# 1. Introduction

**Philip Arestis and Malcolm Sawyer**

The general shift in economic policy in many countries over the past two decades or more can at one level be put under the heading of the continuing rise of neo-liberalism – the doctrine that economic policy should take the form of 'leave it to the market' and for government to retreat from intervention in markets. In a more specific way, some of the notable shifts in economic policy have been:

1. the retreat from fiscal policy and the reliance on monetary policy, and the associated shift in the objectives of macroeconomic policy from concerns over employment and growth to the concentration on inflation and price stability;
2. the promotion of the notion that the causes of unemployment lie in the operation of the labour market, and that 'inflexibility' in the labour market is a major cause of unemployment. The shift in economic policy has taken the form that unemployment is to be tackled by labour market 'reforms', rather than through macroeconomic demand management policies and through regional and industrial policies designed to tackle structural unemployment. The perceived 'rigidities' in the labour market have been associated with trade union power, long-term employment contracts, minimum wages and so on, with the consequent 'flexible' labour market policies designed to remove the source of those 'rigidities;
3. a trend towards the liberalization and deregulation of markets and notably of financial markets (including the lifting of controls on the movement of capital between countries).

The chapters in this book present critical appraisals of these trends in economic policy. The rise in importance of monetary policy has been associated with a focus of monetary policy on the inflation objective, and with many central banks becoming 'independent' – that is, their operations are undertaken without direct reference to government though subject to the edict of using the instruments of monetary policy (notably interest rate) to achieve a pre-stated inflation target. The 'independence' of the central bank and the



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focus of monetary policy on inflation have been justified in the following way. An 'independent' central bank would be more 'conservative' than an elected government in that the bankers would be more averse to inflation and less inclined to promote lower unemployment (as compared with an elected government). This tendency can be reinforced by stating that the objective of the central bank should only be low inflation. Further, the 'independent' central bank was thought to be more 'credible' (especially in the eyes of the financial markets) in the pursuit of low inflation. A more 'credible' policy would then deliver lower expectations of inflation, and thereby enhance the achievement of low inflation.

In Chapter 2, James Forder provides a detailed critical examination of the theory of credibility, exposing confusions in the literature, limitations of the analysis, and dangers from accepting the 'credibility' of central bank argument. He concludes that excessively contractionary policies, the dismissal of distributive concerns and insinuation against democracy can arise from the applications of the conclusions of the literature on the credibility of central banks. There are also serious dangers for the conduct of monetary policy, specifically in a deflationary direction.

In Chapter 3, Santonu Basu considers the experience of South Korea with financial liberalization, and specifically the relationship between financial deregulation and financial fragility. He argues that, contrary to the claim made by the advocates of financial liberalization, there is a theoretical explanation as to why the interest rate alone cannot provide the link between savings, investment and growth. This chapter argues that financial liberalization, instead of delivering a higher growth rate, is more likely to affect the growth rate adversely through its effects on financial fragility and the likelihood of financial crisis. The author seeks to explain why intervention is necessary in the operation of the financial market, specially during the process of development.

The Swedish economy for many years represented a unique policy in combining full employment and equity with growth and price stability, and operated what has been termed the Swedish model, or the Rehn–Meidner (R–M) model. In Chapter 4, Lennart Erixon provides a reappraisal of this model in the light of modern economic analysis. The R–M model was based on a wage policy of solidarity and the use of selective instruments – primarily labour market policies and marginal employment subsidies – within the framework of a restrictive fiscal policy. Erixon notes that a main argument now against the R–M model is that the scope for an economic policy has narrowed by internationalization. However, he argues that while internationalization has served to limit the possibilities of any single country applying this model, there is still a role for modified versions of the model: 'International labour mobility is still limited in scope but certainly a real challenge of solidaristic

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wage policy. The road is long to coordinated wage policy actions on the European Union (EU) level. But the R–M model does not rule out wage differences between individuals based on differences in job content, competence and education'.

The Spanish governments of the past two decades, and notably the Socialist governments in power from 1982 to 1996, have pursued economic policies very much in line with the neo-liberal agenda. In Chapter 5, Jesus Ferreiro and Felipe Serrano examine the economic policies of those Socialist governments. They conclude that the general strategy of economic policy followed by the Socialist governments has been conditioned by a mistaken diagnosis of the core objective of the Spanish economic policy (inflation). It has also been conditioned by the implementation, first, of a tight monetary policy joined to a hard currency policy, and, second, of a set of institutional reforms focused on the labour market to solve a structural-nature problem.

Brazil provides a further example of a country which pursued what may be termed a neo-liberal or neomonetarist agenda during the 1990s. In Chapter 6, Alfredo Saad-Filho and Lecio Morais consider the costs of neomonetarism for the Brazilian economy in the 1990s. They conclude that the slow growth of the Brazilian economy during the 1990s (at 1.7 per cent per annum, the lowest of the century) arose from the costs of the neomonetarist economic strategy implemented in this period, especially through the Real Plan. Investment declined from 22.1 to 19.6 per cent of GDP, while domestic savings fell from 20.1 to 16.8 per cent of GDP. Manufacturing employment fell by one-third, and productive capacity declined in several important sectors, especially the capital goods industry. Industrial restructuring reduced the economy's employment generating capacity, and Brazil became more heavily dependent upon imports and foreign finance.

The economic policy regime surrounding the introduction of the European single currency fits with the characterization of neo-liberal policies given above. In Chapter 7, Philip Arestis and Malcolm Sawyer outline what they see as the theoretical foundations of the Economic and Monetary Union (EMU) model. They examine the policy implications of the EMU, along with its theoretical and institutional dimensions surrounding monetary and fiscal policies, and conclude that the present policy arrangements will not enable the EMU to achieve full employment and low inflation. Indeed the policy regime is overtly deflationary. The authors conclude with a range of policy measures designed to overcome the shortcomings of the present policies.

The contributions to this book serve to illustrate the ways in which neo-liberal policies have been applied (and how those policies fit in with the three shifts in economic policy identified at the beginning of the chapter). They also seek to show both the shortcomings of these neo-liberal policies and that there are alternative policies available.

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