

# **The Economic Crisis and the Neoliberal Legacy in the United States**

Michael J. Piore

*David W. Skinner Professor of Political Economy  
Department of Economics  
Massachusetts Institute of Technology*

Prepared for Presentation at:

Séminaire International  
« Dimensions sociopolitiques et économiques  
de la crise dans les pays émergents »  
Mexico City, Mexico  
November 12, 2009

## Abstract

The economic crisis and the election of President Obama promised a new era in U.S. social and economic policy, but thus far that promise has failed to materialize. This paper discusses some of the reasons why it has not done so. It emphasizes the hold of the neo-liberal framework on the country's thinking, and particularly the emphasis in that framework on monetary incentives as the major motivator of human behavior. The constraints upon the Federal budget produced by the crisis combine with the control which the government has gained over major sectors of the economy to create pressures to look for other sources of motivation and develop non-monetary instruments of socio-economic policy. A major opportunity to move in this direction is offered by the question of executive compensation in firms and sectors of the economy newly under government control. But the Administration has largely side-stepped this issue and has failed to articulate an income policy which might address the enormous disparities in the income distribution which have developed over the last thirty years. A second opportunity may emerge, however, if the economic crisis is followed by a social crisis, as happened late in 1930's and in the 1960's. The likely roots of such a crisis are discussed.

For those of us looking for a fundamental shift in the tenor and direction of American society, the last year was a moment of hope and excitement. That moment was created by the combination of the economic crisis and the election of Barak Obama as President. Together they promised to open the range of approaches to social and

economic organization which has constrained government policy for over thirty years. I am afraid the moment of opportunity is proving short-lived. The Administration has thus far failed to capitalize on the crisis. That failure appears more than anything else to reflect a singular lack of imagination. While the crisis came as a total surprise, and at least momentarily undermined the faith in the framework which guided the policy leading into it, no compelling alternative has emerged. Numbers of people claim – at least in retrospect – to have predicted the financial collapse, but not in terms which offer a systematic alternative approach to thinking about the economy and society. It is to this singular intellectual vacuum in U.S. thinking that I want to speak today. It is an admittedly narrow, parochial, and inward-looking perspective. But given the hegemonic power of the U.S. on the world stage, which ironically the crisis of our own economy actually seems to have enhanced, I trust it will be of some interest to this audience.

The nature of the problem can only be understood by recognizing the framework which dominated American policy going into the crisis and the election of 2008. That framework is captured in summary fashion by the term “neo-liberal,” a term which is widely used in policy debates in most of the world (and probably appears in most of the papers at this conference), but which significantly is virtually never used in the United States, probably because it seems to be so natural that it does not require a name. The term is a shorthand for a framework of thought which has two key components. First, and most prominent, is the notion of the competitive market as understood in standard economic theory as the template for social and economic organization. The second key component is an understanding of human behavior as motivated by narrow self interests which can generally be captured by the maximization of monetary gains. Numerous particular exceptions are recognized to this general proposition, but precisely because they are viewed as particular they have no real conceptual grounding and do not point toward an alternative way of looking at either human behavior or socio-economic organization.

It is difficult to exaggerate the hold which the basic neo-liberal framework has come to have on a very broad swath of the U.S. political spectrum, not simply on the right but extending far to the left as well. The critical difference between the right and the left in this regard is that on the left the validity of market outcomes in the distribution of income is not necessarily accepted. The commitment to the market template, however,

creates a great reluctance to challenge those outcomes through direct intervention in the market itself, and hence a desire to limit policy interventions to the redistribution of income through taxes and transfers after the market has played itself out. After-market interventions are often combined with a focus on preparation for the market through education and equal opportunity in access to education and jobs. But with these limited exceptions on the left, since the middle of the 1970's, distrust of government has been the leitmotif of successive Administrations, Democratic and Republican. Beginning in transportation and telecommunication, expanding in the 1970's and 1980's, and extending to banking and financial services 1990's, the Federal government has progressively curtailed its regulatory responsibilities and privatized whenever possible the provision of goods and services. When the withdrawal of government has for one reason or another proven to be impossible, a remedy has been sought in simulated market and market-like incentives. In this sense, incentive pay for teachers based on the test scores of their students and cap-and-trade in energy policy are all of a piece. In our international economic relations, the U.S. has aggressively sought to impose this approach to policy on other countries. We have insisted in our trade treaties on a set of standard market institutions in other countries; and in the international economic institutions, where the U.S. exercises a hegemonic influence, support for stabilization and development loans have been made conditional on policies which promoted those ends.

The change in the economic and political climate last fall challenged this framework in a number of respects. First, the collapse of the financial markets challenged the reliance on the market as an effective and efficient organizing institution and implied the need for alternative modes of organization. Second, the collapse of the financial markets was widely blamed on the nature of the incentive structure which governed the behavior of the agents in that market, and suggested the desirability, if not the possibility, of alternative motivating mechanisms.

Third, in the attempt to address the crisis, the government was compelled to assume direct control over a major part of the financial services industry and the automobile industry. It then faced the problem of how to manage these new responsibilities; the idea that this problem could be resolved by the market was obviously no longer a sufficient guide to public policy, once they had been removed from direct market control and placed in the hands of government authority. It was further limited by

the fact the political reaction to the crisis, and to the role of the now government controlled firms in producing that crisis, precluded (or at least seemed to preclude) continued reliance on the individual monetary incentives upon which the internal management of the firms when in private hands had depended, and called for alternative mechanisms of management and control which the neoliberal framework could not provide. Fourth, the new administration brought with it commitments to programs which further extended the direct role of government in the management of the economy in several additional sectors, particularly in energy, environment and medical care. These added to the Federal responsibilities in primary and secondary education which had already been expanded by initiatives of the Bush administration which the Obama administration adopted and promised to expand still further. The story about the schools is much too complex and involved to recount here, but it underscores both the way in which the neoliberal conceptual framework has guided American policy and the limits of the guidance it has provided.

Fifth, the attempt of the federal government to address the crisis through the “bailout” of failing firms in the private sector and through an enormous stimulus package have greatly expanded the government’s budget deficit, limiting the degree to which it is feasible, at least politically if not economically as well, for the government to rely on monetary incentives in motivating and directing behavior. Finally, the new administration has brought to power individuals and political forces that are greatly disturbed by the trends in the distribution of income over the last forty years. These trends are striking. Since 1980, the incomes at the very top of the distribution (the top one percent) have increased progressively while the incomes of the remainder or the population have essentially stagnated. Virtually all of the gains in productivity have been allocated to earners in the upper tail—this in sharp contrast to the first three postwar decades when incomes throughout the distribution rose by about the same rate as labor productivity. These trends have been produced in no small measure by reliance on market mechanisms and monetary incentives. It is not clear that they can be addressed through taxes and transfers alone without direct intervention in the market. Indeed at the moment, it is fair to say, I think, that it is not clear even how to think about this problem, let alone to address it.

The scholarly discipline that actually offers a way to think about these problems is not economics but sociology. Classic sociologists such as Weber and Polanyi offer one series of insights. In contemporary social thought, the most relevant is the French school of economics and sociologists, the Conventionalists, which unfortunately has attracted very little attention in the United States. There are two dimensions of sociological thought which bear on this problem. One relates to the question of what is required to create and sustain a market (actually not simply a market but any set of institutions and organizations). The other is about what motivates human beings and governs their behavior. In terms of the issues which need to be addressed at the current juncture in the United States, it is the latter which I would emphasize. And for these purposes, I would draw two broad lessons. One is that financial incentives are not the only way, perhaps not even the most important, to motivate and direct behavior. Second – a lesson developed particularly by the Conventionalists – is that the incentives which do govern behavior, whatever they are, are embedded in and derive from a much broader belief structure which includes a system of worth (*grandeur*) and system of tests (*épreuve*) and that belief structure with its accompanying system of worth and its tests are embedded in a particular structure and organization of work (or perhaps more broadly, activity).

These lessons are particularly important for addressing the problems posed by the new role of government in the medical care field, in energy, in education, and in financial services. In each of these domains, members are evaluated by a particular system of worth and measure of performance which is in principal separate and distinct from a system of financial rewards. The medical profession evaluates its members in terms of the care of the sick; the teaching profession in terms of care of the students. In energy and its impact on the environment, a generation of engineers is emerging in the U.S. who judge themselves and each other by their contribution to addressing the problem of global warming, rather than as so many of their colleagues, by their financial success. The question is whether these local systems could be used in place of financial incentives to manage the sectors of the economy where they are present. The second is the relationship between financial systems of valuation and evaluation and other such systems. The two questions are related in the sense that financial (monetary) gains have become the dominant system of evaluation in U.S. culture. Is it possible for other systems to co-exist with it in subcultures of the society or will the financial ethos drive

out everything else? Could one motivate doctors or teachers, particularly, in some other way?

The more general problem of which these questions are a part is how a single, coherent society is composed out of a series of component parts each of which has its own particular system of evaluation. What I miss in the sociological literature in its preoccupation with theory of local systems is an answer to this global problem. Obviously that problem becomes greater the more people move across different local systems in the course of their daily routines or in their careers over their lifetime. It would thus seem to be particularly difficult in the United States, given the geographic and social mobility which is characteristic of American society and central to the nation's own definition of itself. That problem would seem to have been further aggravated by the shift in economic organization away from large, closed corporate enterprises and well defined professions and crafts toward the "borderless" economy. The individualism of the American ethos poses this problem in the extreme in the sense that it allows—even encourages—each individual to have his or her own system of evaluation. It is, one could say, the Protestant problem.

Reliance on financial reward can be viewed as a solution to this problem: It makes all of these local, in their essence incommensurate, systems of evaluation commensurate. This indeed is the role of money, and the market, in economic theory. It is then follows that the mobility and the individualism of American society should make financial rewards especially attractive there. By the same token, the attempt to move back toward local systems of evaluation, once the hegemony of financial evaluation has been established becomes especially difficult.

On the other hand, the area in which Obama has had the greatest success thus far has been to redefine the national ethos and mission. He has been especially adept in doing this in the international arena, although we have yet to see whether his success in this respect is as successful for Americans themselves as it seems to have been for foreigners. And whether he will be prepared to do that in the country's international economic policy, as opposed to in military and human rights, remains to be seen. Thus far, he has not really attempted to move the country to turning away from monetary evaluation in evaluating worth.

A major opportunity to do so is offered by the debate about limits on executive compensation in the financial bailout package, and about the regulation of financial services more broadly. The public has demanded that executive compensation be limited at least in those companies in automobiles and financial services over which the government took control. The President initially echoed the public indignation and seemed to endorse such controls. But in the end he backed away from his own rhetoric. He opposed the limits in congressional proposals and he failed to propose alternative standards of evaluation of his own (perhaps because he did not know what to propose). Ultimately, he did appoint a “czar” to evaluate executive pay, and restrictions were indeed imposed last week. More significantly, the Federal Reserve has imposed limits on compensation throughout the banking system. But significantly these limits have been imposed quietly – the President himself has kept a distance and sought to dampen the public perception of any movement away from the market model. But the restrictions have focused exclusively on issues of risk and risk management incentives, a discourse which reinforces the neoliberal message about markets and motivation.

The issue has reemerged in the medical insurance debate. Under pressure to control the costs of the reforms the Administration is proposing—which has become the centerpiece of his legislative program—the President has made broad allusions to the professional ethos of the medical care profession as an alternative to financial reward, but he has yet to translate that ethos into specific proposals. And it is very hard to limit the compensation for doctors when one has been unwilling to do so in management compensation or in the compensation of stockbrokers and derivatives designers. An additional contradiction has been created by the Administration’s willingness to endorse, and exert considerable pressure on state and local governments, again through the economic stimulus package, to adopt payment systems in primary and secondary education which link teacher pay to the standardized test scores of their students.

Watching the way in which this has played itself out among my students and colleagues at MIT over the last ten years, there is an additional factor involved here. For some important vocational subcultures of American society, local criteria of evaluation and financial criteria have actually come into coincidence with each other. This seems to have begun, not with the financial revolution of the last several years but with the dot.com boom in the 1990’s. Before the dot.com boom, students (who were asked to

write in a class paper assignment about their careers) felt a strong tension between financial success and what they themselves characterized (drawing the term from assigned readings of Weber's Protestant Ethic and the Spirit of Capitalism) as vocation, i.e., the interest and excitement of engineering or science, and they professed a deep ambivalence about the choices they saw themselves as being forced to make between the two.

But in the course of the 1990's, that tension and ambivalence disappeared; students began to feel that they could have both financial success and a creative and intellectually stimulating and satisfying professional career. Indeed, they came to see the former as a reflection of the latter. The bursting of the dot.com bubble of course challenged this belief, but faith was restored by the financial bubble which followed; indeed the two overlapped in the sense that much of the financial services industry focused on the high tech sectors for which the MIT students were being trained. And the innovations in financing instruments drew upon MIT students' applied math skills and training, so much so that by 2007, 50% of all MIT (basically an engineering and science school) grads went into the financial services sector. Moreover, innovations in financial instruments (particularly derivatives) were viewed as particularly interesting and challenging. Indeed, one MIT finance professor in a seminar in which he admitted the role of new financial instruments in the crisis reluctantly endorsed the kind of government intervention in the markets associated with the rescue plans of the fall of 2008, exclaiming even as he did so: "But they are so clever!" Thus, if we can no longer use monetary rewards in the way we have over the last two decades to test and rank people in these professional sectors, we will have to change the ethos in which they have come to be embedded.

Finally, the difficulty of separating local and global ethos' of evaluation and moving away from financial incentives has been complicated still further by Obama's election as President and the role he has chosen to play as an African-American president. The problem here is that the heavy reliance on financial criteria in evaluation of worth is embedded in the highly individualistic ethos of American society. The real exception to the individualist ethos in the U.S. has been the African-American experience, where the role of history and structure in determining outcomes have been consistently recognized, particularly among African-Americans themselves, but also



more widely, albeit less consistently, in the country as a whole. But Obama as President (but also as candidate) has gone out of his way to deliver a message that African-Americans must take responsibility as individuals for their own fate. The subtext of this message, at least as read in the African-American community itself, is that one must take individual responsibility despite the fact that the structural impediments to success are much greater than those for whites, because that is the only route to a sustainable, dignified life. The problem is that as President, he is not speaking to the African-American community alone but to the country as a whole, and in this larger arena, the message does not carry the qualifying subtext at all. The individualistic message, and with it, the equation of personal and financial success, is reinforced by the spectacle of the black elite which has been so prominent in the President's social calendar, because what the members of this elite have in common with each other and with the other elites which have preceded them historically on the White House stage, is financial success. This too is ironic, because the black elite, probably more than any of the earlier elite groups entertained at the White House, earned their financial success in professional communities—particularly in sports and entertainment—where there are definite standards of *épreuve* and of *grandeur* which are independent of and distinct from financial success, however much in these fields as in the vocations of MIT students, the two sets of standards have come to coincide.

## II

The impact of the new administration and the economic crisis which brought it to power is, however, far from over. In the past, a change in the tone and tenor of American politics as sudden and profound as that from Bush to Obama – the shift from Hoover to Roosevelt in the 1930's and from Eisenhower to Kennedy-Johnson in the 1960's – have been followed by a period of rising political mobilization and extra-electoral political pressure, ultimately addressed through fundamental changes not only in social policy but in economic policy as well. No such mobilization followed the shift from the Reagan-Bush to Clinton in the 1990's. But that transition was not accompanied by an economic crisis – certainly not one comparable to the Great Depression, but not comparable either to the economic malaise of the late 1950's and early 1960's. The mobilization of these

earlier periods, moreover, occurred not at the moment of the electoral transition nor at the nadir of the economic crisis itself, but only in the ensuing recovery, as if it represented an expression of rage and frustration which became manifest only as the threat of unemployment and income loss began to recede. Thus the sit-ins and plant occupations which sparked the industrial union movement occurred in the 1935 recovery, and the Northern civil rights agitation and riots erupted in 1964 and snowballed in the economic boom which accompanied the Vietnam build-up of the late 1960's and early 1970's. If a comparable mobilization follows the present recovery, the Obama administration will get a second chance to articulate an alternative to neoliberalism.

There is a second, more fundamental, reason to think that we are likely to face a social crisis in the coming years comparable to that which produced the trade union movement of the late 1930's and the Northern civil rights movement in the 1960's. And that lies in the nature of the social revolution which actually occurred in the last thirty-five years. This revolution has generally been understood in terms of the enormous increase in the dispersion of wage and salary income, the rise in the incomes of the very top earners at the expense of almost everyone else, the collapse of trade union organization in the private sector and the deterioration of wages and working conditions at the bottom of the labor market. Understood in these terms, it constitutes retrogression in social justice and in the welfare state. But if one thinks of social policy not in the terms in which it was conceived in the New Deal, not in terms of individuals or economic class, but rather in terms of groups of economically disadvantaged and socially stigmatized people, a very different picture emerges. Understood in these terms, the last thirty-five years produced an enormous expansion in the felt sense of social welfare and equality in American society. Measured by race, sex, age, ethnicity, physical handicap, and sexually orientation, the years were marked by a change in social status unimaginable to earlier generations. The opportunities of women today are immeasurably greater than those of the mothers. This generation of aged is more secure and better cared for than their parents and grandparents. The physical landscape has been completely redesigned and rebuilt to accommodate the handicapped. And the major ethnic groups have come to be populated by new immigrants who compare their position in this country to that of those they left behind in their countries of origin.

But it is precisely these gains of the last thirty-five years which suggest that a social crisis is on the horizon. It is inconceivable that any of these groups could experience comparable gains in economic welfare and social status in the coming years. Gains for women in fact leveled off in the last decade; the female labor force participation which had expanded progressively for over one hundred years stabilized and even declined slightly in the last decade; and the wages of women relative to men, which have grown since the 1970's have leveled off. The obligations to the aged through Social Security and Medicare are already straining governmental budgets, and it is difficult to see how they can be sustained let alone expanded as the aged population grows in the coming years. The landscape cannot be changed again for the handicapped.

Most ominous of all, the key ethnic groups are increasingly populated by a second generation of immigrants, whom whatever their place of birth, grew up in the United States and compare their social status not to their parents' villages but to that of other American natives. Not only do they feel trapped in their parents' jobs, but a significant proportion, perhaps as much as half, are undocumented and hence barred from the more prestigious parts of the American labor market. Significantly, the social movements of the 1930's and the 1960's were led by second generation migrants rebelling against the jobs of their parents; the sit-in strikes in the 1930's by the children of European migrants who grew up in the settled communities which emerged after new immigration was stopped first by World War I and then after the war by legislation. The black leaders in the North were the children of the great migration out of the South which began in World War II, and had largely run its course by the early 1960's when the percentage of African Americans living in the North leveled off.

In the current period, blacks may constitute the major exception to the sense that potential for the felt sense of social progress geminated over the last thirty-five years has been exhausted. Certainly, the election of a black president kindled a sense of progress for the current generation at least as great as that of their parents. This is enhanced because of all the previously disadvantaged and socially stigmatized groups, progress of African-American in the last generation has been problematic. For many African-Americans, the gains here are at most of symbolic value. The civil rights revolution spawned the public policies and social changes which has made the advancement of the other groups possible. Roughly half of the black population was able to take advantage

of these opportunities to move into the middle class, but the other half have been trapped in the inner cities, with limited access to jobs, high rates of unemployment, incredibly high rates of incarceration, and menaced by crime, violence, and alcohol and drug addiction unknown by earlier generations. Median black income relative to whites has not changed since the early 1970's.

It is hard to see how the problems of the disadvantaged and socially stigmatized, particularly blacks and second generation immigrants, can be addressed through further gains in upward mobility within the existing, totally skewed distribution of income. Even if Obama's lecturing to fathers about their responsibility to their children and to the children themselves about the importance of doing their homework were eventually to change the sociology of the black underclass, it will not do anything for the current generation of young adults. For them and for the second generation of immigrants – as well the lower half of the income distribution for women and even the aged, further progress will depend on the characteristics and income offered by the jobs they already hold.

But if these groups do mobilize and the society turns to discuss in a systematic way conditions at the bottom of the labor market, anger and resentment are only likely to increase. The truth of the matter is that for all practical purposes we have stopped enforcing our labor laws, particularly at the bottom of the labor market. The U.S. and Mexico, to whom the low wage economy especially is bound by NAFTA, are practically the only countries in the world who devote less resources to the enforcement of labor market regulation today than they did ten years ago (to say nothing of thirty-five years ago). Protection for private sector union organization has been eroded by administrative ruling and court decisions; enforcement of the minimum wage and health and safety protections has been starved of funds. The regulations themselves have been progressively interpreted in a way which encourages evasion. And indeed employers no longer see respect for this aspect of the law as the obligation of good corporate citizenship.

The extent to which things have deteriorated in this domain were revealed by an investigation of New York City greengrocers, where no one seemed to be paying the legal minimum wage. When they sought to understand why this was the case, they discovered that the grocers belonged to an association which gave them a list of the laws

and regulations to which they had to comply. The list included taxes, building codes, licenses, health regulations for the treatment of their merchandise, etc., but labor regulations were completely absent from the list. Somehow, over the years in which the industry developed in New York City labor regulations have fallen out of view.

The Obama administration gives lip service to labor conditions but it has thus far done nothing to address them and it is clear that they currently rank very low on its list of priorities. The Secretary of Labor was the last cabinet appointment, and was totally excluded from the economic team, which were the very first appointments the President made. This stands in stark contrast to the Clinton Administration in which the Secretary of Labor, Robert Reich, was a strong (albeit ultimately unsuccessful) economic advocate, and labor policy was at least initially conceived in the context of the Administration's economic program. Even more disturbing in terms of low wage labor regulation, the key labor department regulatory appointments are being held up in the Senate by delaying tactics which the Democratic Administration and the Congressional leadership have tolerated, although they could, and still can, easily prevail against them.

If a social crisis focused on low wage jobs does develop, the Administration will have to make major revisions not only in its policy priorities but in its approach to economic policy to get out in front and address it.