Deja Vu All Over Again:

The “New” Economy in Historical Perspective

by

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The American public has been bombarded with the claim that a "New Economy" emerged in the U.S. in the 1990s. The exact meaning of the so-called New Economy varies depending on the commentator, but in all versions the rapid advance in information processing technology -- the "IT revolution" -- plays a central role. The essence of the New Economy idea is that the new technologies have produced a significant transformation in the structure and performance of the U.S. economy.

Some New Economy advocates take this idea even further, and assert two additional claims. First, it is said that profound institutional changes in the economy are required to take advantage of the new information technologies. These changes emphasize a "free" market: flexibility, deregulation, and a reduced role for unions. Second, it is claimed that combining these institutional changes with the IT revolution has ushered in a new era of unprecedented prosperity. The performance of the U.S. economy since 1995 supposedly provides evidence for this assertion.

We take issue with these claims in this paper. Our central thesis is that the institutional changes associated with the New Economy are a veiled attack on working people. These changes are not new, they are not required by the new technology, and they have not led to unprecedented prosperity. Fortunately, they may not necessarily be permanent, either.

In the next section, we argue that the new information technology does not require the restructuring and deregulatory initiatives that have been proposed. The New Economy thesis provides a new rationale for the same free-market, anti-labor agenda championed in the 1980s under the guise of improving U.S. competitiveness.

In the third section, we suggest that the free-market initiatives of the New Economy have not permanently improved U.S. economic performance. The strong expansion of the U.S. economy during 1995-2000 collapsed into recession, was boosted by temporary developments, and was hardly unprecedented in any event.

In the fourth section, we show that the free market has not brought prosperity in the past, either. During periods of time in which the free market has predominated, the U.S. economy has performed relatively poorly and exhibited considerable instability. Moreover, throughout U.S. history, free-market, anti-labor regimes have alternated with periods in which government and workers have restrained the worst excesses of the free market and established basic rights and protections. Viewed in historical perspective, the institutional structure of the New Economy may well turn out to be a relatively temporary phenomenon.

Institutional Change and the New Economy

The Institutional Claims of Some New Economy Advocates

According to some New Economy advocates, today's corporations need to be increasingly flexible in order to take advantage of new technologies. The old hierarchical model must be replaced by a new, more flexible business model that emphasizes competition, mobility, and cost-cutting, and the dispersion of decision making within the organization. Instead of clinging to a traditional product line, a company must be prepared to shift into new markets on short notice. The old model of corespective behavior toward rivals must give way to a more competitive mode.

The cultivation of a stable workforce should be replaced with a readiness to shed large numbers of employees. As computers make inventory control and demand management more accurate, corporations say they need a more flexible workforce. They need to pare back to a smaller core of permanent employees and supplement their workforce with contingent and temporary employees who can be added or subtracted with ease. The workforce must adapt to this new practice, trading a stable career in a single company for the life of **an** independent contractor or temporary employee.

As computers make global production management more possible, corporations argue that they need to adjust production to the most suitable locales. They don't want their location decision restricted by union contracts requiring benefit and pension payments to older U.S. workers or by local communities dependent on corporate employment.

Labor unions clearly have little role to play in this brave new world of labor market flexibility. The protections that unions provide for workers might interfere with this flexibility, and the wages and benefits that unions win only cut into the huge profits said to be necessary for successful investment in the new information technologies.

It is also claimed that governments must restructure to take advantage of the IT revolution. Governments need to get out of the way and let free markets operate. They need to promote competition and deregulate markets, especially those for labor, finance, and telecommunications. They must privatize any state-owned enterprises, since the political pressures on government would obstruct the necessary flexibility that business now requires. The government must also pull back from the regulation of labor markets by reducing regulations protecting workers on the job and reducing the social safety net of government benefits supplementing, and sometimes replacing, the wages paid by corporations.

It is not just that these institutional changes are useful. They are presented as if they are required by the nature of technological change in the New Economy that emerged in 1995. As *Business Week* (2000, p. 74) expresses it,

> The worldwide proliferation of mobile phones and Web accounts by itself will not bring about a more vibrant global economy. What's also needed are dramatic changes in core institutions that will translate technology into faster productivity growth. That means financial markets better able to fund innovation, more flexibility in corporations and labor markets, a faster pace of deregulation, and increased competition. . . 'The New Economy is built on old virtues: thrift, investment, and letting market forces operate,' says Treasury Secretary [now Harvard University President] Lawrence H. Summers.

Martin Neil Bailey (2001, p. 227), a Senior Fellow at the Institute for International Economics, argues that "labor market flexibility, *combined* [emphasis in original] with product market flexibility and competition, are consistent with, *in fact essential to* [emphasis added], a full-employment, high-productivity economy." He also says that "heightened competition in an increasingly deregulated economy facing strong international competition" was an important reason for "why the environment in the U.S. economy in the 1990s was favorable both for rapid innovation and rapid diffusion of innovation" (2001, p. 214).

Normally one thinks of a new technology as being available to all countries, or at least to all that are sufficiently economically advanced to take advantage of it. However, without the appropriate institutional reforms, countries supposedly are unable to make profitable use of the new technology. It is claimed that the U.S., which has restructured as required, has accordingly ridden the crest of the wave, while Western Europe and Japan, failing to undertake the necessary reforms, have lagged behind. Alan Greenspan (2000) claims that the relatively higher returns to U.S. corporations from IT investment, compared to Europe and Japan, are due not to technological superiority, but rather to the ease with which corporations in the United States can use IT to displace labor:

> The elevated rates of return offered by the newer technologies in the United States are largely the result of a reduction in labor costs per unit of output. The rates of return on investment in the same new technologies are correspondingly less in Europe and Japan because businesses there face higher costs of displacing workers than we do. Here, labor displacement is more readily countenanced both by law and by culture.

Martin Feldstein (2001, p. 393) extends the argument to include competitive product markets and the ability of corporate executives in the U.S. to personally benefit from higher corporate profits:

> I believe that there are three reasons why Europe has not experienced the same rise in productivity as the United States. First, the rigidities in labor and product markets in Europe make it difficult for companies to lay off redundant workers and to reorganize production and support staff activities. . . . Second, there is less pressure in Europe and Japan to adopt new technologies because their domestic product markets are less

> competitive than those in the United States. Third, European and Japanese managers have less personal incentive to adopt the new information technology. The United States is unusual in its emphasis on bonuses and stock options as ways of motivating managers and of typing compensation to the level of company profits.

The Institutional Claims Are Not New

Despite the claim that IT requires restructuring, labor market flexibility, and deregulation, workers and others who have suffered through the last twenty years in the United States will detect a certain familiarity in these proposals. They are, in essence, the same pro-business, free-market, and anti-labor agenda that Corporate America has been pushing since the late 1970s. As Yogi Berra said, "It's deja vu all over again."

The AFL-CIO **(1999)** has aptly termed these changes a Corporate Agenda, whose ultimate purpose has been to boost corporate profitability at the expense of workers and their unions. Corporations were restructuring, and government was deregulating, long before the influence of computers was thought to be so pervasive, and long before the New Economy supposedly began on August 9, 1995 with Netscape's initial offering of stock to the public (Mandel, 2000).

Deregulation began in the late 1970s with the airlines and trucking industries. It was continued and expanded by the Reagan Administration in the early 1980s as part of its overall free-market initiative. Financial market deregulation began in the early 1980s with legislation to dismantle the Depression-era restrictions on competition among financial institutions. Opening other countries' markets to U.S. exports and investment was a key element of U.S. foreign economic policy in the Reagan and Bush Administrations, and was enforced by the U.S.-influenced international agencies, the International Monetary Fund and the World Bank. Reducing the social safety net and cutting back regulations protecting workers were key elements in Ronald Reagan's economic program in the 1980s.

Under the banner of international competitiveness, corporations laid off permanent employees in the 1980s. They downsized to get lean and mean. Continuing into the 1990s, they have relied increasingly on temporary and contingent employees, closed down plants in the U.S. to avoid unions and to seek low-cost labor abroad, and reduced wages and benefits for U.S. workers.

The Institutional Claims are not Required by IT

The reasons for doubting the validity of the New Economy institutional claims go beyond the feeling of deja vu that they induce. The claim that a free market is required to take advantage of IT is not convincing. It is repeated again and again until it begins to seem almost self-evident, but it is far from self-evident. Consider the following contrary arguments.

First, why should the use of new IT require that corporations act more "competitively"? New IT often greatly increases the fixed costs of doing business. For example, a corporation may have to make a large investment to create a contemporary networked information handling system. Once the system is in place, the marginal cost of operating the system may be relatively low, compared to the fixed cost of setting it up. In an industry with high fixed costs, unrestrained competition tends to be unstable, particularly in a recession. Falling demand leads quickly to large losses when fixed costs are high, and price wars tend to result which produce even larger losses for all concerned. In response to this tendency, historically industries with high fixed costs – such as steel manufacturing or air transportation – have tended to become oligopolistic, with some combination of informal price agreements or public regulation. The enormous merger wave in the U.S. economy may be preparing the way for a new period of increasingly cautious and regulated competition among rivals afflicted with high fixed IT costs.

Second, why are free-market government policies necessary to take advantage of contemporary IT? The huge investments in new IT require economic stability in order to pay off in the long run, and, as we shall argue in a later section of this paper, the economy has been more stable in periods when the government actively regulates the private sector. Government has played a critical role in pioneering most of the new IT and it continues to subsidize the R&D necessary to continue the technological revolution -- the internet did not come from the private sector! The new IT has given rise to natural monopolies in some areas, such as cable services, which require public regulation. A huge amount of infrastructure investment is necessary to make the new IT viable, and in most countries the public sector is the main agent of such investment.

Also, the profitability of private investment in developing new information technologies depends heavily on government-protected patents and copyrights that grant a temporary monopoly. Such government regulation is particularly necessary to make IT investments profitable, since many of them, such as software, are very inexpensive to produce once they are developed -- indeed, that is an inherent feature of information. This is reflected in the U.S. demand that other governments take tough measures to protect the so-called "intellectual property rights" of U.S. corporations, which runs counter to the official free market rhetoric.

Third, why should new IT require "flexible" labor markets? The new technologies create a need for increased technical knowledge and even an ability to make independent decisions on the part of workers. A company that wants well-educated, well-trained, reliable workers must invest in their knowledge, skills, and loyalty, and that suggests a long-term employment relationship, not day laborers.

In truth, neither computer technology nor international competition *required* corporations to attack labor. This strategy was a *choice* made by corporations intent on taking a low road to increased profitability. The road not taken, the high road, regards workers as assets rather than as expenses, seeks cooperation with unions, invests in worker skills, and focuses on quality as well as costs.[1]

For example, Finland and Sweden are among the most successful countries in the IT revolution. Finland is the home of Nokia, one of the biggest cell phone manufacturers, and it is perhaps the most fully wired country in the world. Sweden's Eriksson is another IT star. Yet Finland and Sweden have union densities that rank at the top and also have regulationist welfare states.

The choice of a corporate strategy may, indeed, be more fundamental than the use of particular technologies. Rather than IT requiring an anti-labor, free-market institutional environment, it may be more likely that the causal sequence is reversed: the choice of an anti-labor strategy is enhanced by the use of IT. It is certainly the case that the new technologies have turned out be useful for corporations already determined to boost profits by attacking labor. As *Business Week* (2000, p. 74) notes, "For corporations, the most important justification for spending big bucks on information technology is that it supports restructuring and cost-cutting."

A New Era of Unprecedented Prosperity?

Despite its anti-labor bias, some might argue that the New Economy is a good development because of the positive effect it has had on U.S. economic performance. (See Mandel, 1996, and a series of articles from *Business Week* magazine singing the praises of the New Economy.) Indeed, some have even argued that the New Economy has ushered in a new

[1]For documentation of the argument that the high road leads to higher productivity and better economic outcomes, see Gordon (1996).

era of unprecedented prosperity. It is true that the overall economy, as measured by the growth in real GDP and productivity, and by average unemployment and inflation rates, performed well from 1995 (the supposed beginning of the New Economy) to 2000, especially in comparison to the previous 20 years (see Table 1). However, this performance is not the same as a new *era* of *unprecedented prosperity*.

First, the expansion ended in 2001, and five years is hardly an *era*, especially when the brief period 1995-2000 came at the end of a long business-cycle expansion. Indeed, one can find 5-year periods that had much higher growth rates than were observed in 1995-2000. During 1961-66, for example, GDP grew at 5.3% per year.

Second, the performance of the economy since 1995 is not *unprecedented*, since it is roughly comparable to the early post-World War II period of 1948-73. As can be seen from Table 1, the performance of the economy in terms of GDP growth, unemployment, and inflation is exactly the same in 1995-2000 as during the 1948-73 period (although, of course, this performance was sustained for only 5 years of a business cycle expansion, compared to 25 years including expansions and recessions in the earlier period). However, in the crucial area of productivity, the 2.5% growth rate per year during 1995-2000 was less than the 2.9% annual rate during 1948-73.[2]

[2]A revision of the National Income and Product Accounts in the summer of 2001 reduced the annual growth rate of productivity during 1995-2000 from 2.8% to 2.5%.

This 2.5% annual productivity increase may, in fact, be an overestimate of the impact of IT. This is because computers become obsolete quickly and must be replaced. Thus an increasing proportion of gross IT investment must go to replace obsolete equipment. This is reflected in an increasing rate of depreciation, and it shows up as an increasing gap between gross domestic product and net national product (line 2 of Table 1). Since it is the net addition to output that is important for the growth of living standards, then, as Dean Baker contends (2002), we should subtract the 0.3% discrepancy in growth rates between gross and net domestic product (4.0% vs. 3.7%) from the measured growth rate of productivity. Net productivity growth between 1995 and 2000 would then be only 2.2% per year.[3] [4]

Third, even the idea of *prosperity* is questionable, because the benefits of economic growth during 1995-2000 were not shared equally. Real wage growth (line 6 of Table 1), although finally turning positive after a 22-year decline since 1973, was slower than it was during 1948-73. The growth of family income was stronger for those at the top of the income distribution than for those at the bottom (line 7 of Table 1), reversing the results from 1948-73. The ratio of CEO (chief executive officer) to average worker pay exploded during the 1990s, reaching 310 in 2000 (line 8 in Table 1).

The Speculative Basis of the New Economy Expansion

The New Economy has not brought permanently low unemployment or permanently low inflation, nor has it permanently abolished the trade-off between the two. The unemployment rate did fall below 4% in 2000. However, what is remarkable is that it took six years of

[3]Productivity growth for 1948-73 would not be reduced, because there was no discrepancy then between growth rates for GDP and NDP.

[4]Although lower than that in 1948-73, the rate of productivity growth in 1995-2000 was still a significant improvement over the dismal productivity performance in 1973-1995. Continued strong increases in productivity in the future can not be ruled out.

expansion following the 1990-91 recession for the unemployment rate even to fall below 5%. The eventual achievement of a low unemployment rate was due to the length of this expansion, which is the longest on record in the United States.

The unusual length of this expansion can ultimately be traced to the effects of the speculative boom on the stock market, which began in 1995. As line 1 of Table 2 shows, GDP growth accelerated in 1995-97 and again in 1997-2000. This strong growth in GDP was in turn due to two developments: the strong increase in IT investment and, after 1997, the surge in consumer spending. Both were importantly influenced by speculation on the stock market.

From 1995-99 a speculative buying wave brought the greatest boom ever to the U.S. stock market, as prices rose by 27% per year in 1995-97 and 23.3% in 1997-99 (line 5 of Table 2) – a rate of increase far out of line with any rational estimate of the future profits of the companies concerned. This stock market boom, which particularly affected new technology stocks, produced a further acceleration in the already high rate of investment in IT equipment (line 2 of Table 2). IT investment rose at the rate of 19.2% per year in real terms during 1995-2000, causing an acceleration in GDP growth. It should also be noted that, as the stock market boom stalled in 2000, so did GDP growth in late 2000.

A few years after the stock market boom got started, consumer spending suddenly accelerated (line 3 of Table 2). A recent study by two Federal Reserve economists (Maki and Palumbo, 2001) concluded that this acceleration in consumer spending was due almost entirely to an increase in consumption by the richest 20 percent of the population. This group, which claims 43.7 percent of total disposable income and 59.6 percent of total wealth, gained enormously from the stock market boom. Their increased wealth led them to decrease their saving (so much so that the much-discussed decline in the saving rate in the 1990s is due entirely to this group). Line 4 of Table 2 shows the decline in the saving rate in 1995-2000.

As a result, consumption spending grew at 4.7% per year during 1997-2000, faster than the rate of growth of GDP as a whole (lines 3 and 1 of Table 2). Since consumer spending constitutes about two-thirds of GDP, this has been a powerful force propelling the economy along, and one which encouraged still more investment spending. Despite the rapid growth in consumption, the investment boom was so overdone that the industrial capacity utilization rate trended downward in 1995-2000, instead of continuing to rise as usually occurs during an expansion.

Without the extraordinary speculatively-driven rise of the stock market, it is questionable whether or not the spectacular growth of IT investment could have been achieved. Venture capital financing was an essential source of funds for many of the new IT startups. In turn, the availability of venture capital was sustained by the ability of venture capitalists to "cash out" from successful start-ups and invest their profits in new endeavors (Mandel, 2000). Venture capitalists "cash out" through the use of IPOs (initial public offerings) in the stock market. They fueled the spectacular stock-market ride of the dot-coms in the late 1990s, which in turn contributed to the spurt in IT investment. Clearly, though, venture capital financing depends on the context of a booming stock market enamored of technology stocks. When the NASDAQ (the stock market index composed mostly of technology stocks) fell precipitously from its peak in early 2000, much of this venture capital money dried up.

Although investment in IT will not disappear, it is not clear that we will see a return to the extraordinary levels of investment that characterized 1995-2000. Thus, rather than a new, permanent era of low unemployment and low inflation, the New Economy expansion of 1995-2000 may have produced a temporary period of strong growth, based on the shifting and unstable sands of stock market speculation.

The Indebted Basis of the New Economy Expansion

Underlying stock market speculation, and the expansion it promoted, was borrowed money. Investors in the stock market were borrowing heavily to purchase stock. Margin debt, which is the amount of money borrowed from brokers in order to buy stock, stood at an unprecedented $278.5 billion in March 2000, at the peak of the stock market bubble (Financial Markets Center, 2001). From March 1995 to March 2000, margin debt grew at a rate of 36 percent per year.

Under current regulations, investors can borrow up to 50 percent of the value of the stock purchased. Some have suggested that the Federal Reserve should have raised margin requirements, which would have required investors to purchase stock with a greater amount of cash and a smaller amount of debt. However, Alan Greenspan rejected these suggestions, saying that if investors were unable to borrow as much from brokers they would simply borrow the money elsewhere.

Although the wisdom of refusing to raise margin requirements is questionable, it is indeed true that investors had access to other sources of borrowed money. Total household debt outstanding topped $7 trillion in the fourth quarter of 2000, which nearly equaled disposable personal income of $7.1 trillion (Federal Reserve Board, 2002). Households were borrowing money to profit from the booming stock market and also to increase their consumption. Indeed, borrowing was the primary way that upper-income households as a group converted their rising stock portfolios into consumer spending, since a widescale attempt to finance the consumer spending binge by actually selling shares would have driven share values down and quickly ended the stock boom.

Corporations were also participating in the debt binge. Total credit outstanding for nonfinancial corporate business was $4.6 trillion in 2000, and the ratio of corporate debt to net worth reached 52 percent (Federal Reserve Board, 2002). Corporations borrowed in part to finance buybacks of their stock, which helped to provide for stock options for their top executives and contributed to the escalation in stock prices. New issues of stock for the corporate sector have been negative every year since 1994; for 2000, corporations' net retirement of stock was $153.1 billion (D'Arista, 2001).

So if the expansion of 1995-2000 was propelled by stock market speculation, that speculation was aided and abetted by an explosion of debt. The debt binge has left the economy vulnerable to debt repayment problems if interest rates increase, or if profits and incomes fall.

The Special Nature of the New Economy Expansion

Despite the questionable basis of the 1995-2000 expansion, the fact does remain that we did experience a combination of low unemployment and low inflation during the last three years of that expansion. Why didn't inflation increase, as it has done in the past during the late stages of business-cycle expansions? New economy advocates point to high productivity growth due to the IT investments. There was, indeed, rapid growth in output per labor hour during 1997-2000 (line 6 of Table 2).[5] Although higher productivity did play some role, we argue that there were other important reasons for the low inflation rate. In particular, a series of special factors came together in the late 1990s to help produce the observed positive results.

One important special factor was the relatively sluggish growth in real wages. Towards the end of past business cycles, corporations have raised prices in the attempt to protect profits from the rising wages that have occurred in the context of falling unemployment. However, no such rapid rise in real wages materialized in the current expansion. During 1997-2000, the period of low unemployment when inflationary pressures might have been expected, real wages grew at

[5] The relatively rapid growth in output per labor hour after 1995 was partly, but not entirely, due to investments in new technology. A leading macroeconomist at Yale, William Nordhaus, estimated (at the Allied Social Sciences Association conference in January 2001) that between 1/3 and ½ of the acceleration in productivity growth after 1995 was due to IT investments.

only 1.5% per year (line 7 of Table 2). As Fed Chairman Alan Greenspan has noted, American workers have remained insecure about their jobs even as the unemployment rate has reached historically low levels. **Therefore,** they have not been able to exert **the kind of** leverage to increase their wages **that they have in the past**. This insecurity has several roots, including unions weakened by years of corporate and government attacks and corporate policies of replacing permanent jobs with temporary, part-time, and contract jobs. The Corporate Agenda has kept labor costs down.

Three other factors have kept inflationary pressures at bay. First, the value of the dollar relative to other currencies rose steadily in 1995-2000, as financial crises in Asia and elsewhere, together with the attractions of the U.S. stock market boom, led investors to move their funds to the U.S. This lowered the dollar price of imported goods and hence kept prices down in the U.S. Second, relatively depressed economies in Europe and Asia meant that, as the U.S. economy expanded, it could draw in goods from those areas without putting upward pressure on their prices. This produced the mushrooming U.S. merchandise trade deficit, which reached 4.7 percent of GDP in 2000. Third, the large and growing excess capacity in the U.S. economy, produced in part by the speculatively-induced over-investment of 1995-2000, has prevented firms from raising their prices.

The History of Free Market Eras

From the preceding section, it is clear that the New Economy has not ushered in a new era of unprecedented prosperity. Neither, of course, is a period of fundamental technological change a new development. The field of telecommunications is not without past profound innovations, such as the telegraph, telephone, and television. Moreover, technological change in other fields, such as the railroad, automobile, and airplane, has exerted powerful effects on the overall economy.

In addition, the free-market and anti-union policies of the past few decades, which are supposed to be required by the New Economy technologies, are not unprecedented in U.S. history. Since the Civil War the U.S. has seen an oscillation between two poles of government economic policy and labor relations. Periods of free-market policy and corporate anti-union policy have alternated with periods characterized by significant government regulation of business and a more accommodating corporate stance toward unions.

When large corporations first arose in the decades after the Civil War, the nation witnessed the famous Robber Baron Era, lasting until 1900. During that period corporations operated with almost no public oversight and little legal constraint. They became more powerful as they grew larger, and they fought often violent battles to suppress the young trade unions of that era as well as other workers' organizations. The Robber Baron Era produced a reaction, and after 1900 the regulatory state began to take shape.

During the Progressive Era of roughly 1900-16, the federal government broke up some monopolies and began to regulate certain sectors of the economy, including banking, communication, electric power, pharmaceuticals, and meatpacking. At the same time, a part of the new corporate leadership sought to establish a more cooperative relationship with organized labor. The tide turned again after World War I ended. In the 1920s, free-market, anti-labor policies reigned, and President Coolidge's slogan, "America's business is business," aptly described the period.

The Great Depression of the 1930s, together with the many impacts of World War II, ushered in a long-lasting shift toward interventionist government and corporate acceptance of the legitimacy of trade unions. The Wagner Act affirmed government support for the right of workers to join a union. In general, New Deal employment policies aimed to "take wages and terms of employment out of competition" (Kochan 2000, p. 324). The period 1948-73 saw regulationist states and corporate acceptance of unions throughout the industrialized capitalist world.

International exchange in goods, capital, and currencies was significantly regulated under the Bretton Woods system that was organized under U.S. leadership shortly after **World War II.** In the United States, the federal government established a social safety net, extended public oversight of key sectors of the economy, and used Keynesian demand-management techniques to stabilize the macroeconomy.

The rapid economic growth of that era was based, to a significant extent, on a program of public investment and publicly guided private investment. This included a massive highway building program and large investments in new schools and infrastructure, while a combination of federal programs steered cheap credit into homebuilding. The government-organized investment in transportation, infrastructure, and housing stimulated many sectors of the U.S. economy during this period, often referred to as the Golden Age of capitalism.

During 1948-73 trade unions played a significant role in the economy. The union movement experienced strong growth in the 1930s and 1940s, with more than a third of the workforce organized by the mid-1950s. A "limited capital-labor accord" confirmed the willingness of business to bargain collectively with unions, in exchange for union acceptance of "management rights" clauses in union contracts (Bowles, Gordon, and Weisskopf 1990, p. 56). While unions had to fight to win improvements in wages and working conditions, most major corporations in the core sectors of the U.S. economy did not challenge the unions' right to represent their workers.[6]

Union power enabled workers to share in the economic expansion of that era. Economic

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[6] There were exceptions. Some individual large corporations successfully resisted unionization, **many states passed right-to-work legislation**, and in the South the union movement remained weak and under constant attack.

research has documented that unions increased not only wages, but also productivity, and also decreased wage inequality (Freeman and Medoff 1984). The rising real wages of American workers in this period made it possible for them to buy the homes and consumer products that American industry turned out in growing volume.

The Golden Age of capitalism began to encounter serious difficulties in the U.S. (and elsewhere) starting in the late 1960s. Severe instability struck international financial markets in the late 1960s, and the Bretton Woods monetary system began to break down. Serious inflation broke out in the U.S. in the 1970s, **fueled by demand pressures from the Vietnam War in the context of an overheated economy *as well as other factors*. The government had difficulty controlling inflation** using Keynesian demand management techniques. Imports began to penetrate industries long dominated by U.S. companies, such as autos, steel, and machine tools. The growing economic problems, and an inability to resolve them by means of the usual government policies, set the stage for another turn in the cycle, back to free markets and attacks on trade unions. By the late 1970s corporate-sponsored think tanks and the major media were attacking government regulation and trade unions as undermining the economy. The new era emerged fully with the Reagan Presidency.

The preceding period of unrestrained capitalism and declining union strength, in the 1920s, bears some similarities to the decade of the 1990s. The 1920s saw rapid technological progress, as assembly line techniques spread through American industry, and automobiles, radio, and new household conveniences revolutionized daily life. A growing speculative bubble gripped the securities market, while a runaway corporate merger wave restructured industry. Most of the growing output of the American economy fell into the hands of those at the very top, as inequality of income grew markedly.[7] International economic and financial imbalances grew

[7] The after-tax income of the richest 5% of the population rose from 24% to 33% of the

over the course of the decade.

We believe that several relevant lessons can be drawn from U.S. history concerning the periodically recurring claims about the wonders of the free market and the advantages of a union-free environment. First, such free-market periods bring great and growing inequality. The Robber Baron Era and the 1920s both saw income inequality rise to extreme levels. Similarly, the period since the late 1970s has seen growing income inequality. This is not surprising since, in a relatively unregulated capitalist system, the strong are free to grab **much** of what is produced, leaving **relatively** little for the rest of the population.

Second, free-market periods are highly unstable on the macroeconomic and financial level. The Robber Baron era saw recurrent financial crises and severe depressions, including that of the mid-1870s. **This depression** lasted five and a half years, *[omit comma]* **and was** the longest of any business cycle contraction on record. The 1920s ended with the most severe depression and the worst financial crisis in U.S. history. The period since 1973 has seen the most severe recessions since the Great Depression. Failures of financial institutions, which had become rare in the Golden Age, increased dramatically in the 1980s.

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total from 1919 to 1929 (U.S. Census Bureau, 1961, p. 167).

Third, the claim that, whatever its weaknesses, the free market brings rapid economic growth has not been borne out by the American experience. In the period 1919-29, U.S. real gross national product is estimated to have grown at the relatively rapid rate of 3.5% per year (U.S. Census Bureau, 1961, p. 139).[8] However, in the Golden Age period of 1948-73, growth was 4.0% per year. In the free-market period 1979-2000, the growth rate was 3.0% per year. Thus, the last period of active state regulation and strong trade unions had faster growth in output than either of the last two free-market, weak-union periods.

Conclusion

It is obvious that workers benefit from an institutional environment that sets labor standards, intervenes in markets to prevent wages and benefits from being pushed to the bottom, supports a social wage and a minimum standard of living, and ensures a reasonably equal distribution of income. The evidence of the previous section also indicates that, in addition, the performance of the aggregate economy is enhanced by an institutional environment that regulates the excesses of the free market.

The historical evidence surveyed above shows that periods in which the free market dominates have been, thus far in history, temporary. If history continues to follow the established pattern, the next period of U.S. history may be one in which there are again significant restraints on the free market. But history is not a clock that runs by itself. If the

[8] No reliable data exist for aggregate output growth for the U.S. economy before the 1920s.

economy is to be constrained to function in the interests of workers, there will have to be public regulation of corporate decisions that would otherwise be made in the interest of profits rather than the interests of workers. Such regulation will occur only if workers are organized and have the ability to contest corporate power, in the sphere of government and in the workplace directly. A necessary ingredient for a real "new" economy in the 21st century -- one that benefits all working people -- is a strong and united union movement.

Table 1. Measures of U.S. Economic Performance
(Compound annual percentage rate of increase, except where noted)

	1948-1973	1973-1995	1995-2000
(1) Gross Domestic Product	4.0%	2.8%	4.0%
(2) Net Domestic Product	4.0%	2.6%	3.7%
(3) Productivity	2.9%	1.4%	2.5%
(4) Unemployment	4.8%	6.8%	4.8%
(5) Inflation	2.5%	5.8%	2.5%
(6) Real Wages	2.3%	-0.7%	1.3%
(7) Income Inequality			
Low Income	2.8	0.1	2.3
High Income	2.6	1.4	2.9
(8) CEO / Worker Pay	26	37	310

Sources:

(1) Real gross domestic product. Bureau of Economic Analysis, Department of Commerce website, www.bea.gov, National Income and Product Accounts, Table 2.1, in chained 1996 dollars.

(2) Real net domestic product. Bureau of Economic Analysis, Department of Commerce website, www.bea.gov, National Income and Product Accounts, Table 2.1, in chained 1996 dollars.

(3) Real output per hour of the nonfarm business sector. Bureau of Labor Statistics website, www.bls.gov, Series ID PRS85006093.

(4) Unemployment rate for all civilian workers. Bureau of Labor Statistics website, www.bls.gov, Series ID LFS21000000.

(5) Consumer price index for all items (CPI-U). Bureau of Labor Statistics website, www.bls.gov, Series ID CUUR0000SA0.

(6) Real average hourly earnings in the private sector. Bureau of Labor Statistics website, www.bls.gov, Series ID EEU00500049, in 1982 dollars.

(7) Low income: growth of real income of families at the 20th percentile of the income distribution; high income: growth of real income of families at the 95th percentile. Mishel, Bernstein, and Schmitt, 2003, p. 53. Second column dates are 1947-73.

(8) Mishel, Bernstein, and Schmitt, 2003, p. 213. Data points are for 1965, 1978, and 2000.

Table 2. Phases of the U.S. Economic Expansion of 1991-2000
(Compound annual percentage rate of increase, except where noted)

	1991-95	1995-97	1997-2000
(1) Gross Domestic Product	3.1	4.0	4.1
(2) Investment in Information Processing Equipment	14.2	20.0	18.6
(3) Consumer Spending	3.3	3.4	4.7
(4) Personal Saving Rate	6.9	4.5	3.4
(5) Standard and Poor's Composite Stock Price Index	9.5	27.0	23.3
(6) Output per hour	1.6	2.3	2.6
(7) Average Hourly Earnings	-0.2	1.1	1.5

Sources:

(1) Real gross domestic product. Bureau of Economic Analysis, Department of Commerce website, www.bea.gov, National Income and Product Accounts, Table 1.2, in chained 1996 dollars.

(2) Real investment in information processing equipment and software. Bureau of Economic Analysis, Department of Commerce website, www.bea.gov, National Income and Product Accounts, Table 5.5, in chained 1996 dollars.

(3) Real personal consumption expenditures. Bureau of Economic Analysis, Department of Commerce website, www.bea.gov, National Income and Product Accounts, Table 1.2, in chained 1996 dollars.

(4) Average ratio of personal saving to disposable personal income over the period, expressed as a percentage. Bureau of Economic Analysis, Department of Commerce website, www.bea.gov, National Income and Product Accounts, Table 2.1.

(5) Economic Report of the President, February 2002, Table B-95, p. 430. Index, 1941-43 = 10. Growth rate in 4th column is for 1997-99; the stock market boom stalled in 2000.

(6) Real output per hour of the nonfarm business sector. Bureau of Labor Statistics website, www.bls.gov, Series ID PRS85006093.

(7) Real average hourly earnings in the private sector. Bureau of Labor Statistics website, www.bls.gov, Series ID EEU00500049, in 1982 dollars.

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