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Working Paper

How Neoliberalism Failed, and What a Better Society Could Look Like

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About the Author

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Introduction

Before we can see what a post-neoliberal economy and society might look like, we need to identify neoliberalism's failures. We already know many of neoliberalism's economic failures—most notably slower growth, greater inequality, and increased monopolization. We also know that many people living in deindustrialized parts of the United States feel a deep sense of despair and an alienation from the current economic system, underscored by reports from sociologists who explain that these communities feel they are left behind economically and that their concerns are ignored by the people in power. But many of neoliberalism's failures go beyond the economic: a polarized society with a media controlled by the superrich, shorter lifespans, greater insecurity, and a degraded environment. These failures interact with politics in obvious ways. As just one example, the growth of inequality provides a fertile field for authoritarianism and illiberal ideas.

For almost half a century, economic theory has provided a critique of neoliberalism. Most of neoliberalism's underlying doctrines (especially those associated with perfect competition and perfect markets) were shown to be wrong even before it became fashionable in the latter part of the last century. Even the idea that free trade enhanced welfare was demonstrated to be questionable. Forty years ago, I wrote a paper showing that free trade in the absence of risk markets could make everybody, in all societies, worse off.[2] [3] Similarly, when technology is endogenous, trade restrictions can help developing countries grow.[4]

Neoliberalism is not really a program based on economic theory; it is a political agenda. In recognizing this, it's useful to begin with the word neoliberalism itself: "neo" (new) and "liberalism" (free). Everybody loves freedom, and therefore "freeing up the economy" sounds good. But of course, what we really should have understood was that this "liberalism" or "freedom" agenda entailed freedom for some but not for others. As philosopher Isaiah Berlin pointed out, "Freedom for the wolves has often meant death to the sheep."[5]

[2] D. Newbery and J. E. Stiglitz, "Pareto Inferior Trade," *Review of Economic Studies*, 51(1), January 1984, pp. 1-12.
[3] So, too, capital market liberalization can be welfare-decreasing. See "Capital Market Liberalization, Globalization, and the IMF," *Capital Market Liberalization and Development*, J.E. Stiglitz and J.A. Ocampo (eds.), New York: Oxford University Press, 2008, pp. 76-100.
[4] J. 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).

Power

Under neoliberalism, what was really going on was not a liberalization agenda, it was a "rewriting-of-the-rules" agenda[6]—rewriting the rules in ways that advantaged some groups and disadvantaged others. Rewriting the rules is political. It's about power. The economic model that underlaid neoliberalism was one with perfect markets, with competitive equilibrium in which no one had power, meaning that neoliberalism began with a view that power doesn't exist. It began with that idea as a presumption, and with that belief allowed concentrated centers of power to flourish. 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—sometimes no more than an increase in transaction costs—redistribute power from one group to another. A number of small, subtle changes have made a big difference.

Insecurity

One of the societal changes that's been linked to neoliberalism is a growing sense of insecurity. The question, then, is: Was that deepening insecurity collateral damage because we were making the economy grow? Or was it actually an inherent part of the neoliberal strategy? For example, consider 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 books[7] as partial indebted servitude—those who were overly in debt just had to work to keep paying back the banks.

Power and a Democratic Deficit

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.

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[6] For a more extensive discussion, see J. 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*, A Roosevelt Institute Book, New York: W.W. Norton, 2015; and J. E. Stiglitz, with Carter Daugherty and the Foundation for European Progressive Studies, *Rewriting the Rules of the European Economy: An Agenda for Growth and Shared Prosperity*, New York: W.W. Norton, 2020.
[7] *The Price of Inequality: How Today's Divided Society Endangers Our Future*, New York: W.W. Norton, 2012.

Elements of a Post-Neoliberal Economy

Modern economies are very large and complex and must be decentralized. In this short space I can only sketch a few of the elements of what a post-neoliberal economy might look like. In my two most recent books, *People, Power, and Profits: Progressive Capitalism for an Age of Discontent*[8] and *The Road to Freedom: Economics and the Good Society*,[9] I have described more fully the outlines of what such an economic system would look like.

Limiting Power

One of our objectives should be to create an economy with no—or minimal—centers of power. Policy can affect the extent of power concentration; we can limit the power of any one person or group with greater decentralization (effectively enforcing strong competition laws) and more progressive taxation. Of course, even then some groups will have more power than others, and we will then need to address the remaining power imbalances.

One way to deal with these kinds of imbalances is to create "countervailing power," such as strong unions, a view emphasized in the middle of the last century by John Kenneth Galbraith. The sad truth of neoliberalism is that it allowed the growth of corporate power and weakened the potential for countervailing powers. Our emphasis should be on the prevention of the agglomeration of power. But recognizing that weakening the power of existing behemoths and preventing the growth of new ones is a slow and imperfect process, we need to simultaneously think about countervailing institutional structures and policy actions, such as a stronger civil society and reducing the power of money in our politics.

Collective Action

Part of the post-neoliberal society and economy is a recognition of just how important collective action is and how many forms it can take: 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 action.

The most important form of collective action is government. The COVID-19 pandemic provides an instance of the importance of government action—it was essential in both producing vaccines and sustaining the economy. Governments could, of course, have

[8] New York: W.W. Norton, 2019.
[9] New York: W. W. Norton, 2024.

done more to ensure greater access to vaccines, especially for citizens in less developed countries and emerging markets. Still, in the absence of government action, things would have been a lot worse.

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, contracts sometimes have arbitration clauses that give power to corporations because the arbitrators, the judges, often have a relationship with the corporations. But the Supreme Court not only supported the move to arbitration, which means that businesses have succeeded in transferring the adjudication of disputes—a core part of what ought to be in the domain of the "public"—into the private realm and out of the public arena, it also then made a rule that made collective action in arbitration far more difficult.

This is but one example of a concerted effort by the Right to weaken the scope of collective action. Most important have been their efforts to disempower the government, both by limiting its funds, such as through austerity, and by denigrating it, which can discourage trust and interest in government work.

There is a negative feedback loop. Smaller, more circumscribed government means fewer opportunities to learn how to do the things that government can and needs to do. In every part of the economy, institutional learning-by-doing is important. As Adam Smith emphasized, we get better at doing things through repetition and by experience, and this is not just true of making pins in the private sector but in governing and administering in the public sector. The US has finally recognized the importance of industrial policies, that is, government interventions in the market to affect what is produced and how it is produced. The US has said that the market has not supplied enough domestically manufactured semiconductors and has not been moving fast enough in the green energy transition. But it is difficult to learn how to do industrial policy without having an industrial policy. Countries that have long had such policies have a comparative advantage in conducting those policies.

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. We socialize risk all the time: Medicare and Social Security are important examples of social protection—reducing health and income insecurity for older people. Unemployment insurance provides social protection against the risk of being unemployed. There are many other examples: One is that when Silicon Valley Bank collapsed, its depositors (many of whom were start-ups) were fully protected (beyond the level covered by deposit insurance). We socialized that risk, and I think it was the right decision. Neoliberal ideology criticized these important governmental roles, saying, in effect, that individuals should take care of themselves and be free to do as they please while bearing the consequences. Such freedom would somehow enrich our society, and the private sector would provide social protections more efficiently than the government. The neoliberals ignored the fact that the reason the government introduced Social Security, unemployment insurance, and Medicare in the first place was because the private sector had failed to provide adequate insurance markets.

Neoliberal economists preached that the provision of social insurance (like pensions) should be turned over to the private sector. In practice, things turned out much as the critics predicted. Markets were better than governments in exploitation, but not in providing security.

When the 2008 global financial crisis hit in Chile, which had gone further than even the US in the neoliberal agenda, the elderly were left bereft. The privatized retirement program proved unable to deliver benefits that the retirees needed to sustain a decent living standard. There had to be a government bailout.

Similarly, in the US, greater freedom for the financial sector meant greater freedom for predatory and risky lending. Banks, neoliberals said, should be free. But when banks needed money because of their reckless investments, taxpayers had little choice but to bail them out. Not doing so would have been even more costly.

This ideology of the privatization of gains but the socialization of losses, which I've referred to as *ersatz capitalism*,[10] is not a coherent policy; it is a reflection of power.

I think there is scope for a more coherent post-neoliberal ideology, in which we recognize that there are many risks that we can't bear individually, for which markets seem not to provide adequate insurance,[11] and where social insurance can be welfare-enhancing.

Toward a Post-Neoliberal Macroeconomic Policy

Another area in which collective action is very important is macroeconomics. Even the Right has conceded that the market does not manage macroeconomics very well, and that we need macroeconomic stabilization policies. But it formulates those policies in ways that limit the role of the state both in monetary and fiscal policy.

It has become part of the mantra of modern monetary economics that central banks should be independent; however, in many countries they are effectively run by the financial sector, so they're not only not independent, they're also unrepresentative. Even those who are not from the financial sector tend to be cognitively captured. They

[10] *Freefall: America, Free Markets, and the Sinking of the World Economy*, New York: W.W. Norton, 2010.
[11] Related to the well-known problems of moral hazard and adverse selection.

adopt Wall Street's view of the world, and, more specifically, of what makes for a good economy and a good central bank.[12]

The Right argues, too, that central banks should operate according to simple rules (earlier it was monetarism, but more recently it's been inflation targeting); the intent was to deprive the central banks of much discretion. Similarly, many on the Right believe in fiscal austerity—tying government's hands—for instance with the simple rules of Europe decrying deficits in excess of 3 percent of GDP. When I was in the Clinton administration, there was a proposal to have a balanced budget amendment. We defeated that, but only barely. Where might we have been in the midst of the COVID-19 crisis if that amendment had passed?

The recent debate about how to respond to the inflation resulting from the pandemic and Russia's invasion of Ukraine demonstrates the contrast between a neoliberal macroeconomic policy and what a post-neoliberal policy might be.

The Federal Reserve followed the standard neoliberal rulebook for central banks and required raising interest rates in response to inflation, no matter what the source of that inflation was; the greater the inflation, the more that interest rates should be raised. (There's even a simple formula that says what they're supposed to do called the Taylor rule.) Given the rapid rise of inflation as the pandemic drew to an end and the war in Ukraine began, the Fed raised interest rates rapidly without, it seemed, thinking deeply about the turmoil to the financial system that the move might induce, both domestically and internationally.

It was a no-brainer that it would cause turmoil because it happens every time yield curves change quickly. It happened when former Fed Chair Paul Volcker raised interest rates dramatically 45 years ago. Banks are engaged in maturity transformation—borrowing short-term, lending long-term—so if the cost of their funds goes up quickly and in an unanticipated way, they may get into trouble.

But after the failure of several large regional banks, we discovered that even in its so-called stress tests, which are supposed to assess what would happen under various economic scenarios, the Fed never adequately tested what would happen if the interest rate changed dramatically. In particular, it didn't take into account that the value of long-term government bonds will fall dramatically, with large consequences for the many banks that hold these and other forms of long-term debt. One of the arguments for the Fed raising interest rates put forward by some pundits was that it was necessary if the Fed was to retain its credibility and if confidence in the Fed were to be sustained. But the incompetence of the Fed in its supervision and the conduct of its stress tests almost surely undermined confidence to a greater extent.

[12] See J. E. Stiglitz, "Central Banking in a Democratic Society," *De Economist* (Netherlands), 146(2), 1998, pp. 199-226. (Originally presented as 1997 Tinbergen Lecture at the Netherlands Central Bank.)

The Fed's stated ambition to increase the unemployment rate was even worse. 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 percent. We know that if the overall unemployment rate is 5 percent, the minority youth unemployment rate is going to be over 20 percent. There was ample *talk* about the pain about to be inflicted (on workers), but there was little talk about who would feel the most pain and what should be done to alleviate it.

What was particularly galling was that much of the pain was based on a "theory" that was wrong, which was proven as inflation came down dramatically without the unemployment rate increasing in the way that the Fed had set its sights on.[13]

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

I want to make two final points. The first is about the state of mainstream economic theory, and the second relates more directly to the subject at hand, the relationship between economics and democracy.

Beyond Market Failures

The standard way that economists approach many of the questions we are discussing is to ask: What are the circumstances in which markets on their own don't lead to economic efficiency? And how do we correct those market failures? That approach gives priority to the market. Markets are the default, the place where we begin and end our analysis, while the role of government is to patch things up. That is a useful approach, and one we can take insight from, but I'm not sure it's necessarily the right approach. Much of my work in public economics, both in the theory and the practice, has in fact been based on this approach. But I have come to realize that in many contexts, other, non-market institutional arrangements—including governments—have worked very well. Indeed, so well that I have been convinced that we shouldn't necessarily give priority to markets. This is especially the case in certain sectors—education, health, caring for the aged, and more broadly, the growing "care" part of our economy.

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[13] And, I would argue, to anyone not wedded to neoliberal doctrine, it should have been obvious that the Fed's stance was wrong. For a discussion of the episode, see J. E. Stiglitz, "Time for a Victory Lap?" *The American Prospect*, January 4, 2024; J. E. Stiglitz and Ira Regmi, "The Causes of and Responses to Today's Inflation," *Industrial and Corporate Change*, Vol. 32(2), pp. 336–385, April, 2023; and J. E. Stiglitz, "The Godley-Tobin Memorial Lecture: Neoliberalism, Keynesian economics and responding to today's inflation," *Review of Keynesian Economics*, Vol. 12 (1), Spring, 2024, pp. 1-26.

Moreover, as I have emphasized in other writings,[14] internally, even for-profit market enterprises do not use markets; they rely on other institutional arrangements for the allocation and management of resources.

We have a mindset that even though the market fails in all of these respects, an economy based solely on for-profit firms maximizing shareholder value should still be our paradigm.

When we go beyond textbook economics and think about the actual functioning of the market economy—the inequalities that it generates, 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 in which markets exhibit deep flaws and have severe limitations. We have a mindset that even though the market fails in all of these respects, an economy based solely on for-profit firms maximizing shareholder value should still be our paradigm. I find that a bit paradoxical. We've put markets on a pedestal that they don't deserve; perhaps it's time to remove them from that pedestal.

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 difficult. And what we're calling for here, a change in the system, is particularly difficult because it means changes in many of the pieces all at the same time.

Shaping Society

There is another important critique of standard economics: Its premise that individuals' preferences—their behavior, their identity—is exogenous.[15] *But the economy and our society more generally help shape who we are.* If our economic system encourages people to be selfish and greedy and amply rewards those who behave that way, more people will be selfish and greedy.

If more institutions are based on cooperation, we are 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. For the most part, credit unions in the United States did not

[14] See *The Selected Works of Joseph E. Stiglitz, Volume III: Rethinking Microeconomics*, Oxford: Oxford University Press, 2019.
[15] See, e.g. K. Hoff and J. E. Stiglitz, "Striving for Balance in Economics: Towards a Theory of the Social Determination of Behavior," *Journal of Economic Behavior and Organization*, Issue 126 (June), pp. 25–57.

engage in the very bad behavior that was so prevalent before the crisis, and they continued to lend to small businesses after the crisis. This is not a surprise, because they had a different ethos than other financial institutions.

To be sure, within any type of organization, there will be individuals with a variety of traits and behaviors; but the economic system tilts the scales. For example, there is some evidence that if an individual becomes a banker, a profession where money is at the center and, at least in much of current practice, rewards individuals on the basis of how much money they've brought into the firm with little attention to anything else, that person may wind up being more dishonest and more selfish.[16]

Our socioeconomic system shapes who we are and affects what kind of society we create.

The economy, in turn, is shaped by economic policy—in particular, as we have emphasized, by the rules of the economic game.[17] And economic policy is shaped by our beliefs and values, and by political power. Economic inequalities inevitably get translated into political inequalities.

The important point is that our socioeconomic system shapes who we are and affects what kind of society we create.

Thus, as we think about the design of a post-neoliberal economy, it is important for us to bear in mind how our economic and political system shapes people and society, and how society, in turn, shapes our economic and political system. We have to ask, what kind of people and what kind of society do we want?

Beyond Neoliberalism: Toward an Economy that Supports Democracy

The two most important economists of neoliberalism and the Right of the mid-20th century, Milton Friedman (and particularly his 1962 book *Capitalism and Freedom*) and Friedrich Hayek (and his 1944 book *The Road to Serfdom*), argued that free market economies were both more efficient and delivered more "freedom." We've already explained what's wrong with both of those claims. But they made an even greater claim: Neoliberalism not only delivered on economic prosperity and economic "freedom" but also, and more importantly, on political freedom. Hayek wrote in the aftermath of the

[16] For a discussion of some of the evidence, see Allison Demeritt, Karla Hoff, and J. E. Stiglitz, *The Other Invisible Hand: The Power of Culture to Promote or Stymie Progress*, New York: Columbia University Press. 2024.
[17] Stiglitz *et al* 2015 *op. cit.*

Great Depression, when it seemed obvious to many that markets had failed. John Maynard Keynes had explained how limited government intervention in the form of monetary and fiscal policies could restore the economy to full employment. Keynes seemed to be saving capitalism from the capitalists, but Hayek, like many of the wealthy of that era, would have none of that. In the UK, where Hayek had taught at the London School of Economics, there were growing demands for a post-World War II Britain in which government took an active role not only in stabilizing the macroeconomy but also in ensuring more social and economic justice, with a greater role for a "welfare state"—ideas that would be put into practice by the Labor government right after the war.

Hayek argued that if we have more collective action, a larger government, *we are on the road to serfdom*. Our political freedom is being put into jeopardy.

To the contrary, as I explain in my 2024 book, *The Road to Freedom: Economics and the Good Society*, neoliberalism has led to the weakening of democracy. There has been a growth of authoritarian populism not so much in the countries that have done too much but in those that have done too little.

Our economic system cannot be separated from our social and political system—from who we are as individuals and what we are 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 toward a good, or at least better, society—one in which individuals and democracy can flourish.