

*The world's economic and political order reels under mounting challenges: the global financial crisis, the austerity debacle, a slowdown in economic growth and productivity, the aggravation of inequality and the inadequacy of conventional responses to it, the discrediting of the Washington Consensus, the globalization backlash, the re-emergence of nationalist politics in Europe and the United States, and a contest over the meaning, value, and requirements of democracy. We examine connections among these phenomena and explore alternative ways of thinking about contemporary market economies and their reconstruction. We organize the course around four related themes: the worldwide financial and economic crisis of the recent past and its management; the effort to promote socially inclusive economic growth in richer as well as in poorer countries; the nature, fate, and dissemination of the new knowledge-intensive style of production; and the past, present, and future of globalization.*

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## Previewing the debates: economics, inequality, and the rise of populism and illiberalism in advanced and developing economies

### Rodrik

#### *Brief history of political economy*

- Mercantilism: maximize gold in sovereign coffers
  - All economic activity in service of sovereign → private greed is bad, market highly regulated with guilds/cartels, monopolies
  - Maximize exports, minimize imports → trade surplus is good
  - Politics organized around absolutist/corporatist lines, sovereign hands out power at their discretion

- Classical liberalism: markets and private initiative leads to prosperity
  - Well-being measured not by gold but by satisfaction of individual preferences: consumption
  - Need minimal state: defense, property rights, justice
  - Markets should be as free as possible
    - \* Close correspondence with today's libertarianism
    - \* Want markets separated from politics
- Welfare state: markets are not self-creating, self-regulating, self-stabilizing, self-legitimizing
  - Reaction to Great Depression and interwar turmoil leading to New Deal
  - Labor organization, expansion of franchise, mass media
  - Embed markets in a range of institutions: regulatory, redistributive, monetary/fiscal, conflict management...
  - In practice, Keynes + welfare state + industrial policy = government acts to structure the economy
  - National rather than global system of capitalism
    - \* Bretton Woods regime: slow down international commerce and finance
- Socialism: capitalism is based on exploitation of labor; history is history of class struggle
  - End goal is public ownership of means of production
  - Socialism not incompatible with markets or with democracy
- Neoliberalism:
  - Arose from postwar boom + oil crisis, stagflation, debt crises
  - Keynesianism doesn't work, markets are over-regulated and states overextended
    - \* So, must stabilize, privatize, deregulate → financialization, removal of price controls and trade barriers
  - Hyper-globalization, financial globalization, WTO, regional trade agreements, Eurozone/single market
- Different models rooted in different ideas of human nature, normative frames, ideas of how markets work (self-stabilizing and benign vs. unstable and exploitative), conceptions of politics
- This class responds to increasing *productive dualism* in developed countries – some sectors doing much better than others – which is normally a feature of developing countries
  - And to premature deindustrialization in the developing world
- Populism: claim to represent “the people” + rejection of restraints on use of executive authority
  - Political: aversion to institutions of liberalism, independent courts, etc.
  - Economic: aversion to independent regulatory agencies, independent central bank, eternal restraints

## Unger

- Goal is to define the conditions of socially inclusive economic growth: maximum theoretical and programmatic ambition combined with minimum technical complication
- Take up 3 issues:
  1. Political context of argument, especially in North Atlantic
  2. Address organization/alternatives to market economy (the foreground theme of the course)
  3. Address character of ideas we need to pursue this (the background theme of the course) aimed at a redirection of the social sciences themselves

## Political context

- In politics, the last great moment of realignment was in the mid-20th century, post-WWII
  - Established the social democratic/social liberal consensus (in the US, this is the New Deal)
  - Was a bargain between forces that wanted reshaping and that didn't

- \* The state was allowed to regulate, attenuate inequality through taxes and transfers, manage the economy countercyclically
- Involved a social compact between capital and labor
- This settlement has been eroded as a result of the cumulative impact of:
  - \* The change of the dominant paradigm of production from industrial mass production (standardized goods and services produced by specialized machines), hierarchical structures, semi-skilled labor, factories, big corporations to the knowledge economy
  - \* The financialization of the economy: finance detached from the productive agenda of society
    - Sector absorbs profits, talents, human energy and threatens to turn finance into a bad master, not a good servant
  - \* A particular form of globalization which constrains attempts to create alternatives in national space
- The combined impact has been to diminish growth and confine it to the fringes of a new vanguard of the knowledge economy, and to increase economic inequality and insecurity
- Left-of-center and right-of-center parties have responded by promoting greater flexibility in labor markets – which is a euphemism for insecurity -\* and offering regulatory/redistributive compensation through taxes and social spending
  - \* This response is inadequate to master the effects of inequality and insecurity
  - \* Working people feel abandoned by their political representatives
  - \* Centrist political forces have abandoned the attempt to craft a strategy of socially inclusive economic growth
    - In the US today, there *is* no strategy of economic growth
    - The residual strategy is “cheap money,” executed by a central bank: expansive monetary and fiscal policy
  - \* This creates a vacuum into which populism has risen
- Populism: old (benign) American conception was to defend the working-class interests
- The European definition:
  - \* With respect to policy: solve structural problems via non-structural means offered in the name of the people in an attempt to create a new basis of division
    - On the left: monied vs. moneyless → expansion of redistributive entitlements
    - On the right : foreigners vs. natives → imposition of restraints on migration
  - \* With respect to political action, pushes limits of established institutions → Caesarism, anti-institutional agitation
    - Premise is that we have to choose between the cold/institutional and the hot/extra-institutional (between Madison and Mussolini)
    - Excludes idea of institutions that raise engagement in political life

#### *Organization and alternatives to the market economy*

- In the national space, there are three themes:
  - The relation of the backward to the advanced parts of production
    - \* New vanguard of the knowledge economy, dedicated to permanent innovation but confined to fringes that exclude the majority of firms and workers
      - This drives stagnation and inequality
    - \* How do we make insular vanguardism more inclusive?
    - \* How do we change this rather than correct it after the fact?
  - The relation of labor to capital
    - \* Labor force consigned to precarious employment → degeneration of situation of labor vs. capital

- that seems incompatible with a sustained, inclusive rise in productivity
- \* How do we redirect this? In the short term, address precarity; in the long-term, increase potential of new production to change the relationship between the worker and machine
  - Potential for a different kind of relation – will technology result in unemployment/underemployment through automation that replaces labor?
- The relation of finance to production
  - \* Indifferent in good times, destructive in bad times
- Connected to debate over globalization: imposes convergence to a particular kind of market economy
  - Forbids the kind of coordination that rich countries used to become rich
  - Enhances ability of capital to punish attempts to deviate

*Background theme: where do we get our ideas?*

- Largely from the discipline of economics
- But we need more than the ideas it provides to understand even economic problems
- Each of the social sciences has severed the link between insight into the actual and the imagination of the adjacent possible

## The debates about economic growth and development

**Unger**

Today, address:

1. Basis for takeoff of Europe, basis for all subsequent expansions of growth
  2. Growth “miracles” after initial takeoff
  3. Emerging debate about growth and development today
- Until Industrial Revolution, growth was slow and fragmented
    - Agrarian empires: Chinese, Mughal
      - \* There was a recurrent problem that smothered growth and decentralized economy
      - \* Divided into imperial center, landholders, tradespeople/workers/peasants
      - \* Rulers depended on success in constraining magnates: state needs base of taxes and recruitment
      - \* Characteristic policies to limit greed of magnates
      - \* Not squarely on the side of the people → revolution
      - \* Repeatedly, imperial center failed to constrain landholders → fell apart, invaded, market order reverted to barter economy
    - In Europe, pattern broken by disintegration of Roman empire
      - \* State formation delayed, highly fragmented with space for independent personalities of towns
      - \* Nobody planned this
      - \* Consequence was an irreversible level of social, cultural, economic pluralism
    - Development of natural science that tried to understand nature beyond perceptual experience
      - \* Counterintuitive understanding of nature
      - \* Object is insight into transformations of nature to be used for our own benefit
    - Technological innovation is endogenous to growth process
      - \* Technology is a materialization of the conduit between experiments in the transformation of nature and experiments in cooperation with each other
      - \* Based on science and depends on opening of space by social/economic/cultural pluralism

- \* When we can express formulaically, we embody in machine
- Underlying assumption is the relationship between technological/economic revolution and background/society
  - \* Marx: development of forces of production requires revolution in the mode of production
  - \* Illusions:
    - 1:1 relation between level of development and way of organizing economy
    - Deterministic: closed list of modes of production, laws governing their succession in history
  - \* In fact, there is no 1:1 relation, but there seems to be a direction towards greater flexibility and plasticity
    - Trust and common purpose against different backgrounds
- Persistent elements of growth miracles: the mobilization, the opening, the shield. Ex: US in first half of the 19th century
  - Mobilization: never spontaneous, needs elite vision and strategy to mobilize national resources to the end of developing a new comparative advantage
    - \* In the US, this was Alexander Hamilton
    - \* War economy without a war: massive mobilization of resources, physical construction of country
    - \* Use of national debt to finance mobilization
    - \* Overarching and selective protectionism
  - Opening: in the 2 most important sectors, agriculture and finance, America had a “selective democratization” of the market order
    - \* Didn’t just regulate and attenuate retrospectively – innovated in legal and institutional architecture
    - \* In agriculture: rejected agrarian concentration, distributed land on frontier, strategic coordination between government and family to protect family farming against unique risks through price supports, land grant colleges, stockpiles
      - Promoted “cooperative competition,” leading to economies of scale
    - \* Finance: Andrew Jackson dissolved 2nd National Bank, prohibited interstate banking, created decentralized system of credit
    - \* Constraint: innovation limited by power of entrenched interests (the path of least resistance)
  - Shield: protect from armed and belligerent states
    - \* Military: alliance between armed state and national economic experiment
    - \* Commercial: engage in world economy on terms conducive to own national experiment
      - State must enjoy power of selectivity
      - Ex: “tiger economies” (unlike Latin American countries) limited foreign capital
    - \* Fiscal: national rebels crafting growth miracles must be able to resist financial interests, domestic and foreign
      - Not the vulgar Keynesianism of counter-cyclical management – must be subordinated to the interest of the shield
      - Fiscal realism not to win financial confidence, but so country can rebel against financial markets
      - This has contractionary effect – need to neutralize through private and public investment
- Most advanced practice of production (not necessarily the most efficient) is the vanguard
  - Until recently, productive vanguard was industrial mass production
    - \* Context of world division of labor: capital-intensive production in central economies
  - Now, productive vanguard is the knowledge economy

- \* Exists in every sector as the “intellectually dense” portion, but operates as an exclusive fringe
- \* Its insular character leads to economic stagnation and inequality
- New dilemma: traditional shortcut to economic growth has stopped working
  - \* Long-term growth depends on “fundamentals”: education and institutions
  - \* Shortcut: take workers and resources from less productive sectors and move them to the more productive sector
    - This has stopped working: consider deindustrialization
  - \* Why? The old vanguard is no longer the vanguard
  - \* Race to the bottom in terms of labor and taxes to the state
- Alternative: socially inclusive new vanguard, but knowledge economy is quarantined even in richest economies with the most educated labor force
- If dilemma can be broken, can be broken only by developing inclusive form of the new vanguard

### Rodrik

- Empirical facts about inequality in the knowledge economy:
  - Within firms: outsourcing/offshoring through supply chains, platforms/gig economy
  - Across firms: within every industry, productivity between leaders and laggards growing
  - Wage distribution: winners and losers in labor market are diverging, even for the low-skilled (paid more if associated with productive center)
  - Spatial: urban centers diverging from the rest
- Secular stagnation: technological advances of today have less potential than 40 years ago?
  - A more straightforward explanation: the most productive technologies are being denied to most people, leading to a slowdown

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- Knowledge economy is multisector → shouldn’t identify it with platform companies and the associated network effects
- Depends on legal/institutional arrangements – companies pay nothing for data generated by customers, and this is not neutral; it is an artifact of the legal/institutional background
- How far can productive vanguardism extend? Reason to think it depends on exigent conditions, unlike mass production
  - Needs certain kind of education, accumulation of social capital (discretion and reciprocal trust)
  - Depends on legal/institutional innovation, alternative regimes of property and contract
- Industrial policy, by contrast, essentially consists of buying a few more years
- Current form of the knowledge economy is probably an example of the “path of least resistance”

## The challenge and opportunity presented by today’s knowledge economy

### The nature and consequences of the insular knowledge economy

#### Guest speaker: Yochai Benkler

- Because of information asymmetries, socialized nature of individuals, central role of institutions, markets are pervaded by power
  - Social relations of production/culture, etc. are structured around power

- Here, social = set of institutions and ideologies
- Understand postwar period as a structure of social relations with importance placed on expertise, managerialism, Keynesianism, big business, unions
  - Assembly line method of production, Hollywood system of cultural production
- Transition from the 1970s through the Great Recession has been toward self-interested individuals
  - On the right: individual rationality, on the left: self-actualization
  - State recedes from economy
  - Shapes how technologies get deployed, increases competition in labor markets, shifting power from labor to capital
  - Financialization → internationalization
- At the macro level: readjustments in ways that redistribute power (not just about comparative productivity)
- Markets invest in institutions, technology, ideology that allows them to extract rents
  - Horizontal power: decrease competition for their markets by eliminating innovators
    - \* Consider the App Store or Facebook – learn which apps are successful on the platform then introduce direct competitors
  - Vertical power: over workers, suppliers, consumers
- Labor management platforms make sure workers are paid only when it's useful for employers → this has to be backed by labor market institutions
  - Consider Uber's institutional framework which enables them to offload all risk onto drivers
- Increase in computational capacity, decrease in productivity growth, decrease in business dynamism, increase in concentration, increase in markups, oligarchic extraction in the 1%, wage stagnation
  - Explanation: state stepping back because of neoliberalism
- Need to find a way to harness the state to contain the market – shrink the domain of the market
  - Karl Polyani: everything turns into a commodity
  - This only happens when the state removes the ability to act outside the market
  - Want to decommodify basic necessities: Medicare for All, public savings, free college, etc.
  - Goal is to alleviate imperative of selling to the market
- Restructure power: increase antitrust, labor law, employment law, regulation of technology
  - Can we invert the surveillance system to create accountability?
  - Consider bodycams: initially used to subvert police authority, now they regularize it; they control the video, where it's stored, etc.
    - \* This is a function of the institutional setting, not the technology itself
- Socially embedding production – pre-capitalism, embedded in relations
  - Idea of market autonomous of social obligations is a new one
  - Sanders' idea of worker ownership: grant 2% per year stock to workers
  - Recreate “what a manager needs to do” as a battle in the ideological sphere
- What role can the state play to leverage fiscal power to enable cooperativism?
  - Quasi-utopian vision: some form of homesteading; intervention by state to help construct technology to produce what they need, embedded in social relations that use distributed materials, not centralized production
- Labor-displacing vs. labor-augmenting robots? Nothing inherent in the technology that pushes for one or another – technology doesn't develop exogenously
- Can't depend on the notion that the state is infallible
- Used to be more anarchistic – skepticism about the state and the way it's captured by business,

military-industrial complex

- Radical distribution of computation was first time since Industrial Revolution that the capital requirements of production were distributed in the population
- Possibility of non-market production as an alternative to the market/state production
- Seemed possible, but no historical force that would necessarily make it happen → political battles over laws are central
  - \* Copyright, DRM systems made it easier to enforce one-sided contracts; see this as an ideological battle
- Focused too little on Google, Apple
  - \* This changed around 2008 with the introduction of platforms, which introduced points of control that let them recapture power
  - \* State, too: propaganda, surveillance
- Realized that we need the sustaining, fiscal power of the state, but we can't ignore elite capture

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- Market order is cast against social solidarity
  - Terminology of “embedding” and “re-embedding” is dangerous
- Social relations combine power exchange and allegiance
  - “Sentimentalism of equal exchange”
  - Marx said: good riddance, we don't want that kind of embedding
- Unsentimental version of it: sustain high investment in people and capabilities, withdraw from market's uncertainty a basic package of security-ensuring endowments
  - But consisted in a set of insider deals to the detriment of outsiders
  - We don't want that! We don't want to re-embed market in social relations in this way
- Three concerns:
  1. Economic security and plasticity
  2. Inequality: we want to change the fundamental distribution of advantage
  3. Social cohesion: money transfers not adequate social cement (without racial/cultural homogeneity)
    - Need collective action: innovation in the economic/political arrangements
- Two themes:
  1. Knowledge economy: do firms prefer technology that extracts rents rather than increases productivity?
    - Another explanation: there is increased productivity in vanguard, but the problem is that the knowledge economy doesn't spread
  2. Market order, containment by state: but the market is not one thing → which market order? The market has no one form
    - Can we change the market order by innovating in fundamental legal mechanisms?

## The alternative futures of the knowledge economy

### Rodrik

- Techno-optimists say the 3rd and 4th industrial revolutions are comparable to the 1st and 2nd, and that the benefits can be broadly shared with enough investment in skills
- Techno-pessimists say the scale is not comparable to the 1st and 2nd, and that its application is limited to a few sectors, which drives inequality and joblessness
- In development:



- The optimists say that the rapid diffusion of technology aids developing countries
- The pessimists say that skill and capital intensity and the high-quality institutions/regulations required make it hard for developing countries to catch up
- Evidence?
  - Slowdown and compartmentalization of productivity growth, gap between leading and lagging firms, widening spatial/regional divides
  - Gap between productivity and wages (especially for nonsupervisory workers)
  - Premature deindustrialization in developing countries (because of globalization and skill-intensive technical progress in manufacturing)
- Determinants of technological innovation:
  - What questions are asked and whose problems are solved – this is what social choice is about! Technology isn't exogenous
  - Economics: R&D costs are private but benefits are social, leads to market failure
    - \* Hence, innovation support: subsidies, patent protection, seed funding, etc.
  - Priorities shape support policies – what counts as R&D, which innovations are patentable, etc.
  - Firms prefer innovations that can be monopolized, raise entry barriers, enhance control over workers, have costs/risks that can be shifted onto others
  - Unlikely to invest in innovations with social externalities
  - “High-road strategies”: technology for benefit of workers/public as opposed to pure profit/productivity
    - \* Is there a “win-win”? Is it in the interest of firms to have happy workers?
    - \* No reason to think that these incentives are universal or sufficiently strong, especially because of coordination failures
  - The internalized norm is that technological progress is synonymous with saving on labor

## Unger

- Foreground theme: future of knowledge economy, which is a set of practices associated with potential that presently is suppressed
  - Division of labor: production at scale with destandardization/customization
  - Momentum in production combined with decentralization of initiative
  - Potential to relax constraint of diminishing marginal returns
  - Revolution in moral culture of production: replace low-trust command and control structure with more reciprocal trust and individual initiative
  - Make activity of producing more like activity of discovering
  - Coordination of machine and anti-machine (human being)
- Background theme: how to achieve inclusive growth?
  - Need to reckon with disappointment: we had a burst of scientific and technological development that promised exponential growth, but instead we have stagnation and inequality
- Three steps to argument:
  1. Causation of disappointment
  2. Aspects of programmatic response
  3. Level of transformative ambitions

### *Causation of disappointment*

- Want to contrast 3 narratives. The first two are the most influential, and these RMU will argue against
- 1. Narrative of automation: technological dynamism has run away from us

- Internal logic of technology is that it replaces labor instead of augmenting it
  - Thus, the best we can do is social compensation – e.g. a minimum guaranteed income
  - Objection: it has never happened before that technological advances diminish employment – this is a “lump-sum” fallacy
    - Technological evolution is indeterminate: it doesn’t have a single form, it is *shaped*
    - Whether it replaces or compensates labor depends on what we do
  - The response suggested by this narrative has no relation to the supply side of production. It doesn’t give people good jobs
2. Narrative of exhaustion: contemporary technology is inherently less fertile
- Have we exhausted the low-hanging fruit?
  - Seems like AI, computational biology, etc. have vast potential
  - Repair to Keynesianism: expansionary fiscal and monetary policy
    - But no organic, proximate connection to modern production, c.f. road-building in the New Deal which had a direct connection to the automobile industry
3. Transformation narrative: sustained growth requires breakthroughs on both the supply and demand sides, and there is no automatic correspondence between the two
- Keynes is not actually a general theory, it is specific to Great Depression
  - Supply side: lift up retrograde businesses and backwards parts of industry by giving them access to advanced technological practices and to markets
    - Reach individuals too – vast parts of the parts of the labor force are in insecure/precarious employment, the middle class has been hollowed out
    - Need to reach those detached from large firms: nurse practitioners, IT support
    - Transform into “technologically equipped artisans” – not just skills, but support
    - Then go down to lower part of labor market – janitors, shelf-stackers
    - Then up the ladder to medicine, law, engineering
  - Prioritize things that give access to advanced practices, power to share/manage assets in enterprises where they work
  - In the U.S., need to refinance the state – the aggregate tax take is at least 10% lower in Europe, which is incompatible with reconstruction
    - Only way to do this is an indirect/regressive tax on consumption, which will be “gained back” (in terms of undoing the regressivity) on the spending side
    - Progressives don’t like this – they are against *all* regressive taxation
  - Demand side: prefer distribution of assets to democratization of credit
    - Aspiration to property-owning democracy was replaced with credit democracy, which led to the crisis of 2008
    - Can’t have sustained expansion based on popularization of debt not backed up by sharing of assets
    - Can’t replace labor power with tax-and-transfer – labor needs share in power, protection against insecurity, and a share of assets

*Focus on programmatic response: one aspect of supply side*

- Need a project of inclusive transformation
- What determines if we will break from business as usual? Education and access to the means of production
  - Education: knowledge economy has demanding requirements, general and technical
    - \* Prioritize depth over breadth, cooperation over individualism, dialectical practice

- \* Quality can't depend on geography or circumstance, which necessitates federal standards
- Access to means of production has 3 stages:
  1. Broaden access to larger range of agents (firms and individuals) – need a decentralized procedure to discover what works
  2. Need a different institutional architecture
    - \* Not American model of arm's-length regulation
    - \* Not northeast Asian model of industrial policy imposed top down
    - \* Need a third form: collaboration to the end of disseminating advanced practices
  3. Experiments with property and contract law need to be able to coexist in some market order

*Relation of structural to fragmentary change*

- Programmatic proposal should: (1) mark a direction and (2) select initial steps to move in that direction
- Constituency can't be just the historical constituency of the left: organized labor in capital-intensive production
- Instead, need to build base, must include 4 elements:
  1. Workers in traditional capital-intensive sectors
  2. Precarious workers
  3. Small business class
  4. Rank-and-file of professional business class (which is increasingly separate from plutocratic elite)
- Unifying theme: become bigger together by remaking institutional arrangements of the economy and the state

## The market order and its reconstruction

### Economics, institutions, and the possibility of alternative institutional forms of the market economy

#### Rodrik

- Do contemporary market economies depend on a particular form of institutions?
- Institutions are the “rules of the game in a society”
  - Formal: law, regulations
  - Informal: norms, patterns, moral codes
  - Not organizations in the sense that they don't need a physical form
- A functional typology of market-supporting institutions:
  - Market-creating: property rights, contract enforcement
  - Market-regulating: antitrust, environment/safety regulations, labor market institutions, “industrial policies” = correction of market/coordination failure
  - Market-stabilizing: monetary, fiscal, currency arrangements = macroeconomic management
  - Market-legitimizing: redistribution, social insurance, political democracy
- Don't want to mistakenly associate these functions with forms: there's no unique mapping between the two because of local specificity
  - Ex: macroeconomic stability doesn't necessarily imply independent central banks
- We have an objective like productive efficiency (static and dynamic)
  - That implies certain universal principles: property rights, incentives, the rule of law

- But not particular arrangements: what type of property rights? Is there a role for industrial policy?
- Economics can elaborate the link between these universal principles and institutional arrangements

## Unger

- Institutions are norms, rules, and standards that govern practice in a particular dimension of social life, informed by concepts of what those relations can and should be like in that domain
- Importantly, they are not *things*. This distinction means:
  - The arrangements are mediated by representations (ideas) about what the relations can and should be like
    - \* Law is the institutional form of the life of the people
  - They tilt the scale of experience in a particular direction
    - \* C.f. liberal political thinking, in which the aspiration is to form a framework of rights that is neutral with respect to sectarian visions of the “good”
    - \* But every institutional order encourages and discourages particular forms of relations and social life
    - \* There is no neutral – and this concept is dangerous because it is usually invoked in defense of entrenched ideas
    - \* But neutrality is the perverted (false, dangerous) form of the idea that society should be open and corrigible in the light of experience. These are the legitimate counterparts to the idea of neutrality
  - They are artifacts in that we made them; we should thus try to understand them from the inside, not from the outside as we do natural phenomena
    - \* They are a kind of “frozen politics”: the ordinary struggle of politics is temporarily interrupted and contained in institutions
  - They are not univocal: they exist “more or less”
    - \* They can be organized to insulate themselves against challenge and change
      - Then they appear to be facts about the universe – Marx and Hegel described them as the “alienated parts of ourselves”
    - \* Or we can organize them so they revise themselves
- In economics, the most important debate is about the institutional form of the market economy
  - In the 19th century, both Marxists and conservative jurists shared the belief that the market order has built-in institutional content: you buy the whole package
    - \* This is the Marxist conception that capitalism is a system with a predefined architecture
  - But when you try to determine the architecture of the market economy from first principles, there are choices to be made
    - \* The market has no single, natural, necessary legal form
    - \* This was the main achievement of legal theory from approx. 1850-1950, exemplified in the US by Oliver Wendell Holmes
  - This idea – that the market doesn’t have a natural form – can be inferred at the most abstract level. There are 2 aspects of a market order:
    1. The absolute level of economic decentralization (the number of agents entitled to bargain)
    2. The absoluteness of control over resources (are property rights eternal, hereditary, etc.)
      - \* Unified property rights are an invention of the 19th century
      - \* In most legal traditions, the normal form of property rights involves a disaggregation of the component parts, invested in various stakeholders
      - \* This control can be fragmentary, relative, limited, and temporary

- Conservative thinking usually postulates that decentralization and control go together, but the first can be advanced by limiting the latter
- How has economics approached the problem of the institutional form of the market? In three main ways:
  1. “Pure” economics: started by the marginalist theorists of the 19th century and achieved by the general equilibrium theorists of the mid-20th century
    - Free of any institutional message – it is a form of logic, an analytical apparatus
    - Can be applied to a command economy, which implies that the choice among these systems is a political one
  2. “Fundamentalist” economics: the market order does have a legal and institutional form (this is precisely the idea that the 19th-century jurists subverted)
    - Associated with ideas of Hayek: if Robinson Crusoe traded for long enough, he would reproduce the entire 19th-century system of German private law
  3. “Equivocating” economics: exemplified by the American followers of Keynes who rendered his doctrines palatable by defanging them
    - Seeks to establish law-like correlations between large-scale economic aggregates, e.g. the Phillips curve
    - People challenge them by saying that these correlations depend on institutional details (like unemployment insurance or other social benefits); if the institutions change, then the correlations fall apart
      - \* But they can disregard these challenges by conceding the point and claiming that they are just doing analysis in the status quo
    - They confuse stability and stagnation with lawfulness
- Placing this in the context of the history of ideas:
  - Classical European social theory (Marxism) had a structural bent: to distinguish the surface from the regime that shapes routines and conflicts
  - But they surrounded this instinct with deterministic illusions that corrupted it; for example, within Marxism, the ideas that:
    - \* There is a closed list of basic regimes (modes of production): capitalism, feudalism, socialism, etc.
    - \* Each of these is a complete individual system
      - This means there are only 2 types of politics: reformist management and revolution
      - It excludes change that is structural but piecemeal
    - \* There are laws governing the succession of these regimes: history has a project, therefore we don’t need one
  - Contemporary social theory and policy has abolished structural ideas, which results in naturalizing the established arrangements and presenting them as the outcome of “best practice”
  - Thus, we currently have no usable idea of structural change/structural alternatives
- Addressing DR’s proposal of universal principles: they are a (mistaken) attempt to find a middle ground between pure economics, which is impotent, and fundamentalist/equivocating economics, which are powerful but corrupted
  - They try to take something off the table, with the idea that this is uncontroversial, that everyone can agree – but RMU doesn’t
  - Moreover, the world doesn’t. So is the world ill-advised? RMU says no
  - Example: does the goal of productive efficiency imply the rule of law and property rights?
    - \* The world seems to say no
    - \* Differential mastery of rules about property means that some groups manipulate them better

- than others, which leads to (sometimes violent) redistribution
  - \* Who will have property? And what are the benefits they get?
    - Every tax on capital is a debate about this
    - Should investors be rewarded, or stakeholders (workers) too? This is not a settled question
    - Consider the law of restitution and unjust enrichment – should people be rewarded if they do something to enrich others, even if this wasn't in a contract ex ante?
  - Another example: does the goal of macroeconomic and financial stability imply “sound money” policies (i.e. don't generate liquidity in excess of money demand?)
    - \* The right wing disagrees with this principle: they say the only effective way to achieve this objective is to have a metallic base for money
    - \* This is the neoclassical synthesis: Keynesian economics downsized (macroeconomics) and superimposed on marginalist economic theory (microeconomics)
    - \* Progressives say the principle of sound money is a principle for a world that no longer exists
      - Today, we're closer to the world Keynes was writing about: there are large pools of liquid capital being hoarded, underinvestment
  - Final example: does the goal of distributive justice and poverty alleviation imply targeting and universality?
    - \* Aren't these principle and counter-principle? You can justify anything with this
    - \* The European social democrats and FDR rejected targeting in favor of universal programs; LBJ began targeting with his war on poverty
      - This turned out to be harmful for the poor because in political/economic downturns, the benefits can be turned off or downsized
    - \* Universality is a social compact with normative content; it should be privileged over the principle of targeting
- Five theses for thinking about alternative institutions:
  1. We need to liberate ourselves from the 19th-century idea of both liberals and socialists that there is a predetermined harmony between the institutional requirements for the development of productive power (i.e. “forces of production”) and the liberation from hierarchy, especially class struggle
    - Today, we risk a dogmatic pessimism: that there is an insoluble contradiction between these things
    - But there is a zone of potential overlap in which we seek to find institutional content specific to our context
  2. The focus of ideological controversy is changing: before, it was the market vs. the state, but now we need to find alternative forms of economic/social pluralism that go beyond the North Atlantic social democratic vision
  3. We should have a special interest in the deepening and diffusion of the most advanced productive practice which today is the knowledge economy
    - This means promoting a high-energy democracy and an education system that allows individuals both to resist their context and operate within it
  4. We want institutions that are denaturalized, not ones that resist challenge and change
    - We want structural alternatives, not a structural dogmatism
    - We want to deny our institutions the “last word”
  5. We need to be attentive to a particular dialectic: we want to make the individual secure in a haven of safeguards and endowments, which we do by taking these off the table in day-to-day politics under a rhetoric of “fundamental rights”
    - But the purpose of this arrangement is to throw everything in society and economy open to change

- The liberal discourse has the first but not the second
- We need to figure out how to institutionally arrange for that “storm” of change

## **The market order and inequality: the contrast between corrective redistribution and institutional change influencing the primary distribution of economic advantage**

### **Rodrik**

- Contrast redistribution through tax-and-transfer with changing institutions that influence economy
- Rise in inequality in Europe looks more moderate than in US
  - Why? Technology and globalization trends are the same
    - \* Way economy is organized, more extensive role of state...
  - Difference shows how institutions and policies moderate globalization and technological shocks
- Three stages:
  1. Pre-production: people enter economy with endowments (networks, education, access to financial capital)
  2. Production: system of production creates market outcomes, produces income/wealth distribution
  3. Post-production
  - Can distinguish policies that act at these stages
    - \* Ex: education, UBI are pre-production
    - \* Taxes are post-production
  - Productivist policies intervene directly in stage of production, employment, innovation
- Three targets:
  1. Help people at the bottom
  2. Address wealth concentration at the top
  3. Target middle class insecurity, precarity
- Traditional focus: investment in health, public education (pre-production) and redistribution, social safety net (post-production)
  - Increasing discussion of policies that target production
- Focus on productivist policies addressing middle class: “good jobs”
  - Good jobs: secure employment with benefits, give workers sense of satisfaction
  - 3 categories:
    1. Address productivity of existing jobs and firms
    2. Increase number of good jobs by supporting startups, expansion; attract investment from firms elsewhere
      - \* Currently takes place in distorted form: tax subsidies create “race to the bottom”
    3. Workforce development programs, continuous investment in skills
- Kind of industrial policy: government intervenes to affect structure of production and direction of technological change
  - Traditional type (East Asian model of industrialization): top-down incentives – promote specific sectors (shipbuilding, steel), use specific instruments (export, credit subsidies)
    - \* Presumes ex-ante knowledge and competence on part of public agencies
  - More contemporary: ongoing processes, strategic collaboration across levels. Design principles:
    1. Embeddedness: knowledge embedded in activities of participants

- 2. Institutional capacity: ability to revise policy
- 3. Clear benchmarks of what constitutes success
- 4. Broader accountability
- Four advantages of this way of thinking:
  - 1. Structural approach: focuses directly on employment
    - Transition away from welfare state model
  - 2. Little market/state dichotomy
  - 3. No dichotomy between equity and efficiency
  - 4. Dichotomy between reform and revolution also disappears

## Unger

### *Philosophical prelude*

- How should we think about inequality? Ideological debate of last two centuries: “shallow equality” vs. “shallow freedom”
  - Left gives priority to equality, right gives priority to freedom
- “Shallow” because they are pursued against background of established institutional arrangement
- Theories of distributive justice (e.g. Rawls)
  - On their face, seem radically egalitarian
  - But they are philosophical prop to compensatory redistribution
  - Attempts to achieve equality via redistribution after the fact are limited
  - Pragmatic residue: attempt to attenuate inequality generated in the market through retrospective tax-and-transfer
- Alternatives? Deep equality: give priority to equality of outcome/circumstance
  - “We’re all poor, but we’re poor together”
    - \* Not our aim
- Deep freedom: Bring experience of ordinary people to higher level of intensity, scope, capability
  - Struggle against inequality is subsidiary to this larger objective
  - Narrower and deeper than equality of opportunity
  - Equality of *empowerment* – opportunity to act
  - Conservatives say it is natural for life to be small – exceptions are heroes, thinkers, saints, entrepreneurs
  - Progressives: become bigger only if we become bigger together
    - \* Resist inequality because it is a constraint on this shared empowerment
    - \* Method: structural change in institutional arrangements, ideological assumptions
      - Necessarily piecemeal

### *Historical prelude*

- In medium to long term, equality *among* nations affected most by diffusion of most advanced practice of production
  - Short term, migration
- Long term, equality *within* nations affected most by ability to share in most advanced practice of production
  - Short to medium term, war
  - How can we achieve war economy without a war?
    - 1. Growth: massive mobilization of national resources



2. Plasticity: large-scale mobilization together with radical institutional innovation
  - \* Create economic and political institutions that facilitate their own revision
3. Solidarity: elites recognize that sacrifices must be rewarded
  - \* Peacetime equivalent: multiplication of forms of collective action within and outside the economy

*Relation of production to equality*

- Two options: diminish inequality by correcting inequalities generated in present market order; or diminish inequality by innovating in arrangements that shape fundamental distribution of advantage
  - Initiatives that affect primary distribution have more promise than attempt to correct after-the-fact
  - If we attempt to correct after the fact, we establish tension between established economic incentives and egalitarian commitment: “equity vs. efficiency”
  - This idea conflicts with certain orthodoxy
    - \* Piketty compares direct redistribution (e.g. mandate higher return to labor by increasing nominal wage) to fiscal redistribution
      - Says undermines price system as system for efficient allocation of resources
      - Direct redistribution results in less employment, preference for substitution of labor by capital
    - \* But doesn’t consider extent to which fiscal redistribution can disorganize the real economy
- In influencing primary distribution, three elements have priority:
  1. Status of labor vis-a-vis capital
    - Need different legal regime to reconcile genuine flexibility in labor market with security
    - Future of wage labor as predominant form of free work (c.f. self-employment and cooperation)
    - Consequence of evolution of technology for substitution of labor
  2. Empowerment through productive uplift
    - Cooperative competition among producers
    - Aid to middle part of job distribution
  3. Education
    - Character/quality of general education: form of education that can empower, prefer selective depth to encyclopedic superficiality, approach all subjects dialectically
    - Technical/vocational training: analytic/technical capabilities rather than job- or machine-specific skills

*Relation of innovation in primary distribution to after-the-fact corrective policies*

- Three principles:
  1. Change in arrangements that shape primary distribution has priority over attempts to correct after-the-fact
  2. Common mistake: separate revenue and spending side and focus on progressive profile of revenue
    - Paradox: among rich industrial democracies of North Atlantic, the one that on paper has most progressive tax system is US
      - \* Relies on taxing personal income
      - \* European social democracies based on regressive/indirect taxation of consumption (VAT)
    - In the short run, what matters most for overall redistributive effect is *aggregate* tax take and how it is spent
    - Progressive taxation has marginal effect on inequality, but politicians’ commitment to progressive taxation at election time becomes device to show who’s side they are on
  3. Role for progressive redistributive taxation

- Two targets: hierarchy of standards of living, accumulation of economic power
- Progressive income tax hits neither squarely
- Which instrument hits first target? Individualized consumption tax
  - \* Nicholas Kaldor: The Expenditure Tax
  - \* Take aggregate income (labor and capital) and subtract invested savings; tax this difference on steeply progressive slope
- Second target: tax system reaches more bluntly
  - \* Tax hereditary transfer of property
- Central theme: equality without empowerment is a failed program

## The relation between finance and the real economy as a context for reshaping the market order

### Unger

- Three themes today:
  1. Present coronavirus crisis as a transformative opportunity
  2. Relation of finance to real economy, financial instability to economic breakdown
  3. Develop second discussion in an application to the nature, causes, and consequences of 2008 crisis
- Two major themes of class have been: (1) alternative institutional forms that market economy can take and (2) evolution of productive apparatus of society, in particular, the most advanced practice of production and its relation to rest of economy
  - Frequently referred to idea of a “war economy without a war”
  - History has handed us an astonishing and unwanted example of this problem
  - We have a crisis that in some respects evokes idea of war economy – many political leaders referred to this concept
  - It is (should be) a war economy in the emergency production of medical equipment
    - \* State is source of both demand and supply
  - But in a larger sense, this is the inverse of a war economy
    - \* A radical breakdown in supply and demand where the major part of labor force is sent home
- Transformative response to this problem in 4 areas:
  1. Income of workers
  2. Skills of labor force
  3. Revenue of businesses
  4. Organization of emergency production
- Propose thought experiment: consider what a progressive political force would do in response to this emergency if it had the institutional and productivist focus that almost all existing progressive forces lack
  - Conception of what could happen if we had the right ideas and the right will
- Preliminary: who will pay for it? Initiatives require a large amount of money
  - If ever there were a circumstance in which state has no narrow public finance constraints, this is it
  - All of this spending would represent replacement income and revenue
  - So a great deal could be spent without provoking inflationary spiral
  - State could finance initiatives by creating money – increasing or monetizing public debt
- Income of workers: state has to guarantee large part of wage that workers no longer earn

- Same principle must apply to self-employed or semi-employed workers
- Medium to long term: opportunity to experiment with insurance against “black swan” risks – radicalize, generalize principle of social security
- Skills of labor force: opportunity to use crisis to increase skills of labor force
  - Network with each other within and outside firms
  - Long term – not just boost to productivity, increase in extent to which workers are independent from firms
- Business revenue: governments around the world propose to guarantee revenue
  - Should not be uncompensated – demand reform to executive remuneration, increase in workers’ rights
- Emergency production: specific corner of this problem in which example of war economy is most apposite
  - Governor of NY: propose medical supply chain be nationalized, President resisted: “nationalization is a bad concept”
  - War Production Act 1950 gives wide powers to federal government to direct businesses to produce what needs to be produced
    - \* Point of departure for innovative institutional engineering
    - \* Not just centralized direction of production, but development of public-private partnerships to work in areas that don’t correspond to short-term demands, but to long-term strategic imperatives
- No insuperable technical, financial, economic or legal obstacle
  - Obstacles are fundamentally political and ideological – ideas and will

## Rodrik

- Agree that crisis is not one that poses significant technical/intellectual challenges
  - Puzzle is why so much of the world is failing at meeting those challenges
  - Many of ideas have not percolated up
  - Massive problem of social cooperation and coordination, not just ideas and will
- Alternative thought experiment: imagine US had taken threat seriously – testing kits employed, federal government had invested in widespread testing, would have enabled us to tell who was infected → enabled us to quarantine those who are infected
  - Only stay home 2 weeks → 1.5% GDP lost
  - Instead, we have supply shock with spillover into demand side
  - Now estimate Great Depression levels of unemployment
  - South Korea taken an approach closer to the one here
    - \* Deployed widespread testing and social distancing very rapidly
    - \* Not an authoritarian state, so this is possible in democracy
- Traditional Keynesian approach won’t work – we have a supply shock (ask people to stay home), so significant fall in GDP is inevitable (part of needed public health response)
  - What we can do is support income
  - Britain/Germany: firms being paid to keep workers employed
- Uncertainty about crisis → supply shock creating induced demand shock
  - Even if paid 80% of salary, uncertainty about future → consumers don’t want to spend a lot money
  - So, needs to be significant Keynesian action to increase aggregate demand
  - Particularly with respect to medical supplies
    - \* Hard to understand why federal government is not directly requisitioning medical materials

from suppliers

\* Letting states compete with each other

- Failure of global cooperation
  - WHO could have played much bigger role
  - Arguably greater need for cooperation in public health than in economics (IMF, OECD)
- Failure of many political systems to produce leadership and response makes DR skeptical that we can envisage bridge to productivist agenda
  - Optimistic side: no longer take for granted social/economic arrangements, role of the state, prevailing nature of ideas – opening for the kinds of things we’ve been discussing

### Unger

- Promise of interaction between bold governmental initiative and cooperation/social organization
- Disposition to cooperate is influenced by culture
  - But not just a constant
- Emergency production of needed medical equipment: cooperation becomes essential
  - Ex: Automobile factories don’t immediately know how to produce ventilators
- Capacious view: not just the state acting unilaterally, rather creating opportunities for cooperative breakthroughs

### Rodrik

- Question of how we’re going to pay for this doesn’t arise
  - Low interest rate environment already
- Supply side crisis might generate inflationary pressure, but we haven’t seen that
  - Induced demand side effects are playing a role in dampening inflation expectations
  - Not a time to be fiscally conservative
- Fair amount of consensus:
  - Income support, support demand, invest in medical supply chain, increase capacity at hospitals, backstop financial system (happening through ECB and Fed), work with small and medium businesses to ensure they have resources
  - Much of debate is about practicalities of that
- Can we just print money?
- **Rodrik:** As long as you have a use for it, as long as it doesn’t increase inflation
  - Inflation is the sign you’re running into a resource constraint
  - As long as inflationary expectations and inflation are low, that’s a sign you can increase supply of money (“helicopter money”)
  - Not a big difference between traditional economics and MMT on this front
- **Unger:** Distinction between two levels
  - One level: money created by state is being used to replace personal income/business revenue
    - \* In principle, you can go a long way without provoking inflation
  - Second level: inflation becomes functional equivalent of a tax
    - \* Intervening in distributive conflict with advantages and disadvantages
    - \* Historically, one way states have managed distributive conflict
- **Rodrik:** Even in first level, loss in income is happening because people are not working
  - If we give them income, it’s income that has no counterpart in real production
  - Immediately find ourselves in second phase – we cannot give them real income, only can give income by taking purchasing power away from someone else

- But this is not the situation we're in because no increase in inflationary expectations
- Loss in income to workers generated by loss of expenditures (reduction of demand) – but we've generated supply shock by asking people to stay at home
  - \* So there's an element that can't be compensated by giving people more money
  - \* Unless you find a way to increase production
- **Unger:** Continuing dispute with DR, "if it's already hard to reach the minimum, why are you asking for the maximum?" → need to have higher transformative ambition to deal with basics
- **Rodrik:** Interpret this as: "Why make it difficult if you can make it impossible?"
- **Unger:** Need interaction between state initiative and mobilization of organized civil society
  - Historical reality is that interaction cannot happen in an atmosphere of programmatic minimalism
  - Only happens when there's a transformative campaign

### Rodrik

- Share of financial industry profits as total business, share of finance in US GDP, stock market trading volume over GDP, all up
- Prior to global financial crisis, extraordinary scale: Ireland, Iceland (acting as hedge fund with stocks of financial assets and liabilities 10x GDP)
- One would expect that some good would come out of financialization
  - Narrative behind financial liberalization, deregulation, globalization is that they produce benefits
    - \* Within economy: diversification of risk, distribution of risk from those who do not have ability to bear it to those who do
      - Enable access to homeownership to larger segments of population
    - \* Globally: transfer financial resources from rich countries to poor countries
  - World would experience boom in private investment and growth while experiencing reduction in overall volatility
    - \* Those expectations have not been borne out
    - \* No increase in real resources devoted to investment in developing or advanced countries
      - If anything, private investment has stagnated
- Left with deep disconnect between finance and real economy
  - At best, a source of consumption support for parts of the middle class
  - Spurred homeownership, but in a way that created systemic risk and financial distress
  - Exception: moments of crisis, central banks act as lenders of last resort to commercial banking sector, parts of real economy
    - \* This morning: Fed preparing credit facility for lending to small and medium sized enterprise
- "Smart" development banking
  - Out of fashion – many countries closed down
  - Finance long-term investment in environments where not available through normal commercial means
  - Complemented with another role: intelligence gathering, where are there opportunities for new investments?
    - \* Tightly connected to productive opportunities in private sector
    - \* Make intelligence available to the state and other parts of private sector
- Public venture funds
  - Governments can borrow at very low interest rates → set up quasi-independent venture funds, managed independently, take ownership shares in startups or firms investing in new technologies
  - Direct investment towards employment-enhancing or green technologies

**Unger**

4 sets of comments:

- Locate discussion of finance in general idea of economic instability
  - 2 fundamental causes of instability
    1. Absence of spontaneous/automatic correspondence between supply and demand
      - \* Keynes concerned with one version – violation of Say's Law, aggravated by downward rigidity of wage
      - \* But there are many ways supply and demand can fail to be connected
    2. Troubled relation of finance to real economy
      - \* Keynes: came out of psychological tradition of English political economy
      - \* Liquidity of money balances allow them to serve as plaything of waves of elation, despondency, greed, and fear
      - \* But this is a limited and inadequate understanding of a more general phenomenon
- Orthodox way of thinking about finance, and what's missing from it
  - Orthodoxy: If there is a problem with finance, originates in failure of competition in capital market (such as asymmetry of information) or in failure of regulatory response to localized market failure
    - \* Under this view, makes no sense to say finance is more/less closely related to productive agenda of society
    - \* This selective blindness is an example of the false assumption that market economy has single natural, necessary form
    - \* When Americans in first half of 19th century disbanded national bank and created most decentralized system of credit that had ever existed, they were creating institutional arrangements that tightened relationship of finance to real economy, not simply regulating
- Conventional way of thinking cannot elucidate some things:
  - Under existing arrangements of market economy, production system is largely self-financed on basis of retained, reinvested private earnings
    - \* What is the point of money in banks and stock markets?
    - \* Vast amount of financial activity has oblique relation to production
  - Under these arrangements, finance is relatively indifferent to real economy in good times, destructive in bad times
    - \* When things are going well, productive system largely finances itself
    - \* In times of trouble, distress spills over into real economy
  - In principle, most important responsibility of finance: fund productive agenda of society, fund creation of new assets in new ways
    - \* Turns out to be miniscule part of financial activity
    - \* Venture capital, even in U.S, where it is most established, represents less than 0.5% of financial activity
  - Explanation: structure/arrangements that leave finance disconnected from production
    - \* Best way to make it less dangerous is to make it more useful
- Programmatic horizon: What can we do?
  - Negatively: discourage or prohibit financial activities that have no relation to enhancement of production or productivity
    - \* Options, derivatives contracts increase liquidity in commodity markets but not clear they have a similar role in equity markets → turn into instrument of gambling
  - Positively: channel finance into productive investment

- \* Smart investment banks, quasi-public venture funds are examples of this
- \* Pension systems could be placed in diversified portfolios of risk that would do the undone work of venture capital
- Connect to crisis of 2008. Conventional response to crisis emphasized stimulus (Keynesianism) and re-regulation of finance
  - Causal background of crisis – what was origin of problem?
    - \* Most fundamental origin: country stopped producing enough goods and services that rest of world wanted
  - Masked absence of productivist project with form of economic growth led by mass consumption
    - \* In principle, requires democratization of purchasing power – but in late 20th century, violently regressive redistribution of wealth
      - How to reconcile cheap money and debt/credit with regressive wealth/income?
      - Replace property-owning democracy with fake credit economy, made possible in part by overvaluation of housing stock as collateral
    - \* Enabled by structural imbalances in world economy – debt and credit style of growth financed by export of Chinese financial and trade surpluses
      - Each country used structural imbalance to escape imperative of structural change
      - Americans escaped need for productivist project and need to distribute assets to uplift production/democratize demand
      - Chinese replaced imperative of deepening internal market with style of growth based on exports to deficit-ridden US
  - Aggravated by regulatory approach (left untouched by response to 2008): regulatory dualism
    - \* Densely regulated area of finance where public moved (ex: FDIC), thinly regulated area supposedly populated by professionals who could take care of themselves
    - \* Everything that was prohibited in densely regulated area repackaged and done under different label in thinly regulated area
  - Response to crisis left whole causal background almost entirely untouched
    - \* Didn't develop productivist project, didn't disturb regulatory dualism

## Rodrik

- Revisit housing markets pre-2008. The narrative behind the credit market bubble in housing finance was one that was on the consumption side of the economy – not directly productivist – but story meant to be in line with social objective of increasing homeownership
  - Who wouldn't want financial markets to serve homeownership?
  - Why don't we introduce real competition into mortgage lending → take it out of hands out of monopoly of mainline banks, allow non-banks to make mortgage loans → create more access
    - \* Also, deregulate so intermediaries can offer creative, affordable mortgages
  - Worried about risk? Pool and package them into securities → farm them off to investors
    - \* Divvy up stream of payments into tranches, compensating holders of riskier ones, call on credit rating industries to certify that less risky ones are safe, then create derivatives to allow investors to purchase insurance (credit default swap)
  - Story is compelling – financial innovation, increased competition, new intermediaries, new assets expanding benefits of middle-class homeownership
- Possible to see through tools of conventional economics that something was going to go wrong
  - Incentives create tremendous leverage, tendency for excessive risk taking not being internalized
  - Cautionary note: ensure that financial innovation is disciplined by economics

## Unger

- One aspect of what happened in this story: mortgage market came out of New Deal, most powerful device for deepening of capital markets
  - Organized through ingenious institutions – Freddie Mac, Fannie Mae (quasi-public)
- Late 20th century: securitization of mortgage market under the pretext of increasing competition
  - But became device of speculation disconnected from economic reality
  - Layers of financial engineering – transactions of real economy, rather than being subject of engineering, became simply the pretext
- Inequality increasing in US despite broad-based mass consumption
  - Inequality + cheap money → asset bubbles
- What's the regulatory response? 4 sets of programs
  1. Resurrection of New Deal policies and rules separating investment banks from regular banks
  2. New supervisory, liquidating authority in federal government (deal with too big to fail problem)
  3. International finance: new standards of capital adequacy
  4. New standards for consumer protection
- None of these things dealt with regulatory dualism and separation from real economy → complete failure
  - Now, new crisis against background of old failure
- Every time we try regulatory dualism, the same thing happens: we repackage all the things that are prohibited in thickly regulated sector and do them in the thinly regulated one
- Something like half of graduating class of Harvard College go into finance and management consulting
  - Pushing paper, gambling, rather than investing, making things, doing real things in the world
  - Absorbing leviathan proportion of profits, perverting and misdirecting the intellectual energies of the nation
- Q: How do we reconcile nationalization with decentralized production?
- **Rodrik:** Nationalization is a question about ownership. Mechanism through which it's carried out can be decentralized → no conflict between ownership and control rights and how the work is organized
- **Unger:** Think again of the metaphor of wartime production: government says stop making cars, we need tanks → provides help, puts them in touch with people, but all it wants is the tanks
- Need to invent the institutional machinery of competitive experimentalism. The public initiative should not be seen as a suppression of that
- Logic of the market is the logic of an organized experimental anarchy – we want more of that
- Need initiative by the state to help us have more of it

## The relation between labor and capital as a context for reshaping the market order

### Unger

- Critique of neoclassical theory of firm leads to different options that are all unsatisfactory
  - Business roundtable (social responsibility) → place evaluation of “social direction” in hands of managerial elite
    - \* In practice: genuflect to political correctness of the day, reinforce whatever the current platitudes are. Why do we want this?
    - \* Harvard Business School motto: “Make profit with a conscience.” Would rather they just make profit and leave conscience to the public
  - Capital-intensive parts of economy: workers and employers have common interest against everyone else



- Collaboration model: kind of corporatism in which firms do everything together with the state
  - \* Normal point of departure: as a condition for receiving corporate charter, the corporation must obey whatever is established by law
  - \* Law determines social direction and conditions of corporate activity
  - \* To describe it as “regulatory policy” trivializes it

### Rodrik

- Skeptical of social responsibility model, but two practical advantages:
  - Only one of four strategies that we’ve seen progress on
    - \* Large firms are doing something with practical effects
  - Rebecca Henderson at HBS one of the strongest proponents
    - \* She says this is not an alternative to the government or the law
    - \* Makes them more likely to be willing participants in government-led approaches
- When labor has sense of ownership, participation, good things follow: satisfaction, productivity, technology adoption that is more cognizant of interests of labor
- Law cannot specifically say what wage rate gig workers doing MTurk in this industry in that region should get, other complicated issues about employment standards
  - How do those get determined?

### Unger

- Law can say: you can have flexible contracts, but you have to pay them what you would otherwise
  - Courts and jurists develop series of standards and criteria
  - Law doesn’t determine details, it sets a direction
- If we listen to business school, we always have the pietistic prevail over the transformative

### Rodrik

- Need flexibility in policy that the law cannot provide

Q: Do we think legal institutions are less prone to capture? In U.S., laws like right-to-work being used against workers.

### Unger

- That’s the general problem of politics. Law is not part of the institutions
- 100% of the institutions are manifest in legal detail; they come from struggle in society over the arrangements
- We prefer this struggle over subcontracting part of democratic power to a group such as the managerial elite
- If there’s capture, the solution is more democracy
- Can’t hedge against politics. Politics is fate
  - Either you give the power to the people and recognize that they may make mistakes
  - Or you give power to custodians
- In the US, American liberals tried to sneak program through federal judiciary
  - What always happens: the empire strikes back
- In terms of custodians, the managers are at the bottom of the moral hierarchy

### Rodrik

- Corporate social responsibility is partly due to abdication of national governments
- Firms might rather know what the rules are than have to voluntarily participate

- We have some international examples, but most of the action needs to happen at the national level

### Unger

- Emphasize the labor force and the nature of free labor in the contemporary economy, rather than the firm and its responsibility
- 2 connections to general themes:
  1. Linked to insular/inclusive knowledge economy
    - Technologically-provoked unemployment (automation discourse)
      - \* Take position that technological evolution is underdetermined → choice between technology replacing vs. augmenting labor
    - Historically, organization of labor within firms preceded by “putting-out system”
      - \* Now we see a new putting-out system
      - \* What we consider the “natural” way of organizing labor might turn out to be just an interlude between two putting-out systems
      - \* Increasing part of labor force consigned to precarious employment – can’t allow “flexibility” to serve as pretext for precarity
  2. Alternative institutional forms of market economy:
    - Best thing is not to regulate, or compensate after the fact but to change it, in 3 domains:
      1. Organization of production, relation of backwards/advanced parts
      2. Relation of finance to economy
      3. Relation of labor to capital

### Short-term program

- Proximate objective: increase chances that labor will be organized in a way that supports broad-based rise in productivity
- Ulterior objective: enhance economic freedom, agency
- Marx: most important feature of capitalism is that labor can be bought and sold
  - Is this the way things have to be?
- Establish policies and arrangements that increase likelihood that technology evolves in a way that augments rather than replaces labor. 3 categories of actions:
  1. Ways in which state can exemplify, encourage, mandate productive solutions that augment labor
    - Direct government action in areas such as defense technology
    - Fiscal and regulatory policy
  2. Industrial policy: attempt to uplift retrograde firms to bring them closer to frontier; assist autonomous economic agents → transform into technologically-equipped artisans
  3. Empower labor (by law) to have more access to advanced part of production, more power within advanced part of production
- Legal regime of organization of labor. 2 main sectors:
  1. Parts of economy with stable employment
    - What can or should the labor law regime be? 2 regimes:
      1. Collective bargaining that prevails in North Atlantic, developed to redress radical inequality of bargaining power in employment context. 2 principles: (1) decision to unionize is voluntary, (2) unions are independent from state
      2. Corporatist regime that predominates in Latin America. Originally developed in fascist Italy, adopted by leftist regimes in Latin America. 2 principles: (1) everyone automatically unionized, (2) union structure under direction of state, typically through Ministry of Labor
    - Despite suspect origins, corporatist regime has 3 advantages:

1. Unionization is automatic. A “gift of the law.” Struggle of workers is not whether to unionize, but what to do with union power
2. Solidaristic tilt: less likely that union system reflects and reinforces underlying inequalities of production system
3. Favors claims that are more than economistic (i.e. wages and benefits) – has an institutional and political dynamic
- Unacceptable vice: subordination of union movement to the state
- Solution? Hybrid regime:
  - \* From corporatist regime, take automatic unionization
  - \* From collective bargaining, take freedom of union from the state
2. Unstable/precarious employment. 2 discourses:
  1. Traditional labor discourse predicated on collective bargaining/corporatist regimes, wants to outlaw unstable employment as circumvention of labor laws. 2 defects:
    1. Can’t turn back the clock and suppress new practices of production by decree
    2. Serves interest of organized minority against disorganized majority
  2. Neoliberal discourse preaches radical flexibility
    - Erode rights of workers and throw them into radical insecurity
- Should distinguish flexibility (unavoidable or desirable) from radical economic insecurity
- Need a new legal regime for unstable employment
  - \* These workers should be organized and represented
  - \* Legal principle of price neutrality: unstable employment remunerated at level at which they would be remunerated in stable employment
  - \* One point of departure: Scandinavian system of labor rights and social rights that are universally portable

### *Long-term program*

- Economic freedom becomes a central aim. 3 aspirations:
  1. No human should be condemned to do work that can be done by a machine
    - Reserve our time for the not yet repeatable
    - Machines don’t have imagination
    - Create condition for our partnership with machines
    - This is the opposite of traditional forms of production: worker worked as if he were a machine
      - \* We want the opposite, but it’s unlikely as long as wage labor becomes predominant form of free work
  2. Character of free labor. 3 main forms: wage labor, self-employment, cooperation
    - Liberals and socialists up to middle of the 19th century thought that economically dependent wage labor is a inferior and transitive form of free labor that would give way over time to self-employment and cooperation
      - \* Everyone believed this, not just Marx. Lincoln, John Stuart Mill
      - \* End of 19th century → predominance of wage labor came to seem natural and necessary
      - \* How do we implement this idea in contemporary economy?
      - \* Idea ran into problem of scale in 19th century
  3. Need innovations in property regime
    - Develop range of ways in which economic agents can have decentralized access to productive resources and opportunities
    - Property is a bundle of powers that can be disassembled, components vested in different

stakeholders → superimposed claims on same productive resource

- \* Ex: productive resources vested in decentralized funds, use auctioned off to those groups who can offer highest rate of return (temporarily)
- \* Alternative systems of property and contract coexisting experimentally within same market order

*Philosophical remark*

- The premise of this set of ideas is that we can aspire to have freedom in the economy, not just freedom from the economy
- Marx and Keynes believed we were on the verge of overcoming scarcity, and in the world beyond we could escape hateful burden of work and enjoy “private sublimities”
  - Both of these are false. We are not about to overcome scarcity
  - Also, not true that work is just a hateful burden
    - \* Under the knowledge economy, if we heighten trust and make work approximate the activity of imagining and producing, work can cease to be a hateful burden. But for whom?

**Rodrik**

- Agree on wage neutrality: unstable workers → same conditions as in organized labor force. There should not be a dualism in structure of employment
  - In the taxi industry, avoid “Uberization” of workforce

**Unger**

- Corporatist labor law regimes: Unions negotiate on behalf of large categories of workers sector by sector

**Rodrik**

- Advantage of corporatism: universality
- Labor power, even in capital intensive parts of production (Amazons and Googles), might have valuable spillovers? RMU disagrees
- New technologies can augment labor directly or indirectly:
  - Technology that gives nurses skills to do what doctors do is a direct augmentation of nurses’ labor
  - Alternative: increase number of tasks that need to be performed
    - \* New technology enables teachers to discern learning styles of different students and provide customized education in a highly differentiated way
    - \* Increases the tasks that teachers can do – indirect augmentation of labor
  - How do we change incentives to do both of these things?

**Unger**

- Up to now, thought of this as race between human and machine (i.e. who’s better at playing chess?)
  - In certain respects, machines are more powerful
  - But we have a different hierarchy in the direction of imagination
  - Subsume actual under range of transformative variation
  - We can discover before we’ve made sense of something, in violation of our own methods and presuppositions, and then develop methods to make sense of them retrospectively
  - Enhances hope of partnership between human and machine
- Creation of breakthroughs depends on sifting through alternatives: experimentation
  - Humans have to do it through time. Experimentalism requires time, but it’s our scarcest resource
  - Machine does it through computational power, which can be almost instantaneous

- If machines can help us deal with our scarcest resource, time, they can be immense ally in our liberation

## Globalization and alternative globalizations: the international counterpart to these national debates

### Rodrik

- William Jennings Bryan speech at DNC, 1896: “You shall not crucify mankind upon a cross of gold”
  - Gold standard was target of late 19th century American populists
  - Led by farmers angry at unification of commodity markets at moment of price deflation → prices of agricultural products coming down
  - Relatively scarce gold supplies → nominal interest rates high, even higher real interest rate, given deflation
  - This was a consequence of “tight money” – no freedom to increase money supply, since it was linked to supply of gold
  - Backlash against financiers and bankers in Northeast seen as proponents of these policies
    - \* Analog to today: globalization imposing strict constraints on conduct of economic policy at home which harmed sectors of economy (here, farmers) → political expression
- Alternative globalizations
  - We take for granted a particular type of economic globalization: IMF, WTO, global supply chains
  - All globalizations run on rules (explicit) and norms (internalized) – don’t spontaneously arise from technology
    - \* Majority of countries that have embraced financial globalization (open capital markets) because they think that’s what good behavior is, not because they’re following rules
    - \* Who writes the rules? Whose preferences are privileged?
  - Could have globalization targeted at preventing/mitigating pandemics, with WHO at the center
    - \* Warning system, research budget for pandemics, prevention of export controls on medical equipment, regulated border closures...
  - Another alternative: Globalization targeted at slowing down climate change
    - \* Globally binding emission quotas, research budget for renewable energy, financing for transition to green energy
  - Globalization focused on human development and empowerment
  - Alternative forms of economic globalization, too
    - \* Which flows should be liberalized? Trade, finance, labor?
    - \* Should rules reach behind borders? In which areas?
      - Subsidies, industrial policies, emissions, tax regimes
    - \* Ex: Gold standard included aspiration to labor mobility, but not Bretton Woods or post-1990s hyperglobalization
    - \* Ex: Gold standard and post-1990s regime included restraints on domestic policies, but not Bretton Woods
- Tensions between democracy and economic globalization
  - Trilemma: choose two of national sovereignty, hyperglobalization, mass politics
  - Hyperglobalization = absence of transaction costs on cross-border trade and finance
    - \* No restrictions on goods, services, assets at the border
    - \* Harmonize monetary, legal, regulatory regimes

- \* Credibly pre-commit not to deviate from these regimes
- Differences in national institutional arrangements create cross-border transaction costs and impede globalization
- Hyperglobalization runs on the logic of arbitrage → undermines differences in regulations and social models
  - \* More advanced labor standards? Firms will shift production to jurisdictions with lower labor standards
  - \* More capital market regulations? Banks go to locations where regulations are lax and export products
  - \* More progressive income tax? Wealthy individuals and corporations will move to lower-tax jurisdiction but do business in your market
- Tensions are more manageable when economic integration is limited (GATT) or regulatory differences are small (US states)
- What kind of a state does hyperglobalization require?
  - \* Provide property rights, contract enforcement, monetary stability
  - \* No costs on free flow of goods or capital
    - Sacrifice other objectives to this
  - \* Problematic for democratic regimes, since we want the possibility of divergent policies/institutional arrangements
- Democratic delegation: democratic rule can be constrained without creating undemocratic outcomes
  - \* Limit power of special interests
  - \* Enhance quality of democratic deliberation
  - \* Principle applies to international commitments, too
- But there's a difference between logic of hyperglobalization (justify any rules that restrict domestic autonomy to minimize transaction costs) and democracy-enhancing globalization (impose mostly procedural norms that enhance deliberation)
- Gold standard: hyperglobalization and national sovereignty, seems incompatible with mass politics
  - \* Rules too strict for a representative system to maintain?
- Bretton Woods: maximize democratic legitimacy at home – Keynesian macro policies + welfare state + economic restructuring
  - \* Some sectors left out of international agreements
  - \* When international trade threatened to overwhelm social bargains (1970s: exports from newly industrialized countries affect low-income sectors in advanced economies) → carve out exceptions to give advanced countries room
  - \* Explicitly incomplete globalization
- Hyperglobalization: Post-1990s, WTO + financial globalization
  - \* Due to failure of legitimacy where rules went too far (trade) – too far from democratic deliberation
  - \* And failure of regulation where they didn't go far enough (finance)
- Another alternative: “global governance,” do away with national sovereignty entirely
  - \* “Quasi-federalism” at the global level
  - \* Ideal of the European Union
- Outlines of a desirable form of economic globalization
  - Benefits to all rather than a few
  - Enforce rules for global public goods
  - Leaves space for institutional diversity across nations

**Unger**

- Application of idea of hyperglobalization to labor mobility: seems like what DR and international technocracy mean by “hyperglobalization” is not meant to include radical advance in mobility of labor
- Difference between mobility of capital/goods and labor is very significant

**Rodrik**

- Yes, post-1990s globalization has not included labor markets
- But don’t want to simply extend hyperglobalization to labor
- Want more balanced tradeoff between pushing for gains from trade and maintaining institutional diversity
  - In the case of labor, would require us to move further towards globalization
  - But for goods and capital, move back

**Unger**

- One direction: there should be a radically different treatment of goods/capital and labor
- Other direction: they should achieve freedom together in small, cumulative steps
- This radical difference in direction is concealed under label “hyperglobalization”

**Rodrik**

- Is the ultimate goal complete mobility? That would be hyperglobalization
- My view: long-term tradeoff between gains from trade and gains from institutional diversity
  - This always establishes a limit to how much globalization we can have

**Unger**

- Movement of things and money is sometimes helpful, sometimes harmful
- Movement of people is sacrosanct: significance transcends the merely economic realm
  - But cannot be established instantaneously, radically
- Can’t put this on a spectrum of more or less globalization
- Radical capital mobility is dangerous: suppresses possibility of national development
- Paradox in mainline economic theory: division of world into sovereign states is an accident, an embarrassment – why divide the world at all? Just creates transaction costs
  - Integrated world equilibrium is just a fantasy
  - Division of world into states is basis of trade theory
  - Why is the world divided? Because we value difference – for moral and political reasons, as well as economic benefits

**Rodrik**

- Challenge idea that economics has no explanation for division of rules in sovereign units
- Local public goods: different communities have different preferences → want different types of institutional arrangements
- Idea of gains from trade rooted in comparative advantage; this theory applies to why we want different nation-states
- But this theory doesn’t explain why we have existing structure of nation-states

**Unger**

- Local public goods are a thin, impoverished basis for understanding value of nations
- More fundamental basis: fecundity of method of competitive selection depends on richness of material from which method selects (analog to Darwin)

- Not a provincial accident of people having different preferences in different places
- Difference has to be *created* – we don't want just the difference that arises spontaneously
- Another point: an assumption of established discourse about hyperglobalization is that more openness requires more harmonization (legal and institutional similarity) and fewer transaction costs
  - This is a fundamental mistake
  - History of economics and law show that many earlier experiments in globalization have pushed extent to which openness and trade is compatible with underlying legal and institutional difference
  - GATT characterized by legal and institutional minimalism
    - \* Prior history of same thing: *lex mercatoria* (merchant law) in European history
    - \* Whole point of international commercial law was to reconcile increasing trade with underlying legal and institutional diversity
  - The impulse of this discourse of harmonization and exaggerated significance of transaction costs is to connect openness with legal and institutional similarity

### Rodrik

- How would we measure globalization/openness? Two different ways:
  - Quantities of flows. Lot of globalization because lot of trade, lot of investment crossing borders
  - Size of the barriers: Are there costs to goods/services/people moving across borders
- These can move in different directions. Can have barriers that are relatively high (GATT regime, Middle Ages) – but still have a lot of flows because existing barriers enable countries to manage countries better, creating more hospitable environment for the flows
  - Bretton Woods/GATT regime: expansion in trade. Not primarily because we reduced transaction costs; bulk of expansion because countries individually prospered → ended up trading more with each other
- Differences are definitionally barriers
  - People get around these barriers by costly evasion – bypassing local sovereignty, etc.

### Unger

- Costs of differences are subsidiary to larger point: under established discourse which wants to associate openness with absence of difference, friends of difference are enemies of openness
- There isn't a single spectrum of tradeoffs
- To what extent can we reconcile openness with underlying institutional difference is an empirical question. We can't answer a priori

### Rodrik

- Magnitude of transaction costs is empirical. But whether differences do indeed impose transaction costs can be answered a priori
- Normatively appropriate benchmark is the barriers, not the volume

Q: Why shouldn't we make global governance a goal? Is harmonization of human rights part of hyperglobalization?

### Rodrik

- Some areas where it's easier to establish global norms, e.g. human rights
- Appropriately hyper-global regime (along with climate change, global health)
- These are domains of global public goods
- Not sure the same applies to labor. This economic obligation doesn't rise to the same level
  - Global set of rules creating completely free labor markets is maybe not desirable

### Unger



- We want world trade system to be based on free labor
- One the one hand, different countries have to be able to compete on basis of different returns to labor
  - Don't want this to result in suppression of freedom of labor

Q: Post-1990 system hasn't enhanced labor mobility, but not for lack of trying (consensus on economic benefits of immigration).

### Rodrik

- Business interests not successful at liberalizing immigration
  - Have not been as organized, though, compared to their efforts in IP, banking/financial regulation
  - Businesses can feel direct benefits in, ex: liberalization of H1 visas
  - Not organized where gains are more diffuse – low-skill labor
- To get things done, need to use ideas and narratives, too
  - “Trade-related intellectual property rights” (TRIPS) – economists did not want this, but the narrative (from Big Pharma) gave their cause legitimacy
  - We can provide counter-narratives

Q: To what extent can environmental and health globalizations be separated from economic integration?

### Rodrik

- Could envisage world where every economy is independent (autarky) but climate is still a global public good
- How do we impose rules on carbon taxes? Can just charge countries through body like UN. Doesn't mean they have to trade

## The struggle over the shape of the market order and the contest over ways of thinking: the role of economics and of its possible reorientation

### Unger

- Begin with background theme: alternative futures of economics itself. Where will we get the ideas we need to think about the problems we have been addressing?
- This is where he and DR fundamentally disagree. DR sees nothing fundamentally wrong with established economics
  - RMU recognizes economics is the best established of social sciences
  - Forces on us clarity, especially about tradeoffs and constraints
  - But it's not enough
- Difficult to address nature of limitations/alternative directions because:
  - Confusion of relation of subject matter to method
    - \* Economics is not study of the economy; it's the study of a method pioneered by marginalist theoreticians of end of 19th century
    - \* Study of economy by another method (e.g.: Weber) is not regarded as economics
    - \* Study of something that has nothing to do with production and exchange might be regarded as economics because it deploys this method
  - Familiar criticisms (unrealistic assumptions about competition or rationality) are almost all uncomprehending → rightly dismissed
    - \* Arise from failure to understand character of method and its ambitions

- \* These misleading criticisms crowd out the criticisms we need
- Attempted heresies during course of evolution of mainline economics
  - \* Dialectic of these largely failed heresies suggests we have everything we need by way of intellectual diversity
- If we arrive at conclusion that economics in present state is insufficient, then we have no alternative readily available
  - \* Absence of alternative dissuades us from pursuing criticism and reconstruction
- Place problem of economics in narrative of modern social thought
  - Classical European social theory was a theory of structure – structures that exist in history, how they change, laws that govern their operation and transformation
  - Paradigm was Marx’s critique of English political economy
    - \* English economists represent as universal laws what are actually regularities of particular economic regime: capitalism
    - \* Regimes and structures are contingent and revisable
      - But this was circumscribed by classical social theory by a series of deterministic illusions
      - Thought there was a closed list of regimes, each an indivisible system, with a script governing their foreordained succession
      - Subsequent thought rebelled, but suppressed structural imagination altogether
  - Each social science has severed link between insight into actual and imagination of adjacent possible
    - \* They present as explanation what is a retrospective rationalization of established arrangements
  - Problems of economics are a variant on fundamental theme: suppression of structural imagination
- Deal with main line of economics resulting from marginalist revolution, suggest alternative account of its limitations
  - Marginalists (Walras, Jevens, Menger) saw economy as set of connected markets
  - Viewed operation of markets from the standpoint of individual agents (methodological individualism) who the best available means to achieve their goals
    - \* Competitive selection under constraint of scarcity
  - Results of individual decisions are aggregated by the market and manifest in the system of relative prices
    - \* Prices reshaped at the margin by the last decision → “marginalism”
  - This approach to the economy had 2 fundamental motivations:
    - \* Cut through confusion about the relation between underlying value and price that had beset pre-marginalist, “classical” economics
    - \* Create form of economic science relatively invulnerable to empirical controversy and ideological conflict
  - At time of marginalist revolution, there were many alternative directions for economics:
    - \* Edgeworth’s program: economics as psychological and behavioral science
    - \* Alfred Marshall: develop economics by analogy to natural history (weather or tides) – context-bound, loose causal sequences
    - \* These have resurfaced, but never broken hegemony of approach that resulted from marginalist turn
- What are the limitations of this economics? 4 main ones:
  - Relative dissociation of formal analysis from causal and empirical investigation
    - \* Less a causal science than a form of logic
    - \* In its purest form, it’s an analytic apparatus, innocent of factual stipulations and normative commitments but also of causal theories other than residual causal theories that could be

- inferred from simple scheme of means-ends rationality under constraint of scarcity
- \* Marginalist theoreticians exploited affinity of that scheme to deductive reasoning
  - \* This affinity helps explain why this economics reveres mathematics, but almost all math deployed in economics is relatively primitive
    - Not because economists are incapable, but because higher mathematics is useless to their method
    - Only a relatively simple mathematics is needed to carry the work of this quasi-logical science in which means-ends scheme is the basis of analogy to syllogistic reasoning
  - \* Characteristic procedure of economists is development and substitution of models to explain a set of economic phenomena
    - If model doesn't work, create another one
    - At no point does substitution of models jeopardize underlying theory, because theory at its heart is not a causal theory making empirical statements – it's a logical scheme supporting deductive reasoning
    - Different from, e.g., Standard Model of particle physics
    - If Standard Model faced accumulating level of contrary empirical observation, there would be some attempt to “save” it by rearrangements among its propositions, or by context-bound qualifications, but would be swept aside
    - Can never happen in marginalist economics because there's nothing in the elementary schema that anything that in the world could fundamentally impugn
  - \* This form of analytic invulnerability is an onus preventing dialectic of theory and discovery, of counterintuitive insight into workings of the world, condemning discipline to eternal infancy
    - But hasn't economics become increasingly empirical? “Copious flesh hangs awkwardly from a frail skeleton”
    - Where does causal element come from? Needs to come from means-ends rationality or be imported from a different discipline – behavioral or neuroeconomics (developing what was earlier Edgeworth's program)
    - Or developed on the spot – context-bound economics
- Deficit of institutional imagination
- \* Coexistence between 3 types of economics:
    - Pure economics: empty of institutional assumptions/commitments, exemplified by general equilibrium analysis
    - Fundamentalist economics: Hayek, associating abstract idea of market economy with contingent set of institutional and legal arrangements (contract, property)
    - Equivocating economics: macroeconomics, professes to study lawlike relations among large-scale aggregates against shadowy institutional background. Change in details of background matter, but because background is static, these details can be disregarded
  - \* To the extent this economics is rigorous, it is empty of institutional insight; to the extent it has institutional implications, it has them by virtue of equivocation and confusion
- Lacking proper account of production
- \* Before: theory of exchange and of production had same importance
  - \* Now: economics textbook chapter on production has almost nothing about what we would ordinarily call production
    - Almost everything is about factors of production and substitution, different forms of market organization
  - \* Reduction of production to shadowy extension of exchange made possible by a contingent feature of economies: in them, labor can be bought and sold (what Marx considered the most important feature of capitalism)

- So production can be seen under lens of relative prices
- Theory of competitive selection bereft of any account of how material from which the method selects is formed
  - \* Like if we had only Darwinian natural selection and not the part about genetic recombination
  - \* Fecundity of process depends on richness of material on which it operates
  - \* No account of economic life is acceptable if it's missing that half
- Address 2 largely halfhearted and failed attempts to break out of trajectory that marginalist revolution established
  - Development economics
    - \* Albert Herschmann: potential to represent alternative direction for economic theory, but pursued strategy of peaceful coexistence with dominant paradigm, eventually swept aside, reduced to series of context-dependent studies
      - Squandered opportunity to be point of departure for consequential intellectual rebellion
  - Keynesianism
    - \* Most successful economic apostate of 20th century, but a contained apostasy: insufficient to serve as basis for program of critique
    - \* Almost no institutional content – key variables all psychological: preference for liquidity, propensity to consume, long-term expectations
      - Tendency in English political economy of psychologism, prior to marginalism
      - Institutional observation limited to particular domains like stock market
    - \* Focus on demand side, rather than supply side
      - Can't have alternative economics without comprehensive theory of breakthroughs on supply side and demand side (and relation between the two)
    - \* Theory of economic slumps was not a “general theory,” but one of a particular kind – characterized by hoarding, rigidity of wages, inadequate demand
      - Inadequacy manifest in difficulty we have applying it to recessions of present day: leverage, expansion of credit masking absence of property-owning democracy, concentration of wealth resulting in asset bubbles producing vulnerability that begins in finance, but compromises real economy
    - \* Caught in between theory of equilibrium at low level of employment (which American followers adopted) and permanent disequilibrium
    - \* Lesson in dangers of partial intellectual rebellion. 4 stages:
      - Keynes focused on response to slump that he regarded as politically palatable: only focus on demand side
      - Year later, his follower Hicks developed IS-LM schema – formulaic reduction of his doctrine
      - American followers (led by Samuelson) reinterpreted, downsized theory into theory of fiscal and monetary policy for countercyclical management of economy
      - Labeled “macroeconomics” and placed alongside inherited body of theory (redubbed “microeconomics”)
      - Under headings like “microfoundations of macroeconomics,” economists observed everything new in this theory was unnecessary and could be inferred from microeconomic/marginalist theory
  - After all of this, we have no way of thinking structurally about the economy
    - \* Leftists embraced vulgar Keynesianism when they abandoned Marx
- No alternative to a confrontation
  - Economics is useful, even indispensable as science of tradeoffs and constraints, friend of intellectual clarity and rigor

- But it can't bring us to the threshold of insight into structural alternatives
- How to proceed? Most ambitious: a comprehensive theory. But this is the limiting case

### Rodrik

- This picture of what an alternative economics might look like is setting standards we can't meet – possible advantages are outweighed by disadvantages
  - Mistakes RMU cited: those economists were looking for universal laws or a theory of history that also wants economics to do *too much*
- Economists have carved out useful function by performing a certain trick: study of a method, rather than study of the economy
  - “Thinking like an economist” has compelling power
  - Sometimes taken too far – economic imperialism
- Main disagreement: what RMU is looking for is something universal to think about structural alternatives
  - But not job of economics to provide that
  - Smith and Marx had a particular view of what economic progress might look like
    - \* Universalist view ended up backfiring
- Approach is immune to challenge? True that if particular model is challenged, it's not the way of thinking that's challenged, it's the model
- Economics is different than natural sciences because in principle there is an infinite variety of social reality to describe – no universal constants
  - Cause and effect relationship is always contingent in a potentially infinite number of ways
  - How can something so indeterminate be useful?
    - \* Ex: How would minimum wages work? Depends on competitive equilibrium vs. monopsony. It depends, but we know what it depends on, and we can empirically check which model is relevant
- Economics has moved from programmatic vision (Smith, Marx) to a discipline – a deductive, analytical tool
  - Can distinguish analytical thinking from normative/ideological baggage
  - Normative substance needs to come from elsewhere
    - \* Chicago school libertarians: combined tools with normative judgements of inequality and practical view of government as corrupt
    - \* Krugman-type liberals: same tools, combine with different normative judgements on inequality and more hopeful view of government
- Failings of economics:
  - Mistake model for reality
  - Categorical preference for certain axioms (e.g. rationality)
  - Preference for problems that are amenable to these tools
  - Implicit political-economy theorizing in policy discussions
    - \* Especially in focus on efficiency as only way to evaluate policies
- What RMU calls a shortcoming is an advantage – don't want economists to lay claim to universal framework for thinking about structural alternatives

### Unger

- Task of theory is to provide insight into transformation
  - To understand something is to understand what it can become
- If we use models to represent established economic phenomena, how do we understand how they change?
  - In post-marginalist tradition, theory is doing something else: exempting itself from insight into

- transformation and providing supposedly neutral analytical framework
- Role that would be theory's is played by "art"
  - \* "Intuition for model selection"
  - \* This shouldn't exempt us from having a view on transformation
- Criticize invocation of intellectual modesty: "someone else will deal with structural matters"
  - In current day, central space of social theory and philosophy is vacant
  - Real debate happens in economics and law
  - Both barred themselves against responsibility of transformative insight
    - \* Economics as a result of history of marginalism
    - \* Law because it's representing system of idealized policies and principles
  - Both disciplines are misdirected – but we say someone else will do this work of imagining alternatives
    - \* "Someone else" has to be us

Q: A lot of legal thinking based on categorical morality. Economic thinking based on consequentialism: individual utility maximization, or social welfare. Is there a tension? How do we reform economic models?

### Unger

- Diminishing marginal returns is pretty close to a law in economic thinking
  - If we could loosen or reverse this, we would have potential for exponential growth
  - If we think of innovation as functionally equivalent to input and it's continuous rather than episodic, then we have potential to escape diminishing marginal returns
- No rich background of conversations about transformation of structure
- Phillips Curve stops working → something changed in institutional background → no way of thinking about relation between economic phenomena and institutional background. Another way we might begin
- We don't have to treat this as prerogative of genius
- Can't just enrich and contextualize economics. Look to natural science – rich set of causal conjectures and a physical or social conception of how something transforms
  - Math may or may not be useful
  - But not toy mathematics that is simply the adornment of deductive reasoning
    - \* Sterile as methodological basis for thinking about transformation

## Conclusions: Rethinking political economy

### Rodrik

- Antecedent model: New Deal/welfare state, settlement between working class (accumulated through Industrial Revolution) and business/financial elites
  - Significant social insurance
  - Job security through institutionalized labor markets (trade unions, collective bargaining)
  - Regulated finance
  - Mass production
  - Keynesian macroeconomic management – activist fiscal, monetary policy targeting stabilization of aggregate demand
  - "Thin" globalization: Bretton Woods and IMF = capital controls, GATT system
- Collapse of this model:

- Technological change with unequal rewards
- Hyperglobalization
- Financial globalization: free flow of short-term capital
- Deinstitutionalization of labor markets
- Deindustrialization (premature in low- and middle-income countries)
- Neoliberal narrative on macroeconomic management: downplayed active management, emphasized markets, austerity
- Empirically: decline of middle-class share of income; employment prospects and wage of middle class has suffered most (worldwide)
- Three interconnected challenges:
  - Inclusion: how do we ensure those who have been excluded from advanced technologies are reincorporated?
  - Growth: address slowdown of productivity growth in advanced countries, premature deindustrialization in developing countries
  - (Political: authoritarianism, personalistic strong-man politics)
- Common root: scarcity of productive, stable middle-class jobs
- Remedies?
  - New social contract based on new “industrial” policy
    - \* Increase supply of good jobs
    - \* Redirect innovation in labor-friendly direction
  - State strong enough to achieve inclusive growth, but not strong enough to smother pluralism
  - Balanced globalization. Encourage pluralism, but focus on:
    - \* Global public goods (pandemics, climate change)
    - \* Beggar-thy-neighbor policies (global tax havens)
    - \* Areas with large economic gains (labor mobility)

## Unger

- Transition in most advanced practice of production: traditional mass production to knowledge economy
  - Smith and Marx understood that best way to understand alternative futures is to look to most advanced practice
  - Transition has produced a disappointment and a danger:
    - \* Appears as series of exclusive fringes
    - \* Leads to economic stagnation, aggravation of inequality
  - How do we deepen and disseminate the most advanced practice?
- Broader focus: situation and sequel to last major moment of institutional and ideological refoundation – the social democratic/social liberal settlement developed after WWII
  - In US: New Deal welfare state
  - Regulation, attenuate inequality retrospectively (tax-and-transfer), countercyclical management
  - Most important problems can’t be addressed within the limits of this compromise
- 3 problems in political economy:
  - Relation of backward to advanced practices of production
  - Relation of labor to capital
  - Relation of finance to production
- Social cohesion: money transfers organized by state against background of ethnic homogeneity
  - As homogeneity fades, inadequacy of money as social cement is exposed

- Under arrangement of weak democracies, change continues to depend on crisis
  - No trauma, no transformation
  - Need form of democratic politics that diminishes dependence of change on crisis
- Methods: we have a problem in contemporary thought with the discussion of structural discontinuity, structural alternatives
  - Classical thought had structural vision which was corrupted by various forms of determinism (Marxism)
  - Contemporary social sciences: deficient in structural imagination
  - Embarrassment in programmatic arguments: feasible but trivial vs. interesting but utopian → everything proposed likely to be dismissed as trivial or utopian
    - \* Fall back on bastardized criterion of political realism: proximity to the existent
    - \* False dilemma threatens to inhibit the programmatic ambition
- Hope: past great thinkers had generous vision of unrealized human opportunity motivating search for transformation
  - This whole course is a bet on the marriage of insight to hope
- The only democracies we have are weak and low-energy
  - Based on low level of people's engagement in political life
  - Awaken only when there's trouble
- Not persistent tests of established structure
- Alternatives: authoritarian vanguards that claim to speak in name of collective interest, but hold this collective interest ransom to their dogmas
- Transform weak democracies into strong democracies: depends on institutional innovations in the form of democratic politics
  - Increase level, tempo of politics
- Basic schema of ideological controversy: state against the market (more of one or the other, or synthesis of market and state)
  - Different conception of ideological contest: alternative institutional form of the market, independent civil society
- World is restless under dictatorship of no alternatives