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A Progressive Agenda for the Twenty-First Century

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My intent in writing this chapter is to lay out what I see as a Progressive economic agenda for the twenty-first century. By its very definition, the Progressive agenda has to change, it has to *progress*—as our understandings of the economy and society change, and as technology, the economy, and society themselves change.

But before setting forth a Progressive agenda for the twenty-first century, I would like to explore the key beliefs and values of the Progressive movement. What is it that a Progressive economy should be striving for? Both the left and the right repeatedly pay homage to values, but too often, those values are either left unspecified, or are defined in ways that are so banal as to be uncontroversial: the value of the individual, the value of freedom, the value of the family.

As I see it, Progressives stand for a core set of values, which are far from banalities—values that many on the right would not subscribe to.[2] Too often, the progressive movement is implicitly defined by the conservatives and by what it opposes. Here, I want to deliniate the *positive* progressive agenda.

First on the agenda is the value of progress itself. Society can and should change to help us better achieve what we strive for. Thus the Progressive movement puts a high value on innovation—both technological innovation and social innovation. But in emphasizing change, Progressives do not ignore the legacy of the past, which is to say they value the ideas and understandings inherited from previous generations. This represents a fundamental difference between Progressives and conservatives, whose focus is on preserving the past and the attendant inequities and power structures that have often prevailed in earlier years.

The Progressive agenda is today's embodiment of the Enlightenment project: the belief that through rational and scientific enquiry we can learn, and what we learn can be used to improve well-being. Overall, the Enlightenment project has been enormously successful: for thousands of years, standards of living improved at a rate that was barely perceptible. Most individuals spent all of their energies simply to survive and to acquire the bare necessities of life such as food, clothing, and shelter. Today, because of the Enlightenment and the advances in science and technology that followed, those needs require but a few hours of work a week; the rest of our time can be devoted to the acquisition of goods beyond the bare necessities and to leisure activities, including the development of culture and science, the expanding of our horizons, and the raising of our living standards still further.[3]

We have come to understand too that there may be, at any point in time, limits to what we know or what can be known. Godel's theorem and the Heisenberg uncertainty principle represent the most forceful articulation of these limits to our knowledge. Progressives do not seek certainty where there is none; we have to live with uncertainty and ambiguity.[4]

This rational enquiry extends not only to the physical sciences but also to the social sciences, as well as to our understanding of man, his behavior, and his relationship with others.

Any research agenda attempting to improve the plight of the world's population must begin with an enquiry into the nature of man—what he cares about, what motivates him, how he thinks, and how he behaves. Modern economics is based on a certain conception of the individual. Individuals come into the world with well-formed preferences and beliefs. They are rational. But a rational enquiry into human behavior shows that these beliefs are not always well founded. Individuals' beliefs and preferences are at least partially culturally determined, and there are many ways and instances in which behavior is far from rational.[5] This helps explain why certain subcultures—those belonging to a particular political party, in particular locations, for example—embrace beliefs that seem so at odds with scientific evidence, such as the belief that climate change is a myth.[6]

The notion that individuals and their beliefs are malleable should fill us with hope: for it means that in principle, we might create a society in which more individuals conform to our ideals. We could create a society in which there is more trust, more charity, more cooperation, as well as less selfishness, less greed, and less corruption. We might create a society with less racism and prejudice.

But in another way, the changing nature of beliefs leaves us without an anchor. Standard welfare economics, for example, had a well-defined objective—increasing the well-being of individuals with well-formed preferences that specify the degree of happiness, satisfaction, or utility provided by any bundle of goods and activities. But if preferences themselves are malleable, what is it that we are supposed to maximize? By assuming preformed preferences and beliefs, economists had, however, taken the easy way out of some of the deepest and most important philosophical questions: What is a good society? What is a good individual?

Sketching what might be answers to these questions would take me beyond this short essay. But progressives share certain views on these matters. Individuals should, for instance, take into account how their actions affect others (or at least weigh the externalities[7] that they impose). Progressives also affirm the value of liberty, the right of others to do as they please, so long as their actions do not impose costs on others.

These views are also partially derived from rational analysis: we all live in a society that not only affects our preferences but also affects us in myriad other ways. Indeed, no individual is "self-created," although listening to commentary from the right (even from those who inherited their fortunes from their parents) one might have thought otherwise.[8] As Newton said, even the giants who have made the most profound contributions to our society stand on the shoulders of those who went before.[9] The individual and the collective are inextricably intertwined. And if that is so, we have to think hard not just about how what we do affects ourselves but also how it affects others.

There are many areas where the impacts on others can be quite significant. If I drive too fast, pollute the atmosphere or water, I can impose enormous costs on others, even death. My freedom is your unfreedom. No discussion of liberty can ignore this basic insight. Creating a good society entails imposing restrictions on what one individual does, when those actions might affect others.

There are some cases where, to use the economist's jargon, regulations, standards, restrictions can be Pareto improvements[10]: that is, everyone would be better off living with certain restrictions than with the absence of those restrictions. Without stoplights, no one could drive across Manhattan without fear of an accident or being caught in gridlock. Traffic regulations enhance the safety and speed for (almost) everyone. But often, some regulations provide more benefits to some at the expense of others.

The right has worked hard to give regulations a bad name. At the same time, they talk about the importance of the rule of law. But the law is nothing more than the basic rules and regulations that govern society. And it matters what rules and regulations are in place and whether they serve a few at the top or everyone in society. It matters too how they are enforced and implemented.

On the other hand, what individuals do privately—among consenting adults—should not be restricted. To be sure, someone else's well-being might be affected by the knowledge that something that he disapproves of is occurring. One could argue that there is, as a result, an externality, but Progressives believe that this is a category of externalities that shouldn't be regulated.

This is an arena in which progressives and the right couldn't be more different. Many on the right oppose gun control, arguing that it impinges on the freedom to carry guns. But there is a huge societal cost to that freedom: that cost being in the death of thousands of innocent victims. In balancing the right to live and the right to carry a machine gun, most progressives are solidly for the former.

The opposite is true when it comes to the issue of gay marriage and the extension of legal rights to same-sex couples. Here, Progressives argue that society is attempting to restrict actions that affect no one but the two consenting adults, and therefore there are no grounds for such restrictions. The right, often appealing to basic laws of nature, argues otherwise.

More generally, the right often makes appeals to long-standing institutions like marriage, as if they were God given and that history gives them sanctity. Progressives see institutions as something we create to serve our purposes, and as we come to understand better the purposes they serve, and the way they succeed or fail to fulfill those purposes (or how they might serve other ends), institutions get reformed, or even destroyed and replaced. Intellectual property law, for instance, is not part of natural law but is a human construct, designed to promote innovation. We need to understand the ways in which the latter accomplishes this and how it may actually impede innovation. So too for each of the institutions in our society.

This is not to say that progressives give short shrift to history. As I have said, institutions exist to serve certain needs. The fact that an institution has survived may indicate that it has served those needs well. But society and the economy change, and what served some needs well at one time may not serve them well at another. More importantly, the power structures—whose views are most reflected in existing arrangements—may change. An institutional arrangement that served yesterday's elites well may not be appropriate in a more democratic era.

Moreover, progressives recognize that one cannot create new institutions out of whole cloth. That is why evolutionary processes are often more successful than revolutionary processes. This is also why some of us were skeptical about the "shock therapy" approach to the transition from Communism to the market economy and preferred a more gradualist approach, where new democratic institutions and legal frameworks could be established as a market economy was being created. A market economy without an appropriate rule of law, we feared, would be a jungle. And so it turned out to be.[11]

Earlier in this paper, we explained how the actions of one individual affect others. We are interdependent. This makes it almost inevitable that society engages in collective action. By providing goods collectively,[12] and by providing rules and regulations, we all have a chance to be better off. But once one admits of the desirability of some collective action, one has to have some mechanism for collective decision making with rules and regulations that govern that process, including those that limit what can and cannot be subject to collective decision making. Here, too, progressives tend to share a firm belief in democratic, participatory processes. At the same time, they believe certain restraints on government are necessary. These views are reflected in the Bill of Rights guaranteeing freedoms of speech and religion. Today, we recognize other rights such as the right to privacy and the right to know (e.g., what the government is doing). But we also recognize that there are certain societal obligations, reflected in the Universal Declaration of Human Rights—including the right to health care and to certain other basic needs.

While both progressives and the right pay obeisance to democratic principles, there is often a difference in what is meant. Democracy means more than an election every four years. Modern Progressives put considerable weight on inclusive and participatory processes, aware that in the past certain views, and the views of certain groups, were not heard (or at least were not heard loudly) while other views, and the views of certain other groups, tended to dominate.[13] To be sure, progressives would like some views to be heard more loudly than others: for example, those views derived from evidence and sound reasoning. And they are wary of the power of money.

This is another arena where the progressives and the right couldn't disagree more. In the United States, the right has been actively engaged in a campaign of disenfranchisement of the poor, for which there is a long historical precedent.[14] At the same time, decisions like *Citizens United* and restrictions on campaign finance reform have enhanced the power of money to affect electoral outcomes. As I suggested in my book *The Price of Inequality*[15], America has become a country closer to "one dollar one vote" than to "one person one vote." A key challenge for the country is how to prevent America's outsized economic inequality from being *further* translated into political inequality. An active agenda of gerrymandering by the right has further reduced democratic representativeness and accountability.

The challenge of creating more effective, inclusive, participatory processes is one of the key issues facing the progressive movement. But while we may not know how to create an ideal system, we can identify changes that make the system worse. These are key battlegrounds for progressives today.

By the same token, we know how to increase accountability: "right to know" laws are essential.[16] But also essential is media diversity, to ensure that there is a free and fair marketplace of ideas. This will not be the case if media outlets are dominated only by the rich and powerful.

Antitrust laws were originally enacted more to prevent the concentration of political power than to ensure market efficiency. But in the more than one hundred years since these were first enacted during the administration of Theodore Roosevelt, we have narrowed our vision: we have forgotten the dangers that the concentration of economic power pose to our democratic political process—and nowhere is this more important than in the media. Equally significant, especially in the aftermath of the 2008 financial crisis, is the power of the big banks to stymie the wishes of most Americans to enact more effective regulations in the financial sector.[17]

I would also argue that there is one respect in which the Enlightenment project has failed: we must acknowledge that a significant portion of today's population, while benefiting from the advances of science, do not subscribe to its core tenets and deny one aspect of the findings of modern science or another. Many people do not believe in evolution, and many still do not believe in climate change.[18] But the analytic approach that underlies Progressivism has never come to terms with these seeming anomalies. As I noted earlier, one element of "rational enquiry" involves recognition of the limits of rationality. To make matters worse, it may be in the interests of some groups in society to encourage this kind of irrationality: oil companies stand to gain economically if more people believe that climate change is a hoax, and they are willing to use their money to persuade others that this is true. (In other contexts, the elites deliberately left large masses of the population undereducated.)

I have emphasized that the Progressive agenda is about change, but that raises questions: Change for what ends? What is it that we should be striving for? How do we know whether the change is making things better or worse? These are, of course, extremely complicated questions, encompassing all of the issues we have been discussing. But there is a short answer: change should enrich the lives of *all* citizens, to enable them to flourish and to live up to their potential.

In putting the matter this way, I emphasize one aspect of the Progressive agenda—that of social justice. Social justice and fairness have, of course, many dimensions—not just at a moment in time, but over generations. Part of social justice—and a key way in which its attainment is more likely to be assured—is ensuring *equality of voice*, especially in our political process. Part of social justice is equal access to justice—enshrined in the pledge of allegiance to the flag that school children recite every day. Justice is *for all*, not just for those who can afford it. There is the matter of justice across generations (what economists refer to as "intergenerational" justice). Despoiling the environment today puts those in future generations at risk.

Progressives believe that all individuals, regardless of their parentage, should have the right to live up to their potential and that there should equal opportunity for all. They also believe that *excessive* inequality is morally wrong; that it alters and effectively undermines the functioning of our society, our economy, and our democracy.[19]

There are some inequities that are so egregious that they call for special attention—for instance, inequalities in access to health care. Given all of this, the attainment of certain minimal standards (commensurate with a country's economic capacity), have come to be recognized as basic economic and social rights within the Universal Declaration of Human Rights.

Earlier I referred to the progressive commitment to equal access to justice. This is part of a broader commitment to the rule of law. But what progressives and conservatives mean by the rule of law can be markedly different. It is not *any* rule of law. After all, the feudal order was, in a sense, a rule of law, with well-defined obligations, constraints, and norms. In effect, it enshrined the principle that might makes right. It was a rule of law that served those at the top and acted to preserve a hierarchy. What Progressives mean by a rule of law is intricately related to precepts of social justice: a rule of law designed to protect the weak, not to preserve the entitlements of the strong; a rule of law which, both de jure and de facto, enshrines the principle of equality of all before the law.

In this brief discussion, I have had to elide several key issues. What do we mean by fairness? Many on the right believe that it is unfair to tax the rich whose wealth is their just desserts for what they have contributed to society. Progressives believe that no one is really self-made and that all of us are dependent on what we receive from others and from society more generally. Progressives also believe that there is more than a little bit of luck in determining certain personal economic outcomes.

What do we mean by *excessive* inequality? While that is an important question, for current policy discussions, we don't have to answer it: the level of inequality experienced in the United States and other countries is well beyond the level that should be viewed as acceptable. (Note that progressives do not call for complete equality. Even if that were attainable, there is a recognition that some inequality may be desirable to provide the incentives that are required in order for our economy to function.)

What does it mean to live up to one's potential? Although again I cannot give a full treatment here, let me say what it is not. It is not just maximizing one's income. Humans are more than goods-producing machines, which if fine tuned can do a better job in transforming inputs into outputs. Living up to one's potential means full use of one's mental and physical capabilities. It recognizes that we as individuals gain pleasure from using our minds and that when those talents are turned to problems of societal importance, society as a whole benefits. It recognizes too that we are social beings, and that, as such, social connections are important. Progressivism goes beyond materialism: man cannot live without bread, but man cannot live on bread alone.

Because this is so, progressives eschew GDP fetishism: the objective of our society is not to maximize GDP. As Robert Kennedy famously said, GDP "measures everything, in short, except that which makes life worthwhile."[20] Or, to quote FDR's first inaugural speech, "Happiness lies not in the mere possession of money; it lies in the joy of achievement, in the thrill of creative effort. The joy, the moral stimulation of work no longer must be forgotten in the mad chase of evanescent profits."[21]

THE PROGRESSIVE ECONOMIC AGENDA

Let us now turn our attention to the more narrow set of traditional economic issues: What should be or is the Progressive view of the role of the state in the economy? What should be the Progressive economic agenda? One cannot answer these questions without reference to the underlying foundations presented in the first part of this chapter: the nature of human choices, the relationship between the individual and society, our values and what we are striving for.

Given the high ground that the right has assumed in recent decades, perhaps it is best to begin with an explanation of the counter position and what is wrong with it. The right's economic worldview is predicated on the notion that markets, on their own, are efficient and stable and thus there is no need for government; and even if there were some minor problems, collective action (government) would at best be ineffective, and it would more likely make matters worse. It goes further: even when there is only one firm in a particular market, ever-present *potential* competition fully disciplines the monopolist; and even when there are externalities, Coasian bargaining can (given an assignment of secure property rights) lead to an efficient outcome.[22] There is no need for government intervention, say those on the right, although in some instances there is a need for *voluntary* collective action: for example, non-smokers might have to bribe smokers not to smoke, and so on.[23]

These views seemed to draw upon a long intellectual tradition dating back to Adam Smith, who explained how the pursuit of self-interest would lead, as if by an invisible hand, to the well-being of society. But Adam Smith was far more nuanced in his reasoning than his latter-day followers. He understood the proclivity of markets toward monopolization. He understood the role of government, for instance, in providing for education. Adam Smith was, in effect, describing one of the *attributes* of the market economy, one of the forces at play—countervailed by other forces going in other directions.

It would be nearly 175 years later before economists were able to show the sense in which competitive markets might lead to the well-being of society. This well-being is expressed as "Pareto efficiency," in which no one can be made better off without making someone worse off—a construct that pays no attention at all to distributive justice.[24] As research progressed, it became clear that contrary to the presumption of Smithians, the market was almost *never* efficient: the intellectual underpinnings of these doctrines (that I have referred elsewhere to as *market fundamentalism*) have been totally destroyed in the past thirty years. For instance, with imperfect and asymmetric information or with limited risk markets, markets are never Pareto efficient, even taking into account the costs of gathering information or creating markets.[25] Agency costs and externalities are rife. Markets on their own are not only inefficient, they may not be stable—witness the crises that have afflicted the global economy since the beginning of the era of deregulation.

Even a casual inspection of modern American capitalism has shown that this optimistic attitude regarding markets without government intervention has not worked well: cigarette companies were killing our citizens; chemical companies were polluting our rivers; energy companies are polluting our air; the financial sector neither allocated capital well nor managed risk—and polluted the global economy with toxic mortgages; monopoly power is a reality in large segments of the economy; and corporations often seem more interested in maximizing the well-being of their executives than in enhancing stock market value, let alone the well-being of society more generally.

It should also be clear that the market does not work in the way depicted by economic textbooks, where demand always equals supply. We have homeless people and empty homes. We have vast needs—investments required to retrofit the global economy to address the reality of global warming, and investment needs in infrastructure, technology, and education not only in developing countries but even in advanced countries—and yet we have vastly underutilized resources, large numbers of unemployed workers, and idle industrial plants and equipment. Some may claim there is a savings glut[26]; in truth, we have financial markets that seem unable to redeploy the world's scarce savings to where social returns are highest.

The progressive movement grew naturally from observing these repeated instances in which markets—in the nineteenth- and early-twentieth-century version of capitalism—seemed to be failing to serve the interests of society more broadly. Through the advances in economics over the past half-century, we have come to understand better these pervasive "market failures," and so we now know how to make markets better serve society.

This then is one of the responsibilities of government: *to make markets act like markets*[27], to act more like the textbook models in which what they do does serve societal interests. This entails passing and enforcing good laws on corporate governance, competition, bankruptcy, the environment, conflicts of interest, etc., and strong regulations that restrict the ability of anyone to impose large costs on others.

It is, perhaps, ironic that it has been left to Progressives, often seen as critics of markets, to make markets act like markets. It is not clear what the real problem of the right is: Do they really think that the pervasive market imperfections that have been noted do not exist? Or is it that corporate money sees that by rigging the rules in their favor, they can enhance their own short-sighted interests?

We should also recognize that markets don't exist in a vacuum. They function under a set of rules and regulations, and how they function depends on those rules and regulations. If those rules and regulations allow for greater scope for conflicts of interest, then there will be more "perverse" and inefficient behavior. There will be less trust—a subject to which I will return shortly.

Every rule (and more broadly every policy, every tax, every expenditure) affects not just the efficiency of the market but also the distribution. (This too was one of the main messages of *The Price of Inequality*.) When a bankruptcy law gives first priority to derivatives, it distorts the economy and enriches the bankers buying and selling these weapons of mass financial destruction.

Earlier, I described social justice as a basic Progressive value. But the Progressive equality agenda can be defended on more than just moral grounds: we pay a high price for our high level of inequality; we could have more growth and stability, greater efficiency, and higher standards of living and increased well-being.

This is a marked departure from how the right looks at matters. They see a trade-off between efficiency and equity, and they often argue that any attempt to achieve greater equality would be counterproductive—that it is those at the bottom who would most suffer. They seem to assert (without proving it) that we are in a Rawlsian equilibrium.[28]

Today, the vocabulary has shifted. Since as the rich have gotten richer, *most* of the economy has gotten poorer, it's hard to defend trickle-down economics.[29] Median household income adjusted for inflation is lower than it was a quarter century ago.[30] An economy that, over such a long period of time, fails to increase the living standards of a majority of its citizens is a failed economy.

Thus, rather than trickle-down economics, we need "trickle-up" economics: if those at the bottom and middle do well, so will those at the top. We need, in particular, to build out from the middle.

The argument of the right today is implicitly based on a counterfactual claim: were it not for all the money going to the top, the poor would be even poorer. For the rich are the job creators. Without them, the poor would not have even the meager incomes they have. But this contention flies in the face of both evidence and the right's own economic theories. When there is demand for goods, entrepreneurs will have an incentive to satisfy that demand. That is the nub of Smith's argument. But of course if there is no demand for goods, even the best of entrepreneurs will not make investments. Western economies have demonstrated no dearth of entrepreneurship: when demand was high (and even when tax rates were very, very high) jobs were created. When demand is weak, even if tax rates are low and firms are sitting on trillions of dollars of cash (so money is no constraint) jobs won't be created.

Even more corrosive for our economy, and for our sense of identity, is the lack of opportunity that has come to mark the United States and some other advanced countries. Some on the right claim that what matters is not equality of outcomes but equality of opportunity. But in saying that, they make two fundamental mistakes. The first is the assertion that the United States is in fact a land of opportunity. To the contrary: a young American's life prospects are more dependent on the income and education of his parents than in other advanced countries. And those countries that seek to emulate the US economic system are finding that opportunity is diminishing there as well.

The second mistake is to presume that one can separate inequality of outcomes from inequality of opportunity. Where economic inequality is great, so too is political inequality; and where inequality of outcomes is great, so too is inequality of opportunity.[31]

So far, I have described two of the central roles of government: promoting equality and social justice, and regulating the economy—establishing the rules of the game under which any system has to operate. There is a third role that most even on the right accede to: maintaining growth and stability. As the most recent economic crisis makes so apparent, markets are not self-regulating. They are prone to booms and busts. And when they go into recession, they are not quick to recover on their own. The government has an important role to play in modulating the excesses of markets and, when there is an economic downturn, in helping engineer a recovery.

But there are two more roles for government that are important parts of the progressive agenda: promoting growth, entrepreneurship, and development, and promoting social protection.

Government (collective action) can play a positive role in promoting growth, and—as evidenced by the chapters in this book—it has done so repeatedly. In fact, there are few successful countries in which government has not played that role.[32] Again, we now have a good understanding of why it is that markets are likely to underinvest, say, in basic research—and why it is that government made the critical investments that led to the transformation to modern agriculture and to the creation of modern telecommunications, from the first telegraph line to the modern Internet.[33]

We also have a better understanding of why government needs to play a central role in social protection—why markets have systematically failed in an efficient and fair manner to address widely recognized needs for social insurance, whether it be for retirement, unemployment, or health care.[34] Individuals value security, and yet markets do not seem adequately able to address these needs and desires; hence government has stepped in to fill the breach.[35]

We now recognize that different aspects of the economy are intertwined and that various sectors of the economy—and the policies that are supposed to govern them—have an impact on both economic efficiency and social equality. As economic policy is formulated, the fundamental progressive agenda laid forth in the first part of this chapter need to be borne in mind. Take, for instance, monetary policy, a subject which is usually thought of as technocratic. Conservatives have tried to use technocratic arguments as justification for the existence of an independent central bank that is largely focused on inflation. But an independent central bank, like that in the United States, can easily be captured by financial interests. When this occurs—as was the case in the lead-up to the 2008 financial crisis—little is done to ensure that the financial sector serves the rest of the economy and does not simply exploit it. In such a climate, the central bank may renege on its responsibility to ensure that the banks do not engage in predatory lending, abusive credit card practices, or exploit their market power to the detriment of the rest of the economy. In recent history the central bank's obsession with inflation led to greater financial instability—and almost surely higher levels of unemployment and inequality—than would have occurred if it had maintained a more balanced focus on inflation, growth, employment, and financial stability.[36]

We have also come to understand how inequality leads to macroeconomic instability and lower economic performance overall. The lower level of social cohesion, with the associated lower level of trust, has a direct impact on economic performance but an indirect effect as well, because of the lessened support for vital public investments in infrastructure, technology, and education. Because of these lower investments, larger portions of the population—especially those at the bottom of the economic pyramid—are not able to live up to their potential. Social inequities feed on themselves in a downward vicious circle. As a result we waste one of our most precious resources: human resources.[37]

CONCLUDING OBSERVATIONS

I have discussed at length the roles that successful governments can and have played in enhancing the well-being of society.

Some twenty-five years ago, I delivered a lecture in Amsterdam on the economic role of the state.[38] There, I explained at greater length how modern economic theory had shown why markets often fail to produce efficient or socially acceptable outcomes. These have been labeled "market failures," and I described the roles of the government in remedying these failures. The roles that I described roughly accord with those just illustrated.

I explained how the powers of government enabled it to potentially remedy these market failures but then went on to identify certain limitations of government (e.g., its limited abilities to make commitments, the fact that it had the power of compulsion made constraints on equity and due process more imperative but that these constraints were often costly).

Here, I want to comment briefly on how recent events and advances in economics over the past quarter century have modified and enriched our understandings of these issues—several of which I have already alluded to.

We have learned more about the strengths and limitations of government and learned more about how we can improve government performance. We have come to understand better the risks of capture of government (including cognitive capture)—the role of money and revolving doors—and how transparency can help. The reinventing government initiative during the Clinton administration also showed how we can improve both the efficiency and efficacy of government, making it more responsive to citizens. Some parts of the government have demonstrated remarkable competencies: for example, the transactions costs associated with Social Security are but a fraction of those associated with most private annuities. Looking around the world, the public health-care systems in Australia and many European countries manage to deliver better health outcomes at a fraction of the costs of America's largely private system. Citizens value and respect the teachers that teach their children, the firemen that protect their property, the policemen that ensure law and order. They even like their own Congressmen, overwhelmingly tending to reelect them. They tend to make denigrating remarks about *other* teachers, *other* Congressmen, and most importantly, about faceless gray bureaucrats. But the numbers of these bureaucrats, especially relative to the size of the population or the government's budget, has in fact been in marked decline, suggesting that government has become *more* efficient.

An understanding of the limitations of government has implications not so much for *what* the government does but *how* it does it. Even in countries with limited governmental capacities, it is still desirable, for instance, for the government to pursue industrial policies that promote faster growth, more equality, higher employment, and a better environment. But it may be desirable for such governments to utilize broader based instruments, like the management of the exchange rate.[39]

The financial crisis has, of course, made the reality of market failures all the more obvious, demonstrating that markets by themselves are neither efficient nor stable. It is not just that the market economy is not good at accommodating shocks; the market, in fact, amplifies them. It is also that the market economy is prone to create its own shocks, with credit cycles and asset bubbles.

Moreover, the recent crisis has heightened our sense that waste is not the monopoly of government: no government has probably resulted in a waste of economic resources on the scale of America's financial markets, with the cumulative loss from the gap between potential and actual output of the nation's overall economy now totaling trillions of dollars.

We have come to understand the importance of informational and related imperfections: agency costs are pervasive, in both the public and private sector. Deficiencies in corporate governance, no less than in public governance, are omnipresent. The economics profession has been slow to take on board Berle and Means[40] insights about the consequences of the separation of ownership and control, or Herbert Simon's observation that if there is a difference between public and private sector performance, it is *not* simply a matter of incentives: incentive problems are universal.[41]

By the same token, we have learned that privatization is no panacea. This is not just a theoretical observation. The only circumstances in which privatization would fully resolve the problems posed by government ownership are the highly restricted conditions under which markets are themselves Pareto efficient.[42] But real phenomena observed time and time again, from British railroads to Mexican roads, to American prisons to America's use of mercenary armed forces, shows us otherwise.[43]

We have seen that the imperfections of information are endogenous: banks and CEOs have the ability and incentives to distort the information that they reveal, to engage in nontransparent transactions.[44] And we have seen how they have fought for the right to maintain such lack of transparency, even within government-insured institutions.

We have come to understand that there are very important related macro-externalities. A crisis in one bank can lead to problems in other banks—and then to problems in the economy as a whole.

The most recent crisis has also heightened our understandings of the extent to which individuals can be exploited by others, as they were systematically, through insider trading, market manipulation (e.g., libor, foreign exchange), predatory lending, abusive credit card practices, etc. Most fundamentally, the notion that the economy can be well described by models based on rational well-informed individuals with rational expectations has been totally undermined.[45]

But what was perhaps most shocking about the crisis to people on both sides of the Atlantic, was the ample evidence of *moral turpitude,* especially in the financial sector. It was not that there was a disease that was particularly prevalent in the southern part of Manhattan, or that struck with a particular virulence in the early days of the twenty-first century, with a relapse a few years later. Rather, it was that the economic, political, and social system that had evolved over the preceding decades had given rise to an entire class of individuals without moral moorings. We had as such created a society in which many Americans found distasteful, all of which reinforces the observations I made at the beginning of this chapter: preferences and behavior are, in part, malleable and culturally determined, and the direction that the United States had taken since the beginning of the Reagan revolution was the wrong direction.

It is understandable that political disillusionment set in when those that had caused the crisis (i.e., the bankers) were bailed out, while innocent victims—those who lost their jobs and homes—were left largely to suffer on their own. The fact that in the aftermath of the crisis inequality worsened, with the top 1 percent getting 95 percent of the gains from 2009 through 2012[46] has led to further disillusionment with our political and economic system. For most Americans, the crisis is not over. We can trumpet having prevented another Great Depression; however, we cannot claim that we quickly restored America to prosperity. Indeed, as noted, the loss resulting from the Great Recession—measured by the gap between the trend line, where we would presumably have been had the crisis not occurred and the economy's actual output—amounts to trillions of dollars.

The crisis undermined our society's claim not just to fairness, but even to having a meaningful rule of law. We had rules governing what should happen when banks can't pay back what they owe: a seemingly well designed system of conservatorship. But we rode roughshod over these and basic principles of capitalism as we bailed out the bankers, their shareholders and bondholders, and we failed to hold accountable those who had caused the crisis. An even more egregious violation of the rule of law was manifested in the foreclosure crisis, where people who did not owe money were thrown out of their homes. A "good" rule of law is supposed to protect the vulnerable, not the rich and powerful. We did just the opposite.

President Clinton began his Administration with a manifesto called *Putting People First.* If one does put people first, it means a focus on the things they care about: jobs and wages, education, health and home, opportunity and security. The progressive economic agenda must concentrate on these. We know what to do to make significant progress on each of these fronts. We know what to do to increase equality and opportunity. The problem is the politics. And that is why a progressive economic agenda cannot be separated from a progressive political agenda.

Notes

1. The author is University Professor, Columbia University and chief economist, Roosevelt Institute. The author would like to acknowledge the helpful comments of David Woolner and of the other members of the November 2013 Roosevelt Institute conference in Dublin at which this was first presented ("Progressivism in America: Past, Present and Future"), and the assistance of Eamon Kircher-Allen.
2. There are, of course, large differences both within the Progressive movement and within the Conservative movement. Still, the values and economic agenda that I ascribe to Progressives would, I believe, garner widespread if not unanimous support; and my caricature of the Right (the Conservative movement) is, I believe, accurate in describing a set of beliefs adhered to by the vast majority of those of that persuasion.
3. This is a central theme of my 2014 book with Bruce Greenwald, *Creating a Learning Society: A New Approach to Growth, Development, and Social Progress* (New York: Columbia University Press, 2014).
4. That is, we cannot be sure either of the consequences of our actions, of the actions that others will take, or future states of the world.
5. This is a central message of the 2015 *World Development Report* of the World Bank, *Mind, Society, and Behavior.*
6. See "Climate Change in the American Mind," a 2013 report of the Yale Project on Climate Change Communication and the George Mason University Center for Climate Change Communication, available at <http://environment.yale.edu/climate-communication/files/Climate-Beliefs-November-2013.pdf>.
7. Externalities are simply the effects that individual actions have on others for which those are actions not compensated (in the case of positive externalities) or for which they do not provide compensation (in the case of negative externalities).
8. This point has important implications for taxation: Conservatives often argue *for* inequality on the grounds that the rich are simply receiving the *just deserts* from their contributions to society. Progressives note that each individual's productivity in fact is a consequence in large measure of what others have done, not only for him directly, but in creating the environment in which he can prosper. Thus, even if it were the case that compensation reflected individuals' (marginal) productivities, that productivity would not be what it is without the contributions of others. See the discussion below.
9. The precise quote is from a 1676 letter to Robert Hooke: "If I have seen further it is by standing on the shoulders of giants."
10. A Pareto improvement is simply change that makes one or more individuals better off without making anyone worse off.
11. There is a huge literature on this subject, with many warning that in the absence of the appropriate institutional framework, the transitions would fail to produce the desired benefits (see, e.g. J. E. Stiglitz, "Some Theoretical Aspects of the Privatization: Applications to Eastern Europe," *Revista di Politica Economica,* December 1991, 179–204. Also in M. Baldassarri, L. Paganetto and E.S. Phelps (eds.), *Privatization Processes in Eastern Europe* (St. Martin's Press: New York, 1993), 179–204. As the process unfolded, it became clear that these warnings were prescient. See, for instance, the keynote address I delivered as chief economist of the World Bank looking back at the first ten years of transition (J. E. Stiglitz, "Whither Reform? Ten Years of Transition," in *Annual World Bank Conference on Economic Development,* B. Pleskovic and J.E. Stiglitz (eds.), Washington: World Bank, 2000, 27–56). For a more extensive comparison of the gradualist Chinese approach and the shock therapy invoked in Russia, see Athar Hussain, Nicholas Stern, and J. E. Stiglitz "Chinese Reforms from a Comparative Perspective," in *Incentives, Organization, and Public Economics: Papers in Honour of Sir James Mirrlees,* Peter J. Hammond and Gareth D. Myles (eds.) (Oxford: Oxford University Press, 2000), 243–277. For a discussion of some of the theoretical explanations for the failure of shock therapy, see

K. Hoff and J. E. Stiglitz, "After the Big Bang? Obstacles to the Emergence of the Rule of Law in Post-Communist Societies," *American Economic Review*, 94(3), June 2004, 753–763 and K. Hoff and J. E. Stiglitz, "Exiting a Lawless State," *Economic Journal*, 118(531), 1474–1497. Some years later, as the process of transition continued, these perspectives were confirmed. See S. Godoy and J. E. Stiglitz "Growth, Initial Conditions, Law and Speed of Privatization in Transition Countries: 11 Years Later," *Transition and Beyond*, S. Estrin et al, eds. (Hampsire England: Palgrave Macmillian: Hampshire, England, 2007), 89–117.

12. The theory of public goods (P. Samuelson, 1954) explains why there are certain goods that can more efficiently be provided collectively. For a textbook treatment, see J. E. Stiglitz, *The Economics of the Public Sector* (New York: W.W. Norton, 5th edition, 2015).
13. When the US *Declaration of Independence* says that "All men are created equal," it did not mean, of course, that they were equal in all respects, but that there should be equality in their political voice. See Danielle Allen, *Our Declaration*, A Reading of the Declaration of Independence in Defense of Equality, Liveright Publishing. 2014. Recent decisions and actions (discussed below) often seem inconsistent with the values expressed in the Declaration of Independence.
14. See the papers prepared for the Roosevelt Institute's November 2013 conference in Dublin, "Progressivism in America: Past, Present and Future."
15. J. E. Stiglitz, *The Price of Inequality: How Today's Divided Society Endangers our Future* (New York: W.W. Norton, 20120).
16. See, for instance, A. Florini, ed *The Right to Know: Transparency for an Open World* (New York: Columbia University Press, 2007) and J. E. Stiglitz, "On Liberty, the Right to Know, and Public Discourse: The Role of Transparency in Public Life," in *Globalizing Rights*, Matthew Gibney ed. (Oxford: Oxford University Press, 2003), 115–156. (Originally presented as 1999 Oxford Amnesty Lecture, Oxford, January 1999.)
17. Though we saw their power even before the crisis, e.g. in the repeal of the Glass Steagall Act and the passage of legislation preventing the regulation of derivatives. See J. E. Stiglitz, *Freefall: America, Free Markets, and the Sinking of the World Economy* (New York: W.W. Norton, 2010).
18. According to "Climate Change in the American Mind" (Op. Cit.), nearly a quarter of Americans believe global warming is not really happening; according to a Pew study, a third of Americans reject the idea of evolution. See "Public's Views on Human Evolution," Pew Research Center, December 30, 2013, available at <http://www.pewforum.org/2013/12/30/publics-views-on-human-evolution/>.
19. This is a central theme of my book *The Price of Inequality, op cit.* The effects of excessive inequality on economic performance have now been well documented. See, for instance Andrew Berg and Jonathan D. Ostry, 2011, "Inequality and Unsustainable Growth: Two Sides of the Same 28 Coin?" *IMF Staff Discussion Note* 11/08.
20. Address at University of Kansas, Lawrence, Kansas, March 18, 1968. This view has been emphasized by the international Commission on the Measurement of Economic Performance and Social Progress, whose report is available as *Mismeasuring Our Lives: Why GDP Doesn't Add Up*, J. E. Stiglitz, J. Fitoussi and A. Sen (New York: The New Press, 2010).
21. There were many other remarks in FDR's First Inaugural that echo the themes stressed here: He spoke of "the falsity of material wealth as the standard of success," and that "we now realize as we have never realized before our interdependence on each other."
22. With well defined property rights, the "Coasian" view is that bargaining between affected parties would ensure efficiency. For instance, if the smokers in the room have been given the right to smoke, if the benefits of clean air to the non-smokers exceeds the benefits of smoking on the part of the smokers, they would "bribe" the smokers not to smoke. See Ronald Coase, "The Problem of Social Cost," *Journal of Law and Economics*, Vol. 3, 1960, 1–44. The result that such bargaining leads to efficiency only holds, however, if there are no transactions costs—and a number of other conditions are satisfied.

23. Thus, even the Coasian approach does not abnegate the need for collective action: Coase does not provide an alternative solution for the free rider problem in the context of public goods.
24. Arrow, K. J., 1951. "An Extension of the Basic Theorems of Classical Welfare Economics," *Proceedings of the Second Berkeley Symposium on Mathematical Statistics and Probability*, J. Neyman, ed. (Berkeley: University of California Press, 1951), 507–532; Debreu, G., 1954. "Valuation Equilibrium and Pareto Optimum," *Proceedings of the National Academy of Sciences*, 40(7), 588–592; and *The Theory of Value* (New Haven: Yale University Press, 1959).
25. B. Greenwald and J. E. Stiglitz, "Externalities in Economies with Imperfect Information and Incomplete Markets," *Quarterly Journal of Economics*, Vol. 101, No. 2, May 1986, 229–264
26. See for example Ben S. Bernanke's March 10, 2005 speech as Federal Reserve governor, "The Global Saving Glut and the U.S. Current Account Deficit," available at <http://www.federal-reserve.gov/boarddocs/speeches/2005/200503102/>.
27. This is the title of an important initiative of the Roosevelt Institute undertaken in the aftermath of the financial crisis.
28. John Rawls, in his classic 1971 book *A Theory of Justice* (Cambridge, MA: Harvard University Press), argued that society should maximize the well-being of the worst off individual.
29. Trickle down economics argued that money given to the rich would "trickle down" to the rest of society, and in so doing, everyone would benefit.
30. See U.S. Census Historical Income Table H-06.
31. This relationship has come to be called the Great Gatsby curve. There has been a wealth of research supporting the existence of this systematic relationship. See Alan Kruger, January 12, 2012, "The Rise and Consequences of Inequality in the United States," speech given as Chairman of the Council of Economic Advisors, available at <http://www.whitehouse.gov/sites/default/files/krueger_cap_speech_final_remarks.pdf>.
32. While a few years ago, this perspective would have seemed controversial, today it is much less so. One of the main items in the agenda of Justin Yifu Lin as Chief Economist of the World Bank from 2008 to 2012 was the promotion of industrial policies. See, e.g. J. Lin and J. E. Stiglitz, *The Industrial Policy Revoltuion I: The Role of Government Beyond Ideology* (New York and Houndmills, UK: Palgrave Macmillan, 2014). For a broader theoretical discussion, see J. E. Stiglitz and B. Greenwald, *Creating a Learning Societ: A New Approach to Growth, Development, and Social Progress*, New York: Columbia University Press, 2014.
33. See Maria Mazzucato, 2013, *The Entrepreneurial State: Debunking Public vs. Private Sector Myths*, London: Anthem Press.
34. These market failures are closely linked with problems of information asymmetries—moral hazard and adverse selection. Indeed, our understanding of these limitations largely grew out of the analysis of failures in the insurance market. See, e.g. Kenneth Arrow, "Uncertainty and the Welfare Economics of Medical Care," *American Economic Review*, 53(5), 1963, 941–97; Kenneth Arrow. *Aspects of the Theory of Risk-Bearing (Yrjo Jahnsson Lectures)*, Helsinki, Finland: Yrjo Jahnssonin Saatio, 1965; Richard Arnott and J. E. Stiglitz, "The Basic Analytics of Moral Hazard," *Scandinavian Journal of Economics*, 90 (3), 383–413, 1988; and Michael Rothschild and J. E. Stiglitz, "Equilibrium in Competitive Insurance Markets: An Essay on the Economics of Imperfect Information," *Quarterly Journal of Economics*, 90(4), 629–649, 1976. For further discussion, see J. E. Stiglitz, "Perspectives on the Role of Government Risk-Bearing within the Financial Sector," in *Government Risk-bearing*, M. Sniderman (ed.), Norwell, MA: Kluwer Academic Publishers, 1993, 109–130.
35. The failure to assess the value of security is one of the failings of GDP—and one of the reasons that reforms in social insurance, allegedly to improve economic performance may have had just the opposite effect (which would be apparent if economic performance were correctly measured). See Stiglitz, Sen, and Fitoussi, *op. cit.*
36. See J. E. Stiglitz, *Freefall, op cit;* J. E. Stiglitz, *The Price of Inequality, op cit.;* and J. E. Stiglitz, "Central Banking in a Democratic Society," *De Economist* (Netherlands), 146(2), 1998, 199–226. (Originally presented as 1997 Tinbergen Lecture, Amsterdam, October).

37. This is one of the central messages of my book *The Price of Inequality.*
38. *The Economic Role of the State,* A. Heertje ed. Oxford: Blackwells, 1989.
39. See B. Greenwald and J. E. Stiglitz, "Industrial Policies, the Creation of a Learning Society, and Economic Development," in *The Industrial Policy Revolution I: The Role of Government Beyond Ideology,* Joseph E. Stiglitz and Justin Yifu Lin (eds.), Houndmills, UK and New York: Palgrave Macmillan, 43–71.
40. *The Modern Corporation and Private Property,* (New York: Macmillan, 1932).
41. Simon H. A., 1991. "Organizations and Markets," *Journal of Economic Perspectives,* 5(2), 25–44
42. David Sappington and J. E. Stiglitz, "Privatization, Information and Incentives," *Journal of Policy Analysis and Management,* 6(4), 567–582, 1987.
43. By the same token, we have come to understand that ownership may not be the central issue: publicly owned enterprises may also not serve the public interest; they may exploit workers and abuse the environment. What is crucial is establishing control (regulatory) mechanisms; ownership may affect both access to information and the design of these mechanisms.
44. Edlin, A. and J.E. Stiglitz, 1995. "Discouraging Rivals: Managerial Rent-Seeking and Economic Inefficiencies," *American Economic Review,* 85(5), 1301–1312.
45. For a more extensive discussion of these failings, see J. E. Stiglitz, *Freefall, op. cit.* For a more technical discussion, see J. E. Stiglitz, "Rethinking Macroeconomics: What Failed and How to Repair It," *Journal of the European Economic Association,* 9(4), 591–645, 2011.
46. See updated tables to Thomas Piketty and Emmanuel Saez, 2003, "Income Inequality sin the United States, 1913–1998," *Quarterly Journal of Economics,* 118(1): 1–39. (Longer updated version published in A.B. Atkinson and T. Piketty eds. (Oxford: Oxford University Press, 2007); tables and figures updated through 2012 on the website of Emmanuel Saez, <http://eml.berkeley.edu/~saez/>.