# Exiting from the Crisis: Towards a Model for More Equitable and Sustainable Growth

JOHN EVANS AND DAVID COATS

G20 leaders at Pittsburgh committed themselves to putting »quality employment at the heart of the recovery,« but it is clear that they have not lived up to their promise. Far from receding, the economic crisis may simply be moving to another – and potentially more dangerous – stage. Governments appear to have embraced austerity policies with enthusiasm while seeking export-led recoveries. But the underlying causes of the crisis – global imbalances, inadequate regulation of international financial markets, weak institutions for global economic governance – have yet to be addressed and the risk is that the recovery will be sluggish, with jobless growth and persistently high unemployment. From a trade union standpoint the development of an alternative demands that governments must focus on the following two priorities: in the short term the implementation of measures to reduce unemployment; and in the medium term the development of a new model of growth that is balanced, sustainable, creates decent work and distributes income fairly.

The trade union effort to develop alternative policies is being managed by a Trade Union Task Force on a New Growth Model. Established by TUAC, the ETUI, the ITUC and GURN, the Task Force's report is being published in the first part of 2011 with contributions from more than 30 authors drawn from the trade union movement and institutions sympathetic to organized labor.

## The Failure of a Model

The starting point for this enterprise is the belief that the global financial and economic crisis has invalidated the assumptions on which economic policy has been based for the past thirty years. The view that light-touch regulation, limited government, low taxes, labor market deregulation, and weak labor 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 work. While the richest in many parts of the OECD have seen their relative position improve (sometimes dramatically) the poorest have seen their relative position deteriorate. The OECD itself documented the rise in inequality in its publication *Growing Unequal* in 2008. In the United States even those on middle incomes have seen little improvement in their earnings or living standards over a twenty-year period. Nor is it true that the policies that we might usefully label »market fundamentalist« led to better economic performance before the crisis broke. This troublesome fact was recognized by the OECD in their reassessment of the 1994 jobs study, published under the title *Boosting Jobs and Incomes* in 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 United States and the UK, and those pursuing policies with higher taxes, stronger employment protection legislation, more generous unemployment benefits, and much higher investment in active labor market programs (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 to tackle climate change and protect the environment. The model that operated before the crisis was failing to deliver these objectives. Rising inequality, stagnating wages, and under-development 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 fragile instruments for the sustained generation of demand. There was plenty of evidence to show 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 believed that »this time is different.«[1] After all, almost thirty years of liberalization, deregulation, tax cuts, and efforts to shrink the size of the state ought, on the orthodox view, to have made the crisis impossible. Unfortunately, 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 capita. 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. As Amartya Sen[2] has pointed out, economic growth has to be for a purpose and the most straightforward way of characterizing that purpose is to say that citizens should be enabled to choose lives that they value. »Development as Freedom« means that people can enjoy genuine freedom only insofar as it is based on economic and social security. President Sarkozy appointed an expert panel to devise a more balanced set of benchmarks and we broadly endorse the approach adopted by the Commission for the Measurement of Economic Performance and Social Progress of moving to a wider »dashboard« of indicators in addition to GDP. Simply expressed, in the post-crisis world we need to recognize that the objective is not to accept the world as it is and adapt

1. Reinhart, Carmen and Kenneth Rogoff (2009): *This Time Is Different: Eight Centuries of Financial Folly,* Princeton University Press.
2. Sen, Amartya (1999): *Development as Freedom,* Oxford University Press.

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

The response of policymakers 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 recapitalized, 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.

What the policy response also demonstrated was that the state could not simply absent itself from the economic policy scene. No other actor could have recapitalized the banks and no other actor could have sought to offset the reduction in demand from the corporate and household sectors. Contrary to the strictures of market fundamentalists, the state had proved that it played a necessary role in the stabilization of what was obviously an inherently unstable economy. For the sake of clarity we should emphasize that this does not mean the trade unions should 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 inter-dependent, 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. There is 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.

Unfortunately, the timely, coordinated intervention at the beginning of the crisis now seems to have been matched by the recrudescence of the conventional wisdom. 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 difficulty. 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. And the new arrangements for economic governance in the Euro area appear to have a built-in deflationary bias that may lock this important global region into a period of sluggish or jobless growth. Governments fear the contagion of financial panic but are likely to produce it by the contagion of austerity.

Moreover, despite the OECD's recognition of the need to balance flexibility with security in *Boosting Jobs and Incomes* (the Jobs Study reassessment) policy is now based on a more conventional analysis. Policymakers seem to have embraced the economic policy paradigm described by the OECD's report *Going for Growth* and revived the belief that the only efficient labor markets are lightly regulated labor 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 labor markets have weathered the storms of the recession rather better than the market fundamentalist model would predict. For example, 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.

One might say that these results are not surprising. After all, the OECD's original Jobs Study analysis (1994), which drove the deregulatory impulse for almost a decade, could not explain differences in labor market performance during the boom. So, for example, the Netherlands enjoyed better employment performance than Germany throughout the 1990s even though it had a more »regulated« labor market (stronger employment protection legislation and higher unemployment benefits). Similarly, there is strong evidence to show that the central prediction of the OECD's thesis – that disadvantaged workers would do better in »flexible« labor markets – was never an accurate description of reality.

Disadvantaged workers in the UK (the low skilled and the young) did no better in the 1990s than their counterparts in more »protected« labor markets in France and Germany. If all these critiques are right then it is difficult to understand how recovery from the worst global recession for more than seventy 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. As a first step, it would be useful to recognize 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 a creation of the state: markets could not exist at all without the rule of law, the impartial administration of justice, the enforcement of contracts, and the protection of intellectual property rights.

Recent experience has demonstrated that the global economy is in a precarious situation. A successful return to growth requires action to build effective institutions of global economic governance alongside national action to reframe monetary and fiscal policy. From a trade union standpoint a new approach to labor market policy is needed, which recognizes – as did the Jobs Study reassessment – the need to avoid a one-size-fits-all solution.

## Key Recommendations

Specific action therefore needs to be taken in the following areas:

- Policymakers must consider how demand that leads to the kind of economic progress we described above can be generated, 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 tackled effectively. 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 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-neighbor 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 ensure 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 up of markets. This approach is to be preferred to the conventional argument for immediate liberalization, privatization, 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 recognize 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 recognize that their judgments need to be both justified and legitimized 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.

- So far as fiscal policy is concerned, the crisis has proved the power of counter-cyclical activism. This means that policy in the future must provide for robust automatic stabilizers 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 to maneuver 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 they must boost their capacities to develop new products and new services. This demands the creation of what the British commentator Will Hutton calls »an innovation ecosystem,« in which 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 and welfare policy is devised to facilitate economic transitions (as with the Danish approach).
- Sustainable demand 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 workers can be guaranteed that their earnings will rise in line with productivity. One obvious route is through the promotion of collective bargaining, but policymakers may need to consider other instruments (labor 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 labor standards to legitimize the process of economic

integration, to protect vulnerable workers against exploitation, and to 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* in 2006. Those countries that had achieved high employment and a more equitable distribution of incomes focused attention on the broad sweep of labor market policy, including: skills formation systems before labor 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 labor – 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; and a combination of high unemployment benefits and job search obligations with high levels of investment in active labor market programs 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 caring responsibilities. This helps to explain the better performance on gender pay equality and the high employment rate for women.

## Sustainability and a Reconceptualized 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. In addition, 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 recognizes the duties it owes to the workers it employs and the communities in which it operates. The maximization of shareholder value is a somewhat anemic conceptualization of corporate purpose and we favor a richer and more sophisticated notion that recognizes 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 support the imperative of reducing carbon emissions and, more generally, decarbonizing the economy. But, consistent with the generally egalitarian approach described here, this 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 capita 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 labor 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 demands for a different approach and have acted accordingly.