

“Economic Policy in the Time of Reactionary Populism”*

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Abstract

This paper is an attempt to address some of the problems which have surfaced in the political reaction which produced Brexit in Europe and Donald Trump’s surprise victory in the 2016 elections in the US. It argues that the prevailing policy has been conceived and understood in terms of a series of policy paradigms which are in many ways limited and misleading. Those policies include the Silicon Valley consensus, the Washington consensus and globalization. These paradigms have promoted major structural changes in the economy, the costs of which have been concentrated in the old industrial heartland of the Midwest and undermined the employment opportunities which sustain the communities in which the identities and self-conception of the people who lived there were embedded. It argues that the paradigms offered a limited and incomplete view of the nature of productive knowledge, the way it is acquired and the way it evolves over time. They have also led to a focus on the potential welfare gains of the processes of technological changes and of globalization while ignoring the processes through which we adjust to these changes and the way in which the costs of adjustment are distributed across different groups and communities. It does not offer a fully developed alternative set of public policies. But it does identify a series of ways which public policy might moderate the pace of change and promote a more even distribution of the costs and benefits.

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My talk here today is one of several which I have committed myself to give over the course of the fall months on a variety of different topics. I made these commitments without really thinking about what they entailed in terms of the range of topics I was asked to address, the amount of international travel I was committing myself to do, and the diverse national audiences to which I was going to be trying to relate. But as I sat down to figure out what I was going to say in these different settings, I realized that in each case I could not escape a set of fundamental questions about how to think about the economy and public policy. These questions are of course always in the background of any analytical endeavor but usually we start from a developed framework of thought which we proceed to apply to the problem at hand, without reflecting on where that framework comes from and whether it is indeed relevant to the problem we are attempting to solve. Political developments in the last year—nobly the 2016 electoral campaign in the US, and Brexit in England—have forced me, at least, to go back to first premises and I am going to ask you to join me in this exercise. It has, at least in the United States, become increasingly clear that though these campaigns may have centered on economic problems, they have revealed a depth of anxiety and resentment that go well beyond the economic environment and probably cannot be addressed by economic policy alone. Nonetheless, the economy appears to have been the key to the political upheaval though which we are now living, and while solutions to these problems may no longer be enough to stabilize the political and social environment it is difficult to imagine how we can restore a sense of order without addressing the economic concerns.

Those concerns I would submit are the product of the pressures for structural change and adjustment which have battered the economy over the course of at least the last thirty years. Pressures for structural change and adjustment are of course inherent in any dynamic economy; indeed they are the engines of economic growth and development. One can argue about whether the recent pressures have been greater than those which the economy has absorbed in the past, but in my own country there is no question that whatever their absolute magnitude, their costs have been very concentrated in the old industrial heartland of the Midwest where they have undermined the communities in which people's identities were embedded and the terms in which they understood themselves. These communities were a key constituency of the Democratic Party, and their desertion of the party was the determining factor in the electoral victory of Donald Trump.

The principle forces producing the structural changes against which the Midwest electorate was reacting were globalization and technological change. But they have been aggravated, I would argue, by institutional changes in corporate governance associated with financialization. But most important for the discussion I would like to engage here, the country has been guided in its response to these pressures by a framework of economic analysis which has made the forces producing these changes seem beyond the control of politics and policy, and is crippling our ability to anticipate the problems which they have engendered and to conceive of alternative solutions.

That analytical framework can be understood in terms of what might be called “policy paradigms,” the broad frameworks through which policy makers tend to think about the economy, judge its performance and attempt to influence its direction. (Hall 1993). In the post-World War II period, policy has been guided by four such paradigms: A Keynesian paradigm in the immediate postwar decades, the so-called Washington consensus, emerging in the late 1970s and continuing through the 1990s and into the new millennium, and more recently what might be called the “Silicon Valley” consensus encapsulated by the mantra “Innovation and Entrepreneurship in the Knowledge Economy”. The Silicon Valley and Washington consensus have been linked to globalization in a way which constitutes almost a fourth paradigm, but in ways that are differently understood in each case. In the Silicon Valley consensus, globalization is seen as the product of innovations in communication and transportation. In the old Washington consensus, it is promoted by trade treaties and innovations in regional and international governance conceived as an expression of the efficiency of a market economy as understood in terms of standard economic theory.

That such paradigms exist and that they vary over time is difficult to deny. Where they come from and what role they *actually* play in the evolution of the economy is on the other hand unclear: Do they reflect social and economic reality or do they actually influence and direct its evolution? Are they, in other words, a camera or an engine (to borrow a phrase from the academic researchers who are most concerned with this problem).¹

The difficulties which the conservatives in Britain and the Republicans in the U.S. are having translating the political reaction which brought them to power into a coherent program brings this question to the fore and suggests the intellectual vacuum in which the political

¹ See MacKenzie (2006).

reaction is taking place.. These are ominous developments, given the way communism, fascism and two world wars grew out of the collapse of what my colleague Suzanne Berger calls the “first globalization” in the early 20th century (Berger, 2013). And the parallels and the dangers were reinforced this summer, at least in the U.S., in Charlottesville, Virginia, by the marching of youths shouting Nazi slogans seemingly encouraged by President Trump. But a major difference between this and the earlier period is that the reaction against globalization today is occurring without the kind of alternative paradigm which Communism and fascism offered in the earlier period, creating an opportunity to meet the challenge with a new series of ideas.

It is evidently premature to say what an alternative policy paradigm might look like—anyway I certainly do not have an alternative to propose here. But at least with respect to issues surrounding the income distribution and human resource policy, one can, I think, identify some of the limits of the prevailing paradigm which any alternative would have to take into account.

First, putting aside the question of entrepreneurship (largely because of the limitations of time here), the two pillars of the Silicon Valley consensus are “innovation” and the “knowledge economy”. For labor, they imply the evolution of the job structure toward sophisticated technology which requires highly skilled workers to create and manage it. Combined with globalization, it implies the increasing dependence in legacy industries on low-skilled, uneducated labor in the developing world, with which that part of the U.S. labor force that cannot be absorbed into the high tech sectors is basically unable to compete. Implicit here is a view of technological change and a view of knowledge, both of which are highly suspect.

The view of technological change is particularly suspect given that it is not attached to any real theory about the direction of technological change but is promulgated in a world in which there is a belief (which the Silicon Valley consensus promotes and reinforces) that knowing that direction and pursuing it successfully is the key to economic prosperity, both for individual actors in the economy and for cities, regions and nation-states. And hence it is bound to play a role in determining what projects inventors work on and which ideas entrepreneurs and financiers choose to develop. Its role in this respect seems to have been enhanced by the changes in corporate governance associated with financialization. As business has become increasingly dependent on outside financing, outsiders have become increasingly influential in business decisions. And management is called upon to justify decisions which depart from fad and fashion

to people who are not in a position to form an independent judgement about what the business is doing.

But the commitment to the development of Silicon Valley technology goes well beyond a diffuse consensus which influences private decision-making. In the US, the Federal government plays a pivotal role in the evolution of technology. The government finances over half of national expenditures on R&D, and has been responsible for the key innovations in communications and bio-medical technologies. It has been financing and promoting robotics technology as well, most prominently through the DARPA robotics challenge. And most recently, as the loss of manufacturing jobs has become a major concern of public policy, it has launched a program to promote advanced technology in a way which ironically seeks to preserve manufacturing by reducing the employment requirements and increasing the educational requirements of the jobs which remain. To the extent the concern is with the gap between worker qualifications and job requirements, the focus is on raising worker qualifications rather than technological developments which could lower the job requirements and hence bridge the distance between the existing labor force and the employment requirements.

At the same time, the consensus about the direction in which technology is evolving leads policy makers to tilt investments in education and training toward the formation of engineers and scientists or, more broadly, toward institutions of higher education, rather than, for example, primary and secondary education or vocational training or, a point to which I return in a minute, training on the job. It makes it easier to staff the new technologies which these beliefs foster and to expand the R&D facilities which generate those technologies. And it has these kinds of effects not only in advanced developed economies: It also leads developing economies like China and India (and the country which is actually a model of this pattern of development, the Philippines)² to overinvest in higher education and then export the educated labor force to North America and Europe where they facilitate the movement of technology in that direction. The belief in the inevitability of this kind of technological change has led to a virtual panic about the availability of skilled and highly trained manpower. This despite the fact that half of the STEM graduates trained in the United States are working in non-STEM jobs and occupations. Thus, there is an interaction between the policies of the U.S. and those of India and China which is leading to

² See Ruiz (2014).

increasing immigration of highly educated workers from abroad as opposed to the adjustments in job design and recruitment practices in which business might otherwise be forced to engage.

The second problem with the Silcom Valley consensus is that the “knowledge” around which it is built is exclusively formal knowledge acquired through classroom learning in distinct educational institutions and carried into the productive sector by students who graduate from these institutions and by their professors working as consultants and entrepreneurs. It does not recognize at all tacit or clinical knowledge, acquired on the job in the process of production. Clinical knowledge, moreover, appears to evolve informally through practice as less educated workers working alongside formally trained engineers and managers gradually take over many of their tasks, actually inventing other ways of doing the job and understanding the work (Doeringer and Piore, 1971; Iskander and Lowe, 2010). The relationship between formal and clinical knowledge is unclear in large part because clinical knowledge is seldom explicitly recognized, and because it goes unrecognized it is understudied. Recognition is complicated by the fact that tacit knowledge is by definition immeasurable and its nature, even existence, draws on anecdotal evidence which is easily dismissed as atypical or anachronistic and which is destined to be replaced by the kind of formal “scientific” analysis³ which we think of as characteristic of modernity.

It therefore seems particularly relevant to underscore the role of tacit knowledge in the development of software, since we think of Information Technology (IT) as emblematic of contemporary modernity. Efforts to standardize and formalize software development have proven particularly frustrating, and instead rapid, efficient development depends on the tacit understanding embedded in a community of practice which grows up through direct, personal interaction among a team of developers and the architects and designers of the programs which they are attempting to write. Thus, for example, GE, when it began offshore development in India found that it was difficult to limit the number of people from the Indian team in the U.S. at any moment of time to 30% of the total workforce assigned to the project. And Fred Brooks in his famous treatise on software development, The Mythical Man Month (Brooks 1975), argues that adding new people to a development project as it falls behind schedule actually slows down the development process still further because the newcomers do not share the tacit understanding of the architecture, an understanding which can only be developed through interaction with

³ But see Polanyi (1944).

experienced members of the team on the job. This suggests—to underscore the point—that for certain processes clinical knowledge is indispensable. Even where it is not over a range, possibly a very wide range, clinical and formal knowledge are substitutes for each other. But clinical knowledge provides opportunities for upward mobility to workers for whom a lack of resources or educational preparation bars access to formal education. But clinical knowledge goes largely unrecognized and certainly undeveloped when employers are able to recruit formally trained labor abroad and public policy reinforces this bias.

The third problem with both the Silicon Valley consensus and with globalization is widely recognized and almost universally ignored. Both technology and trade policies in recent years imply fundamental structural changes in the economy. As we are quick to point out in elementary economics courses, such changes typically generate both gains and losses. The structural changes are desirable and the public policies which encourage them justifiable if the gains outweigh the losses. In other words, if there are net social gains. Where this is the case, the gainers can compensate the losers. But in fact net gains are not enough to justify such policies. In the conventional theoretical framework, the structural changes are only justified if the compensation is actually paid. And in practice compensation is almost never actually paid. This is moreover not surprising: There is no institutional mechanism to ensure that compensation will be paid. Indeed, there is no institutional mechanism for systematically weighing the gains against the losses to determine whether there is a net social benefit. The people who make the critical decisions and reap the gains are not generally linked to the people who experience the losses. In fact, it is not usually possible to trace worker displacement to particular causal factors, and certainly not the displacement of a particular worker. And if the problem is, as argued above, that the high cost of displacement in recent years is the way that technological change and globalization have been imposed together on the same communities so that alternative employment opportunities have been limited and ancillary economic activities in these communities destroyed, then you cannot really argue that the costs are directly related to any identifiable gain.

The major exceptions here are programs designed to provide training (or rather retraining) to workers displaced by globalization. Such programs exist in virtually all advanced developed countries. And in the trade debate ignited by the US presidential campaign, the only policy which has been proposed in support of trade has been adjustment assistance of this kind for displaced

workers. But such programs are everywhere also very limited in scope and their success has been limited as well, even for those displaced workers who actually get to participate. Studies suggest that the returns to participation in such programs relative to control groups of similarly displaced workers who do not participate are barely enough to yield a positive return on the investment, let alone actually compensate the worker for the loss of his or her previous job. I do not have space here to discuss the reasons for those failures in depth, but the basic problem is the institutional difference between the schools which run the programs and the businesses who first “create” the displaced workers which the programs are supposed to aid but which eventually would have to hire the graduates of the programs if the issue of compensation for those workers were to be addressed in this way. Schools and productive enterprises have different missions and face different constraints and different incentives. To take one example, schools face a hard budget constraint which leads them to minimize the wear and tear on the equipment and wastage of material used in the teaching process, whereas businesses are willing to tolerate equipment damage and material scrap in order to meet tight delivery schedules. Thus schools train workers to be, from a business perspective, overly solicitous of equipment and material consumption, and in the eyes of business, graduates from school training need to be retrained; often it is easier to hire untrained workers than to break what business views as the bad habits cultivated by the schools. Unless the enterprises take an active interest in the schools and intervene to mold the programs to their needs, the schools do not produce graduates who are useful to employers. That enterprise participation is important is now widely recognized particularly in the literature on vocational education and community colleges. What is not recognized is that getting the enterprise to take an interest in the schools is itself an institutional problem: The firms have no incentive to do so if they can find trained workers more easily in other enterprises by poaching or in other countries by recruiting immigrants.⁴ Most programs try to recruit business participation by appealing to civic responsibility. But without the pressure of labor shortages and a tight labor market, they must compete in their appeal to businesses with the Boy Scouts, breast cancer and the homeless, and it is unclear why business should care more about displaced workers, particularly workers displaced from other enterprises than these other civic ventures.

But the more serious problem is that in failing to focus on the adjustment costs, policy analysts fail to examine analytically the adjustment *process*. They do not consider the way in

⁴ See Cavaco et al (2013), Jacobson et al (1993), Jacobson et al (2005), and Kletzer and Koch (2004).

which that process is affected by the timing of trade treaties or the way in which they overlap in their impacts with other treaties or with technological change. Ideally, the pace of employment displacement should be held to the rate of natural employee attrition; this of course would for a variety of reasons be very costly and difficult institutionally to achieve (although government restrictions upon layoff and discharge do work in this direction) but policy makers do not even know how the impact of the different treaties and technical innovations they have promoted in recent years relate to each other. In retrospect, it seems crazy that in the waning years of the Obama Administration, when the political reactions in the form of the Trump candidacy and that of Bernie Sanders on the Democratic side were already setting in, policymakers were promoting two new major trade treaties, one with the countries of the Pacific Rim and the other with Europe. What could have been presented as a question of the pace and timing of globalization was instead made an issue of globalization itself. (The “fast track” process through which trade treaties are reviewed by Congress encourages the negotiation of multiple treaties at the same time). Moderation in the pace of change could in fact have been built into the treaties themselves and their impacts spread out over time, but this was not considered either.

Indeed, the analytical framework through which trade was viewed did not lead these considerations. In this sense, the failure to consider time and geographic dimensions of trade are basically symptoms of the general problem with the paradigms in which policy has been conceived in recent years, as well as with the Washington consensus which dominated thinking before them, in their treatment of structural change. They all imply major changes in the structure of the economy; they promote and celebrate such changes, viewing them generally as producing desirable increases in social welfare, at times arguing that such changes are inevitable. But they are focused on the end point of the changes which they advocate, and have very little to say about the process of change, about alternative paths of adjustment. They foresee an increase in overall social welfare, but offer no insight into the costs as well as the benefits, nor as to how those costs and benefits will be distributed. Thus the whole debate around NAFTA, arguably the pivotal point in the US turn toward globalization, was conducted in terms of “computable general equilibrium models,” focused as the name implies on a comparison of equilibria under the new and old trading regimes. Much more recently, and tragically, the sudden end of the Multi-Fibre Arrangement, which distributed the production of garment exports to the industrial world across developing countries, led to an abrupt concentration of production in Bangladesh,

which the real estate market did not have time to anticipate. Production facilities moved into hazardous buildings, one of which collapsed causing thousands of fatalities. Other tenants moved out of the building when it was condemned, but the garment manufacturer remained, fearing that if they moved they would miss the tight production deadlines imposed by the international brands and be blacklisted as a result, denied any contracts in the future.

This discussion leads to several distinct points. First, the foregoing argument implies that the Silicon Valley consensus has had the effect of divorcing the process of adjusting workers to jobs and to new technologies from the productive process itself. The result is that forms of learning and understanding which would facilitate worker adjustment are neglected. Most importantly, the key decisions which affect structural change—in technologies and in trade—are made by institutional actors who reap the benefits of these changes but escape the social cost. As a result, the costs are not only uncompensated, they easily go unrecognized as well and are not taken into account in the key decisions that determine the direction in which the economy evolves. This is true not only in the Silicon Valley consensus, but it was also true in the Washington consensus which preceded it. It was not true of institutional structures which emerged out of the first of the postwar policy paradigms, the Keynesian consensus. In the early postwar decades, businesses were not free to lay off workers when they introduced new technologies or developed new patterns of trade. The restrictions on their ability to do so varied from country to country but for the most part layoffs required the consent of government or of worker representatives or both, and typically compensation was required as well. Nor were companies free to adjust wages so as to attract better trained substitutes and thereby avoid providing training themselves or adjusting new technologies so that jobs were accessible to the existing labor force. The institutional structures which the policy paradigm sustained forced adjustment to take place within the productive sector, closely linked to the production process. This was true not only in Western Europe and Latin America, where the Washington consensus has brought those institutions under particular scrutiny, but it was also true in the US, despite the efforts in the last several decades to paint the country as the paragon of a liberal market economy.

In the US of the early decades of the post-WWII period, union seniority rules imposed restrictions that made layoff and discharge costly and adjustments in the wage structure virtually impossible. The threat of union organization imposed these restraints even on non-union firms.

Wage adjustments were further inhibited by Federal government incomes policy: The policy involved statutory wage controls during the WWII and the Korean War periods which left a legacy that persisted in the 1950s. After formal controls were lifted, in the 1960s, the wage-price guidelines were promulgated by the President and enforced by among other things public shaming and regulatory and tax harassment which had a similar effect. Statutory controls were reinstated once again in 1971 and only finally eliminated at the end of the decade (at which point, incidentally, the income shares at the top of the distribution began to diverge sharply and progressively from those which had prevailed in the earlier postwar decades).

Restrictions of this kind are not an ideal way to force companies to take into account the social costs of structural adjustment. Where individual firms compete with new companies which do not have any institutional obligations to the legacy of older forms of production, restrictions which force the enterprise to absorb the costs of structural adjustment jeopardize the efficiency and competitiveness of the economy. Obviously this problem is more serious in an open, global economy than in the relatively closed economies in which the Keynesian paradigm was conceived. But as Andrew Schrank and I have argued elsewhere (Piore and Schrank, 2016) the general systems of labor inspection in Southern Europe and Latin America have the administrative flexibility to adjust the regulations to accommodate competitive pressures of this kind. And a similar flexibility was introduced into the US system by the collective bargaining which generated the restrictions in the first place.

The point here is not, however, to promote a revival of the Keynesian paradigm nor of the particular institutions to which it gave rise and sustained. It is to use the contrast between Keynesian and the prevailing policy paradigms to overcome the limits of the frameworks in which policy is currently conceived and widen the range of approaches with which we can respond to the political pressures to which existing policy are giving rise. The institutions of the Keynesian period are not irrelevant here, but the world has changed so that they cannot be uncritically recreated. What is more relevant is the critical spirit which Keynes brought to the policy process.

This endeavor would, I submit, be worthwhile at any time. But as noted earlier, it seems particularly important at the current moment, which in so many ways resembles the interwar period where public policy was caught by surprise, unprepared and ill-equipped to respond to the political reaction against globalization.

In that earlier period, economic policy was paralyzed by an intellectual impasse between market liberalism and Marxist historical materialism, diametrically opposed to each other, but each deterministic in a way which left little room for policy innovations to address the crisis. What is most unsettling is the way in which this dichotomy is reproduced in the contrast between the Silicon Valley consensus, which is after all technologically deterministic in the way that Marxism was—however different the technological trajectory which it thinks we are forced to accommodate—and the Washington consensus, which is basically a revival of the deterministic market liberalism of the earlier period. In this context, the great contribution of the Keynesian paradigm is that notion that there is room for action. And it is that aspect of Keynes that we need to recover today.

A second point which emerges from our analysis is also captured by Keynes, in his famous dictum “In the long run, we are all dead.” The point in this context is that the dominant policy paradigms, particularly that of globalization, have focused on the far horizon, where we reach a new, long run equilibrium without recognizing the process through which we get there or the path which we follow in doing so. They do not recognize the possibility that there may be alternative adjustment trajectories or indeed that the end point might not be independent of the adjustment process. Nor do they recognize that the process may be more or less rapid, more or less spread out over time in ways that are critical to the welfare impact of change and, not incidentally given the present moment, to the political tolerance for the policies which promote it.

Finally more broadly and more fundamentally, we have failed to recognize and take responsibility for the role which public policy has played in putting us where we now are. We have subscribed to a kind of technological determinism, and ignored the role of the federal government through its financing of research and development that contributes to the upskilling of jobs and then facilitating an institutional environment which dampens pressures to prepare the labor force to meet the jobs which public policy has promoted.

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