

PO230 States and Markets: An Introduction to International Political Economy
Seminar Week 16. Neoliberalism Theory and Practice

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Why did the Great Depression happen?

The Keynesian explanation vs the Neoliberal explanation

Friedman and Schwarz:

- The Great Depression was not the necessary and direct result of the stock-market crash of October 1929, which they attribute to a speculative investment bubble. The popping of the “bubble” may have been instigated by the Federal Reserve’s raising of the discount rate—the interest rate the Fed charges on loans to commercial banks—in August 1929.
- Friedman and Schwartz accepted that the bubble was caused by investors, seemingly endorsing—at least partly—the Keynesian “animal spirits” explanation.
- The economy could have recovered rather rapidly if only the Fed—the central bank of the United States—had not engaged in a series of disastrous policies after the crash.
- Bank runs increased exponentially in December 1930—in that single month 352 banks failed. Most of the failing banks were in the Midwest. Rather than providing liquidity through loans, the Fed just watched as banks dropped like flies. As Milton and Rose Friedman wrote in *Free to Choose*: “The [Federal Reserve] System could have provided a far better solution by engaging in large-scale open market purchases of government bonds... In the main, it stood idly by and let the crisis take its course.”

Why was the Fed asleep on the job?

Great Depression and policy failures pointed out by Friedman

- 1) In response to a sharp decrease in tax revenues in 1930 and 1931 (caused by a slowdown of economic activities), the federal government passed the largest peacetime tax increase in the history of the United States, which clearly applied the brakes on any recovery that could have taken place.
- 2) Smoot-Hawley Tariff Act in 1930
- 3) the government also instituted all sorts of “public works” programs, beginning under Herbert Hoover and increasing dramatically under FDR; the programs removed hundreds of thousands of people from the labor market and engaged them in economically wasteful activities, such as carving faces of dead presidents into the sides of a mountain, preventing or delaying necessary labor-market adjustments
- 4) Another federal policy that prevented (labor and other) market adjustments was the price and wage controls enacted under the National Recovery Administration and in effect from 1933 until 1935 (when ruled unconstitutional); this policy massively distorted relative market prices, impairing their ability to function as guides to entrepreneurs
- 5) the Fed was not blameless after 1933 either. It increased bank-reserve requirements in three steps in 1936 and 1937, leading to another significant decrease in the money supply. The result was the 1937–38 recession within the Depression.

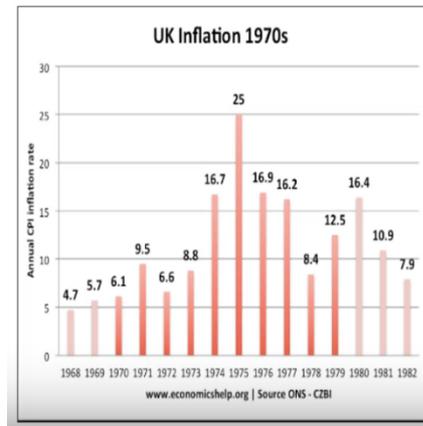
(See <https://fee.org/articles/the-great-depression-according-to-milton-friedman/>)

“Great Depression not caused by unfettered market forces”. Discuss.

What is neoliberalism?

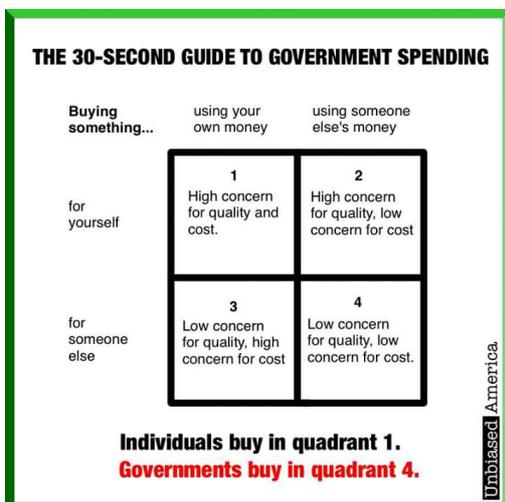
Other explanations? Depoliticization and dedemocratisation at the core of Neoliberalism? (Stahl 2020)

- “A critique of the economic activity of the state has been at the core of the neoliberal wave but overt focus on the size or power of the state obscures the logic of the neoliberal turn



within macroeconomic theory. What is disguised is primarily the issue of democracy and popular participation in the shaping of macroeconomic policy.”

- New Classical Macroeconomics (NCM): In their attack on the Keynesian demand management of the postwar era, they critiqued the lack of predictability and consistency associated with the democratic setting of macroeconomic aims, and advocated for the replacement of political discretion with a set of restricted policy rules.
- The neoliberal critique of government is not government in an abstract general form, but rather the specific form of distortion of the market economy that arose in the postwar era. All these perceived distortions were the result of democratic influence on economic decision-making.



What is the optimal neo-liberal relationship between State and Market?

Hayek challenged the view, popular among British Marxists, that fascism (including Nazism) was a capitalist reaction against socialism. He argued that fascism, Nazism and socialism had common roots in central economic planning and empowering the state over the individual.

What is the “Washington consensus” and is it a useful economic strategy?