

After Neoliberalism: The Need for New Paradigm

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Neoliberalism and market fundamentalism

- Neoliberalism: The notion that markets, on their own, are basically efficient and fair, and should be relied upon for the allocation of scarce resources
 - Government is the problem, not the solution
- Long history—motivated by politics, denigrating the role of the State
 - Source of opposition to Keynesian economics
 - Advocates didn't want to admit to a market failure
 - Especially one that could be corrected by government

The modern rebirth of market fundamentalism

- Revived by Reagan and Thatcher
 - Under name of supply-side economics
 - Minimizing/ignoring market failures (externalities, like pollution; lack of competition, imperfect information), giving free reign to corporations (shareholder-value maximization), and concerns about distribution/inequality
 - Exaggerating government failures
 - No country has been successful without a large role of government
 - Even an imperfect government can make a difference
 - Ignored the potential of strengthening public institutions—and took actions to weaken them
 - Ignored the potential for other forms of collective action—and made these more difficult
- Historical anomaly: came just after we came to understand why markets are almost never efficient, why they are often associated with extensive exploitation, why they often give rise to excessive inequality, and how appropriate government interventions could improve societal well-being

The end of history

- With the defeat of Communism, market fundamentalist views were energized
 - Wrong interpretation: Wasn't victory of capitalism, but failure of Communism and authoritarianism
- Belief that eventually (and quickly) world would converge to liberal democracies and free-market economies
 - Belief now seems naïve
 - With the rise of demagogues, authoritarian figures, and protectionism

Three key questions

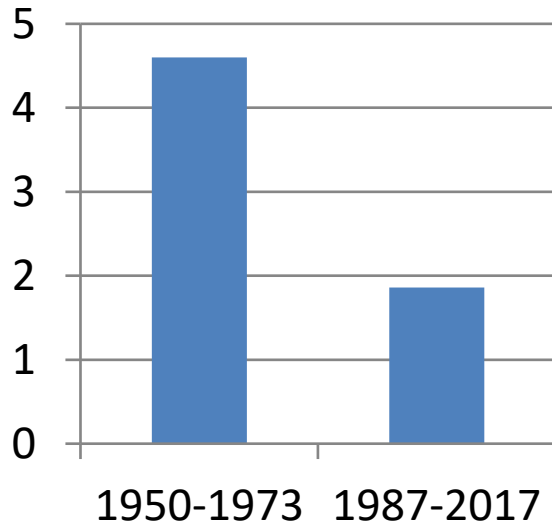
- How do we explain what has happened?
- What are the dangers?
- Is an alternative world possible? The policy response to the current moment

The failure of neoliberalism

- Neoliberal policies: lower taxes, especially at the top, deregulate
 - Incentivize and free economy: Would result in faster growth from which all would benefit; even tax revenues would grow
- Results were the opposite: Growth slowed and inequality grew; those at the bottom and middle saw their incomes stagnate or fall; deficits soared; eventually, the economy went into crisis
- When things didn't work out well, “doubled down” on strategy: Things worked out even worse
- After forty years, “experiment” can be declared a failure; need to move on to an alternative

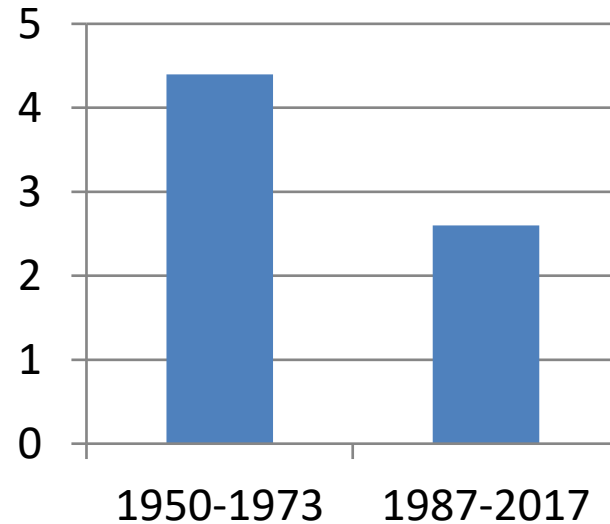
Growth after WWII and last three decades

Europe



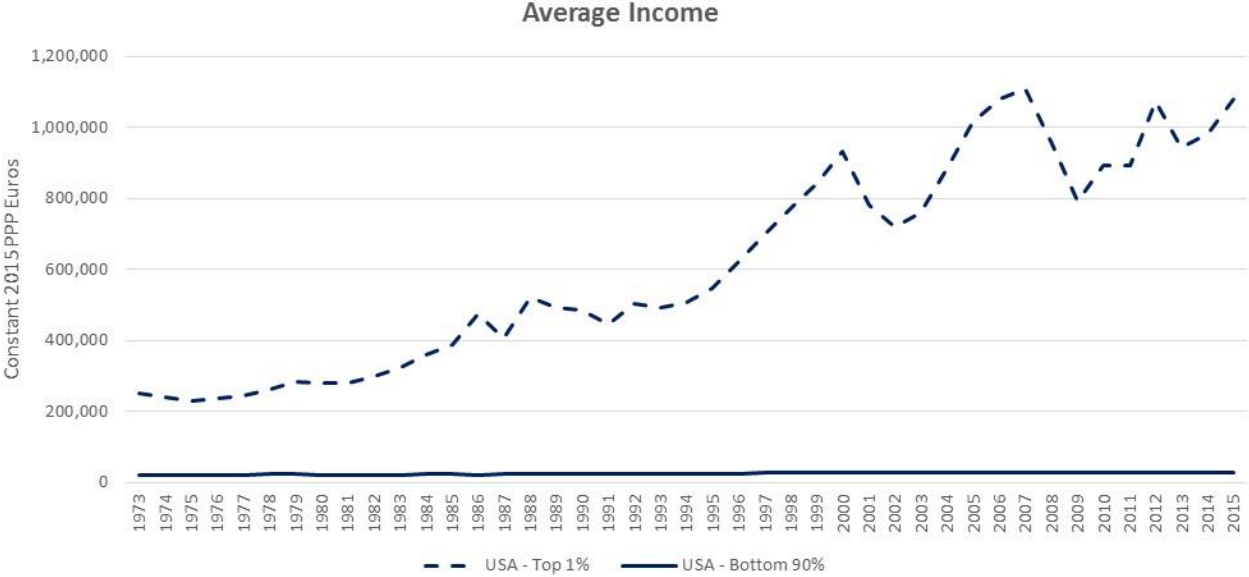
Source: Maddison, Dynamic Forces; World Bank

US



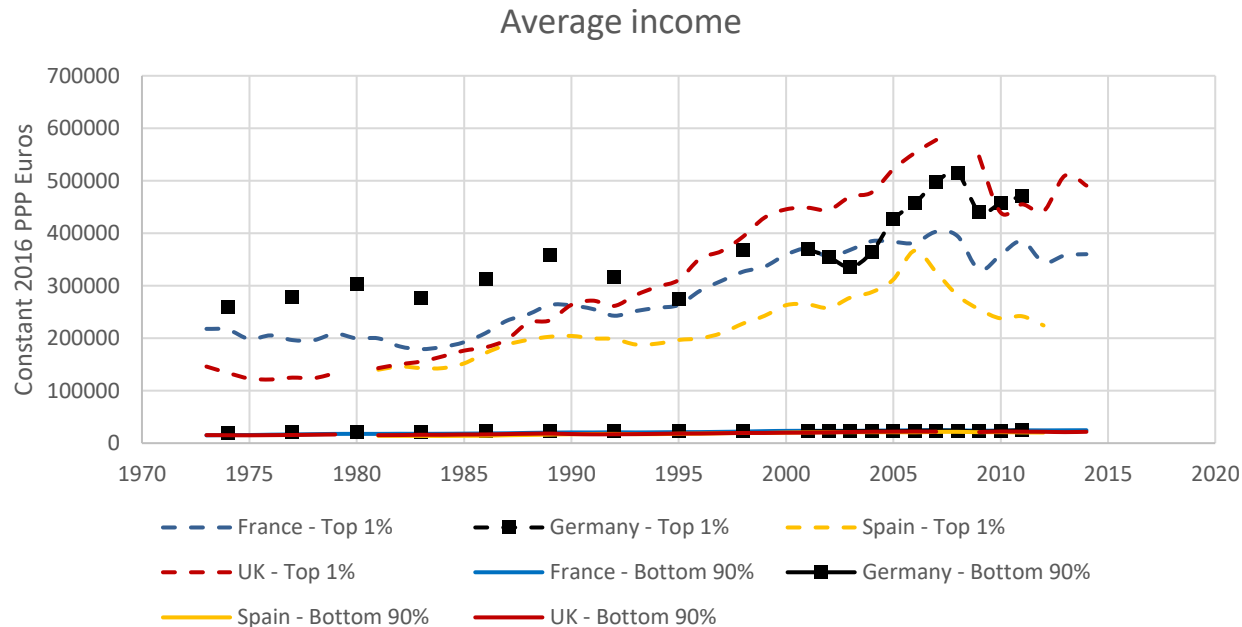
Source: FRED data

US: bottom 90% have seen little increase in income over last third of a century



Source: World Inequality Database

Europe: Less increase in inequality in some countries than in others



Source: World Inequality Database

Ideology vs. Theory

- Neoliberalism was based on ideology and special interests that benefited from ideology
 - Rich who didn't want to pay their fair share of taxes
 - Companies that wanted to exploit others
 - Including coal and oil companies that wanted to pollute the world
- Never was theory behind neoliberalism
 - To the contrary: Research had explained why market failures and exploitation were pervasive, even limited government action could improve matters, shareholder value maximization did not lead to societal well-being; globalization would lead to lower wages for workers, especially unskilled workers

Anger at elites who had promised that neoliberalism and globalization would bring benefits to all

- Were they lying?
- Were they honest but simply misinformed?
- But even after financial crisis, Obama appointed same individuals who had been responsible for financial market deregulation to lead in recovery
 - Money flowed freely to banks, but little to homeowners and those who lost their jobs
 - The political and economic system seemed rigged
- In Europe, Growth and Stability Pact was supposed to assure growth and stability, and convergence
 - Did none of these. Growth slowed, the euro crisis was severe, and the rich countries got richer, the poor poorer: there was divergence
 - Austerity was supposed to restore growth
 - In Greece, led to 25% fall in incomes, 25% unemployment

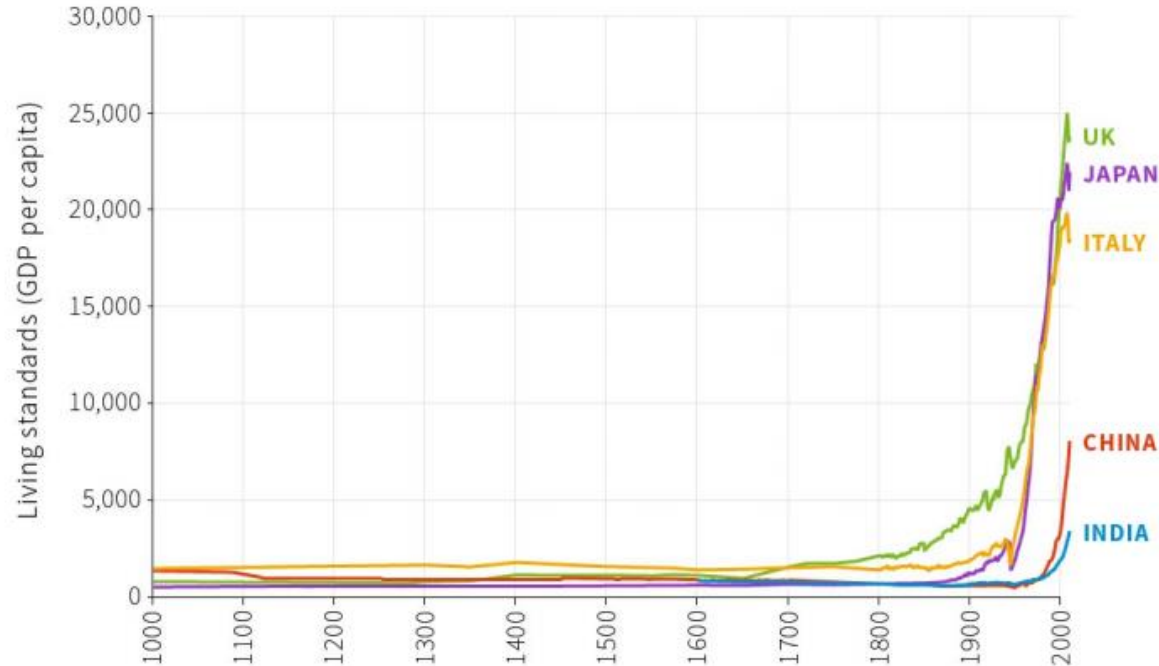
Globalization also undermined democracy

- Key areas of concern—those affecting economic well-being—seemed to be taken out of hands of citizens
 - Including environmental, health, safety, and even economic regulation
 - Countries could be sued if they violated “rights” of corporations, even when corporations’ activities threatened public interest (under investment agreements)
- Problems were even more severe in developing countries and emerging markets, where capital market liberalization allowed Wall Street to pull its money out if they didn’t like leading candidate
 - Actually happened
 - Seemed as if Wall Street had more voting power than citizens

While the backlash is understandable, it represents a threat to our civilization and standards of living

- Increases in standards of living and life expectancy over past 250 years have been enormous

Historical living standards



Source: INET

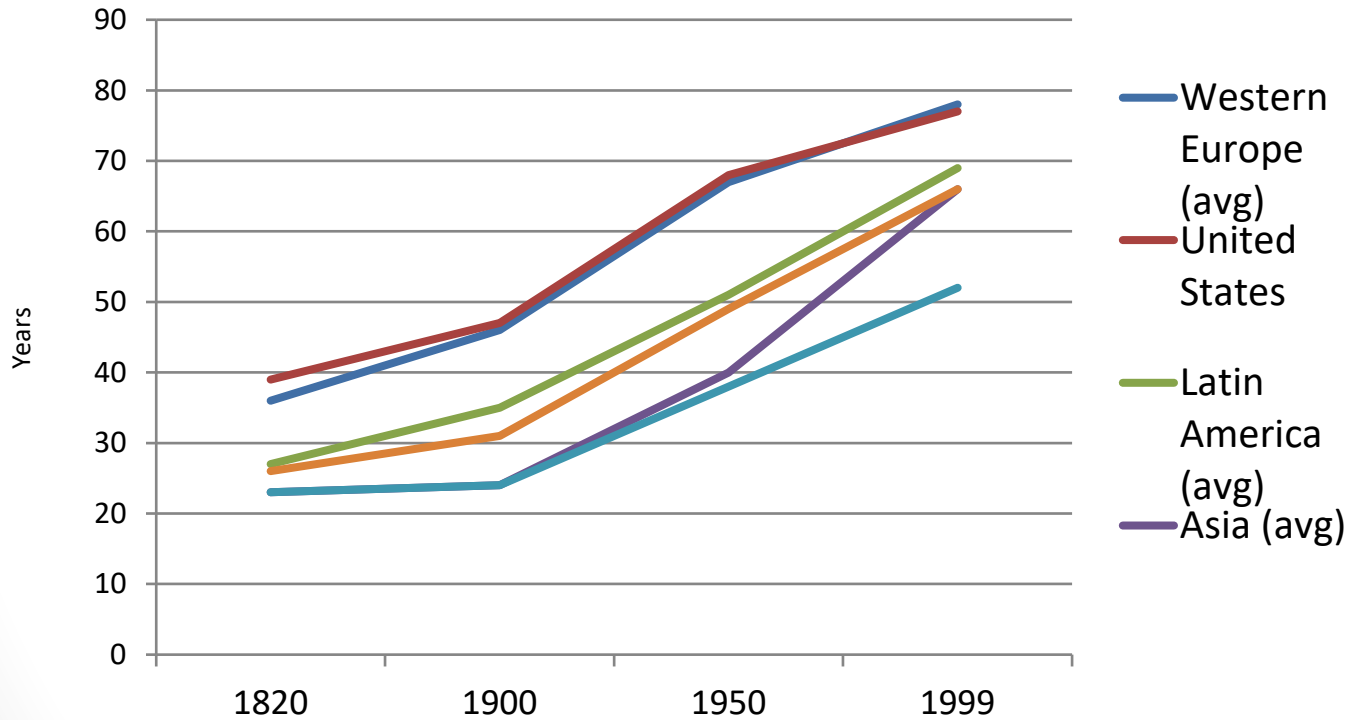
Real wages of London craftsmen, 1200-2000



Figure 3. *Real wages over seven centuries: craftsman (skilled worker) in London (1264-2001).*

Source: INET

Improvements in life expectancy since 1820



Data are estimates from A. Maddison, 2001, "The World Economy: A Millennial Perspective," OECD.

What made all this possible?

- Science—advances in our understanding of the world around us
- Social sciences—advances in our understanding of humankind
- Advances in social organization—ability to organize cooperative activities, to coordinate on a large scale
 - Economic activities through markets, governed by the rule of law
 - Collective action—necessary for a modern economy and society
 - Politics—which set the rules of the game—with separation of powers, checks and balances, etc.

All central ideas of the Enlightenment—and it set the stage for progress

The critical role of “truth institutions”

- All the systems described above require systems of assessing “truth”
- But all are now under attack: the media, the judiciary, our universities, our research institutions, our independent bureaucracy
 - Most disturbing aspects of our political moment is the attack on our basic epistemological system, with far-reaching effects on our civilization, our standards of living, and the functioning of our systems of political and social organization
 - Denying climate change has existential implications

There is an alternative: progressive capitalism, a reinvigorated social democracy

- New social contract between the market, the state, civil society
 - “Capitalism” to remind us that the market plays a central role
 - “Progressive” to remind us that it is not unfettered capitalism; capitalism is not an end in itself, but a means to broader societal objectives; “democracy” to remind us of importance of democratic values; “social” to remind us that we are trying to create a better *society*
- Recognizing that a successful society must be based on a rich ecology of institutional arrangements
 - Cooperatives, not-for-profit institutions, NGO’s
 - America’s most successful institutions, its universities, are not-for-profit institutions
- Economic relations shape who we are—cooperatives encourage cooperative behavior—and have broad implications for the nature of our society

These ideas have long tradition

The belief that progress is possible, and it is within our power to construct an economic and social system that advances progress

- Sustainable increases in standards of living
 - Including life expectancies
 - Living within our planetary boundaries
- And in social justice—not just a matter of economics
 - A more humane society
 - With less prejudice, discrimination, exploitation
- Harking back to earlier period when abuses of our political and economic system became intolerable (in US, at end of nineteenth century, the “Gilded Age,” when inequality reached very high levels)
- America succeeded (through social legislation, anti-trust, etc.) in creating a more dynamic capitalism and a prosperity that was better shared, and in which *power* was not concentrated in the hand of relatively few

Major elements

Four major elements

1. Rewriting the basic rules—to constrain power and its abuses, to create a more efficient and fairer economy, to ensure that we live within our planetary boundaries
 - Current rules constrain opportunities for collective action—collective bargaining, class-action lawsuits
 - Favor narrow view of capitalism
2. Public expenditures—to do what the private sector cannot or will not do, or to do what the government has a comparative advantage
3. Fair and efficient taxation to help finance the public expenditures
4. Ensuring access to a middle-class, decent life

1. Rewriting the rules of the market economy

- Markets don't exist in a vacuum—they have to be structured
- Societies can't function without good rules (part of “rule of law”)
 - Without stoplights, a simple regulation for governing taking turns at intersections, cities would be in gridlock
- Rules have large distributive consequences
- They affect market distribution of income
- Changing rules to achieve more equitable distribution is sometimes referred to as pre-distribution
 - Reduces extent of required redistribution

1. Rewriting the rules of the market economy

Rules were rewritten in era of neoliberalism in ways that led to more inequality, more market power, less efficient economy

- Ignored need for, and importance of, collective action
 - Markets can't address problems of externalities—collective action; or of massive exploitation
- Narrow view of market economy
 - Shareholder capitalism vs. stakeholder capitalism

Now they have to be rewritten again, to achieve more dynamic economy and greater equality

Virtually every rule governing the economy has to be rewritten

1. Rewriting the rules of the market economy

- To ensure more competition
- Better corporate governance, bankruptcy laws
 - Current rules have led to short-sighted policies
 - Marked change in US in perspectives—growing support for stakeholder capitalism, away from shareholder capitalism
- Better-managed financial sector—not just preventing it from harming rest of society, but ensuring that it serves its important social functions
- Better-managed globalization
 - Including IPR, investment agreements
 - Addressing tax avoidance and evasion, money laundering
 - Stopping tax competition, regulatory race to the bottom
- Better macroeconomic management, including monetary policy

1. Rewriting the rules of the market economy

- To reduce scope for exploitation in all of its forms
- To facilitate collective action
 - Collective bargaining, class-action suits
 - To help regress existing imbalances of power
- To ensure that we live within our planetary boundaries
- In Europe, the rules of the Eurozone need to be rewritten
 - Especially the Growth and Stability Pact
 - Need for a banking union, with common deposit insurance
 - Need for a common support for unemployment
 - A solidarity fund for stabilization
 - Other reforms identified in *The Euro*

A Green New Deal

- Have to live within planetary boundaries
- Need prices to guide economy
- But prices alone won't suffice: Have to be complemented by regulations and public investments
- Urgency and scope—of a kind associated with New Deal, or a world war
- Can provide opportunity to change social and economic structure—in way that our social and economic structure was altered by World War II
- Resolves fundamental quandary: Some worry about technological unemployment and a savings glut; others assert that we cannot afford a quick green transition.
 - But a rapid transition is best way of ensuring full utilization of resources for the immediate future—and it can easily be financed

2. Progressive Expenditures

- **Public investments** in education, science, technology, and infrastructure are at the heart of a successful economy
 - Knowledge is a public good, and will be undersupplied by private markets
 - Evidence of high returns
- Government assistance in **structural transformation** and better systems of **social protection**, with **active labor market and industrial policies**, are essential for maintaining the flexibility required by a dynamic society, and ensuring resources are well used
 - We are going through a major set of transitions and transformations
 - Markets on their own don't handle these transitions well
 - For reasons that are well understood—imperfect capital and risk markets, based in turn on imperfections of information
- **Taxes and transfers** can help promote societal equality: Evidence that societies with greater equality have better economic performance

3. Progressive taxation

- Public expenditures have to be financed in fair and equitable way
 - US actually has a regressive tax system
- Large opportunities for creating a more efficient and fairer economic system—raising large revenues for public investments and promoting equality—and actually increasing overall economic performance
 - Taxing “bads”—pollution, excessive financial transactions
 - Taxing rents—non-distortionary, and in standard models, leading to more *real* investment
 - Eliminating regressivity and introducing at least a modicum of progressivity
 - Eliminating special provisions of capital gains and dividends
 - Including eliminating step-up of basis of capital gains
 - A wealth tax
 - A global minimum corporate income tax

4. Won't suffice to ensure middle-class life for most citizens—what is needed is a 21st century reinvigorated welfare state

- Further role—to ensure access to jobs, housing, healthcare, decent retirement, education for children, opportunity and security
 - 21st century welfare state
 - Going beyond just social protection; helping individuals as they go through life; ensuring opportunity, including opportunity to work
 - After World War II, there was a commitment by government to ensure full employment
 - Relying on *indirect* (monetary and fiscal) instruments has failed to fulfill commitment, for long periods of time and for significant groups within the population
 - Should reconsider using new instruments—**guaranteed job program**

A new course is needed

- Old economic model has failed for over four decades—“experiment” with neoliberalism (supply-side economics) should be over, results are conclusive
- Mild changes are not likely to make matters much better
- Requires major changes—based on what we have learned from successes and failures here and elsewhere
- What you call it is not important—what is important is what we do
- New social contract, new economic order, based on a new relationship between the market, state, and civil society
 - Can produce greater growth with more equality, and address the climate and inequality crises that we are confronting