Critiques of Economics

A New Political Economics—and Political Economy

Amitai Etzioni

It was deregulation that caused the credit crisis, says this long-time economic observer. He says mainstream economics provides a gloss of mathematical certainty to what has become an ideology. That must be recognized and be changed.

To understand how we got ourselves into the recent near-global economic crisis—and more importantly, how we can protect ourselves from falling into another one—we need a new economics, a *political* economics. It must merge what we know about intra-economic processes (such as the negative effects of deficits, inflation, and trade imbalances with, say, China) with a systemic understanding of the main players who wield power over the economy, to reach an understanding of the ways their game may be changed. For instance, how can we get Washington to regulate the banks, rather than the banks' getting Washington to do their bidding? Fair warning: have your box of tissues nearby.

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During the first year of the crisis, we were bailing out as if there were no tomorrow to be sure that the world economy would not sink into a global depression. Now that this danger has been averted, we are more of a mind to look for who torpedoed the ship, who was asleep at the wheel, and how to restructure the political economy to avoid such crises in the future. According to several key observers, while there is enough blame to go around—Floyd Norris at the *New York Times* believes we were done in by accountants—economic theory (and economists) belong at the top of the list.

Paul Krugman, himself a Nobel Prize winner in economics, reports that economists—both the mavens we trust to serve as leaders of major institutions like the Fed and those who command the president's ear—failed miserably. They did not expect the crisis, did not understand what was happening as it was occurring, and are confused about what is to be done now. Krugman proceeds to provide a long list of technical and conceptual reasons that economists' blinders were, well, so blinding.

Even the *Economist,* usually a cheerleader for economists, started examining "what went wrong with economics" with the observation "Of all the economic bubbles that have been pricked, few have burst more spectacularly than the reputation of economics itself." The magazine then proceeds to show that the bust was quite justified.

Others who have long called economics "the dismal science" showed that economics confuses what "works" in neat mathematical models with real-world results, is given to wrong predictions and tautologies, and is arrogantly dismissive of the insights of other disciplines, especially psychology.

To be fair, not all economists are birds of the same feather. There are green, Catholic, social, and still other kinds of economists who march to different drummers. However, in the Anglo-Saxon world, such economists are highly marginalized. When Americans speak of economics, they refer as a rule to the dominant school, namely neoclassical economics, which is relied upon by our policymakers. It is the only brand of economics discussed from here on.

As I see it, the main failing of economics is that it provides a scientific gloss, an aura of empirical evidence and mathematically assured

logic, to an ideology, namely an attenuated, soft form of libertarianism. (A more accurate term may be laissez-faire conservatism.) The key tenets of textbook economics are that people are rational beings who know what is best for them; that if they are freed from "distorting" government "interventions," the aggregations of their choices will drive the economy to do ever better for all concerned; and that the market is basically a self-regulating system.

The reasons these tenets of what economists themselves call "orthodoxy" sound very familiar are highly revealing. Economics is not merely an academic discipline, like biology, or a profession, like medicine. It also feeds and reflects a particular worldview, a view of how the world around us is composed, functions, and might be harmed or improved. Economics helps to inject antigovernment, libertarian ideas into the minds of millions of students who are exposed to economics in high school or take it as part of their distribution requirements in liberal arts colleges. Moreover, economists urge voters and policymakers alike to embrace the idea that the less the economy is managed by the state, the more golden eggs that wondrous goose will lay.

I choose my words carefully. I do not claim that economics introduced libertarianism into the worldview of the majority of Americans. It has deep roots in American history, in the high regard accorded to rugged individualism and being left alone, and in the suspicion of all authority, especially that of the state. (The mirror opposite is continental Europe, where the state is assumed to be on your side, the one to take care of you.) Economics "merely" undergirds these beliefs by implying that they are as empirically valid as the observations of physics.

Some of my distinguished colleagues in economics departments will scream bloody murder here, pointing out that they are life-long, left-leaning Democrats, that they do see merit in some kinds of government interventions. A fair number favor labor unions, wealth reallocations to benefit the poor, and other liberal measures. Fair enough. However, they do so either by carving out exceptions to the dominant economic theory or by creating pockets of deviance (appropriately called "heterodoxy"). But for the discipline as a whole, the default is free choice—free from government intervention.

This too-brief retracing of the basic tenets of economics provides the key clue to a major culprit of the 2008 crisis, and hence he whose moves must be next arrested. It was not Alan Greenspan, who is blamed for having kept interest rates too low and not bursting the housing speculation bubble, although he may have contributed to the crisis. It was not those who sold mortgages to homeowners despite the fact that they knew well that these owners would be unable to keep up the payments. Nor was it engineered by banks that sliced and diced these mortgages and stuck others—gullible or stupid or irresponsible—with the risk. Nor was it greed, which has been around since the seven sins were first recorded. All of these were intermediate or secondary causes. The main immediate cause was deregulation, the grand change in public policy that reflected the "less-government" ideology—sanctified by economists. It started in earnest in the 1990s and took off with a vengeance during the Bush administration.

True, both libertarian ideology and neoclassical economics have been with us for a long time. Indeed, a reading of American history shows that the same combination pushed us into previous difficulties—most recently, the savings and loan debacle and, before that, the depression. There are those who argue that American history shifts back and forth between liberal eras, in which expanding the role of the government—especially regulation—is favored, and conservative ones, in which its role is curtailed. Actually, American history is dominated by antigovernment periods that are interrupted by short liberal intervals, the last of which took place during the Johnson administration. Since the election of Reagan, the precept that government is the problem and not part of the solution has come to dominate the American view of the federal government. After the election of George W. Bush, it gained further support from an aggressive White House, a Republican majority in Congress, and above all, the courts—including the Supreme Court—which were loaded with judges who sought to, and did, "free" the markets.

All this came to a head with the removal of many state-based barriers to greed, some of which had been in place since the Great Depression. This included the repeal of the Glass-Steagall Act in 1999, which had previously prevented commercial banks from trading in risky financial

instruments; the passage of the Commodity Futures Modernization Act in 2000, which prevented the regulation of complex financial derivatives; a 2004 SEC decision that instituted a policy of "voluntary regulation," which allowed the five biggest investment banks to take on unprecedented amounts of debt; and the Credit Rating Agency Reform Act of 2006, which failed to effectively regulate the credit-rating agencies that were supposed to alert investors to potential risk. Given free range, banks, real estate agents, investment houses, and their ilk did what comes naturally to them: they maximized their profits, with little concern about the longer-run effects of their enrichment on others and even on their own businesses.

The guilt of this main culprit—the one that economists blessed and the public cheered—can be determined without a doubt by examining what did *not* happen in those nations that maintained strong government controls over what financial institutions could do. These include developed countries, such as France and Germany, as well as emerging nations, especially China. In contrast, among the nations hardest hit were those that had instituted almost as much deregulation as the United States, and especially the United Kingdom.

The second failing that neoclassical economics promotes—and which blinds us to what must be done—is a profound misunderstanding of the political dynamics involved. The main body of economic theory—which greatly influences our public deliberations—treats the markets as if they were free-standing and focuses on resetting the dials that control its internal processes: raise or lower interest rates, promote saving and free trade, and so on and on. To the extent that relationships to the polity are studied and elucidated, the focus is on government "interventions" in the marketplace. Most times, the fact that economic actors—banks, investment firms, corporations, labor unions—interfere in the work of the government goes unnoticed. However, we will not be able to form the kind of policies that will protect us from future meltdowns unless we understand who prevents the government from doing its job and, above all, how the political lineup may be realigned. In short, *we need a new political economics to help us form a new political economy.*

In thinking about this matter, I find it useful to think about nuclear energy. A nuclear power plant, well equipped with warning systems, cooling mechanisms, and proper controls that do not interfere with the fission processes taking place within this fortified container, can be a major boon. It can provide ample low-cost, environmentally friendly, secure energy. The main danger is not in the nuclear fission itself, but in those who seek to weaken the container. Granted, there is room for arguing about when the container is too expansive and when it begins to thin out, but the main point is that the container is not the source of the problem but an essential part of the solution. The economy, like fission, is not self-regulating; it requires the powers of the state to contain it. We need an economics that studies which are the best containers rather than one that de-legitimizes them—one that supports a pro-state (European, if you wish) view of the economy and polity and helps identify the political forces that can bring about the essential state controls.

To proceed, we need a political analysis that will inform us who is locking us into a course that is sure to lead to more meltdowns and which forces may help save our future. One major virtue of such an analysis is that it reveals that there are many power players, large and small. That is, we do not face one consolidated power elite, the way C. Wright Mills had it, or a military-industrial complex, the favorite bugaboo of the left, but a much more complicated array of players who sometimes work together and sometimes clash. It is this cardinal fact that gives the system more play and, frankly, more hope than it would have if there were one monolithic force in control, say the ruling class, against which populists love to rail. For example, while the U.S. Chamber of Commerce is strongly opposed to the cap-and-trade approach to saving the climate, a whole slew of corporations openly broke with the chamber and now support the cap-and-trade bill, including Nike, Apple, Exelon, Pacific Gas and Electric, PNM Resources, the Public Service Enterprise Group, and Levi Strauss. And while Ron Paul, Glenn Beck, and Bill Frist rally against the estate tax, a whole bunch of billionaires called for its reinstatement.

In addition, such an analysis reveals that in contrast to democratic

theory and the hope of many reformers, voters are often a weak sister. Their voice is mainly heard once every two or four years, and even then, half of them sit on their hands. Each voter has but one vote and hence does not have a say on specific issues, such as deregulation or bailouts for banks but not for people. Also, voters' thinking and choices are affected by the worldview they absorbed long ago and by campaigns run by the main political-economic players. Above all, in between elections—when Congress enacts thousands of laws, the White House issues hundreds of rulings, and the courts issue numerous judgments—there is very little voters can do. (This is, by the way, the reason fireside chats, addresses from the Oval Office, and even speeches to joint sessions of Congress do not provide much of a boost for needed reforms.)

It is no wonder that those who expected that Obama's election by a majority would change the political-economic landscape are increasingly disappointed. Right now, he is not dealing with voters, but with the economic-political powerhouses. And currently, the most powerful ones oppose meaningful re-regulation, an essential step required to avoid future meltdowns. Hence one should not expect significant reforms in the way financial institutions are governed (or not governed) or the way the market is allowed to run amok—until there is a change in the distribution of economic-political power.

To determine who the main players are, to establish how new players may enter the arena (say a social movement that champions regulation), how opponents may be flipped (for instance, suburban, college-educated Republicans), and above all how the pro-change players may be combined to form a pro-change coalition, we need a new kind of economics. We need to understand the ways the new coalitions were formed that made it possible to launch the New Deal and the Great Society and—in Britain—the New Labour party, which brought the change party into power after decades of exile and kept it in power for three terms, and, above all, the ways these political changes that deeply affected economies in earlier eras can be applied to our tomorrow.

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