deficit and of a policy of systematically low interest rates' weakened confidence in the dollar.

In May 1972, Shultz replaced Connally as secretary of the Treasury, and it was clear what direction policy would now take: an end of capital controls and a switch from pegged rates to floating. Shultz did not rush and asked Volcker to come up with a plan for reform.Volcker still hoped to reform the Bretton Woods system and came up with a plan for Shultz. Then on 23 June 1972, the pound floated – the first break in the Smithsonian rates.

The decision reflected the announcement of the Chancellor of the Exchequer, Anthony Barber, in the budget in March 1972 that 'it is neither necessary nor desirable to distort domestic economies to an unacceptable extent in order to retain unrealistic exchange rates…. I do not believe that there is any need for this country, or any other, to be frustrated on this score in its determination to sustain economic growth and to reduce unemployment' – he embarked on a 'dash for growth'. When the pound came under pressure in June, he preferred to abandon the fixed rate rather than deflate.

When Nixon was informed, he commented 'I don't care. Nothing we can do about it', and when he was told that the lira would be next in line, his response was blunt: 'I don't give a shit about the lira'. In 1973, floating of currencies was generally accepted – and in 1974 Schultz abolished capital controls and pushed for financial liberalisation. It was the start of a new economic order.

The consequences for the rest of the 1970s were alarming.

Floating meant it was possible to avoid corrective action on domestic wage demands or lack of competitiveness. The exchange rate could take the strain by letting the currency float downwards rather than face unions. This was the issue in Britain.

- Heath wanted to join the European monetary system which kept currencies of members more closely aligned to encourage trade between members of the EEC without the disruption of currency fluctuations – it would be a sign of British commitment as a new member of the EEC.
- Barber did not wish to deflate the domestic economy; and the Treasury saw that it would only be possible to keep to a narrow band by standing up to unions but was that going to happen?

Late in 1973 coal miners demanded a large wage increase and embarked on industrial action that led to the imposition of a three-day working week from 1 January to 7 March 1974. Heath called a general election on the issue of who controlled Britain – to which the answer was 'not the Conservative government'.

The new Labour government created a 'social contract' with unions to control wage demands – but in crisis by 1976 with high inflation, wage demands and the pound came under pressure. There were two possible solutions:

1. Alternative Economic Strategy of left, above all Tony Benn. Austerity and higher interest rates would reduce industrial investment. Britain needed to increase industrial capacity, modernise factories, and raise the amount of capital per worker, by turning from trade liberalisation to protection. Industry could then invest without fear of deflation or the loss of domestic markets. In his view, protectionism and a siege economy would bring trade unions rather than international bankers within the citadel.
2. Jim Callaghan and Denis Healey: the party is over, accept austerity in return for assistance from IMF. Callaghan's speech to the Labour Party conference said that 'Britain has lived too long on borrowed time, borrowed money, borrowed ideas', and that it had postponed 'facing up to fundamental choices and fundamental changes in our society and in our economy':

   The cosy world which we were told would go on for ever, where full employment would be guaranteed by a stroke of the Chancellor's pen, cutting taxes, deficit spending, that cosy world is gone…. [Unemployment] is caused by paying ourselves more than the value of what we produce…. We used

> to think that you could spend your way out of a recession, and increase employment by cutting taxes and boosting Government spending. I tell you in all candour that that option no longer exists, and that in so far as it ever did exist, it only worked … by injecting a bigger dose of inflation into the economy, followed by a higher level of unemployment as the next step.

Keynesian economic policies were in crisis.

The ending of the Bretton Woods regime by 1973 had not led to stability and order as Friedman hoped – but to inflation as a result of a lack of discipline, allowing rates to take the strain, and the political difficulties of standing up to union demands, and allowing unemployment to rise.

These tensions in the international monetary system ran alongside a challenge to the advanced industrial economies – or what was coming to be called the Global North.

## 2. The challenge of the New International Economic Order and OPEC Crisis

In the 1960s, Kennedy and the UN launched a development decade, and the less developed countries demanded a more radical agenda through the United Nations Conference on Trade and Development. The outcome had been disappointing.

In October 1970, the General Assembly of the UN proclaimed a new development decade to 'create a more just and rational world economic and social order', with preferential treatment for their exports and 'full exercise … of permanent sovereignty over their natural resources'.

The less developed countries seemed to have the initiative:

- Domestic tensions in West with student protests of 1968, civil rights in US and 'Third Worldism'
- United States were struggling in Vietnam – Tet Offensive in 1968, domestic opposition to the war.
- Crisis in international monetary system and divisions within the advanced economies

In 1972, UNCTAD appointed a working group to draft a Charter of Economic Rights and Duties of States, and the Non-Aligned Nations met at Algiers in September 1973 to stress that imperialism was 'still the greatest obstacle to the emancipation and progress of the developing countries', and that it would take an 'aggressive attitude towards those who oppose its plans, trying to impose upon them political, social and economic structures which encourage alien domination, dependence and neo-colonialism'. They complained of 'ever-increasing disparity between the industrialised countries and the under-developed world', and the way that developed countries maintained a 'stranglehold on the resources of the developing countries to ensure all kinds of privileges and reliable outlets for their manufactured products and services.' The Algiers Declaration called for a 'fighting front by challenging imperialist and neo-colonial exploitation structures and by organising cooperation and solidarity with one another'. It went on to 'reaffirm each country's inalienable right to the full exercise of national sovereignty over its natural resources and all domestic economic activities'. Each state had the right to nationalise their resources on whatever terms it wished, and to free itself from transnational corporations which infringed the sovereignty of developing countries. It was a radical call for distributive justice in the global economy.

These demands were given reality by the power of oil producers.

The Organisation of Petroleum Exporting Countries was created in 1960. One of the founders was Juan Pablo Pérez Alfonzo who in 1948, as minister of development in Venezuela, negotiated a deal with the American oil companies for a 50:50 split in profits. In the middle east, imperial powers had worked with the oil companies to impose more stringent terms on the sovereign landlords, but the same 50:50 split was imposed as production increased. Price setting was in the hands of the companies rather than the states. In 1958, Alfonzo returned from political exile and was appointed minister of mines and hydrocarbons. Discussions with Abdullah Tariki of Saudi Arabia led to the creation of OPEC which questioned the 50:50 split and called for an increase in the government's share. By 1971 most petrostates went further and agreed that more direct control was needed – whether by 'participation' as in Iran, or nationalisattion as in Algeria and Iraq.

In October 1973, Egypt attacked Israel and, in retaliation for western support for Israel, the Arab producers imposed an embargo on oil exports. OPEC raised the price of oil from $3.02 to $5.12 a barrel on 16 October and to $11.6 in December 1973 – the first unilateral increases by the oil producers. The result was a squeeze on household consumption, an increase in industrial costs, and recession in most major economies

The limited success of UNCTAD stood in stark contrast to the achievement of OPEC in the eyes of the less developed countries. At the UN, the delegate from Guinea praised OPEC's 'brilliant victories in bringing about a just and more harmonious equilibrium in international economic relations'. Members of OPEC emphasised their status as 'developing countries, which believe that their first and foremost duty is to raise the standards of living of their peoples in all spheres, in order that they may keep pace with world progress ... and make an effective contribution to international development in general'.

Although many developing countries were oil importers who were hit by higher prices, they maintained a common front in demanding a New International Economic Order. The United States and other developed countries realised that opposition would be counter-productive, and, despite their reservations, they went along with the proposal. On 1 May 1974 the General Assembly agreed, without a vote, to establish a New International Economic Order.

The Declaration on the establishment of a NIEO called for

> *"equity, sovereign equality, interdependence, common interest and cooperation among all States, irrespective of their economic and social systems which shall correct inequalities and redress existing injustices, make it possible to eliminate the widening gap between the developed and the developing countries."*

The developing countries wanted 'active, full and equal participation … in the formulation and application of all decisions that concern the international community'. Several principles followed. All states had the right to adopt whatever social and economic system they wished, and they should cooperate on the basis of equality in the 'accelerated development of all the developing countries'. Each state was to have

> *"full permanent sovereignty … over its natural resources and all economic activities. In order to safeguard these resources, each State is entitled to exercise effective control over them and their exploitation with means suitable to its own situation, including the right to nationalization or transfer of ownership to its nationals, this right being an expression of the full permanent sovereignty of the State."*

Further, the less developed countries demanded full compensation for the exploitation of their resources in the past by colonial powers and requested the regulation of transnational corporations. There should be 'a just and equitable relationship' between the price of developing countries' imports and exports, 'with the aim of bringing about sustained improvement in their unsatisfactory terms of trade and the expansion of the world economy.'

The NIEO caused alarm in the Global North, and debates over the best response. There were two main approaches:

1. Henry Kissinger and the US: 'we should be in the rear guard of those who are joining in', but 'we shouldn't throw any sand in'. In 1974, Kissinger attempted to create solidarity between consumers of oil, including less developed countries. He rejected 'a never-never land in which tiny, poor and weak nations can hold up for ransom some of the industrialized world'. Why should 800 million people in the advanced industrial countries be 'mesmerized while 50 million people in certain producer countries control the situation'? His strategy was to divide the less developed countries and unite the west. 'We have to avoid an international dispute where Americans say the existing system is great and the LDCs call for a new economic order. This is a losing wicket'. His approach was to 'fuzz it up' – to ensure that the NIEO failed while avoiding confrontation, or - as President Ford put it - there was 'no reason to talk theory when we can in a practical way just screw up the negotiations'.
2. Work with the Third World: Giscard wanted cooperation of producers and consumers. In November 1975, the Rambouillet summit committed six industrialized countries to closer cooperation with less developed countries to overcome high unemployment, inflation and energy problems. The Rambouillet Declaration stressed that 'A co-operative relationship and improved understanding between the developing nations and the industrial world is fundamental to the prosperity of each'. The Americans derided French policy as empty gestures.

The challenge of OPEC and the NIEO continued until the second oil shock of 1979 – and contributed to the inflationary pressures and created by the shift in the monetary system.

### 3. The return of financial liberalisation

The Bretton Woods agreement had allowed capital controls so that pegged exchange rates could be combined with an active domestic economic policy.

These controls could be subverted.

- There were ‘leaks’ through financial centres such as Hong Kong.
- Convertibility was on current account and not capital account – but it was possible to blur the line.
- Multinational corporations were becoming more important which moved money between national branches.

These changes meant that the Bretton Woods trade off was under pressure – and attempts to preserve the regime had the unintended consequence of undermining it further.

In 1963, Kennedy introduced an Interest Equalisation Tax: a tax was imposed on new issues of foreign securities and equities sold in the United States which meant that borrowing by foreigners was discouraged without increasing interest rates for domestic investment. The tax did not apply to direct investment by US companies, and an attempt was made to limits outflows by exhortation before President Johnson imposed a tax on direct American investment in 1967. Nixon promised to remove these controls, but the crisis of Bretton Woods meant they remained in place.

The result of these measures was to encourage a new market for Eurodollars:

- American businesses retained their earnings in Europe to avoid controls.
- US banks turned to the market to avoid New Deal restrictions.
- Communist countries were reluctant to place their dollar earnings in New York where they might be ‘frozen’ during the cold war. They also saw that they could use their dollar holdings to create friendly relations with Europe.

Holdings of offshore dollars in the hands of international bankers, above all in London, were beyond the control of a single state and, despite the wish of some European central bankers, were not subject to regulation. a financial commentator pointed out in 1969, ‘The empire may have disintegrated, and the UK may now be a third-rate military power, but the City of London has staged a comeback which would be the envy of any child movie star reaching maturity’.

The emergence of Eurodollars outside national control could be a source of instability if funds moved suddenly. In the US, Connally and Burns saw risks, as did the Europeans – at the Smithsonian it was agreed that regulation should be considered. The Bank of England and British Treasury were not convinced – it was a source of revenue. The possibility of regulation did not anything:

The need to recycle petrodollars. In March 1973, the head of the Saudi Arabian central bank remarked that he was ‘sinking under a sea of billions of dollars’ – and even more with the OPEC price rise. AN outlet was needed for these funds.

Shift in the US to a belief in the efficiency of free markets. Floating allowed Shultz to abolished capital controls – and his successor William Simon, a former banker at Salomon Brothers, was even more a free marketeer. He argued that the private market ‘performed marvelously. Commercial banks and the Euro markets have been able to absorb the inflows’.

The outcome was that commercial banks – rather than the IMF - would recycle money, above all, lending to Latin America. An IMF discussion paper of 1977 pointed out that ‘the broad aim should be to encourage a role by the commercial banks which would constructively assist in the adjustment process’. This was a radical change from Bretton Woods in 1944 when the aim was to subordinate bankers to government control. The IMF also moved from the use of controls over capital flows to active encouragement of capital flows. In May 1982, the managing director of the IMF, Jacques de Larosière pointed to a major change in the international financial system. ‘Twenty years ago – and perhaps even as recently as ten years ago – the international monetary system was dominated by governments and official institutions. Today, the private commercial banks play a key role in the running of that system’. He was confident that banks were efficient in transferring funds, that they had experience in assessing risk, that markets worked, and that too much regulation would be harmful.

What could possibly go wrong? In 1982, a serious debt crisis started in Mexico.

### 4. Changes in the economy

Economic growth slowed down. In western Europe, growth of GDP per capita was 4.05 per cent pa 1950 to 1973; from 1973 to 1997 only 1.75 per cent.

end of transfer from agriculture to industry in countries of western Europe – in Britain, had already been completed earlier and its growth was slower

exploitation of technological transfer after war

Squeeze on profitability: in Britain, the net pre-tax real rate of return in industrial and commercial companies fell from 13.2 per cent in 1960 to 8.7 per cent in 1970 and 3.2 per cent in 1981. A Treasury economist noted in 1981 that 'the secular decline in company profits has probably reached a point where many firms have an inadequate incentive to produce' – since the 1970s, the real rate of profit was below the real cost of capital. Profits fell in other countries and led to a fall in investment which made it more difficult to escape from the trap of low productivity.

The crisis of stagflation – the inflation and low growth – put pressure on the post-war social contract and the coooperatin of government and unions. It was no longer possible for productivity growth to allow wage improvements, greater welfare, low prices and good profits. Something had to give, as we saw in Britain in 1973/4 and 1976. In Germany, wage demands in 1975 led the Bundesbank to increase interest rates – and the SDP was not willing to challenge its independence which led to high unemployment.

### 5. Change in social assumptions

The crisis was not only in economics but in social attitudes. In simple terms, there was a shift from the collective assumptions of solidarity in the war and post-war reconstruction to a greater sense of individualism based on desire and choice. It is what the American historian Dan Rodgers calls the 'age of fractures' – a breakdown of collective identities in terms of class to a more fluid sense identity based on gender or sexuality: the emergence of feminism, student activism, sexual politics, civil rights.

The rhetoric of choice was used both on the left and right - on the progressive left, the women's right to choose or changing attitudes to homosexuality; on the right, freedom to choose in the market rather than via collective consumption.

The shift was reinforced by falling employment in industries such as steel and coal affected workers with specific skills, little formal education, and a cultural identity defined by industrial communities. Mass trade unions started to weaken. Instead, employment grew in technical and service roles that either required formal qualifications and paid high wages, or casualised, precarious jobs.

In these ways, the basis of the post-war order was breaking down in the 1970s, before a new order was created from around 1980

## Resolution

This crisis led to a remaking of capitalism from around 1980 – and is associated above all with Thatcher and Reagan. It resulted in what is often called neo-liberalism or the Washington consensus, both contested terms, often of criticism. I will take them as descriptive terms to mean fiscal and monetary discipline; tax reform to reduce marginal rates; financial liberalisation and free flows of capital; privatisation and deregulation of business. Above all, it marks a belief in the efficiency of the market and a rejection of Keynesian or corporatist approaches.

### 1. Breaking inflationary expectations

The initial adoption of floating exchange rates meant a removal of discipline – the rate could take the strain. In the 1970s, politics prevented the use of fiscal or monetary discipline. At the Fed, Arthur Burns saw that a tight policy 'would be frustrating the will of Congress to which it is responsible – a Congress that was intent on providing additional services to the electorate and on assuring that jobs and incomes were maintained, particularly in the short run'. More generally, the Fed was constrained by the political and cultural environment that meant 'Fear of immediate unemployment – rather than fear of current or eventual inflation – … came to dominate economic policymaking'. Burns was resigned to fighting a losing battle against increased government spending and generous wage settlements.

This changed when Volcker became chair of the Fed in 1979. He imposed tight domestic money and high interest rates to stabilise the dollar and squeeze inflation out of the American economy, at the cost of a severe recession.

> *"An entire generation of young adults has grown up since the mid-1960s knowing only inflation… it is hardly surprising that many citizens have begun to wonder whether it is realistic to anticipate a return*

*to general price stability, and have begun to change their behaviour accordingly. Inflation feeds in part on itself. So part of the job of returning to a more stable and more productive economy must be to break the grip of inflationary expectations."*

His aim was to end 'the uncertainties and distortions inherent in inflation' and 'to restore a solid base for sustained growth and stability...Above all, the new measures should make abundantly clear our unwillingness to finance a continuing inflationary process.' In the past, efforts to control inflation had been 'prematurely truncated' so that 'markets had developed a high degree of cynicism' about the willingness of the Fed to stand firm. He was determined to stand firm to show that the Fed meant business in bringing inflation under control and showing that 'we would have a chance of affecting ordinary people's behaviour'.

President Carter was alarmed at the increase in unemployment and thought 'the strictly monetary approach to the Fed's decision on the discount rate and other banking policies is ill-advised…. [T]he Fed ought to look at the adverse consequences of increased interest rates on the general economy as a major factor in making their own judgements'. Volcker held to his position – and had more support from Reagan.

In Britain, the new Chancellor in Mrs Thatcher's government – Geoffrey Howe – adopted the Medium-Term Financial Strategy to drive out inflation – again, with a rise in unemployment and with measures to weaken the power of trade unions through legislation, a willingness to take a firm stand as against the miners.

### 2. Defeat of the NIEO and drop in oil prices

In October 1981, the final North-South summit – the International Meeting on Cooperation and Development – met at Cancun in Mexico. The circumstances were not auspicious, and the challenge of the NIEO was contained.

- Oil was coming online outside the OPEC countries – not least from the North Sea.
- There was a growing divergence between successful industrialising countries in east Asia and large parts of Africa where growth was falling or even going into reverse. The political solidarity of the developing world fractured.
- There was little chance of progress with Mrs Thatcher in power in Britain and President Reagan in the White House. Reagan announced that 'we will promote a revolutionary idea born more than 200 years ago…. It is called freedom and it works. It is still the most exciting, progressive and successful idea the world has ever known'. The need was 'to help the developing countries to help themselves. It is here that trade, and private finance is of such importance'. Thatcher was of a similar opinion. In her memoirs, she explained she was attending to argue her own position: 'there was no way that I was going to put British deposits into a bank which was totally run by those on overdrafts'.
- Latin America borrowed heavily from commercial banks in the 1970s - in 1982 a debt crisis hit Mexico and other countries. The debtors were assisted on condition that they adopted structural change in accordance with the ideology and interests of the Washington consensus, and banks were rescued from their folly.

The NIEO had failed. It had been a brief moment that caused alarm in the North and hope in the South, before and the North used its economic and political power.

### 3. Financialisation and marketisation

Thatcherism entailed a radical shift in assumptions about economic behaviour – it appealed to pre-existing trends about individualism in the 1970s and now entrenched them in economic policy. The change was introduced above all by two Chancellors – Geoffrey Howe and Nigel Lawson.

The general aim was set out by Howe in 1979:

> *"We need to strengthen incentives, by allowing people to keep ore of what they earn, so that hard work, talent and ability are properly rewarded. We need to enlarge freedom of choice for the individual by reducing the role of the State. We need to reduce the burden of financing the public sector, so as to leave room for commerce and industry to prosper."*

Their budgets were based the following assumptions:

- A shift from institutional investors in life insurance companies which were seen as passive and conservative to cover their liability, and which tied the money of savers into long-term contracts. Weakening these institutional investors would – it was hoped – create a more active entrepreneurial regime. Tax breaks on life insurance that had been n place since 1853 were abolished in 1984 – instead, in 1986 tax breaks on Personal Equity Plans.

- Linked with privatisation – encourage participate in markets, as in the Don't tell Sid campaign.
- Big Bang in the City which increased the role of major banks and power of finance.
- Improve profitability by changes in the tax regime for corporations to stimulate enterprise and reward innovation.
- Reduce higher levels of personal income tax to create incentives.

The aim was to create a new sense of enterprise, dynamism and personal responsibility. To critics, the result was growing inequality; profits from privatisation – except for council housing – to managers and major investors, not to consumers or workers.

The financial sector expanded, and the power of financial interests increased in London and New York. Although financial liberalisation had far-reaching implications, it did not produce immediate losers or hit defined areas as did changes in trade policy. Instead financialisation came to permeate society through a wider range of interests from consumer credit, the ability to buy shares in privatised assets, or the encouragement of tax-efficient investment in the stock market and pensions.

### 4. Deindustrialisation

The other side of the coin of financialisation was deindustrialisation.

In the United Kingdom, the proportion of workers in industry fell from 48 per cent of the workforce in 1957 to 15 per cent in 2016. The output did not fall to the same extent as a result of changes in technology. In the British car industry, output has returned to 90 per cent of the peak of the 1970s, but employment fell from around 500,000 in 1972 to 140,000.

There was a radical shift in the nature of the work. Industrial towns based on Fordist mass production such as Detroit or Birmingham offered decent wages and secure employment to workers who lacked formal qualifications and had skills specific to their sector. They were highly organised with a strong bargaining position at a time of full employment after the War. It was a world of 'tangible capital' based on investment in physical industrial equipment and buildings with limits to the economies of scale.

The new world was different. New production technology needed fewer workers with higher skills: the proportion of workers in British manufacturing with no qualifications fell from 26 per cent in 1993 to 8 per cent in 2013.

Polarisation between well paid, highly qualified workers and low paid, insecure, and unqualified workers was even more striking in the expanding service sector. In Britain, between 1979 and 1999, employment of care assistants expanded by 419.5 per cent, of shelf fillers by 95.5 per cent. By contrast, information technology and legal or financial services needed formal credentials and paid high salaries.

The new sectors often relied on 'intangible capital' with few limits to the economies of scale in, say, selling licences for computer operation systems. The leading entrepreneurs in these sectors made huge fortunes and salaried employees received large incomes. Further, a shift from anti-trust policies led to dominance by a few firms with higher profit margins, and barriers to entry in many sectors of the economy delivered high incomes for professionals and entrepreneurs.

At the same time, the bargaining power of labour was weakened by deindustrialisation and erosion of union power. Highly qualified and well-paid employees producing sophisticated algorithms and data analysis for Amazon contrasted with workers in the company's warehouses or casualised, precarious delivery drivers. The labour market was polarised by deindustrialisation and skilled-based technological change – between 'lousy' and 'lovely' jobs.

### 5. The IMF: developing and transitional economies

Many of these policies were adopted in the former Soviet bloc and developing countries in return for assistance from the IMF during financial crises.

- In 1997, a crisis in East Asia – funds looking for higher returns moved to South Korea and other countries and then left to avoid a loss from devaluation. The IMF intervened and saw the problem as the nature of 'crony capitalism' and forced major changes in policy, without understanding the nature of South Korean economy and society. To critics, it was a triumph of ideology over reality that saw American capitalism as the solution – despite the success of the different development model pursued by Korea and for that matter Japan and Taiwan. Martin Feldstein, an economist at Harvard and president of the National Bureau of Economic Research, pointed out that a member who applied for assistance was

> *"the IMF's client or patient, but not its ward. The legitimate political institutions of the country should determine the nation's economic structure and the nature of its institutions. A nation's desperate need for short-term financial help does not give the IMF the moral right to substitute its technical judgments for the outcomes of the nation's political process."*

South Korea and other countries in the region vowed not to turn to the IMF again and built-up reserves.

- In Poland and in the former Soviet Union, the adoption of 'shock therapy' – a sudden move to market prices from a command economy, complemented by privatisation and austerity to hold down inflationary pressure. It worked reasonably well in Poland which could be more easily integrated into the European economy and had experience of markets before the war. It was not so easy in Russia – and price liberalisation led to hardship, the privatisation of industry destroyed work-based welfare, and gains were taken largely by the oligarchs.
- China was more successful – drew on ideas from the World Bank, avoided IMF loans and conditions; opted for gradualism by 'growing out of the plan' – that is keeping a state planned sector and allowed the market to grow. The emergence of China was, of course, the major shift in the global economy and capitalism.

## What Next?

In 2006, Ben Bernanke, the chairman of the Fed, claimed that 'The management of market risk and credit risk has become increasingly sophisticated… Banking organizations of all sizes have made substantial strides over the past two decades in their ability to measure and manage risks'. He referred to the 'great moderation' – the removal of booms and crashes. In June 2007, he still took the view that 'the troubles in the subprime sector seem unlikely to seriously spill over to the broader economy or the financial system'

This confidence turned out to be misplaced. Economists had been worrying about the wrong thing – the imbalance between US trade deficits and Chinese surpluses – and not the sub-prime market at home. In 2007/8, the global financial crash had a devastating impact.

Critics pointed to the weaknesses of the capitalist system as it emerged from the crisis of the 1970s:

- Too great power for financial interests in driving policy.
- Growing inequality in wealth, income and security within the developed world – the gainers were the very rich and the middle class in developing economies.
- Making up for lagging income by reliance on personal debt – a bigger issue than state debt.

The question in 2009, when the leaders of the G20 assembled in London, was how they would respond. Would the approach that had emerged in the last quarter of the twentieth century be overturned? The answer was 'no' – which poses a further question – 'why not?'

In my next lecture, I will explore the reasons for the global financial crash and the response to it – and ask whether the impact of covid might lead to a further realignment of capitalism.

Faced crisis in turn with the global financial crash of 2007/8. Would that lead to a major reassessment and a remaking of capitalism and rejection of neoliberalism? If not, why not? And if it did not, would covid mark a change.

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