

The Failures of Neoliberalism and the Future of the World Economy

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Why Didn't History End in 1989?¹

Arising from the stagflation and uncertainty of the 1970s, the Neoliberal Order² was a cohesive economic ideology that combined monetarism in macroeconomics with free markets and limited government intervention in microeconomics. With the fall of the Berlin wall in 1989 marking the collapse of the other competing 20th century ideology, all that was left, it seemed, was the natural convergence of developing countries into a global Liberal economy. General prosperity was at hand. Things have not gone as expected. The Neoliberal Order is collapsing without full convergence due to some clear policy failures, a resurgence of once-defeated competing ideologies, and accelerating climate change. What led to the end of perhaps the most dominant global economic ideology to date? What comes next?

Inequality in Capitalist Economics

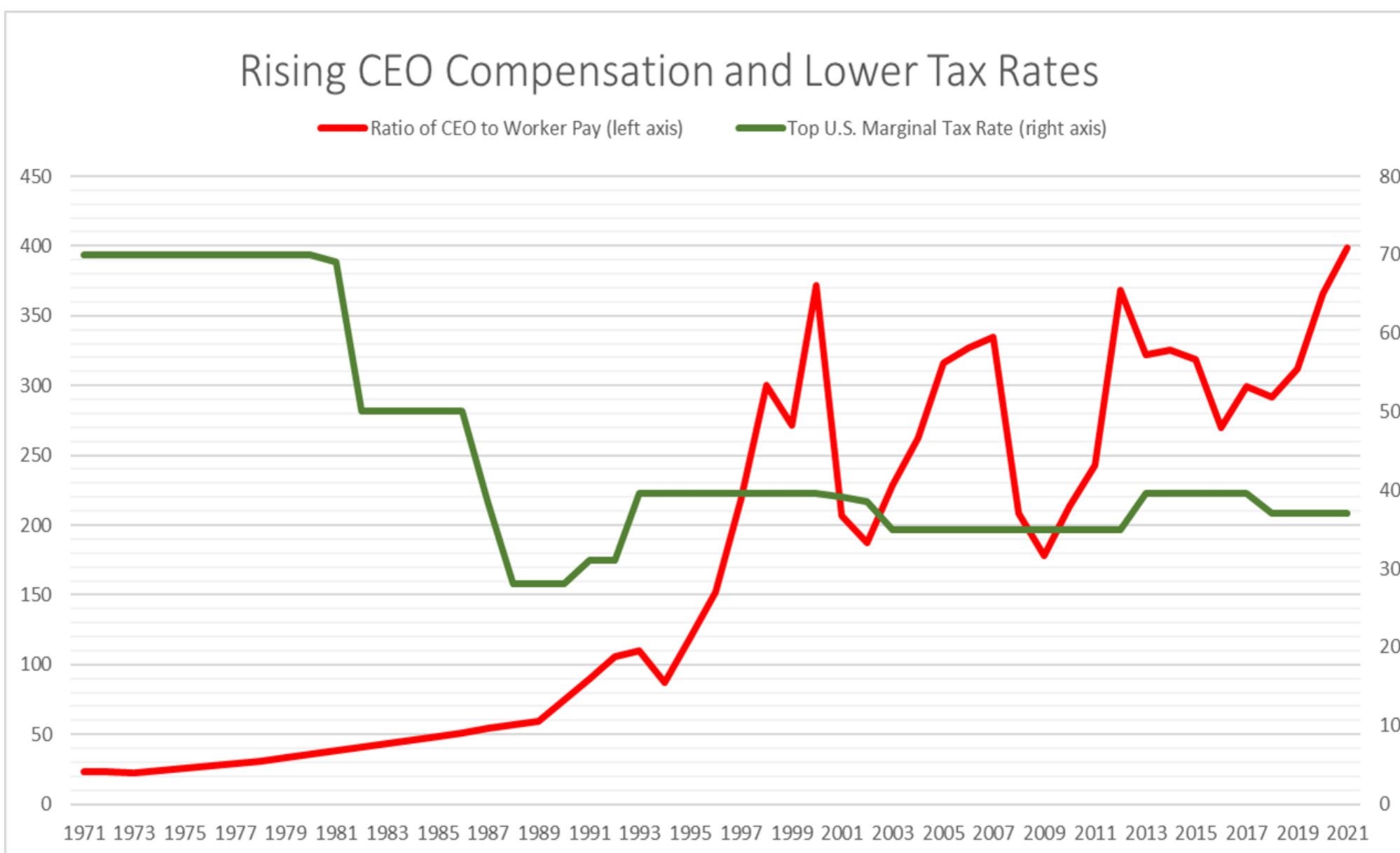
Lucas stated the neoliberal consensus on redistribution: it was a "poisonous and seductive" endeavor for economic study.²

- His argument: focus on growing the pie to avoid the efficiency/equity tradeoff.
- The underlying assumption was that inequality was *inherently stable* and would not impact overall growth – to address it through redistribution was to risk much greater inefficiency.

Inequality was not inherently stable. Piketty has shown convincingly that the tendency in capitalist economies is for inequality to increase.³

- Policy moved in a regressive direction in the U.S. and inequality has increased steadily since 1970.
- Workers have seen not only stagnant real incomes, but a policy environment that has led to decreasing life expectancy in the U.S.
- The U.S. decline in living standards is evidence of a breakdown in democratic accountability. Inequality has contributed to political polarization.
- High inequality represents a dangerous consolidation of power that undermines average living standards.

Figure 1: Ratio of CEO to worker pay and top marginal tax rate in the U.S.⁴



Financial Volatility and Inefficiency

Neoliberal macro policy began with the Volcker disinflation and the adoption of monetarism in the U.S. Globally, it included opening financial markets with the transition to floating exchange rates.

- Free financial markets were expected to result in efficiency: *stable currencies and funds flowing downhill* (to investments with the highest returns). Monetarism was successful domestically; U.S. inflation stabilized and the "Great Moderation" began.
- However, high dollar interest rates brought on the Latin American debt crisis.
- Floating exchange rates resulted in high volatility, which impacted developing countries most acutely.
- IMF loans were conditioned on austerity, so developing countries could only have pro-cyclical macro policy that prolonged their recessions.

Figure 2: Systemic Banking Crises were common in the Neoliberal Era⁶

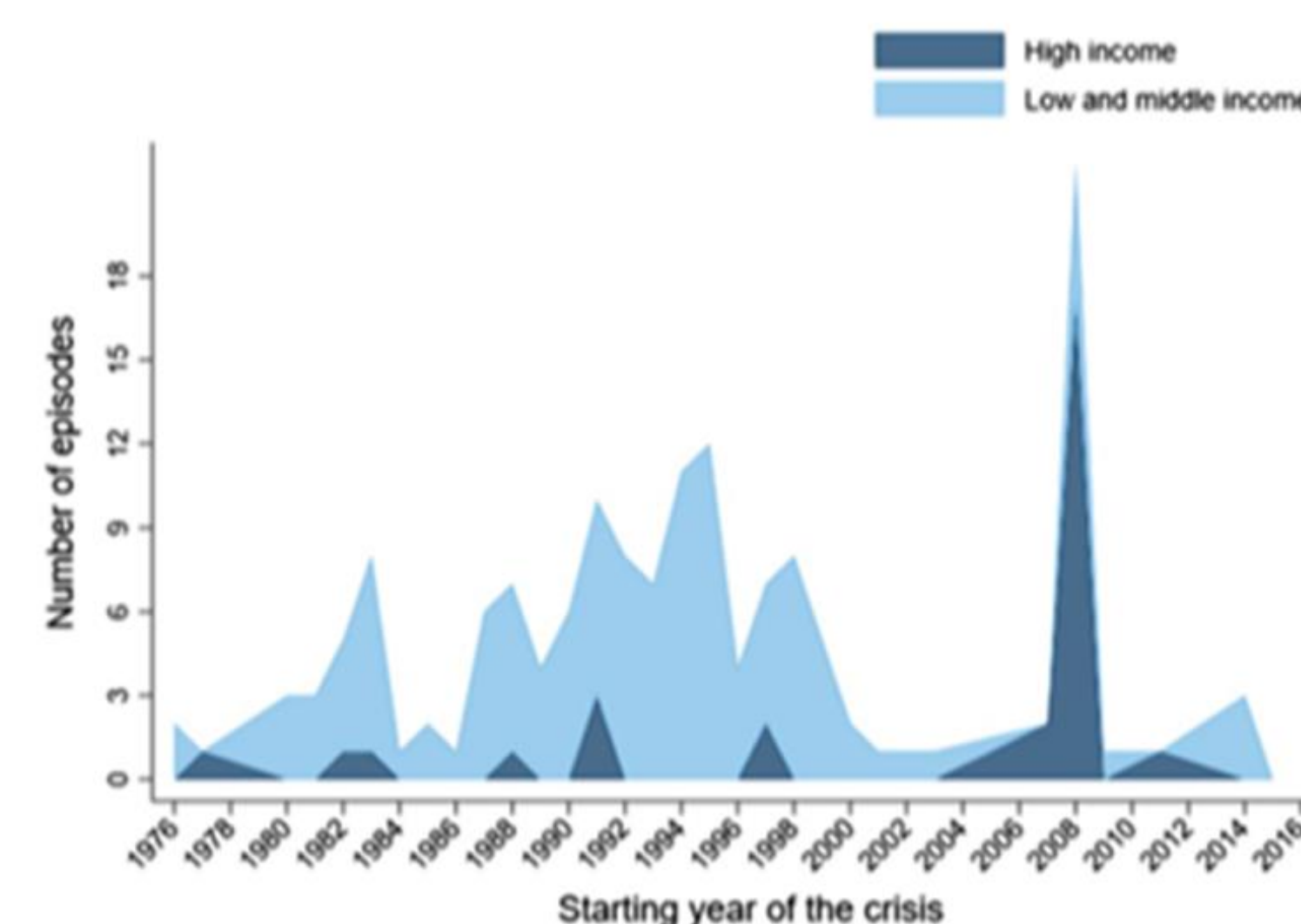


Fig. 2 Systemic banking crises episodes by income level, 1976–2017. Source: Authors' calculations

Through the 80s and 90s, financial crises recurred in developing countries, and neoliberal policy solutions failed repeatedly (later acknowledged by the IMF⁷).

- China protected itself by devaluing the Renminbi to accumulate USD assets and avoid IMF bailouts.
- Net financial flows went "uphill" from developing countries to the U.S., and then the 2008 crisis hit.

The global financial system throughout the Neoliberal era has been neither stable nor efficient.

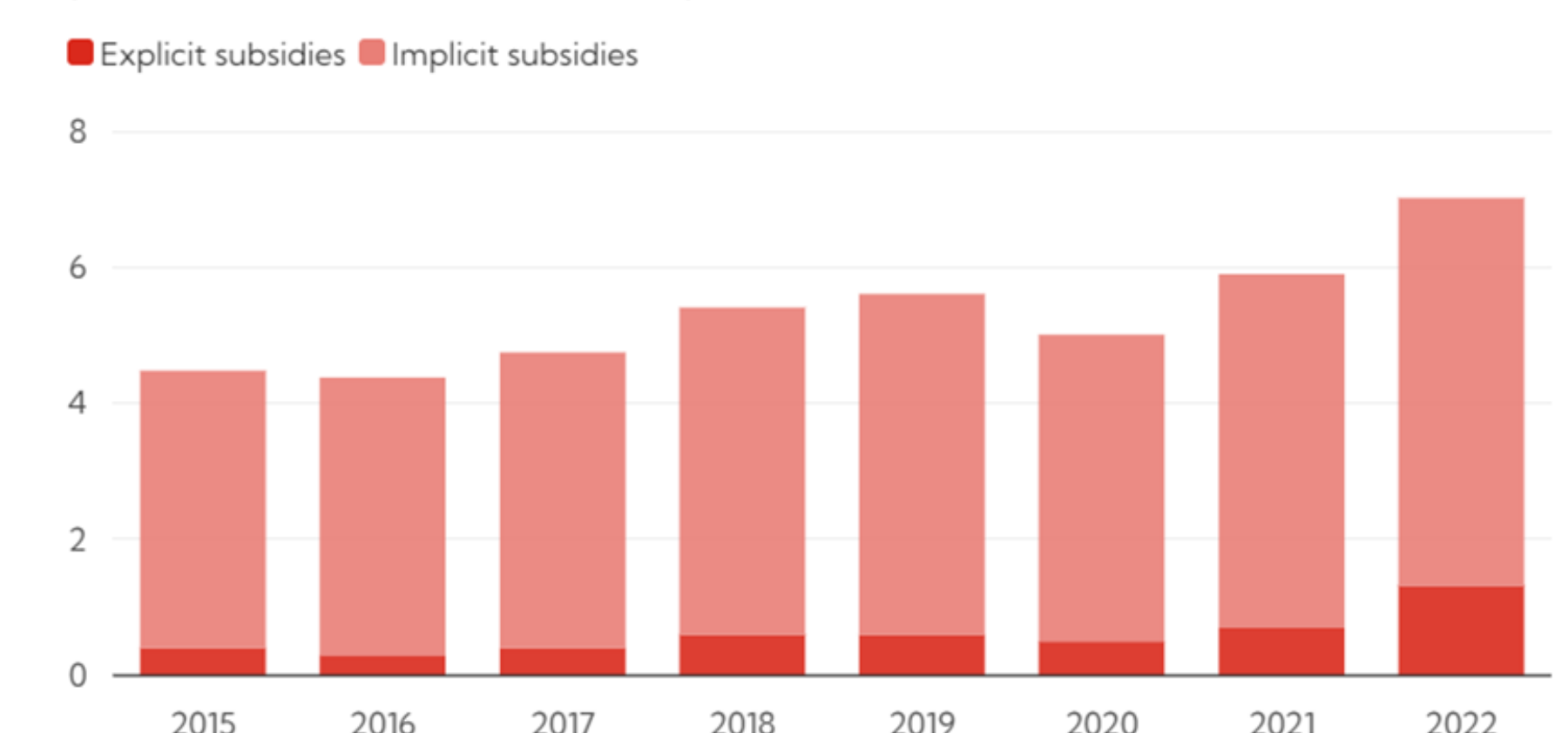
Energy Policy & Climate Change

Scientific consensus on climate change and economic consensus on the efficient policy response (carbon pricing) have been established for at least 15 years.

- But actual policy continues to subsidize fossil fuels.
- Neoliberalism has had inefficient energy policy.

Figure 3: Fossil fuel subsidies have been large in the Neoliberal Era⁸

Fossil fuel subsidies topped \$7 trillion last year (total fossil fuel subsidies, trillions of USD)



Source: IMF staff calculations. Note: Figures from 2019 onwards use projections for fuel use. Explicit subsidies: undercharging for supply costs. Implicit subsidies: undercharging for environmental costs and forgone consumption taxes, after accounting for preexisting fuel taxes and carbon pricing.

IMF

For most of the history of capitalism, *only Liberal capitalist countries achieved high average incomes.*

- This changed in the Neoliberal era as oil producing countries that remain autocratic (petro-states) became wealthy.
- Increasingly, petro-states impact (and sometimes disrupt) domestic policy in other countries to rent-seek, maintain subsidies for fossil fuels, and prevent action on climate change.

Neoliberal energy policy sought stable gas prices to avoid stagflation, but subsidies to that end enriched anti-Liberal countries and interests, which have effectively blocked policy action on climate change.

Table 1: 5 of the 30 richest countries today are petro-states⁹

Country	GDP per capita (current USD)
Luxembourg	\$126,598
Norway	\$105,826
Ireland	\$103,311
Switzerland	\$93,657
Qatar	\$83,521
Singapore	\$82,808
United States	\$76,343
Iceland	\$74,591
Denmark	\$68,295
Australia	\$64,814
Netherlands	\$57,428
Sweden	\$56,188
Canada	\$55,037
Israel	\$54,337
Austria	\$52,192
United Arab Emirates	\$51,400
Finland	\$51,030
Belgium	\$49,843
Germany	\$48,756
New Zealand	\$47,226
United Kingdom	\$45,461
France	\$42,350
Brunei	\$37,851
Darussalam	\$36,092
Kuwait	\$36,092
Malta	\$34,819
Saudi Arabia	\$34,441
Italy	\$34,085
Japan	\$33,854
Aruba	\$33,032
Taiwan	\$32,687

The Future of the World Economy

The Neoliberal Order is ending, but what comes next? Consider three purported alternatives:

- 1. State Capitalism:** it's capitalism but with state-led economic policy, typically in a one-party system (e.g. China). While initially appealing for supposed policy decisiveness and efficiency, state capitalism suffers from corruption and a lack of accountability. State capitalism has no record of fostering innovation for long-term growth at the technological frontier and lacks even a consensus definition.
 - People in state capitalist countries lack basic freedoms. In sum: it's like Liberal capitalism, but with more corruption and less freedom.
- 2. Ethnonationalism:** it's a system that prioritizes one group (e.g. ethnic Russians) and asserts the superiority of a nation where that group is dominant. It has some tenets of capitalism, but these are subsumed by the nationalist agenda. It looks a lot like fascism, especially in Russia and groups Russia supports in other countries.
 - Aggressive ideologies based on arbitrary notions of superiority lead to violent conflict.
 - There is not a coherent economic system here; rather, there is an unjustified assertion of superiority. This is not a universally applicable ideology.
- 3. Communism/socialism:** the specter of Marx returns and the appeal is equality, presumably with universal basic income a great life for the average person. But communism itself remains completely impractical, having been reduced to authoritarianism everywhere it's been attempted.
 - What about Socialism? It is typically poorly defined. If it means no private firms, then it becomes weaker communism and less efficient capitalism. If it means a mixed economy, with government ownership of some sectors, that's what rich countries have now. So calls for socialism are really calls to:

Fix Liberal capitalism. How? Reinvigorate democracy around addressing the three issues shown here: redistribute to combat inequality, regulate global finance for stability and growth, and address the externalities of climate change.

This work is part of a project to synthesize economic and historical understanding into an accessible history of capitalism. For inquiries, contact:

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6. Figure 2 is from: Laeven, Luc, and Fabian Valencia. "Systemic banking crises database II." *IMF Economic Review* 68 (2020): 307-361.
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