

Raghuram Rajan: A Better Populism

The only policy that left – and right-wing populists can agree on to address economic decline is trade protectionism, which will make the world poorer. A new type of populism that puts more trust in local communities may well have a greater chance of success writes **Raghuram Rajan**



Source: Wikipedia Commons

The postwar economic success of liberal democracies was not simply the result of letting markets flourish. The United States and European countries also embedded markets in a structure that allowed people to take the fullest advantage of them. That structure is breaking down, energizing populist leaders of both the left and the right. While they pose the right questions, they rarely have the right answers. Perhaps, instead, they should make it easier for people to devise their own solutions.

Why is the postwar structure breaking down? In the immediate postwar era, a formidable system of secondary education in the US prepared students for work or further study at the world's best universities. Students entered the workforce with the skills to land good jobs. Rapid economic growth and relatively light regulation encouraged many to start their enterprises. Flexible labour-market policies allowed laid-off workers to find a job quickly somewhere else. Recessions, when they came, were shallow and brief.

The superior “pre-market” preparation of Americans via the education system, and the many economic opportunities available to them allowed the US to function with relatively limited social protections against market volatility. Unemployment insurance was modest, while many people had no health-care coverage – even after the introduction of federally-backed insurance schemes for the elderly and the very poor in the 1960s.

Continental Europe's education system started off far behind. In 1950, the average French male completed only 4.75 years of schooling (a level similar to Myanmar today), compared to eight in the US. But Europe steadily narrowed the gap, and also built strong job protections and social safety nets. In a sense, Europe made up for its initially lower “pre-market” preparation with stronger “post-market” support. Both systems worked well in the postwar decades.

Unfortunately, growth stalled in the early 1970s. The capitalist democracies of the West responded with increased liberalization at home and deeper economic integration with one another. Although the US emphasized the former, and continental Europe the latter, the two systems also converged somewhat. In particular, Europe improved its pre-market support while undoing some of its post-market protection, which was increasingly unaffordable in an era of slow growth.

Yet growth never really returned to the heady levels of the postwar decades. And more recently, the technology revolution has automated many well-paid but routine jobs, and contributed to the outsourcing of middle-income manufacturing positions. Today's well-paid jobs require more skills, and thus more pre-market support.

Regrettably, such support has become far less egalitarian in the US. Successful urban and suburban communities give children the capabilities they need to succeed, while declining semi-rural areas and urban ghettos do not. For decades, the US has tried to improve failing schools. But growing income segregation makes the task harder. As professionals flee with their children into successful upper-middle-class communities, the high costs of living and real estate keep the rest from following. The demands of the market are creating a meritocracy, but a hereditary one, where the children of the successful are more likely to succeed.

The disparate quality of schooling is also a growing problem in more egalitarian Europe, as immigrants move into affordable working-class communities. Because immigrant children

generally must adjust to a different school system and a new language, they almost inevitably require disproportionate attention from teachers and school staff as they catch up. This, too, adversely affects the experience of existing students, and creates an impetus for the upwardly mobile to leave the community.

The relative dearth of opportunities for those left behind is probably compounded by the growth of superstar firms, which has coincided with a slowdown in the creation of start-ups and entrepreneurial ventures in the US. Jobs in superstar firms require higher skills. Amazon's promise to create thousands of jobs in its planned new headquarters in Queens, New York City, was less attractive to the local community than the headline numbers suggested, because many of the better positions would be out of reach for most in the community. Progressive Democratic politicians mobilized against Amazon, which has now abandoned its plans.

Left-wing populists respond to the decline in pre-market support for their natural constituency by calling for additions to the safety net, such as universal health care (in the US), job guarantees, and forms of universal basic income. The populist right sees such proposals as a threat, because they will erode the sustainability of the existing safety net for the native-born majority.

The response of right-wing populists to community decline is to blame immigrants and other minorities, as well as trade. True, keeping immigrants out might initially reduce pressure on schools and services in working-class communities. In the longer run, however, it will deprive these areas of the youth, energy, and eventual revitalization that immigrants bring. And while the populist left supports immigration as essential to sustaining new welfare programs, it tends to sympathize with the right on trade protectionism.

Unfortunately, beggar-thy-neighbor protectionism will make the world poorer. Declining communities urgently need alternative ways to attract new economic activity, and to make their citizens better able to respond to globalization and technological change.

Capital cities are often too remote from local concerns, and too paralyzed by infighting, to take the lead. What is needed are local solutions, implemented with community knowledge and engagement, and supported by national governments with funding and light oversight where necessary.

If such measures can improve pre-market preparation for people in struggling communities, augmenting the post-market safety net will become less necessary and more affordable. Would it not make sense to eschew the grand centralized policies of the populist left and right, and instead put more trust in local communities? That would be a truly populist idea.

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