Neo-liberalism: What Is It? What Is Wrong with It? What Next?

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For the last four decades, we have been watching a new animal called neo-liberalism. At first, we did not know what it was; we hoped that it would bring global prosperity; we thought that the deregulation would be a blessing for the businesses, we hoped that the IMF doctrine of structural adjustment would strengthen the economies of developing countries; we imagined that the privatization of public corporations would improve the efficiency of the national economy; we wanted to believe that the free trade agreements would make us happier.

But, the doctrine of neo-liberalism has turned out to be a disappointment for many; it appears to be a blessing only for a few. Its performance has betrayed our hopes and expectations; it is so bad that it even threatens the very survival of the healthy free-market capitalism; its failure is so serious that we are now looking for new economic doctrines.

In this paper, I intend to share with the readers my honest concern for the future of neo-liberalism and the survival of the free-world capitalism. I am asking these questions. What is neo-liberalism? How destructive is it? What are the alternative doctrines?

1. What is Neo-liberalism?

The developed economies, especially the U.S. economy, enjoyed rapid economic growth during several decades following the World War II, mainly due to the vast reconstruction of war torn social and industrial infrastructure and the production of civil goods and services which was not easy during the war.

However, by the end of the 1960s, the process of the reconstruction of infrastructure was almost completed and the shortage of goods and services for civil use was solved. In other words, the rate of economic growth of the economy slowed down. This meant declining profit for businesses and it was a challenge for businesses to deal with. To make the matter worse for the business, the oil crisis of the 1970s shot up the cost of production and provoked decade-long inflation and at the same time, rising unemployment, that is, the world had to cope with "stagflation".

Stagflation is one of the rare economic phenomena observed in the free-market economy. When stagflation happens, inflation and wide spread unemployment occur at the same time. In normal cyclical variations of the economy, inflation is accompanied by employment increase.

Suppose that a large number of immigrants come into the country or the income of citizens rises so that the demand for housing and other goods and services increases. The result is the increase in the price of goods and services. If the cost of production does not increase as much the price increase, the expectation of profit improves; the producer will expand the production and create more jobs. In other words, inflation goes with job creation and GDP growth.

But, if inflation caused by the demand increase is accompanied by increasing unemployment, something is wrong. This is the stagflation and it happens when the supply of goods and services does not increase along with inflation. This happens when the inflation is caused by the increase in the cost of production more than price increase,

The decade of the 1970s was an era of stagflation in the U.S. To understand what happened we have to go back to the period of 1960s which was the decade of President Johnson's heavy spending on welfare and war resulting in increased demand for goods and services. The period of 1960s was the decade of Lyndon Johnson's (1963-1969) "The Great Society" of equality and prosperity.

The period of 1960s was also a decade of heavy spending for the Vietnam War. The heavy spending of the government led to the expansion of demand for goods and services. But industries were not able to produce consumer goods and services rapidly enough meet the rising demand. The end result was inflation caused by increasing demand; it was the demand-pull inflation.

Then, in 1973, the oil embargo by the Organization of the Petroleum Exporting Countries (OPEC) shot up the oil price provoking cost-push inflation. The 1973 oil crisis provoked a grave recession in 1974-1975. The GDP in the first quarter of 1974 fell by 3.4% compared to the same period of the previous year. In the first quarter of 1975, the GDP fell by 4.8%.The rate of unemployment was as high as 9%. At the same time, the price of consumer goods and services rose by 12% in 1975. This was how the U.S. had to cope with a brand new strange phenomenon called stagflation unknown in the past.

Hoping to get out of the recession, the Federal Reserve Board increased substantially the money supply; the money supply rose by 10% in the period 1970-1974 compared to an average money supply increase of 4% in the 1990s. The money supply was designed to fight the recession; the expansion of the money supply was additional factor for the inflation of the 1970s.

In short, the inflation of the 1770s was the combination of the three types of inflation: the demand-pull information, the cost-push inflation and the money supply-led inflation

Despite the price increase, the companies did not increase production and create new jobs. There were two main reasons. First, when inflation goes beyond a certain level, the future prospect of profit becomes uncertain and the producer waits and would not increase investments. Second, President Richard Nixon (1969-1974) imposed price control; in 1970, he introduced the ACOLA (Automatic Cost of Living Adjustment).

Moreover, Nixon raised tariffs on imported goods. To make the matter worse, after the removal of the U.S. currency from the gold standard regime, the value of the American dollar fell. The end result was the higher cost of getting imported parts and components.

The combination of these factors made industries to hesitate to invest, hire more people and produce more goods and services. Here you are. You have your stagflation.

In a way, the stagflation of the 1970s was partly the fault of the government policy, but the private sector was not entirely free from blame, for they could have better responded to the increased demand for goods and services brought about by Johnson's expanded public spending related to his Great Society policy.

This unusual phenomenon has stirred up heated controversy over the selection of better economic doctrines and policy measures. The economic doctrine which had ruled the economic thought during two postwar decades was the Keynesian doctrine. In 1937, a British economist John Maynard Keynes published a book called "The General Theory of Employment, Investment and Interest" in which he proposed policy measure to combat economic recession; this was the Keynesianism.

The structure of national demand may be expressed in terms of a simple equation: $Y= C + I + G + (X-M)$: Y represents GDP, or national demand; C, household consumption expenditure; I, companies' investment expenditures; G, government expenditures; X, value of exports; M, value of imports.

Suppose that the economy is suffering from severe recession and that the government is looking for measures to overcome the recession. Of these five variables in the above equation, all the four variables, except G, belong to the decision of the private sector; they are beyond government's direct control; the only variable which can be controlled directly by the government is its own expenditures, G. Hence, the best way of overcoming the economic recession is the expansion of government expenditures.

The controversy was about whether the Keynesian remedy can solve the stagflation. The experience of stagflation of the 1970s has made a large number of economic think tanks, academics and politicians began to look at the freer private market as being better equipped than the government for the solution of economic problems. This was the theoretical justification for making the private market freer and even more liberal than the previous liberal private market. In other words, they were looking for new (neo) liberalism.

There is a basic difference between Keynesian remedy and neoliberal remedy of solving economic recession; the former relies on the demand side of the economy, while the latter, on the supply side. In fact, the postwar neo-liberalism is sometimes called the "supply-side economics"..

The neo-liberalism was boldly applied by British Prime Minister, Margaret Thatcher and U.S. President Ronald Reagan in the 1980s. However, it was more formally structured by the concept of "Washington Consensus" by John William of the Institute of International Economics in Washington. William suggests ten points for the solution of economic problem.

Of these ten points, some are relevant to neo-liberalism; they are tax cuts for firms, smaller government, free-market determined interest rate, competitive exchange rate, trade liberalization, liberalization of foreign investments, privatization of government-owned enterprises, and deregulation. There is one more part in the Washington Consensus, namely the Structural Adjustment Policy conceived by the International Monetary Fund (IMF) imposed on countries indebted to the IMF.

All of these measures are designed to minimize government interventions in national economic matters. But, a more important point is that they are in fact designed to let the private enterprises to make as much profit as they can without government interference.

In the final analysis, these measures allow the human greed to rule the economy. Why not? After all, the greed is the most powerful motivational factor of hard work; but, it is at the same time, the most devastating factor of immorality and the merciless exploitation of the weak.

The world led by unbound human greed ends up by destroying itself.

There is one more instrument in the tool bag of neo-liberalism; it is the system of Structural Adjustment imposed by the neoliberal policy makers, especially the International Monetary Fund (IMF); this measure requires, as the condition of IMF loans, the transformation of the debtor country into neoliberal free market system economy.

2. What is wrong with neo-liberalism?

In this section, I will deal with the impact of the following neoliberal measures: deregulation, privatization, free trade and structural adjustment and the global production chains.

2.1 Deregulation

The measure of deregulation affects a host of sectors of the economy. The deregulation of the entry of new firms, foreign investments, labour unions and a host of other deregulations are all designed to minimize government interventions and let the private firms to make more money..

One of the most important deregulation is the removal of regulations designed to protect labour union rights. This type of deregulation is expected to produce labour flexibility; this means restriction of unionization of workers, abolition of minimum wage and prohibition of labour strike. The end result of labour related deregulation is lay-offs, increase in part-time works and inequitable income distribution.

The most devastating deregulation is that of national and international finance. This deregulation is truly one of the key elements of the neoliberal regime. It has allowed the global integration of finance on the one hand and, on the other hand, it has permitted the creation of unlimited range of financial products. Moreover, under the neoliberal regime, the international mobility of funds has no barriers.

The trouble is that these mobile funds are not development funds but highly speculative funds. In fact, the Asian Financial Crisis of 1997 initiated in Thailand was caused by the sudden flight of speculative funds.

What is more troubling is the emergence of diverse financial products. Many of these products are the securitized financial products (derivatives) such as the mortgage-backed securities (MBS) which are debts transformed into assets. The securitized assets can be further securitized and, as the securitization goes on, the quality of the assets decreases and the risk of default rises. In fact, the global sub-prime financial crisis of 2007 was caused by the multiplicity of securitized assets.

The main reason for the multiplication of financial products is low production cost of the asset and high profit. The attractiveness of these financial products is so great that the amount of funds invested in these products is of much greater amount than funds invested in the production of consumption goods and related services. It is why it is difficult for real good producers to acquire funds.

In the normal situation, the financial sector must serve the real sector which produces goods and services, but because of the deregulation, the former rules the latter.

2.2 Privatization of Government-Owned Enterprises (GOE)

The privatization of GOE is the core of the neoliberal regime. In fact, the idea of privatization was so popular in the 1990s that the World Bank devoted important human resources to study the privatization of SOE in Easter European countries which had been parts of the Soviet Union.

However, countries of democracy and free-market including South Korea also undertook massive privatization of SOEs. The privatized SOE are often those enterprises which are responsible for the production of public services such as transportation and telecommunication. The privatization of SOEs raises several problems

First,the rational of the justification of privatization is the argument that the government is less competent than the private enterprises in managing businesses. The usual criterion of efficiency is the rate of profit. The profit of an enterprise can increase either by good planning and management of production or by cutting the cost of production. But, in many cases, the profit is increased not through good management but through the cut of labour cost. In most of the cases, the efficiency of the privatized firms come from the decrease in labour cost obtained through lay-offs, use of part-time workers and the cut of wages

Second, many of the privatized companies are those which produce goods and services that are basically public goods and services such as hospitals, public transportation, telecommunication and highways. The proper criteria for the evaluation of their performance cannot be efficiency measured by profit but it should be measured by public welfare.

Third, once the SOEs are privatized, the government has no more control over the companies which have bought the SOE. We must remember that the reason for buying the SOE being profit, the price of privatized goods or services will rise and the quality of the service might worsen. In this game of privatization of the SOE, the losers are the government and the citizens; the winners are large corporations which are often friends of corrupted politicians, high-ranking civil servants and “leaders of the society”.

Fourth, the privatization further worsens the corruption culture. In South Korea, until 1980, the government could control the Chaebols such as the group Samsung and the group Hyundai through, among others measure, the generous “policy loans”. But, from the 1990s, the wind of neo-liberalism swept over South Korea and the government gave up any hope of controlling the Chaebols. This happened when South Korea had to liberalize the financial sector allowing the Chaebol to have unlimited access to international funds. At the same time, the government stopped the practice of policy loans which had been, in fact, the best way of disciplining the large corporations.

From there on, it was rather the Chaebols which started to dictate the government policy; this was how the conservative government-Chaebols collusion became the every-day collective life in Korea. This collusion transformed itself into the culture of corruption in which the income of privatized corporations was shared between the corruption partners.

The Korea Telecom (KT) was privatized; since its privatization, its priority shifted from the telecommunication business to the horizontal integration of unrelated businesses in order to make money through dubious ways. To protect itself from possible investigation by the authorities, it appointed a large number of "advisors" who were former ranking civil servants, prominent politicians, former judges, former prosecutors and "leaders". These people do nothing for the company but get every month several thousand U.S. dollars. The similar phenomenon happens in the case of the Pohang Iron and Steel Company (POSCO) which was also privatized company; it used to be and is one of the largest steel producers in the world.

2.3 Free Trade

In the university class room of economics, free trade based on "comparative advantages" has been the Bible of economics. But this theory is based on the assumption that there are no trade barriers such as tariff and non tariff restrictions. But trade barriers have been necessary in many cases, especially at the early stage of the take-off of the economy. For instance, as happened in South Korea, in the 1970s, the import substitution policy was needed in order to create a solid basis for the industrialization.

The Washington Consensus requires the total elimination of all trade barriers through the intervention of the WTO and countless free trade agreements. In these days, rare are the countries which have no free trade agreement. As soon as the free trade agreement is signed, more than 80% of goods traded are free of tariffs. It goes without saying that free trade agreements offer some advantages.

For instance, there are several econometric estimates of the benefice of the free trade agreements; the GDP can increase as much as 0.5% and the value of exports of goods can rise, in some cases, by more than 50% over the period of tariff elimination. There is also the welfare benefit made possible by the decrease in the price of imported goods and services. In the case of Canada-Korea free-trade agreement, it is about 3 billion Canadian dollars available to both Koreans and Canadians combined.

But, the reliability of these estimates is debatable in view of simplistic assumptions used for the estimation. One of the principal shortcomings of these econometric estimates is the lack of considerations for the negative effects of increased imports on the national economy.

The free trade imposed by the Washington Consensus has the following issues to be tackled: benefits of tariff removal, absence of the trickle-down effects, negative effects on SMEs, worsening income distribution, the Industry State Dispute Settlement (ISDS) system.

2.3.1 Benefits of Tariff Removal

There is no doubt that the removal of tariffs would facilitate international trade. But, the beneficial effect is controversial. In the first place, the negotiations of free trade agreement are undertaken in secret and led by exporting companies. Hence, the negotiations are not undertaken between governments; they are undertaken between large corporations through government negotiators. As a result, the choice and the timing of goods selected for tariff removal is made for exporting companies. This is not necessarily good for the overall economic growth of trade partner countries. The more serious problem is that advantage coming from the tariff removal is short lived. You must remember that as free trade is generalized so that tariffs are all removed, exports of goods no longer depend on trade barriers but on real competitiveness.

2.3.2 Absence of Trickle-Down Effects

There are two ways by which exports of goods and services contribute to the national economy: growth of the economy and its trickle-down effect. The trickle-down effects comprise the creation of jobs and fair income distribution.

There is no doubt that the exports of goods and services make the GDP grow; the greater the weight of exports in the economy, the greater will be its GDP contribution. However, such contribution tends to decrease because of two reasons.

First, an increasing part of the value of exports is more and more of foreign origin. In the case of South Korea, more than 40% of the value of exports of goods is of foreign origin. Second, the production of goods exported relies more and more on the advanced technology which kills jobs. The combination of these factors tend to minimize the trickle-down effects of the exports of goods

2.3.3 Negative Effect on SMEs

In many countries, exporting companies are usually of fair size and close to the government and those who have power. This is especially so in South Korea and Japan.

The pro-large corporation and pro-export policies of many governments have resulted in the prevention of the healthy development of the SMEs for two reasons.

First, in order to take advantage of good opportunities offered by the free-trade agreements, the government allocates a major part of financial and fiscal resources to the exporting companies, namely, the Chaebols in the case of South Korea; this has been one of the major factors responsible for the under-development of SMEs. Another reason is Chaebols' unfair treatment of SMEs which are their sub-contractors. A sample survey shows that 30% of SMEs claim that the quality of products asked by the Chaebols is too high given the product price paid by the Chaebols. According to 53% of SMEs, the Chaebols do not pay what is due in time. Almost 25% of the SMEs complain that the Chaebols change the contracts without prior consultation with the subcontractors

There are almost 4 million SMEs in Korea; they account for as much as 99.9% of the total number of firms, account for 85% of jobs. The under-development of SMEs means therefore the difficulty of job creation and the unfair income distribution. Thus, free trade agreements have been one of the factors which prevent the normal healthy development of SMEs and job creation.

2.3.4 Unfair Income Distribution

The export friendly policy has another serious problem; it worsens the fairness of income distribution. The exporting companies use more and more labour- cost-saving high technology to be competitive. The exports of goods generate the labour income and the capitalist income. As the exports increase, the gap between these two types of incomes widens. In fact, according to the official data in South Korea, in recent years, labour income has not increased or decreased, while the capitalist income rose by more than 15%.

The trend of the widening income disparity is a universal phenomenon. But, before the coming of the Washington Consensus, the government intervened to narrow the income gap through the progressive income tax and the transfer payment. Unfortunately, under the neoliberal regime, the government is powerless, because the large corporations dictate the government policy. This was especially pronounced in South Korea under the conservative government which has ruled South Korea for 58 years out of 70 years since WWII.

2.3.5 The Industry State Dispute Settlement System (ISDS)

One of the troubling aspects of free trade agreements is the ISDS. This is a mechanism of settling disputes between the host government and foreign corporations which are investing in the areas of natural resource development and even public utilities. If the corporation thinks that it has lost profit because of the host government's interventions, the arising dispute is settled through a "tribunal" composed of representatives of parties concerned.

Canada is one of the countries which have lost most in the ISDS. Within the NAFTA (North American Free Trade Agreement), Canada lost 6 cases of disputes paying US $171 million. The U.S. won 11 cases; it has won all the cases. In most of the cases, Canada has lost by trying to protect the environment and public welfare.

The Canadian government did put a ban on the export of toxic PCB wastes. S.D. Myers, an American Co. waste disposal company sued the Canadian government and got US$ 6 million. The Canadian government applied guidelines for foreign offshore oil investments. The U.S. oil giant Exxon Oil sued and got US$ 17.3 million. Canada imposed a ban on the import of MMT a gasoline derivative. Canada was sued by Ethyl Corporation, an American Company, and Canada lost US$ 15 million. One can go on and on illustrating how Canada could have been prevented from protecting its environment because of the NAFTA's ISDS.

The ISDS has the following problems. First, it seriously challenges the sovereignty of the host country in resource development and environment protection. Second, the tribunal of the ISDS is composed of the representatives of parties involved in the dispute who are not always those who know international laws and the tribunal may come up with unjust judgment. Third, to the extent that the process of the ISDS is highly political, the corporations of militarily and diplomatically dominating nations may have upper hand and get the better deal. In fact, it is a known fact that corporations from North America are known to be bullying the governments of developing countries.

2.4 The Structural Adjustment

The structural adjustment policy of the IMF is the condition of loans and it is applied without proper considerations for cultural and political conditions of the debtor countries.

The policy of Structural Adjustment is designed to facilitate the debt repayment. It has two main parts. First, it requires harsh fiscal discipline; it requires drastic cut in public spending and balanced budget. This measure ends up with deep cut in welfare spending; this makes citizens' life miserable, a life which is already hard to cope with. Second, it requires harsh monetary policy leading to very high interest rate which invites inevitably mass unemployment and wide-spread bankruptcies of firms. In the 1997 crisis in South Korea, interest rate was as high as 20%. Third, the value of the national currency fell to the bottom from about 1,000 Korean Won per American dollar to 1,700 Korean Won

These measures have led, in South Korea, to the dreadful bankruptcies of several thousand firms, galloping inflation, massive unemployment and deep recession. But, South Korea could pay back the debts before the debt maturity date owing to solid macroeconomic environment and heroic devotion of the population. We still remember how millions of ordinary Koreans donated gold wedding rings, gold necklaces and other small gold items in order to facilitate the debt repayment

2.5 Global Production Chain (GPC)

The free trade agreement has allowed major multinational corporations (MNC) to acquire, at low cost, raw materials, parts and components from developing countries and assemble them into finished goods to be exported to advanced countries. This is the global production chain.

It is true that this process allowed developing countries to increase GDP and exports of goods and services. But, it has two problems. On the one hand, these countries have to keep wage as low as possible, otherwise, the production chain moves to another country of lower wage. Thus, the host country has the risk of being caught in the prison of poverty. On the other hand, since the GPC is not integrated into the overall local economy, its impact on the sustained development of the host country economy is very limited.

3. What Next?

The Washington version of neo-liberalism is, in reality, not a new liberalism; it is going back to the 19th-century laissez-faire regime in which the strong exploits the weak. In the laissez-faire regime, the market is governed by the “invisible hand”; it is the hand of price mechanism. Whenever there is demand-supply gap and the price departs from the original equilibrium position, the invisible hand intervenes and the original equilibrium price is restored. The invisible hand insures, in theory, the establishment of the market stability.

But, in order that the laissez-faire system works, the market should be one of perfect competition. To have such competition, the market should be perfect in such a way that there should be a great number of producers; there should be neither monopoly not oligopoly; the goods should be perfectly mobile; both the consumer and the producer should have perfect market information; the goods should be homogenous and perfect substitute. What is important is that there should be no government. But, the reality is far from being such a perfect market.

It is true that the invisible hand works, but it works with crooked fingers in such a way that the market equilibrium may not be secured.

We need the free market but we need also strong government.

Our experience with the neo-liberalism makes us to re-examine the meaning of the success of economic doctrine and economic policies. Up to now, we have been focusing, as criteria of such success, on the GDP growth; most of the international organizations including the World Bank, the IMF, OECD and others evaluate the performance of national economies in terms of GDP growth.

But, is this really the right way of judging the economies? What we have learned from living with neo-liberalism is that we need another criterion for judging the performance of national economies; it is the fair distribution of income. Even the most ardent proponent of the neo-liberalism, namely the IMF, is now recognizing that the neo-liberalism has worsened the national income distribution.

The fair income distribution claims its right for two reasons. First, the good old Judeo-Christian tradition of the Western world requires that the rich should look after the poor and the weak; this is the matter of human decency and social justice. If the western civilization has flourished for so long, it is precisely because of these virtues.

The second reason is something more down-to-earth thing. As we saw above, one of the worst performances of the neoliberal economic regime is the concentration of wealth and income in the hands of a few. But this means that the vast majority of the people have less and less income and weaker and weaker purchasing power. What come after is economic down fall.

Thus, the very success of the neoliberal economic regime brings down the economy.

The neo-liberalism has caused the financial crisis in 2007-2008; the world economy has been barely surviving because of the massive injection of money into the economy. But, the benefit of this desperate measure is dying. Nobody knows where the world economy will go.

Are there any other economic regimes better than the neo-liberalism? Should we go back to the Keynesian remedy? How about hybrid system of socialism cum private market system? To be more precise, should we adopt the Beijing Consensus? This concept was coined in 2016 by Joshua Cooper Ramo and it has been discussed by numerous experts in Chinese affairs. The discussion on the concept may be summarized as follow.

The Beijing Consensus, or simply the Chinese economic model, is a hybrid model. In this model, there are, by and large, three groups of enterprises: the government-owned enterprises (GOEs), the joint-enterprises (government-private enterprises or local enterprises-foreign enterprises) and the genuine private enterprises.

At the bottom, there are the private firms mainly in the agricultural sector; at the middle, the joint-enterprises producing a variety of goods and services for export and domestic consumption; at the top, the GOEs produce goods and services which are essential for the sustained development of the economy including steel, telecommunication, transport and energy.

The role of each type of enterprises evolves in time and in space. The GOEs have been the leading the economy, but its relative importance in the Chinese economy is now 30%, much lower than what they have been. As the economy develops, the private enterprises will increase in importance and replace the other two types of enterprises.

There is no doubt that the Chinese model has made possible the Chinese miracle. However, it has many problems including, the difficulty of coordinating the rules and regulations governing the different types of enterprises, the biased finance in favour of the GOEs, the collusion between the GOE and ranking Party members which lead inevitably to the corruption practices.

Nevertheless, nobody can deny the fact that without the strong government interventions, China's economic miracle would have been impossible. That is, neo-liberalism would have been useless in China.

By the way, the Chinese model is very popular among developing countries; the utility and the relevance of the Washington Consensus are more and more questioned. One of the reasons for the popularity of the China model is its non-interference in the internal affairs of the country which receives Chinese aid. On this point, the China model is very different from the IMF's Structural Adjustment Policy

My final remark is this. What we need at this time of search for more universally applicable economic models is neither the Washington Consensus nor the Beijing Consensus; we need a Global Consensus allowing each country to combine the virtues of the free-market and the usefulness of the government not only for the growth of the economy but also, in particular, more equitable distribution of income generated by the growth.

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