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From Depoliticisation to Dedemocratisation: Revisiting the Neoliberal Turn in Macroeconomics

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ABSTRACT
The last decades of the twentieth century saw a liberal turn in macroeconomic policy from government discretion towards policy rules and depoliticisation. Intellectually, this turn was inspired by the wave of the New Classical Macroeconomic (NCM) theory that emerged to eclipse Keynesianism in the 1970s. This paper revisits some of the central papers and models of NCM, including Kydland and Prescott's 1977 'Time Inconsistency Model', Sargent and Wallace's 1976 'Policy-ineffectiveness proposition' and the micro foundations of the Lucas-critique from 1976. Through an investigation of the political and economic context inspired by Ellen Meiksins Woods' social history of political thought, this paper investigates the ideological tenets of the neoliberal turn in macroeconomics associated with NCM. In policy and scholarly debates, NCM has primarily been viewed as a critique of government intervention in the economy. This paper challenges this notion and stresses that NCM is not primarily a critique of government action, but rather a critique of the role of democracy and popular participation in governance. This rereading offers new insights into the relationship between neoclassical economics and neoliberal policy in the 1970s transition and casts new light on our general understanding of the relations between liberal political economy and democratic governance.

KEYWORDS
History of economic thought; depoliticisation; neoliberalism; economic governance; democracy; critical political economy

Introduction

The concept of neoliberalism has been intensely debated in the recent scholarly literature, sparking a flurry of definitions of what exactly constitutes the core of the neoliberal project. At the centre of this debate, it has been assumed that a critique of the economic activity of the state has been at the core of the neoliberal wave. From Hayek's early writings of the 1930s over Friedman's works of the 1960s to the supply side economics of the 1980s, the bête noire of neoliberal movements has been the state as the organiser and planner of economic activity.

This article argues, however, that such an 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. This argument was developed through a historical reappraisal of the rise to prominence of neoliberal macroeconomic policy in the 1970s, especially as associated with Robert Lucas and the school of New Classical Macro-economics (NCM).

In order to shift focus towards the issue of democracy in the debates around macroeconomics, this article aims to deconstruct the division between the economic and political spheres and introduce a reading of neoliberal economics as a form of political theory. In doing this, the article draws

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inspiration from approaches developed within the history of political thought by Quentin Skinner (Skinner 1969, 2002, Tully 1988) and his 'contextual intellectual history', and Ellen Meiksins Wood's framework of 'social history of political thought' (Wood 1995, 2008). These two thinkers, although they differ widely in their methodological approach, share characteristics that are central to the approach taken here. First, on a methodological level, they emphasise the importance of context and the intentions of authors when reading political texts. Second, on a substantial level, they both offer a critique of the liberal ideas of freedom and democracy.

Using this approach, this article revisits the central theoretical pillars behind the neoliberal policy revolution of macroeconomics, and interrogates them in their immediate and more macrohistorical context. This involves the works of economists such as Robert Lucas, Finn Kydland, Robert Prescott, Thomas Sargent, and Neil Wallace.

Lucas especially emerged as a central figure in the rise of neoliberal macroeconomics. He is arguably the dominant macroeconomist in the last quarter of the twentieth century (Fischer 1996, Chernomas and Hudson 2017). In their recent work on the impact of the Economics Nobel Prize, Offer and Söderberg describe how 'Robert Lucas (…) held sway as the leading light of neoliberal model making between the late 1970s and the 1990s' (Offer and Söderberg 2016, p. 23). Lucas and his collaborators, through the development of concepts such as 'rational expectations', 'time inconsistency theory' and the 'policy-ineffectiveness proposition' were succesful in the denunciation of Keynesianism and the construction of a new macroeconomic paradigm based on neoclassical microfoundations, 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 programme in itself, with methodological strictures and propositions such as the complete renunciation of fiscal policy by governments, was never adopted by the macroeconomic community. Nevertheless, Lucas and colleagues have had a profound impact on the implementation of macroeconomic theory and practice in the period since (Backhouse 2005, 2010, Fine and Milonakis 2009b, Offer and Söderberg 2016) insitituting what Oxford economist Simon Wren-Lewis describes as 'microfoundations hegemony' (Wren-Lewis 2018). Some of the most astute analyses of the movement from political discretion to policy rules within macroeconomics have described the movement as *depoliticisation* (see Burnham 1999, 2001, Hay 2007). While I build on this theoretical work, I will argue that the idea of depoliticisation is insufficiently specific, and that we should instead describe it as a process of *dedemocratisation*.[1]

The central theme that emerges from such a reading of neoliberal macroeconomics as political theory is the question of democracy[2] and the critique of democratic governance, rather than the questioning of state power. Here, the question of the power of government versus markets on an abstract level somewhat fades into the background, and a different picture emerges. In this picture, the object of 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. Despite this technical formulation, the neoliberal theories on the sources of government overextend to problems concerning democratic governance.

This may appear to be a surprising element of neoliberalism as the traditions present themselves as the champions of liberty and democracy against totalitarianism (Friedman 1982, Gray 1984, Hayek 2006 [1944]). However, the neoliberal definition of democracy is an extremely restricted one, where popular rule is under strict constitutional curtailment, and a number of scholars have recently pointed out the neoliberals' practical opposition to democracy (Farrant et al. 2012, Mirowski 2013).

The realisation is that the main thrust of the neoliberal macroeconomic critique focused on democracy rather than the state is not only important as a historical revisionist point. This is becoming crucially important in a situation where the neoliberal project is in a deep crisis, and we observe increasing tension between capitalism and democracy (Crouch 2004, Streeck 2011). Many of these tendencies are direct reactions to the attempts to dedemocratise the economy that was integral to the neoliberal project. Looking at democracy as the central category makes the real development of neoliberal economic governance much more intelligible. The aim was never primarily the size or reach of the state, but instead the internal organisation of the state.

Methodological Approach

In this article, I focus on the wave of new theoretical macroeconomics from the 1970s associated with the introduction of microeconomic methods (called micro foundations) and rational expectations into macroeconomics, headed by Robert Lucas. Despite the fact that the pure form of these theories, in the form of New Classical Macroeconomics, was mostly considered too extreme to achieve complete hegemony in the field of economics, it nevertheless transformed the theoretical basis of macroeconomics (Watson 2014, Offer and Söderberg 2016). The idea of micro foundations became completely dominant within mainstream economics, especially after the introduction of the so-called 'New Keynesian' theories from the 1980s, where authors such as Romer and Krugman introduced Keynesian policy elements into the rational expectations framework (Fine and Milonakis 2009b, Backhouse 2010).

In a 2004 article, Colin Hay developed a distinction between *normative* and *normalising* theory in the development of neoliberalism (Hay 2004b). Normative theory, like Hayek's *The Constitution of Liberty* (1960) or Friedman's *Capitalism and Freedom* (1982), puts forward philosophical arguments for the merits and benefits of the free market doctrine of neoliberalism with clearly stated normative intentions. *Normalising theory,* on the other hand, provides theoretical or technical solutions to policy problems with clear liberalising consequences, but without any stated normative considerations. This is the frame of Kydland and Prescott's work on time-inconsistencies or of the rational expectations of the Lucas critique, with their denial of the efficacy of Keynesian demand management policies. This form of theory does not carry explicit normative content, but nevertheless implies clear policy implications – in the case of the Lucas critique, the point of state non-interference in an economic recession or in the case of the time-inconsistency thesis, a clear implication of central bank independence.

With a few notable exceptions, such as the strong influence of Hayekian think-tanks in the early Thatcher years (Cockett 1995), normalising theory has been the dominant form through which neoliberal ideas have been introduced into policy circles across the western world. This is true in economics science, international organisations such as the IMF and the World Bank, and at the national level (See Hay 2004a, Fourcade 2006, Backhouse 2005, Chwieroth 2009, Fine and Milonakis 2009a, Ban 2015, 2016, Stahl 2018). As such, it seems worthwhile to examine the normalising theories and interrogate the normative content that lies underneath the surface of technical neoliberalism.

Reading Economics as Political Theory

Reading economics as political theory implies, of course, that one does not accept the dictum that economic analysis lies beyond the purview of politics, despite its technical focus. Furthermore, one has to challenge the standard labelling of economics as a positive rather than a normative science. Despite these protestations, probably no other discipline of social science has developed in such a tight correlation with policy trends (Backhouse 2005, 2010); no other discipline has had public prestige and influence associated with economics (Fourcade *et al*. 2014); few other disciplines have experienced the same sort of acknowledgement from outside forces through constructions such as the 'Nobel prize' in economics, or from the investment of private money in think tanks and university chairs (Blyth 2002, Mayer 2016).

The main condition of examining economic theory as political intervention is understanding the historical context. In the same way, this article aims to investigate the sort of 'government' that was really being discussed in the debates on macroeconomics in the 1970s. To do this, the article draws inspiration from two contrasting perspectives in intellectual history: Quentin Skinner and Ellen Meiksins Wood.

In reading macroeconomics as political interventions, it is crucial to explore the rhetorical and societal context in which those interventions were implemented. Here, I draw inspiration from the methodological works undertaken in recent decades within intellectual history, especially in the history of political thought. The most important figure here is the intellectual historian Quentin Skinner, and his focus on *contextual* understanding in the history of political theory (Tully 1988). Inspired by Wittgenstein's notion of *language games* and Austin's theory of *speech acts*, Skinner sees texts as essentially a form of intentional act, that is, as purposeful interventions in debates. Authors of texts and theories do not just describe the world; they are always doing something to the world with their works (Skinner 2002, p. 128). To understand the meaning of political texts and their beliefs, it is necessary to understand the polemical contexts in which they operate (Skinner 1969, 2002). Skinner describes how the aim is to 'interpret specific beliefs by placing them in the context of other beliefs, to interpret systems of belief by placing them in wider intellectual frameworks' (Skinner 2002, p. 4). This intellectual context encompasses the concrete linguistic context (which concepts are being employed, defined, and redefined) as well as the broader social context (which actors are engaged in battles over certain political objectives).

The concept of historical context is further developed by the Marxist historian and political scientist Ellen Meiksins Wood under the framework of 'the social history of political thought'. Wood's approach is, to a certain extent, developed as a critique of Skinner and the Cambridge school. While she follows Skinner in the focus on context and in viewing the history of political thought as 'essentially the history of ideologies' (Wood 2008, p. 7), she also criticises the Cambridge school, which she sees as focusing overtly on the intellectual, linguistic context, while ignoring the broader social and economic context under which the political theories are formulated, and in which they try to intervene. The stress on the macrosocial context means that the focus is not simply on the biographical or polemical context in which the formulation of theory took place. While such considerations are important, they also have the disadvantage of restricting the relevance of the texts and theories to the concrete historical circumstances. To understand the relevance of economic or political theories, and if we are to conceptualise them into a larger set of theories on political and social change, the focus also needs to be on the issues of general relevance in these texts.

Application in Practice

As mentioned above, there are large differences between the methodological and theoretical approaches of Skinner and Wood. Nevertheless, I argue that it is possible to use their divergent perspectives as the basis for a common but differentiated notion of varied levels of contextualisation. This represents a simplification of the context of the two authors, which perhaps does justice to neither.[3] I argue, however, that combining elements from the two approaches allows for a more comprehensive model of contextualisation that I develop below.

I propose three levels of contextualisation: the immediate rhetorical context, the political context, and the social context. At each of these levels, the texts under analysis can be seen as purposeful interventions in the ongoing debates and contestations, under the restrictions of the limits of the horizons of debates at the time, and utilising the intellectual resources available. Here, the rhetorical context represents the immediate rules for valid argumentation in the local intellectual field. The political context represents the broader political contestations into which the local intellectual debates are embedded, and the social context represents the basic social questions of the society in which the debates take place, including the state form and the distribution of property and rights. While this analytical model, like all forms of categorisations of the social world, involves a reduction of multiplicity of grey zones and overlaps into discrete boxes, it can nevertheless be instructive to view the three levels of contextualisation as concentric circles of greater generality and abstraction, so that each higher level includes and envelops the former (Figure 1).

Depoliticisation

How does this reading of neoliberal economics as political theory fit into the state of the literature on neoliberalism and politics?

A way of getting closer to the contradictory relationship between state and politics in liberal economic governance is through the idea of *depoliticisation,* the process by which concepts and elements are removed from the sphere of political contestation and displaced to a realm of technical deliberation. In his article 'The politics of economic management in the 1990s', Burnham (1999) describes *depoliticisation* as a specific attitude towards economic governance. Here, he describes the process of transition, from the politicised management of the postwar period, where the weight was on discretion-based management and the direct steering of the economy, to the depoliticised management of the 1990s, where the emphasis was on rule-based management, and 'rule through market mechanisms'.[4]

The idea of depoliticisation allows us to analyse the paradoxical nature of the liberal economic government. On one hand, it avoids collapsing the practices of governance into a direct realisation of ideological self-representation, as is the danger of the market fundamentalist approach. On the other hand, it avoids dissolving the practice of neoliberal governance into a generalised system that encompasses so many aspects of late capitalist society that it obfuscates the specific dynamics of economic policy at the core of the neoliberal project.

Looking at the neoliberal project, however, I argue that depoliticisation is in itself too vague a term to understand what is going on. Outside some insignificant fringe circles, few neoliberals have had problems with active government power in practice. Figures such as Mario Draghi and Allan Greenspan have been popular as central bankers with wide discretionary power. What has been targeted most successfully has not been discretionary political action as such, but rather the democratic

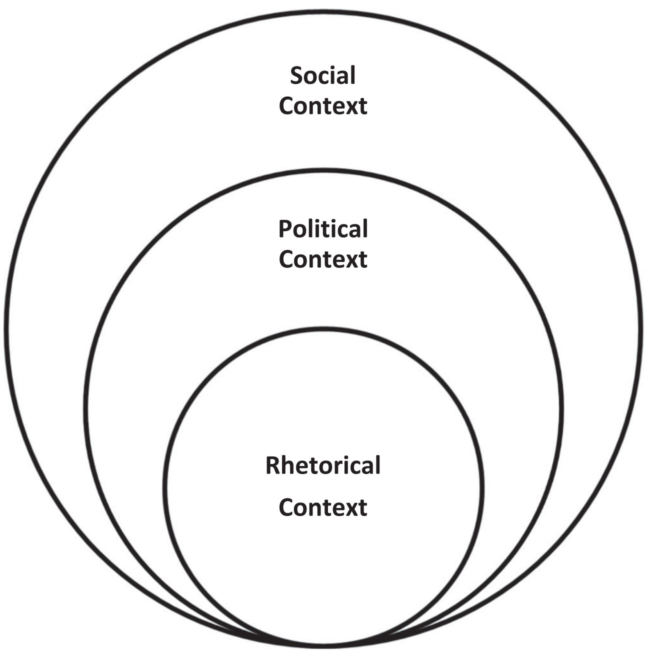

Figure 1. 3 levels of contextualisation.

component of such actions. In particular, the political scopes of national parliaments, as the most susceptible to popular pressure from movements and interest groups, have been heavily curtailed in the last decades (see Crouch 2004, Streeck 2011). As such, it might be more fitting to speak of *dedemocratisation* than *depoliticisation*. I argue that this is not an accidental development, but an intention that is reflected in neoliberal theory. Dedemocratisation is not a bug or an unintended by-product of neoliberal policy prescriptions. It was rather one of the central features of the neoliberal reorganisation of macroeconomic thinking that was initiated by the NCM scholars in the 1970s. This is the story that we explore below.

The Rational Expectations Revolution

The setting of the Rational Expectations Revolution was the discussion around the instruments of Keynesian demand management launched in Friedman's 1968 presidential speech to the American Economic Association (Friedman 1968). Here, Friedman attacked the idea of a stable trade-off between inflation and unemployment. This idea, often connected to the Phillips curve, was criticised by Friedman for not integrating the expectations of market actors in such inflationary policies by the government, thus underestimating the self-negating factors of inflationary expectations in Keynesian fiscal and monetary policies.

Despite this, Friedman was successful in framing this idea of a break with a supposedly naïve assumption at the heart of Keynesian approaches to fine-tune the economy; his wider project of macroeconomic analysis based on adaptive expectations of microeconomic actors, and a policy based on rules rather than political discretion, spawned a virtual revolution within macroeconomics. It was not Friedman, however, but rather his successor in Chicago, Robert Lucas, who proved to be the key figure in the theoretical formulation of a new approach. While Friedman proved successful in launching a critique of the Keynesian policy proscriptions, his monetarist theory never developed into a full-fledged alternative to Keynesianism in the macroeconomics field. Instead, Lucas and his generation of younger macroeconomists managed to develop a sustainable hegemonic alternative to Keynesianism.

New Classical Macroeconomics

Robert Lucas integrated Friedman's insights around adaptive expectation into the framework of neoclassical microeconomics, under the idea of rational expectations. In this move, he radicalised the attack on the policies of Keynesian demand management. These were not only problematic under special circumstances, but were, due to the rational anticipation of market actors, even theoretically impossible in the long run. This led to the coining of a new field, New Classical Macroeconomics (NCM), that alongside Lucas, was spearheaded by Robert Barro, Thomas Sargent, and Neil Wallace (Barro 1976, Sargent and Wallace 1976). The underlying ideas of the rational expectation models were focused on the investment decisions of firms and households under conditions of uncertainty, as formulated in an early form by Lucas and Prescott in their 1971 article *investments under uncertainty* (Lucas and Prescott 1971). A common denominator of these theories was the notion that government action, however well-meant and benign, is doomed to fail because of the anticipations of the rational actors of markets. The adaptive expectation of these actors would automatically price the long-term fiscal and monetary consequences of current government policies into their current investment decisions.[5] As a consequence, the discretionary policy scope of governments and parliaments had to be restricted in favour of policy rules. Lucas and Sargent in their 1979 article *After Keynesian Macroeconomics* formulated this as 'the need to think of policy as the choice of stable rules of the game, well understood by economic agents' and further added that 'policies (…), such as monetary instability and deficit financing, have the capacity only to disrupt' (Lucas and Sargent 1979, p. 15).

While the theoretical and policy implications of NCM were too extreme for many to adopt wholesale, the theories nevertheless had a large impact by shifting the parameters of the debate. In the economics profession, the idea of micro foundations became a basic precondition of theoretical orthodoxy, and with the development of the so-called new Keynesian theories that accepted the need for micro foundations in the 1980s, this came to be accepted by the dominant mainstream of the profession. The effect of the NCM project can be seen both in the (limited) direct impact of the school in the 1970s and 1980s as well as the universal effect they had in forcing their Keynesian opponents to accept their restructuring of the rules of the debate,[6] effectively shaping the format of the later hegemonic DSGE models (Morgan and Knuuttila 2012, Wren-Lewis 2018). Through concepts such as sticky wages and market failures, the New Keynesians adapted the new dominant neoclassical framework, but allowed for a limited use of the traditional instruments of Keynesian demand management (Eatwell and Milgate 2011, p. 59). On the enduring influence of Lucas' brand of rational expectations, Offer lays out how, of the new theories introduced in the 1970s,

> rational expectation was the most insulated from falsification, the most empirically empty and in terms of adoption by economists, by far the most successful. This doctrine continues to be influential in macroeconomics and is practiced across ideological divides by Chicago market fundamentalists and by liberal-minded neo-Keynesians. (Offer and Söderberg 2016, p. 25)

These theories provided critical delegitimisation for the policies of full employment that had characterised the postwar Keynesian paradigm at a time when they were under attack from several sides. By denying that the instruments of demand management had the ability to actually deliver, the NCM further weakened the paradigm at a crucial moment of crisis.

Methodological Innovation from Inside the Mainstream

The new classical macroeconomics, while reaching similar policy prescriptions of monetarism, nevertheless had major methodological differences. Primarily, this stemmed from a conscious understanding of working within the economic mainstream, rather than outside it.

In the 1960s, the mainstream of the discipline, as codified by Paul Samuelson and his paradigmatic 1948 textbook 'Foundations of Economics' (Samuelson 1998) in particular, was dominated by the so-called 'neoclassical synthesis'. This was a combination of a neoclassical apparatus drawn from Marshallian marginalism in microeconomics, and a certain form of formalised Keynesianism, as developed by Samuelson and Hicks in the years following the publication of Keynes's *A General Theory of Employment Interest and Money* (see Hicks 1937). This synthesis included a contradiction between the neoclassical theories of microeconomics and Keynesian macroeconomics. Neoclassical microeconomic theories state that the rational actors in the economy would naturally gravitate towards market-clearing equilibrium through the mechanism of market prices. On the other hand, the Keynesian theories of macroeconomics posit the fickle character of economic actors and the possibility of an economic equilibrium at less than full employment, and thus significant room for government intervention.

Lucas argued that the theories of macroeconomics needed a firm foundation in the rational actors of microeconomics, and that these actors, in contrast to 'un-rigorous' Keynesian ideas of animal spirits, would have to be assumed to make rational choices, based on the perceived long-term consequences of government economic policies. This meant that any government action would have always already been incorporated into the actions of the market actors. In the case of deficit spending, the rational actors would automatically assume that deficit spending would mean further inflation or taxation in the future, and accordingly lower their investment now, leading to the opposite of the intended effect (Lucas 1972, 1976). This gave a new theoretical credibility to the monetarist critique provided by Friedman's presidential address, which stated that government attempts at countercyclical interventions would always be mistimed because of time lag, and that they, even if well-intended, would lead to perverse effects.

Lucas's project, described by Robert Backhouse as a 'quest for a rigorous macroeconomics' (Backhouse 2010, p. 117), was an attempt to solve the tension within postwar economics between micro- and macroeconomics. Lucas, importantly, spent the early years of his career working within the standard Keynesian framework of postwar economics (Kasper 2003, p. 134), and his earliest notable works, co-authored with Leonard Rapping, aimed to augment the standard Keynesian models (Lucas and Rapping 1969). Lucas stated this quite directly in a 1984 interview, speaking of his NCM colleagues of the Chicago school 'We want to claim ourselves to be right in the mainstream. We think we are using the language of modern economics that, sooner or later, everyone will be using' (Klamer 1984, p. 49),[7] and he and Sargent stated that their own work would have been impossible 'without the econometric successes achieved by the Keynesian models' (Lucas and Sargent 1979, p. 15). The success of the strategy can be seen in the same volume, where even a Keynesian opposed to the NCM project like James Tobin calls Lucas' argument 'ingenious' (Klamer 1984, p. 107).

Problems of Inconsistency and Credibility

Another important development of the NCM project was the 'Time inconsistency model' developed by Kydland and Prescott (1977). This model involved studying policy making, such as monetary or tax policy, as a series of sequential policy choices by policymakers. Here, the ability of policy makers to revise earlier decision meant that government faced a 'credibility constraint' when dealing with private economic actors with rational expectation. The problem, they argued, was that the investment decisions of market actors, in line with Lucas, were shaped by the expectation of future government policies (Kydland and Prescott 1977, p. 474). This means that attempts at countercyclical policy, even if they made sense in the short term, would be detrimental in the long run, as market actors would adapt to expectations of future inflation or taxation, and thus lower their current investment. The way out of the bind of time-inconsistency is to make credible commitments to keep monetary policies stable in the long run. However, this theory runs into the inability of governments to make optimal policy decisions when the inherent short time horizons of the elected officials means that they always have to take the short-term preferences of voters into consideration at all times. This means institutionalising the ability to make credible commitments. The most important area here is the fight against inflation, especially the threat of future inflation. This means that in order to find an optimal monetary policy that conforms to the preferences of the investing class, monetary policy decision-making has to be taken out of the hands of politicians and put into the hands of actors not bound by voter pressure. The reason that they should not have discretion, the authors argue, 'is not that they are stupid or evil but, rather, that discretion implies selecting the decision, which is best, given the current situation. Such behaviour either results in consistent but suboptimal planning or in economic instability' (Kydland and Prescott 1977, p. 487).

Kydland and Prescott themselves imagined a set of rules restricting the ability of policy actors to enact countercyclical measures. In practice, they suggested a two-year lag period on all monetary and fiscal legislation by congress that 'would make discretionary policy all but impossible' (Kydland and Prescott 1977). This radical proposal was never attempted in practice. The translation of the time inconsistency principle into policy was instead primarily done through the principle of central bank independence, as laid out by Alesina *et al*. (1989), a later follower of the time inconsistency theory. This position became policy orthodoxy in the 1980s and 1990s (McNamara 2002) and was later supported by Prescott as being in line with his work (Klein et al. 2013, p. 557). Furthermore, Kydland and Prescott's theories were directly cited as arguments for the persistence of strong non-majoritarian institutions in the EU system (Majone 1996). Central bank independence generally took two forms. The first involved a firm constitution that bound the central bank to certain market-conforming policies, such as price stability. This is the model for the German Bundesbank and, later, the European Central Bank. The other was a wider scope of discretion, with credibility assured by the choice of directors and staff that had the trust of the markets, such as in the case of the US Federal Reserve or the Bank of England.[8]

Rhetorical, Political, and Social Contexts

To understand the meaning of the central papers of the rational expectations revolution, it is first necessary to examine them in the intellectual context into which they were formulated. This will involve three steps. First, we examine the immediate rhetorical context of postwar macroeconomics; second, we examine a wider view of the broader political questions that shaped the macroeconomic debate in the 1970s; and third, we examine the general tensions between politics and economics inherent in the capitalist order.

Rhetorical Context – Mathematics and Postwar Economics

The arguments put forward in the papers discussed have been formalised in a mathematised form. While the roots of the mathematical neoclassical theories applied can be traced back to the rise of marginalism in the 1870s (Watson 2005), the standardised form of economic arguments can be traced back to the formalisation and standardisation processes developed in the postwar US period (Backhouse 2010).

Here, a range of young economists, with Paul Samuelson at MIT as the most central, developed a new form and language of economics that would soon come to dominate economics in the West. These intellectual entrepreneurs largely drew on resources developed in the 1930s by Keynes, who, using Marshall's microeconomics as formulated in *Principles of Economics* (Marshall 2009) as the starting point, first developed a real framework of *macro*economics. Much ink has been spilled on the question of to what extent Keynes' theories represent a break from or development of the neoclassical economics of Marshall and the marginalists. Without resolving this question here, it suffices to state that there was no such conflict in the way Keynesianism was formalised by economists such as Samuelson and Hicks, a way that came to dominate in economics (Hicks 1937, Samuelson 1998). Instead, Keynesian macroeconomics and neoclassical microeconomics were integrated into a common framework known as 'the neoclassical synthesis'. The union of the two was always uneasy though, with different assumptions dominating the micro and macro levels. The actors in the rational expectations revolution utilised this tension to great effect. Claiming that microeconomics presented the most rigorous set of principles, the ideas of 'micro foundations' set up a principle that every macroeconomic theory had to be explainable in the form of the individual action of agents under the assumptions of rationality. In this way, what Roger Backhouse describes as the 'quest for rigorous macroeconomics' (Backhouse 2010, p. 117) presented the virtual colonisation of macro- by microeconomics. This mobilisation of existing intellectual resources might be a reason the normalising mode of the rational expectations revolution was able to gain more traction within economics than the more normative work of the earlier generation of neoliberals.

Monetarism was, to a certain extent, successful in delegitimising the Keynesian mainstream but proved to be unable to replace Keynesianism in the academic and modelling fields. Here, it was the next generation of new classical macroeconomists who proved to be more successful. In order to understand this, we need to understand the differences in approach. While NCM and monetarism were similar in the macro – and meso-level contexts, providing answers to some of the same contradictions in the Keynesian restructuring of postwar capitalism was quite different when it came to the micro-level context. Here, the new classical macroeconomists were able to utilise the existing resources of the economic profession, especially the tension between the macro and micro economics embedded in the neoclassical synthesis of the postwar profession.

Political Context – Crisis of the Keynesian Hegemony

If we examine the wider political context around the formulation of the theories of the rational expectations revolution, the central questions in the macroeconomic debates were shaped by the structure and apparent crisis of the Keynesian paradigm of the postwar order.

In the postwar period, one of the central questions was what the proper role of the state in the economy should be. This question of course developed around an ongoing dichotomy of liberal thought between what is considered private (and thus economic) and what is public (and thus political). In classical liberalism, the ideal was, even though political practices would often differ, that the state should provide a neutral framework that allows for economic transactions to take place, but that all substantive productive and commercial activities should take place in the private realm.[9] The postwar order changed in two crucial ways:

- The emergence of a public sector of state-owned enterprises producing for the market, and a welfare state, involving decommodified production in fields such as health, transportation, and infrastructure.
- The emergence of the government and the central bank as powerful planners of overall economic activity, via new and powerful tools of fiscal and monetary policy.

This new role of the state was developed through the rise of a new form of government activism in the fiscal and monetary sphere, inspired by Keynesian macroeconomics. The dominance of Keynesian theories in economic governance in the postwar era is well described in the literature (Hall 1989, van der Pijl 1989, Hall 1993, Hay 2001, Eatwell and Milgate 2011). Keynes's theories were, on the surface, about the stabilisation of the capitalist economy through the smoothing of the business cycle and prevention of the crisis of unemployment. This moderated form of Keynesian macroeconomics was imported into the curricula of economics by figures such as Samuelson and Hicks (Hicks 1937, Samuelson 1998).

However, the Keynesian system of macroeconomic governance also meant a reconfiguration of the capitalist economy at a deeper level. Keynes was himself a firm believer in private property and the capitalist market economy. However, by taking control of the overall level of investment in the society out of the hands of private investors, the Keynesian programme ultimately involved a major shift in power from the owners of private capital to elected governments. In the *General Theory,* Keynes describes this as 'the euthanasia of the rentier, and, consequently, the euthanasia of the cumulative oppressive power of the capitalist to exploit the scarcity value of capital', and furthermore describes how the saving and investment function carried out by the rentier class should be taken over by the 'communal saving through the agency of the State' (Keynes 2008 [1936], p. 235). This idea of the government as an investor of last resort and guarantor of full employment instigated tension between the rentier class and the voting public.[10]

Michael Kalecki already pointed out this tension in his 1943 essay, 'Political aspects of full employment' (Kalecki 1943). While full employment policies might lead to higher overall economic output, and thus potential profits, they would also lead to a fall in the social power of the owners of capital. As the state could step in to ensure lagging investments, it was no longer dependent on enacting the policy preferences of the business sector in order to induce them to invest and thus ensure economic growth. This means that the problem facing neoliberals of the postwar era was not the general problem of labour against capital, but instead the conflict between the investor class and the (democratised) state. In this way, the environment in which the liberal counter-revolution in macroeconomics took place was one of conflict, not only between labour and capital in the sphere of production, but also between the voting and investor classes in the political sphere.

The combination of rising inflation, falling growth rates, and uncertainty in the long-term prospects of profitability meant that it was increasingly impossible to combine a successful capitalist economy with a successful parliamentary democratic state (Lindblom 1982). Here, the new wave of new classical macroeconomics presented itself as a way of getting out of this unsolvable dilemma by strategically limiting the power of democratic governance within the state. Through the theoretical insertion of rational expectations and micro foundations into the macroeconomic models, the school attempted to demonstrate the inability of governments to intervene in the market economy and produce more optimal outcomes (Lucas 1976, Sargent and Wallace 1976). Following this, the logical step was to create time-consistent and credible modes of policy formation through the imposition of policy rules and limitations of government discretion – 'rules rather than discretion' – as stated in the title of Kydland and Prescott's 1977 paper (Kydland and Prescott 1977, p. 474). This has been read by both proponents and detractors as a way of depoliticising the field of macroeconomics, thus only leaving the state with the tools of long-term supply side reforms (Kasper 2003, p. 127). It is important here to stress that this restriction in scope did not entail a relegation of state power as such, but rather the reconfiguration of the use of state power.

Robert Lucas states in an approving assessment of his mentor Milton Friedman's policy aims that 'Friedman's policy is not exactly laissez-faire (…) I do not think of the Friedman countercyclical policies as stemming from a general dislike for government as much as calling for a very specific, well-defined form of government intervention' (Klamer 1984, p. 43).

If we examine some of the policy innovations of the rational expectations evolution, such as budgetary rules and independent central banks, the consequences have not resulted in a reduction of state power as such, but rather the transfer of power from elected parliaments to unelected officials, administrating with a set of rules. If we observe the objections to an active government macroeconomic policy formulated in theories such as 'time inconsistency hypothesis' and the 'policy-ineffectiveness proposition', what is criticised is not really the presence of political decisions, but rather the arbitrary nature of democratic politics. This is because an unrestricted popular majority always has the possibility of rolling back earlier decisions. Democratic rule was seen as far too unpredictable for effective economic governance. In order to get a form of governance that allowed for predictability and credible commitments, the democratic influence on important macroeconomic decisions had to be rolled back.

The focus on rules rather than discretion does, of course, not rule out democratic involvement. However, the sort of long timeframes that the authors expect in practice means that parliaments, and thus electoral politics, would not exercise any meaningful role in everyday economic governance. It was not less government and more market, which was the logical outcome of the NCM revolution, but rather the use of new forms of state power to shield the markets and investors from democracy.

Social Context: Capitalism and Democracy

The discovery of the economic problems of popular democracy in the new theories of macroeconomics in the 1970s can be more properly seen as a rediscovery of a much older liberal ambiguity towards democracy that is as old as liberal economic theory itself. In Ellen Meiksins Wood's major work, *Capitalism versus Democracy* (Wood 1995), she shows how liberalism has had an uneasy connection to democracy from the very start of the early modern period. Liberalism was from its earliest conception a movement of the property-holding middle class that wanted the protection of life, body, and property from the overreach of the monarchical state. This liberal political project was essentially an attempt to use the rule of law to set up protections for private property against the encroachment of the state as well as from the unpropertied majority (Wood 1995, 2012).

This aspect of democracy, was what lead James Madison to argue against democratic rule in Federalist Paper no. 10, 'democracies have ever been spectacles of turbulence and contention; have ever been incompatible with personal security or the rights of property; and have in general been as short in their lives as they have been violent in their deaths' (Madison et al. 1961, p. 76). Even John Stuart Mill, arguably the strongest nineteenth-century proponent of inclusive liberalism, feared the prospect of majority rule and wanted to set up protections of the propertied minority, such as extra votes for the propertied and educated, and restrictions for servants and recipients of public relief (Mill 2010, chap. 8, Sects. 1–2).

While the new anti-democratic theories of macroeconomics were, to a certain extent, the rediscovery of earlier liberal anxieties, there are also considerable differences. The main solution of nineteenth century liberalism to the fear of popular rule was through the restriction of partitions in the political process for popular classes. This could take the form of property qualifications on the vote through the division of active and passive citizenship. At the international level, the scope of government monetary independence was restricted by the Gold Standard. The problem for a new generation of economic liberals was that these tools seemed impossible to implement in the postwar world. While there are a few economic liberals, such as Hans Hermann-Hoppe or Jason Brennan (Hoppe 2001, Brennan 2012), who reject electoral democracy completely, the vast majority find this position to be far too extreme.

The solution to the tension between economic liberalism and popular democracy was thus not to restrict access to political participation, but rather to rein in the reach of democratic state power. The methods aimed to bring the modes of decision-making into macroeconomic matters in line with the needs of investors for political predictability and looseness of regulation. In fiscal policy, this meant the limitation of attempts at countercyclical measures or full employment policies through the introduction of budgetary rules or international norms. In monetary policy, this meant the complete removal of the area from political and democratic deliberation, and instead leaving policy formation to independent central banks, where appointed bankers were presumed to have more 'credibility' in the eyes of the investing class. Here, the language of technical economics was used as an argument for excluding parliamentarians from the supposedly complicated world of finance and monetary matters. An overall summation of the contradiction at play in the rhetorical, political, and social context can be seen in Figure 2.

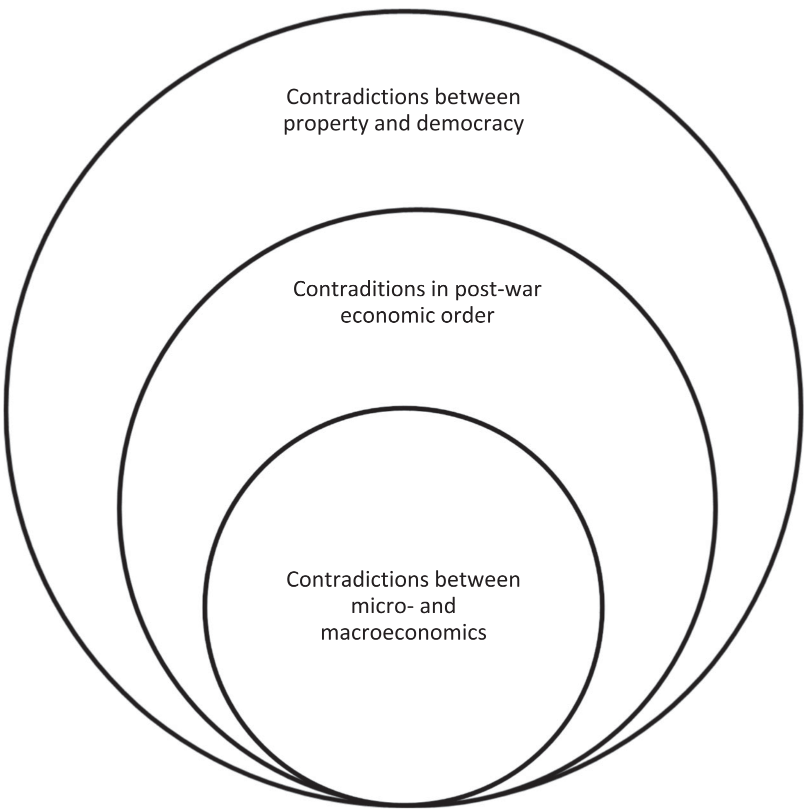

Figure 2. Specific context for the rational expectations revolution.

Conclusion

The article has presented a reinterpretation of the relation of neoliberalism to democracy and government through a reading of the central papers of the neoliberal macroeconomic theory of the 1970s as political interventions. The article's focus is thus not primarily on the normative theory of neoliberalism, as formulated by Hayek or Friedman, which has been thoroughly discussed in the literature on neoliberalism in recent decades, but instead on the normalising theories of the New Classical Macroeconomists. The main point of this reinterpretation is to point out that the target of the critique of the NCM theorist was not, as is often assumed, a rollback of the state from the economy. Rather, the aim was to remove the specific democratic influences on economic policy that posed a threat to the confidence of investors in future profits, and thus to the health of the capitalist economy. In the short term, the democratic influence is deemed problematic in this literature because it produces a chaotic, unpredictable element that excludes the sort of stable, credible commitment that is necessary to induce investments. In the long term, the consequence of general suffrage is constantly increasing public spending.

As a result, there is an assumed contradiction between economic performance and democratic participation in economic and fiscal affairs. The solution of the neoclassical liberals is to prioritise the health of the capitalist economy by insulating the sphere of economic decision-making from the whims of elected politicians, under the assumption that the public has an interest in binding itself in order to maximise economic outcome. The implication of the theoretical ideas of rational expectations and time-inconsistency was a virtual removal of fiscal policy as an active measure of countercyclical policy, and a parallel increase in the importance of monetary policy, a development coupled with the removal of monetary policy decisions from elected politicians and the placement of these decisions into the hands of central bankers in newly independent central banks. This development has been seen as a move towards depoliticisation. I argue however, that this is insufficiently specific, and that the issue here is rather a move towards dedemocratisation. In his description of depoliticisation in 'why we hate politics' Colin Hay defines politics as 'the realm of contingency and deliberation' (Hay 2007, p. 93). In this context, the transformation of macroeconomics following the rational expectation revolution is not so much the removal of deliberation and contingency, but rather their displacement from the sphere of representative democracy, to spheres of expert or elite deliberation.

This reinterpretation, with its focus on democracy, furthermore has the virtue of resolving one of the central paradoxes of the study of neoliberal policy: why three to four decades of hegemony of a purported anti-government ideology have not shrunk the size of the state (see Mirowski 2009, Cahill 2014). This misunderstanding can be understood by realising that the neoliberals did not have a problem with the state as such – instead, they had a problem with the specific democratic parts of the state governance that constituted a problem.

The interpretation of the neoclassical liberals was that the crisis of macroeconomic policy of the 1970s was a contradiction between the needs of investors and the aims of the voting public. To solve the macroeconomic problems, this contradiction had to be resolved in favour of investors. Here, the aim was not a rollback of the state, but instead an internal reorganisation of the state, such that the balance of class forces within the state apparatus was tipped in favour of investors. This was not done by restricting the access to vote, as was the preference of nineteenth century liberals, but by restricting the domain of democratic deliberation in economic policy.

Notes

1. I am indebted here to Wendy Brown, who in Undoing the Demos (2015), centres the idea of dedemocratisation as a main function of neoliberal economic thought (see also Kiely 2017). Her use of the term is distinctly different from the way it is employed in this article as Brown's Foucault-inspired framework identifies the dedemocratising effects of neoliberalism primarily in the realm of subjectivity (Brown 2015, p. 17).

2. The definition of democracy in this article is rather 'thin', dealing with the control of state institutions by officials elected by a majority of the adult population under free and universal suffrage. This also means considering liberalism, the rule of law, and democracy as separate entities/principles, in contrast to many classifications of 'liberal democracy' as simply meaning 'full democracy' (Møller and Skaaning 2012). It also means not considering deeper forms of democratic participation such as deliberative or direct democracy (Held 2006). The aim of the article is to discuss the real, existing forms of democratic participation, in which elections have been dominant in the period surveyed, rather than a full history of the idea of democracy, which lies outside the scope of this investigation.
3. Without trying to integrate the two perspectives on a theoretical and ontological level, one can, in the model presented above, see Skinner as focusing on the rhetorical and political levels, while Wood focuses on the social and political context.
4. The concept of depoliticisation has since been developed further and expanded to cover more than just economic policy by amongst others, Hay (2007), and Buller and Flinders (2005). Here, the focus will be solely on employment on the economic terrain.
5. Given the logically maximal scope of this rationality and foresight, all government intervention in the economy would tend to be detrimental as the welfare preferences of the electorate would not be aligned with market actors.
6. The later fusion of NCM elements with neo-Keynesianism have been described as *new consensus macroeconomics*, encompassing the dominance of monetary over fiscal policy, and the relegation of the problem of unemployment as primarily a supply side problem concerned with inflexibilities in the labour market (Arestis and Sawyer 2004, 2008).
7. In a 1994 interview, Sargent mirrored this opinion when stating that the interventions of the rational expectations school were especially 'destructive' for Keynesianism because they were seen as insiders (Sent 2006, p. 166).
8. In the UK case after the 1997 implementation of full operational independence for the Bank of England by the recently elected Chancellor of the Exchequer Gordon Brown.
9. This denial of state intervention in liberal economic theory should not be seen as directly mirrored in a denial of the use of state power in practical liberal economic governance. For more on the ambiguous relation to the state in the history of economic liberalism, see (Stahl 2019).
10. In time, this meant that the Keynesian programme went from being seen by business as a programme for shoring up the capitalist economy, the increasing power of the state and an emboldened work force, and instead began to be seen as a threat to corporate profits (see Panitch and Gindin 2012, p. 136).

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