The Unsustainable American State

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The Political Crisis of the American State

The Unsustainable State in a Time of Unraveling

Lawrence R. Jacobs and Desmond King

The American economic and financial system is experiencing upheaval on a scale last seen in the Great Depression of the 1930s. A number of the largest and most established banks and investment firms have declared bankruptcy (including Bear Stearns and Lehman Brothers) or have been taken over at fire-sale rates (as was the case, for example, with Merrill Lynch). In the fall of 2008, Congress and the U.S. Treasury along with the Federal Reserve Bank committed more than $8 trillion in payments, loans, and guarantees of various sorts to prop up financial institutions (including the semi-government mortgage entities, Fannie Mae and Freddie Mac) as well as the country's largest insurer, American International Group (AIG). The speed, number, and scope of these interventions lack historical precedent.

The immediate cause was the collapse of a new and largely unregulated "shadow" financial system consisting of over-the-counter derivatives including collaterized debt obligations, credit default swaps, and a little recognized (and underregulated) sector of the housing mortgage market—loans to so-called subprime borrowers who failed standard credit worthiness tests based on stable income or employment. The devastating impact of defaults in this financial system was magnified by the loosening of capital requirements for investments. (Government agencies acquiesced in the drive by financial firms to heavily leverage their assets until they accumulated $33 of debt for every dollar in equity.) By the end of January 2009, even before passage of the new Obama stimulus package, the U.S. government had assumed a potential maximum commitment of $8.5 trillion in rescue funds, of which it had deployed $3.2 trillion.

Despite the overwhelming focus on the mistakes made by Wall Street and key industries, **the economic and financial unraveling is fundamentally a political crisis of the American state**. The collapse of private markets both reflects and propels an unsustainable constellation of government administrative practices and claims to legitimacy.

The systematic failure of government agencies such as the Securities and Exchange Commission (SEC) and members of Congress to identify the risks of the new financial system or to regulate them are manifestations of the American state's comparatively weak administrative capacity and easy penetration by the financial sector and other related societal interests. Although the George W. Bush administration has been the principal target of criticism, the truth is that the failure to monitor and constrain subprime loans, credit swaps, derivatives, and over-leveraged investments represents a philosophical deference to private markets and a pattern of administrative practices that crosses party lines. Indeed, the roots of the policies pursued by the Bush administration extend to previous administrations of both parties, including the Clinton administration, which terminated the Glass-Steagall Banking Act that had been enacted in the 1930s to stabilize the banking system. Put simply, the immediate media focus on assigning blame to a party and to a small circle of individuals misses the institutional and administrative sources of the economic turmoil, which themselves have resulted from uniquely American political developments.

The meltdown of the American economy not only reflects comparatively porous and underdeveloped administrative capacities but unsettles the legitimacy of the American state as a representative democracy. The massive direct and explicit government "rescues" of private businesses have starkly revealed chummy personal relations among government officials and business and the dependence of government on private markets. It is telling that the harshest initial criticism of the Bush administration's first proposal for a $700 billion infusion of money into the financial sector was for its poor "messaging"; its use of the language of "bailout" rather than "rescue" stripped bare the purpose of government.

More than creating opportunities for personal favoritism, the American state's policies themselves (including loans to automotive companies that required further reductions in wage and non-wage benefits for workers) worsened the circumstances of some American families while failing to directly respond to those of others (including those who experienced home foreclosures by banks that the government propped up). Government "help" to business turned out to "hurt" or fail to do much for everyday families. The resulting backlash has taken aim at the government's focus on "Wall Street" rather than "Main Street." Implicit in these attacks are challenges to the government's creedal foundation—popular sovereignty and the idea of government by and for the people.

The economic and financial crisis that culminated in the fall of 2008 was a political crisis. It both reveals the unsustainability of the current American state and poses warnings for the Obama administration, which is pursuing new policies but will face daunting obstacles in stabilizing the U.S. economy

and democracy. The essays in *The Unsustainable American State* critically examine the sustainability of the American state and the nature and degree of the crises it faces. This volume explores the analytic territory between, on the one hand, the complacent assumption of durability and sustainability that has characterized many studies of American politics and, on the other hand, the claim of imminent collapse.

This chapter introduces the principal strains besieging the American state. These strains, we argue, predate the Obama administration and point to deep-rooted dysfunctionalism in the operation of the American state's administrative institutions and the regeneration of its legitimacy.

THE NATURE OF UNSUSTAINABILITY

The nature of the crisis facing the American state has been obscured and clouded by a preoccupation with the missteps of individual government officials, such as President George W. Bush or President Barack Obama, or individual government entities, whether Congress or particular agencies such as the U.S. Department of the Treasury. Identifying the fundamental sources of the current economic and political breakdown requires a broader analysis of the tensions and contradictions embedded in the American state. The broader organizational principles of the American state's administrative capacity and legitimacy help to explain the breakdown of the financial system and the zigzagging character of how it is has been handled.

Our approach to understanding the current financial and economic turmoil rests on a notion of the state as an interconnected set of institutions that monopolizes force within its territory, rely on administrative capacity to conduct basic economic and political functions, and maintain its legitimacy by inducing the consent of its citizens (Weber 1978; Skocpol 1979 and 1985; Shils 1965 and 1958; for related relevant discussions of the state in general and in the US see Aronowitz and Bratsis 2002; Block 1977, 1987; Brownlee 1996; Evans et al. 1985; Gold et al. 1975; Krasner 1978; Lieberman 2003; and Lindblom 1982).

Administration: How the American State Is Increasingly an Instrument of Special Interests

The current economic and financial crises are portrayed as "causing" the breakup of the Republican hold on government and the general disruption of established philosophical commitments and interests. In truth, the financial breakdown and ensuing economic downturn were as much consequence as cause. In particular, it resulted from severe and deeply

embedded administrative pathologies. Chapters in this volume reveal that the national administrative capacity necessary for economic and financial operation in a global age was hobbled by historical developments that created conflicted and overlapping lines of national authority and the federated operational control to the states. Gary Gerstle's chapter uses new historical research to uncover a complex tapestry of federated state building characterized both by the dispersion of national authority and the formation of islands of police power. Kimberly Johnson picks up on this theme of capacity building by state and city governments; state capacity expanded during the "First New Federalism" but it left operational control out of the hands of the national government. In addition, the chapter by Desmond King and Marc Stears uses the work of Louis Hartz to explore the implications of this complex evolution of extensive state development and weak national administrative capacity. They find that Hartz's argument for a "liberal tradition" of limited government both acknowledged the weak national state and encouraged a robust civil society to resist conformitarianism that might permit encroachments, including those from state governments. Finally, the chapter by Desmond Kind and Robert Lieberman provides a cogent synthesis of the complex mix of state capacity and incapacity that both empowered the U.S. government and left it hapless to fend off rapacious bankers and financiers.

The long-standing weakness of the American state's administrative capacity loaded the dice in ways that amplified both the mistakes of a string of administrations in managing the financial sector and the anti-government disposition of the Bush administration, which in turn increased the probability that banks and investment firms would over-leverage, embrace excessive risks, and engage in fraud.

Stephen Skowronek (1982) aptly describes the American state as a "hapless giant" to capture its distinct amalgam of enormous (and growing) size and institutional incoherence. Decades of research confirm this characterization of American institutions as consistently lacking (though with notable exceptions) the administrative capacity of their western European counterparts (Skocpol 1985). This provides an important element of the historical context in which the financial and economic unraveling occurred.

In particular, *two* administrative pathologies stand out. First, the American bureaucracy and agencies are hobbled by multiple and crosscutting lines of authority that trammel efforts to establish an organizational chain of command to implement policies (Lowi 1979) and by personnel who lack the appropriate skill and training and who lag behind the preparation of their European counterparts (Aberbach 2003; Aberbach and Rockman 2000; Moe 1985), deficiencies including but not confined to the operation of key regulatory agencies. Second, the internal deliberations and independent decisions

of civil servants and authoritative policy makers are persistently compromised by the interference of outside interests (Jacobs and Page 2005).

The Administrative Liability of Underqualified Staff and Internal Disagreements: Missing the Early Warning Alarm

In hindsight, the inept response of the Bush administration to the devastation and destruction wrought by Hurricane Katrina in New Orleans was a warning siren about the broader threat posed by the administrative turmoil of the national American state. The president's public praise of his FEMA director Michael Brown—"Brownie, you're doing a heck of a job"—jarred with media images of a devastated city that featured near rioting among displaced city dwellers combined with the shocking hardship for refugees forced to flee the city.

The broader implications and foreboding threat suggested by FEMA's incompetence were lost in the onslaught of criticisms of President Bush and his administration. What was missed was the larger risks of persistently failing to recruit and retain civil servants who graduated from the premier colleges and universities (as is the case in Europe) and instead to rely on political cronies (a problem identified as long ago as 1988 by the National Commission on the Public Service, chaired by Paul Volcker, and restated in a 2004 Brookings study that Volcker also helped chair). The blinking alarm that was missed after Katrina should have read: "the danger of relying on political loyalty instead of competence." Indeed, the message coming out of political science was the rationality of political loyalty over competence (Moe 1985).

The Bipartisan Embrace of State Weakness as Smart Policy

The weak capacity of the American state to identify risk, combined with a bipartisan philosophy that embraced an uncritical commitment to markets, invited and produced a series of regulatory decisions over the past three decades that opened the door for the financial and economic meltdown in 2008 (Brown and Jacobs 2008).

The most recent iteration of this pattern of bipartisan policy making were the decisions of the Clinton and Bush administrations to reduce the limits on speculative and heavily leveraged risk taking; the incentives to pursue those risks grew as regulatory controls eased. The implosion of "subprime" loans to home purchasers who lacked the financial capacity reliably to repay their mortgages was the match that ignited the "house of cards." But the house itself was built on an administratively unsound foundation, which permitted and, indeed, invited the packaging of debt as securities that were sold to investors around the world, who purchased them on the assumption of competent oversight by the American state. In a sense, the 2008 financial

meltdown illustrates the globalization of administrative incompetence, or at least the global consequences of American ineptitude.

The financial implosion of 2008 resulted from decided policy choices during the Clinton administration to repeal the Glass-Steagall Banking Act (in 1999) as well as the Bush administration's laissez-faire approach to oversight. The conditions that fueled passage of Glass-Steagall in 1933 were alarmingly similar to the circumstances leading to the present financial crisis. In the first third of the twentieth century, hundreds of mainly small retail banks throughout the United States set up investment operations that highly leveraged deposits to float bonds and underwrite corporate securities. These investment strategies generated enormous profits until the sharp drop in the stock market in 1929 prompted bank depositors to request withdrawal of funds that had been invested and lost. By the winter of 1933, over 4,000 banks declared bankruptcy. President Franklin Roosevelt recast the financial system with short-term steps (such as closing banks temporarily and soothing Americans into returning their savings to banks) and by a major new legislation landmark—the Glass-Steagall Banking Act in June 1933. (Congress concurrently enacted federal insurance of bank deposits, creating the still existing Federal Deposit Insurance Corporation.)

Glass-Steagall erected a fire wall between commercial retail banking, which was geared toward protecting the savings of depositors, and investment wholesale banking, which was permitted greater leeway for risk taking. As intended, Glass-Steagall restricted banks and investment firms from leveraging the enormous capital held in bank depositors to finance buy-out deals, mergers, equity investments, and other activities that would entail risk but would also hold out the promise of significant profit. Large banks and investment firms chafed at these restrictions. Instead, such restrictions were pilloried as excessive government interference stifling market innovation and growth. But corporate lobbying efforts to repeal Glass-Steagall from the 1960s to the late 1990s proved abortive. Memory of the financial implosion of the 1930s remained a steady bulwark against eleven initiatives introduced to Congress between 1980 and 1998 to end Glass-Steagall.

Even though Glass-Steagall's fire wall between risky investment and protection of deposits remained into the late 1990s, restrictions on the financial institutions were loosened. In 1979, President Carter approved the U.S. Department of Labor's recommendation to permit pension funds to invest their assets in less-established firms and corporations than the traditional blue-chip stock assets to which they had been restricted. This modification helped spur the explosion in venture capital between 1980 and 2002. In 1994 a Democratic president and Congress overturned the 1927 ban on retail banks opening new branches across state lines, a reform that encouraged takeovers and the development of super-sized consolidated banks.

Although these reforms were relatively incremental, the Clinton administration at the urging of then Treasury Secretary Lawrence Summers promoted and signed into law legislation that made two dramatic changes. First, the Gramm-Leach-Bliley Act of 1999 dismantled Glass-Steagall. Second, the new law divided government regulatory authority over commercial banking: responsibility for the investment firms' securities and brokerage operations was transferred from the Federal Reserve System to the SEC while the holding companies of these firms continued to be regulated by the Federal Reserve System. The 1999 legislation not only breached the fire wall between commercial and investment banking, but the two operations came under separate regulatory authorities, which did not necessarily communicate regularly or systematically about their respective spheres, nor did they have the capacity or sense of mission to exercise similar levels of attentive oversight.

With the Gramm-Leach-Bliley Act of 1999 opening the flood gates for increasingly unconstrained financial activity, President Clinton signed legislation in 2000 that removed another brick from the regulatory infrastructure by granting more leeway for derivatives and credit swap deals. Specifically, the new law removed these financial instruments from the purview of the Commodity Exchange Act, which propelled their expansion.

As the financial industry achieved the permissive latitude that they had sought for decades, investment banking expanded rapidly into a "shadow banking system" in a number of countries led by the United States. The seven large investment banks dominating the sector (Goldman Sachs, Morgan Stanley, Bear Stearns, Merrill Lynch, Lehman Brothers, JP Morgan, and Citigroup) pressed the U.S. government to further dilute the SEC's regulatory regime.

Further demonstrating the weak and porously exposed American state, the SEC agreed in 2004 to replace its enforcement of the remaining regulatory responsibility over investment firms with industry self-policing based on a new voluntary code for the large investment banks, entitled the Consolidated Supervised Entity (CSE) program. This scheme resulted in periodic audits of the affected institutions in place of having regulators on site; the SEC assigned only seven members of its staff to oversee the investment banks despite the size of their collective securities market, which had reached the trillions by 2007. It was voluntary and enabled investment banks to opt in or out of the scheme. The SEC also created a process to exempt firms from government rules on leveraging; crucially, the application by broker dealers to become part of the CSE program entitled them to exemptions from the SEC's standard net capital to debt rule.

In short, industry lobbying, combined with weak administrative capacity for sophisticated risk assessment and a presumption in favor of "free" markets, created a flawed process of oversight and protection against investments

that would deliver enormous profits in the short run but expose the financial system in the United States and other countries. The SEC's Office of Inspector General concluded its report in September 2008 that the CSE regulatory regime was "fundamentally flawed" and that the SEC had not effectively regulated the investment firms.[1]

The American State Trips into the TARP Trap

Americans and U.S. businesses, as well as governments and markets around the globe, were unnerved by the Bush administration's stumbling search for a "solution." Press reports have tended to blame the personal failings of key policy makers—the short-sightedness and other flaws of President Bush, Treasury Secretary Henry M. Paulson, and congressional officials. Although some blame may lie with these figures, a more probing explanation for the zigzagging and uneven quality of the U.S. response would acknowledge the changing contours of the financial markets as the subprime meltdown broadened out to threaten financial institutions and the freezing of the credit market (effected by permitting Lehman Brothers to collapse suddenly without assessing the likely consequences).

The Bush administration's most substantial initiative to deal with the financial crisis—the Troubled Asset Relief Program (TARP)—offers a case study of the changing and, to some, incoherent U.S. government response. TARP was initially designed to buy up bad debt but then, in an extraordinary admission of its incoherent initial mission, flipped into a plan to recapitalize banks in exchange for granting the government equity.

The explanation that focuses on personality misses two critical and revealing features of the financial crisis. First, it assumes that there is a "solution" that an all-knowing "smart state" could design and impose to restore financial health. The truth is that policy responses by economically developed representative states face fundamental contradictions within the global economy that have prevented any from developing a full-fix solution. The rapid adoption of new phases of policy by central bankers—such as zero interest rates and credit or quantitative easing—illustrates this conundrum.

Second, and of particular interest to us, the cross-national variations in the response to the financial crisis and the distinction of the United States in originating the financial meltdown result to an important extent from the American state's comparatively uneven administrative capacity related to the skill and sophistication of its financial analysis and its crosscutting and divided lines of authority. The American state's weak administrative capacity not only opened the door to financial crisis, but it also trammels the efficacy of its attempts to rescue and to reconstitute the financial sector moving into the future.

Two underlying factors help account for TARP's incoherent approach and ineffectiveness. First, the personnel in the Treasury Department, SEC, and other front-line administrative bodies were uneven and, in key respects, inadequate to the challenge of monitoring the financial sector and then managing the ensuing crisis. (This incompetence is perhaps most dramatically conveyed in the ill-thought-out decision to permit Lehman Brothers to collapse suddenly, a decision that severely undermined confidence in the financial system around the globe.) The breakdown in oversight at the SEC resulted from too few and insufficiently trained personnel (Labaton 2008). In a revealing acknowledgment of its weak staff, the Treasury Department scrambled to hire new personnel to run TARP and ended up outsourcing critical tasks to professional asset managers. But even this new staff evaded the core problem presented by the logic of TARP—the assumption that asset prices could be assigned to securities with no or unclear value.

Second, the response by the U.S. government was confounded by divided lines of authority, not only between the legislative and executive branches but also within the administration's plethora of multiple and competing entities—the Treasury Department, Federal Reserve Bank, Federal Deposit Insurance Corporation (FDIC), SEC, and others. For instance, the Treasury Department's approach of bolstering large financial institutions was challenged by FDIC Chairman Sheila Bair. Bair openly campaigned, against the Bush administration line, for using federal funds to modify troubled mortgages that would help home owners. Uneven staffing and internal conflict contributed to the Bush administration's lack of preparation for a rescue plan. Although the financial crisis had been building for months, the collapse of major financial institutions in the early fall of 2008 caught the U.S. Treasury Department utterly unprepared. The initial three-page proposal, which asked for $700 billion and wide discretion for its dispersement, was developed in a matter of days and without congressional consultation. The result was bipartisan outrage, which contributed to an initial rejection by Congress.

The administration's first approach (buying up toxic bad debt assets) was poorly conceived. Indeed, the rescue plan rested on a false or overstated set of expectations. For instance, the critical question of how best to measure the "real value" of the toxic assets was not spelled out in the legislation and remained elusive, forcing the Treasury Department to later shift strategies. This problem led to the eventual redesignation of TARP into a recapitalization program, a unilateral reformulation of such a large legislative initiative.

Thus, a major hurdle in implementing TARP was how to measure accurately the balance sheets of banks without "mark to market" inventory (i.e., the process of setting value based on the demand for financial instruments in market trades). With banks and other investors too worried to purchase

assets, there is little or no trading in the underlying mortgage-backed assets and therefore there is no or incomplete information about whether such securitized assets have any value. In the absence of robust market activity, it is difficult to set a value. In contrast, for instance, the Savings and Loan clean-up was simpler because the government's rescue body (the Resolution Trust Corporation) was able to engage in some reasonable mark to market accounting (as did Swedish banks in that country's early 1990s banking crisis) (Allen and Gale 2007; White 1991).

The Treasury Department's poor preparation and hurried assumption about a process to set value revealed a failure to understand that banks are too worried about the weakness of their balance sheets to engage in trading, thereby creating an impasse (only deepened by the sudden collapse of Lehman Brothers). The original idea of conducting "reverse auctions" turned out to be more daunting than first appreciated and was abandoned.

The immense scale of the TARP task was underestimated in part because the Bush administration was blinkered by an unwavering devotion to the notion of "free" markets but also because it lacked the sophistication to fully understand what it was proposing to accomplish. The result of poor design was a shifting set of approaches that careened from the planned objective of acquiring bad debt to providing capital to banks in exchange for granting the government equity when the initial effort failed. Less than two weeks after TARP was enacted, the Treasury decided to invest much of the $700 billion in banks; $115 billion was invested in eight of the largest financial institutions, including Bank of America, Citigroup, and JPMorgan Chase, with another $155 billion distributed to 77 smaller banks. The Treasury approach to recapitalization lacked targeted conditions to spur investment and has produced disappointing results, according to the Government Accounting Office and an oversight body created by Congress. Indeed, senior Bush officials initially rejected Britain's approach as "nationalization [and a] . . . punitive approach"; it was the failure of its administration's policies that compelled policy change, though ideology and weak analytic capacity continued to hinder its diagnosis of the problem and development of an appropriate remedy, the continued failure of alternative policies under Bush may prompt the Obama administration to adopt a more full blown nationalization strategy.[2]

Government as Instrument

The government's response to the financial meltdown deepened the crisis by its double action of first expanding the reach of the state and then ceding this new authority back to the groups and individuals with ties to the banks, investment firms, and manufacturers that became the beneficiaries of the new programs. In the first move, Republican leaders, including President

Bush, joined with Democrats to discard their earlier principles of anti-statism to rally behind authorizing $700 billion and over $7 trillion more in loan guarantees for what was presented as serving the common good of the nation.

The second move relinquished back to certain financial and manufacturing firms substantial influence over the government's newly expanded authority and resources. This double move—expanded government and wider sectional influence—compromised internal government deliberations and decision making. The ostensible aim of advancing the national interest became a tool to serve and privilege particular industries.

Particularistic interests have penetrated government decisions through three avenues. First and most obviously, industry moles have permeated government. Senior officials from the financial industry and other sectors have held senior positions charged with doling out money and authority. In one of the clearest cases, Treasury Secretary Paulson was a former head of Goldman Sachs, a firm receiving new status as a holding bank, making it eligible for Federal Reserve funds and guarantees. The giant insurance firm, AIG, was rescued in a huge bailout (initially $85 billion, then supplemented with $38 billion and perhaps additional investments[3]); Goldman Sachs was a large AIG trading partner and stood to lose $20 billion if it collapsed.[4] Paulson multiplied the presence of industry personnel by hiring a number of present and former Goldman Sachs employees to administer TARP.[5]

Having former industry heads deciding how to dole out government funds not only helped certain firms, it also hurt others. Goldman Sachs's rival, Lehman Brothers, was denied support in a decision that has been widely criticized as undercutting confidence in the credit market and accelerating the fall 2008 credit crunch (globally as well as in the U.S.).[6] In addition to omitting certain firms, the Bush administration chose not to offer direct support for another group without a strong proponent sitting at the table of decision makers—namely, home owners struggling to avoid foreclosure.

A second, more shadowy avenue to shape the government's financial rescue policy has been lobbying. Such lobbying has occurred throughout the 1990s and 2000s, with mortgage banks and brokers contributing $847,000 to the Bush reelection campaign in 2004.[7] The lax regulation and oversight by the SEC and the huge performance-based expansion in Fannie Mae and Freddie Mae were responses to intense and prolonged lobbying by the finance industry.

The third avenue for molding government policy is the most difficult to discern. There is a form of structural constraint that operates through the anticipated fear among government officials of the loss of jobs and tax revenues that would result if massive holders of U.S. debt (such as the Saudis or Chinese) decided to withdraw their investment or to stop using the dollar as a reserve currency (Lindblom 1977). In October 2008, the U.S. Treasury

securities amounted to $3,041.7 billion, of which $652.7 billion was held by China, $585.5 billion by Japan, and $187.7 billion by a group of oil exporting countries dominated by Saudi Arabia. Since then the amounts have grown considerably as the Federal Reserve has issued Treasury notes, bonds, and securities to fund bail outs and other measures. These states, together with other sovereign wealth funds, exert a complex influence on American policy makers: given the scale of their investment, they harbor a strong interest in maintaining the U.S. public debt as a viable resource that can be repaid over the long run. Yet this very global integration makes U.S. debt funding vulnerable to sudden collapse.

This structural constraint extends the influence of sectional interests beyond the direct connections between personnel on Wall Street and key government institutions. Bush officials concluded that their top priority was to restore financial markets rather than to directly reinvigorate the manufacturing or service industries. The same fear of financial instability drove the New York Federal Reserve Board's coordinated rescue of the Long Term Capital Management hedge fund in 1998 (a decision that looks unjustifiable in retrospect since it sent a positive signal to high risk leveraged based speculation); it also explains why the Bush Treasury Department provided almost limitless capital to the AIG insurance company. Maintaining the confidence of American and foreign investors is imperative for sustaining the U.S. debt load and preventing flight to other investments.

The degree of this dependence is revealed in the myopic and poorly conceived response in fall 2008 by the Treasury and the Federal Reserve to the deepening and diffusing crisis. There was no intellectually defensible framework that guided the decisions about which firms to rescue, when, and how to operationalize such key decisions as the federal guarantee of Freddie Mac and Fannie Mae or the implementation of TARP. The perceived threat of a systemic financial meltdown that would prompt a massive flight of capital appeared literally to spook senior financial policy makers; Federal Reserve Chair Ben Bernanke warned members of Congress of collapse and the need for desperate measures. The resulting haphazard and rushed policy was, in this sense, a response to perceived imperatives of global finance as much as a catering to individual lobbyists or former employees at major financial firms.

Barack Obama openly acknowledges the broader constraint of capital markets even as he cracks down on direct lobbying. Referring to swings on Wall Street, he explained that "I've got to pay some attention to market psychology [given the]...the loss of trust both in the marketplace and in government." Even without high-priced Wall Street lobbyists, President Obama openly acknowledged the reality that "restoring that trust [on Wall Street]...is going to be very important."[8]

Lee Ann Banaszak's chapter reports a long and more diverse lineage of sectional penetration of the American state. In particular, she provides

a deeply researched account of how women activists succeeded in placing themselves in federal government structures to advance feminist aims.

Legitimacy Deficit

Generations of policy makers and social thinkers have treated the legitimacy and durability of the political and social systems as inherently unstable and subject to disruption under situations of economic crisis and significant or rising economic inequality. Karl Marx and his progeny argued that economic and social relations were fundamentally conflictual and subject to instability. Changing economic conditions, they suggested, would require increasing government intervention to ensure private sector profitability, which in turn would erode claims of popular sovereignty and generate conflict between the classes. Non-Marxists like Karl Polanyi (1944) similarly found the concurrent and causally interrelated development of state intervention and market expansion: state power was a necessary element in changing society to accept market processes and competitive capitalism through the punitive or incentivized means of government public policy.

The British sociologist T. H. Marshall (1964) acknowledged that the private enterprise system and representative democracy were in conflict but insisted that the conflict was reconcilable through the democratic means of "politics against markets" (Stephens 1979; Esping-Andersen 1985). In particular, Marshall argued that the development of status equality among citizens, the universalizing of political rights to participate in the representative process, and social rights that lifted the floor of material subsistence "provided the foundation of inequality on which the structure of [capitalist] inequality could be built" (1964, 34).

The legitimacy of the American state as representative and as devoted to the national interest conflicts in important respects with the intense interests and beliefs of a plethora of groups and individuals. John Ferejohn's chapter presents a probing examination of multiple and at times competing conceptions of legitimacy and the challenges in analyzing legitimacy.

We now turn to three factors that may strain the American state's legitimacy: significant and rising economic inequality; the targeting of public money to business at a time of significant and growing economic pain for American families; and the contradictory nature of government policies.

Legitimacy amid Economic Collapse

Sustaining the consent of Americans in an era of exceptional economic dislocation is made particularly daunting because of extraordinary economic inequality. Despite important steps toward greater racial, ethnic,

and gender equality, as epitomized by Barack Obama's election as president, the distribution of income and wealth across American society has become increasingly concentrated among its most affluent citizens, and this increased density has happened at a level and rate that are rare among affluent democracies. [9]

Independent and well-respected studies based on authoritative government and non-government data demonstrate that gaps of income and wealth have grown since the 1970s, not just between the poor and the rest of society, but also between privileged professionals, managers, and business owners on the one hand, and the middle strata of white-collar and blue-collar middle class on the other hand. In terms of income distribution across quintiles, perfect income equality would mean that each fifth of the population would receive 20 percent of the country's income.[10] In 2005, however, the most affluent fifth received 48.1 percent of family income; the middle class (the third and fourth fifths) earned 15.3 percent and 22.9 percent, respectively, and the bottom 2 quintiles each received less than 10 percent. Put simply, the richest 20 percent enjoyed nearly half of the country's income—and fully 21 percent of family income went to the top 5 percent of Americans.

The rich, of course, have always enjoyed a disproportionate hold over income. The top quintile has cornered more than 40 percent of the country's income since at least 1947. But patterns of income growth across segments of the American population have shifted significantly over time. For twenty years after World War II, the hold of the top fifth on the country's income was slightly weakened as income at the top grew less rapidly than income in the middle and at the bottom. After 1973, though, the trend toward income equalization reversed. Figure 1.1 displays the sharply different distribution of income growth that prevailed in 1947 to 1973 versus the period after 1973. Between 1973 and 2000, income growth was much more rapid for those in the top fifth than for all other Americans, and growth was especially anemic toward the bottom: the top fifth experienced about double or more the rate of increase for 1973–2000 compared to the other quintiles, including middle income earners. It also experienced far smaller declines than the bottom three quintiles during 2000–2005.

One of the most striking patterns of recent economic distribution is that inequality increases as you move up the ladder. Even within the top fifth of income earners, rates of gain were faster for the richest 5 percent and, especially, the top 1 percent. Figure 1.2 shows that the concentration of income in the top 1 percent since the early 1990s is unparalleled since the 1920s and early 1930s.

As the distribution of income has tilted sharply toward the top, the most affluent have amassed an even larger slice of the country's wealth (including stock holdings, mutual funds, retirement savings, ownership of property, and

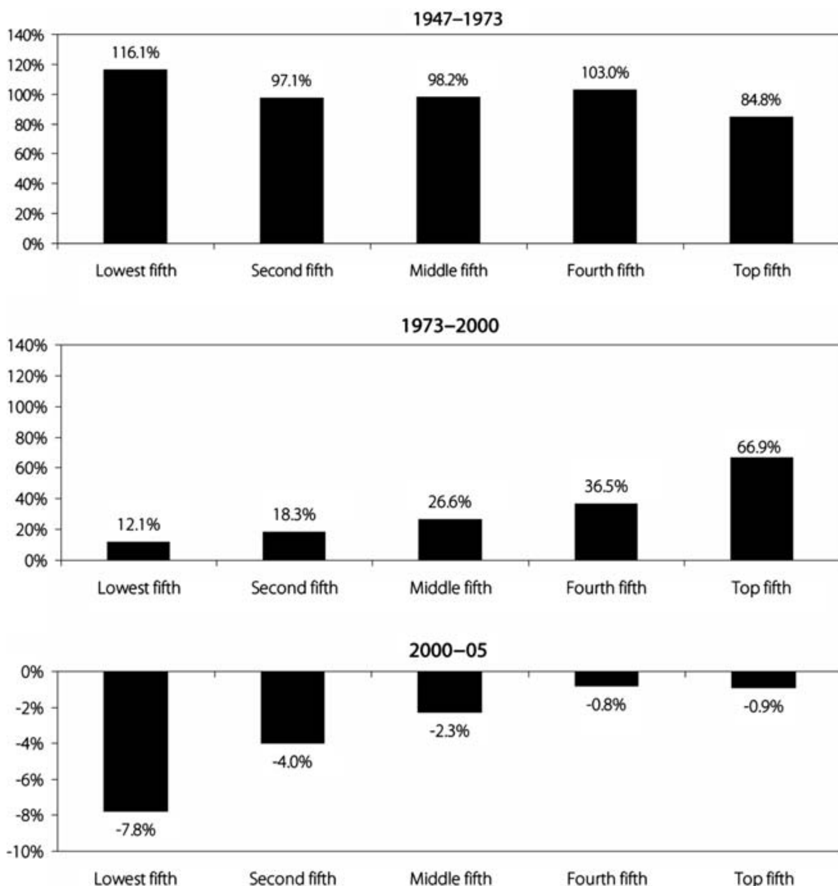

Figure 1.1. Real Family Income Growth by Quintile, 1947–2004. Source: Figure 1L from: Lawrence Mishel, Jared Bernstein, and Sylvia Allegretto, *The State of Working America 2006/2007*. An Economic Policy Institute Book. Ithaca, NY: ILR Press, an imprint of Cornell University Press, 2007.

other assets). Table 1.1 is based on a survey of consumer finances conducted by the Federal Reserve Board in 2004 as part of its Survey of Consumer Finances; it shows the distribution of household income and net worth (i.e., total family assets minus its liabilities such as mortgages and other forms of debt). The top 1 percent of households drew 16.9 percent of all income but wielded control over more than double this proportion of the country's wealth (34.3 percent). By contrast, the supermajority of the country—the "bottom" 90 percent of households—earned the majority of household income (57.5 percent) but controlled only 28.7 percent of the country's wealth.

Inequalities in wealth and income in the United States are much greater and have risen faster than in comparable advanced industrial democracies

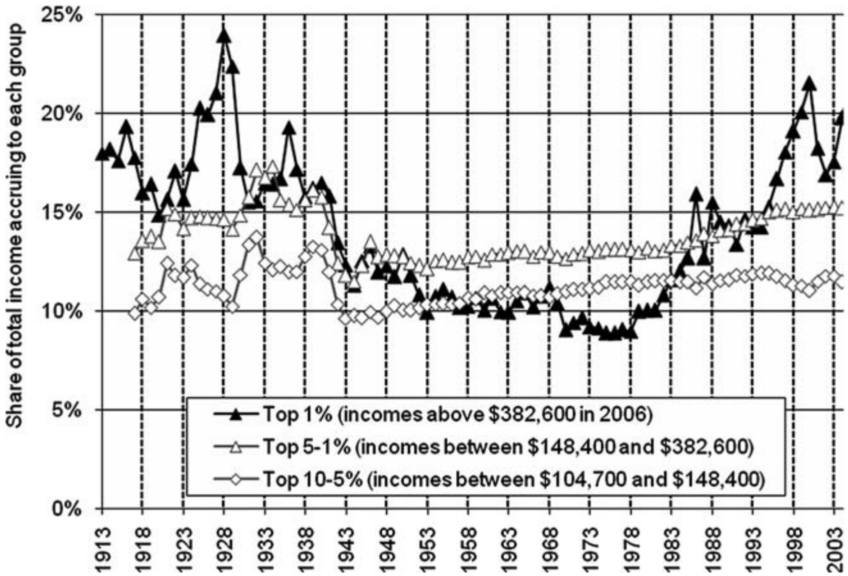

Figure 1.2. Concentration of Income in Top 1 Percent, 1913–2006. Source: Piketty and Saez (2003), series updated to 2006. Income is defined as market income including capital gains. Top 1% denotes the top percentile (families with annual income above $382,600 in 2006). Top 5–1% denotes the next 4% (families with annual income between $148,400 and $382,600 in 2006). Top 10–5% denotes the next 5% (bottom half of the top decile, families with annual income between $104,700 and $148,400 in 2006).

Table 1.1. Distribution of Income and Wealth, 2004

	Distribution of:		
	Household income	Net worth	Net financial assets
All	100.0%	100.0%	100.0%
Top 1%	16.9	34.3	42.2
Next 9%	25.6	36.9	38.7
Bottom 90%	57.5	28.7	19.1

Source: Table 5.1 from: Lawrence, Mishel, Jared Bernstein, and Sylvia Allegretto, *The State of Working America 2006/2007*. An Economic Policy Institute Book. Ithaca, NY: ILR Press, an imprint of Cornell University Press, 2007.

in Europe, Canada, and other similar countries. Figure 1.3 presents information about income trends for American families compared with families in Britain and France. The proportion of income accruing to the top one-tenth of one percent of families ran along parallel tracks for much of the twentieth century. All three countries decreased inequality from the end of World

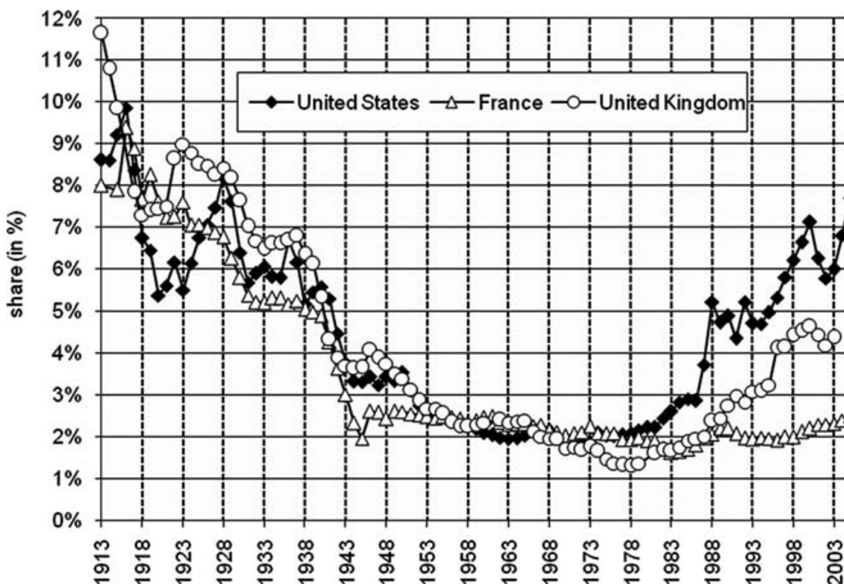

Figure 1.3. Top 0.1% Income Shares in the U.S., France, and the U.K.,1913–2006. Sources: United States: Table A1, column P99.9–100. France: Computations based on income tax returns by Piketty (2001b), Table A1, col. P99.9–100, and Landais (2007). United Kingdom: Computations based on income tax returns by Atkinson (2001), col. Top 0.1% in Tables 1 and 4. and Brewer, Saez, and Shepard (2008). In all three countries, income is defined before individual taxes and excludes capital gains. The unit is the family as in the current U.S. tax law.

War I through World War II and until the 1960s. But from the mid-1970s on, the United States rapidly diverged from its two allies and became far more unequal. By 1998, the share of income held by the very rich was up to three times higher in the United States than in Britain and France.

Although evidence of economic inequality is relatively clear, there are significant debates over its causes. A range of demographic, technological, and political factors have been identified as key drivers (see the discussions in Burtless 1999; and Mishel, Bernstein, and Boushey 2003, 56–82). Disputes generally focus on the relative impact of these factors.

There are several basic distinctions in the analysis of economic inequality. As suggested above, economic equality focuses on distribution—how much of income and wealth is controlled by distinct segments of society, which are often defined in terms of quintiles, decentiles, and the top 1 percent of the population or households. A common measure of inequality used by government agencies and a range of analysts is the "gini coefficient," which ranges from zero (each individual has exactly the same income) to one (one person controls all income). An average is obviously a different kind of measure.

Average income levels in the United States are comparatively high ($39,728 compared to an OECD average of $28,761 [excluding the U.S.]) (Mishel et al. 2003: 325, Table 8.1), and the nation as a whole has become wealthier as well. The distinction between the average and the distribution of income and wealth is a common area of confusion.

Another important distinction is between levels and rates of change in inequality. Compared to the Nordic countries of Sweden and Finland, the level of inequality—as measured by the gini coefficient and other measures of income distribution—is considerably higher in the United States. By contrast, the rate of increased inequality has been surprisingly steep in Sweden and Finland (exceeding that of the U.S. for certain periods). Even with changes in Nordic countries, however, the levels of economic disparities are higher in the United Kingdom and even higher still in the United States.

How state policy impacts taxation and income or in-kind transfers has significant impacts on inequality. Inequality measured pre-tax and pre-transfer reflects market distributions as well as important institutional features including unionization and labor-management relations. By contrast, post-tax and post-transfer measures reveal the redistributive effects of government policy. Although inequality increased sharply in Nordic countries during recent decades, government policy substantially offset market-generated inequalities. Tax and transfer policy helps to explain why Finland and Sweden experience less income inequality than the United Kingdom and, especially, the United States.[11]

Economic disparities across race offer a telling illustration of these important distinctions. Following the civil rights legislation and activism, the absolute levels of income and wealth enjoyed by African Americans and Latinos rose, but they remain far behind white America in distributional terms. In the late 1980s, the median white household earned 62 percent more income and possessed twelvefold more wealth than the median black household. Nearly two-thirds of black households (61 percent) and half of Hispanic households lack any net worth, as compared with only a quarter of their white counterparts.[12] Even young, married black couples in which both adults work—a family structure and work history that are singled out as an engine for reducing economic inequality—still earn 20 percent less income than their white counterparts and possess 80 percent less net worth. More recent analyses continue to show a similar pattern of improvement in absolute terms but continuing racial disparities in distributional terms. According to an analysis of the Federal Reserve Board's Survey of Consumer Finances, the median net worth of African Americans rose nearly fourfold, from $5,300 in 1989 to $19,000 in 2001. Nonetheless, the median net worth of whites in 2001 was more than tenfold greater ($121,000) than for African Americans ($19,000). Broadening the analyses to Latinos in 2004, the

median white non-Latino family enjoyed double the income of non-white and Hispanic families (49,400 versus $29,800) and over fivefold more net worth ($140,700 versus $24,800). The bottom line is that African Americans have increased their income and wealth but continued to have much less income and net worth than whites into the twenty-first century (Bucks et al. 2006; Kennickell 2003, 2006).

Economic inequality is a broad environmental condition that may strain an American ethos of opportunity, even one that has shied away from promises about outcome. The critical issue is how economic inequality interacts with the perceptions and trust of citizens as well as the coherence of the state's organizing principles among governing elites. Economic inequality, public trust, and coherent policy have cast a cloud over the sustainability of the American state's legitimacy.

Uncertain Stability of Public Trust

The general public's sustained belief in the American state has been the subject of significant research, especially in the wake of the Vietnam War and protests, the Watergate crisis, and inflation during the 1970s. Researchers distinguish between "diffuse" support for the political system as a whole and "specific" evaluations of incumbent officeholders (Easton 1975, 445). Scholars find dramatically different results: stable majorities of everyday Americans during the 1960s and 1970s continued to support the political system and to express pride in the country's political arrangements even though specific government officials (notably, Presidents Lyndon Johnson and Richard Nixon) received strong negative approval ratings (Nie, Verba, and Petrocik 1976, 35–36; Miller, 1974a, 1974b, and 1979; Citrin 1974; Citrin and Green 1986; Weatherford 1987).

The initial concern, then, that the widespread sense of powerlessness and cynicism would threaten the established political and social order failed to materialize during the 1970s and 1980s; even individuals with quite strong negative attitudes about the political system were unable to identify specific changes in the system of government that they favored (e.g., Sniderman 1981, 130ff).

Past research poses two helpful lessons for analyzing the legitimacy of the current political system among everyday Americans. First, strong disapproval of a president can and does coincide with support for the overall political system. It is a mistake, for instance, to conclude that the legitimacy and stability of the existing political order threatened to unravel owing to President George W. Bush's historically low popularity as measured in approval ratings. Indeed, the election of Barack Obama on the promise of change could well reinforce the legitimacy of the political system by demonstrating its responsiveness.

A second lesson is that regime legitimacy is contingent on context. The events of the 1960s and 1970s demonstrably resulted from the discrete policies and actions of specific presidents—President Johnson's highly visible (though misleading) set of decisions to expand troop levels in Vietnam and refusal to withdraw them in the face of military setbacks and domestic protest, as well as President Nixon's abuses of power, which generated constitutional crises. By contrast, the circumstances of the 2008 financial breakdown may pose quite different dynamics that extend beyond the policies of individual administrations to raise questions about the general operations of the economic and political systems. Rather than assuming that the political order is safely stable based on earlier research, it is critical to track and closely study system legitimacy in the wake of disruptions in the financial and economic system that are unprecedented in the period since World War II.

The uncertain and fraught nature of sustaining legitimacy in today's state are explored adroitly in Cathy Cohen's chapter on the alienation and hostility of black youth toward the political system, regardless of class. In addition, the chapters by Larry Bartels and by Benjamin Page and Lawrence Jacobs introduce another critical strain on the American state's legitimacy—its weak responsiveness to the preferences of the mass public. Page and Jacobs reveal a surprising broad cross section of Americans (including Republicans and high income earners) aware of and opposed to the current scale of income inequality and in favor of government programs (and the necessary taxes) to support them in order to expand opportunity and security. Jobs paying good wages should be available to everybody. Policy makers mostly fail to respond to this broad consensus. Larry Bartels goes further, demonstrating the disproportionate influence of the rich on U.S. senators compared to middle and lower income earners.

Contradictory Policy: Helping Business and Hurting Citizens

It is important to widen the analytic lens from a closely cropped study of public attitudes in order to consider the coherence of basic government policy. We would argue that the legitimacy of the American state faces a growing future deficit as it simultaneously funnels trillions of dollars to businesses to restructure them and seeks to sustain the trust of everyday citizens who bear the consequences of that restructuring. This deficit may receive some short term relief from the new president but will not dissipate quickly. Indeed, the Congressional Budget Office and others are predicting that measures to revive the economy, subsidize financial markets, and cover the costs of the Iraq and Afghan wars will produce colossal annual budget shortfalls in excess of a trillion dollars and 10 percent of the gross domestic product, the highest levels since World War II (Stiglitz and Bilmers 2008).

The "messaging" of government officials and allies that helping business helps American families is shrewd but it runs into two problems. First, there is widespread suspicion of favoritism for particular industries (e.g., banking over automotive) or firms (Goldman Sachs over Lehman Brothers) at a time of perceived neglect of the everyday citizen who has yet to receive comparable support. The populist backlash against what is portrayed as venal deal making among well-placed insiders has been fueled by the government's failure—according to the Government Accounting Office and the press—to ensure that the tens of billions of dollars funneled to banks have been tracked; they may even have been committed to paying bonuses to executives.

The second and more profound hurdle is the cycle of reinforcing contradictions in government policy. The recession damaged two golden birds with one fell swing—it rapidly reduced tax revenues for state and national government at the same time that it rapidly eliminated many jobs and thereby increased the costs for a host of safety-net provisions for unemployment, food stamps, and other essentials. Government efforts to stabilize the financial system and revive a crumbling economy were imperative, earning extraordinary bipartisan support. And, yet, the intended remedy—rescue packages to help sustain businesses as they struggled to reconstitute themselves—accepted or actually encouraged these firms to take the necessary steps to survive, namely laying off employees and taking other steps that diminished the living circumstances of everyday Americans. Loans to the automotive industry, for instance, are tied to reducing the wages and benefits of union members. The hundreds of billions of dollars given to financial investment firms are designed to keep them afloat as they "write off" "toxic" loans, which means in practice evicting families from their homes. Even proposals to streamline health care record keeping, which are geared to reducing "unnecessary" costs, will require firing thousands of workers who currently process the paperwork.

In short, there is a fundamental incoherence in government policy: government policies that ostensibly "help" everyday families in practice hurt many. The state's legitimacy as the incarnation of the popular will is undercut by the perception of favoritism and by the reality that government funds and requirements diminish the living conditions of certain families by pushing up unemployment in some areas, cutting wages in others, and generally accepting the decline in the credit and home ownership of many families.

The contradiction of "help that hurts" registers in a ballooning fiscal deficit, which is on track to top one trillion. The tendency to portray the federal government's budget deficit as the work of undisciplined and corrupt politicians larding legislation with "pork" misses a more fundamental dynamic. Government help to business to sustain its operation end up

undermining the economic circumstances of everyday families, which the government then seeks to partially offset through spending on unemployment checks, subsidies for food, health care services, and other cash and in-kind benefits.

The legitimacy problem is that the state's imperative to sustain core industries like finance and automotive collides with its requirement to maintain its standing as a government for and by "the people." This collision of opposing necessities may eventually show up in surveys of public trust in the political system; it also manifests itself in the incoherence of government policy and the confusion of government officials in the Bush and Obama administrations who find themselves both advocating for policies to sustain business while also approving policies to respond to the natural consequences.

Suzanne Mettler's chapter reveals a similar dynamic of contradictory initiatives by government. In the past, state loans for college education widened access to tertiary level institutions as a necessary element in advancing the American creed of equal opportunity. But mounting costs and pressure from the better organized sectors led national policy makers since the 1980s to scale back support for the less advantaged while continuing to serve the already advantaged. The implication is that steps to control ballooning budget deficits collide with policies to foster shared opportunity.

CHANGE AND CONTINUITY

The current economic maelstrom has given rise to breathless media reports of the utter destruction of American business. Phrases like "collapse" and "free fall" are rampant. Analyses of American political development and economic history make clear, though, that even unusual economic turmoil spurs not only significant and salient changes, including the bankruptcy of longstanding businesses and enormous government interventions in the private sector, but also the continuation of already established norms and patterns of behavior and practice. The administrative incompetence that set the trap for the current financial breakdown and the looming legitimacy deficit that may precipitate increased alienation and declining support for the political system were structured into American political development and are likely to be reconstituted in the new business and government institutions that emerge. The exceptional expectations of President Obama to deliver the transformative change he promised during the 2008 presidential campaign will be complicated by a mix of significant change along with substantial compromises necessitated by existing institutional reality.

Unfortunately, few scholarly models of political systems are well-positioned to analyze this duality of change and continuity in current political

economic developments. The general orientation of many models is toward studying stability and the formation and long-standing maintenance of equilibrium. For instance, the varieties of capitalism approach to political economy is essentially about stability and equilibrium, with a focus on identifying the self-reinforcing logic of economic and political development (Hall and Soskice 2001; and see King and Rueda 2008 on the rise of cheap labor regardless of the form of capitalism). Analysis of "path dependence" similarly emphasizes the positive feedbacks that load the dice toward the reproduction of established institutional dynamics arising from the political equivalent of economic investment in fixed costs (Pierson 2000). Path dependent arguments imply incremental, not dramatic, change in policy trajectories and offer little for the task of understanding the duality of substantial but embedded change.

Students of economic and political institutions have similarly tended to focus on equilibrium, with debate focused on its institutional conditions (Shepsle 1979). Long-standing analyses of "incrementalism" (Lindblom 1959) and, for instance, the development of budgets (Wildavsky 1964) and social welfare programs (Derthick 1979) point to gradual adjustments in institutional and policy frameworks that stand out for their remarkable stability and stasis.

While analyses of institutions and policy regimes focus on durability and stability, the study of political change (especially when precipitated by severe economic demands or downturns) tends to focus on the propensity for crisis and collapse. The long-standing "crisis school" warned of the real or imminent collapse of market-based democracies owing to citizens "overloading" government with their demands for more and more (Huntington 1975), declining profitability (Mandel 1975), growing demands to prop up markets and reassure citizens (O'Connor 1973), and other factors. The common theme is that the state faces a persistent threat of collapse due to exogenous shocks that trigger systemic breakdowns, political regime reordering, or collapse.

In short, existing scholarly analyses are not well-positioned to analyze a political economic regime that is undergoing significant change (as illustrated by the recent financial market turmoil) but avoiding collapse. **Enduring political systems experience stress and significant change without collapse**. We need to understand this process.

Although critical aspects of America's twenty-first-century system of political and economic operations, norms, and relationships remain entrenched, the generation of mutual (if not proportionate) benefits and legitimacy to citizens and the business world is unsustainable in the future for several reasons. First, the current political and economic systems are not satisfying the expectations of Americans for a high standard of living and business

for strong profitability. Even prominent business leaders and conservative economists question whether today's political and economic systems can continue as they have.

Second, the commitment of trillions of dollars to resuscitating businesses and the financial sector significantly limits the public and private sector's future capacity. It burdens government (and therefore citizens) with massive debt and saps the government of its legitimacy as the embodiment of the popular will. The twin concerns are that the current interventions are not renewable and inflict future generations with deep and damaging consequences.

Models of punctuated equilibrium do helpfully account for long periods of stability that are on occasion broken by significant electoral shifts that bring to power a new party, changes in public opinion, or "changes in society" (Baumgartner and Jones 1993; Givel 2006; Gersick 1991). The unsustainability of the American state, however, stems from a more fundamental break in the interconnection of the economy and political system as well as a more thoroughgoing interconnection of society and politics.

The strains in sustaining the American state are also conditioned, as King and Lieberman argue in their chapter, by its distinctive origins, modalities, and economic dynamics, which are much better understood now after three decades of significant scholarship moving beyond pluralism and Weberian analyses. A once-dominant approach to studying American politics rested on a pluralist framework with several sorts of analytic consequences. First, the horizontal separation of powers and vertical federalism diminished the centralization of governing and institutional resources that are necessary for strong national administrative state capacity. Second, the American polity was deliberately designed to play interests—social, political, economic, institutional, and so forth—against each other, constraining majoritarianism and rendering public policy outcomes the product of conflicts and resolutions among these interests. Pluralism precluded unified elitism.

This complacent view of the comparatively weak American state was exploded by at least two intellectual developments, themselves grounded in empirical changes in American politics. First, the national government promoted and maintained a particular racial order that divided the country and structured American political development from the beginning (Cohen 1999; Frymer 2004; Gerstle 2001; Katznelson 2005; King 2007; King and Smith 2005; Lieberman 1998; Mills 1997; Roediger 2005; Skowronek 2006; Skrentny 2006). Over the past half century or so, the federal government partially dismantled segregated race relations. This is hardly the ineffectual and deferential American state that the "weak state" view assumed. Second, a series of major scholarly works, encouraged by Theodore Lowi's *The End of Liberalism* (1979) and commencing in seriousness with Stephen Skowronek's classic study *Building a New American State* (1982), moved

beyond dichotomous choices between weak or strong states that typically dismissed the U.S. case as "exceptional" and instead analyzed the particular institutional and other features of the U.S. case (Carpenter 2000; Johnson 2007; Mettler 2002). Among other achievements, Skowronek's work shifted discussion from the negative question (why no American state?) to the more positive question—what kind of state does exist in the United States (Orren and Skowronek 2004)? How can the institutional changes and developments that have evolved historically be described and explained (Pierson 2007)?

SITUATED FUNCTIONALISM

The Obama administration came to office committed to enhancing the state's administrative capacity to restore the functioning of private markets. In a long-established but often misunderstood paradox, state capacity creates and sustains private markets (Brown and Jacobs 2008; Polanyi 1944). Obama's efforts to restore regulation over financial markets are geared toward reestablishing confidence in the economic system and propping up critical industries—like finance and automobile—to allow them to restructure by, in part, reducing their workforces; and to provide expanded help for the growing ranks of unemployed American workers. His administration has also taken aim at reversing the kind of shoddy or incomplete oversight by the SEC and other regulators that permitted Bernard Madoff's $50 billion Ponzi scheme and a Wild West financial sector. Questions are also being raised about overseeing or taking over the job of so-called independent ratings agencies whose dependence on earning fees from the firms whose securities they rated compromised their judgment.[13] Increased regulation will likely (as earlier critics warned) introduce restrictions and impede future growth, though also reduce the probability of industry-wide crisis.

The Obama administration is also committed to using the state's administrative capacity to expand collective social welfare provisions. Taking steps to improve the living circumstances of everyday Americans hurt by the economic downturn may strengthen state legitimacy. Taking steps to halt or slow down the massive wave of home foreclosures and extend health coverage to more Americans may counterbalance the government's persistent responsiveness to the affluent and powerful as exemplified by the Wall Street bailouts (Bartels 2008; Hacker and Pierson 2005; Piketty and Saez 2007).

Whether Obama succeeds in restoring private markets and renewing the state's legitimacy are open questions. America's emerging fiscal crisis of successive trillion dollar deficits expresses the contradictions of the American

state and complicates its sustainability. Tens of billions have been and will continue to be pumped into the financial, automotive, insurance, and other industries to keep them afloat and, yet, these lifesaving measures also erode the credible notion of a "private" sector. The more government intervention, the greater the public review and influence on management prerogatives. Further demonstrating that government intervention is redefining rather than merely providing an uncomplicated "rescue" is the impact on credit markets: gargantuan government expenditures to rescue businesses necessitate a corresponding ballooning of public debt, which in turn will eventually drive up interest rates and constrain business efforts to secure loans on attractive terms. An additional contradiction exists: businesses benefiting from government largesse are basing their revival on cutting employees, benefits, and pay, which in turn diminishes the living circumstances of everyday Americans—producing the very outcome that the Obama administration sought to avoid and even reverse.

The concluding chapters in this volume offer telling accounts about the Obama administration's prospects. Liz Cohen warns against losing historical perspective, insisting that contemporary concern about an unsustainable American state be situated in longer term evolution of state development and the contours of equality and inequality in America. Stephen Skowronek shows how the American state transformed into a "discretionary policy state" after the resolution of fundamental questions about democratization and inclusion in the 1960s; yet he finds that the absence of a "coherent whole" in respect to the American state and the lack of "seamless transitions" between key periods of governance helps understand why a sustainability crisis arises.

Understanding the nature and contradictions of the Obama administration and the course of economic and political developments during this period requires, in our view, analyses of both micro-institutional dynamics as well as larger systemic developments. A reconstructed form of functionalism may help to complement fine grained institutional analyses.

Reconsidering functionalism and political systems must be based on a candid and careful assessment of its limitations. Functionalism fell out of favor after the 1970s largely because functional theorists' preoccupation with the mechanistic performance of predetermined imperatives precluded due attention to political conflict, empirical attention to causality, and the potential for system-level strain that might arise from policies that were detrimental to the political and economic order. Despite its limitations, the crisis of our times may justify a reconsideration of functionalism that incorporates conflict and empirically grounded analyses of institutional and societal situations. The "critical functionalist" tradition of the 1970s (e.g., Gans 1972; Piven and Cloward 1971 [1993]) included some of

the mechanistic limitations of functionalism more generally, but it offers an important platform for combining functionalist analysis of broader system dynamics with the grounded analyses of institutions and political conflict.

Situated functionalism is valuable in studying state sustainability. State operations that sustain private markets and the legitimacy of the existing political and social systems are fundamental anchors for the sustainability of society and government. Whether and how the state maintains market operations and legitimacy are open questions that require close and critical inspection. After the fall of 2008, the American state's sustainability requires extensive and enduring analysis.

NOTES

1. U.S. Securities and Exchange Commission, Office of Inspector General Office of Audits, *SEC's Oversight of Bear Stearns and Related Entities: The Consolidated Supervised Entity Program,* September 25, 2008, Report No. 446-A.

2. In the Stamp Lecture at the London School of Economics on January 13, 2009, Federal Reserve chairman Ben Bernanke revived the idea of the Treasury using TARP money to buy up banks' so-called "toxic assets" but did not detail how values for those assets would be reached. And see "Nationalization Gets a New, Serious Look," *New York Times,* January 26, 2009.

3. "A.I.G. May Get More in Bailout," *New York Times,* November 10, 2008.

4. "Behind Insurer's Crisis, Blind Eye to a Web of Risk," *New York Times,* September 28, 2008. The head of Goldman Sachs participated in the group gathered urgently in the Federal Reserve Bank of New York who organized the federal bailout; he was the only Wall Street chief executive present.

5. "The Guys from 'Government Sachs,'" *New York Times,* October 19, 2008.

6. For Treasury Secretary Paulson's response to criticisms about the Lehman Brother decision see the interview with him in *Financial Times,* December 31, 2008.

7. Quoted in "White House Philosophy Stoked Mortgage Bonfire," *New York Times,* December 21, 2008.

8. Barack Obama interview with CNBC on January 7, 2009.

9. Data on economic inequality has been collected from a number of authoritative sources including the U.S. government (e.g., U.S. Bureau of the Census, U.S. Bureau of Labor Statistics, U.S. Bureau of Economic Analysis, and U.S. Internal Revenue Service) and the Luxembourg Income Study. Information on the distribution of income and other economic rewards in the United States can be found in Mishel, Bernstein, and Boushey (2003). Evidence that compares income and wealth distributions in the United States and other advanced-industrial democracies can be found in the Luxembourg Income Study (http://www.lisproject.org).

10. Unless otherwise noted, the next three paragraphs are based on Mishel et al. (2007), Table 1.9, Figure 1L, and Table 5.1.

11. A number of studies document income inequality cross-nationally. A nice synthesis can be found in Kenworthy (2008, chapter 3). The Luxembourg Income Study Web site posts a number of studies of cross-national inequality.

12. This analysis is based on Oliver and Shapiro (1997, 86–90, 96–103), a survey of income and wealth among African Americans from 1987 to 1989 (unfortunately, a more recent comparable survey does not exist). The survey shows that the median income for white households during that period was $25,384 as compared with $15,630 for their black counterparts; the net financial assets of whites was $43,800 compared with $3,700 for blacks.

13. "Debt Watchdogs: Tamed or Caught Napping?" *New York Times,* December 7, 2008.

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