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Fixing What Is Wrong With Our Economy

The economic policies that led to the financial crash of 2008 and the subsequent Great Recession should have been permanently discredited by their epic failure. Instead, the Republican presidential candidates are now resurrecting the same failed policies and pretending the crash never happened.

America cannot afford to go down this path again. If we want to fix what is wrong with our economy, we have to learn from our mistakes and avoid repeating them.

The crash of 2008 and the Great Recession were inevitable consequences of three decades of economic policies designed by and for Wall Street and the wealthiest Americans. At the heart of the problem was the hollowing out of American manufacturing, the growing dysfunction of our financial sector and a rapid increase in economic inequality, all of which crippled the growth engine of the U.S. economy.

Starting in the 1980s, corporate America decided to boost profits by shipping U.S. jobs overseas. NAFTA and the admission of China into the World Trade Organization (WTO) accelerated the drive to relocate production to "export platforms" in foreign countries that would ship goods back to the U.S. market. Corporations that sent jobs overseas became forceful proponents of a "strong" (overvalued) dollar, which enhanced the profitability of their overseas operations but at the same time made much of the U.S. manufacturing sector uncompetitive and led to perennial U.S. trade deficits.

Also by the 1980s, the U.S. financial sector was failing to perform its essential function of channeling savings to productive investment in the real economy. Financial firms on Wall Street focused instead on making a quick buck by stripping assets from existing businesses and downsizing their workforces, and on various forms of complex financial engineering that had little economic value. Financial firms also provided critical support for a "strong dollar" policy that diverted productive investment away from the U.S. manufacturing sector toward overseas operations. By the eve of the crash of 2008, the manufacturing sector had shrunk to half its 1960 size, while the financial sector had doubled in size and accounted for 40 percent of corporate profits.

The deindustrialization of America and the substitution of speculation for productive investment were not accidents, they were not inevitable, and they were not the outcome of natural forces. They were the predictable results of mistaken policy choices made by politicians of both parties for more than a generation. These policy choices had victims with first and last names: millions of displaced workers, shuttered factories and hollowed-out communities across the country hobbled by shrinking tax bases that no longer could support vital public services.

Both deindustrialization and the dysfunction of finance contributed to a remarkable rise in economic inequality starting in the late 1970s. Trade deficits and offshoring wiped out millions of well-paying, middle-class jobs, and the threat of offshoring held down wages for all workers. But a long list of other deliberate policy choices also played key roles in the rise of inequality. These included the abandonment of full employment in favor of fighting inflation, the prolonged attack on workers' right to organize and bargain collectively with their employers, the erosion of the minimum wage and other labor protections and massive tax cuts for the wealthy. In the end, nearly two-thirds of the pre-tax income gains after 1979 were captured by the richest 10 percent and more than half was captured by the richest 1 percent.

The experience of the past 30 years shows that rising inequality is bad not only for workers, but also for the economy as a whole. Less affluent households tend to spend more of their income, generating more economic activity, while more affluent households tend to consume less. Wage stagnation undermines political support for the levels of taxation necessary to support public investment in things like roads and schools, which underpins future economic productivity. And high levels of inequality are associated with political decision-making that leads to slower growth. In short, the upward redistribution of income throws sand in the gears of the economy.

The combination of all these policy mistakes caused the growth engine of the U.S. economy to sputter. Starting in the early 1980s, the economy's average annual growth rate slowed considerably in comparison with the postwar period. The expansion of the Bush years was the weakest since World War II in terms of output growth, investment growth, employment growth and wage growth. In fact, the Bush expansion was the first since World War II in which real income for the typical middle-class family actually declined. There was clearly something wrong with the U.S. economy long before the crash.

The weakness of the economy was temporarily papered over by a bubble in real estate prices at the turn of the 21st century, which was made possible by the deregulation of Wall Street. Instead of broad-based, sustainable growth fueled by rising wages and investment, the U.S. economy was artificially inflated by complex financial engineering that made credit more easily available and exposed the entire economy to enormous risk. The bubble allowed working families to maintain their standard of living, despite stagnant wages, by borrowing against the value of their homes and going deeper into debt. But of course households could not keep increasing their debt loads forever. When the real estate bubble finally burst, the house of cards came crashing down and working people were once again forced to pay for the sins of Wall Street with their homes, their dreams and their children's futures.

We are still digging our way out from the rubble of the crash. It typically takes years to repair the damage from the collapse of speculative asset bubbles. When the U.S. real estate bubble burst, households lost more than $10 trillion in wealth from the plunge in housing and stock prices, and they were heavily indebted to begin with. Even today, households are still digging their way out of debt, and it may take years for them to see daylight. This helps explain why progress toward closing our jobs deficit has been so difficult, and why the economic

recovery is still so fragile. Another drag on the recovery has been the loss of 765,000 jobs at the state and local levels between 2007 and 2011, more than in any modern downturn.

The Republican presidential candidates not only failed to learn anything from Wall Street's mistakes, they now want to double down on more of the same. They propose to deregulate the financial sector yet again, pass more trade agreements that encourage the offshoring of U.S. jobs, suppress wages by intensifying the assault on unions, prioritize inflation-fighting over full employment and perpetuate overvaluation of the dollar and the U.S. trade deficit. We already tried this approach, and it already failed spectacularly.

The Republican candidates pretend that tax cuts for corporations and the wealthy are the answer to wage stagnation and the economic crisis, but the Bush years taught us that these obscenely wasteful tax cuts only make the problem worse. They are the equivalent of eating our seed corn, because they starve the kind of public investment in education, infrastructure and innovation that is indispensable for long-term economic growth.

President Obama has shown that he understands the problem. He has said clearly that "we are not going back to an economy that's all about outsourcing and bad debt and phony profits," we cannot return to a "bubble and bust" economy propped up by "fleeting bubbles and rampant speculation," and we "must make sure such a crisis never happens again." He has called for rebuilding an economy "built to last" through a sustained program of public investment in infrastructure, education and innovation. He has called economic inequality the "defining issue of our time" and sounded the alarm at the decline of the American middle class over the past 30 years. He has opened a national conversation about encouraging businesses to bring jobs back to the U.S. instead of shipping jobs overseas. He has acknowledged that America can no longer "serve as the consumer engine for the entire world," and called on trading partners that run trade surpluses every year to rebalance their economies by consuming more of what they produce.

What we need now is an economic program as serious and far-reaching as the problem President Obama has correctly diagnosed. We must start by shifting the focus of U.S. economic policy from one of maximizing the competitiveness and profitability of corporations that happen to maintain headquarters somewhere on U.S. territory to one of maximizing the competitiveness and prosperity of the human beings who live and work in America.

First, if we want to be competitive with Germany and China in the 21st century, we will need trillions of dollars in productive public investment over the next 10 years in affordable education and apprenticeship programs for young people, who have suffered greater income loss than any other demographic; infrastructure; energy; manufacturing; transportation; skills training and upgrades; and new technologies; all of which have been starved by successive rounds of tax cuts for the wealthy and inaction on long-term federal investment initiatives. Wall Street and the wealthiest Americans, who have benefitted most from the economic policies of the past 30 years, will have to start paying their fair share. We need to pass a financial speculation tax, let the Bush tax cuts for the wealthy expire, tax capital gains at the same rate as ordinary income and

establish a minimum effective tax rate of 30 percent for households earning more than $1 million.

Second, to encourage domestic investment and lay a stronger and more stable foundation for long-term growth, it is essential that we tackle the problems of wage stagnation and economic inequality. This will require reforming our labor laws so that all workers who want to form a union and bargain collectively have a fair opportunity to do so, making full employment the highest priority of our economic policy, increasing and indexing the minimum wage, shrinking the trade deficit and, again, eliminating incentives for offshoring.

Third, we need to start making things in America again. We cannot hope to revive U.S. manufacturing without bringing our trade deficit under control, which means ending the overvaluation of the U.S. dollar and combating currency manipulation by our trading partners. We will also need to enhance Buy America safeguards, aggressively enforce our trade laws and end incentives for offshoring in the tax code and in our trade agreements.

Fourth, we need to shrink our bloated financial sector and make it serve the real economy once again. We can no longer afford a financial sector that squanders scarce resources on unproductive gambling and exposes the entire economy to the intolerable risk of speculative bubbles. This means reregulating Wall Street, eliminating tax advantages for leveraged buyouts and finding other ways to favor strategic investment over short-term speculation.

Fifth, if we expect other countries to stop relying on trade surpluses as their source of growth, we will have to make it easier for them to rely on domestic incomes as their source of growth. This will require a global New Deal that establishes minimum standards for the global economy, prevents a race to the bottom, creates vibrant consumer markets in the global South and in the process creates new markets for advanced U.S. manufacturing.

We also have unfinished business in digging out from the rubble of the crash. America wants to work, and decisive action to close our jobs deficit must not be delayed any further. An immediate multi-year program of public investment in infrastructure and clean energy would draw in business investment and buy time while households dig their way out of debt. To stop the foreclosure epidemic and stabilize housing prices, broad-based reductions in mortgage principal will also be needed. The U.S. economy cannot recover until the housing market—the single largest market in the country—is healthy again, and the banks must be held accountable for their contribution to the crisis.

One thing is clear: We can no longer rely on household debt, real estate bubbles, tech bubbles, stock bubbles or any other kind of bubbles to fuel our economic growth. We cannot go back to a low-wage, high-consumption economy. We need bold leadership to draw the right lessons from the mistakes of the past 30 years and forge a new model of economic growth in which we make things in America again, workers can form a union and bargain collectively if they want to, working people can afford to buy the things they make, the U.S. economy produces as much as it consumes, everybody who wants to work can find a good job and prosperity is broadly shared.