Exiting from the crisis: towards a model of more equitable and sustainable growth

Edited by
David Coats

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Exiting from the crisis: towards a model of more equitable and sustainable growth

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Report of a trade union task force

Edited by David Coats

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Preface

Even before the crisis, as the chapters in this book point out, there were several alternative forms of market economy, with different policy frameworks. While in most metrics, the Nordic model delivered better performance over longer periods of time than alternative models, including the American model, there was an active policy debate: could the Nordic model apply to countries with markedly different circumstances? Could it compete in delivering high levels of innovation over an extended period of time?

The crisis has called into question the strengths and weaknesses of various models, and the criteria by which we evaluate alternative policy frameworks. The broad landscape of issues and countries examined in this book provides a vital background for the reassessments that are, and should be, going on in countries, all over the world. Some countries have weathered the storm better than others. Some countries and policies were more responsible for creating the storm. Some policies, long advocated by financial markets and international financial institutions, contributed to the rapid spread of the crisis around the world.

The moment when everyone was a Keynesian economist has now passed. There was even a moment when Alan Greenspan would cast doubt on the viability of the notion of self-regulated markets. This has now passed. Financial markets are demanding a return to the old ways and, as fiscal debts have increased, to consolidations – which almost always entail cutbacks in services vital to working men and women. And in a world with already high levels of unemployment, the austerity they demand will imply even higher levels of unemployment; and that in turn will put downward pressure on wages. The conservatives' old blame game has continued apace: it was the government's attempt to provide housing for more Americans and its support for rigid wage policies that underlie the current problems. It is a matter of structural unemployment, not cyclical unemployment: if workers were only 'flexible' in their wage demands, we could get the world back to work.

Any economic system has to be graded on its ability to provide sustainable increases in well-being to the vast majority of its citizens – that is the central message of the International Commission on the Measurement of Economic Performance and Social Progress (Stiglitz et al. 2010). In recent years, America's economic system has not been scoring well – even before the crisis. Those in the middle have seen their income stagnate or decline. Today, the vast majority of Americans are worse off than they were a decade ago – and this account does not even reckon with the increase in insecurity as a result of the risk of higher unemployment, accompanied by inadequate unemployment insurance and the loss of health insurance.

This growing inequality in the US and many other countries has been linked by the UN Commission of Experts (Stiglitz and Members of a UN Commission of Experts 2010) to the deficiencies in global aggregate demand, that in turn were and are at the centre of the current crisis. In a sense, lower-income Americans were told not to worry about the decrease in their incomes, but to maintain their standards of living by borrowing. This policy worked for the short run, but was clearly unsustainable. It will be hard for robust *sustainable* consumption to be restored without improving equality. Unfortunately, downward pressures on wages from unemployment may result in exactly the opposite, one of several instances demonstrating that markets on their own are not stable.

By the same token, calls for more wage flexibility – hidden calls for reducing the wages of the most vulnerable – will also weaken aggregate demand and be counterproductive. Such calls are particularly foolish in a context of widespread debt contracts which are not indexed. Lower wages will make it more difficult for workers to make their debt payments, compounding their suffering and increasing the turmoil on already unsettled financial markets.

Not surprisingly, some of the countries that have better systems of social protection have done better than those with inadequate systems, even as they faced much worse external shocks. So-called reforms in recent decades have had the unintentional effect of weakening the economy's automatic stabilisers, thereby weakening the resilience of the economy.

Most of the increases in national indebtedness in the advanced industrial countries in the aftermath of the crisis are a result of the working of these automatic stabilisers, and it would be a mistake to undercut them.

Fiscal conservatives say that cutbacks in spending now are imperative, or else the US will face a Greece or Ireland style crisis. Ireland has faced a crisis largely because it followed the standard free market orthodoxy: unfettered markets led to a bloated financial sector which put at risk the entire economy; while politicians boasted of the growth (the benefits of which were not uniformly shared) they took little note of the risks to which they were exposing the economy. The core lesson of Ireland's experience – and that of the US – is that one cannot rely on unfettered markets or self-regulation.

Spain provides an answer to those who say that *all* one has to do is enforce more strictly the fiscal guidelines of Maastricht, not letting governments have unbridled deficits. Before the crisis, Spain had a surplus. Government leaders even recognised that markets were leading to a distorted economy (although those of the previous government were wedded to free market fundamentalism, as were many in the Central Bank.) But they didn't have the time and tools: today, Spain has a large deficit, with 20 per cent unemployment and 40 per cent youth unemployment.

It is remarkable that reasonable economists, when assigned to think about public policy, quickly lose their grounding. When looking at the health of a firm, they would look at its cash flows and its balance sheet – assets and liabilities. But when it comes to the government, they only look at liabilities. One can't help thinking that these blinders are political in nature: by reducing debt, they hope to force (in times such as these) cutbacks in social spending. There is a more rational economic response: increasing investments, even if debt financed, can improve the nation's overall strength and even reduce the medium-term debt/GDP ratio. For countries such as the US with a backlog of high return investments and with the ability to borrow at close to zero interest rates, government tax revenues will increase far more than the interest that will have to be paid, so debt will be lower and GDP higher. With a lower numerator and a higher denominator, economic growth is *more* sustainable.

These are win–win policies. There are other policies that can help to improve the overall efficiency of the economy today and promote long-term growth. Forcing firms to pay for the costs they impose on their environment amounts to the elimination of a distortionary subsidy, thereby increasing economic efficiency. Societal well-being has improved since the introduction of environmental regulations, which have led to air that is more breathable and water that is safer. Using market-based incentives – taxing bad things rather than good things, such as work and savings – can both generate revenue and increase economic efficiency. America's toxic financial products polluted the global economy, and imposed enormous costs on others. There are a variety of taxes on the financial sector (including a financial transactions tax) which would generate considerable amounts of revenue and potentially even lead to a more stable economy. By the same token, taxes on the oil and other carbon emitting sectors could help increase the energy and carbon efficiency of the economy at the same time that such taxes provide revenues for dealing with the deficit.

Finally, there are policies that involve hard trade-offs – not everyone may gain in the short run. If there is to be fiscal consolidation, it should not be on the backs of those who have been suffering from a dysfunctional system for the past quarter century, but rather of those who have benefited from the system. In the United States, for instance, with approximately a quarter of all income accruing to the upper 1 per cent, moderate increases in income, capital gains, and estate taxes could generate substantial revenues without significantly compromising their standards of living. Even a small financial transactions tax could raise large amounts of money.

The economic system is governed by a set of rules. Any set of rules advantage some players of the game at the expense of others. And the rules affect how the system as a whole performs. Over the past thirty years, we have changed a large number of rules on a piecemeal basis, under the influence of an ideology which said that the best rules were those that interfered least with the markets. That, at least, was what the advocates of the rules said. But in fact, there was another agenda. Deregulation did not, in fact, result in less involvement in the market, but more: there was less involvement in the years before the crisis, but far more in its aftermath. This was predictable and predicted. What these advocates of so-called free markets were doing was creating a system I have called 'ersatz capitalism', the essential ingredient of which is the socialisation of losses and the privatisation of gains. This ersatz capitalism is closely related to the corporate capitalism that flourished under Bush and Reagan. In some cases, who pays for these gifts to corporations is not so transparent: in the end, of course, it is ordinary citizens, whether as taxpayers or consumers who pay, but often in ways that are not easy to detect, for example, through tax expenditure or through higher prices on the goods they purchase.

But some of the changes in the rules during the Bush years were targeted on the most vulnerable. Reforms that made it more difficult for those with large debts – combined with no limits on the usurious rates which banks could charge – reintroduced into the United States a system of partial bonded servitude. It enabled banks to be more reckless in their lending, knowing that they had a better chance of getting back their loans, with interest, no matter how outrageous the contract. One might have hoped that moral scruples would have prevented the widespread predatory practices, but evidently greed triumphed; and with free market regulators either in bed with the banks or succumbing to free market ideologies, there was no check on these abusive practices. The banks had discovered that there was money at the bottom of the pyramid, and they created techniques, and a legal framework, to help move it towards the top. No one looking at what happened would say that these 'voluntary' but all too often deceptive transactions enhanced the well-being of those at the bottom. But in the end, our entire global system paid the price.

Four years after America's real estate bubble broke, bringing down the global economy, the price for these misdeeds has not yet been fully paid. Output remains well below its potential in most advanced industrial countries, with the losses in trillions of dollars – in addition to the losses due to the financial sector's misallocation of capital and mismanagement of risk before the crisis. No government outside of war has ever been responsible for the magnitude of losses that have resulted from the financial sector's misdeeds. And yet, four years later, the rules of the game, the regulations which government imposes on banks, have yet to be adequately changed. Incentives for excessive risk taking and short-sighted behaviour remain; indeed, the problem of moral hazard posed by too-big-to-fail banks is worse, not better. In some areas, there have been improvements, but even then the laws remain riddled with exemptions and exceptions, determined not on the basis of economic principles but raw political muscle.

Any society functions on the basis of a sense of social cohesion and trust, a sense of fairness. We should not underestimate the extent to which the crisis and how it has been dealt with has broken the social contract and all of these elements which make a society function well. That the bankers have lost the trust of those they have served is obvious; one bank that had engaged in deceptive practices simply said that it was the responsibility of others to take care (caveat emptor); banks that you can trust are evidently a thing of the past. Inequality is typically justified on the ground that those who are paid well have made more of a contribution to society, from which we all benefit. But when taxpayers financed bank bonuses in the millions – paid to those who were responsible for losses to their firms in the billions, and to society in the hundreds of billions – this story no longer made any sense. When an Obama Administration official announced the double standard – workers had to rewrite their contracts to make the car companies competitive, but the bankers' contracts were sacrosanct and could not be rewritten – it too contributed to a perspective that the system was fundamentally unfair, and that the government, rather than correcting the inequities, was there to maintain them.

Worse, ordinary citizens are being asked to bear more austerity, higher unemployment and cutbacks in public services, all to pay down debts that were created by the actions of the financial sector, and in part to protect banks' bondholders and shareholders.

An economy cannot work without trust, but when banks insist on trying to return to the world as it was before the crisis, citizens rightly feel sceptical. Trust will not return until good and strong regulations are passed, and until a sense of balance has been restored. The financial sector is supposed to serve the economy – not vice versa. We have been confusing ends and means.

We have the same resources – human and real capital – today that we had before the crisis. There is no reason we should compound the financial sector's mistake of misallocating capital *before* the crisis with the further mistake of underutilizing society's resources *after* the crisis. Modern technology has the capacity to enhance the well-being of *all* citizens – and yet in some countries (including the United States) we have created an economy in which *most* citizens are worse off, year after year. We might boast of the increases in our GDP, but what good is that if that increase in GDP does not redound to the benefit of ordinary citizens? If that growth does not lead to broader increases in well-being? Or if the increases are ephemeral, and not sustainable, either economically or environmentally?

The challenges facing governments, our societies and our economies are enormous. We may have pulled back from the brink at which we stood in the fall of 2008, but we are not out of the woods. Even if profits, bonuses and growth are restored, we cannot claim victory until unemployment is brought down to where it was before the crisis, and until the real incomes of workers are not just growing, but have made up for the losses that have been suffered in the interim. We can do it – but only if we correct the mistakes of the past, change course and keep in mind the true objectives for which we should be striving.

Professor Joseph Stiglitz, Columbia University
April 2011

Foreword to the report of the trade union task force

At the time of writing, the global economy is still struggling to emerge from the worst financial crisis and global recession since the Second World War. The recovery is uneven and still very fragile. For most working families an economic recovery has yet to be felt. Unemployment rates in industrialised countries remain 50 per cent higher than in 2008. One hundred million more people live in extreme poverty than before the crisis. The shift announced by governments to fiscal consolidation and austerity policies, before the recovery is self-sustaining, risks slowing, if not stalling the recovery and raising unemployment further.

Thrust into prominence in the near financial meltdown of 2008, the G20 has emerged as a policy coordination forum that in its first two years was successful to the extent that the world's leading economies largely avoided a second Great Depression. However, governments must step up their coordinated efforts to reduce unemployment and restore effective social protection. If employment and social protection are not addressed global social unrest will grow. If financial regulation with real constraints on speculative activity in food and other commodities is not implemented global inequality, deprivation and poverty will escalate, as will the risk of a renewed economic crisis.

Beyond the immediate crisis response the scale of the recent economic disaster raises questions about the policies that led to the crisis. OECD Secretary-General Angel Gurría has said that the crisis reflected massive failures of financial regulation, supervision and governance. The IMF Managing Director Dominique Strauss-Kahn has said that '[f]undamentally, the growth model that co-existed with globalisation was unbalanced and unsustainable ... Inequality may have actually stoked this unsustainable model.' The crisis should be provoking a serious rethink in all these areas, but the scenario looks very much like 'business as usual'. On the one hand, profits are booming and bonuses are back, symbolising the lack of fundamental financial sector reform. On the other hand, attacks are being launched on the very social protection and labour market institutions that helped to shield (some) economies from the worst effects of the crisis.

Following the crisis, it has been striking that the more regulated labour markets of the Nordic area and Germany have fared best in terms of unemployment, while the more 'flexible' labour markets of the US and some other EU countries have been dominated by brutal layoffs of workers by firms, with a reluctance to hire back not seen in any previous post-war cycle. Despite this, many mainstream economists and commentators continue to call for the weakening of employment protection legislation, decentralisation of collective bargaining and the encouragement of workers to 'price themselves into jobs'.

The lessons of recent experience need to be learnt and a new model of growth developed based on a more balanced relationship between government and the economy. Governments must ensure that banks return to their core task of allocating capital efficiently, and that corporations recognise their responsibilities to their customers, employees and the wider community. Governments must ensure that the growth process emerging from the crisis is both socially just and environmental sustainable.

To provide a forum for debate, TUAC, the European Trade Union Institute, the Global Union Research Network and the ITUC created a Task Force to define the parameters of a new growth model. This report is the initial result of its work. It consists of contributions by more than 30 authors from both industrialised and developing countries. The report has been edited by David Coats, Research Fellow at the Smith Institute, supported by John Evans, Andrew Watt and Frank Hoffer. We are pleased to include a preface by the Nobel Laureate Joseph Stiglitz.

As the report's conclusion states, faith in unconstrained markets should have been undermined by the collapse of the banking sector and the ensuing global crash, but it now appears that policymakers are retreating to the comforting nostrums of economic orthodoxy. This would be a strategic error. Returning to policies that failed in the run-up to the crisis cannot be expected to return the global economy to growth following a very deep recession. TUAC, the ITUC and the ETUC will be seeking to ensure that policymakers take this message to heart, both this year and beyond.

Sharan Burrow (General Secretary, ITUC)
John Evans (General Secretary, TUAC)
John Monks (General Secretary, ETUC)
April 2011

Towards a new growth model: introduction

David Coats

The collapse

> I made a mistake in presuming that the self-interests of organisations, specifically banks and others, were such that they were best capable of protecting their own shareholders and their equity in the firms ... This modern risk-management paradigm held sway for decades ... the whole intellectual edifice collapsed in the summer of last year.
>
> Alan Greenspan, former Chairman of the Federal Reserve, testimony to the House Committee of Government Oversight and Reform, 23 October 2008

For most of his time as chairman of the Federal Reserve Alan Greenspan's interventions in policy debates had a Delphic quality. 'Just what did he mean by that?' was a question that often perplexed the 'commentariat'. It is all the more surprising, then, that he should have been absolutely clear in his evidence to Congress in 2008 following the collapse of Lehman Brothers and the most serious banking crisis for eighty years. By admitting that he made a mistake in believing that enlightened self-interest was the most important element of market discipline, Greenspan was accepting the failure of a mindset, a model and a faith that had held sway over public policy for the preceding three decades.

The essence of the model is easy to explain. It tells us that markets are 'smart' (in the American English sense of 'clever'), while governments are dumb. Regulatory interventions intended to do good are more likely than not to do harm. Indeed, most regulations are a burden on business and the best solution to any economic problem is to liberate markets to do their best (or worst). High taxation is bound to have disincentive effects that hold back economic growth and keep countries poorer than they would otherwise be. Strong welfare states, especially if they offer generous out of work benefits, may be good at protecting people from poverty, but economies – and ultimately workers – pay the price in high structural unemployment. Strong trade unions create rigidities in the labour market. By forcing up wages to uneconomic levels trade unions achieve nothing more than a combination of high inflation and high unemployment.

Central to the model is a profound hostility to action by the state and a touching faith in the perfection of markets. Governments, once they branch out from their night-watchman role, are said to be agents of economic destruction. Financial markets and asset markets in particular, if left to their own devices, will ensure that the right prices are offered at all times. A rather crude interpretation of Adam Smith's 'invisible hand' – that a kind of selfishness is the coordinating instrument in markets – is easily conflated with the notion that 'greed is good', that rising income inequality is unavoidable and that any attempt to put a cap on the earnings of the richest will lead to an exodus of talent to those countries with low taxes and a high tolerance of excess.

What is most alarming about the market fundamentalist faith is that it allows no room for disagreement or debate: this view is right and all others are wrong. Before the crisis hit, anyone who suggested that the model might be flawed, or partial, or based more on faith than evidence rapidly found themselves marginalised in the public debate and exposed to ridicule. Often such critics were bluntly told that they simply did not understand economics. Experience has proved that the critics were more prescient than the enthusiasts. But while there is some satisfaction to be drawn from being proved right – and many of the contributors to this volume have a record of speaking out against market fundamentalism going back years before the crisis – the challenge now is to construct a credible alternative.

That is broadly the purpose of this volume, which flows from the work of an international trade union task force established by the European Trade Union Institute, the Trade Union Advisory Committee to the OECD, the ITUC and the Global Unions Research Network. It draws together the best thinking from across the world, with contributions from trade unions themselves and commentators sympathetic to the labour agenda. Far from being a restatement of entrenched trade union positions, this volume also seeks to generate fresh insights that are relevant to contemporary debates. The issues covered are wide-ranging – from monetary and fiscal policy, to income inequality, industrial policy, the role of public services, the regulation of financial markets, the importance of labour standards, the role of global institutions and the transition to a sustainable growth model. The scope is ambitious, but the recommendations are designed to be practical. They start with the world as it is, not the world as we would wish it to be, and they are rooted in evidence, not the wishful thinking of which trade unions are so often wrongly accused.

Market fundamentalism makes a number of claims about the superior economic performance derived from policies of light-touch regulation, fiscal rectitude and inflation targeting. But even before the crisis broke there was ample evidence to demonstrate that there was more than one route to prosperity. The 'varieties of capitalism' analysis, popularised by Peter Hall and David Soskice, showed that very different institutional arrangements produced rather similar results in terms of GDP per capita (Hall and Soskice 2001). And the OECD's review of their 1994 Jobs Study demonstrated that labour markets with high taxes, high benefits, strong unions and expensive labour market policies were just as likely to achieve full employment as the more liberal economies of the UK and the USA (OECD 2006). Not only that, but they did so while maintaining much higher levels of social cohesion, equality and social mobility, with all the attendant benefits of better health, higher levels of trust and lower levels of incarceration (Wilkinson and Pickett 2009). Moreover, it was not entirely clear that the developing world had benefited from observing the strictures of the conventional wisdom, as Joseph Stiglitz documented so powerfully in his pre-crisis critique of the international financial institutions (Stiglitz 2002 and 2006).

The hard work of rethinking had already begun in some quarters before hubris overtook the global banking system, and trade unions were already part of the coalition offering alternatives to the dominant ideology. We have sought in this collection of articles to take the argument further and offer prescriptions as well as analysis.

When the crisis broke, policymakers were confronted with the immediate challenge of preventing a global depression, the strategic task of rebuilding the structures of global economic governance to ensure sustainable growth in the future and the strenuous political test of explaining all of this to sceptical or hostile electorates. Initially, at least, there was a degree of panic and confusion. Finance ministers were trapped by the status quo and only reluctantly intervened to prevent the failure of significant financial institutions. But then it seemed that policy measures that had been off the agenda for the previous thirty years – such as deficit spending and public ownership – were suddenly back in vogue. After the failure of Lehman Brothers, governments did take action to recapitalise the banks. And when it was clear that the banking crisis had pushed the real economy into recession, a (more or less) coordinated global fiscal stimulus was administered, combined with what central bankers described as unorthodox monetary policy: quantitative easing to inject more liquidity into the financial system and the economy.

The G20 appeared to play an important role, suggesting that the richest countries in the world had understood the need to involve emerging economies in critical economic policy decisions. Support for the G20's approach came from what would have been unlikely quarters in the 1980s and 1990s. For example, the IMF supported the stimulus policies and emphasised that if the household and corporate sectors continued to grow sluggishly then governments should do more. Keynesianism was being taken seriously again. This was a dramatic and welcome development and some saw it as a fundamental change in the dynamics of capitalism. Just as Thatcherism and Reaganism had overthrown the post-war consensus in the developed English-speaking countries, so the banking crisis had overthrown the belief in the perfection of markets and the optimality of all market outcomes (Kaletsky 2010).

This suggestion that we are witnessing a paradigm shift is not entirely groundless, but subsequent experience has suggested that it may overstate the nature of the change taking place. A dramatic swing in the direction of state action has been swiftly followed by an equal and opposite clamour for immediate fiscal consolidation. The banking crisis, which generated the right policy response, has been followed in a number of countries by a sovereign debt crisis, with policymakers retreating at high speed to the comforting nostrums of orthodoxy. Financial markets are determining the policy context once again, just as they did in the pre-crisis period, despite the fact that the markets were largely responsible for the crash and are now seeking to penalise those governments that saved the banking system from catastrophe.

In the euro area (more popularly known as the 'Eurozone'), for example, austerity policies are back with a vengeance. Even countries with a current account surplus, such as Germany, are cutting budget deficits immediately. And public sector retrenchment across the Eurozone, even as households pay down debt ('deleverage') and firms see little incentive to invest, is likely to lead to sluggish growth, and might even tip the entire economy back into recession. Unless the household and corporate sectors in Germany and other surplus countries take up the slack and start consuming imports from elsewhere in Europe the nascent recovery could be snuffed out. Unemployment could remain high, and the threat of a misguided attack on the European socio-economic model – as in similar circumstances in the mid-1990s – would be very real.

The muted nature of the recovery in the USA leaves open the possibility of a double dip recession. And in the UK, fiscal consolidation is being pursued at a reckless pace, with the public sector bearing the brunt of the pain – 80 per cent of the reduction in the deficit is to be achieved through cuts in services and only 20 per cent through tax increases.

Put simply, a measured response to the crisis in its initial phases (following some moments of perplexity) which, while insufficient, at least averted the threat of a repeat of the Great Depression, has been followed by the return of a rising sense of panic. The moderately good start has been largely wasted and there is a serious risk that policymakers are now, through fear of the bond markets, about to plunge the global economy into a prolonged slump.

These choices are inevitably related to the shifting sands of politics. Govern ments that were enthusiastic about stimulus policies or a measured approach to fiscal consolidation are either in difficulty or have lost power. Electorates across the developed world appear to be turning to the centre-right and a more conventional set of economic policies – although this is not true everywhere, with South America (most recently Brazil) as a notable counter-example. Politicians of the centre and the left have struggled to articulate a clear economic policy prospectus and continue to pay the political price. The questions they need to answer are clear: How should the exit from the crisis be managed? How can fiscal consolidation be achieved without compromising progressive objectives, including the pursuit of greater income equality and a higher level of social cohesion? And how can a new growth model be constructed that offers decent jobs, rising living standards and a sustainable approach to the environment?

In the meantime, trade unions are therefore confronted by three significant challenges: the return of austerity policies as governments seek to deal with the fiscal consequences of the crisis; the return of the argument that an immediate job-rich recovery requires deregulation; and the belief that high structural unemployment can be avoided over the long term only if labour markets are flexible, taxes are low, unions are enfeebled and welfare states are weak. Any impartial observer will be driven to conclude that the market fundamentalist orthodoxy is staging something of a comeback, despite the empirical evidence casting doubt on the model before the crisis and its self-evident failure during the crisis. To a degree, then, the contributors to this volume are fighting old battles at the same time as they seek to develop a new approach to sustainable growth.

More than anything else, the objective of this volume is to offer a clear description of an alternative. The goals of the trade union movement remain the same: to give working people a voice in determining their futures; to guarantee sustainable, decent jobs for all those who wish to work; to ensure that developing nations can experience rising incomes and rising labour standards; to establish a growth model consistent with environmental responsibility; and to secure greater income equality as the best route to social cohesion. Nonetheless, simply to call for a return to the policies of the post-war boom period would be a catastrophic mistake. The world has changed and the trade union movement has changed with it. The arguments presented here are designed to show that both unions and other progressive voices linked to the labour movement have new, relevant and credible policies for the difficult period ahead. It is for others to judge whether we have succeeded.

Conclusions

Ron Blackwell and David Coats

The failure of a model

The global financial and economic crisis has invalidated many of the assumptions on which economic policy had been based for the previous thirty years. The belief that light touch regulation, limited government, low taxes, labour market deregulation and weak labour market institutions are all necessary ingredients of economic success has proved to be a recipe for volatility, excessive risk taking, growing income inequality and, in some countries, the rise of precarious employment. While the richest in many parts of the OECD saw their relative position improve – sometimes dramatically – the poorest saw their relative position deteriorate. The OECD itself documented the rise in inequality in its landmark publication *Growing Unequal* in 2008 (OECD 2008). In the United States even those on middle incomes saw little improvement in their earnings or living standards over a twenty year period. Nor was it true that the policies that we might usefully label as "market fundamentalist" led to better economic performance before the crisis broke. This troublesome fact was recognised by the OECD in their reassessment of the 1994 Jobs Study, published under the title *Boosting Jobs and Incomes* in 2006 (OECD 2006). It was accepted that two groups of countries had achieved 'good results' (defined as a high employment rate, moderate inflation and apparently robust growth): those pursuing 'market reliant' policies, such as the US and the UK, and those pursuing policies with higher taxes, stronger employment protection legislation, more generous unemployment benefits and much higher investment in active labour market programmes (including Austria, the Nordic countries and the Netherlands).

Even before the global recession it was clear that there was more than one route to growth and high employment rates. Moreover, the life chances and life expectancy of the poorest was rather better in this second group of countries than in those pursuing more orthodox policies. These must now be relevant considerations as policymakers consider how to build a new economic model in the post-crisis world.

The pre-crisis problem

Trade union objectives have remained broadly the same over a prolonged period. In large measure, this is because they are based on clear values. There is a very strong commitment to building a global economy that offers sustainable, decent jobs for all those who wish to work, allows developing countries to experience rising incomes and ensures that the growth process is consistent with the imperative of tackling climate change and protecting the environment. The model that operated before the crisis was failing to deliver these objectives. Rising inequality, stagnating wages and underdevelopment in sub-Saharan Africa could hardly be described as successes.

Moreover, much of the supposed prosperity in those countries most committed to the orthodox model was dependent on either rising house prices, against which households were willing to borrow, or a level of financial innovation (the development of exotic derivatives) that proved to be a fragile instrument for the sustained generation of demand. There was plenty of evidence that these arrangements were unsustainable and that dangerous bubbles were emerging in asset markets. But policymakers, seduced by the efficient markets hypothesis and dynamic equilibrium theory, chose to believe that 'this time is different' (Reinhart and Rogoff 2009). After all, almost thirty years of liberalisation, deregulation, tax cuts and efforts to shrink the size of the state ought, on the orthodox view, to have made the crisis impossible. Unfortunately, as with the previous "eight centuries of financial folly", to use Reinhart and Rogoff's formulation, the iron laws of economics proved impossible to resist and in the end the bubble burst. There was a misplaced belief that the supposed diversification of risk was also an effective device to eliminate uncertainty.

The goals of economic policy

For most of the recent period economic progress has been measured almost exclusively by growth in GDP per head. This is a narrow measure that is being increasingly seen as an inadequate benchmark of social progress. It is clear, for example, that beyond a certain point measured increases in GDP appear to have little or no impact on either happiness or life satisfaction (Layard 2004; Offer 2006; Wilkinson and Picket 2010). As Amartya Sen has pointed out, economic growth has to be for a purpose and the most straightforward way of characterising that goal is to say that citizens must be able to acquire the capabilities the they need to choose lives that they have reason to value (Sen 1999). Moreover, Sen's notion of 'development as freedom' means that people can enjoy genuine liberty only insofar as it is based on economic and social security.

In response to this line of argument, President Sarkozy appointed an expert panel to devise a more balanced set of benchmarks. The approach adopted by the *Commission for the Measurement of Economic Performance and Social Progress* is a welcome step in the right direction and should be endorsed by policymakers in all countries. Put slightly differently, the objective is not to accept the world as it is and adapt citizens to the demands of the economy, but to reshape the economy to ensure that it serves the interests of citizens.

Fiscal stimulus, austerity measures and the return of the conventional wisdom

Policymakers' response to the crisis was, to begin with, encouraging. The G20 played a leading role, the global economy received a coordinated stimulus, the banking sector was recapitalised and catastrophe was averted. Indeed, without this level of policy activism the trough would have been much deeper and global unemployment would have rocketed to alarming levels, with a real threat to social cohesion in some countries.

The policy response also demonstrated that the state remains an indispensable actor in the economy. Only the state had the wherewithal to recapitalise the banks and only the state had the resources to offset the reduction in demand from the corporate and household sectors. In other words, contrary to the strictures of market fundamentalists, the state had proved that it plays an essential role in the stabilisation of an inherently unstable economy.

For the sake of clarity we should emphasise that this does not mean that the trade unions automatically advocate public ownership (although there may be a case for this in some sectors) or the revival of centrally planned economies. But we do believe that the democratic state must play a role as a provider of quality public services and as a regulator, setting the stage for market actors and intervening (either through fiscal or monetary policy) to cool a speculative boom or to halt a recession. Moreover, there is a strong case for saying that the public and private sectors are interdependent; that developed economies cannot thrive with small states; and that the process of economic growth has generally been associated with a significant rise in social spending (Lindert 2004). There is very little evidence to suggest that shrinking the state, as some policymakers suggest, is a sustainable medium-term strategy. Indeed, it may act as a brake rather than a stimulus to growth.

There is also, as Tim Page makes clear in his paper, a strong case for governments to develop active industrial policies by setting clear regulatory frameworks, providing capital for investments that will not be funded on the open market and encouraging the transfer of technologies, as well as the dissemination of best practice.

Unfortunately, the timely, coordinated intervention at the beginning of the crisis now seems to have been matched by the recrudescence of the pre-crisis orthodoxy. Put more crudely, austerity policies are back with a vengeance. In part, this is because governments are concerned that the banking crisis has become a sovereign debt crisis – with borrowing, deficits and debt-to-GDP ratios rising. It is obvious that, following the Greek debt crisis, some countries are in difficulties. But countries without comparable problems appear to be embarking on a process of fiscal consolidation at breakneck speed. This is certainly true in the UK, where the government is looking to cut public spending and reduce deficits further and faster than is demanded by the economic situation. And it is, to a lesser degree, true in Germany, where an effort is being made to cut the deficit when action is urgently needed to stimulate the domestic economy. The new arrangements for economic governance in the Euro area also appear to have a built-in deflationary bias that may lock this important global region into a period of sluggish or jobless growth.

Moreover, despite the OECD's recognition of the need to balance flexibility with security in *Boosting Jobs and Incomes* (the Jobs Study reassessment), policymakers are now applying the 'going for growth' paradigm of structural reform and seem to have reverted to the belief that the only efficient labour markets are lightly regulated labour markets.

From this standpoint, the best route out of the crisis is to embrace once more the ideology of a small state, low taxes and weak unions. However, contrary to these predictions, countries with more regulated labour markets have weathered the storms of the recession rather better than the orthodox OECD approach or IMF policy prescriptions would have predicted. German unemployment is lower than unemployment in the United States – in part because of the effectiveness of the temporary short-time working scheme, coupled with negotiations between the unions and firms – and the Nordic countries are recovering moderately well from the recession.

Perhaps it is worth emphasising at this point that the OECD's original Jobs Study analysis (1994), which drove the deregulatory impulse for almost a decade, could not explain differences in labour market performance during the boom. For example, the Netherlands enjoyed better employment performance than Germany throughout the 1990s, even though it had a more regulated labour market (stronger employment protection legislation and higher unemployment benefits) (Schettkat 2005). Similarly, there is strong evidence to show that the central prediction of the OECD's thesis – that disadvantaged workers would do better in 'flexible' labour markets – was never an accurate description of reality. One authoritative study shows that disadvantaged workers in the UK (the low skilled and the young) did no better in the 1990s than their counterparts in more heavily regulated France and Germany (Schmitt and Wadsworth in Howell 2005). If all these critiques are correct then it is difficult to understand how recovery from the worst global recession for more than 70 years can be secured through the application of policies that had no impact on the position of the unemployed or disadvantaged during a period of robust growth.

Out of the crisis and beyond

Policymakers are therefore confronted with the need to abandon the conventional wisdom and develop new strategies to exit successfully from the crisis. Building a model of sustainable and stable growth demands nothing less. A necessary first step is to recognise that the state plays an indispensable role in a capitalist economy. The market depends upon the state. Indeed, one might go further and say that the market is an artefact of the state, in the sense that markets could not exist at all without, among other things, the rule of law, the impartial administration of justice, the enforcement of contracts and the protection of intellectual property rights.

This much would be accepted by all but the most extreme market fundamentalists. But recent experience shows that it is possible to go further in the way that has been described above. Most importantly, perhaps, markets, if left to themselves, will never develop effective institutions for global economic governance. Markets alone cannot solve global imbalances, deal with exchange rate questions, establish a fair trading regime, tackle climate change or reduce income inequality. On the other hand, it is equally clear that governments alone may struggle to resolve these problems. That is why civil society institutions such as trade unions remain important in shaping and legitimising such decisions certainly, for example by making the reduction of income inequality a collective bargaining priority.

Wherever one sits on the spectrum of economic policy opinion it has been clear for some time that the pre-crisis status quo offers no route out of the crisis. In this sense, there can be no return to business as usual. But, as the OECD has recognised, the situation of the global economy remains precarious. The choices are often presented as either slow growth and a prolonged period of high unemployment generated by sluggish investment or a fairly rapid return to robust growth with a particular focus on innovation, knowledge services and environmental technologies. From a trade union standpoint the latter is more attractive, but it is by no means clear that the current orientation of policy will lead to a positive outcome. And while it would be absurd to suggest that a return a stable growth path can take place with high budget deficits or rising debt-to-GDP ratios, there is a strong belief – shared by the contributors to this volume – that governments, running in fear from the bond markets (and the credit rating agencies) are cutting spending too far, too fast, putting the fragile recovery at risk. It is one thing to call for 'growth-friendly deficit reduction' and quite another for governments to cut public investment in science, research and higher education when the dominant knowledge economy narrative tells us that such things are indispensible in successful dynamic economies. Put crudely, growth-friendly deficit reduction can rapidly metamorphose into a conventional austerity programme.

If this analysis is correct then it suggests that the direction of policy today must change if a successful exit from the crisis is to take place and, more importantly, a firm foundation is to be laid for sustainable growth in the future. A synthesis of the contributions to this volume would suggest that action must be taken in the following areas:

- Policymakers must consider how demand can be generated that leads to the kind of economic progress we described above, where success is measured by more than the growth in nominal GDP per head. It is important to understand that the global imbalances that gave rise to the crisis have yet to be effectively tackled. Those countries running current account deficits need to save more and those with surpluses need to boost domestic demand. Inevitably, this requires consideration of exchange rates and the question of the relationship between the US dollar and the Chinese yuan. At the very least, G20 countries need to move beyond the conclusions of the recent Seoul summit and devise a process for the gradual and managed rebalancing of the global economy. In other words, a global economy can thrive only if it possesses effective institutions for global economic governance to which all the major players are committed. The alternative is a return to the protection of national interests, beggar-thy-neighbour policies, sluggish growth and instability. There is a very strong case for an international financial transactions tax to put some sand in the wheels of speculative investment, provide resources for fiscal consolidation and fund global public goods.
- Some emerging and developing countries have sought to ensure that the fruits of growth are more widely distributed, with a particular emphasis on reducing inequality by improving the incomes of the poorest. This is the case in Brazil, for example, and it is designed to bring it about that domestic demand grows in line with the growth of the economy. Moreover, the model is unorthodox to the extent that it adopts a pragmatic approach to deregulation and the opening of markets. This approach is to be preferred to the conventional argument for immediate liberalisation, privatisation and deregulation. It offers a development model that might usefully be pursued elsewhere, most obviously in sub-Saharan Africa where there is a pressing need for investment in infrastructure and an imperative to improve the incomes of the poorest citizens.
- One of the causes of the crisis was inadequate monetary and fiscal policy coordination at both global and national level. Policymakers must recognise that the explicit goals are to achieve full employment, rising living standards, economic stability (including price

stability) and social cohesion. Central banks should be given the objective of doing more than simply targeting inflation. But if full employment and nominal GDP growth are to supplement the inflation targeting regime then banks need more than the interest rate weapon in their arsenal. This is why consideration should be given to the introduction of asset-based reserve requirements so that central banks can pursue price stability and deflate any emerging asset price bubbles. There should also be adequate policy space for 'unorthodox' monetary policy or quantitative easing. And central banks should recognise that their judgments need to be both justified and legitimised to other social actors, not least the social partners. There is a strong case for independent central banks to have formal structures that permit such an informed dialogue.

– Turning to fiscal policy, the crisis has proved the power of counter-cyclical activism. This means that policy in the future must provide for robust automatic stabilisers that kick in when the economy begins to slow down. But there must be equally robust counter-cyclical pressures during periods of robust growth. This is when governments should be accumulating the surpluses that give them room for manoeuvre in recessions. And, contrary to the tax cutting obsessions of the conventional wisdom, sometimes it is appropriate for taxes to rise if that is the best instrument available to prevent the economy from overheating. One-sided mechanisms such as the 'debt brake', which is now part of the German Constitution and the proposed stringent fiscal consolidation rules now being proposed in Europe are potentially dangerous and should be avoided.
– At national level, policymakers should devote more attention to the question of innovation institutions and industrial policy as sources of growth and demand generation. If the global economy is to continue to grow and if OECD countries are to maintain their relative advantage then they must develop their capacities to develop new products and new services. This demands the creation of what the British commentator Will Hutton calls an 'innovation ecosystem', where the state invests in education and training (reducing spending on higher education would therefore be a major strategic error); there is easy access to capital (especially for the development of environmental technologies or knowledge based services); there are institutions for information exchange and technology transfer (like the Fraunhofer Institutes in Germany); and welfare policy is devised to facilitate economic transitions (as with the Danish approach) (Hutton 2010).

- Sustainable demand generation requires that workers have incomes that enable them to purchase the goods and services produced by a dynamic private sector. This is what is meant by 'income-led growth'. Policymakers must consider how it can be guaranteed that workers' earnings rise in line with productivity. One obvious route is through the promotion of collective bargaining, but policymakers may need to consider other instruments (labour clauses in public contracts, for example) if trade unions are either weak or absent from the scene. Moreover, an increasingly integrated global economy demands some global labour standards to legitimise the process of economic integration, to protect vulnerable workers against exploitation and ensure that workers in the developing world are able to share in the rising prosperity of their nations.
- There is much to be gained from returning to the analysis presented by the OECD in *Boosting Jobs and Incomes* (the reassessment of the jobs study) in 2006. Those countries that had achieved high employment and a more equitable distribution of incomes focused attention of the broad sweep of labour market policy, including: skills formation systems before labour market entry that give workers a sense of occupational identity and self-confidence; an emphasis on lifelong learning as a route to employability; a focus on the balance of power between capital and labour – including the strength of the trade unions and the extent of collective bargaining coverage; the pursuit of policies to narrow unjustifiable differences between groups of workers; a combination of high unemployment benefits and job search obligations with high levels of investment in active labour market programmes to get the unemployed back to work. In addition, these approaches are reinforced by a strong welfare state funded by relatively high taxation, which offers generous services (including childcare provision and maternity/paternity leave) so that women and men can combine work and their caring responsibilities. This helps to explain the better performance on gender pay equality and the high employment rate for women.

Sustainability and a reconceptualised corporation

The idea of sustainability is central to the argument presented here. This is often viewed as a question of environmental protection and resource use, but we are using the term in a wider sense to embrace the notion of a corporation that embeds sustainability in all its operations. A sustainable corporation seeks to grow by building market share or developing new products and services rather than through financial engineering or merger and acquisition activity. A sustainable corporation is a responsible corporation that recognises the duties it owes to the workers it employs and the communities in which it operates. The maximisation of shareholder value is a somewhat anaemic conceptualisation of corporate purpose and we favour a richer and more sophisticated notion that recognises the interdependence of the corporation, its employees and society.

This is not to underplay, of course, the significant challenges associated with climate change and resource use. Trade unions at global and national level have endorsed the imperative to reduce carbon emissions and more generally to decarbonise the economy. But, consistent with the generally egalitarian approach described throughout this volume, that process must be associated with a just transition to a low carbon world. In other words, the loss of jobs in some sectors must be a managed process. There must be investment in training and retraining, a proper assessment of the economic impact of environmentally driven structural change and a sharing of the burden.

Conclusion

The global financial and economic crisis necessitates a fundamental review of the prevailing economic policy paradigm. The faith in unconstrained markets should have been undermined by the collapse of the banking sector, but it now appears that policymakers are retreating to the comforting nostrums of economic orthodoxy. This would be a strategic error. Returning to policies that failed in the boom cannot be expected to return the global economy to growth following a very deep recession.

Most importantly, perhaps, there is a compelling need to achieve a higher level of clarity about the goals of economic policy. The model described in outline here goes beyond securing increases in GDP per head and adopts a more sophisticated set of measurements. It makes rather different use of monetary and fiscal policy, demands the effective regulation of financial markets and explains how both developed and developing countries can go about creating more inclusive labour markets. The priority must be a return to full employment. But this is not an argument for any jobs at any price. Sustainable work is decent work, secure work and work that offers the prospect of rising living standards, development and progression. These goals are perfectly compatible with economic stability (including price stability) and robust productivity growth. The challenge for trade unions is to make a compelling case for change. The challenge to policymakers is to demonstrate that they have heard the demand for a different approach and have acted accordingly.

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Exiting from the crisis: towards a model of more equitable and sustainable growth

Edited by David Coats

"The challenges facing governments, our societies and our economies are enormous. We may have pulled back from the brink at which we stood in the fall of 2008, but we (...) cannot claim victory until unemployment is brought down to where it was before the crisis, and until the real incomes of workers (...) have made up for the losses that have been suffered in the interim. We can do it – but only if we correct the mistakes of the past, change course and keep in mind the true objectives for which we should be striving."
(From the Preface by Nobel Prize laureate Joseph Stiglitz)

This publication takes up the challenge of developing progressive alternatives to the failed neo-liberal model that has dominated economic policy for over three decades. It contains contributions from some 30 authors, all with links to the global labour movement, that analyse the causes and implications of the crisis and propose alternative ways toward more equitable and sustainable models of growth. A comprehensive approach is taken and the topics addressed include: the need for a new approach to macroeconomic policy to promote strong and stable growth and high employment; developing alternative welfare measures to GDP; how to re-regulate financial markets so that they serve the real economy; a development model for the global South; a new approach to labour markets that ensures that they deliver decent jobs and promote greater equality; the need for a comprehensive set of policies to make economic activity ecologically sustainable.

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