In M. Kahler and D. Lake, eds. *Politics in the New Hard Times* (Ithaca: Cornell University Press 2013)

5

THE POLITICAL ORIGINS OF OUR ECONOMIC DISCONTENTS

Contemporary Adjustment Problems in Historical Perspective

Peter A. Hall

The financial crises and recession of 2008–9 are the worst experienced by the developed democracies since World War II. Will this crisis inspire radical changes in policies or in the economic models that underlie them? How do we explain the adjustment paths countries take in the wake of such a crisis? These are economic questions about the sources of demand and supply in a chastened world, and political questions about how the will to adjust is generated. Such issues can be approached in various ways, but in the political economy as in the forest, if we want to know where we are going, it is useful to know from where we have come. Therefore, this chapter considers how the developed democracies addressed parallel challenges over the past seven decades with a view to understanding better how they are responding to the current ones.

To this problem, I bring a synoptic perspective that emphasizes the architecture of the political economy, seen as a set of interdependent institutional structures, encompassing organizational relations among economic actors, the policy regimes supporting those relationships, and the international regimes in which they are embedded (Eichengreen 1996b). Drawing on a well-established literature, I outline the institutional architecture of the developed political economies

Although he may disagree with the arguments in this chapter, Peter Gourevitch will recognize the inspiration I have drawn from his writing and our many conversations. I am grateful to Catherine Yang for efficient research assistance, to the Hanse-Wissenschaftskolleg for its hospitality while this chapter was revised, and to Chris Allen, Albena Azmenova, Arie Krampf, Waltraud Schelkle, Herman Schwartz, David Soskice, Peter Swenson, Mark Thatcher, and Kathleen Thelen for helpful comments on an earlier version.

during the Keynesian era of the 1950s and 1960s. I then try to construct a parallel account of that architecture for the neoliberal era of the 1980s and 1990s. This analysis yields a set of claims about the economic formulas underpinning economic growth in these eras, but it generates a puzzle: On what political conditions did these economic formulas depend? The institutions of the political economy do not spring full-blown from the head of Zeus. Moving beyond accounts that treat national economic models as matters of effective institutional engineering, I inquire into the politics that makes them possible. From this analysis, I then draw some conclusions to explain variation in the initial response of governments to the crisis of 2008–9 and some propositions about the paths ongoing economic adjustment is likely to follow.

The Institutional Formulas of the Keynesian Era

The operation of the developed political economies during an era stretching from the 1950s into the 1970s illustrates the importance of the institutional architecture of the political economy. These were decades of high growth, when the size of the German economy quintupled, the French quadrupled, and the British tripled. Of course, postwar growth had many sources, including a transition from agricultural to industrial production (Crafts and Toniolo 1996). But there are strong grounds for thinking that the economic success of these years also depended on a set of institutional frameworks and supportive policy formulas, nicely described by the regulation school of economics and analysts of the social structures of accumulation (Noel 1987; Boyer 1990, 2002; Kotz, McDonough, and Reich 1994).

Based on this literature, we might say that the success with which a political economy secures economic growth and social peace depends on arrangements in four institutional fields. The first is that of the production regime, reflected in the organization of firms, of work relations, and of the production process more generally. The second is the industrial relations regime, marked by the ways in which bargaining over wages and working conditions is organized. The third is the socioeconomic policy regime, which distributes the fruits of production, determining who secures work on what terms and what social benefits go to those who do not get paid work. The fourth is composed of the international regimes relevant to the operation of domestic political economies, including those regulating trade, exchange rates, and international finance.

During the 1950s and 1960s, mass production in industry was at the heart of the production regime. Using Fordist techniques, the production of complex goods was divided into simpler tasks, often accomplished by semi-skilled workers on automated production lines. One result was rapid productivity gains, as laborers who had been only marginally productive on the farm could be mobilized to create products of higher value (Boyer 1990). The expansion of industrial production was crucial to the resolution of the unemployment problem following World War II. However, mass production requires high levels of long-term capital investment likely to be forthcoming only if investors receive assurances that aggregate demand will rise steadily over the long term and that profits will be high enough to sustain such investments. Reforms regularizing collective bargaining in this period served these purposes. By granting trade unions an established role in wage determination, they made possible steady wage increases that fueled aggregate demand but encouraged unions to leave room for profits by giving them the long-run power to punish firms that did not translate profits into subsequent wage gains (Przeworski and Wallerstein 1982; Boyer 1990; Howell 1992, 2005).

The policy regimes of this era were built around the development of a Keynesian welfare state also crucial to sustaining aggregate demand. Although countercyclical fiscal policy was practiced in only a few countries, and with more fanfare than effectiveness, the Keynesian principle that governments would "manage the economy" underpinned most policy regimes, including indicative planning in France, the social market economy of Germany, and the Rehn-Meidner model of Sweden, enhancing the confidence of investors and consumers about the trajectory of employment and demand (Hansen 1968; Martin 1979; Hall 1989; Sally 2007). The increasing social benefits of the Keynesian welfare state gave workers enough assurances about their income during retirement or unemployment to persuade them to invest in skills and to spend, rather than save, their income (Estevez-Abe, Iversen, and Soskice 2001). As Eichengreen (1996) has noted, the international regimes established after World War II were equally important. The General Agreement on Tariffs and Trade and the European Economic Community increased demand steadily through trade, while the European Payments Union and Bretton Woods monetary regime provided stable monetary frameworks for that trade, limiting the capacity of governments to protect industry through exchange-rate manipulation.

Of course, my account of this era is a stylized portrait that emphasizes similarities across countries in order to highlight the changes that subsequently took place (cf. Piore and Sabel 1982; Streeck 1991; Hall and Soskice 2001; Amable 2003). However, the developed political economies had a distinctive institutional architecture during the 1950s and 1960s, marked by Fordist production regimes, organized collective bargaining, a Keynesian welfare state, and outward-looking international regimes.

Where did this institutional architecture come from? Its origins are complex and inflected by national histories (Shonfield 1969; Manow 2001; Streeck and Yamamura 2001; Thelen 2004; Iversen and Soskice 2009). However, to see this institutional architecture as economically determined would be to miss important parts of the picture. The collective bargaining arrangements, socioeconomic policies, and international regimes of the Keynesian era had important political roots. Three sets of political factors made the development of these regimes possible during the 1950s and 1960s.

The first was a historical memory, still fresh in the public mind during the 1940s and 1950s, of the intense class conflict that had polarized electoral competition in the 1930s, under the shadow of mass unemployment and Bolshevik Revolution, with disastrous consequences manifest in the Weimar Republic (Abraham 1988). The political elites of western Europe and America left World War II determined to avoid the social unrest of the interwar years, of whose relevance they were reminded by a new Cold War (Maier 1981). Thus, concerns about class conflict provided much of the initial *motivation* for the construction of the Keynesian welfare state.

The *means* were provided by Keynesian ideas applied in diffuse forms across a wide range of countries. As they were taken up by postwar economists, those ideas gained economic credibility, and they had political appeal because they provided the rationale for a class compromise that had eluded interwar governments (Hall 1989; Fourcade 2009). At the heart of the Keynesian compromise was the notion that governments could ensure full employment, the key demand of the working class, by pursuing active fiscal or industrial policies, without depriving businessmen of control over the means of production, which was the key demand of capital. At conferences from Brighton to Bad Godesberg, this formula encouraged mainstream parties of the left to make peace with capitalism, and it allowed parties of the political right to accept responsibility for employment without alienating their business allies (Offe 1983, 1985).

However, the *motor* driving the construction of the Keynesian welfare state was the logic of partisan electoral competition in the 1950s and 1960s. At a time when social class still structured much of the vote, lining up parties of the political left that claimed to represent the working class against middle-class parties that sought cross-class appeal, class-based distributive issues held center stage, and both sides of the spectrum began to offer social benefits and active economic management in return for electoral support. The result was a new kind of political convergence around the managed economy and the welfare state from which only those at the margins of the political spectrum in Europe and America dissented (Lipset 1964; Beer 1969; Shonfield 1969).

The institutions of collective bargaining were built for similar reasons and in much the same way. Governments of the left and right supported the extension of collective bargaining in order to move class conflict out of the political arena into the industrial relations arena where it could be contained (Pizzorno 1978; Goldthorpe 1984). By enabling trade unions to secure better wages and working conditions, they hoped to weaken the abilities of the radical left to exploit issues of class in electoral politics. Even the shape of international institutions was influenced by such concerns. Their architects designed the postwar international regimes to accommodate the policies of the Keynesian welfare state, partly to limit the influence of western communist parties in the midst of a new Cold War (Ruggie 1982).

In short, the institutional architecture of the postwar political economies rested on a particular set of political conditions defined by the prominence of social class in the politics of the day. If concern to avoid class conflict provided the initial impetus and Keynesian ideas the means, class-oriented electoral competition drove the development of those institutions forward.

From this perspective, the 1970s were years of transition, when the institutional architecture of the Keynesian era broke down, partly under the weight of its own liabilities and partly in response to international developments led by large rises in commodity prices and the collapse of the Bretton Woods monetary regime.[1] The result was stagflation, marked by simultaneous increases in unemployment and inflation. In response, governments turned to more interventionist measures. Many increased social and industrial subsidies (Berger 1981). In economies where wage bargaining could be coordinated by powerful trade unions and employer associations, governments used neocorporatist bargaining to contain inflation, often with favorable results (Schmitter and Lehmbruch 1979; Goldthorpe 1984). In liberal market economies, where decentralized systems of wage bargaining threatened wage-price spirals, governments often resorted to incomes policies that imposed direct controls on wages and prices, thereby shifting distributional conflict back from the industrial to the political arena.

However, these policies failed to restore previous rates of growth, thereby discrediting Keynesian policy formulas and setting governments in search of new ways to cope with what some called "Eurosclerosis" (Hall 1993). The result was a profound backlash against state intervention. In liberal market economies, where unwieldy attempts at incomes policies generated political conflict over wage differentials, the authority of the state suffered deeply from crises of governability,

1. For more detailed studies of this period, offering different perspectives, see Crouch and Pizzorno 1978; Ferguson et al. 2010; Sandbrook 2010.

often linked to apprehensions of national decline (Crozier, Huntington, and Watanuki 1974; Goldthorpe 1978; Krieger 1986). This was the tide that Margaret Thatcher and Ronald Reagan rode to power. Even in continental Europe, the political backlash against stagflation and slower rates of growth was significant. For the 1980s and 1990s, the climacteric of the 1970s became what the interwar years had been for the 1940s and 1950s, a totemic set of events that would condition the course of policy for another generation (cf. Kingdon 1995; Sewell 1996).

The Institutional Formulas of the Neoliberal Era

In response to these and other developments, the structure of the developed political economies shifted during the 1980s and 1990s, as did policy, in terms that marked the end of the Keynesian era and the inception of what might be called a neoliberal era. Although I have relied on a familiar literature to describe the former, we do not yet have parallel accounts of the latter. Therefore, the initial question must be: Can we identify an analogous institutional architecture for this neoliberal era, whose component parts reinforced each another to produce distinctive aggregate and distributive economic outcomes?[2] Key developments in each of the relevant institutional spheres gave rise to such an architecture.

The production regime of the neoliberal era was deeply affected by two central developments. One was a shift in employment away from manufacturing to services, including well-paid employment in high-end sectors such as health care and finance, and low-paid positions in sectors such as retailing, restaurants, and tourism. This shift was the result of long-term secular trends whose effects became pronounced in the neoliberal era (Iversen and Cusack 2000). The second defining feature of that era was a shift away from Fordist modes of production toward methods that made more intensive use of knowledge, high technology, and skilled labor, often embedded in global supply chains (Womack, Jones, and Roos 1991).[3] Enterprises once interested in vertical integration turned to outsourcing: the traditional Fordist enterprise became a thing of the past in the developed democracies, demand for semi-skilled industrial labor fell, and job creation took place mainly in services (Berger 2005).

These changes were encouraged by developments in international regimes during the 1980s and 1990s that increased the flows of goods and capital across national borders (Berger and Dore 1996; Keohane and Milner 1996). One of

2. For insightful reviews bearing on this topic, see Glyn 2006 and Eichengreen 2007.
3. I am indebted to David Soskice for drawing my attention to this feature of the neoliberal era.

Margaret Thatcher's first acts was to eliminate currency controls. The Single European Act of 1986 and trade agreements such as the Uruguay Round promoted the movement of low-cost manufacturing offshore, thereby accelerating the shift to services and knowledge-intensive manufacturing in Europe and America (Wood 1994; Leamer 1996; Antràs, Garicano, and Rossi-Hansberg 2006).

Collective bargaining arrangements moved in tandem with these developments. More intense global competition opened up cleavages in bargaining systems, between more and less competitive firms and the traded and sheltered sectors (Pontusson and Swenson 1996; Thelen and Kume 1999). As a result, the locus of bargaining shifted downwards and firm-level bargaining became more important in most countries, as firms reorganized production in the face of global competition (Iversen 1999; Lallement 2007; Baccaro and Howell 2011). The power of trade unions declined, as average union density in the OECD dropped from 33 percent in 1980 to 18 percent in 2008, leaving many workers outside the scope of collective agreements.

Socioeconomic policy regimes also changed dramatically during the 1980s and 1990s. If Keynesians had treated unemployment as a demand-side problem, requiring active macroeconomic management, the new policy formulas treated unemployment as a supply-side problem that could be alleviated only by structural reforms to labor, capital, and product markets. Industrial policies targeted on promising industries gave way to manpower policies designed to push people into employment. Symbolic of the shifting approach were the steps taken in the 1990s to make central banks more independent of political control.

These developments fit the circumstances of more open economies, where the effects of a fiscal stimulus leak abroad, as it always has in the small northern European states. Economic doctrine gradually converged on a "new Keynesianism," and most governments pinned their hopes for growth on the expansion of trade. There was some variation in national strategies. The Nordic countries used public employment to create jobs in services without lowering wage floors, while liberal market economies promoted low-wage employment in services by making part-time work and layoffs more feasible (Esping-Andersen 1990, 1999; Iversen and Wren 1998; Scharpf and Schmidt 2000). After experimenting with costly early retirement programs to shrink the workforce, the continental coordinated economies used manpower policies featuring large subsidies to employers to expand employment. In the liberal market economies, measures that weakened trade unions were used to lift profits, while coordinated market economies relied on coordinated wage bargaining to restore profits and competitiveness.

In short, the neoliberal era had mutually reinforcing production, industrial relations, policy, and international regimes analogous to those of the Keynesian era. But the economic results were quite different. Wage inequality rose faster during the 1980s and 1990s, especially in liberal market economies, and rates of growth were slower, partly because productivity gains were harder to secure in services than in manufacturing.

The Political Formula of the Neoliberal Era

How is this shift in institutional architecture to be explained? Most accounts cite the inexorable pressures of globalization, and they played a role, but the international regimes that opened up emerging markets were created by governments. Global competition put enormous pressure on firms to change their business practices, and business lobbied governments for supportive policies (Berger and Dore 1996; Keohane and Milner 1996). Governments saw many of these policies as the most feasible way to create jobs in services. However, to view the institutions and policies of this era as a "natural" response to economic circumstances is to neglect the extent to which they had to have a political underlay. The policy formulas of this era were not simply reflexive responses to economic conditions but artifacts of a certain kind of politics. What then were the political conditions that made this new architecture possible?

The answer is not obvious. The Keynesian welfare state can be seen as a class compromise, but it is difficult to view the policies of the neoliberal era in such terms, because they have not delivered benefits in anything like equal measure to both sides of the class divide. In many countries, the affluent have enjoyed significantly greater increases in income and well-being over the past thirty years than those at median or below-median incomes (Kenworthy and Pontusson 2005; Barnes and Hall 2013). However, the case of the Keynesian welfare state is instructive. I have argued that three factors underpinned its construction: it was motivated by a historical memory, given shape by Keynesian ideas, and put into place by electoral competition around a class cleavage. The same types of elements made the transition to neoliberal policies possible, but in new forms dictated by the historical circumstances of the 1980s.

The crisis of the 1970s provided the initial motivation for the shift to neoliberal policies. If the specter of class conflict inspired the Keynesian welfare state, the neoliberal policies of the 1980s were initially a reaction to the traumatic events of the 1970s, when stagflation and the failure of assertive government intervention discredited activist states more generally. Disillusioned by the failure of activist policies, political elites emerged from the 1970s looking for alternatives and open to the view that renewing market competition might be a better way of reviving economic growth. Of course, the subsequent reforms entailed assertive state action, but the common objective of the new policies was to increase the role of markets relative to states in the allocation of resources and to intensify market competition (cf. Gamble 1994; Vogel 1998).

The means for this shift were supplied by a "new classical economics" built on monetarist foundations. Although available in some form since the 1960s, monetarist perspectives remained a minority view until the 1980s, when they were assimilated into mainstream economic doctrine and succeeded by a wave of work built on rational expectations frameworks. By the middle of the 1980s, the result was an economic orthodoxy skeptical about the value of active macroeconomic management and convinced that countries face a "natural rate of unemployment" reducible only by structural reforms (Crystal 1979; Cuthbertson 1979; McNamara 1998). These doctrines gained credibility as they secured traction within the economics profession, and they appealed to politicians interested in shifting the blame for high unemployment from governments to markets. Party platforms on both the political left and right moved in neoliberal directions during the 1980s and 1990s (Cusack and Englehardt 2002; Iversen 2006).

However, in democracies, changes in the views of elites are rarely enough to explain major changes in the direction of policy (Hall 1993). We also have to ask: what happened in the realm of electoral competition to make the market-oriented policies of the neoliberal era feasible? The effects of those policies were adverse for large numbers of workers. They made jobs more insecure, reduced social benefits, and increased income inequality. Why did parties running on platforms opposed to those policies in the name of working-class defense not emerge and win elections?

In large measure, those policies seem to have been made possible by a fragmentation of the electorate. In the years after 1970, the electoral space of most western democracies became disorganized, in both ideological and institutional terms. Long-standing divisions, rooted in class or religion, lost their hold over the attitudes of the electorate. The most obvious indicator was a decline in the class alignment of the vote, but most important were corresponding changes in how people thought about politics (Dalton, Flanagan, and Beck 1984; Clark and Lipset 2001).[4] The result was a permissive electoral dynamics, in which durable electoral coalitions to promote neoliberal policies were rarely formed, and the opposition that might have been mounted to such policies was effectively undercut, allowing governments to pursue neoliberal agendas.

Three factors lie behind the declining electoral salience of class. The first is a familiar set of socioeconomic changes identified by Lipset (1964) long ago.

4. Whether the extent to which social class structures voting has declined is an issue hotly debated. Much depends on how class is measured and decline defined. My reading is that there has been decline in the dimensions relevant to this argument, but for a range of alternative views, see Manza, Hout, and Brooks 1995; Evans 2000; Elf 2007; Oesch 2008.

—-1
—0
—+1

Thirty years of prosperity improved the living standards of ordinary workers enough to reduce their sense of grievance vis-à-vis the upper classes. Shifts in occupational structure eroded class boundaries, as deindustrialization decimated working-class communities and employment in services blurred the lines once separating blue-collar and white-collar workers. Second, political developments were equally important. In some ways, the Keynesian welfare state was a political accomplishment that sowed the seeds of its own demise. Contemporary analyses emphasize the sense of entitlement that social programs create but neglect their ancillary effects on social democracy (cf. Pierson 1996). As social benefits became more generous, they eroded the material insecurity central to working-class mobilization. The welfare state was the historic achievement of postwar social democratic parties, even if they were not its sole sponsors; but once its programs were in place, social democracy was left without a distinctive political mission around which to mobilize.[5] On other fronts, reaction against the experiences of the 1970s discredited its interventionist stance. In many respects, the decline of the class cleavage was the reflection, as well as the cause, of the exhaustion of social democracy.

The third important factor was the appearance of a new cleavage, crosscutting the traditional left-right spectrum. This is the right-authoritarian/left-libertarian divide identified by Inglehart (1990) and Kitschelt (1997). On one side of it are those who embrace the post-materialist values promoted by decades of postwar prosperity and reinforced by the new social movements of the 1980s. On the other side are those attached to more traditional values, not only because of lingering material concerns but also in reaction to the cultural revolution of the 1960s. Of course, this cleavage is about more than values (Martinez-Alier 2003). In Europe, its salience was raised during the 1980s and 1990s by a reaction against immigration and the market initiatives of the European Union (EU), seen by many as threats to their material well-being (Kriesi et al. 2008). In the United States, it mobilizes many who associate post-materialist values with unpatriotic opposition to the military, disregard for religion, or sympathy for waves of immigration that are changing the racial complexion of the country (Carmines and Layman 1997; Frank 2004; cf. Bartels 2008).

This new cleavage is significant because it crosscuts the class cleavage in two ways. Because right-authoritarian voters are more likely to be working-class, it drove a wedge through the constituency that social democracy might otherwise have mobilized in opposition to platforms of neoliberal reform. Significant proportions of the European working class now vote for parties of the radical right.

5. For an alternative view that ascribes more importance to religious cleavages, see Manow 2001 and Van Kersbergen and Manow 2009.

Many Americans have been drawn away from the segments of the Democratic and Republican parties sympathetic to activist government. Moreover, by drawing a middle-class constituency of post-materialists to the Democrats and social democratic parties, this cleavage also undercuts the inclination of those parties to operate as parties of working-class defense, since middle-class voters are more likely to benefit from neoliberal reforms.

In sum, if the policies of the postwar era reflected a class compromise, born of electoral competition around the agendas of working-class parties, the policies of the neoliberal era have rested on a different politics, marked by class dealignment, rising electoral volatility, and a shift away from class-based political competition.

Cross-National Variation

In order to make comparisons over time, I have emphasized commonalities across the developed political economies during the Keynesian and neoliberal eras. Social and economic policy became more market-oriented during the 1980s and 1990s. However, we can also distinguish four different growth models in the recent period, based on how countries mobilized economic demand for their products and political consent for their policies. These differences bear emphasis because they significantly affect the dilemmas facing those countries today.

The first is a liberal growth model adopted with some variation in virtually all the liberal market economies described by Hall and Soskice (2001) but exemplified by the United States and United Kingdom. In these political economies already dominated by market competition, neoliberal reform went farthest (Hall and Gingerich 2009). Margaret Thatcher and Ronald Reagan took pioneering steps to intensify competition, privatize national enterprises, and contract out public services (Gamble 1994; Thatcher 2004). In high-profile battles with miners and air controllers, they broke the power of trade unions, and their successors tightened controls on social benefits with a view to turning "welfare" into "workfare."

For most of the period, such measures kept average real wages in these countries low, thereby promoting employment growth in services such as retailing, restaurants, tourism, and child care. Loose regulatory environments promoted job growth in finance and health care in the Unites States, where the financial sector was responsible for almost a third of all profits by 2008. The result was a "jobs miracle' " envied in continental Europe, but the distributive consequences were stark. At one point in the 1990s, almost a fifth of the U.S. labor force worked for wages and benefits lower than those available at the minimum wage in

France, and real median income stagnated while below-median incomes declined (Hacker and Pierson 2010). More than half of total growth in U.S. GDP over this period went to the top 10 percent of income earners.

The danger, of course, was that this approach would depress aggregate demand and make the mobilization of political consent for neoliberal policies difficult. However, the Anglo-American model spoke to these problems with deregulatory measures that promoted housing booms, an influx of cheap consumer goods from emerging economies, and unprecedented expansion in consumer credit (Crouch 2009). Thanks to a number of programs symbolized by federal support for Freddie Mac and Fannie Mae, the proportion of people owning their own home rose to 69 percent in the United States in 2008; and house prices in the United States and United Kingdom doubled between 1990 and 2008, giving many people the sense that their wealth was increasing even if their incomes were stagnant (Schwartz and Seabrook 2009; Rajan 2010).

An influx of cheap goods from Asia helped sustain purchasing power, and the opportunity to borrow freely became a crucial complement to the "privatization of risk" that was a feature of Anglo-American policy in this period (Hacker 2004). Credit cards and home equity loans were the safeguards that carried many people exposed to highly flexible labor markets through fluctuations in the economy and adverse life events. In these respects, loose financial regulation was a substitute for social policy (Schelkle 2010). Since the establishment of the Household Finance Corporation in the 1930s, Britain and the United States had pioneered the use of consumer credit, but between 1980 and 2008 American household debt expanded from about 70 percent to 122 percent of disposable household income (Trumbull 2012). This formula allowed these countries to run growth models led by consumer demand, even though median incomes were rising only slowly; and its wealth effects, however illusory, mobilized political consent for neoliberal initiatives whose acceptance is otherwise hard to explain.

In the coordinated market economies of continental Europe, such formulas were not available. Trade unions were more powerful and wage coordination so central to the strategies of firms that it made no sense to try to break the power of the unions, aside from marginal steps epitomized by the French Auroux laws (Howell 1992). Moreover, stronger traditions of social solidarity made it difficult for governments to mobilize political consent for neoliberal reforms. The solution, on which the governments of the European Community (EC) agreed, was to inflect their institutional architecture for a global age. The decisive innovation was the Single European Act of 1986 that transformed the EC from an association to promote free trade and agricultural protection into an agent for market liberalization. Although its member governments were always in the driver's seat, the move to qualified majority voting ensured that they could take shelter from the political flak generated by neoliberal initiatives behind the protective shield of EC action (Hall 2006).

Facing trade unions willing to defend wage floors, the European governments also had to find another approach to the creation of employment in services. As Esping-Andersen (1990, 1999) has observed, the Nordic countries developed a second growth model based on expanding public employment in health care, education, and child care, funded by high tax rates that depressed disposable income and thus limited the growth of private services (Iversen and Wren 1998). In keeping with the policy legacy of the Rehn-Meidner approach, they also operated "flexicurity" systems in which low levels of employment protection were combined with generous wage-related unemployment benefits to allow firms to rationalize in the face of global competition while still encouraging workers to invest in skills (Martin 1979; Estevez-Abe, Iversen, and Soskice 2001; Campbell, Hall, and Pedersen 2006). These strategies were highly successful.

The approach to the employment problem initially pursued in a third growth model adopted by the continental coordinated market economies such as France and Germany, which was to encourage exit from the labor force through early retirement, soon proved so costly that it was abandoned in favor of active manpower market policies, which subsidized the costs to employers of training or taking on new workers. By the 1990s, France was spending almost four percent of GDP on such policies, and active labor market policy had become a pillar of the EU's Lisbon strategy (Levy 2005). However, employment expanded significantly only when these countries developed secondary labor markets, by relaxing restrictions on part-time work and temporary contracts. Much as Japan had done earlier, these economies developed dual labor markets, marked by stable employment in the manufacturing or public sector and precarious employment often in private-sector services (Visser and Hemerijck 1997; Palier and Thelen 2010).

To mobilize political consent for such initiatives, these continental countries increased spending on social benefits, however counterintuitive that might seem to apostles of neoliberalism. By the end of the 1990s, French social spending had reached Nordic levels, and even after the Hartz reforms, the German welfare state remained generous. One of the characteristic features of European growth models is the extent to which taxes and transfers are used to offset the effects of earnings inequality on the distribution of disposable income (Kenworthy and Pontusson 2005).

The other constitutive feature of European growth models was the Economic and Monetary Union (EMU) established in 1999. The EMU was designed to bind Germany to Europe and counteract protectionist pressure building up in the European monetary system (Dyson and Featherstone 1997; Eichengreen

1997). Its "convergence criteria" forced firms in many parts of Europe to rationalize in the face of a new single market joined to relatively high exchange rates. Once established, however, the EMU induced a further bifurcation in growth models, between northern and southern Europe. At issue was the familiar question of how to ensure levels of demand sufficient to sustain investment and economic growth. Designed along neoliberal lines that gave short shrift to fiscal policy, the EMU provided no institutional mechanisms for the long-term coordination of fiscal policy across Europe, aside from a Stability and Growth Pact limiting national deficits to three percent of GDP. This arrangement privileged the member states capable of restraining labor costs in order to stimulate growth led by exports. Given their capacities for coordinated wage bargaining, the small states of northern Europe were well placed to implement such strategies of export-led growth; and over the ensuing decade, Germany, Belgium, and the Netherlands did so with considerable success (Katzenstein 1985).

By contrast, with labor movements divided into competing groups that could not readily coordinate wages, the countries of southern Europe were poorly equipped to pursue such strategies and can be said to have pursued a fourth growth model. Many, such as Portugal and Greece, lacked strong export sectors. In the short term, they were rescued from this dilemma by entry into a strong currency union awash in funds generated by Germany's trade surpluses. Led by the public or private sector, they used that bonanza of cheap credit to fuel domestic growth, centered on a construction boom in Spain, commercial lending in Portugal, and public spending in Greece. These were rational short-term responses to the prevailing incentive structure. In the longer term, however, this formula left southern Europe vulnerable to the kind of credit squeeze induced by the recession of 2008, which forced deflation on them when concern in the bond markets rose about their elevated levels of debt.

The Implications for Adjustment

What does this historical analysis imply for the contemporary politics of economic adjustment? The global recession of 2008–9 marked an inflection point in the neoliberal era. As large financial institutions collapsed and unemployment rose, many governments rediscovered the value of what has sometimes been called "emergency Keynesianism," stepping in with massive support for the financial sector and stimulus packages, but rates of unemployment in the Eurozone and the United States were still close to 10 percent of GDP in 2012. Governments faced continuing adjustment problems of substantial dimensions. How might national variations in their responses be explained? This problem can be approached as one of understanding the initial response to the crisis, the medium-term response, and the long-term prospects for more radical change in economic policies.

My analysis highlights the extent to which each nation's initial response to the crisis was conditioned by its institutional architecture. If recession floods the basement and financial crises set fire to the roof, the first reaction of governments will not be to tear the edifice down but to address their problems with the building materials on hand. Thus, the initial response of the governments of liberal market economies, where growth had long been led by domestic demand, was to expand consumer demand through cuts in taxation and increases in public spending, letting flexible labor and capital markets reallocate resources.[6] By contrast, in many coordinated market economies, the stimulus was designed to preserve existing jobs. This type of approach makes sense in countries whose manufacturing regimes depend on employees with high levels of industry-specific skills. In such regimes, firms need to retain skilled labor and, once lost, such jobs are difficult to recreate. Thus, key components of the German stimulus included a pioneering subsidy for automobile purchases (soon copied by other countries) that sustained employment in metalworking, and a large program of subsidies for short-time working so that employees in core manufacturing could be retained. Although widely criticized by the Anglo-American media, the German response was highly successful at preserving jobs.

One of the lessons of the 1970s is that governments are likely to revert, even in the medium term, to strategies on which they have relied in the past. In the face of stagflation with which Keynesian policies could not cope, the governments of the 1970s struggled to make those policies work for more than half a decade before moving to different strategies (Hall 1986, 1993). The medium-term strategies pursued by both the American and German governments conform to this template. From 2009 through 2011, the American government desperately tried to revive the housing market, arguably the source of the financial crisis, pouring billions of dollars into Freddie Mac and Fannie Mae in addition to subsidies for first-time homebuyers. Despite calls for fiscal discipline, the Bush-era tax cuts were extended, and the Federal Reserve Bank mounted two programs of "quantitative easing" worth more than $1 trillion to encourage lending, indicating a tolerance for inflation that has historically been one way to erode national debt.

The political structure of the United States encourages such an approach. Although nominally independent, the Federal Reserve Bank is sensitive to political pressure and hence inclined to target unemployment as well as inflation. A system

6. Initially, cuts in taxation figured more prominently in the response of liberal market economies, while the stimulus packages of coordinated market economies relied more heavily on public spending (OECD 2009b).

that combines undisciplined political parties, frequent elections, and unbridled campaign finance confers unparalleled political influence on business interests (Hacker and Pierson 2010). It is not surprising to find that tax cuts for the wealthy and subsidies to the financial sector figure prominently in the American response, accompanied by calls to cut social programs in order to finance them. Although tighter financial regulations have been mandated in the wake of the crisis, business retains enough influence to ensure those regulations do not significantly reduce the role of credit in the American growth model (Hacker and Pierson 2010).

In international terms, the American economy is also well placed to pursue growth led by consumer demand. A floating exchange rate allows the government to cushion adjustment by using depreciation to erode real wages rather than depending on domestic deflation to make such adjustments. The principal threat to such a strategy stems from the large reserves of American securities held by other countries. If they were to develop a sudden reluctance to hold American assets, a precipitous decline in the dollar could make adjustment painful. However, China has no incentive to pursue such a policy and few substitutes for American securities. The more likely scenario is one in which depreciation gradually erodes the purchasing power of American consumers without plunging the economy into another recession: by 2011, the real value of the dollar in trade-weighted terms had already fallen to its lowest level since the dollar was floated in 1973.

Across the Atlantic, the German government also reverted to a familiar strategy, built on export-led growth in manufacturing that takes advantage of Germany's formidable capacities for wage coordination and the strong demand for capital goods from emerging economies. The government modified this strategy slightly in 2010 by encouraging a large wage settlement in metalworking in order to fuel domestic demand during a year of multiple state elections and, since the Hartz reforms of the early 2000s, employment has been increasingly reliant on part-time jobs. But the striking feature of continuity in German policy was the government's refusal to treat Germany's trade surplus as a problem for Europe and its insistence that fiscal discipline, rather than coordinated reflation, was the only way to resolve the crisis in the Eurozone.

Although this stance was of dubious value from a European perspective, it was conditioned by the institutional structure of the German political economy. Demand-led growth is difficult to inspire in an economy dominated by a manufacturing sector dependent on unionized workers with high levels of industry-specific skills. On the one hand, expansionary fiscal policies encourage wage settlements that threaten the competitiveness of the export sector at the core of the German economy. On the other, even in the context of expansion, the German savings rate tends to remain high, because workers with industry-specific skills worry that equivalent jobs would be hard to find if they were to become unemployed (Carlin and Soskice 2009). Germany's view of what is best for Europe has been driven by its view of what is best for Germany; and just as the American government was influenced by a powerful financial sector, the German government has remained in thrall to export-oriented manufacturing.

What does this analysis imply about the longer-term prospects for more radical changes in policy? I have argued that the transitions to both the Keynesian and neoliberal eras required motivation, means, and a motor. Do we see those elements in the current conjuncture?

The search for new policies that marked the advent of the Keynesian and neoliberal eras was motivated by widespread perceptions that existing policies had failed. The sense of failure present today varies across countries, largely in line with how they have fared in the wake of the recession. High levels of unemployment trouble Americans, but similar levels in Europe during the 1980s and 1990s induced only incremental changes to policy. If the United States settles into a decade of sluggish growth, pressures for more radical shifts in policy are likely to mount. Recall that it took almost a decade for the Keynesian consensus to unravel in the 1970s.

In some other countries, such as Greece, Spain, Portugal, and Ireland, where up to a fifth of the workforce has been unemployed, the effects of the recession have been devastating enough to motivate a search for new policies. But their governments are currently constrained by pressure from the bond markets and the deflationary conditions attached to rescue packages from the EU. Reflecting standard neoliberal doctrines, the latter were imposed by governments in northern Europe, which have seen few reasons to change direction because their economies recovered relatively rapidly from the recession. EMU itself clearly failed and is being reconstructed. However, there is no consensus about what precipitated the failure or what reforms will rectify it. Many northern Europeans cling to the view that the crisis of the euro was caused by the fiscal profligacy of southern European firms and governments, while others point to the structural asymmetries in the political economies of the member states. Efforts to reform the EMU have been correspondingly slow and disjointed (Baldwin, Gros, and Laeven 2010). Although the capacities of the EU to enforce fiscal rules and to subsidize the debt of its member states are being reinforced, it remains to be seen whether the EU will acquire the capacities for coordinated reflation over the medium-term that are arguably more important to its future. Here, too, much will depend on the continent's growth trajectory. Unless deflation in southern Europe significantly depresses the economies of northern Europe, consensus on a new growth strategy is unlikely to emerge.

Equally important to dramatic shifts in policy is the matter of means. The transitions to the Keynesian and neoliberal eras were made possible by the availability of new policy paradigms with appeal for politicians and credibility among economists. It is illuminating to compare the British governments led by Edward Heath and Margaret Thatcher. Both entered office determined to make radical changes to the course of policy, but Heath soon retreated, in no small part because he lacked the alternative policy paradigm that Thatcher had in the form of monetarist economics, which had substantial support among economists by the time she became prime minister (Hall 1982). Although the current recession has discredited some of the tenets of neoliberalism, such as the efficient markets hypothesis, there are still no alternative paradigms available with sufficient credibility among economists to constitute clear alternatives to the "new Keynesianism" that has been guiding policy for some years (Fox 2009).

Thus, debate has been concentrated between those who favor a sustained fiscal stimulus directed at unemployment and others who are concerned to reduce the sizable debt burden left in the wake of an initial stimulus; and the latter have had the upper hand. In the emerging economies, there is renewed interest in the doctrines associated with a developmental state. But in both Europe and North America, widespread support for large programs of public investment substantial enough to have a major effect on unemployment has been notably absent.

Movement in that direction cannot be ruled out, since the oft-repeated injunction that "structural reform" is the only way to promote higher growth is largely empty. Making competition in product markets more intense and employment less secure may improve the competitiveness of some economies, but it is unlikely to build a strong export base where one is lacking. In this respect, the managers of the euro look increasingly like defenders of the gold standard during the 1920s. The dominant motif of policymaking in the OECD has been confusion, among officials torn between the desirability of sustaining demand and the dictates of international bond markets urging fiscal prudence. Nothing illustrates that better than the divergence between American and British policy in 2009–11. The default option has been fiscal tightening amidst monetary easing, which sustains the financial sector but does little to address the immediate hardships suffered by the unemployed and others on low incomes.

I have argued that radical shifts in policy also depend on the character of partisan electoral competition. What are the coalitional possibilities today? Many hope that economic recession will swing the political pendulum to the left, ushering in more interventionist policies, as the depression of the 1930s did in the United States and Sweden (Gourevitch 1986). But, in politics, there is no Say's law: economic crisis does not necessarily inspire political mobilization, let alone effective mobilization on the political left. The secular socioeconomic changes that undermined class boundaries have not disappeared, and the neoliberal era has seen new conflicts of interest arise inside the working class, between "insiders" and "outsiders" and older and younger generations (Chauvel 1998; Rueda 2005).

Thus, the main effect of the crisis has been to inspire a *sauve qui peut* politics that eschews redistribution, as everyone lobbies to retain what they have at the expense of others (Alt 1979). Where economic recovery is improving the security of those who have jobs, while leaving others unemployed, it is gradually translating economic dualism into political dualism. The Tea Party, for instance, ranges older Americans defending their Medicare and Social Security benefits against those seeking more social support for the young and unemployed (Palier and Thelen 2010; Skocpol and Williamson 2011). In similar ways, successive attempts to resolve the euro crisis have been stymied by the efforts of the relevant actors to ensure that others pay the costs of adjustment.

In this context, the dominant motif of politics has been dissatisfaction with the government in power whatever its partisan complexion. Deep recessions typically inspire a reaction against the governments of the day. Virtually every government in office during the recessions of the 1970s was turned out at the next election. Contemporary governments face a similar backlash from electors outraged that many of the financial institutions seemingly at the root of the crisis have been rescued, while their neighbors paid the costs of recession in the form of lost jobs or higher impending tax burdens. Seventy-seven percent of Americans have indicated they are "frustrated" or "angry" with the federal government (Pew Research Center Survey, March 11–21, 2010, Q. 20). The result is a diffuse discontent, visible in Ireland, in Länder elections in Germany, in the American Tea Party movement, and in Britain where a government committed to social justice was turned out for one committed to fiscal austerity. The corollary has been growing hostility to immigration, born of the nativist reactions that recessions typically fuel.

How this discontent will play out is dependent, to some extent, on electoral rules. Social progressives have applauded systems of proportional representation because they are more likely to elect redistributive coalitions (Iversen and Soskice 2006). However, those are the politics of good times. Amid hard times, proportional representation is no longer so clearly an advantage, as Weimar demonstrated (Abraham 1988). This crisis is moving voters to the radical right and left of the political spectrum. Under systems of proportional representation, that increases the vote for smaller parties on the political extremes, making it more difficult for mainstream parties to retain control of governments and forcing some into fragile coalitions with some strange bedfellows. This makes for an unpredictable and indecisive politics. Even majoritarian systems are betraying such strains, visible in unprecedented ideological polarization in the United States, coalition government in Britain, minority government in Canada, and significant support for the Front National in France.

In sum, although discontent with governing parties is palpable, new electoral coalitions offering alternative policies are not yet in sight. Meanwhile, producer group politics goes on as usual, conditioned by each country's distinctive economic model. Although the financial sector faces heavier regulation on both sides of the Atlantic, its strictness is still in doubt as the details are negotiated. The United States and Britain continue to argue for latitude on behalf of their financial *entrepôts*, while the governments of continental Europe generally favor more restrictive regulation. The striking feature of these negotiations is the determination of each government to preserve the advantages of its own firms (Clift and Woll 2012). Although lending is likely to be less expansive in the next decade, the era of finance capitalism is far from over.

Moreover, the crisis does not as yet seem to have thrown national varieties of capitalism off course. Although the crisis initially brought more assertive state intervention, the liberal market economies continue to pursue growth models based on highly flexible labor and capital markets. Thanks to continuing growth in the emerging economies, the coordinated market economies of northern Europe recovered well based on classic export-led growth strategies. However, the euro crisis has left the southern European economies in disarray and a question mark hanging over Europe: Can the Eurozone prosper without a balanced growth strategy that entails more expansion of domestic demand in northern Europe and some kind of coordinated reflation in the south? To date, the German, Dutch, and Finnish governments have refused to move in that direction, but the result is hardly a stable equilibrium. The draconian deflations imposed on southern Europe are inspiring deep political discontent and a backlash against the European Union that could plague the continent for some years.

However, these are still early days from which to identify the political fallout from this economic crisis. As Peter Gourevitch (1986, 239–40) reminds us, there is an intrinsic openness to politics at such conjunctures. As governments look for new ways to cope with new problems, this crisis will inspire experimentation with new policies, as earlier crises did in the 1940s and 1970s. In the Eurozone, that process is manifestly under way. In many countries, the politics is complicated by the simultaneous emergence of demands to create jobs and to reduce debt, which have set in motion intense conflicts about who is to pay the costs of adjustment. That politics calls for complex bargains, not only across sectors, but across countries and generations, in which the already tenuous capacities for redistribution of many political economies are at stake.

In sum, the political tail of this crisis has not yet stopped wagging. This account yields an explanation for the initial response of governments to the recession and a cautionary tale about whether it will usher in radical changes to policy. The ultimate lesson, however, is that in order to find durable new paths for policy, governments have to address not only the economic dilemmas of our time but also the problem of assembling political support in electoral arenas beset by tides of discontent. History suggests that any new economic formula will have to be rooted in a corresponding political formula and that has yet to emerge in any of the developed democracies.