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After Neoliberalism

All Economics Is Local

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After Neoliberalism

All Economics Is Local

RANA FOROOHAR

For most of the last 40 years, U.S. policymakers acted as if the world were flat. Steeped in the dominant strain of neoliberal economic thinking, they assumed that capital, goods, and people would go wherever they would be the most productive for everyone. If companies created jobs overseas, where it was cheapest to do so, domestic employment losses would be outweighed by consumer benefits. And if governments lowered trade barriers and deregulated capital markets, money would flow where it was needed most. Policymakers didn't have to take geography into account, since the invisible hand was at work everywhere. Place, in other words, didn't matter.

U.S. administrations from both parties have until quite recently pursued policies based on these broad assumptions—deregulating global finance, striking trade deals such as the North American Free Trade

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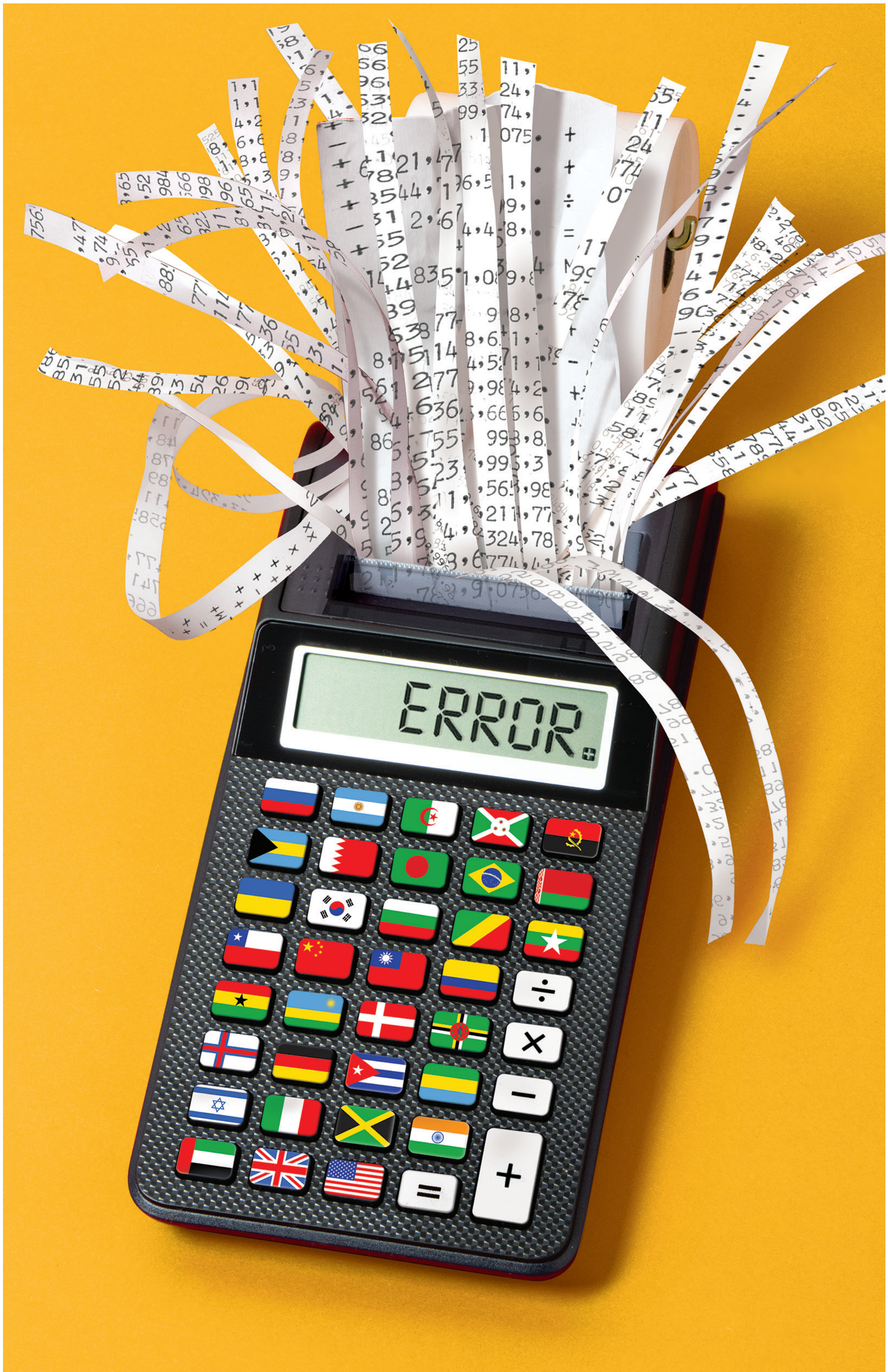

Illustration by Doug Chayka

Agreement, welcoming China into the World Trade Organization (WTO), and not only allowing but encouraging American manufacturers to move much of their production overseas. Free-market globalism was of course pushed in large part by the powerful multinational companies best positioned to exploit it (companies that, of course, donated equally to politicians from both major U.S. parties to ensure that they would see the virtues of neoliberalism). It became a kind of crusade to spread this new American creed around the globe, delivering the thrill of fast fashion and ever-cheaper electronic gadgets to consumers everywhere. American goods, in effect, would represent American goodness. They would advertise American philosophical values, the liberalism tucked inside neoliberalism. The idea was that other countries, delighted by the fruits of American-style capitalism, would be moved to become "free" like the United States.

Neoliberal policies caused the global economy to become dangerously untethered from national politics.

By some measures, the results of these policies were tremendously beneficial: American consumers in particular enjoyed the fruits of cheap foreign manufacturing while billions of people were lifted out of poverty, especially in developing countries. As emerging markets joined the free-market system, global inequality declined, and a new global middle class was born. How free it was politically, of course, depended on the country.

But neoliberal policies also created immense inequalities within countries and led to sometimes destabilizing capital flows between them. Money can move much faster than goods or people, which invites risky financial speculation. (The number of financial crises has grown substantially since the 1980s.) What is more, neoliberal policies caused the global economy to become dangerously untethered from national politics. Through much of the 1990s, these tectonic shifts were partly obscured in the United States by falling prices, increased consumer debt, and low interest rates. By the year 2000, however, the regional inequalities wrought by neoliberalism had become impossible to ignore. While coastal U.S. cities prospered, many parts of the Midwest, the Northeast, and the South were experiencing catastrophic job losses. Average incomes among U.S. states began to diverge, having converged throughout the 1990s.

Trade with China especially altered the economic geography of the United States. In a 2016 article in *The Annual Review of Economics*, the economists Gordon Hanson, David Autor, and David Dorn described how neoliberal policies had laid waste to certain regions of the United States even as it had conferred enormous advantages on others. China "toppled much of the received empirical wisdom about the impact of trade on labor markets," they wrote. Suddenly, there wasn't a single American dream, but rather a coastal dream and a heartland dream, an urban dream and a rural dream. The invisible hand didn't work perfectly, it turned out, and its touch was felt differently in different parts of the country and the world.

This was not an entirely new insight. Since the beginning of the neoliberal era, a handful of economists had pushed back against the received wisdom of the field. Karl Polanyi, an Austro-Hungarian economic historian, critiqued classical economic views as early as 1944, arguing that totally free markets were a utopian myth. Scholars of the postwar period, including Joseph Stiglitz, Dani Rodrik, Raghuram Rajan, Simon Johnson, and Daron Acemoglu, also understood that place mattered. As Stiglitz, who grew up in the Rust Belt, once told me, "It was obvious if you were raised in a place like Gary, Indiana, that markets aren't always efficient."

This view, that location plays a role in determining economic outcomes, is only just beginning to land in policy circles, but a growing body of research supports it. From the work of Thomas Piketty, Emmanuel Saez, and Gabriel Zucman to that of Raj Chetty and Thomas Philippon, there is now a consensus among scholars that geographically specific factors such as the quality of public health, education, and drinking water have important economic implications. That might seem intuitive or even obvious to most people, but it has only recently gained broad acceptance among mainstream economists. As Peter Orszag, who served as President Barack Obama's budget director, told me, "If you ask a normal human being, 'Does it matter where you are?' they would start from the presumption that 'Yes, where you live and where you work and who you're surrounded by matters a ton.' It's like Econ 101 has just gone off the path for the last 40 to 50 years, and we're all little islands atomized into perfectly rational calculating machines. And policy has just drifted along with this thinking." He added, "The Economics 101 approach, which is place-agnostic, has clearly failed."

The importance of place has become even more evident since the start of the COVID-19 pandemic, the economic decoupling of the United States and China, and Russia's war in Ukraine. Globalization has crested and begun to recede. In its place, a more regionalized and even localized world is taking shape. Faced with rising political discontent at home and geopolitical tensions abroad, governments and businesses alike are increasingly focused on resilience in addition to efficiency. In the coming post-neoliberal world, production and consumption will be more closely connected within countries and regions, labor will gain power relative to capital, and politics will have a greater impact on economic outcomes than it has for half a century. If all politics is local, the same could soon be true for economics.

THE NEOLIBERAL VISION

Neoliberalism's agnosticism about place is striking, given the origins of the political philosophy. It emerged in Europe in the 1930s, when nations were turning inward and international trade was breaking down. Later, neoliberalism became a pillar of the post–World War II economic system precisely because it sought to ensure that such problems of place never recurred. Neoliberals wanted to connect global capital and global business to prevent nations from warring with each other. But ultimately, the system went too far, creating not only asset bubbles and a glut of speculation but also a major disconnect between capital and labor. This in turn fueled the rise of a new kind of political extremism.

These events have in some ways mirrored those of 100 years ago. Between 1918 and 1929, the prices of nearly all assets, whether stocks, bonds, or real estate, rose in Europe and the United States. Central bankers everywhere had opened the monetary spigots and encouraged people to buy things on credit. But this sense of easy money and a rising tide lifting all boats masked ominous political and economic changes. The Industrial Revolution had accelerated urbanization in many countries and displaced millions of workers. Labor forces that were once primarily agricultural now toiled mostly in factories and industry. Wages didn't rise as fast as prices, which meant that economic well-being for most people depended on debt.

Meanwhile, trade between countries slowed. World War I and the 1918 flu pandemic, which lasted well into 1920, caused international trade to fall from 27 percent of global output in 1913 to 20 percent on

average between 1923 and 1928. The debt bubble exploded in 1929, and the ensuing Great Depression caused international trade to collapse to just 11 percent of the world economy by 1932. Trade tariffs and punitive taxes on both sides of the Atlantic added to the problem, and it wasn't until after World War II that cross-border flows of goods and services exceeded 15 percent of the global economy again.

Out of this bleak economic landscape grew fascism, first in Italy and then in Germany. European nations hunkered down in their colonial stances, grabbing resources from the developing world to finance their war efforts. A Hobbesian atmosphere of "all against all" fell over Europe, leading inexorably to the horrors of World War II.

In the aftermath, leaders and intellectuals in Europe and the United States understandably sought a way to prevent such carnage from ever happening again. They believed that if capital markets and global trade could be connected through a series of institutions that floated over the laws of any given nation-state, the world would be less likely to descend into anarchy. They also thought such a liberal arrangement could counter the rising threat of the Soviet Union. As the historian Quinn Slobodian has argued, the goal of the neoliberal thinkers was "safeguarding capitalism at the scale of the entire world." The institutions of the neoliberal project, he claims, were designed "not to liberate markets but to encase them, to inoculate capitalism against the threat of democracy, to create a framework to contain often-irrational human behavior."

CAPITALISM UNBOUND

For a long time, this idea worked, in part because the balance between national interests and the interests of private businesses didn't get too far out of whack. Even during the presidency of Ronald Reagan, there was a sense that global trade needed to serve the national interest rather than merely the interests of large multinational companies. Reagan framed government as a problem rather than a solution, but his administration made national security a consideration in trade talks and used tariffs and other trade weapons to push back against Japanese efforts to monopolize supply chains for computers.

The notion that trade should be a handmaid to domestic policy interests fell out of favor during the Clinton administration, when the United States struck a series of trade deals and pushed for China's entry into the WTO. That latter development was a seismic shift that removed the guardrails from the global economy. Adam Smith, the

father of modern capitalism, believed that for free markets to function properly, participants needed to have a shared moral framework. But the United States and many other liberal democracies were suddenly enmeshed in major trade relationships with countries—from Russia and the petrostates of the Middle East to numerous Latin American dictatorships to the biggest and most problematic trading partner of all, China—that had fundamentally different moral frameworks, to say nothing of their economic ones.

Since the turn of the twenty-first century, the two biggest beneficiaries of neoliberal globalization have been the Chinese state, which never played by the letter of the WTO's laws, and multinational companies, which were mostly unaffected by national political turmoil. The result in the United States has been more political extremism on both sides of the aisle, much of it capitalizing on the economic disenchantment of the masses. The idea that the global economy must be put back in the service of national needs is gaining traction, but neither party has put forward a complete plan for how to do so (although the Biden administration has come the closest).

What is clear is that globalization is in retreat, at least in terms of trade and capital flows. The 2008–9 financial crisis, the pandemic, and the war in Ukraine all exposed the vulnerabilities of the system, from capital imbalances to supply chain disruptions to geopolitical turmoil. Countries now want more redundancy in their supply chains for crucial products such as microchips, energy, and rare earth minerals. At the same time, climate change and rising wages in many emerging markets are reducing the incentive to ship low-margin products such as furniture or textiles all over the world. Different political economies call for different financial systems and even different currency regimes. Technological innovations such as 3D printing that allow products to be made quickly and in one place are changing the economic calculus, too, making it far easier and cheaper to build hubs of production close to home. All these shifts suggest that regionalization will soon replace globalization as the reigning economic order. Place has always mattered, but it will matter even more in the future.

NO GOING BACK

At some point, the pandemic will end, as will the war in Ukraine. But globalization will not revert to what it was a decade ago. Nor will it disappear entirely, however. Ideas and, to a certain extent, data will still

flow across borders. So will many goods and services, albeit through far less complicated supply chains. In a 2021 survey by the consulting firm McKinsey & Company, 92 percent of the global supply chain executives polled said they had already begun changing their supply chains to make them more local or regional, increase their redundancy, or ensure that they are not reliant on a single country for crucial supplies. Governments have encouraged many of these changes, whether through legislation such as the Biden administration's industrial policy bill or guidance such as the European Union's New Industrial Strategy, both of which aim to restructure supply chains so that they are less far-flung.

Place has always mattered, but it will matter even more in the future.

The exact shape of the coming post-neoliberal economic order is not yet clear. But it will likely be far more local, heterodox, complicated, and multipolar than what came before. This is often portrayed as a bad thing—a comedown for the United States and a risk for much of the world. But arguably it is just as it should be. Politics takes place at the level of the nation-state. And in the post-neoliberal world, policymakers will think much more about place-based economics as they work to rebalance the needs of domestic and global markets.

This is already happening in the arena of trade. In the United States, for example, both major political parties are rightfully questioning certain aspects of neoliberal trade policy. The idea that local politics and cultural values don't matter when it comes to trade policy is belied by the rise of authoritarian countries, particularly by the rise of China. Partly as a result, the Biden administration has kept in place many of Trump's tariffs on Chinese products and sought to bolster domestic manufacturing of goods that are critical for national security.

Nationalism isn't always a good thing, but questioning the conventional economic wisdom is. Rich countries such as the United States cannot outsource everything save finance and software development to emerging markets without making themselves—and the broader economic system—vulnerable to shocks. Conventional trade policy will therefore have to evolve as countries and regions rethink the balance between growth and security, efficiency and resilience. Globalization will inevitably morph into regionalization and localization.

Consider the debate about manufacturing, which represents a small and declining proportion of jobs in most rich countries and in many

poor ones, too. Some economists argue that countries should cast off factory work as they move up the food chain to services, trading low-skilled labor forces for higher-skilled ones. But manufacturing and services have always been more intermingled than the jobs data suggest, and they are becoming ever more so. Research shows that knowledge-intensive businesses of all sorts tend to spring up most frequently in manufacturing hubs, spurring higher overall growth. No wonder industrial powerhouses such as China, Germany, Japan, South Korea, and Taiwan have opted to protect their industrial bases in ways the United States does not. They have done so not with wasteful subsidies or failed policies such as import substitution but by incentivizing high-growth industries and training a workforce to support them. The United States and other developed countries are looking to do that now, particularly in key parts of the supply chain, such as semiconductors, and in strategically important industries, such as electric vehicles.

Muscular industrial policy will be increasingly common in the post-neoliberal world. Even in the United States, most Democrats and a growing number of Republicans believe that government has a role to play in supporting national competitiveness and resilience. The question is how. Subsidizing skill building, underwriting domestic demand, and spending to keep prices of key goods relatively stable will likely all be part of the answer. The United States is more reliant on overseas manufacturing inputs than many of its competitors, including China. It meets just 71 percent of its final consumer demand with regionally sourced goods while China meets 89 percent and Germany meets 83 percent with such products. Achieving parity with China could add $400 billion to the U.S. gross domestic product, according to estimates by McKinsey, and that is without taking into account future earnings from clean energy and advanced biotech innovations such as gene therapy. Pandemic-related efforts to fill supply chain gaps for essential products such as personal protective equipment and pharmaceuticals—along with efforts to increase domestic capacity in strategic areas such as electric batteries, semiconductors, and rare earth minerals—have created a tailwind for local production of high-value goods. And that could eventually pay enormous dividends for the United States.

As global trade and supply chains regionalize and localize, global finance will do the same. Russia's invasion of Ukraine will have lasting consequences for currency and capital markets. One consequence will be to accelerate the division of the financial system into two systems,

one based on the U.S. dollar and the other on the yuan. China and the United States will increasingly compete in the realm of finance, using currency, capital flows, and trade as weapons against each other. U.S. policymakers have yet to seriously consider the implications of broader competition of this sort: asset values, pensions, and politics will all be affected. Capital markets will become a place to defend liberal values (for example, through sanctions against Russia), pursue new growth strategies, and create new alliances. All this means that markets will be far more sensitive to geopolitics than they have been in the past.

Decentralized technologies will allow more goods to be produced for local consumption, something that may benefit the environment. High-tech "vertical farms" that grow produce on city walls or rooftops rather than in vulnerable climates are springing up as a solution to food insecurity. Large companies have been moving toward vertical integration—owning more of their supply chains—as a way to cushion themselves against shocks, whether climatic or geopolitical. Cutting-edge manufacturing technologies such as 3D printing will speed up this shift toward local industrial systems. Such manufacturing saves money, energy, and emissions. And during the pandemic, it helped plug supply chain gaps, allowing everything from masks and other protective equipment to testing devices and even emergency dwellings to be "printed" locally. The 3D printing market grew 21 percent from 2019 to 2020 and is expected to double by 2026. Taken together, these trends foretell a surge in localized manufacturing.

THE POST-NEOLIBERAL WORLD

Like the neoliberal world, the post-neoliberal world will bring challenges as well as opportunities. Deglobalization, for instance, will be accompanied by a number of inflationary trends (although technology will continue to be deflationary). The war in Ukraine has put an end to cheap Russian gas. The global push toward carbon neutrality will add a permanent tax on fossil fuel usage. Spending by companies and governments to shore up supply chains will fuel inflation in the short term (although to the extent that it boosts strategic industries such as clean tech, it will ultimately spur growth and improve the fiscal position of countries that invest now). Meanwhile, the end of the U.S. Federal Reserve's bond-buying program and its repeated interest-rate hikes are putting a cap on easy money, pushing up the prices of goods and services.

Aspects of this new reality are good. Counting on autocratic governments for crucial supplies was always a bad idea. Expecting countries with wildly different political economies to abide by a single trade regime was naive. Polluting the planet to produce and transport low-margin goods over long distances didn't make environmental sense. And maintaining historically low interest rates for three decades has created unproductive and dangerous asset bubbles. That said, there is no getting around the fact that a deglobalizing world will also be an inflationary one, at least in the short term, which will force governments to make tough choices. Everybody wants more resilience, but it remains to be seen whether companies or customers will pay for it.

As U.S. policymakers and business leaders seek to address these challenges, they must push back against conventional economic thinking. Instead of assuming that deregulation, financialization, and hyperglobalization are inevitable, they should embrace the coming era of regionalization and localization and work to create productive economic opportunities for all segments of the labor force. They should emphasize production and investment over debt-driven finance. They should think about people as assets, not liabilities, on a balance sheet. And they should learn from the successes and failures of other countries and regions, drawing place-specific lessons from place-specific experiences. For too long, Americans have used outdated economic models to try to make sense of their rapidly changing world. That didn't work at the height of neoliberal mania in the 1990s, and it certainly won't work today. Place has always mattered when it comes to markets—and it is about to matter more than ever.