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Kicking Away the Ladder: Neoliberalism and the 'Real' History of Capitalism

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1 Introduction

As is well known, since the 1980s, developing countries have been put under great pressure to adopt a set of "good policies", including liberalisation of trade and investment and privatisation of state-owned enterprises. In the first decade of the twenty-first century, they began being put under pressure to adopt a set of "good institutions" – including an independent central bank and strong patent law – to foster their economic development.

When some developing countries show reluctance to adopt these measures, the proponents of this recipe often find it difficult to understand those countries' stupidity in not accepting such a tried and tested recipe for development. After all, they argue, these are the policies and the institutions that the developed countries used in the past in order to become rich. Their belief in their own recommendations is so absolute that, in their view, they must be imposed on the developing countries through strong bilateral and multilateral external pressures, even when those countries don't want them. Naturally, there have been heated debates on whether the recommended policies and institutions are appropriate for developing countries. However, curiously, even many of those who are sceptical of the applicability of these policies and institutions to the developing countries take it for granted that these were the policies and the institutions that were used by the developed countries when they themselves were developing nations.

Contrary to the conventional wisdom, the historical fact is that the rich countries did not develop on the basis of the policies and institutions they now recommend to, and often force upon, the developing countries. This fact is little known these days because the "official" historians of capitalism have been very successful in rewriting its history.

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2 Widespread use of tariffs and subsidies

Almost all of today's rich countries used tariff protection and subsidies to develop their industries in the earlier stage of their development. It is particularly important to note that Britain and the USA, the two countries that are supposed to have reached the summit of the world economy through free-market, free-trade policies, are actually the ones that most aggressively used protection and subsidies (Bairoch 1993).

Contrary to the popular myth, Britain was an aggressive user and, in certain areas, a pioneer of activist policies intended to promote its industries. Such policies, although limited in scope, date back to the fourteenth century (Edward III) and the fifteenth (Henry VII) in relation to woollen manufacturing, the leading industry of the time. England was then an exporter of raw wool to the Low Countries, and Henry VII, for example, tried to change this by protecting woollen textile producers, taxing raw wool exports, and poaching skilled workers from the Low Countries.

Particularly between the trade-policy reform of its first prime minister, Robert Walpole, in 1721 and its adoption of free trade around 1860, Britain used very dirigiste trade and industrial policies, involving measures very similar to what such countries as Japan and Korea later used in order to develop their economies (on Walpole's policies, see Brisco 1907). During this period, it protected its industries a lot more heavily than did France, the supposed dirigiste counterpoint to its free-trade, free-market system. According to a study by Joseph Nye (1991), France's average tariff rate was significantly lower Britain's throughout the first half of the nineteenth century. Germany, another country frequently associated with state interventionism, had much lower tariffs than Britain during this period, although the German states tended to use other means of economic intervention more actively. Given this history, argued Friedrich List, the leading German economist of the mid-nineteenth century, Britain's preaching free trade to less advanced countries like Germany and the USA was like someone trying to "kick away the ladder" with which he had climbed to the top (List 1885).

The USA, today's supposed champion of free trade, was even more protectionist than Britain throughout most of its history before the Second World War. According to the authoritative study by Paul Bairoch (1993), between the Civil War and the Second World War, it was literally the most heavily protected economy in the world.

In this context, it is important to note that the American Civil War was fought on the issue of tariffs as much as, if not more than, on the issue of slavery. Of the two major issues that divided the North and the South, the South had actually more to fear on the tariff front than on the slavery front. Abraham Lincoln was a well-known protectionist; he had cut his political teeth under the charismatic politician Henry Clay in the Whig Party, which advocated the so-called American System, based on infrastructural development and protectionism (thus named in recognition that free trade was in

the British interest). On the other hand, Lincoln thought that blacks were racially inferior and slave emancipation was an idealistic proposal with no prospect of immediate implementation. Indeed, he is said to have emancipated the slaves in 1862 as a strategic move to win the War rather than out of moral conviction.

The USA was also the intellectual home of protectionism throughout the nineteenth century. It was in fact American thinkers like Alexander Hamilton, the first treasury secretary of the USA, and the economist Daniel Raymond who first systematically developed the so-called infant industry argument to justify the protection of manufacturing industries in a less developed economy. Indeed, List, who is commonly known as the father of the infant industry argument, started out as a free trader (he was an ardent supporter of the German free-trade customs union, the *Zollverein*) and learnt about the Hamiltonian infant industry argument during his exile in the USA during the 1820s.

In heavily protecting their industries, the Americans were going against the advice of such prominent economists as Adam Smith and Jean-Baptiste Say, who saw America's future in agriculture. However, they knew exactly what the game was. They knew that Britain had reached the top through protection and subsidies and therefore that they needed to do the same if they were going to get anywhere. Criticising the British preaching of free trade to his country, Ulysses Grant, the Civil War hero and the U.S. president between 1869 and 1877, retorted that "within 200 years, when America has gotten out of protection all that it can offer, it too will adopt free trade". When his country later reached the top after the Second World War, it too started "kicking away the ladder" by preaching free trade and even forcing it on less developed countries.

The United Kingdom and the USA may be the most extreme examples, but almost all the rest of today's developed countries used tariffs, subsidies, and other means to promote their industries in the earlier stages of their development. The cases of Germany, Japan, and Korea are well known in this respect. But even Sweden, which later came to epitomise the "small open economy" to many economists, also strategically used tariffs, subsidies, cartels, and state support for R&D to develop key industries, especially textile, steel, and engineering.

There are some exceptions – the Netherlands and Switzerland, for example – that have maintained free trade since the late eighteenth century. However, these were countries that were already then on the frontier of technological development and therefore did not need much protection. Also, it should be noted that the Netherlands had deployed an impressive range of interventionist measures up till the seventeenth century in order to build up its maritime and commercial supremacy. Moreover, Switzerland did not have a patent law until 1907, flying directly against the emphasis that today's orthodoxy puts on the protection of intellectual property rights (see below). More interestingly, the Netherlands abolished its 1817 patent

law in 1869 on the ground that patents were politically created monopolies inconsistent with free-market principles – a position that seems to elude most of today's free-market economists – and did not introduce a patent law until 1912.

3 The long and winding road to institutional development

The story is similar in relation to institutional development. Contrary to what is assumed by today's orthodoxy, most of the institutions that are regarded as prerequisites for economic development emerged after, not before, a significant degree of economic development in the now-developed countries. Without claiming to be exhaustive, let us examine the six categories of institutions that are widely believed to be prerequisites of development: democracy, bureaucracy, intellectual property rights, institutions of corporate governance, financial institutions (including public finance institutions), and welfare and labour institutions.

Whatever one's position is on the relationship between democracy and economic growth in today's world, it is indisputable that today's developed countries did not develop under democracy. Until the 1920s even universal male suffrage was a rarity. It was not until the late twentieth century that all developed countries became truly democratic. Spain and Portugal were dictatorships until the 1970s, votes were given to all ethnic minorities in Australia and the USA only in 1962 and 1965, respectively, and women in many countries were given suffrage only after the Second World War and in Switzerland as late as 1971. Until the Second World War, even when democracy formally existed, its quality was extremely poor. Secret balloting was introduced only in the early twentieth century even in France and Germany, and corrupt electoral practices, such as vote buying, electoral fraud, and legislative corruption, lasted in most of today's developed countries well into the twentieth century.

In terms of bureaucracy, sale of offices, the spoils system, and nepotism abounded in most countries until the early twentieth century. Modern professional bureaucracies emerged first in Prussia in the early nineteenth century, but only much later in other countries – even Britain got a modern bureaucracy only in the mid-nineteenth century. Until the Pendleton Act (1883), U.S. federal bureaucrats were not competitively recruited, and even at the end of the nineteenth century, fewer than half of them were.

A similar story emerges in terms of intellectual property rights institutions, which have become a key issue following the recent WTO controversy surrounding the TRIPS (trade-related intellectual property rights) agreement. Until the late nineteenth century, many countries allowed patenting of imported inventions (Penrose 1951). As mentioned earlier, Switzerland and the Netherlands refused to protect patents until the early twentieth century. The United States did not recognise foreign citizens' copyrights until 1891. And throughout the nineteenth century, there was a widespread

violation of British trademark laws by German firms producing fake "made in England" goods.

Even in the most developed countries (the United Kingdom and the United States), many key institutions of what is these days regarded as a "modern corporate governance" system emerged after, rather than before, their industrial development. Until the 1870s, in most countries limited liability, without which there would be no modern corporations based on joint-stock ownership, was something that was granted as a privilege to high-risk projects with good government connections (e.g., the British East India Company), not as a standard provision. Until the 1930s there was virtually no regulation on company audit and information disclosure. Until the late nineteenth century, bankruptcy laws were geared towards punishing bankrupt businessmen (with debtors' prison being a key element) rather than giving them a second chance. Competition law did not really exist in any country until the 1914 Clayton Act in the USA.

As for financial institutions, it would be fair to say that modern financial systems with widespread and well-supervised banking, a central bank, and a well-regulated securities market did not come into being even in the most developed countries until the mid-twentieth century (Kindleberger 1984). In particular, until the early twentieth century, Sweden, Germany, Italy, Switzerland, and the United States, among other countries, lacked a central bank.

Much the same goes for public finance. The fiscal capacity of the state remained highly inadequate in most now-developed countries until the mid-twentieth century, when most of them still did not have income tax. Even in Britain, which introduced the first permanent income tax in 1842, Gladstone was fighting his 1874 election campaign with a pledge to abolish income tax. With limited taxation capability, local government finance in particular was in a mess. A most telling example is an episode documented in Cochran and Miller (1942), where the British financiers put pressure in vain on the U.S. federal government to assume the liabilities of a number of U.S. state governments after their defaults on British loans in 1842 – a story that reminds us of the events in Brazil following the default of the state of Minas Gerais in 1999.

Social security institutions (e.g., industrial accident insurance, health insurance, state pensions, unemployment insurance) did not emerge until the last few decades of the nineteenth century, although once introduced they diffused quite quickly. Germany was a pioneer in this respect. Effective labour institutions (regulations on child labour, working hours, workplace safety, etc.) did not emerge until around the same time even in the most advanced countries. Child-labour regulations started emerging in the late eighteenth century, but until the early twentieth century most of these regulations were extremely mild and poorly enforced. Until the same period, in most countries regulation of working hours or conditions for adult male workers was considered unthinkable. For example, in 1905 the U.S. Supreme

Court declared in a famous case that a ten-hour working limit for bakers enacted by New York State was unconstitutional because "it deprived the baker of the liberty of working as long as he wished".

One important conclusion that emerges from historical examination is that it took the developed countries a long time to construct institutions in their earlier days of development. Institutions typically took decades, sometimes generations, to develop. Just to give one example, the need for central banking was perceived at least in some circles from at least the seventeenth century, but the first "real" central bank, the Bank of England (founded in 1694), was instituted only by the Bank Charter Act of 1844, some two centuries later.

Another important point emerges from historical comparison of the levels of institutional sophistication in today's developed countries in their earlier periods with those in today's developing countries. For example, measured by the per capita national income level (admittedly a highly imperfect standard), in 1820 the United Kingdom was at a similar level of development as that of India's today, but the former did not have many of the most "basic" institutions that India has had for decades. The United Kingdom did not have universal suffrage (it did not even have universal *male* suffrage), a central bank, income tax, generalised limited liability, a generalised bankruptcy law, a professional bureaucracy, meaningful securities regulations, and even basic labour regulations (except for minimal and hardly enforced child-labour regulations).

For still another example, in 1913 the United States was at a level of economic development similar to that of today's Mexico, but at the level of institutional sophistication, the former was then well behind what we see now in the latter. Women were still formally disenfranchised, and blacks and other ethnic minorities were de facto disenfranchised in many parts of the country. It had been just over a decade since a federal bankruptcy law was legislated (1898) and it had been barely two decades since the country recognised foreigners' copyrights (1891). A (highly incomplete) central banking system and income tax had literally only just come into being (1913), and the establishment of a meaningful competition law (the Clayton Act) had to wait another year (1914). Also, there was no federal regulation on securities trading or child labour, and what few state-level laws that existed in these areas were of low quality and were very poorly enforced.

These comparisons could go on, but the point is that the developed countries in earlier times were institutionally *less* advanced than today's developing countries at similar stages of development. Needless to say, the quality of their institutions fell well short of the "global standards" institutions that today's developing countries are expected to install.

4 Kicking away the ladder

If the policies and institutions that rich countries recommend to poor countries are not those they themselves used when they were developing, what

is going on? One might well conclude that the rich countries are trying to kick away the ladder that allowed them to climb to where they are. It is no coincidence that economic development has become more difficult during the last three decades, precisely when the developing countries were forced to adopt "good" (read "neoliberal") policies and institutions.

At the height of neoliberalism (between 1980 and 2000), the average annual per capita income growth rate for the developing countries was half of the 3 per cent achieved in the previous two decades (1960–80). Growth picked up in the 2000s; so the growth rate for the period between 1980 and 2009 was 2.6 per cent, largely due to the rapid growth of China and India, two giants that, while liberalising, did *not* fully adopt neoliberal policies. Even including the 2000s, the growth performance of Latin America and sub-Saharan Africa – two regions that have faithfully followed the neoliberal recipe – has been much inferior to what they had in the ISI period. Per capita income in Latin America grew at 3.1 per cent per annum between 1960 and 1980, while it remained at 1.1 per cent between 1980 and 2009. Per capita income growth in sub-Saharan Africa in the former period was 1.6 per cent, while in the latter 0.2 per cent. Economic instability has increased markedly, as is manifested in the dozens of financial crises witnessed over the last decade and half alone, culminating in the 2008 global financial crisis. Income inequality has been growing in the majority of developing countries, and poverty has increased rather than decreased in a significant number of them.

The double standard of the rich countries has become even more evident since the outbreak of the 2008 crisis. When they were faced with a crisis situation, the rich countries deployed policies that were the exact opposite of what they have preached to – and often imposed upon – developing countries in similar situations. Following the crisis, the rich countries did not adopt the contractionary macroeconomic policies that they recommend to developing countries in financial crises; rather, they maintained or even boosted demands by way of unprecedented budget deficits, lowest-ever interest rates, and even "quantitative easing". Instead of shutting down failed industrial firms and financial institutions, as they make developing countries in crises do, they have bailed out or even nationalised key firms and banks. Rather than cut subsidies – a standard recommendation to crisis-stricken developing countries – they have increased them, especially to the automobile industry, under the guise of "green subsidies".

5 What can be done?

What can be done to change this iniquitous situation? First, the facts about the historical experiences of the developed countries should be more widely publicised. Some of this has happened in recent years but nowhere near enough. This is a matter not just of "getting history right" but of allowing developing countries to make more informed choices.

Second, the conditions attached to bilateral and multilateral financial assistance to developing countries should be radically changed. It should be accepted that the orthodox recipe is not working and also that there can be no "best practice" policies that everyone should use.

Third, the WTO rules should be rewritten so that developing countries can more actively use tariffs and subsidies for industrial development. These countries should also be allowed to have less stringent patent and other intellectual property rights laws.

Fourth, improvements in institutions should be encouraged, but encouragement should not be equated with imposition of a fixed set of institutions on all countries. Special care has to be taken not to demand excessively rapid upgrading of institutions by developing countries, especially given that they already have more developed institutions than today's developed countries had at comparable stages of their own development and given that establishing and running new institutions is costly.

By being allowed to adopt policies and institutions that are more suitable to their conditions, developing countries will be able to develop faster. This will also benefit developed countries in the long run, as it will increase their trade and investment opportunities. That the developed countries cannot see this is the tragedy of our time.

Note

This chapter is updated and expanded from the related materials in my book *Kicking Away the Ladder: Development Strategy in Historical Perspective* (London: Anthem Press, 2002). An earlier, shorter version appeared as "Kicking Away the Ladder: Neoliberals Rewrite History", in *Monthly Review* 54, no. 8 (2003).

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Neoliberalism in Retrospect? It's Financialisation, Stupid

Ben Fine

1 Introduction

The current global crisis has, unsurprisingly, brought comparisons with other such episodes in the past, not least the collapse of the post-war boom and the Great Depression of the 1930s. Beyond competition for degree of severity, comparative analysis has not preceded much further, not least because differences between eras tend to dominate shared characteristics. The thirties heralded the emergence of Keynesianism (undoubtedly propelled by wartime interventions), while the stagflation of the 1970s witnessed the blossoming of the monetarist counter-revolution, the most extreme forms of perfect market economics, and the period of neoliberalism.

Of course, what all three periods highlighted share in common is turbulence in financial markets – the Great Crash of 1929, the breakdown of Bretton Woods in 1971 as the U.S. dollar came off the gold standard, and the sub-prime crisis of the late noughties (i.e., 2000–9). In this light, how are we to situate the role of finance in the current crisis: as something unique or uniquely extensive or as more of the same? One of the remarkable features of the current crisis is that no one is blaming the poor or other "usual suspects" for the crash and its aftermath. Far from it, unlike other instances of economic malfunction in my own lifetime and earlier, excessive wages (money or social) have not been targeted as causal, as has occurred in the past, not least in legitimising the shifting of the burden of adjustment upon working people and the poor. Instead, finance and its excesses are to blame, but it must be rescued in order to prevent an even worse impact upon the rest of us. We have to restore sound finance, reluctantly or otherwise, to pre-empt even more dire outcomes. It's not your fault or mine, but the milk is spilt, and the pitcher is broken, and so we have to work together to fix it, with less to go around in the meantime.

In addition, the current crisis marks the closing phase of a longer thirty-year period of slowdown in accumulation, certainly relative to the Keynesian

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