BUILDING A JUST ECONOMY:

BEYOND THE FREE MARKET MYTH

John M. Balder, Jr.

Abstract

Our economic system has failed to deliver economic security and shared prosperity to the vast majority of Americans over the past forty years. With the turn to the free market (aka, neoliberalism, market fundamentalism or market liberalism) that began at the end of the 1970s, finance has ascended, median wages have stagnated, debts have exploded, and income and wealth inequality have reached epidemic levels. The US now is a barbell, namely the top 10% of US households and everyone else (bottom 90%). And within the bottom 90%, the bottom 50%, largely working-class households, have endured traumatic levels of distress. This book will examine the reasons and will compare the neoliberal era with the preceding period of managed capitalism (the New Deal).

Under the New Deal (1945-1980), established by Franklin Delano Roosevelt, labor was empowered, and wage increases were closely tied to productivity growth. The financial system directly contributed to growth in productive activity with guardrails (e.g., Glass-Steagall Act of 1933) that successfully protected the economy from financial instability and crisis. **Most impressively, the New Deal represented the first time the US economy was geared to meet the needs of ordinary working people (those in the bottom 90% and bottom 50%), as real wages increased.**[1]

The social and economic success of the New Deal eventually generated rising inflation that slowed the pace of economic growth in the second half of the 1960s and throughout the 1970s. Standing in the wings was an alternative approach (neoliberalism) that had been incubated decades earlier. Advocates included Friedrich von Hayek, founder of the Mont Pelerin Society (MPS), and Milton Friedman. Neoliberals wanted to excise barriers on the expansion of capital, via market liberalization, deregulation, globalization, privatization. They wanted to create an unfettered market that they claimed would maximize “economic freedom.”

Politicians, including Margaret Thatcher and Ronald Reagan, emerged at the end of the 1970s promising that turning to the free market would generate “marketplace magic.” The revolution likewise spread to the financial markets with significant support from the right-wing University of Chicago. These ideas would never have met with success if it was not for financial and political support provided by a phalanx of US corporations, financiers, and wealthy individuals, who financed right-wing think tanks that provided propaganda in favor of neoliberal policies and

[1] It is important to acknowledge that the New Deal was by no means perfect. Given that FDR decided to include southern segregationists in the coalition that supported it, the New Deal did not benefit Blacks, other minorities, or women. It has been referred to as an “affirmative action program for white heterosexual men.”

ideology. As one author so aptly puts it, advocacy of the free market and freedom obscured the underlying reality, which was the restoration of power to owners of capital.

The shift that followed in the US economy over the next four decades included: tax cuts for wealthy households and corporations, removal of guardrails on financial markets, rapid growth in debt, suppression of organized labor and wages, globalization of production, and cutbacks to the social safety net. These measures restored corporate profits and fueled a secular asset price bubble that lasted until the global financial crisis in 2008. In addition, the market turn fueled financial speculation in assets at the expense of productive activity and creation of quality jobs, empowering wealth holders at the expense of everyone else. Ultimately, it created a two-tier (barbell) society.

Financialization and the "Great Moderation"

The underlying shift in the role of finance has had major consequences for economic activity. First, it shifted income, wealth, and power from households at the bottom to those at the top. Second, the economy transitioned away from productive activity (creation of value and quality jobs) toward short-term speculation in existing financial and real estate assets (what is often referred to as the financialization of the US economy). In the early 2000s, the financial sector alone generated an astounding 40% of total corporate profits, up from an average of 10% to 15% during the 1960s. **Importantly, inflation in the prices of goods and services after 1980 declined sharply and became embedded in asset prices. In this framework, inflation ("capital gains") enhanced the wealth of financial asset owners at the expense of everyone else.**

The defeat of traditional sources of inflation -- in the prices of goods and services -- fueled discussion of what some, including former Fed chair Ben Bernanke, described as a "Great Moderation," a period in which growth and inflation stabilized following the volatile 1970s. **However, inflation never vanished – instead, it became embedded in asset prices, given the explosive growth in debt and the financialization of the US economy.** Wealth over the past four decades has been channeled to households at the top of the distribution (top 10%, top 1%, top 0.1%, etc.) at the expense of the bottom 90%, and especially the bottom 50%.[2]

Meanwhile, given stagnant wages and their desire to maintain living standards, households borrowed, creating financial obligations that (indirectly) are paid via the financial system to households at the top. Throughout the late-1990s and early 2000s, middle- and even low-income households participated in the real estate boom via ownership of their primary residence. The ongoing expansion of credit boosted the prices of their homes. They borrowed against the rising equity they held in their homes. This worked for a while, but when the collapse in home prices occurred in 2007-2010, the average middle-class homeowner lost 44% of her net worth.

Unlike productive enterprises that create value added, the real estate cycle is a zero-sum process. Real estate values were grossly inflated by the easy availability of credit from the financial system

[2] We shall see that the turn toward maximization of shareholder value, a concept introduced by Milton Friedman in 1970, has played an influential role in hollowing out the core activities of US corporations. The pursuit of shareholder value, via share buybacks by corporations, is often driven by the manner in which CEOs and other senior executives are compensated.

to household borrowers. From 2000 to 2007, real estate loans doubled from $5 trillion to $10 trillion, an astronomical rate of increase. And the conditions under which many of these loans were extended (liar loans, et al) all but assured their eventual collapse. In response to the global financial crisis, the Fed stepped into the breech to stabilize an unstable financial system while indirectly providing extensive financial support (QE, et al) to owners of financial assets. As the financial sector recovered given public sector support (bailouts), very little was done to address the enormous amount of underwater real estate held by many affected households, which undermined the subsequent economic recovery.

<u>Next Steps</u>

The unexpected arrival of the COVID-19 pandemic in March 2020 once again exposed the vulnerability of the US working-class. Even before the pandemic, half of all US households reportedly would have been unable to afford a one-time payment of $400. This time the government responded with stimulus payments to many of these households, which helped stabilize growth in aggregate demand and GDP. The use of fiscal policy provided key short-term support to many of these households, unlike the response to the GFC.

What can be done to address extreme levels of inequality? **Long-term economic policies are needed that target income growth and economic security for the bottom 90% (and especially the bottom 50%) of US households who have experienced decades of stagnant (and suppressed) wages.[3]** At a minimum, these policies should include job guarantees, a citizens' wealth fund (CWF), a universal basic income (UBI), a national investment bank (NIB), as well as an overhaul of tax policies, the role of the central bank, the financial system, antitrust, and political contributions.

Steps are already being taken in this direction, though not without enormous resistance from those who have benefited over the past forty years. Building a workable, consensus-driven narrative that propels a progressive cross-racial movement is needed to create a just economic system. And this effort can only evolve from within civil society, given the state of politics today, keeping in mind that "democracy is a long game." We could do far worse than return to the ethos of the New Deal and social democracy, with its focus on providing economic security and shared prosperity, with one important exception. This time it will need to apply to <u>all of us.</u>

[3] The Bipartisan Infrastructure Law, Inflation Reduction Act, and the CHIPS and Science Act passed during the Biden administration provide an impressive start to this process. They reportedly will create millions of jobs, many of which do not require a college degree targeting rebuilding the economy in distressed communities. For more information, see Pollin (2024) and Brookings (2024).