

The Squandering of America's Assets

Interview with Robert Kuttner

*No one quite masters the comprehensive picture of the U.S. economy as well as Robert Kuttner. In his recent book, *The Squandering of America*, he finds a country in distress. And the culprit, he says, is politics. Is he optimistic nevertheless? Read on.*

Q Congratulations on your latest book. Often in the past when you have written, you have put economic problems in political terms. In other words, the problems you saw had political solutions. But this time you more specifically blame America's economic problems on its politics. What in particular are you talking about?

A. First, there is a distributive issue. Productivity and pay have diverged, and the average American finds that his economic situation has become much less secure, much more precarious. Then there is a systemic risk issue, as evidenced most dramatically and most recently by the meltdown in subprime mortgages. Both of these very serious sets of problems represent political failure. If you are in the top 1 percent of the population, they represent political success, but for most people, they represent political failure because the remedies are not on the radar screen of mainstream politics.

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Q. Why not? What has changed?

A. There has been a tilt in what J.K. Galbraith used to describe as countervailing power. The countervailing institutions that used to offset the influence of concentrated wealth no longer countervail, so the public sector itself—the labor movement, the power of mobilized voters, the power of the whole mutual sector—has basically been annihilated.

Q What do you mean by the mutual sector?

A. I mean, for example, thrift institutions that were nonprofits, pre-paid group health plans that were organized as nonprofits, or producer and consumer co-ops. In a little-noticed change in the institutional fabric of American society, these resources hardly exist anymore. They have almost all been converted to for-profit institutions. Their reserves have all been looted. This is another example of the weakening of institutions that once offset the power of concentrated financial wealth. If you enumerate the kinds of policy remedies that once made for a more equal and stable society (economic dynamism operated just fine, and you had more institutional stability in the quarter-century after World War II), every one of the institutions offering them—the public sector, the labor movement, economic regulation—has been weakened. And in this period of more managed capitalism, economic dynamism operated just fine.

Q You spend a lot of time talking about what I would call the rise in power of Wall Street. Wall Street has always been powerful to some extent. Has it ever been more powerful than it is now?

A. Wall Street has been less powerful at times. Let us recall that Wall Street was disgraced by the crash in 1929. Fortunately, in the next election, we subsequently got not just a Democratic president, but a very effective, very progressive Democratic president in Franklin Roosevelt. So in the 1930s a regulatory regime was constructed that harnessed Wall Street for the benefit of the public good and tried to

ensure that a great crash would never happen again and that the political influence of Wall Street would be constrained. The government tried to make sure that the financial economy would be the servant of the real economy rather than the master. And, to a large extent, that regime worked. So, financial speculation was institutionally constrained, and it was somewhat politically constrained both by the fact of its disgrace and by the fact of the regulatory system that was set up during the New Deal.

All that in turn went hand in hand with other regulatory strategies that not only constrained opportunism but also provided for a more egalitarian wage structure. For example, if public utilities or airlines or the telephone companies are regulated, a certain kind of competitive regime is put in place, but a secondary effect is that wages are removed from competition. Thus a regulated public utility can compete by signing up new customers, reducing costs, and making its product more widely available as it becomes cheaper; it does not compete by trying to see how little it can pay workers. And so a secondary effect of the deregulation of industry after industry has been the weakening of wages.

A whole model of regulated capitalism—managed capitalism, which Paul Samuelson called a mixed economy—that was put in place in the wake of the Great Depression to anchor a system of much greater security, much greater equality, and much greater stability for a quarter-century after World War II started being dismantled in the 1970s. Inflation and stagflation were mistakenly blamed on regulation. In retrospect it had everything to do with the collapse of the system of fixed exchange rates launched at Bretton Woods and the OPEC oil shock, and very little to do with regulation. But regulation became the scapegoat, and then during the Carter administration, both parties embraced deregulation as a remedy for stagflation.

In the meantime, Wall Street regained the normal influence that finance ordinarily has in a market economy. So by the 1980s and also in the Clinton era in the 1990s, both parties became financially beholden to Wall Street and essentially are complicit in deregulation and in the broader ideology of *laissez-faire*.

Q **In which areas did this actually take root? Taxes?**

A. Yes, and in the early 1980s a bidding war arose in which both parties were trying to ingratiate themselves with business and demolish progressivity of the tax code. One thing done inadvertently, which was a real windfall for the right, was the rescue of social security through pre-funding a surplus by raising taxes on this generation of workers by as much as trillions of dollars. The taxes that were increased were payroll taxes, which are the most regressive kind.

In the early 1980s, the Greenspan Commission, whose leaders were Alan Greenspan, former Commissioner of Social Security Bob Ball, and Speaker of the House Thomas P. "Tip" O'Neill, proposed a repair of the shortfall in the Social Security system—one part tax increase, one part increase in the retirement age. Except for the way that it was financed, it was a perfectly successful rescue. But no one quite appreciated at the time that it was a massive tax increase on working people that funded a surplus, which George W. Bush gave away in the form of tax cuts for the rich. So there were huge tax increases on this generation of working people who pay payroll taxes, to underwrite the next generation's retirement.

Q **I do not believe that people fully understand what actually happened. Payroll taxes were raised so much that, in effect, they exceeded what was needed for annual payouts, and therefore a surplus was created over those years—deliberately created.**

A. Right. But because of the way this was financed, it was a massive tax increase on working people at the same time that Reagan was cutting taxes on corporations and rich people.

Q. A regressive tax?

A. A very regressive tax. In the tax-and-spend calculation, taxes and spending become less attractive because an ordinary worker is paying higher taxes but getting less back from government. I certainly do not think that Bob Ball understood this. I do not think that even

Greenspan was cynical enough to realize what the political effect of this would be, but it was a real windfall for the right.

Q What about some of the things that were directly influenced by powerful corporations—such as the general tax cuts?

A. I think the tax cuts were tilted toward the top. And the complete gutting of the 1935 Wagner Act, which guaranteed the right of collective bargaining, made it harder for workers to organize unions—and a lot of workers want to be members of unions—as did the utter lack of enforcement of the Wagner Act.

Q When did that weakened enforcement begin? Give us a bit of history on that.

A. Business started becoming viciously anti-union in the early 1970s. And by the late 1970s the labor movement was sufficiently concerned about this assault that it tried to get Carter to support labor law reform, meaning enforcement of the Wagner Act. There was an effort in 1978, which failed by two votes in the Senate because Carter refused to spend any political capital on it, and then this assault only became more extreme in the 1980s and the 1990s. For a period under Clinton, there was a friendlier National Labor Relations Board, but the momentum in favor of union busting never ceased.

And then there was deregulation itself, particularly of finance but also of several other industries. With a couple of exceptions, deregulation has been a failure even on its own terms. For example, in the case of electricity deregulation, all the studies now show that retail competition for the price of electricity has proved to be a fantasy, and the states in which the industry has been deregulated have had much, much higher rate increases than those where it remained regulated.

Airline deregulation has been a mixed blessing at best. Former chair of the Civil Aviation Board Fred Kahn—the godfather of it—says now that he never envisioned complete deregulation, only regulated competition. But, combined with a lack of antitrust enforcement, the

result has been gigantic hubs, a crazy quilt of fares, and a colossal deterioration of service. Trucking deregulation, which has generally been considered a success in terms of cost, has had all kinds of side effects that are not accounted for. For example, because of deregulation, port truckers who arrive at ports and offload containers are independent contractors. They make \$7 or \$8 an hour, and their vehicles are ten or twenty years old. So, instead of having a system in which the driver has a modern truck with a computer on board his vehicle, as UPS has—which indicates that the container is at, say, Bay 36 and should be picked up at 12:15—the trucker waits in line, crawling for several hours with his engine on, waiting to be directed to the right bay while spewing diesel particulate (which has the potential to increase asthma among children in the vicinity) and wasting fuel. And nobody cares because it is only the time of an independent contractor that is being wasted. Now there are efforts to re-regulate this process by having ports determine pollution standards and equipment standards for the trucks that enter their premises, which would recreate a regularized system of large certified companies that could be unionized—unlike independent contractors—and made to pay their workers decent wages. So even regulation of trucking, which is sort of the poster child for successful regulation because it reduced rates, is somewhat a mixed blessing when you count all the social costs.

Q. Let us talk a little about financial deregulation.

A. The poster child for that, of course, is the subprime mortgage. In researching my book, I went back and read a lot about the 1920s. If you look at all the kinds of abuses that went on in the 1920s, they can be broken down into three basic types: insider conflicts of interest, lack of transparency, and excess leverage. All the reforms of the 1930s were intended to prevent or tamp them way down.

Then fast forward to the 1990s. The Glass-Steagall Act, separating commercial banking from investment banking, is first gutted by regulatory exemptions and then repealed. What happened when SEC chairman Arthur Levitt tried to regulate through the Securities and Exchange Commission? Members of Congress from both parties threatened to cut off his appropriations. And the accounting and

stock-price manipulation scandals of the 1990s—Enron, WorldCom, Global Crossing—were the result. The 2002 Sarbanes-Oxley Act passes, requiring honest corporate bookkeeping, but then life goes on, with just different abuses. Again, if you look at the abuses of the 1990s and the abuses of this decade, it's the same unholy trinity: lack of transparency, insider conflicts of interest, and excess leverage. Efforts to bring greater transparency or regulation to derivatives or to hedge funds have been beaten back. And in the meantime, these increasingly exotic financial products keep being concocted. Innovation, by definition, is supposed to be a good thing, so the regulators do not keep up with it. They are not empowered by Congress to keep up with it. The people whom Bush appointed to the regulatory agencies do not really want to keep up with it.

So this all comes together with the subprime mortgages, in which an unregulated mortgage company originates a loan that has a high likelihood of not being paid back. But in another unregulated process, a Wall Street investment bank or a commercial bank turns it into a bond, and in another unregulated process, a private bond rating agency that is paid by the same bank somehow blesses it as an AAA security, and then in another unregulated process, a consenting adult is induced to buy it. So it is a classic case of what happens when there is a lack of transparency or regulatory scrutiny. And this all could have been prevented if the Federal Reserve had deigned to enforce the 1994 Home Ownership and Equity Protection Act, which directed the Fed to establish underwriting standards for lenders, even lenders that were not otherwise federally regulated. But Greenspan, because he believes in free markets, did not want to issue the regulations.

Q **As the consequence of deregulation, is the credit crisis the primary danger, or are there other consequences of equal danger?**

A. The biggest problem with financial deregulation is excess leverage, lack of transparency, and systemic risk. And systemic risk takes multiple forms, one of which is being played out right now—a credit crunch that the Fed and the Treasury are having some difficulty bring-

ing under control—but there are others. I actually thought a big hedge fund meltdown would happen before the subprime meltdown, but both of these were, and are, accidents waiting to happen. In addition, both the Republicans and the Democrats have looked at trade with China naively—as good for us and good for them—but the tolerance of Chinese mercantilism has created a chronic trade deficit and now financial dependency on China, which now holds as much as \$1.4 trillion in U.S. dollars, and a gutting of American manufacturing industry because the rules of the trading system do not require symmetry.

Q. Explain that a little further.

A. Under the World Trade Organization, export subsidies are illegal, but subsidies intended to induce industry to relocate are not explicitly illegal. Nor is currency manipulation illegal. China has taken advantage of these loopholes to become a bizarre spectacle of a country that is still a one-party authoritarian, in many respects Leninist, state, yet a partner with the ugliest face of global capitalism. China, serving as the agent of American capitalists and providing them with subsidies and with docile workers who have no rights, creates a wildly asymmetric trade relationship. The entire American elite is whistling past the graveyard as if this is not a problem. Since it is in China's interest to keep selling us goods; supposedly it is also in China's interest to keep lending us dollars to import their products. But at some point, as in musical chairs, the music stops, and when the music stops, we are the ones who are stuck.

Q. It depends on keeping the value of the dollar high.

A. The dollar is already losing a lot of value relative to other currencies, but it is not losing much value against the yuan.

Q One thing that you talked about in the book that I find interesting is that wages in developing countries are suppressed not by the free market but by the failure of the free market to function. Wages are suppressed by business power, which ends up holding down export prices. Have I explained that right?

A. The sweep of the history of the West includes a struggle dating

back 125 years for workers to obtain decent wages, for trade unions to be recognized as legitimate social actors, and for the institution of various regulations that give labor a little bit more bargaining power, such as minimum wages and health and safety regulations. In the absence of those advantages, business naturally has more power than labor, especially in a situation where there is residually high mass unemployment. I have never thought of myself as a Marxist, but I have to say that “reserve army of the unemployed” sounds less stilted to me than it did when I was studying economics forty years ago. It sounds pretty much like a description of what is going on in much of the world.

And when the state is colluding with Chinese trade and labor practices, the situation is only exacerbated. Trade unions can increase worker bargaining power to some extent, but free unions are illegal in China, and so the Chinese government is working hand in glove with American multinational enterprise to keep wages below what they would be if it allowed unions. Moreover, China keeps wages below what they would be if you paid workers in proportion to their productivity—if it had some kind of labor norms in international trade alongside property right norms, as in the United States. Thus, there is an implicit subsidy by exploited workers, in which the disparity between productivity and wages entices jobs overseas. There are also these WTO-illegal industrial subsidies that the Chinese government very kindly gives to American industry.

Q Trade is not free, in that sense.

A. No, of course not. Once you acknowledge that you need property rights and contractually enforceable rights of investors for commerce to flow, there is no such thing as “free trade.” The only question is who sets the ground rules. And in this case, when it comes to cross-border trade, the ground rules and the agenda are set mostly by industry, whereas for 125 years within our country there has been greater symmetry between the rights of property and the offsetting social rights. A lot of that symmetry is being undermined, not by trade per se but

by the disproportionate power that the financial elites in the United States have had to define the terms on which trade occurs.

Q So here we have financial elites, and other business elites, I suppose, defining vast areas of our life: taxes, trade, deregulatory policies in general. How can this be countered? Is it possible?

A. Yes, that is a good question. Normally, you would expect the opposition party, which in this case is the Democratic Party, to offer a different economic ideology and program. But I think the Democratic Party, half of it anyway, is financially beholden to the same elites, certainly at the presidential level, because of the money that is needed to run for office. So entire areas of possible public policy are off limits. Re-regulation in any serious way is off limits, as is serious public spending; budget balance as a supreme virtue has crowded out public outlay. And if you look at what it would take to restore a degree of income security and income equality in the United States, almost all the things that you would need to do are beyond the pale of mainstream politics.

Q. Both Democrat and Republican?

A. Yes. For example, if you wanted to restore health insurance security and retirement security—by paying for it socially rather than making it a function of who the employer happens to be—maybe a hundred Democrats in the House and maybe twenty or thirty senators would support that. So that is outside the realm of the politically thinkable, as is the idea of deficit spending of the sort that was normal in the postwar era for social purposes—1.5 percent of the gross domestic product. But because of the influence of fiscal conservatives such as Robert Rubin on the Democratic Party, that is not the consensus view. Now, 1.5 percentage points of GDP is more than \$200 billion. That is enough money to restore a lot of social spending. You could pay for universal child care—universal pre-kindergarten—and have enough left over to go a long way toward universal health insurance, as well as restoring neglected investment in public infrastructure.

The restoration of labor bargaining rights is the one area that will

likely be addressed if a Democratic president is elected; you will probably get what is now called the Employee Free Choice Act, which is basically just the enforcement of collective bargaining that has been on the books for seventy-two years but has not been enforced in any meaningful way. So most of the things that you might do to restore greater security and greater equality for ordinary people are off the radar screen, except for the restoration of collective bargaining. Trade also splits the Democratic Party right down the middle. Questions of whether to bring greater symmetry to the trading system, whether it is legitimate to try to retain industrial and technological leadership in the United States, are very controversial.

Q Do you mean through trade protections? What would you recommend?

A. I would recommend labor standards and other social standards as part of trade deals so that if you want to be a totalitarian country that does not recognize core labor rights, you are perfectly free to do that, but you do not get tariff-free trade with the United States. And you also do not get to offer subsidies to induce American industry to relocate offshore.

I could imagine bolder action in another key area: How do you replace the good middle-class, blue-collar jobs that have been disappearing so that you can have a more egalitarian distribution of primary income? I would be in favor of a policy that ensures that all service jobs are good jobs, because this is where the job growth is. We could stipulate that we as a society are going to make heroic efforts to turn any job taking care of a sick person, an old person, or a young person into a professional job. That would take some public money, but it would be a very good use of public money. Interestingly, Scandinavia, which has such policies, has not had the erosion in the income distribution that we have had, even though we have been subject to the same technological forces and even though they trade to a greater degree than we do—because they have had in place equalizing institutions of the sort that we have lost. Denmark is a

full-employment economy, which spends about 4.5 percent of GDP on labor market policies. So if you lose your factory job, you will get as good a job, if not better, in the service sector, and you do not have the disparities in wages.

Q How does one raise the standards? What specific policies can raise those kinds of standards?

A. The way the Danish system works is that when you lose your job, you go to a jobs center, which comes up with an individualized plan for you. It may involve sending you back to college, it may involve training, or it may involve a wage subsidy for a period of time. Because Denmark is strongly unionized, it does not have industry trying to crush unions, so it does not have low-wage sectors. The really interesting statistic is that Denmark has either the highest or the second-highest degree of labor mobility in the Organization for Economic Cooperation and Development, in sharp contrast to France. There is no effort to protect workers by making it hard to fire them. In Denmark, it is easy to fire workers. In addition, there are a lot of voluntary job changes because workers are always looking for better opportunities, and government is always looking for opportunities to shift workers to higher-productivity work. But Denmark spends 50 percent of GDP socially. So it is possible, it seems to me, to reconcile open trade and a flexible labor market with an egalitarian society, but it is a heavy burden politically and institutionally, and we do not come close.

Q. In general, given all that has happened and given what you have written, how can you be optimistic?

A. I believe that the cycle of conservatism has nearly played itself out. This is a country where nothing succeeds like success and nothing fails like failure; and the Bush administration has been a spectacular failure in its foreign policy and now increasingly in stewardship of the economy. GDP has grown a total of 18 or 19 percent since 2000, and, yet, according to Andy Sum at Northeastern Center for Labor Market Studies, only the top 3 or 4 percent of workers have received

real wage increases. This is why in the 2006 midterm election, despite very low unemployment, the economy was a major issue: the low unemployment rate was not translating into increased living standards. When you add to that the insecurity that people feel regarding the risk of loss of their job, health insurance, or pension and the stress on families because there is no policy to ease work-family dilemmas, the average person feels very vulnerable economically.

So the question is, is there a Democrat who will be even partly responsive to that feeling? Or will the Democratic nominee be a captive of the Wall Street donors? Events may well force the Democratic nominee to embrace a more progressive politics. Franklin Roosevelt, after all, campaigned on a pledge to balance the budget. And when he took office he realized that that would not be wise policy. I would be very surprised if, over the course of the election year, the Democratic nominee fails to embrace more progressive economic themes.

Q Do the people want it? You cite some surveys in the book.

A. Yes, I think that people are hungry for some kind of affirmation of the fact that they are hurting economically. In the absence of that affirmation by leaders, there is a vicious circle where people do not see politics as delivering much for them, so they do not become very enthusiastic about politics. But you could turn that circle in the opposite direction.

Q. So you remain optimistic through all of that?

A. I'm semi-optimistic. If ever there was a moment for progressive leadership, this is it. Whether the leadership will materialize remains to be seen.

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