

## **TRANSCRIPT FOR SOCIETAS EPISODE #6: Finding the Public Interest in Response to the Financial Crisis**

**Paul Price:** Craig, How are you today?

**Craig Calhoun :**I'm good Paul, how are you?

**Paul Price:** Is your money doing okay?

**Craig Calhoun:** Well, it could be doing a lot worse!

**Paul Price:** Yes, well, I thought I would bring up that question because of the subject that I wanted to talk to you about today. I should note, though, immediately, that we're sitting in a new environment for me, which is the Institute for Public Knowledge at New York University, and gee, it's beautiful Craig.

**Craig Calhoun:** It is nice, isn't it?

**Paul Price:** It's stunning. I thought I would note that for people out there. Come on down! To the Institute for Public Knowledge!

**Craig Calhoun:** It is public.

**Paul Price:** A new institute that New York University is sponsoring and setting up, and Craig is the director of that, as well as the president of the Social Science Research Council. Getting back to money, yes, Craig – you know, yesterday, I was looking through the *Wall Street Journal*, I figured we'd go there to see what was really going on...

**Craig Calhoun:** Things got really bad, so you started reading the *Wall Street Journal*.

**Paul Price:** Yes sir. I must admit that I don't usually read the *Wall Street Journal*, but I have been paying attention recently. And I noted that on the very front page—several quotes that really made me pause, stop and scratch my head. One of them was, “In many respects, the financial sector last week all but ceased to function.” In the same article, a mention of “the worst financial crisis in 80 years,” and then I think it was also interesting to find on the front page, along with these very dire kind of statements, an article on how it's not simply a matter of investment companies going under, it's not simply a matter of massive bailout, it's not simply a matter of people being thrown out of their homes, but there are now indications that people for example are cutting spending on health, foregoing taking their three and four years old daughters to the doctor for checkups, etc. etc.

In other words, the ripple effects of this crisis are extending outward and outward. And I think it's safe to say that this is not an insignificant crisis, and I think it's safe to say that in the presidential race, that both candidates are acknowledging this. But I also think that—and I want to ask you about this—I'm also finding that the framing of the crisis by

both McCain and by Obama, and also the framing of the crisis by leaders in Congress, is rather narrow. Narrow in the sense that the take on this is, “All right, what we need to do, we do this bailout, but we need to set conditions”—at least for the Democrats—that executive compensation is trimmed back as much as possible, that of course homeowners should be able to stay in their homes, etc. etc.—but there is not much addressing of a broader systemic question, which arguably goes back quite a few years. One narrative has it going back to the Internet bubble bust, and Greenspan, and flooding capital markets with money, and with the lowering of the interest rate. But I’m wondering if this crisis doesn’t go back a good bit further.

**Craig Calhoun:** Well Paul, every crisis has a history, and so this is in many ways a set of events that bring into acute focus some longer-term trends, and then some very short-term contingencies. So there are histories at different time spans.

It seems to me that one of the really compelling ones is simply the proportionate amount of capital and of profit making that went into the finance industry. And that’s a trend particularly of the last 30 years or so, and growing rapidly since the 1990s. So the amount of capital that is not in factories, not in farmland, not even in the manufacture of computer software, but in *finance* per se, went up strikingly. And so when you have something like a third or more of the profits in the economy being made in finance—that means being made essentially in exchanges that are in varying degree disconnected from the underlying material productivity—you have a vulnerability. Now that doesn’t mean a crisis on any particular day—is it Tuesday, is it next week?—but it’s a vulnerability.

Secondly, there has been the phenomenon of securitization of more and more kinds of risk, so that in an effort to manage risk, but also an effort to create new opportunities for profit, a variety of new kinds of securities have been created and sold. “Derivatives” is the word used to describe lots of these, and the core idea is simply creating a sellable instrument to give a value to particular kinds of risk, the—in essence—*bets* on whether particular markets are going to go up or down. And lots of investment went into these sort of derivative instruments, which have arcane pricing algorithms and which are often traded in partially automated, roboticized ways.

The implications of this are many and complex, and some of them very technical. But one of the implications of this is simply that there is a lot of money in instruments whose behavior people don’t understand very well, whose behaviors are untested. At the extreme, they depend on assumptions about liquidity that got brought to a test—and that’s what turned a long term trend into a short term crisis, in part that liquidity was threatened—but it’s not only liquidity. It’s the question of simply knowing what the value is or should be. So you quoted the *Wall Street Journal* saying that the financial markets essentially ceased to function. And part of why they ceased to function is that they were searching for ways to establish value.

So there are questions about liquidity, which may be assumed to be unlimited in any particular algorithm, but which isn’t really unlimited in the world, but also short term questions, just figuring out values, and values changing very rapidly when you have all of

these different kinds of financial instruments in play; you have currency in play, you have conventional stocks in play, you have the housing market and its intersection with mortgage instruments and insurance for all these things. The question of what sort of value things would land at became crucial. We saw that in the valuation of whole firms, Lehman Brothers, or others, which could lose 90% of their market value over a very short period of time, and it raised questions then about what was that value, that underpinning value? And I think a lot of what we see is the way in which value gets assigned being mysterious, certainly to the vast majority of ordinary people, but even to lots of the specialists. When you move outside a trading band, you move outside of the range of ordinary trading, suddenly it becomes really opaque what this instrument is going to be worth. And it can turn out to be worth nothing the next day.

So various investors, famously Warren Buffett, began to say, “This is not something that you can really invest wisely in.” Warren Buffett moved away from derivative markets, even though he is very heavily invested in insurance, shifted his asset mix, did not invest in lots of these highly volatile securities that were making other people a lot of money in the short run, and said he didn’t believe in investing in what amounted to *gambling*, because you couldn’t really know the underlying values. He wanted to invest as a value investor in things where you could establish the value.

So that whole kind of financial instrument, and that huge influx of money into finance capital—as distinct from industrial capital or other forms of capital—is really basic. Now that doesn’t mean that the crisis is exactly chronic or long term, but it means that the conditions for having the crisis can’t be captured by just relating it to the last few weeks, or to the mortgage finance market, or even the larger problems of junk bonds and relatively shaky debt instruments. [It means] that it’s deeper. And we have to ask, “How did this come about?”

It’s also in arenas where there’s next to no regulation. Not always because there was deregulation, often because there are new kinds of instruments in new arenas, and so the regulations have never been written, but with the result that in many cases there are not clear rules for making transparent the financial underpinnings of businesses. There are not strong regulations in the nature of trading, and so forth, so that it was easier to get into this immediate crisis.

Now all of that kind of answering is still within the frame of thinking about what’s the financial crisis.

So you asked about framing in the beginning. I think if we’re going to stay within the financial crisis frame, we still need to look longer term, at what are the conditions of possibility for this kind of crisis, how did it come about? What *is* the story of investment banking houses, this now nearly extinct form? But there’s also the fact that lots of people’s lives are lived in relation to real goods and real services, and not simply financial instruments. And so they may be worrying about taking their daughters to the doctor, in your example, or buying a car, or paying the mortgage on their house, and not working in the financial industry and not profiting from this.

This movement of more than a third of the profit making in the economy into finance probably greatly increased inequality. It's something that benefited and made fortunes for one segment of the population, not others—it made the stock market go up and it looked like boom times for some during a period when many in the rest of the economy were hurting. The mortgage crisis has a long extension, and there's a whole story we could go into about housing. The issue of health insurance—being able to take your three or four year old daughter to the doctor—is a long term problem in the United States about the lack of availability of affordable health insurance, and about health care costs themselves. And that's not anything new with this crisis; that just means that this is a very expensive item, and when people get under financial pressure, they look for things they can cut somehow. And this is something they can cut in their family budget.

The implication here is that we would be missing something of why this is a politically significant phenomenon if we just looked at it in the narrow financial terms. And so to come to conclusion, back to your comments about the presidential candidates, my sense is both of them have to show that they can take hold of this as a specific more or less technical financial problem, because they have to show competence to deal with it, that they will bring in the advisors and they will create the teams, and that they are willing to take the hard actions that are required to stabilize the financial markets.

But they also have to show that they understand that this is more than just a technical financial problem. And that's why there's such outrage when somebody says, "Oh, really, the fundamentals are okay." It's important for both candidates to be able to demonstrate not only technical competence, but a grasp of the ways in which this [crisis] affects a wide range of people who never knowingly bought a derivative of any kind; the ways in which it creates problems for the future of the economy, even outside of the financial sector; and the ways in which it's tied up with the intensification of inequality.

And part of the moral response of many people to this is a focus on the fact that the bailouts that may be part of that technical solution to stabilizing the markets are windfall profits for a number of people who helped to create this problem, and already profited from it.

**Paul Price:** You know, the idea behind risk is, "Well, you can win, you can lose. You can win big, and you can lose big." And this is what makes it justifiable, I think, in our culture. And yet what seems to be panning out is that the second part of the equation is not operative, that is, that people took the big risks, and then lo and behold, it doesn't look like they're really going to have to lose big as a consequence. Or that the losing big will then be passed on to people that really didn't choose to risk in the first place.

**Craig Calhoun:** Right, so there's a big question about *who* got to make the choices about this risk, and that has to do with a long term pattern of essentially saying that these are private choices, and whoever has the property—the capital—can make the choices. That's a bit disingenuous because there are a variety of pension funds and banks and others doing this on behalf of other people, and there's a sort of larger system. It's not

quite as discrete. So we have a misleading account of it if we just think that it's discrete private investors in the first place.

**Paul Price:** It's not all just the fat cats.

**Craig Calhoun:** Right, and it's not all them with their own money. I mean, it's people who are profiting on the investment of other people's money in risky ways, in which they profit, whether the other people get a gain or not. And that's part of the moral story here.

The other thing, though, is the question of moral hazard, the question of whether we are encouraging people to keep investing in highly risky ways by essentially bailing out the risky investors. We should be clear that there *are* people who suffered big losses; there are people who were worth \$100 million a few weeks ago, and are worth \$10 million now. So that's a big loss and they feel pain. I don't think that that is making a lot of people on Main Street in small towns in America feel sorry for them, only having \$10 million of their \$100 million left, but it is the case that there have been some serious losses sustained by investors.

The problem is, I think, that we don't really see much pattern in which the losses are clearly related to the risks that people took. Lots of people took big risks and were able to make big rewards and keep that. Other people were not intentionally taking the risks or were not profiting in big ways from them, but are going to get hurt by this.

It's that arbitrariness of connection that's a problem. The classical Adam Smith story of why a free market works is in part that it teaches you to invest wisely, that is, that there's a sort of condition, in which you learn to buy cheap and sell dear, and otherwise obey the laws of the market because of the system of rewards and punishments. But if the rewards and punishments become arbitrary, so that they *aren't* teaching people any sort of better economic behavior, but instead they're somewhat random, we move away from investment into gambling, and we move away even from, if you will, really skilled gambling—the professional poker player—into speculation. It's probably no accident that poker playing has enjoyed such a renaissance, and that various kinds of gambling are linked to this sort of mentality. But this is trying to be skilled at gambling, often. And the sense that there is no long term pattern in which the economy is teaching investors to invest wisely, is punishing appropriately where they invest poorly, is the real worry in many cases.

As I said though, it goes also to a sort of moral issue. It looks like we are going to distribute the pain from this economic crisis very widely. But we distributed the profits very narrowly, to a small number of people. There are more billionaires in the economy than ever before. There are more millionaires in the economy than ever before, and they're not all losing their shirts. Most of the people who became millionaires and billionaires out of this speculative bubble will still be millionaires and billionaires next week. They're not the ones who can't take their daughters to the doctor.

That doesn't mean that we have any option to try to stabilize this in the short term that isn't going to leave some of that wealth—including some of that speculative wealth—in place. But it does mean that presidential candidates—and pretty frankly, everybody else—need to pay attention to the moral and political message here, which looks dangerously like: you can gamble with other people's money and other people's lives, and if you get out of the market fast enough, it's okay, no matter what damage you caused. And that's not a message most people are happy with. They're happy with seeing people who invest and take risks wisely, and create jobs, be rewarded for that. But they're not really happy at seeing people who *gamble* with other people's money rewarded with a significant percentage of the take, sometimes even an unknown percentage, because hedge funds for example—and they're big players in this world of derivatives—weren't required to disclose even what they were taking out of the market.

**Paul Price:** Well now, you know, requiring that that disclosure occur, trying to establish a fairer, more just way of distributing risk, and the rewards of risk—what lurks in the background here is the *state*, obviously. There's another backstory there as well—which goes back, I believe, to the Reagan and Thatcher days, and has been ongoing—which is a persistent and growing delegitimation of the state, a view that the state is the least able agent in our modern society for executing these kinds of collective strategies to reward justly, and to punish justly. We haven't described, I don't think quite yet, this other story of the atrophying state, if you like, and the privatization really of much that was not privatized before.

**Craig Calhoun:** Let me take that back even one generation before the Thatcher-Reagan period. I think you have to go back at least to the '60s, way before that even. There's a longstanding debate over what states are good at doing, and debates over socialism versus capitalism, and very big picture models but in much more specific ways: Are state-owned enterprises efficient? What are the conditions under which they're efficient? Can states manage the health care system? Should there be state-run social security? And so forth. And we see all this carried into the present era.

What shifted in this debate—I think in the 1960s—is that there was suddenly both a left and a right wing anti-state position at the same time. There was an anti-authoritarianism associated with the sort of romantic side of the student movement and the countercultural movements in the 1960s that saw the state as oppressive and bureaucratic and threatening, and was in favor of self-reliance. And maybe that took the form of communes in Oregon rather than the creation of giant corporations.

But that romantic anti-state, anti-authoritarian ideology from the Left is mirrored in an anti-state, Libertarian ideology from the right, associated with people Friedrich von Hayek and a variety of followers of von Mises, then the Chicago economists and so forth—who in many ways had one of the most successful programs of demonstrating that social science could make a difference in the world by promoting the notion that individuals were natural and real, and all kinds of collectivities, like communities, were not; that it was appropriate to think in terms of private property having a naturalness just

like that of the individual, whereas any kind of public ownership was artificial and probably a problem.

The spread of this sort of more conservative private market-centered anti-state position wasn't checked by a more conventionally socialist or even liberal Keynesian Left. Instead it sort of coincided with that romantic anti-state position. Socialism came to be viewed relatively negatively during much of this period, the actually existing socialist countries made a bad example, a bad argument, for anything like a socialist policy. Welfare systems were often badly administered, there really were significant problems with states.

**Paul Price:** Bureaucracies were cumbersome...

**Craig Calhoun:** Right. So there were genuine problems with states, but there also was a sort of loss of enthusiasm for the *good* side of the state, for the effective delivery of services. So in all sorts of arenas—take education, where there were genuine problems with schools. The question is: do you make the public schools better? Or do you provide a variety of incentives for people to send their children to private schools? And if you begin to privatize more and more of the public education system, what happens to the rest of the public education system?

And that's an issue at every level of the system, all the way through to universities, in which one of the things that we've seen in recent years is the massive increase in the endowment wealth available to the richest universities, which are overwhelmingly private universities, at the same time that state budgets are often cutting back or holding limits to the public universities. And this shifts who can get a benefit from an education. We still have a lot of opportunities for people to go to college, but we have an intensifying hierarchy. It's this issue of inequality again. There has long been a gap between Harvard and a lot of state universities, but the gap got bigger.

And you can say the same thing in health care, and you can say the same thing in a whole variety of institutional areas. And the state may or may not be the most effective provider of what Harvard provides, but there are often occasions in which the state has demonstrated itself to be extremely effective at providing very high quality higher education, very high quality research. If you look at the University of California, or Michigan, or Wisconsin, or North Carolina, or Virginia, you're looking at public institutions in which people could see the model of something really important being done by the state. But we became inarticulate, I think, about the virtues of the public, and the good examples of the public.

And in an era, in a whole era which in almost every sector we move towards more and more private contracting, even the military—if you look at the Iraq war, you will see almost every political figure talking about how important it is to stand by our troops, and how much we value our troops, yet we have privatized a very significant part of that war. We employ mercenaries. One of the things that used to be distinctive about the United States—compared to, say, the British forces who fought against the United States in the Revolutionary War—is that we were a citizen army of people defending our own homes,

right? We were not mercenaries just fighting for pay. Well, what's Blackwater? Blackwater is a mercenary organization being hired to do work—that would otherwise have been U.S. military work—on a for-contract basis, creating some millionaires...

**Paul Price:** And the numbers are huge.

**Craig Calhoun:** And the numbers are large! So we have invested a bigger percentage of the Iraq war budgets in private contractors than in any conflict the United States has ever had before. We have been outsourcing and privatizing, rather than depending on those American soldiers we say we respect so much, rather than using what is one of our most effective public institutions, because the U.S. military is actually pretty effective! It works pretty well.

**Paul Price:** You know, the Veterans Administration Hospital is the most—by all measures—is the most effective deliverer of health care in the United States.

**Craig Calhoun:** Exactly!

**Paul Price:** The Walter Reed hospital is run by the Pentagon, by the way, it's not part of the Veterans Administration.

**Craig Calhoun:** Right, it's a military hospital, not a Veterans Administration hospital. But even the military, for the most part—for all of the cost overruns, and all of the corruption scandals and all of this—is an institution that most people will say has delivered most of what it was asked to deliver. And you could draw the conclusion therefore that sometimes public solutions are actually good solutions.

What we've not done, I think—and here social science shares in the responsibility for not doing it adequately—is figure out what kind of mix that public and private initiatives, and what different kinds of initiatives from non-profit organizations versus business organizations, what kind of regulatory system that sets the terms of the competition for the for-profit organizations, would make for the best delivery in healthcare, in education, or wherever else.

To our credit, on the good side, we've done some experimenting in the last 30 years with some creative ways of trying to design incentive systems and alternative organizations that can work for the future. But to the negative side of the ledger, we have become inarticulate about what we want out of our public institutions, and we've often forgotten that they can be pretty good at delivering *some* things. It doesn't mean that we want everything delivered by the public institutions, but that they can be very effective for some purposes.

And that relates to the financial crisis because it relates to this massive shift away from thinking in terms of public institutions to manage risks and provide goods, towards privatization of risk and a privatization of service delivery.

**Paul Price:** Now we have both candidates now, both McCain and Obama, talking the talk, at least, of strengthening public institutions, of the value of public service, etc. etc., and yet one senses that it is more just kind of paying lip service. Now, that's not to say that McCain and Obama have identical positions on this. For example, in the case of McCain, you have this—I take it to be—a very contradictory kind of stance, which is on the one hand, to really be on the side of privatization, to be on the side of those who implicitly, at least, belittle the potential for the government to achieve these important kinds of things—collective goods. And yet he also then talks about public service, and he talks about the importance of these public institutions. It seems like a contradiction at the heart of his stand. I can't say that for Obama, and I guess I'm being slightly partisan here, but what are your thoughts on that?

**Craig Calhoun:** Let me start by saying that I think there's something good in both candidates here, and we ought to be trying to bring this out and push for it in either one of them, that there's something very positive in the fact that each of them sees a reason to celebrate public service. And each of them sees a reason to call for more of it. And they have somewhat different ideas of what they're calling for—it's different to celebrate military service than to celebrate the kind of service to fellow citizens that comes from community organizing.

But the common core of valuing the public, of valuing what we can do for each other, of going back to the sort of John Kennedy line of “Ask not what your country can do for you, but what you can do for your country,” which of course has got ancestors going back to Rousseau and back to classical antiquity. That kind of thinking about what we can do for the public good is thinking that needs to be encouraged. If we're lucky, this campaign will bring that out and we will see two different visions of doing that. Now if we're unlucky, what we'll see is a lot of mudslinging, and we'll see the kind of distortions and lies we've seen particularly from one side during the last couple of weeks. We may not get that kind of educational campaign, but we could, because I think as individuals, each of these two men—McCain and Obama—*does* believe in public service, and *does* have the potential to articulate a vision of citizens' involvement in trying to build a better country. And that's really positive.

I think that there are differences, we pointed to one of them. I would stress more than the differences, the commonality—I would say each need to be pushed further. It's one thing to say, “I was a war hero and I support our troops,” but it would be nice to hear McCain say, “and I think we could extend that into a national service program in the United States, in which there would be a universal national service, some of it military, some of it civilian, in which every young person would be brought into a government-sponsored program of trying to do something for the collective good of the country.” I think that's something he could endorse, it's something I would endorse, it's something I think Obama could endorse. But it would be nice to see him extend his call for public service in that way.

Similarly, I think that Obama does extend his own biographical example of community organizing into the broader idea of public service, through both government and non-

government organizations, and through churches. A lot of public service community organizing goes on through religious organizations that try to improve the communities in which they live, and where their members live, and also other neighboring communities—cities—whole cities—not just services to their members. When you're talking about "outreach," you're talking about something that is for the larger public good, not just the good of the members of a church or a synagogue.

The ideal public service, though, extends to trying to rebuild cities, trying to create better institutions, and it should extend to rewarding public school teachers adequately for their teaching. Now here I think Obama does push some of that—the Democratic platform does push some of that—but what I would like to see is a clearer statement of the importance of both working *in* institutions like the schools, but also local government, and also the importance of working in social movements in activist ways to try to build a better society.

I think that one of Obama's strengths is that he calls for an "ethic of public service." One of his strengths is that he asks people to act on their higher values, for what they think we *could* create together. The financial crisis is sort of a threat to this, because it could throw the campaign off of that message—of what we can build through public service—and derail it into: How do we protect our private fortunes? What's going to happen to your retirement investments tomorrow....

**Paul Price:** Or turn it into a technicist conversation.

**Craig Calhoun:** As long as the conversation stays either defensive (How do I keep mine?) or very technical (What do the economists think, and who has economists who have more impressive degrees?): It's anti-democratic, and it's at odds with this ideal of public service. But I think precisely, if you pay attention to the bigger picture of this financial crisis, as we started out discussing, *then you see that valuing the public can be directly connected to a better way of building the economy in the future.* That if we recognize that there's a role for public access to information, transparent information for shareholders and for the general public; if you see therefore that we need certain kinds of regulation in order to have a capitalist economy that does not generate this kind of crisis; if you see that we need to have a recognition that private property is not an unlimited right to engage in any kind of speculation without expecting recourse; if you see that the way in which the meltdown of our financial system was prevented, *I hope*, or might be prevented, *I hope*, is by public action—that there is no private market action that is getting us out of this mess. There is *only* one form of public action or another.

And the political question, and economic question, and moral question before us right now is: *What kind of public action are we going to have in response?* What are we going to do through the Federal Reserve, through the U.S. Congress, to deal with this? Are we going to bail out firms but leave executive compensation untouched? Or are we going to say that for every bailout, there has to be a cap on what the compensation to the people who engaged in the speculative behavior can be? Those kind of questions are public questions.

For about thirty years we've been out of practice asking public questions about the market. We've been assuming that the private questions —should you or should you not invest in a hedge fund?—were sufficient. But now, in this crisis, we find ourselves, *despite* ourselves and against our wishes, and in a big and problematic way, forced to ask the public questions. What are we going to do through the government to try to restore public confidence in our financial system for the public good?

**Paul Price:** Well I hope we come up with the right answers, Craig.

**Craig Calhoun:** I hope so too, Paul. It won't be easy.

**Paul Price:** Thanks a lot.