

Markets and Democracy¹

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The natural place to begin to see what a post-neoliberal economy and society might look like is to identify the failures of the neoliberal agenda. We already know many of the economic failures of neoliberalism. These go beyond the economic – slower growth, shorter lifespan, greater inequality. The ways in which these interplay with the politics are pretty obvious. The growth of inequality has provided a fertile field for authoritarianism and illiberal ideas.

The kind of despair in de-industrialized places in the United States provides a reason for people to feel alienated from the current economic system. The social dimensions have been emphasized by sociologists talking about how these communities feel like they are left behind, not recognized, their voices not heard. All of these aspects of the failures of neoliberalism are fairly clear.

I want to begin with two points. One, for almost half a century economic theory has provided a critique of neoliberalism. Most of the doctrines that underlie neoliberalism were wrong even before neoliberalism

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became fashionable. Even the idea that free trade would be welfare enhancing was questionable. I wrote a paper showing that free trade in the absence of risk markets could make everybody in all societies worse off.² Similarly, capital market liberalization can be welfare decreasing.³ So too, when you have endogenous technology, trade restrictions can help developing countries grow.⁴ To repeat: the “perfect markets” theory behind neoliberalism had already been rejected at the very time when neoliberalism became fashionable. One has to understand that neoliberalism is not really a program based on economic theory, but a political agenda.

Now, when you recognize that it is a political agenda, it’s useful to begin with the word neoliberalism itself: it’s neo (new) and liberalism (free). The naming of things is interesting. One of the things governments have learned is to always name things the opposite of what they are. So, when you’re talking about free, what does that mean? Everybody loves freedom, and therefore “opening up” sounds good. You’re taking off the yoke that has kept you down. But of course, what we really should have understood was that it was freedom for some but not for others. As Isaiah Berlin pointed out, “Freedom for the wolves has often meant death to the sheep.”⁵

Under neoliberalism, what was really going on was not a liberalization agenda; it was a “rewriting of the rules” agenda⁶: rewriting the rules in ways that advantage some groups and disadvantage others. Rewriting the rules is political – it is about power. The economic model that underlaid neoliberalism was a perfect and competitive equilibrium in which no one had power. So, neoliberalism began with a view that power doesn’t exist.

- 2 D. Newbery and J.E. Stiglitz, “Pareto Inferior Trade,” *Review of Economic Studies*, 51(1), January 1984, pp. 1–12.
- 3 Joseph E. Stiglitz, “Capital Market Liberalization, Globalization, and the IMF,” in J.A. Ocampo and J.E. Stiglitz (eds), *Capital Market Liberalization and Development*, New York: Oxford University Press, 2008, pp. 76–100.
- 4 Joseph E. Stiglitz and Bruce Greenwald, *Creating a Learning Society: A New Approach to Growth, Development, and Social Progress*, New York: Columbia University Press, 2014. Reader’s Edition published 2015.
- 5 Isaiah Berlin, *Four Essays on Liberty*, Oxford: Oxford University Press, 1969.

It began with that as a presumption, and then created centers of power. Financial liberalization led to the unfettered growth of the financial sector, which became a major center of power in the American economy.

Details in the rules matter, partly because even small changes to rules – transaction costs we might call them – redistribute power from one group to another. A lot of really small, subtle things have made a very big difference.

One of the societal changes that's been linked to the growth of “illiberalism” is a growing sense of insecurity. And the question, then, is: was that deepening insecurity collateral damage, as we were making the economy grow? Or was it actually an inherent part of the strategy? Consider again, for example, our financial sector. We created a system that got people *on the hook*, that essentially encouraged indebtedness (in the case of mortgages, even making interest tax deductible). Then we created a bankruptcy code that I've described in one of my books⁷ as partial indebted servitude: those overly in debt just had to work to keep paying back the banks.

The changes in the rules of bankruptcy that led to these dire outcomes illustrate the importance of power and the deficiencies in our democracy: There was little public discussion of this change. But it had a very large effect on the distribution of wealth and power.

There are other economic and political (power) aspects to neoliberalism, but I want to talk very briefly about the moral overtone. I already mentioned “the freeing of all” that was associated with marketing neoliberalism. Milton Friedman wrote a book, *Capitalism and Freedom* (1962), to show not only that a neoliberal economic system was more efficient, but also that it led to greater freedom. Friedrich Hayek wrote *The Road to*

6 For a more extensive discussion, see Joseph E. Stiglitz, with Nell Abernathy, Adam Hersh, Susan Holmberg, and Mike Konczal, *Rewriting the Rules of the American Economy: An Agenda for Growth and Shared Prosperity*, New York: Norton, 2015; and Joseph E. Stiglitz, with Carter Dougherty and The Foundation for European Progressive Studies, *Rewriting the Rules of the European Economy: An Agenda for Growth and Shared Prosperity*, New York: Norton, 2020.

7 Joseph E. Stiglitz, *The Price of Inequality: How Today's Divided Society Endangers Our Future*, New York: Norton, 2012.

Serfdom (1944), in which he argued that if we have more collective action, we are on the road to serfdom. To the contrary, as I explain in my 2024 book, *The Road to Freedom: Economics and the Good Society*,⁸ neoliberal, unfettered, capitalism has set us on the road to fascism. The implication is that we have to rethink the principles of a market economy.

Elements of a post-neoliberal economy

I want to turn now to discuss some of the elements of what I see as a post-neoliberal economy. I begin by emphasizing that modern economies are very large, complex, and have to be decentralized. I also want to challenge a view put forward by John Kenneth Galbraith that was very fashionable in the middle of the last century, which was of the importance of “countervailing power.” Galbraith’s view was that you must create large power groups to countervail existing powerful groups. I think that’s part of the story. But we ought to be thinking about how we decentralize to make sure that there are no – or only minimal – centers of power. That is to say, there are always going to be groups that have power, more power than others, but we have to have much more decentralization, which will limit the power of any one person or group.

Another aspect of a well-functioning post-neoliberal society is the importance of *collective action*. If the government had not responded to the COVID-19 pandemic, we would all be at risk of the disease continuing. It was the government that provided the COVID-19 vaccines, and it was the government that kept our economy growing. So, we have just had a very dramatic example of the importance of collective action. Collective action is important in a wide variety of areas.

But even in the area of collective action we ought to think of decentralization. There’s not just one form of collective action. Workers working together in unions is a form of collective action. Class action suits are a form of collective action. NGOs that try to represent the voices of people who have different perspectives are a form of collective

8 Joseph E. Stiglitz, *The Road to Freedom: Economics and the Good Society*, New York: Norton, 2024.

action. So, I think a part of the post-neoliberal society/economy is a recognition of just how important collective action is and how many forms it can take.

Part of the strategy of the right has been to destroy, or at least weaken, collective action in every one of these areas. For instance, in contracts you can have arbitration clauses that give power to the corporations because the arbitrators, the judges, often have a relationship with the corporations. But then the Supreme Court ruled that there can't be collective action in arbitration. So businesses have succeeded in moving the adjudication of disputes out of the public arena – which is a core part of what ought to be in the domain of the “public” – into the private realm. And then they said that in that private sphere there can't be collective action. This is a concerted effort to weaken the scope of collective action.

The most important unit for collective action is our government, operating at all levels. And again, there's been a concerted effort to disempower the government, both by limiting its funds – that's what austerity is about – but also by denigrating it, making sure that high-quality people don't work there and limiting the domain of government learning-by-doing. If you don't have industrial policies, you're not going to learn how to do industrial policy. If you don't have a central bank, you don't know how to do central banking. We recognize now that we need central banks. Similarly, we need institutions that promote industrial policy. By limiting government resources and denigrating the public sector over the past 50 years, we've made the public sector weaker, and therefore made it more difficult to engage in collective action.

An important aspect of collective action is the socialization of risk. This goes back to the role of insecurity as creating a fertile field for demagogues and illiberal democracy. We socialize risk all the time. When the Silicon Valley Bank went down but its depositors were protected (beyond the level covered by deposit insurance), we socialized that risk. I think it was the right decision. But what is so interesting is that we have a neoliberal ideology that says, in effect, that we individuals should take care of ourselves and be free to do as we please, bearing the consequences. In the same way, banks should be free – but when banks need money, we *have*

to bail them out. This ideology, which I've referred to as *ersatz capitalism*⁹, with the privatization of gains but the socialization of losses, is not coherent; it is a reflection of power. I think there is scope for a more coherent post-neoliberal ideology, where we have to recognize that we can't bear a lot of risk individually. In some circumstances, we ought to socialize risk and we should do it in a systematic way, with a coherent set of principles.

Another area where collective action is really important is macroeconomics. Even the right wing has conceded that the market does not manage macroeconomic activity very well. They have conceded that we need macroeconomic stabilization policies. But then they formulate those policies in ways that limit the role of the state and weaken it. An example is central banks. It has become part of the mantra of modern monetary economics that central banks should be independent; but in many countries they are effectively run by the financial sector, so they're not only independent, they're also unrepresentative. And this is true even in countries in which those from the financial sector do not dominate the bank's governance. Even people who are not from the financial sector tend to be cognitively captured: they adopt Wall Street's view of the world, and, more specifically, what makes for a good economy and a good central bank.¹⁰ The right argues, for instance, that they should operate according to simple rules (earlier it was monetarism, more recently it's inflation targeting); the intent was to deprive them of much discretion.

Wall Street believes in austerity, tying government's hands. When I was in the Clinton administration there was a proposal to have a balanced budget amendment. One of the big things we did was defeat that. But it was only by a margin of one or two votes. One could imagine where we would have been in the midst of the covid-19 crisis if that amendment had passed. And some countries have passed laws like that.

9 Joseph E. Stiglitz, *Freefall: America, Free Markets, and the Sinking of the World Economy*, New York: Norton, 2010.

10 See Joseph E. Stiglitz, "Central Banking in a Democratic Society," *De Economist* (Netherlands), 146(2), 1998, pp. 199–226. (Originally presented as the 1997 Tinbergen Lecture delivered in October 1997 at De Nederlandsche Bank, Amsterdam.)

A post-neoliberal macroeconomic policy

For the last few years, I have been working¹¹ on a vision for post-neoliberal macroeconomic policy. You can see the contrast between a neoliberal macro policy and what might be a post-neoliberal policy in the debate going on about how to respond to inflation. The Federal Reserve raised interest rates rapidly, without thinking about the turmoil to the financial system that might induce, either domestically or internationally. It was a no-brainer that it would cause turmoil. It has happened every time yield curves change quickly. Banks are engaged in maturity transformation, borrowing short-term, lending long, so if the cost of their funds goes up quickly and in an unanticipated way, they may well get into trouble.

But after the failure of several large regional banks, we discovered that even in their so-called stress tests, the Fed never tested what would happen if the interest rate changed dramatically. This is mind-boggling, undermining confidence in the Fed and its competence.

Even worse is the Fed's stated ambition to increase the unemployment rate. It is odd, to say the least, for a major public agency to say that its goal is to have an unemployment rate that is greater than 5%. And we know that if the overall unemployment rate is 5%, the minority youth unemployment rate is going to be over 20%. Now, the president of the Fed should say to the fiscal authorities, "This is going to be the unfortunate consequence of what I'm doing. It's beyond my remit to address such structural problems. You better do something about this. Let's make sure that that disparity in unemployment rates is reduced as I raise interest rates." But, while there was ample *talk* about the pain about to be inflicted (on workers), nary a word about that.

If we want an inclusive society, it's clear we need to build a post-neoliberal macroeconomic policy framework.

There are two final points I want to make. The first is a statement about the state of economic theory, and the second relates this to economic policy.

11 With support from the Hewlett Foundation.

A premise of all economic theory is that individuals' preferences, their behavior, who they are, their identity, is exogenous.¹² *But, in fact, the economy helps shape who we are*, and the economy, in turn, is shaped by economic policy, the rules of the economic game.¹³ There is some evidence that if an individual becomes a banker, that person may wind up being more dishonest and more selfish, and if one studies to become an economist, one may become more selfish.¹⁴

The important point is that our socio-economic system shapes who we are and affects what kind of society we create. If more institutions are based on cooperation, we may be more likely to wind up with more cooperative people. And, in fact, the one part of our financial system that worked relatively well in the run-up to the 2008 crisis and post-2008, were our co-ops, which are called credit unions. And, for the most part, the credit unions in the United States actually did not engage in the very bad behavior that was so prevalent before the crisis, and after the crisis they continued to lend to small businesses. This is not a surprise, because they had a different ethos. As we go into a post-neoliberal economy, it is important for us to think about how our economic, political, and social system shapes people.

The final thing I want to say is about the standard way that economists approach many of the questions we are discussing today. They ask, what are the market failures? And then how do we correct the market failures? That approach gives priority to the market. Markets are the defaults. Markets are where we begin our analysis, and then we patch things up. I'm not sure that that's the right approach. It is a very useful approach, and I think one gets a lot of insights from it. Much of my work in public economics, both in the theory and the practice, has in fact been based on

12 See, e.g., Karla Hoff and Joseph E. Stiglitz, "Striving for Balance in Economics: Towards a Theory of the Social Determination of Behavior," *Journal of Economic Behavior and Organization*, 126 (Part B), 2016, pp. 25–57.

13 Stiglitz et al., 2015, *op. cit.*

14 For a discussion of some of the evidence, see Allison Demeritt, Karla Hoff, and Joseph E. Stiglitz, *The Other Invisible Hand: The Power of Culture to Promote or Stymie Progress*, New York: Columbia University Press, 2024.

this approach, so I don't want to criticize it too much. But, at the same time, I want to say that in many contexts, other, non-market, institutional arrangements have worked very well and one shouldn't necessarily give priority to markets. Moreover, as I have emphasized in other writings,¹⁵ internally, even for-profit market enterprises do not use markets; they rely on other institutional arrangements for the allocation and management of resources. The flaws and limitations of markets are actually very deep. When we go beyond textbook economics and think about the actual functioning of the economy – the inequalities to which it contributes, the exploitation by the tobacco and food industries, the devastation to the environment, the opioid and financial crises, the depressions and recessions, and so forth, we see a world enmeshed with deep flaws. We have this mindset that while the market fails in all of these respects, the market based solely on for-profit firms maximizing shareholder value should still be our paradigm. I find that a bit paradoxical. We need to take a more open approach to institutional arrangements. We should ask ourselves: What institutional arrangements really work? And if they're not working, how do we reform them to make them work better? I acknowledge that designing institutions is really difficult. And what's particularly difficult is what we're calling for here, a change in the system, and that means changes in many of the pieces all at the same time.

In my two most recent books, *People, Power, and Profits: Progressive Capitalism for an Age of Discontent*¹⁶ and *The Road to Freedom: Economics and the Good Society*¹⁷, I have described the outlines of what such an economic system would look like, and in the latter book, I have described – contrary to the claim of Hayek¹⁸ and Friedman¹⁹ – that this alternative

15 See *The Selected Works of Joseph E. Stiglitz, Volume III: Rethinking Microeconomics*, Oxford: Oxford University Press, 2019.

16 Joseph E. Stiglitz, *People, Power, and Profits: Progressive Capitalism for an Age of Discontent*, New York: Norton, 2019.

17 Stiglitz, 2024, *op. cit.*

18 Friedrich A. Hayek, *The Road to Serfdom*, London: Routledge, 1944.

19 Milton Friedman, *Capitalism and Freedom*, Chicago: University of Chicago Press, 1962.

system is best both in promoting freedom and in supporting democracy. Indeed, I claim that neoliberalism has set us on the road to populism – to 21st century fascism.

Thus, our economic system cannot be separated from our social and political system – from what we are as individuals and as a society. More is at stake in the move away from neoliberalism than just economic efficiency. Moving away from neoliberalism is a critical step in moving towards a good, or at least better, society.

