



COMPETITIVE MARKET ECONOMIES: SELF-REGULATING MARKETS VS. ECONOMIC STABILITY AND THE PARADOX OF CHANGE

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ABSTRACT

Competitive market economies are a relatively new economic system, and while very productive, they are not self-sustaining, are unstable and require significant state support and regulation to function properly. Nevertheless, self-regulating market economies are superior to other political-economic systems—such as dictatorial fascism or autocratic communism—but they can be mismanaged. From 2009 through 2012, the Federal Reserve's four quantitative easing programs and deficit spending by the federal government—use over \$7 trillion dollars, or 45% of a year's GDP—trying to solve the ongoing 2008 credit crisis. It is reasoned, the U.S. economy will soon experience negative GDP growth, and a double-dip recession will become evident—which will, at that time, call the Fed's experimental policy of quantitative easing into question. Instead, the U.S. 2008 credit crisis could have been solved in two years, and cost the U.S. government and the Federal Reserve about 5% of a year's GDP, by following the tried-and-true credit crisis management rules of Bagehot and Kindleberger.

1. INTRODUCTION

Competitive or self-regulating market economies are historically, relatively new. They promote dynamic creative destruction and rebirth—led by people's needs, wants and desires, thus properly directing economic progress. All free human beings should be permitted to fully participate in self-regulating or competitive market economies; be they politically connected or not, virtuous, psychopathic, intelligent, thoughtless, rational or irrational.

Economic systems are studied and reported on by the social sciences, which are unlike the physical sciences (e.g., physics, biology, chemistry). Social scientists require a unique awareness in order to perform dependable research. For example:

Physics has an absolute that never changes: the speed of light.

Social sciences have change that is an absolute: on one level.

Self-Evident Social Science Axiom:

"The only thing that doesn't change—is change itself."

Life and living is a journey, a process of change.

However, in the social sciences, there is added complexity:

Social Sciences Include Faith:

“*There is nothing new under the sun,*” (Ecclesiastes 1:9), or said in another way, “*The more things change, the more they stay the same.*”

Because human nature is universal, once the cover of cultural differences is removed, and human beings have a tradition of religious faith, using various names for God, such as Yahweh, Allah and Ahura Mazda. Apparent change does not ultimately affect the underlying morality and deeper reality of persons’ existence—through time.

Social sciences have meanings on different levels, because of the “paradox of change.” Change is always with us, but the underlying truth of humanity (e.g., the subjective truth of how and why), remains constant down through the ages. Or, as is said, “*History doesn't repeat itself, but it rhymes.*” Consequently, along with the near impossibility of performing appropriate, controlled social science experiments in a laboratory—the social sciences are difficult to test, evaluate and develop valid researched solutions to problems. Thus, in the social sciences, hardly anything is what it appears. Researchers need a worldly viewpoint, extensive experience, and the ability to perform in-depth studies with a profound understanding of human nature. Maturity is essential. Young prodigies perform better in other fields—such as mathematics or playing a musical instrument.

Economics is, perhaps, the premier social science.

2. LITERATURE REVIEW

2.1. Past Economic Systems

Market economies are nonexistent through most of history. Polanyi (1944) writes—for many thousands of years, first in tribal societies, then up to and including feudal societies, throughout the majority of man’s existence, the following societal values dominate all then-existing economic systems:

- 1) *Reciprocity in social behavior*—giving gifts and thereby expecting to receive gifts in return.
- 2) *Redistribution of material gain*—this occurs in small primitive communities, and right up to and including wealthy empires. A portion of the food produced is put into storage and freely offered for the benefit of the entire community. Individual food collection and storage for family use is not practiced during these times.
- 3) *Social Approbation*—the need to be thought well of in the community, according to one’s contribution to society.

During most of human history, primarily, individuals are motivated by:

- 1) *Self-Respect*—a proper regard for oneself, for one’s good character and conduct.
- 2) *Joy-of-Work*—to work for its own sake, on one’s own terms.

For many thousands of years, workers are not individually motivated by personal gain or self-interest. In the Western tradition of faith—greed is scorned as a deadly sin. Economic systems are rooted in social relations. The distribution of wealth this determined by the community, irrespective of economic motives. Wealth in past economic systems is not economic, but social in nature.

Long-standing customs, laws and religion support the societal norm, controlling the then-existing economic systems. Societal values have a strong hold on persons in all communities—who do not want to be ostracized, isolated or boycotted. Or as Aristotle says, “*Only gods or beasts can live outside of society—man is neither.*”

2.2. Money Use through History

During early and feudal times, metal coins are used to partially pay taxes and make donations to the church. The state uses metal coins to partially pay government officials and military salaries. However, those in the community pay mainly in kind. Likewise, the state pays their officials and soldiers, mainly in kind. Money, through most of recorded history, is not decisive in determining the types of then-existing economic systems.

Money, during feudal times, among peasants and laborers, is rarely used in everyday life. Social organization in Europe, during feudal times, has peasants tied to the land on farms, and laborers in towns formed into craft guilds. Peasants and laborers have access to a garden plot for growing food and to grazing land, in order to tend to their animals. Peasants and laborers are often paid in kind, making money earnings much less important.

Economic rules are set by each guild trade. Guild leaders are also civic leaders, which combines politics and economics. For most of recorded history, human beings live with their social system controlling the economic system, and metal money is not an important factor in the peasant and laborer’s life. Money, to the common man or woman, has only peripheral economic significance and eventually rises in importance only because of its use in external foreign trade.

2.3. Trade Begins

Trade does not begin, in early or feudal societies, between individuals. Trade is only sanctioned by civic leaders—between whole communities. Trade does not rely on markets, but is the means of carrying goods over long distances, and may be thought of as simply a hunting expedition. Exchanges between towns are limited, regulated, and do not govern society. Instead, reciprocity and retaliation are the guiding societal principles governing external foreign trade.

Local markets are nonexistent during primitive times, and even during feudal times, local markets remain small, with no tendency to grow. Local markets are organized by townships, carry the same regional products, and cooperation is the basis for exchange.

Markets for local community goods do not mix with markets for goods that come from afar. Local and external foreign markets differ in size, origin and function. External foreign markets carry specialty items—such as spices, salted fish and wine. Local and external foreign markets are not only strictly segregated, but neither is permitted to enter the countryside.

Beginning in the sixteenth century, markets become more numerous and important. However, markets still do not dominate human society. National protection of external foreign trade begins with the advent of tariffs on imported goods. The mercantile economic system develops and begins state control of external foreign trade.

2.4. Mercantilism and External Foreign Markets

Feudal society transitions into the mercantile society of the 16th to late 18th centuries, to preside over external foreign trade. The state determines it is crucial to control vital natural resources in foreign lands, for military purposes, and to run a positive balance of trade surplus, for economic advantage—often requiring governments to impose high tariffs on imported goods.

External foreign trade proves risky, without the backing of a strong state and military. External foreign trade is only created and maintained by a substantial increase in government administration, and by intervening in the societies and legal systems of the countries being traded with, all to protect the businesses doing the trading.

The state monopolizes the economic system for the state's benefit. Colonies are forbidden to trade with other countries, and workers' wages are restricted. However, mercantilism proves divisive; fostering imperialism, colonialism and many wars between the Great Powers. Market economies have yet to arrive, and would not do so until after 1790.

2.5. Market Economies Arrive

The Industrial Revolution creates the need for market economies. Production processes transition from handcrafting methods, into mechanized manufacturing. As a result, labor productivity and wealth creation significantly increase. In the industrialized countries, real wages accelerate, living standards improve, populations grow and the resulting favorable demographics have a positive effect on the industrialized country's well-being. Therefore, the Industrial Revolution prompts the state to design and implement the market economy, and then spend a great deal of time and resources maintaining and controlling their organization.

Private business entrepreneurs are the driving force pushing the state to found the market economy, during the Industrial Revolution expansionist period. Capitalism—the private ownership of the means of production—now mechanized and highly profitable, becomes the guiding economic principle in the West. The merchant class does not arise from the agrarian feudal society, but from the Industrial Revolution. Once established, defense of market economies also includes the traditional landed class and the emerging industrial workers.

In market economies, the source of a person's income is the result of sale of products to far-off, unknown customers. However, for many thousands of years, production is mainly for household use—that is, for family, friends and community members—never for sale to outsiders. Production for sale of goods in faraway markets, to those outside the community, is highly unusual for peasants and laborers, up to this time. Manufacturing centralizes industrial workers into towns, creating mass urbanization. Thus, the Industrial Revolution changes how societies are structured.

Unfortunately, in practice, market economies result in corporate monopolies. Corporations may use a product dumping predatory pricing strategy, by charging less than their cost to produce, in a specific market, in order to drive weaker, smaller competitors out of business, and then significantly raise prices at a later date, in order to gouge the consumer. If the monopoly is in a vital economic area and the company institutes monopoly pricing to overcharge the consumer, only the state has the power to protect its market economy from monopolistic inefficiencies and break up the offending company—thus re-instituting competitive pricing.

Government regulations and market economies develop simultaneously. Leaving business a free hand, especially when dealing with far off customers, leads to misrepresentations, shoddy practices and fraud (Rosner, March 12, 2013). For example: toxic subprime mortgage securitizations sold worldwide causes the 2008 credit crisis—and international corporations selling horsemeat as beef, reportedly triggers plummeting hamburger sales. This requires the government to protect market participants from difficult to detect fraudulent business practices. As a result, the state establishes the Food and Drug Administration, the Department of Weights and Measures and the Securities and Exchange Commission. Consumer trust, in everyday market transactions, is paramount for market economies to function properly.

Akerlof and Romer (1993) explain how businesses practicing fraud produces competitive advantage for dishonest companies, at the expense of honest companies. For example: the financial sector collapse in Chile, the 1980s U.S. savings and loan debacle leading to the collapse of real estate prices, and the U.S. junk bond market that funded business takeovers—all having similar fraudulent boom and bust cycles.

Without regulation and transparency, bad businesses drive out good businesses, following Gresham's Law. The economic system then atrophies, with a loss of trust in the marketplace. What is lost is not just the money on an inferior product or service, in the short run, but more importantly, the bad businesses may use their outsized profits to buy political protection and start changing laws, to make new laws favorable only for them—thereby damaging the market economy and reducing the state's long-term economic growth and welfare.

2.6. Management of Market Economies

Managers in market economies find they get what they measure, incentivize and dis-incentivize. Capitalism only works properly when disincentives are as important as the incentives. Wrongdoers have to be taken out of their employment positions and insolvent companies have to go out of business, in order to cleanse the economic system and restore confidence in the marketplace. If the government practices crony capitalism, malinvestment occurs, to the economy and society's detriment.

Once society has danger impressed upon it, after a credit crisis, fear remains latent in people's memory, until the cause of the danger is removed. This is why prosecuting fraud by the state is so important. Without justice restored, people now distrust those who remain in power, after they prove dishonest, because they believe fraudulent practices will quickly resume. Consequently, trust leaves the economic system, hindering economic recovery.

The next step in economic advancement is the institution of self-regulating or competitive market economies, which currently dominates social order in the West.

2.7. Self-Regulating or Competitive Market Economies

An economic market system capable of directing the whole of economic life, without outside help or interference, is called self-regulating. Once the self-regulating or competitive market economy is designed and implemented by the state, to give all participants an equal opportunity for success, the self-regulating market is to be let alone by the state and allowed to function, without after-the-fact government or outside intrusions, regardless of the expected consequences. The government's role is to set up and enforce impartial laws, not to play the game.

Self-regulating markets require competitive markets for labor, land and money. The state devises laws and regulations for their development and maintenance. This is the revolutionary change to how societies were previously organized. Land, unlike human beings, is part of the physical world (i.e., nature). However, land and people, down through history, are inexorably tied together. Institutions in tribal and feudal societies are dependent upon the people-land whole, and they are never separated. In contrast, self-regulating or competitive market economies split land and labor into two separate units of trade, resulting in a change in societal values.

In a self-regulating or competitive market economy, market prices are allowed to seek their own level—which is a price setting and market clearing mechanism. Initially, markets are expected to be in balance. However, when random information or external shocks to the self-regulating market

economy moves prices, markets are assumed to be self-equilibrating, without outside interference from government.

2.8. Liberal Economic Theory

Economic theory supporting the historic transition to a self-regulating or competitive market economy is called “liberal economics.” Which, beginning in 1820, stands for: 1) competitive markets for land, labor and money; 2) the gold standard; and 3) foreign trade without protective tariffs, government subsidies or imposed monopolies.

Liberal economic theory champions decentralized competitive markets, rather than centralized, day-to-day state operation of the economy. Because decentralized self-regulating markets do an excellent job of allocating scarce resources, by setting market clearing prices, they therefore are more productive than centralized state operations. However, liberal economic theory of self-regulating markets proves utopian in practice. Competitive market economies go into disequilibrium, with falling sales, thus reducing industrial production and producing stagnant personal income, resulting in the scourge of self-regulating or competitive market economies—high unemployment and falling real wages. Consequently, liberal economic theory is discredited.

2.9. Death of Liberal Economic Theory

The first Great Depression lasts from 1873-to-1886. At the start of Great Depression 1, Germany and France have a most favored trading nation status and international trade is expanding. By the end of Great Depression 1, protective tariffs are in place, competitive markets change into monopolistic markets, and a social insurance system is established, to lessen the worst effects of the self-regulating market economy on workers.

The Russian revolution of 1905 is the result of a contraction of the western European money market, which the Russian economy is tied to. The Bolshevik revolution overthrows Tsarist Russia in 1917, and begins a collectivized, communist economic system, discarding both the autocratic Tsarist government and their failed self-regulating market economic model.

The second Great Depression, occurring less than 50 years later, lasts from about 1929-to-1940. The international trading system fails, once again. This prompts President Franklin D. Roosevelt to implement the New Deal, to help reduce social strife, as a result of the second major failure of a self-regulating or competitive market economy.

In Italy, Benito Mussolini, the duce of fascism, is installed in government in 1922, because of the market economy crash of 1919-1920. Adolf Hitler Nazi party fascists come to power in Germany in 1933, and Francisco Franco Nationalists fascists take over Spain in 1936, because of the economic turmoil resulting from the Great Depression 2. Fascists attack democracy and gain a foothold, because of self-regulating market economic failure. Fascists promise and deliver on market interventions to lessen the worst consequences of the Great Depression 2.

Communism and fascism reject the self-regulating or competitive market model and re-establish social society, as transcendent over failed self-regulating markets. Fascism and communism organize workers into “colleges” with a national purpose, so workers can pool their efforts and thereby eliminate poverty. Hitler’s extensive public works, including building the Autobahn, extensive military spending, and Stalin’s Five Year Plans are examples.

Communism succeeds, at this time in Russia, because they had no democratic traditions, the population was largely illiterate and the economy was not industrialized. However, keeping the

economy always expanding is impossible. So instead of regular business cycles that perform the creative destruction of driving out the bad and allowing the new to take over, in small manageable increments, the resulting long-term economic imbalances become sovereign in size, which brings the Soviet Union (USSR) to an abrupt end in 1991, when their centrally planned state-operated economy ultimately fails.

The strength of strong-man dictatorial governments, in re-establishing societal values over the self-regulating market economies, also proves to be the system's greatest weakness. It is impossible for the countries to rid themselves of dictators, tyrants and their corrupt network of followers, short of death or political revolution—and absolute power corrupts absolutely. The wellbeing of the state is no longer of importance, since the economy's benefits are now mainly allocated among crony political officials.

Communism and fascism will not tolerate a self-regulating or competitive market economic system—at all—or for long. A self-regulating market economy has too many recessions and gets in the way of corrupt officials looting the economy. A self-regulating market or competitive economy can only function in a democratically elected republican form of government, but even then, it is unstable and prone to catastrophe, if mismanaged by the state.

2.10. Human Nature and Self-Regulating Market Economies

Those in Western societies are told that competitive market economies, which have self-regulated prices for land, labor and money, set solely by the market, are normal, and that human beings develop market economies on their own, without help from the state, which is the proof of human progress. Also, that market institutions will arise naturally and spontaneously, if only persons are left alone to pursue their economic interests, free from government control. This is incorrect.

Throughout most of human history, self-regulating markets are unnatural and exceptional. Human beings are forced into the self-regulating market economy, by the state. Look at the following false competitive market economy assumptions.

We are told people naturally bartered goods. Actually, human beings, down through history, have no predilection to barter. Social anthropology says that assuming tribal and feudal men and women bartered are rationalist constructs, with no basis in fact. Market economies are the result of often violent government directives, imposing a market society for the state's own non-economic benefit—for example: imperialism. The international trading company's aim is economic gain, achieved by partnering with governments, whose main goals are supremacy and conquest.

The assumption is man is a trader by nature, and that any different human behavior is an artificial economic construct. By not interfering in human behavior, markets will spring up spontaneously. This is proven incorrect in social anthropology.

2.11. Competitive Market Economies Dominate Society

Creating labor markets separates men and women from other priorities in life, subverting the other historical forms of society, replacing them with the laws of the marketplace. In a self-regulating market economy, initially, "nature's penalty" (i.e., starvation) forces the poor to become willing laborers. This is a major change in societal values. In tribal and feudal societies, individuals did not go hungry, unless the community itself is in danger.

The self-regulating or competitive market economy requires social relations to be embedded in the market economic system. That is why a self-regulated market economy only works if the society

has trust and faith in its proper and continued functioning. Capitalism, the globalization of trade and stable currencies alone, do not assure international order. Only society can guarantee, maintain and control competitive market economies.

2.12. Gold Standard

The gold standard is the second leg of liberal economic theory. Doing away with the gold standard in the 1930s during the Great Depression 2, the breakdown of the 1944 Bretton Woods agreement, requiring each country to tie its currency to the U.S. dollar, and finally President Nixon breaking the last link of direct convertibility of the U.S. dollar to gold, in 1971, destroys the long-standing monetary system, thought necessary for self-regulating market economies to function properly. This breakdown of a stable money market is, historically, sudden. One of the three legs of a competitive market economy is missing. This is still being felt, worldwide. The fall of the gold standard, and the rise of fiat currencies, is an ongoing complication in the globalization of international trade today.

Central banks, in the U.S., Japan and China, are currently electronically printing money to monetize their governments' debts—called quantitative easing (QE). As of the first quarter of 2013, the Federal Reserve (Fed) is injecting an open-ended \$85 billion dollars a month of QE into the financial system. The Fed plans to continue QE3 and QE4 until either the U.S. unemployment rate drops below 6.5% or until inflation expectations increase above 2.5%. The Fed is pursuing this policy, despite the fact that government has no evidence that QE works.

These developed economies are using a “beggar thy neighbor” monetary policy, thus expecting to increase their country's foreign trade. This seems improbable, because central bankers are using the same QE electronic money printing strategy.

One function of a central bank is to instill confidence in current economic policies. If central bankers squabble among themselves, this hurts the required confidence in the international economic system. Currency wars typically transition into countries instituting trade protections and higher tariffs, thus harming global trade and world economic growth.

Fiat currencies allow central bankers great leeway in monetary policy. However, it is doubtful that central bankers can responsibly handle this freedom, over the long term. Since there is no restraint until the fiat currency completely collapses, see Zimbabwe as a recent example.

2.13. Neoliberal Economic Theory

The neoliberal economic theory grows out of the failure of liberal economic theory, during the Great Depression 2. Originally, in 1938, neoliberal economic theory means, “free enterprise, competitive markets, the priority of the market price setting mechanism, and a strong and impartial state—to ensure it all functions properly.”

Milton Friedman and the University of Chicago school of economics go a step further and advocate “free markets,” thus rejecting government regulation—calling it inefficient—and promote their efficient market theory (EMT), based on statistical analysis. However, new evidence shows the University of Chicago researchers asked the wrong questions, use erroneous data and an incorrect research method to analyze the data, and then jump to false conclusions based on half-truths (Prentis, 2011). Consequently markets are not efficient, as defined by the EMT, which goes to the heart of the market vs. state debate.

Today, neoliberal economic dogma promotes “free market” radicalism of reducing the size of government through the privatization of government services, deregulation and globalization. Privatization professes to reduce the state’s authority over the economy, but state money is now being used by private companies to lobby legislators, to change laws, which will increase the government’s demand for these same private corporation services. Privatization of government services by corporations, does not promote the common good, only private profit.

Essentially, neoliberal “free market” thinkers have doubled down on the failed liberal economic theory, with the ongoing 2008 credit crisis as the result. The only way a self-regulating or competitive market economy can function properly is to have fair laws and regulations, set up and enforced impartially, by a strong state. Yet neoliberal economists trumpet government deregulation because it is claimed, regulated markets are inefficient. However, neoliberal economists offer no proof, and recent evidence shows that deregulated markets are inefficient (Prentis, 2012). Therefore, government deregulation may hinder rather than help solve the ongoing 2008 credit crisis, possibly resulting in Great Depression 3.

The “free market,” ideology, as practiced today, is just the opposite of what is stated. Instead, governments step in to save insolvent large international corporations, when they make bankrupting mistakes, and give the bill to the taxpayer. This transforms the current difficult but manageable ongoing 2008 credit crisis, mainly involving insolvent banks, into a much larger and dangerous sovereign credit crisis, involving entire countries, with potentially calamitous political consequences.

Nowhere is competitive market deregulation more highly trumpeted by neoliberal economists than in the financial markets. The foundation of neo liberalism is a deregulated financial sector will regulate itself efficiently, making better use of capital, thus ushering in a new age of prosperity. Tragically, the massive deregulation of the financial markets during the Clinton and Bush presidencies (1993-through-2008) results in the ongoing 2008 credit crisis—which the U.S. Government Accountability Office (January 16, 2013) reports, has cost the U.S. economy about \$13 trillion dollars in lost GDP output.

The ongoing 2008 credit crisis is a result of changing the Glass-Steagall law to allow the combination of insurance, commercial and investment banking, creating too big to fail financial institutions; no regulation of the \$700 trillion dollar OTC derivatives market; changing the bankruptcy law; falsified underwriting and subprime lending; securitization of toxic mortgages sold to unsuspecting purchasers worldwide; using Mortgage Electronic Registration Systems (MERS) to evade county title transfer fees; falsifying mortgage documents using robo-signing; and influencing politicians so that criminal bankers are not held accountable for fraudulent behavior. Only the uninformed or politically connected—who have something to gain—use the term “free markets,” denoting the need for more deregulation, rather than the correct term, “competitive markets,” which require government regulation to function properly.

2.14. Control Fraud

Financial deregulation has led to control fraud, as defined by Black (2005). Bankers lobbied to change U.S. laws to shield them from prosecution, when they practice control fraud, which is their financial “weapon of choice.”

Unscrupulous CEOs use government deregulation, and their authority to install complicit corrupt executives in sensitive corporate positions. They use control fraud in their internal accounting system, thus removing all checks and balances, to fraudulently rapidly grow the business, typically

by using difficult to verify loans, lessees and asset market values, all while employing extreme debt leverage. Usually, this occurs in low barriers to entry businesses and industries, which also has the effect of driving good existing companies out of business.

Accounting control fraud produces rapid profit growth, however fictitious. Creditors then freely lend to these seemingly highly profitable borrowers. It is impossible for the markets to discipline accounting control fraud, since the wrongdoing is unknown. Instead, the marketplace, ironically, funds the fraudulent business' fast growth. Thus, the seemly high risk strategies are actually a sure thing.

Dishonest CEOs receive stock options and bonuses that pay off handsomely if the business grows quickly, even though the reported growth is actually fabricated. Executive compensation schemes incentivize this type of control fraud. When the truth becomes known, deceitful top executives merely walk away with their ill-gotten bonuses and let the government sort out the company's bankruptcy. Government prosecution is not a factor in stopping control fraud, because duplicitous CEOs are rarely brought to justice. Control fraud is material and significant, representing more losses than all other property crime—combined!

Control fraud occurs not just at the top executive level in financial institutions, but also at bank trading desks that are also profit centers. The looting happens when traders execute a trade that shows a profit this year, and the trader then receives a large bonus for making the trade, but the trade has a high probability of going bad in future years, especially in the \$700 trillion dollar OTC derivatives market. This is called “gaming the firm's compensation system.” The expression, “IBG, YBG” is used by unethical traders to justify their actions. It stands for “I'll be gone, you'll be gone,” thereby implying there will be no negative consequences to their fraudulent behavior.

Schwab (2011) in the World Economic Forum's (WEF) Global Competitiveness Report 2011-2012, lists the 12 pillars of a country's competitiveness. One of these is, “the necessity of a well-functioning financial sector that allocates resources to high expected rate-of-return investments, irrespective of politics.” Assessing financial risk correctly is essential to raising living standards. Consequently, “the banking sector needs to be trustworthy and transparent,” and “financial markets require regulation to protect investors and other actors in the economy at large.” The WEF report argues for “competitive markets” not deregulated “free markets.”

Government financial regulation is required to ensure trust and fair competition. Regulation does not take away from effective and efficient allocation of scarce resources, which is the market's function. In addition, the only way to combat control fraud is with effective government regulation. “Self-regulation” by the financial industry is no regulation at all,” it is only a pretense, leading to cover up—and when wrongdoing is identified by outsiders, only excuses and promises of change are forthcoming.

In practice, “free market” deregulation leads to crony capitalism and political corruption. Consequently, neoliberal economic theory is a complete failure, but the bankers still defend neoliberalism because they use moral hazard to privatize bubble economic gains, caused by the Fed, and socialize the inevitable losses when the bubble bursts, and then shift the bankers' massive losses to governments so the people have to pay for banker wrong doing. The resulting income inequality from this disruptive strategy is politically destabilizing (Stiglitz, 2012).

Ever increasing international business profits—coupled with negative real wage growth and increased labor productivity, leading to income inequality—is not the answer to a nation's economic prosperity. It is much too one sided. A better balance between capital and labor is

required. U.S. consumers need disposable income to spend, in order to show business what to invest in, and thereby restore the competitive market economy to balance.

2.15. Globalization

Globalism is another tenet of neoliberal economic theory—defined by no international trade barriers and unrestricted capital flows. However, this “free trade fundamentalism” is a myth. Business wants freedom from government production regulations, while still demanding government protection from outside competitors and foreign state intervention.

Globalization allows international companies to outsource production to countries with weak labor laws, lax environmental regulations and low taxes. The globalized free trade assumption of comparative advantage is proving incorrect, if the general population has to pay for international corporations’ mistakes.

The correct name for current neoliberal economic theory should be corporatocracy. Laws and regulations favorable to large international corporations are solely for their own benefit, and detrimental to the U.S. common good. And because the media in the U.S. is largely owned by the same international corporations, this ensures the American people hear only self-selected news that the large corporations want them to hear. Obviously, this is a conflict of interest between large international corporations and the U.S. public.

“Free trade fundamentalism” cannot long endure. When global international trade is expanding, along with ever increasing debt levels, cooperation among countries is forthcoming. Declining international trade, because of falling real incomes and stagnate personal debt levels, leads to falling final demand, and increases business competition and conflict between sovereign nations. International corporations are now competing in declining demand markets. Therefore, business and sovereign nation conflicts are inevitable.

Globalization is an unstable system created under the “free market fundamentalist’s” assumption of comparative advantage. Culture and politics make the “free market” assumption incorrect. Markets are dependent on the state for the rule of law, political stability and ultimately, military might. There is nothing free about a “free market.”

3. EMPIRICAL FINDINGS

3.1. Self-Regulating or Competitive Markets vs. Economic Stability

Self-regulating or competitive market economies are dynamic, but are frequently unstable and experience recessions. The National Bureau of Economic Research (NBER) records 33 U.S. recessions or business cycles, from 1854 to 2009, each averaging 4.7 years in duration, from peak to peak. NBER reports the last U.S. recession started in December 2007 and ended June 2009 (18 months), the longest recession since WWII. Federal Reserve Chairman Bernanke, in response to the 2008 credit crisis, implements an experimental quantitative easing (QE) program, first used—unsuccessfully to date—by the Japanese, in their vain attempt to extricate themselves from a 23 year ongoing credit crisis. Surprisingly, there is no empirical evidence that QE solves credit crisis, yet governments persist.

Market economies are prone to devastating secular credit crises, leading to social catastrophe, if the state allows a credit crisis to spiral out of control. The grand art for the state is recognizing the difference between a cyclical recession and a potentially devastating credit crisis collapse, and

then when to step in, and how to solve the credit crisis. Bagehot (1892) presents tried-and-true management rules that states have followed numerous times, to successfully solve credit crises. They are: “1) first and foremost, the character of the borrower has to be judged excellent, with no taint of scandal or fraud; 2) only then lend freely; 3) at high interest rates; and 4) to solvent borrowers offering high quality collateral in return.”

The state’s timing in taking action in a credit crisis is also crucial. Stepping in too early, the state saves wrongdoers. Too late, the resulting downward spiraling economy causes political upheaval and possibly, war! The art, says Kindleberger (1978), “is after the credit crisis has occurred: 1) it is important to wait long enough for the insolvent firms to fail; then, and only then 2) not wait so long as to let the causes spread to solvent firms, needing liquidity.” U.S. leaders, during the ongoing 2008 credit crisis, regrettably, violate all four of Bagehot’s management rules and both of Kindleberger’s timing requirements.

3.2. Case for the U.S. Economy Experiencing a Double-Dip Recession

The Economic Cycle Research Institute (ECRI) has an excellent professional reputation—correctly forecasting the past three U.S. recessions. During the last week of September 2011, ECRI gives advance warning that the U.S. economy had recently reached a peak expansion high, and the U.S. economy would then begin slowing down. On the same day as ECRI’s recession announcement, Fed Chairman Bernanke reveals a new quantitative easing (QE) policy called operation twist, and in September 2012, QE3, and in December 2012, an open-ended QE4. The Fed’s actions slow the inevitable economic decline, but will not stop it, says ECRI, and may ironically, make the eventual trough of the recession even worse. For as former Bundesbank President Axel Weber says, “*Central banks can buy time, but they cannot fix issues long-term.*”

U.S. GDP growth is slowing. In 2010, GDP growth is +2.4%; in 2011, + 2.0%; and for 2012, it further slows to +1.7%. Nalewaik (April 14, 2011), a Federal Reserve researcher, investigates economic growth, and discovers slowing economies reach stall speeds. Since 1947, a sub +2% GDP growth, year-over-year, as an economic expansion slows, always correctly predicts an economic recession, which normally becomes evident, 70% of the time, within the next year. Consequently, negative GDP growth is 70% probable in 2013, and if not then, almost a certainty by 2014. From this we can infer the U.S. economy is now in a recessionary slowdown, and will experience quarters of negative GDP growth, perhaps within the year.

Important real economic measures indicate the U.S. economy remains weak. The civilian labor force participation rate drops to 63.3%, during March 2013, from a high of 67.3% in 2000, matching levels last set in 1979. The unemployment rate decline over the past three years, from 10% to 7.6%, is almost solely attributed to discouraged workers leaving the labor force. About 90 million working age Americans do not have a job.

In addition, the quality of jobs in the U.S. is declining. Real wages, a good indicator of living standards, turn negative in both 2011 and 2012, falling by about 0.5% a year, even though labor productivity is increasing, according to the 2013 Economic Report of the President. This is indicative of a shift in the mix of U.S. jobs, from high wage full-time jobs, to low wage part-time jobs. The hollowing out of the U.S. economy continues. Good jobs are sent overseas, as part of U.S. corporations’ globalization strategy—even while U.S. corporate profits, as a percentage of GDP, reach an all-time high. Without real wage growth, it is difficult for Americans to pay down their high levels of debt. Consequently, the 2008 credit crisis continues.

Other real economic indicators are just as dire. Over the past four years, the number of persons on the Supplemental Nutrition Assistance Program (SNAP) increases +50%, to about 48 million Americans. The Center for Retirement Research reports an increase in the number of the unemployed applying for Social Security Disability Insurance (SSDI) benefits, once their unemployment insurance ends. Social Security Research, Statistics, & Policy Analysis, as of January 2013, lists 10,895,000 Americans in the SSDI program, including their dependent spouses and children, up about +15% over the past four years. Few on disability insurance ever re-enter the labor force.

U.S. leaders hope a technological or energy discovery will help the U.S. economy recover, giving America a new growth engine. This is less likely to happen, because of massive malinvestment. Good money is being thrown after bad, going to insolvent banks and bankers, rather than to innovative engineers and productive operations managers.

4. DISCUSSION

4.1 High Debt Levels Are the Problem

To make up for lost employment income demand, debt levels significantly increase from 1980, when President Reagan said debt doesn't matter, to today. Total U.S. government and private debt-to-GDP was about 165% in 1980, and 33 years later, it is now at 350%. The total debt peak is 260%, in 1929, leading up to Great Depression 2. Therefore, the U.S. has hit a debt ceiling.

A nation's economic engine is circular and goes: employment income>consumption>production>employment income. Americans can no longer service their high debt levels. Therefore, there is leakage in demand from employment income to consumption, because of high consumer debt payments. In addition, since production is now moved offshore, this reduces payments from production to U.S. employment income, leaving less monetary demand to rotate through the next economic cycle.

High debt servicing levels and production outsourcing act as a break on U.S. economic growth. The ever increasing debt economic model is now exhausted. Deleveraging will have to occur. The longer the deleveraging is put off, the worse the eventual economic collapse could be.

4.2. Businesses Follow Demand

International corporations are cash rich, after championing weak trade unions, aggressive cost cutting displacing workers, slowing wage growth and reducing capital investment. However, these same companies are not hurrying to invest their large amassed cash reserves, because they do not know which products or services to invest in.

The Fed's Zero Interest Rate Policy (ZIRP) is taking about \$425 billion dollars a year of interest income out of consumers' pockets (Duy, January 29, 2012). This is ironic, because when interest rates are high during the mid-1980s, the U.S. economy is strong. Restraint of economic growth is not because of high interest rates, but hinges on profitable productive opportunities for businesses to expand operations, based on growing consumer demand.

Because U.S. consumers have reduced disposable income to spend, businesses will not make capital investments if they observe declining demand for their goods and services. Even technology led products are risky and prone to economic failure. Rather than investing, large corporations are simply increasing stock dividend payments and buying back their shares.

The major economic problem is the U.S. is lacking final consumer demand, because of ZIRP and an over-indebted society. Increased government demand is not real demand, decided on by consumers. Businesses, rightly so, do not trust this fabricated government demand, since it can change on a politician's whim.

5. CONCLUSION

Society is dominated by markets for land, labor and money. Decentralized, competitive or self-regulating markets are extremely productive, but are unstable and prone to catastrophe, if mismanaged by the state. Centralized, state operated political-economic systems, such as dictatorial fascism and autocratic communism, are not successful, for long.

Self-regulating or competitive markets need effective and evenhanded laws, imposed by an impartial state, to guard against monopolies, cartels and shady business practices. Fraud makes "free markets" unproductive and a burden on society. "Free market fundamentalism" is promoted either by the uninformed, who do not understand what is necessary to make competitive markets function properly, or by those who have a political agenda and profit from the fraudulent behavior allowed by weak and poorly enforced government laws. "Free market fundamentalism" carries the seed of its own destruction—witness the ongoing 2008 credit crisis.

Competitive or self-regulating market economies experience recessions, which are necessary for healthy long-term economic growth. This is the paradox of change within capitalism. Individual companies, whole industries, even most large banks can fail, but the underlying economy will revive, stronger and better able to achieve future success.

From 2009 through 2012, the Federal Reserve's four quantitative easing (QE) programs, including operation twist, and the federal government's massive deficit spending—use over \$7 trillion dollars, or 45% of a year's GDP—trying to solve the ongoing 2008 credit crisis. A strong case is made the U.S. economy will soon experience negative GDP growth, and a double-dip recession will become evident for everyone to see. This will call the Fed's experimental policy of quantitative easing into question. Instead, the U.S. 2008 credit crisis could have been solved in two years, and cost the government and the Federal Reserve about 5% of a year's GDP, by following the tried-and-true credit crisis management rules of Bagehot and Kindleberger.

For the U.S. to extricate herself from the ongoing 2008 credit crisis, it is recommended that politicians: 1) allow insolvent banks to go bankrupt; 2) prosecute fraudulent behavior; 3) permit interest rates to rise, by doing away with the Fed's ZIRP, thereby increasing consumer demand; and 4) eliminate austerity for the people, by sharing productivity gains with workers. This will help restore income equality and further grow final demand, which will direct businesses on where to make profitable investments. Thereby benefiting the common good, and strengthening the United States.

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