Aftershock

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Introduction: The Pendulum

- The initial analysis in 2009 of the reason for the Great Recession was that Americans needed to spend less and save more.
- While that was a prescription for what we needed to do, it did not describe the underlying problem.
- The underlying problem is that the middle class did not participate in the economic growth over the last 30 years. While only the wealthy benefited, the middle class expected to share that growth and spent accordingly.
- This is not a new cycle and our economy seems to be a series of pendulum swings, though never quite returning to where we were before – more like a spiral.
- Technically the Great Recession has ended, but our fundamentals are profoundly skewed and we will either correct them or repeat our problems and possibly destabilize our society.
- With the current income inequity the middle class cannot be the engine driving future economic growth, therefore all recoveries will stall.
- This book is intended to identify the central choice we face in the years ahead, and how we should respond.

I. The Broken Bargain

1. Eccles's Insight

- Marriner Eccles chaired The Federal Reserve Board from 1934 – 1948.
- Business tycoon who saw that the playing field was tilted in favor of those with the most wealth and power.
- His Senate Finance Committee hearings recommendations
  - Government must go deeper in debt to offset lack of spending by consumers and businesses.
  - Get more money into the hands of the beleaguered middle class.
- The major cause of the Great Depression had nothing to do with excessive spending; rather it was the vast accumulation of income in the hands of the wealthiest people, siphoning purchasing power away from the middle class.
  - Borrowing had been used to keep spending high until this was no longer available
    - Mortgage debt on homes and commercial buildings
    - Consumer installment debt
    - Foreign debt

2. Parallels

- Mark Twain: History does not repeat itself, but it sometimes rhymes.
- The government remembered the lesson of how to use fiscal and monetary policies to contain the economic threat.
- The government did not learn the larger lesson that when the distribution of income gets too far out of whack, the economy needs to be reorganized so the broad middle class has enough buying power to rejuvenate the economy over the long term.
- Wages of typical Americans were flat in the three decades leading up to the Crash of 2008, even though the economy had gotten much larger.
- Parallels between the Great Depression and the Great Recession
  - Our most prosperous periods are when the top 1% of the richest Americans control around 10% of total income earned.
  - The only way Americans could continue to participate in the growing economy was by incurring debt, with

much of this debt backed by the rising value of people's homes.
    - In both periods richer Americans used their soaring incomes, and access to credit, to speculate in a limited range of assets, creating exploding values.
    - Debt was repackaged by banks and resold as new securities.
- The difference between the two eras was in what happened after the bubble burst.
    - In 1929 the economy went into a viscous downward cycle and the government reacted by reducing spending and tightening credit.
        - As a result of the government actions over an extended time, almost all Americans shared the ravages of the Depression, resulting in an unusual degree of social cohesion, and giving the nation the political will to create a new economic order.
    - The government reacted quickly in 2008/09 and halted the slide of the economy quickly enough that not all Americans were ravaged by the Great Recession.
        - This meant powerful forces were still determined to maintain the status quo.
        - There was no general agreement that any new economic order was needed.

3. The Basic Bargain
    - Maintain aggregate demand so that the productive capacity of an economy doesn't outrun the ability of ordinary people to buy, which would give businesses less incentive to invest.
    - Give workers a proportionate share of the fruits of economic growth.
    - When this basic bargain breaks down, the government must step in to reinforce it, or the economy will shrink.
4. How Concentrated Income at the Top Hurts the Economy
    - Rich Americans simply do not spend enough to drive the demand economy.
    - Money not spent is hoarded, used for speculation, or invested abroad.
    - The middle class and poor must spend most of their money back in the economy to survive and better themselves.
    - Therefore, policymakers must focus on the real economy, not only the financial one, and some of the earned money must flow from the rich to the government, to be cycled back to the middle class and poor.
5. Why Policymakers Obsess About the Financial Economy Instead of About the Real One
    - Inhabitants of the real economy, including corporations and small business owners, do need to borrow money form the financial economy.
        - Their overwhelming reliance on Wall Street is a relatively recent phenomenon.
        - Most people use to borrow from each other or from local institutions.
        - Rules have been loosened over time driving much of the money in local circulation to Wall Street firms.
        - Wall Street firms function is to make financial bets to earn money, putting local money at much higher risk.
    - Many economic policymakers cannot see the real economy because they have spent their formative years on Wall Street and share its view.
6. The Great Prosperity: 1947-1975
    - During this period everyone's wages grew and everyone shared in the prosperity.
    - Productivity also grew quickly and the bargain was maintained.
    - Government programs undergirded the Great Prosperity by supplying retirement insurance, a minimum wage, overtime for extra work, education through the G.I. Bill, unemployment insurance.
    - With this safety net people were better able to spend and grow the economy, making the business owners wealthier.
    - The progressive tax structure drew in substantially more from the rich, to compensate for the advantage their wealth and power gave them.
7. How We Got Ourselves into the Same Mess Again
    - Beginning in 1977, the Growth of Average Hourly Compensation & Productivity has remained flat, while the Productivity has continued to climb.
        - Global trade has contributed to this downward pressure on wages
        - Automation has also reduced the need for jobs
    - The number of jobs has not been decreased, but the new jobs created do not pay as well as the jobs replaced.

- Left to its own devices, the market concentrates wealth and income – disastrous to an economy as well as to a society.
- Pay for jobs at the top of the corporate and financial pyramid have skyrocketed, creating an increasing gap between rich and average.
- Companies were allowed to break the bargain.
    - Power was increasingly concentrated with the very rich and their short term interests were served by maximizing their wealth at the expense of everyone else.
    - The rich and powerful also had substantial influence in propaganda presenting the choice as being between free markets and inefficient big government.
    - This was possible because the people on the receiving end of this propaganda were two generations away from those who lived through the Great Depression (generational memory).

8. How Americans Kept Buying Anyway: The Three Coping Mechanisms
    - Americans accepted the backward swing of the pendulum as long as they could mitigate its effects.
        - Women moved into paid work to supplement the flat wages of their spouses until they reached a point of diminishing returns.
        - Everyone started working longer hours until this too reached a limit.
        - Savings were drawn down and borrowing on the house, credit card, or other available instruments increased.
    - When the credit bubble burst, there were no more coping mechanisms and the economy collapsed.
9. The Future Without Coping Mechanisms
    - The fundamental economic challenge ahead is to lift the means of middle class Americans and reconstitute the basic bargain linking wages to overall improvements.
    - Until the bargain is restored the economy will remain precarious.
    - The Great Recession has accelerated the structural change in the economy that began in the late 1970's.
        - Cutting payrolls permanently
        - Replace people with technology
        - Outsource work overseas
10. Why China Won't Save Us
    - Personal consumption in China is actually declining as a percentage of the total economy while the percentage going to companies and investment is increasing.
    - The largest explanation for Chinese frugality is that the nation is oriented toward production, not consumption, while the reverse is true in the U.S.
    - China wants America's know-how, not our products.
11. No Return to Normal
    - The underlying problem is not that financial institutions were reckless, although they were. The solution, therefore, isn't just to make them more prudent.
    - The underlying problem is not that consumers borrowed too much, although they did. The solution, therefore, isn't merely to get Americans to save more and consume less.
    - The fundamental problem is that Americans no longer have the purchasing power to buy what the U.S. economy is capable of producing. Reason: A larger and larger share of total income has been going to the very richest.
    - How to remake the bargain: There are two possible paths from where we are and only one will get us where we want to be. The last two major sections discuss each possible path.

II Backlash

1. The 2020 Election
   - The Independence Party wins the Presidency and has a significant number of members in Congress
   - The Independence Party stands for…
     - Zero tolerance of illegal immigrants and a freeze on immigration.
     - Increased tariffs on all imports.
     - A ban on American companies moving their operations to another country or outsourcing.
     - A prohibition on foreign "sovereign wealth funds" investing in the U.S.
     - America will withdraw from the U.N., WTO, World Bank, and IMF.
     - Refuse to pay interest on existing debt to China.
     - Stop trading with China unless it freely floats its currency.
     - Profitable companies will be prohibited from layoffs.
     - The Federal Budget must be balanced.
     - The Federal Reserve will be abolished.
     - Banks will only be allowed to take deposits and make loans.
     - nvestment Banking will be prohibited.
     - To balance the budget all personal incomes will be capped at $500,000/yr with earnings above that taxed at 100%.
     - Earnings above $250,000 taxed at 80%.
     - Net worth above $100,000 subject to 2% annual wealth tax.
     - Americans found sheltering income in a foreign nation will be stripped of their U.S. citizenship.
   - The Dow Jones drops 50% the next day.
   - The dollar plummets 30% against a weighted average of other currencies.
   - How could this have happened?
2. The Politics of Economics, 2010-2020
   - Politics is inextricably bound up with economics.
   - Even accepting the prior statement, a scenario like the one noted above would have as much to do with voters' cumulative frustrations and pent-up anger as with specific economic conditions on Election Day so…
     - After the stimulus ends, the Fed tightens the money supply, raising interest
     - rates; after business replenishes inventories now depleted; and after consumers replace worn out products, then the job machine stalls and economic growth ceases.
     - More companies determine their workers are overpaid, relative to equally productive workers elsewhere, available software, or automated equipment.
     - Consequently, large numbers of middle class Americans have to accept lower pay if they want to stay employed.
     - With their coping mechanisms destroyed they have to make do with less on a permanent basis.
     - The poor will be much worse off.
   - Frugality itself is unlikely to ignite a political firestorm; therefore, we need a deeper understanding of the confluence between economics, politics, and behavior to understand the 2020 election.
3. Why Can't We Be Content with Less?
   - Historically our cultural obsession to consume has been tempered by the "higher virtues" of thrift and self-sufficiency.
   - As long as we're not destitute, happiness is less about what we want than about appreciating what we already have.
     - Basically we need food, shelter, sex, and sleep.
     - Then come safety and security.
   - Our coping mechanisms have meant that both spouses are working (no sex) and we get little sleep (long work hours) and have lost our house (mortgage debt), meaning that we are more stressed out and unhappy – i.e. we require more medication to get through the day.

- This argues that we would be better off if we consume less, but this prognosis ignores several painful adjustments we will have to make.

4. The Pain of Economic Loss
   - A lower standard of living
     - Losses are more painful than gains are pleasurable.
     - Societies whose living standards drop experience higher levels of stress than do societies that never had as much to begin with – the deeper the drop, the higher the stress (i.e. suicide rates).
     - An example of this type of stress occurred in Germany after WW I.
   - In the U.S. during the depression, many people who lost a good deal of wealth were never able to completely adjust and were filled with sadness and regret for the remainder of their lives.
   - However, this by itself is not likely to turn most people into angry reactionaries.
5. Adding Insult to Injury
   - The second painful adjustment for most will be to see their standard of living markedly decline in relation to that of the rich in America (those getting an increasing share of the wealth).
     - When the income of the rich soars, while your income declines, you and your contemporaries feel poorer than you really are.
   - Adam Smith defined necessities as "not only the commodities which are indispensably necessary for the support of life, but whatever the custom of the country renders it indecent for creditable people, even of the lowest order, to be without."
     - People who live in states where incomes are more equal register higher levels of satisfaction than do people where the gap is wider.
   - Better education is not only costlier, but is going to wealthier people, meaning better jobs are increasingly less available to people who are not rich. The same is true of health care.
   - In the past this has resulted in a desire and ambition to be rich, rather than the backlash of envy. However, real frustration is likely to ensue if people no longer feel they have a chance because the dice are loaded against them.
6. Outrage at a Rigged Game
   - When all our sacrifices are added to a perception that the economic game is rigged – that no matter how hard we try we cannot get ahead because those with great wealth and power will block our way – the combination may very well be toxic.
   - Recall the busting of unions, slashing of payrolls, and shedding of employee benefits, without any attempt by government to constrain or reverse these practices. Compare these with the government reaction to save Wall Street from follies they inflicted on themselves, never mind that the government regulators were asleep at the switch in the years leading up to the Great Recession.
     - The public felt duped and although most of the banks repaid the government, the inspector general predicted that much of the bailout, including the money sent to AIG, would never be repaid.
     - Within a year the banks were back with the same behavior, but Congress would not enact legislation to control this behavior.
   - Political campaigns and the strength of lobbyists is another example of where the middle class American feels they have no chance to influence their government. The most convincing evidence of a rigged game is the deafening silence about all this.
     - Even when lobbyists do not directly dictate a politician's vote they and the congressmen inhabit the same world, with the same values and opinions. Members of Congress find it harder and harder to even understand the middle class voter's attitudes and opinions, because they do not live in that world, but in the world of the wealthy and powerful.
   - Given the intransigence of high unemployment, it is probable that increasing numbers of voters will move from distrust of Congress to anger. Something like the Independence Party will likely fill the void.

7. The Politics of Anger

- When people are angry about the injustice in their life, they often feel the desire to punish the people who are better off, even if that results in no better situation for themselves. If their rich neighbor has a cow and they can't afford one, they prefer to kill the cow and have their neighbor suffer, than try to find some way to improve their own situation.
  - Slashing trade is a self destructive act, but it is also an action against the wealthy who make their living by trade.
- Before economic stresses and resentments have risen too far, America has traditionally opted for reform. That reform is the subject for the next section.

III. The Bargain Restored

1. What Should Be Done: A New Deal for the Middle Class

- The Great Recession has accelerated both of the following troubling trends…
  - Unless America's middle class receives a fair share, it cannot consume nearly what the nation is capable of producing.
  - Widening inequality, coupled with a growing perception that big business and Wall Street are in cahoots with big government for the purpose of making the rich even richer, give fodder to demagogues on the extreme right and the extreme left.
- The following measures are needed to start our system moving in a positive direction.
  - *A reverse income tax:* A sliding scale for workers earning less that $50,000 starting at $15,000 for people making less than $20,000. People making between $50,000 - $90,000 would be taxed at 10%, regardless of the source of their income. People making between $90,000 - 160,000 would be taxed at 20%, regardless of the source of their income.
  - *A carbon tax:* Tax fossil fuels based on how many tons of carbon dioxide such fuels contain. The tax would be collected at the mine or port of entry and would gradually rise over time. The revenues from the carbon tax would go into wage supplements, meaning middle- and lower-income Americans would be protected.
  - *Higher marginal tax rates on the wealthy:* The top 1% (over $450,000) would be taxed at 55%, regardless of the source of their income. The top 2% (over $260,000) would be taxed at 50%, regardless of the source of their income. The top 5% (over $160,000) would be taxed at 40%, regardless of the source of their income. These tax rates are not out of line with most of our history over the last 100 years.
  - *A reemployment system rather than an unemployment system:* Wage insurance would provide 90% of the difference in wages for up to two years for someone who had to take a job that pays less. For workers needing additional skills, income support of 90% for up to a year while engaged full-time in approved training or education programs.
  - *One time severance tax:* Profitable corporations would pay this tax, equaling 75% of the full cost of a laid off worker's yearly salary for all workers under the median wage and 50% for all workers above the median wage up to 200% of the median. This would be used to help pay for the wage insurance and skill upgrades of the reemployment system.
  - *School vouchers based on family income:* Example - $8,000 now spent on a student in a particular state would be turned into $14,000 for each child in a poor family, sliding to $2,000 for each child in a very wealthy family. Progressive vouchers would encourage the good schools to recruit poorer children and allow poorer schools to invest in their physical plants and teachers.
  - *College loans linked to subsequent earnings:* Tuition should be free at all public colleges and universities and students who elect to attend private college or university should be eligible to take out a federal loan. Graduates of public colleges and universities, and borrowers of federal loans, should be required to pay a fixed percentage – say 10% - of their taxable earnings for their first 10 years of full-time work into a fund financing public colleges and universities and student loans. After those 10 years they would have no further obligations. In this manner students electing to pursue low-income occupations such as social work, teaching, or legal services would be subsidized by graduates who pursue high-income occupations. The % used should be enough to recoup the full cost of tuition or loans.

- *Medicare for all:* This is not as large a step as first thought, as currently almost half of Americans received some form of public health care (older people through Medicare, poorer people through Medicaid & Children's Health Insurance Program, veterans through VA, government workers through a federal health plan).
- *Public goods:* There should be a sizable increase in public goods such as public transportation, public parks and recreational facilities, and public museums and libraries and they should be free of charge. This improves the quality of life for many people who cannot afford the equivalent private goods. This helps make up for stagnant or declining wages for very poor people.
- *Money out of politics:* Strong campaign-finance laws, more generous public financing of elections (with matching dollars), stricter limits on campaign contributions, and limits on so-called issue advertising. Until we can get to this all political contributions should go through "blind trusts" so that no candidate can ever know who contributed what.

2. How It Could Get Done

- An aftershock in the form of another deep recession might be enough to spur reform, but a slower aftershock – characterized by several years of high unemployment, languishing or declining wages, and slow growth – may not be enough to upend vested interests.
- Sooner or later the chief executives of America's largest corporations and Wall Street banks will become concerned about the lackluster economy.
- The CEO's will also notice the public's increasing anger, increasing number of bills being introduced to raise tariffs and reduce trade, restrict immigration, and limit global investment.
- If the vested interests that have so far resisted change begin to understand where all this is heading, they are likely to see that the alternative to this bargain is far worse for them.
- A virtual pendulum underlies the American political economy where the swing is from eras in which benefits are concentrated in fewer hands to eras where the gains are more broadly shared. We are approaching the end of one such cycle and the question isn't whether the pendulum will swing back, but how it will swing back. Will reforms widen the circle of prosperity or will demagoguery erupt that turns America away from the rest of the world, shrinks the economy, and sets Americans against one another?