IN DEFENCE OF NEOLIBERALISM

Those who prefer growth to stagnation must make defending and extending the global liberal order their top priority, argues **Sam Bowman**

We are living in an era of staggering technological change. Smartphones alone are well beyond the dreams of science fiction even from 20 years ago—Star Trek's electronic 'PADD' looks primitive compared to any $200 Chinese-made device.

Yet advances in electronics, communications, information technology, robotics and artificial intelligence have not obviously fed through to economic growth. Increased global trade may have raised living standards, but its main macro-level effect has been to create economic disruption which, in many developed countries, has fed through to politics in a harmful way.

It is as a reaction to these trends in Western labour markets and politics that a group of people, mostly globalist free marketeers as well as some market friendly left-liberals, have begun to self-identify as 'neoliberals'. Both to avoid a repeat of the history of a century ago and to keep Western politics focused on economic growth, above all, as the key priority, neoliberals are increasingly trying to outline what they see as a flexible and appealing way of defending the global liberal order.

We've been down this road before

The parallels between today and the 'long depression' of the late 19th century are striking. That too was an era of rapid technological advance, leaps forward in global trade, economic dislocation and political backlash.

The 'long depression' began with the financial panic of 1873, which triggered a six-year long recession across much of Europe and North America. Milton Friedman argued that the cause of this recession was the elimination of the free coinage of silver, which made a gold standard inevitable; in this reading the 'depression' was a long period of below-potential growth caused by expectations of excessively tight money in the future.[1]

Such a reading is rejected by historian Norman Stone, who sees 'depression' as a misnomer. As Stone tells it:

> In the last third of the 19th Century, Europeans became much richer than ever before: the liberal, or capitalist, revolution had done its work. It is curious that this era should be known to historians as the 'Long Depression'—an expression to describe the decline ('depression') in prices, profits, exports which also brought about unemployment. In reality, apart from a few bad moments (1879-83, 1891-5), these years were ones of remarkable development in the towns. The 'Depression' affected some quite distinct social groups, who became loud in complaint at the economic liberalism that had caused such troubles.[2]

What is not in doubt is that real interest rates and profits fell steadily after 1873 in the Western world; *bonne bourgeouisie* 'rentiers'

Sam Bowman is Executive Director of the Adam Smith Institute in London.

who had invested their savings in safe bonds could no longer rely on those savings to maintain their livelihoods.

A coincidence of technological advancements around this period led to enormous economic change. The adoption of innovations like railroads, refrigeration and the Parsons steam engine, which cut crew sizes and fuel needs on ships, created for the first time a global market in food and other raw materials. Transport costs fell dramatically. In 1874, it cost 20 cents per bushel of grain transported from New York to Liverpool; seven years later the cost was two cents. It cost 200 francs to ship a ton of goods from Marseilles to Hong Kong in 1875; by 1906 that had more than halved to 70 francs.

Food prices fell by half in Europe as American, Argentine, Australian and Ukrainian imports flooded Europe's markets. A similar story was true of other raw materials like coffee, rubber, guano, copper, iron ore, wine and dairy products.

In other words, this was an era of technological progress and globalisation in the wake of a financial panic (not dissimilar to the 2008 Global Financial Crisis), which nevertheless did not produce high real economic growth rates.

The main consequence of this was a massive migration from the countryside to towns across much of Europe, speeding up a trend that had been taking place throughout the century. Small towns became large cities. Manufacturing centres like Dusseldorf and Sheffield exploded in size; Leeds grew by 50% from 200,000 people to 300,000 in the twenty years between 1861 and 1881.[3] People whose ancestors had made their living working the land now found both that farming was no longer profitable and that cheaper food made urban life affordable for the first time, with the economic opportunities that presented.

Tenement slums grew, endless quantities of labour in the cities led to the second industrial revolution and the emergence in many countries of the first organised political labour movements. Miners striked in Britain, France and Germany; independent artisans and smaller manufacturers were squeezed out of business by large factories. Eventually, landowners and the other remaining rural interests got their act together and succeeded in pushing for tariffs on food.

The ensuing rise in food prices hurt this new urban working class badly, who in turn demanded socialism and communism as an answer to poor living conditions. Imperialist and nationalistic movements grew in popularity on the right, and within the liberal movement the classical liberal free traders were blamed for their 'do nothing' attitude and eventually eclipsed by protectionist and interventionist radical liberals like Joseph Chamberlain. Chamberlain, incidentally, is the political hero of UK Prime Minister Theresa May's former chief policy advisor, who many consider the architect of her corporatist Toryism.

In other words, this was an era of technological progress and globalisation in the wake of a financial panic (not dissimilar to the 2008 Global Financial Crisis), which nevertheless did not produce high real economic growth rates. Falling prices meant cheaper goods, but also created economic dislocations that disrupted old ways of life and ultimately led to the eclipse of classical liberalism alongside demands for extremism and populism on the left and right.

One does not need to exaggerate the parallels with the present day—where, at least, internal migration is much less of a factor in ongoing economic dislocations and most (88%, according to one estimate) of the jobs that have been lost have been to automation, not trade.[4] Nevertheless the similarities are clear.

To free marketeers, there is little question that this change is worth it. Automation and technological progress may disrupt people's lives but ultimately we think of new things for people to do and the extra wealth and tools that technological advances create raise everybody's living standards in the long run.

Trade, usually blamed for hurting ordinary workers while helping the rich, is actually especially good for the poor. A 2014 study in the United States estimated the gains from trade to different parts of American society based on baskets of goods designed to represent different consumption patterns along the income distribution, and then calculated how much poorer the bottom 10% would be without global trade, compared with the top 10%.[5] The gains from trade accruing from cheaper goods were not felt equally between rich and poor: the real income loss from closing off trade is 63% at the bottom 10% of the income distribution and 28% for the top 10%.

Globally, extreme poverty has fallen from 44% of the world's population in 1981 to 9.6% today.[6] Openness to trade, better property rights and the de-nationalisation of state-run industries in China have between them driven at least two-thirds of that country's growth since 1980, lifting millions of people out of poverty. Under communism, Chinese GDP per capita was $300 a year. Today it's $10,000 a year and rising.

Migration, generally a mild net positive for natives, can make the *migrants themselves* far richer. World Bank officials have argued that there is 'simply no contest' between guest worker programs and other anti-poverty programs like cash transfers or microfinance—participants in New Zealand's seasonal worker program experience huge increases in income, greater subjective well-being, and more schooling for their kids.[7]

But the shocks are real enough and the trend is not particularly encouraging. David Autor, David Dorn and Gordon Hanson recently evaluated the 'China shock' of greater Chinese imports to the US between 1990 and 2007.[8] They found that in areas with existing manufacturing that were competing with Chinese imports, rising imports raised local unemployment, cut wages, and drove more people out of the labour force altogether, whether onto disability benefits or into early retirement.

Other studies have looked at the declining labour share of GDP—a trend observable in most OECD countries since the early 1990s, ending a previously stable 'stylized fact' of the ratio between returns to capital and labour.[9] The reason seems to be entirely driven by the rise of so-called 'superstar firms' like Google, Facebook and Amazon in new kinds of markets where very low marginal costs mean there is no inherent ceiling on firm size.

Software often does not have the same diseconomies of scale that normal products do, so one firm would be expected to dominate each market at a time. These 'winner takes all' markets are not inherently monopolistic, because these large firms are still vulnerable to rivals with better products, but whoever has the best product on offer at a given time is likely to have a very large amount of market share. Low marginal costs and high fixed costs (of innovating better products) have, so far, meant that only a small number of extremely talented workers are necessary for success. The result has been something of a divergence between economic growth and wage growth which may continue.

> Regulation to try to brute-force firms into paying workers more usually backfires, and protectionism is not the answer to disruption caused by trade.

Trying to reverse or undo these trends would be counterproductive, yet this is often the usual political answer. Regulation to try to brute-force firms into paying workers more usually backfires, and protectionism is not the answer to disruption caused by trade. As Paul Krugman writes:

> The lesson I took from the widely cited Autor, Dorn, and Hanson paper on the China shock was that Ricardo and Heckscher-Ohlin were less relevant to the political economy of trade than the sheer pace of change, which disrupted local manufacturing concentrations and the communities they supported. The point is that a protectionist turn, reversing the trade growth that has already happened, would be the same kind of shock given where we are now. It's like the old joke about the motorist who runs over a pedestrian, then tries to undo the damage by backing up—and runs over the victim a second time.[10]

The neoliberal agenda

There is no new 'neoliberal moment', though it is convenient to suggest that France's Emmanuel Macron represents one. But for a group of us the term is a useful differentiation from fellow travellers (see the box overleaf on how to spot a neoliberal).

How to Spot a Neoliberal

1. **We like markets—a lot.** We think that markets are by far the best way of organising most human affairs that involve scarce resources, because they align people's incentives in ways that communicate where resources can be used most efficiently, and give people reasons to come up with new ways of using existing resources. This means that markets and market-like systems are desirable in many, many places they're not present at the moment—from healthcare, education and environmental policy to land-use planning, traffic congestion and organ allocations.
2. **We are liberal consequentialists.** A system is justified if it is the one that best allows people to live the lives that they want to live, or makes them happiest or more satisfied than any other. There are no inherent rights that override this. People's well-being is all that matters, and generally individuals are best at defining what is best for themselves.
3. **We are individualistic.** We promote low simple taxes because we want economic growth and to give people more power over their money, so it is individuals and not the state who choose where their income goes. We promote competition in healthcare, education, utilities and other public services because we want those things to be better through a process of experimentation and individual choice.
4. **We care about the poor.** Caring about people's well-being leads us to caring about the worst-off people. Usually an extra $100 makes a pauper better off than it makes a millionaire. This diminishing marginal utility means that poor people's lives are the easiest to improve for a given amount of time, energy and money.
5. **We are globalist in outlook.** It's natural to feel more in common with people who live near you and live like you, just as it's natural to care much more about your family than about strangers. But when it comes to policy, we care about improving everyone's lives, wherever they are. We promote globalisation because we want to raise the living standards of people around the world through trade and investment. We also tend to be pro-immigration—not just because it's good for the natives, but because it's good for the migrants themselves.
6. **We are empirical and open-minded.** There is an unlimited number of stories that you can tell about the world, but only a few are true. You find out which are true by comparing the stories to reality with experiments and throwing away the ones that don't fit, even though it's often painful to do so. It doesn't matter if a theory appears to be internally coherent—if it can't stand up to experimentation, it's wrong. In particular, quantitative empirical research is what we look for.
7. **We are optimistic about the future, and think the world is getting better.** And, really, it is: pro-market ideas have taken hold, raising living standards by an extraordinary amount for a huge number of people. The centre-ground consensus in nearly every developed economy is much more pro-market and liberal compared to where it was 50 years ago. Although it is often less pro-market than it was 100 years ago, that is offset by major advances in the rights of women and non-whites
8. **We believe that property rights are very important.** Predictable and formalised ownership of scarce resources is extremely important. It allows people to make long-term plans for the future, which incentivises improvement of their own circumstances. Overriding property rights capriciously undermines the incentive people have to hold off from consuming and invest in their futures instead, because they will be unsure about whether they'll actually get to enjoy the returns of that investment. This is especially important in the developing world, where weak or non-existent property rights preclude capital accumulation and growth.
9. **We're comfortable with redistribution, in principle.** Because we're consequentialists we don't think that property rights are morally significant in and of themselves—they're a useful rule that allows the economy to function properly but there is no intrinsic value to them. People don't really deserve the talents they're born with any more than they deserve to have been born in a rich country rather than a poor one. Because of this, redistributing wealth or income from lucky people to unlucky people may be justifiable, if it's done without depressing economic growth too much. Too much redistribution can have bad consequences because taxes tend to depress investment and growth, but too little redistribution has bad consequences too—poor people don't live good enough lives. A neoliberal is someone who believes that markets are astonishingly good at creating wealth, but not always good at distributing wealth.

We are globalist consequentialists who have concluded that free markets, property rights, free trade and liberal migration policies are effective tools for fostering economic growth and improving the well-being of the global poor. We're suspicious of politics; democracy is not the panacea for our problems that many on the left and, increasingly, the populist right seem to think. We cannot hope to solve political problems by chucking out experts and replacing them with politicians or referendums.

We are comfortable with redistribution of income, done simply through cash transfers instead of a complicated welfare state. In a sentence, a neoliberal's worldview might be something like this: Governments should facilitate as much wealth creation as possible, and redistribute some of it after.

This differs from left-liberal Blairism in its scepticism about the effectiveness of government as a piecemeal problem-solver and its *prima facie* preference for markets in most cases where scarce resources must be allocated. It differs from libertarianism and classical liberalism in its support for a fairly large degree of income redistribution, though done differently to how most developed nations do this at present.

Neoliberals are alarmed at the right's embrace of nationalism and the populist idea that economics and good policy doesn't matter, that 'experts' are systematically biased and should be ignored. At the same time, the lurch towards the hard left in the form of people like Jeremy Corbyn, Bernie Sanders, Beppe Grillo and Jean-Luc Melenchon suggests that the old ideological battles that many thought had been settled must be fought once again.

The 'neoliberal agenda', then, is to resist both zombie Marxism and right-wing populism in the areas where these are making the biggest gains. Trade, in particular, is vulnerable. Defending and extending the global liberal order means, above all, resisting moves away from trade openness favoured by the Trump administration and some 'hard' Brexiteers who have toyed with the idea of tariffs and subsidies to protect British jobs from better foreign competition.

Seen costs dominate unseen benefits. The negative consequences of trade openness and automation—the 'destruction' of some old jobs and the low status of many of the new ones—seem to be much more salient to people than the benefits. A cheaper iPhone is seen as a frivolity compared to a rewarding, high status job in manufacturing, and the other benefits of trade and automation are nearly invisible.

Welfare and labour market reforms may at least mitigate some of the harms here. Replacing complicated welfare systems (in Britain there are over 50 different kinds of benefit payments available) with simple cash payments, whether in the form of a Negative Income Tax, a work-contingent payment (similar to the Earned Income Tax Credit) or wage subsidies to employers may make uneconomic jobs that give workers a greater sense of self-worth (such as some of those involving manual labour or manufacturing) more viable. Combined with labour market deregulation, greater innovation about how to use workers may stop or reverse the shift of income away from workers' wages.

Ultimately, a lack of economic growth across much of the developed world seems like the biggest cause of our present woes. People will put up with a lot if they feel like their family's lives are getting better.

The lurch towards the hard left in the form of people like Jeremy Corbyn, Bernie Sanders, Beppe Grillo and Jean-Luc Melenchon suggests that the old ideological battles that many thought had been settled must be fought once again.

'Going for growth' involves a focus on the lowest-hanging policy fruit. For example, in most English-speaking countries, urban zoning and planning laws have created housing crises in prosperous cities. Living in Sydney, London or San Francisco is astonishingly expensive now by historical or international standards. Apart from the first-order effects this has of raising people's cost of living, the second-order effect is probably a significant drag on growth. By preventing people from moving to where they could be most productive, expensive housing holds economic growth back. This 'spatial misallocation' is estimated by Chang-Tai Hsieh and Enrico Moretti to have lowered aggregate US growth by more than 50% between 1964 and 2009.[11] The same is likely true in other English-speaking countries. (Continental Europe has different problems.)

Another example is tax, where the structure of corporation tax is such that investment is usually taxed heavily. This need not be the case: full capital expensing would effectively shift the burden of corporation tax away from investment towards consumption and be far less of a drag on growth.

This would also probably allow the creation of more manufacturing jobs in developed countries, since it is machinery and property investment that are typically hit hardest by corporation tax. (In the UK, former Chancellor George Osborne funded his headline corporation tax cuts by increasing the relative tax burden on machinery and property investment.)

Neoliberals will always be a small group. But the idea of neoliberalism has captured some people's imaginations and seems to be filling an open niche in the political market. Online especially, many younger people who are uncomfortable with libertarianism's dogmatic image and enjoy the naughtiness of re-appropriating a political swear word have adopted the label.

Many younger people who are uncomfortable with libertarianism's dogmatic image and enjoy the naughtiness of re-appropriating a political swear word have adopted the label.

But it must be understood as a product of a time when both left and right seem to be lurching away from global openness. Our focus is on the political margin, defending and extending the global liberal order however we can and avoiding a repeat of the early 20th century. If we don't, who will?

Endnotes

1 Milton Friedman, 'The Crime of 1873', *The Journal of Political Economy* 98:6 (December 1990), 1159-1194.

2 Norman Stone, *Europe Transformed: 1878–1919*, 2nd edition (London: Wiley Blackwell, 1999).

3 According to the 1861 and 1881 censuses.

4 Michael J. Hicks and Srikant Devaraj, *The Myth and Reality of Manufacturing in America* (Indiana: Ball State University, June 2015 and April 2017), 6.

5 Pablo D. Fajgelbaum and Amit K. Khandelwal, 'Measuring the Unequal Gains from Trade', *NBER Working Paper No. 20331* (Washington: National Bureau of Economic Research, July 2014).

6 Max Roser and Eesteban Ortiz-Ospina, 'Global Extreme Poverty', *Our World in Data* (2013 revised 27 March 2017), https://ourworldindata.org/extreme-poverty/

7 David McKenzie, 'The Most Effective Development Intervention We Have Evidence For?' (July 2010), http://blogs.worldbank.org/allaboutfinance/the-most-effective-development-intervention-we-have-evidence-for

8 David H. Autor, David Dorn and Gordon H. Hanson, 'The China Shock: Learning from Labor-Market Adjustment to Large Changes in Trade', *Annual Review of Economics* 8:1 (2016), 205-240.

9 David H. Autor et al, 'The Fall of the Labor Share and the Rise of Superstar Firms', *CEP Discussion Paper No 1482* (May 2017).

10 Paul Krugman, 'The China Shock and the Trump Shock', *The Conscience of a Liberal* (December 2016), https://krugman.blogs.nytimes.com/2016/12/25/the-china-shock-and-the-trump-shock/

11 Chang-Tai Hseih and Enrico Moretti, 'Housing Constraints and Spatial Misallocation' (May 2017), http://eml.berkeley.edu//~moretti/growth.pdf