How the Menu Gets Set: Permanent Austerity, Political Parties, and Growth Regimes

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Recent work in comparative and international political economy stresses the importance of distinct "growth models" (Baccaro and Pontusson 2016) and "macroeconomic regimes" (Blyth and Matthijs 2017). This work draws attention to the ensemble of institutions and ideas that produce distinct forms of capitalist accumulation in particular historical periods. That is, one can think of capitalism as constituted, in a given period, by a specific set of institutions that are configured in such a way as to produce distinct and desired policy outcomes. This literature looks at how particular ensembles of institutions are entrained such that over time they produce endogenous pathologies. Also, rather than concentrate, as is done much of the time in comparative political economy, on distinctions between systems in a given moment as an exercise in comparative statics, this body of work looks to explain continuities over time and at the level of the system as a whole, and in a dynamic framework.

In this regard, Blyth and Matthijs (2017) in particular have forged a link between the rise and decline of specific macroeconomic regimes/growth models and particular forms of politics. Specifically, they have linked the rise of populism across the globe in recent years to the failure of the 1987–2007 growth regime; a regime that focused upon price stability as the major policy target, promoted flexibility in labor markets, and, in various forms, globalized, liberalized, privatized, and financialized.

The broad argument they make there – and that I expand upon here – is that the macroeconomic regime that both governed the markets and set the menu of policy choices for political parties in the advanced capitalist democracies from 1945 to 1977 was predicated on a growth model that was particularly favorable to labor. And while the means to get there varied across countries – demand-side management, active labor market policies or export-led growth – they were all typified by a policy target of sustained full employment. While successful insofar as full employment was both attained and sustained for over 20 years, three pathologies endogenous to the regime produced its downfall.

The first was the familiar Kaleckian dynamics of cost-push inflation (Kalecki 1943). Sustaining full employment and the profitability of capital together is contingent upon sustained growth in productivity. That is possible so long as the real rate of return on capital remains higher than its cost. In an environment in which labor – especially skilled labor – is being bid up by wage pressures, the rate of return on capital will fall as inflation is bid up. Once that threshold is reached, inflation acts as a tax on investment and capital withdraws investment. The result is the well-known "puzzle" of stagflation, which is not a puzzle if investment falls in an environment of inflation and unemployment rises.

The second pathology was the global macro-framework that sustained these national full-employment regimes, the Bretton Woods exchange rate regime (Helleiner 1994). With the US dollar as the global reserve currency and all other major currencies pegged to the dollar, as soon as the Post-War Dollar Shortage ended and the dollar glut began, countries were effectively earning devalued export dollars, which ended up stoking import inflation (Eichengreen [1996] 2008). The third pathology was an exogenous shock rather than an endogenous pathology. The 1974 and 1979 oil shocks provided yet another inflationary boost to an otherwise unstable inflationary order and pushed it over the edge. At that moment, a regime that targeted full employment, restricted financial flows, insulated labor markets, and provided extensive transfers across (not up) the income scale while provisioning public goods failed (Blyth 2002).

The failure of the growth regime prompted a reset of the system. Thatcher and Reagan and the neoliberal order that followed had a new policy target, price stability. Enforced first through national-level fiscal austerity and high interest rates, and then through autonomous central banks, price stability was the target needed to restore the real rate of return on capital after the inflationary crisis that put paid to the first regime. In its place a growth regime built on principles orthogonal to the first one was generalized across the OECD.

Price stability, enforced by autonomous agencies, was the policy target. Labor markets were deregulated; that is, opened to global competition. Capital markets were similarly globalized. State functions were privatized. Transfers continued, but mainly upwards and to the old (who vote more), and economies became more integrated. As a result, the rate of return on capital was not only restored, it soared, and the capital/labor share reversed. Crucially, private credit took the place of public deficits – or rather, the deficits persisted while their private complements boomed. Banks became dominant actors in the economy and the shadow banking system ballooned to multiples of GDP across the OECD.

This regime had many pathologies – the generation of a massive income and wealth skew, falling investment, mass unemployment, cyclical instability – but only one really mattered. The critical weakness endemic to financialized economies is that there is liberalization really only where there is a pent-up demand for credit, as there was in the inflationary 1970s. In such a world the demand for credit is high but supply is low because regulated markets cannot offer rates of return above the rate of inflation (Krippner 2011). But if one liberalized and dis-inflated at the same time, what were historically low real interest rates (the nominal rate plus inflation) became historically high real interest rates. Real rates plus a pent-up demand for credit created a bonanza for private finance, and private finance, released from its regulatory box, duly obliged (Crouch 2009).

The problem with relying on a credit boom to fuel growth is that unless wages are rising then the debt burden become heavier on borrowers. But as the pool of capital increases due to capital market integration, and inflation falls, the real rate falls, making it easier to borrow. The result is a massive leveraging-up of the system as a whole that went nuclear in 2008 (Blyth 2013). That regime failed in a crisis of deleveraging in 2008, but has not yet been replaced by a new growth model, due to both the continuing power of capital, and the interventions of globally important central banks (Blyth 2012).

So far, so macroeconomic. But where is the politics in all of this? Blyth and Matthijs used this framework to explain how the failure of a second macroeconomic regime in 2008 produced an ever-increasing asymmetry in the returns to capital over labor that has resulted in creditor–debtor stand-offs, both within and between countries, which is how they explain the rise of populism today. Building on this, I draw on subsequent work with Jonathan Hopkin that explores the co-evolution of growth regimes, political party forms, and party systems (Blyth and Hopkin 2018).

Specifically, we argue that the 1945–1977 labor-friendly growth regime co-evolved with a particular type of political party and party system; one that turned mass parties of integration into catch-all parties of electoral competition and public goods provision (Kirscheimer 1966). We then argue that developments in the post-1977 growth regime caused these party forms to become mal-adapted to their new environment, and as the new inflation-focused growth regime evolved, it demanded further changes in party form in order to survive, the optimal form before the financial crisis being the emergence of cartel parties and cartelized party systems (Katz and Mair 1995; 2005; Blyth and Katz 2005).

We argue that over the lifetime of the 1945–1977 growth regime, parties moved from being mass parties of mobilization to being "catch-all" parties of integration that abandoned appeals to core constituencies while emphasizing the provision of public goods rather than party identity. As the ability to do so broke down in the collapse of productivity and the rise of inflation in the 1970s, catch-all parties evolved into cartel parties. That is, catch-all parties downsized their constituents' expectations, externalized policy commitments, and separated themselves from both party members and their traditional constituencies in order to insulate themselves from electoral volatility and partisan demands (Blyth and Katz 2005). These parties governed less so that they could rule more. Moving into the 1980s and 1990s and embracing both a new macroeconomic framework and new economic ideas that made such a policy shift seem "inevitable," these parties effectively became managers rather than transformers of capitalism (Blair and Schroeder 1999). But here lay the political pathology with a political order that was produced by the shift of regimes.

While the cartel party-form and increasingly cartelized systems acted as local optima for such parties in the low-inflation "Great Moderation" period, they were in serious trouble the moment the macroeconomic environment shifted and they had to govern more, rather than less. That moment also came in the crisis of deleveraging in 2008. Lacking the capacity to intervene effectively in this moment, or even the ideas that would legitimate doing so, such parties relied on the organizations to which they had externalized their commitments – central banks, G-associations, supra-national and sub-national authorities. The result has been the survival of a party form that is mal-adapted to its environment, and is therefore unable to "change the menu" that it has been offering for the past three decades. Populism and the collapse of center-party vote shares are the twin results.

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