

# Progressive Governance

London, 2010



## Jobs, industry and opportunity: Growth strategies after the crisis

**Jobs, industry and opportunity:**  
Growth strategies after the crisis

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# Welcome

Dear friends and colleagues,

It is our pleasure to welcome you to this Progressive Governance Conference on “Jobs, industry and opportunity: growth strategies after the crisis.”

The progressive centre-left is at a critical juncture. Are we capable of winning the political and intellectual argument on how to shape our post-recession economies so that they deliver long-term sustainable economic growth as well as more and better jobs?

This is the challenge we have to take on. Not through backward looking debates or ideological introspection, but by mobilising the political and intellectual capital of the entire progressive community within and beyond our countries.

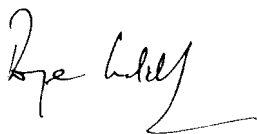
Which industries have growth potential and how can governments support their development by nurturing initiative, enterprise and innovation? Given the priority of tackling unemployment and fostering more and better jobs, what kind of policies and institutional structures can deliver the best outcomes? How can economic growth and job creation be encouraged in the context of the transition to a low-carbon economy? And what is the future of international cooperation and global governance after Copenhagen and the G20 summits?

The aim of this conference is to help shape this new politics of sustainable economic growth and job creation, one that is forward thinking and transformative and acknowledges the role of an “active” state and strategic public investment in our shared prosperity.

The event follows in the tradition of previous Progressive Governance Conferences, which have always been so generously and actively supported by David Sainsbury, to whom we once again owe an immense debt of gratitude.

We are delighted and honoured to welcome you back to London and look forward to working with you in the future.

With warm regards,



Roger Liddle  
Chair of Policy Network



Olaf Cramme  
Director of Policy Network

# Agenda\*

08.15 Registration

09.00 Welcome: **Roger Liddle**, Chair of Policy Network

09.15 – 9.30 **Opening speech: Gordon Brown**, UK Prime Minister

## 09.30 – 11.00 SESSION I

### **New growth models: fostering more and better jobs in a low-carbon economy**

*Chair:* **Peter Mandelson**, UK First Secretary of State

*Speakers:* **Jean Pisani-Ferry**, Director of BRUEGEL

**Karen Kornbluh**, US Ambassador to the OECD

**Joaquín Almunia**, EU Commissioner for Competition

**John Kay**, Columnist, The Financial Times

11.00 – 11.30 Coffee Break

## 11.30 – 13.00 SESSION II

### **Markets and the public interest: towards a new socio-economic settlement**

*Chair:* **David Miliband**, UK Foreign Secretary

*Speakers:* **Wouter Bos**, Dutch Finance Minister and Deputy Prime Minister

**Mona Sahlin**, Leader of the Swedish Social Democrats

**Sigmar Gabriel**, Chairman of the German Social Democrats

**Enrico Letta**, Deputy Secretary of the Italian Democratic Party

13.00 – 13.30 **Speech: Pascal Lamy**, Director-General of the World Trade Organisation

13.30 – 14.30 Lunch

## 14.30 – 16.15 SESSION III

### **Europe after the global crisis: a strategic role for government**

*Speakers:* **Prime Minister José Luis Rodríguez Zapatero** (Spain)

**Prime Minister Jens Stoltenberg** (Norway)

**Prime Minister George Papandreou** (Greece)

**Prime Minister Gordon Brown** (UK)

16.15 **Concluding remarks: Peter Mandelson**, UK First Secretary of State

16.30 Close

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\* Correct at the time of going to print.

# **A new political economy: ideas for debate**



## Editorial

Olaf Cramme

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What does it take to initiate and perpetuate a “paradigm shift” in political economy? This is the question which many on the centre-left in Europe and beyond might ask themselves at the present time. They may do so because the financial crisis was supposed to trigger such a shift – after all it demolished the political foundation of “neo-liberalism” and led to a return of long-condemned economic interventionism.

But as Andrew Gamble pointedly reminds us, “it is premature to talk of a new relationship between the state and the market”. One reason for this is relatively simple: as long as a new intellectual and political framework for wealth creation remains unarticulated or fails to impress, people tend to cling on to perceived wisdom. And that is why many neo-liberal ideas are already “re-appearing by default.”

The progressive reaction to this must not be one of complacency and dogmatism, but to review and sharpen our policy and political arguments in the quest for a new socio-economic settlement, one that can deliver on *all* fronts – from dynamic economic growth and financial stability to enhanced social security and environmental sustainability.

Hence, fresh thinking will be paramount. This selection of short articles, written by leading experts in the field, attempts to guide, inspire and, in particular, challenge us on some of the key issues at stake.

To begin with, we need greater clarity about the institutional legacy of the crisis. This concerns both the global dimension, where questions of legitimacy are hampering efforts to permanently enshrine the unprecedented degree of international coordination which characterised the immediate response to the crisis (Kemal Derviş); and the national level, where governments are now confronted with a series of considerable “aftershocks” (Anton Hemerijck) which will define the political, social and economic parameters for years to come.

Indeed, it is the middle and lower classes who are suffering most from the financial crisis as pension funds and other institutional investors incur significant losses. An unsustainable growth strategy was thus inextricably interwoven with our social systems, undermining the very bedrocks of our welfare state. For Allan Larsson, these systems must consequently be submitted to a “5P-stress test” which puts productivity, poverty reduction, pensions, political involvement and public finances under close scrutiny.

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Yet if the banking crisis has merely been replaced by a number of other crises, how do we go about creating a political economy which is truly geared towards the common good? Part of the challenge is to make sure that the concept of a low-carbon society, as well as that of a knowledge economy, actually resonates with the vast majority of our citizens. To date, they merely enthuse the privileged few.

For this to happen, it seems that fundamental changes will be required not only in the distribution of power and responsibilities in our collective institutions and economic sectors (Andrew Gamble), but also in facilitating the reassertion of the power of labour after years of wage stagnation for large parts of our population (David Coates).

At last, the centre-left has reached a consensus on the view that the gross distortion of top-level incomes is no longer acceptable and needs to be tackled with determination. While this must now be part of any new “social justice” agenda, any measures taken are alone unlikely to ease the budget constraints and correct the financial imbalances which many countries currently wrestle with.

Jeffrey A. Frieden therefore offers us a valuable reminder of why progressives need to take financial consolidation and macroeconomic responsibility seriously. The intellectual challenge, in turn, will be to develop an “effective strategic state” (Patrick Diamond/Roger Liddle) that offers the highest social and economic returns, and to elaborate a “progressive opportunity agenda” (Will Marshall) which acknowledges the co-existence of anti-business *and* anti-government sentiments in our societies.

After the hard-earned modernisation processes of centre-left movements in the 1990s, calls for not “throwing out the baby with the bath water” arise for a good reason. Yet there are also challenging arguments for why social democrats should reclaim the “public realm” more forcefully, make job creation programmes the priority (James K. Galbraith) and increase the revenue base of the state so that it can assume its role in risk management more vigorously (John Quiggin).

What matters, after all, is that the re-calibration, re-invention or protection of the state is a means to an end, and not the end in itself. More creative thinking will therefore be required to deliver where the policy and political needs are greatest: unemployment, economic innovation and pressing global problems are cases in point. Dean Baker, Reinhilde Veugelers and Jean-François Rischard respectively demonstrate how “out of the box” ideas can make a real difference in these areas.

The way to a “paradigm shift” is a long one. Eternal verities on their own have little purchase in a society characterised by diversity and complexity. If the centre-left aspires to define the new political economy for the 21st century, it needs to pull out all its intellectual and political stops. Policy Network will help drive this agenda forward, as Elena Jurado and Krystian Seibert outline in their contribution.

**Olaf Cramme is director of Policy Network**

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## Progressive internationalism and the great crisis

International cooperation is key to effectively tackling global crises. Finding the political language to strengthen global governance legitimacy is our central challenge

Kemal Derviş

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The great crisis that engulfed the world economy at the end of 2008 has again forcefully highlighted the need for strong international cooperation, and the benefits that it can provide as well as the huge obstacles that must still be overcome to make it an ongoing reality. While the major cause of the crisis was no doubt the lack of adequate financial sector regulation and supervision in the United States, the large global current account imbalances that had become structural in the pre-crisis years, as well as “the race to the bottom” that characterised financial sector supervision across borders were also powerful contributors to the crisis.

When real panic struck in the autumn of 2008, there was a cooperative response. Central banks consulted each other and acted largely in concert. The Bush administration, not known for its multilateralism, convened the G-20 leaders in Washington. Not much was achieved at that first meeting, but the second G-20 leaders meeting in London in early April 2009 deserves substantial credit for initiating a tripling of the capacity to lend of the IMF and a new SDR allocation. These actions helped reverse the slide into crisis and potential sovereign default in many of the financially weaker emerging market economies, suffering from a case of massive contagion of negative expectations as well as from the collapse in world trade.

What appeared as a serious effort to work on coordinating financial sector regulation was also initiated, and confirmed again at the third G-20 meeting in Pittsburgh. The Pittsburgh and London meetings also agreed on international consultations to be facilitated by the IMF on macroeconomic policies, with special emphasis on global imbalances and on the transformation of the Financial Stability Forum into a Financial Stability Board, enlarged to include all G-20 members.

These were important steps and, particularly through their impact on expectations, they contributed to arresting the spread of crisis and encouraged the recovery in financial markets, and then in output, that the world economy experienced in the latter half of 2009.

As the immediate crisis recedes, however, the movement towards greater international cooperation seems to have lost momentum. On climate change, in Copenhagen, the international community barely managed to agree on a very vague declaration of intent, let alone on an actual framework for climate protection. Since

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climate change had not been a significant topic at the G-20 meetings, maybe the Copenhagen outcome was inevitable. But cooperation has also visibly weakened on macroeconomic policies and financial sector regulation.

Global imbalances have started rising again and the political discourse on exchange rates reflects increasing antagonism rather than the cooperative search for solutions. Perhaps even more surprising has been a series of obviously uncoordinated announcements on financial sector regulation reforms by national leaders, who seem to neglect the critical need for harmonisation and the very multinational nature of large financial institutions and their worldwide operations.

It is clear and understandable that national politics is still first and foremost in the minds of political leaders. Politics remains a local and national affair. And yet the challenges everyone faces have huge global components. These included: macroeconomic policies; the management of global imbalances; interest rate policies; the nature and pace of fiscal retrenchment to address the post-crisis rise in public debt in many countries; the specifics of financial sector policies with respect to proprietary trading, capital and liquidity requirements and attitudes to the size of financial institutions; the volatility of commodity and energy markets with particularly harmful effects on the poorest countries; and climate protection.

All these problems require international cooperation. If ignored, the policies adopted will not be effective. Would it be effective, for example, if the US decided to limit the size of its financial institutions while Europe and China encourage even larger sizes? Or that some countries heavily tax bonuses or balance sheets, while others don't?

It is time for progressives to work on politically feasible ways to build the links between national policies and the management of global issues. Progressives have always been internationalists. It has been difficult, however, to find the political language that can carry citizens and build the political space across borders needed to make global governance legitimate and fully compatible with democratic processes. Herein may be the key challenge for progressives at the start of the second decade of the 21st century.

Kemal Derviş is vice president of the Brookings Institution and director of Global Economy and Development. He is a former head of the United Nations Development Programme



## Crisis aftershock alert

Aftershocks may delay or even jeopardise the recovery, severely constraining the choices available to governments both in the short-term and the long-term

Anton Hemerijck

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The current economic crisis is fundamentally redrawing the boundaries between states and markets, calling into question many issues of economic governance, ranging from central banking, fiscal policy, financial regulation, global trade and welfare provision. Thus far, intellectual and policy attention has largely focused on immediate crisis management, especially with respect to financial sector risk management. But other major questions remain to be answered. Will the political rules of the economic game be rewritten? Does the crisis mark a new opportunity to reinvent 21st century capitalism?

Policymakers are anxiously awaiting signals of whether or not we have fully emerged from the global downturn. At the same time, there are forces pulling governments in opposite directions – some are pulling towards a return to the neo-liberal settlement that existed prior to the crisis, but there are also positive signs that governments are actively seeking to recalibrate their policy approaches. These political decisions are taking place in a context of considerable anxiety as governments face the real possibility that a series of “aftershocks” will delay or even jeopardise the recovery, severely constraining the choices available to governments both in the short-term and the long-term.

First, there is the aftershock of deglobalisation. The forces of financial deglobalisation we are currently experiencing are not dangerous *per se*, as unfettered financial globalisation through unbridled capital market deregulation is in part the root cause of the global downturn. What is dangerous, however, is the risk of financial deregulation cascading into real economy protectionism.

Second, there is the looming crisis of unemployment. Unemployment usually lags behind general economic activity by roughly a two- to- three quarter delay, so labour market conditions in the advanced industrial world are still likely to worsen in the coming years.

Third, there is the aftershock of the pension crisis – the sharp fall in equity markets has severely affected the value of pension fund assets, jeopardising pensioners’ incomes in countries with large private pension provision.

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Fourth, there is the aftershock of a fiscal crisis of the state. Costly bank bailouts, tax cuts, and other stimulus measures have drained the public purse. In Europe, the automatic stabilisers of comprehensive social insurance could result in a double bind of rising social benefit expenditures combined with declining government revenues.

The fifth aftershock concerns the expectation of a protracted period of low growth. The financial crisis has severely curtailed the most important growth drivers of the recent decade: easy credit and private consumption. The key question is which growth drivers can serve as replacements.

To be sure, at some point in time the recession is likely to fully recede. Before that happens, we may experience a sixth aftershock of rising prices in raw materials, especially in oil and other energy sources. Because of these likely economic, social and political aftershocks in the labour market, banking system, pension system, public finance, and social spheres, there is a real danger that the crisis will persist for more than just a few bad years. Japan's "lost decade" following the crisis in the early 1990s provides a worrying antecedent.

Notwithstanding these challenges, economic crises also create windows of opportunity for extraordinary politics to transform existing regimes of social and economic governance. Indeed, after practically three decades of neo-liberalism, there are signs that a critical re-imagining of economy and society, including the role of public authority and political sovereignty, is underway. But just as the neo-liberal rise to dominance was largely evolutionary, the formation of a new post-crisis policy paradigm is unlikely to take place within the space of just a few years.

A fundamental insight that emerged from the crisis is that economic markets are not self-creating, self-regulating, self-stabilising, nor self-legitimising. While this important lesson is certainly not new, in the past decades of neo-liberalism policymakers did seem to forget the fundamental truth that the benefits of global economic interdependence rely heavily on robust social and political institutions.

The crisis has transformed the domestic institutional arrangements for economic governance, pushing central banks into a broad range of new interventions, aimed at safeguarding financial stability. Central banks will now be required to perform a variety of new functions, including undertaking liquidity and credit enhancing measures, becoming a lender of last resort, and maintaining general financial stability. In addition, the global crisis has laid bare important changes in the global distribution of wealth and power. The power of the US is on the wane, and emerging economies such as India and China have become key global economic players.

In many advanced economies, welfare policies are also being re-calibrated. In Europe, the crisis has been, in many ways, a stress test for the welfare state. Although the crisis may put a strain on many redistributive institutions, this can also have positive consequences. For one, social policy has resurfaced at the centre of the political debate, with the crisis reminding many Europeans of the importance of social programmes to support the unemployed, the disabled, and the others negatively affected by the crisis. A major political challenge is that this economic crisis coincides with an unprecedented environmental crisis, the solution of which requires a complete transformation of our modes of production and ways of living.

At a European level, the crisis has demonstrated that instruments such as the Growth and Stability Pact are not barriers to a swift response to changing global economic conditions. In fact the European Central Bank responded very quickly, by providing essentially unlimited amounts of liquidity to the euro-area financial systems. These and other EU measures may have helped to offset the relative weakness of national stimulus plans.

At the same time, although there is a case to be made for further European macroeconomic integration in the wake of the crisis, at the level of domestic European politics, the crisis has prompted a shift towards welfare nationalism. In the end, any sustainable solution to the global crisis will continue to rely heavily on public legitimacy. The European Union must develop a new narrative based on multilateralism and globalisation for the coming half-century. Europe needs a new moral vision, a social narrative capable of restoring its legitimacy in difficult times.

Anton Hemerijck is dean of the faculty of social sciences at the Vrije Universiteit Amsterdam and former secretary and director of the Scientific Council for Government Policy in the Netherlands (WRR)



## Stress-testing Europe's social systems

Closer scrutiny of our social systems' health must be matched by entry and re-employment strategies which offer people new jobs, skills and security

Allan Larsson

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Behind the financial crisis, the economic crisis and the social crisis there is something more fundamental. The fact is that it is a crisis of the economic development models of the past ten years, models that caused global imbalances and financial bubbles.

These growth strategies were not sustainable, neither financially, socially or ecologically. And now the rebalancing of the global economy, new stable structures and frameworks for financial markets and a global climate strategy, are all at the top of the agenda.

However, the agenda would be incomplete without new social policies. They are badly needed and have to be part of new global development models. In the case of the EU member states, better social policies are needed – we must maintain our social safety nets in times of deficit reduction, but also make social protection systems more productivity oriented.

Europe will need a new deal to strengthen both the social dimension and the Single Market – even to save the Single Market from disintegration. We have to show citizens that the Single Market and well-functioning social systems are mutually supportive.

The exit strategies now under discussion by macroeconomic policymakers need to be well timed. Too early an exit risks bringing the economy back into recession, too late an exit will lead to new financial bubbles. But the policy mix is just as sensitive as the timing of the exits: to avoid making such exit strategies an immediate failure, they have to be combined with strong microeconomic incentives to skills, employability and recruitment, i.e. to active labour market and education policies.

Thus, we need to start talking about entry strategies, re-employment strategies, to bring people back to work, to new jobs with new skills. As an important element in the overall policy response to the crisis, I propose that Europe undertakes a “stress test” of its social systems with five main elements.

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But why do we need such stress tests? There is one simple reason: we have to do what we did with the banks, to ensure that those systems had the strength to serve the economy and enterprise in a severe situation. Now we have to ensure that the social systems have the strength to serve people when the financial and economic crises are causing a social crisis. I propose a 5P-test, where P stands for Productivity, Poverty reduction, Pensions, Political and social involvement and finally Public finances. These are examples, not an exhaustive list of political parameters.

### **Productivity – promotion of change and management of change**

My starting point is that our social systems have – or should have – a fundamental role in the creation of prosperity by contributing to the improvement of productivity. The most urgent task is to facilitate re-employment of those who are unemployed. More focus on active labour market policies, education and training and early intervention to prevent long term unemployment is key to success in this field. More emphasis is also needed on the quality of jobs.

### **Prosperity/poverty reduction**

Second, widely shared prosperity is the goal of all social market economies, which implies both prevention of poverty and a fight against existing poverty. Our social protection systems are among the most highly developed in the world and yet, today, almost 80 million people live below the poverty line, with poverty even existing among the employed. The social impact of the economic crises will be severe. Social protection systems have to be allowed to play their role both of macroeconomic automatic stabilisers, and microeconomic floors against poverty, over several years.

### **Pensions in an ageing society**

The long-term stability of our pension systems has to be tested. Those systems are central in the fight against old age poverty. Here we can be proud of progress made over the last few decades. However, the pension systems are under stress due to the ageing of our populations. A higher pension age is one way, but that will not help much if workers are unable to stay in working life until the formal retirement age. More than half of the member states are still below the 50 per cent target for employment for workers aged 55–64. Pension reforms must be closely linked to reform of labour market policies to give new opportunities, not only “a second chance,” but a number of new chances for re-employment all throughout working life.

### **Political and social involvement**

Fourth, I think that one element in a stress test of our social systems is the degree of political and social involvement. A high degree of involvement is a sign of health, while a reduction in involvement is a signal to observe and react to.

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### **Public finances**

Finally, to the bottom line, public finances. How can we return to sound public finances and at the same time maintain our social protection systems? This is the most difficult question. A first step is to identify the automatic stabilisers, recognising that budgets have to serve as shock absorbers. A second step is to make a qualified analysis of the budget deficits – identifying the origin of the deficits, and the difference between permanent tax reductions as one extreme and active re-employment policies as the other extreme – and use such information to shape fiscal policies. A one-size-fits-all approach would lead in the wrong direction; a more nuanced approach is needed.

Let me end by emphasising the political nature of this form of stress test. It is an opportunity to set the agenda for the next five years. The President of the European Commission has got a new mandate and made a commitment to *“a new, much stronger focus on the social dimension in Europe, at all levels of government”*. Now that a new Commission is in place, it is time to take immediate action to set a European agenda to defend and develop social systems, confirming the basic European ideas and values – competition between enterprises, cohesion between member states and solidarity between citizens.

Allan Larsson is chairman of Lund University and a member of President Barroso's high level group on energy and climate change. This article is based on a speech delivered to the Bureau of European Policy Advisers, and was first published by the European Trade Union Institute (ETUI)



## Markets and the public interest

We need to develop conditions for a new political economy which encourages resilience and promotes the common good

Andrew Gamble

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The dramatic events of 2008 appeared to tear up many of the assumptions which had guided economic policy since the 1980s. There was much talk of the return of the state, after governments acted so decisively in the immediate aftermath of the crisis. The speed of the reaction averted the threat of a meltdown following the collapse of Lehman Brothers, as the state acted in its role as guarantor of last resort, making possible the slow recovery in Europe and North America during 2009.

But it is premature to talk of a new dispensation or a new relationship between the state and the market. Many of the assumptions of neo-liberalism have been discredited, but there is little fresh thinking of what might replace it, and many neo-liberal ideas are already reappearing by default.

The actions of governments in 2008 bought time, but in doing so they have turned the problem from a banking crisis into a fiscal crisis. Governments are now plunged into the politics of managing national deficits, trying to balance the consent of their citizens with credibility in the financial markets. They are faced with an acute problem of legitimacy.

Policies of austerity will be resisted by low and middle-income households, especially in societies where there is already substantial poverty and large inequalities in the distribution of wealth and income. In such hard times the issue of fairness comes to the fore, but this does not necessarily favour the progressive left, since the issue can be framed, as the tea party movement in the United States is attempting to do, as government imposing unjust taxes on the people. In a period of low growth governments are easily blamed for the hardships so many individuals experience.

The recession has also seen a rise in scepticism about climate change, and this is fuelling some powerful campaigns in both the United States and in Australia against the green agenda, using the argument that hard-pressed middle-income citizens cannot afford the taxes necessary for the transition to a low-carbon economy, and that the evidence is not compelling enough to deem them necessary.

Developing a new strategy of growth in this political context will not be easy. Protecting certain groups during the recession is essential for political survival, but the short-term policies this involves need to be combined

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with thinking about the medium and longterm. The fundamentals for a new period of growth appear strong, but four political conditions have to be met:

- Investment in the knowledge economy and the technologies of the future has to be maintained.
- Transition to a low-carbon economy has to be facilitated by combining infrastructural investment with a regulatory and fiscal framework which encourages individuals to change behaviour.
- The economy has to be rebalanced, both in terms of the distribution of power within it and the size and character of its organisations.
- An open international economy has to be sustained through changed governance and regulatory arrangements which encourage co-operation and inclusion and limit the trends towards protectionism and isolationism.

The third condition has had least thought devoted to it; but it is crucial for creating a political economy which enjoys greater legitimacy. Such a political economy must encourage *resilience* and promote *the common good*. Resilience directs attention to the way a future growth strategy should be designed to withstand turbulence and shocks, and to allow organisations and citizens to navigate successfully through them, by reducing their vulnerability and encouraging greater self-reliance and self-awareness, and in this way reconnecting growth strategies with people's lives. At present, aspirations for a low-carbon economy or the idea of a knowledge economy enthuse a minority but can appear remote to many others.

New ideas of the common good are needed to involve citizens in debating the direction their societies are to move, and this means giving much greater attention to how the public sphere is organised and sustained. A key issue is the border between the market and the non-market, where that line should be drawn and what are the consequences for drawing it in one place rather than another. After three decades during which the market sphere has expanded into more and more areas, there is an urgent need for a fresh assessment of the ecology of enterprises and organisations it is desirable to promote, and how power is distributed within different sectors of the economy.

A growth model that is resilient needs to pay attention not only to equipping individuals with the opportunities, skills and assets which they need to enter the labour market, but also to the size and character of the organisations in which they work, and the degree of control they can exercise over their lives.

Andrew Gamble is professor and head of the politics department at the University of Cambridge



## The Anglo-Saxon cul-de-sac

Our economies need to be re-calibrated to take into account the environmental and social costs of unregulated globalisation

David Coates

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There is much talk in progressive circles on both sides of the Atlantic these days of the twin need to tame over-mighty financial institutions and to correct entrenched global imbalances. Both needs are indeed paramount. As Martin Wolf correctly observed, it has become the UK's misfortune to enjoy comparative advantage in the world's most irresponsible industry (*The Financial Times*, May 22, 2009). It has also become its misfortune to play junior partner to the United States as the globe's consumer of last resort.

The special position of the US economy makes that a continuing possibility for American consumers, at least for a while; but the UK does not have that luxury. A growth model based on unprecedented levels of personal debt and a persistent trade deficit has lasted longer than in truth it should have, kept in play by the unprecedented volume of credit flowing round the global system. Those flows are now much reduced, and should not be allowed to reappear. The UK needs a new growth model, and it needs it fast.

New growth models are best designed based on a clear recognition of the weaknesses of the old one. The weight of financial institutions in the contemporary UK economy was neither accidental nor inevitable. The rise of finance paralleled the *decline of manufacturing*. The inequalities in income and wealth associated with the explosion of bank bonuses reflected the *reduced power of labour* in the underlying social compact. Tighter banking regulation and the taxing away of excessive bonuses, vital as both currently are, will not bring financial institutions back into a healthy relationship with the rest of the UK economy unless the rest of that economy is itself healthy. A growth strategy based on high levels of consumer debt (and the spending of income not yet earned) will not be replaced by one based on the spending of existing wages unless those wages are higher and more secure than is currently the case.

New Labour came into power in 1997 committed to the creation of a high investment, high productivity, high wage domestic economy. The commitment needs to be renewed, and re-calibrated for the requirements of a world now significantly more aware than it once was of the environmental and social costs of unregulated globalisation.

Achieving economic strength from a position of weakness will be extraordinarily difficult. Private market forces will not effect the transition unaided. If that transition is still possible at all, targeted public policy will be

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vital to its design and achievement. A complete rupture will be required with orthodoxies that privilege financial deregulation and unmanaged free trade. Progressive lessons will need to be taken from the few economies – once Japan, then South Korea, now China – that did manage to lift themselves from a low growth trajectory to a higher one. Full advantage will need to be taken of UK membership of a dynamic European Union. The attempt to protect a special space for the UK (and the City) on the edge of that Union will need to be abandoned. Playing poodle to a neo-liberal America will need to be replaced by full participation in the European social model.

To that end, the UK must at least work towards:

- The immediate development of a publicly-owned industrial bank, charged with facilitating balanced regional growth by small and medium sized companies.
- The rapid and extensive public provision of social housing, to ease rental and mortgage burdens on working and middle class families.
- An active extension of individual and collective worker rights, to build a rising wage floor and a new social contract underneath industrial growth.
- The creation of a strong “green” Department of Trade and Industry, as a new super-ministry to balance the power of the Treasury.
- Enhanced public investment in key infrastructure projects, from transport to higher education.
- The resetting of competition policy as “job creation and innovation policy”, with competitive bidding for public funds by private firms willing to generate either or both.
- Full membership of the euro-zone, and the resetting of the UK’s trade deficit with the EU as a regional imbalance within the European Union.

Realignments of this scale are extraordinarily difficult. Recreating industrial strength is a huge challenge. Restoring trade union rights after thirty years of erosion will be an enormous struggle. Admitting that a new direction is needed will be politically costly. But the great thing about driving into cul-de-sacs is that you can get out of them only by reversing direction. The weaknesses at the core of the Anglo-Saxon model can no longer be ignored. Tinkering at the edges of that model will no longer suffice. It is time for a new model. It is time for fundamental change.

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## Rehabilitating macroeconomic sanity

The demand for the day should be restoring economic responsibility and social equity

Jeffrey A. Frieden

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The current crisis has caused widespread suffering, and the suffering is far from over. We welcome signs of recovery from the crisis, but this will not end the need for continued sacrifice. A decade of irresponsible policies caused the crisis, and left many countries in an unsustainable position. The impact of attempts to remedy the mistakes of the past decade will be felt for another decade to come. Progressives need to respond to the crisis and its aftermath in a way that is both economically sensible and socially defensible.

We in the United States are living through a classic debt crisis. The roots of the crisis go back to 2001, when massive tax cuts drove the federal government from large-scale surpluses to huge deficits. This began an extraordinary surge in American foreign borrowing, which averaged between a half trillion and a trillion dollars a year between 2001 and 2007.

The borrowing binge was intensified by American monetary policy, as the Federal Reserve kept interest rates at unprecedentedly low levels. This encouraged households to join the borrowing bonanza, expanding housing and credit card debt at a dizzying pace. The five trillion dollars flooding into the country from abroad had the typical effects of an inflow of foreign funds: demand for hard goods rose, leading to an import surge and swelling the trade deficit, while demand for non-traded goods and services also rose, leading to a surge in the price of such non-tradables as healthcare, entertainment, education and housing.

As is typical in classical capital flow cycles of this sort, foreign borrowing sparked an economic expansion, which became a boom, which became a bubble, which has now burst. This pattern was common to a phalanx of deficit countries – the US, the UK, Spain, Ireland, countries in central and eastern Europe.

The American economic policies that caused the crisis all had political underpinnings. The Bush administration cut taxes to satisfy its wealthy base, and to appeal to middle-class voters, despite the clear knowledge that the inevitable deficits would be a heavy burden upon future generations.

The Fed's loose monetary policy almost certainly was designed to help get Alan Greenspan reappointed in May 2004, and to help get George W. Bush reelected in November 2004; interest rates began rising within

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weeks of the election. The regulatory laxity of the nation's ostensible financial guardians was enabled and encouraged by the undue influence of banks and other financial institutions on the agencies that were supposed to be regulating them.

The stabilisation phase of crisis management will be difficult, and it will be followed by a long, arduous phase of economic adjustment. The economic policy patterns of the past decade are no longer sustainable. For the past ten or more years, one large group of countries relied on massive borrowing from abroad to allow them to consume more than they produced, invest more than they saved, and have their governments spend more than they took in.

These relationships will have to be reversed. As adjustment takes hold, the deficit nations will have to produce more than they consume, save more than they invest, and have their governments take in more than they spend in current costs. All of this will almost certainly require stagnant or declining consumption, stagnant or declining real wages, stagnant or declining standards of living. The austerity we face will not be pretty, but it is close to unavoidable.

The reality bequeathed to us by a decade of recklessly negligent economic policies constrains the choices available to progressives. The macroeconomic reality requires austerity measures to reduce the imbalances and get our societies back on a healthier footing. We could attempt to match the crass short-sightedness of the Bush administration, but this would be imprudent and immoral. Progressives can and should take the lead in insisting that the current generation not visit its macroeconomic sins on its children.

But progressives can also attempt to redress some of the unjust distributional effects of the past decade's follies, and of the immediate crisis response. The upper ten per cent of the American income distribution benefited disproportionately from the tax cuts, deficit spending, and borrowing boom.

To add insult to injury, the cost of the crisis itself has fallen disproportionately on those who benefited least from the preceding boom. Some of this is inevitable, as with the measures needed to restore the financial system. It is a sad fact of any panic, including this one, that measures to bring the banking system back from the brink require bailing out the guilty in order to protect the innocent.

Yet there is no need for such an unjust burden of adjustment to continue. We can and should insist that policies to restore macroeconomic balance and financial sanity also restore social equity. Financial regulation, tax policy, and spending priorities should have as a prominent aim helping those in need – and taking from those who have profited the most from the excesses of the past decade. While such policies may not appear

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to be prominent on the agenda today, there is a powerful undercurrent of resentment centred on the inequitable nature of the adjustment process as currently structured.

There is nothing preordained about this inequity, and progressives would do themselves – and society – much good by insisting on a rebalancing both of the macroeconomy and of our social priorities.

Progressives can and should stand both for macroeconomic responsibility, and for helping those most in need and most neglected by past policy. These two requirements are economically and politically urgent; they are compatible with one another, indeed they complement one another. The demand of the day should be for economic responsibility and social equity.

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## The role of government in the post-crisis age

The challenge for progressives is not to expand the boundaries of the state, but to be zealous in reforming government

Patrick Diamond & Roger Liddle

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The financial crisis has been as challenging to the ideological worldview of global progressives as it has to the financiers and speculators who have reaped the whirlwind of global markets over the last two decades. Of course, markets around the world have spectacularly failed and, as a result, the end of the long era of free market fundamentalism is being triumphantly proclaimed. Indeed, the world recession has exposed the bankruptcy not only of institutions, but of the very ideology of neo-liberalism itself.

But it is quite wrong to assume that the crisis will automatically justify a radical extension of the frontiers of the state into new areas of economic and social activity. In mapping out a coherent response to the crisis, progressives should remind themselves that social democracy neither exists to promote nor protect the state, but to ensure that the state upholds the public interest rather than the vested interests of an elite. We should seek to echo John Maynard Keynes in arguing that markets and states should be the servants of people, not their masters. Social democrats need to fashion not larger government, but an effective strategic state that can steer and intervene in the complex networks and institutions of a globalised economy and society.

The global financial crisis has dramatically resurrected the social democratic case for an “active state”. Nonetheless, we recognise that there must be no retreat from the market economy. Open markets are among the best available means of stimulating innovation and efficiency, and have been strengthened by globalisation. This is definitely not the time for a return to a model based on protectionism and anti-globalisation.

The progressive choice is not to turn our backs on the dynamic strengths of economic openness. Instead, liberated from past neo-liberal constraints we should explicitly recognise that the market has limits and that the inequalities it produces must be better managed in the public interest. The new framework should be one of multi-level governance: through political action at national, European and international level, governments must garner the necessary strategic capacity to act in order to positively shape the forces of globalisation.

This means that public policy towards industry has to change. Before the crisis, “pro-growth progressives” put the emphasis on supporting the right framework conditions for growth such as skills, competition, infrastructure, research, and so on. In Britain at least, this has proved insufficient to revitalise our industrial and

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economic base: a new era of policy activism is necessary to identify and nurture new sources of sustainable growth. For instance, we need to stimulate a green industrial revolution for a low-carbon age based on high-value added manufacturing that will provide jobs and higher living standards for future generations.

In turn, the modernising left needs to frame a new model of welfare capitalism to compliment the new model of high-growth industrial activism. There has been widespread concern about the excesses of financial capitalism in recent years, not least the avoidance of any form of public accountability and the large rewards often unrelated to long-term wealth creation. Social democrats have to develop remedies that promote responsible business behaviour without negating the dynamic potential of markets. This has to involve, for example, the abandonment of “race to the bottom” regulatory competition, and the development of a sensible pan-European approach.

Of course, regulatory action at the European level is necessary, but still insufficient. There should certainly be greater transparency over top pay; a more open-minded approach to workplace empowerment might improve lagging productivity; revised competition rules could discourage unhealthy merger and takeover fever; and the inclusion of stakeholder obligations in company law reforms certainly ought to be considered.

The global economic crisis makes the case for an active state, not a big state; for a new politics of production and a new growth model to rejuvenate sustainable recovery that better harnesses but does not stifle the power of markets; for a new approach to distribution that recognises the real concerns of the squeezed and insecure middle; and for a new progressive politics centred on international engagement reconciling security with openness – thereby building support for globalisation which remains fundamentally beneficial to our economies.

The challenge for progressive politics is not to expand the boundaries of the state, but to be as zealous in reforming government as we are in bringing new discipline to the operation of global markets. As the reach of government has extended in some areas – acquiring stakes in the banking sector to avoid financial catastrophe, for example – so in others the state’s role may become less important over time. Regardless of the turbulence afflicting global markets and the concomitant need for public action, we must continue to pose searching questions about the scope and scale of government activity in the post-crisis age. Otherwise, we will fail to learn the striking and invaluable lessons from the most devastating crisis in modern economic history.

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## Champion individual enterprise and middle class aspiration

A progressive opportunity agenda must strike a balance between new regulation and entrepreneurial risk-taking

Will Marshall

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For many on the left, the near-collapse of America's financial system during the winter of 2008-2009 was irrefutable proof of the failure of free market ideas. The new consensus – let's call it the anti-Washington consensus – was solemnised by business and political elites in Davos last month. Fittingly enough, French President Nicolas Sarkozy delivered the eulogy for neo-liberalism.

The Anglo-American model is dead. Long live state capitalism!

Not so fast. In America at least, popular attitudes have not lurched in a more interventionist or social democratic direction. If anything, there's been a backlash against the emergency measures the Obama administration has undertaken to unlock credit, bail out big banks holding worthless securities, reduce home foreclosures, and keep big US automobile companies afloat.

That has perplexed and frustrated Democrats, who believe the government should get more credit for again saving capitalism from the capitalists, just as it did in Franklin Roosevelt's day. But Wall Street's fall from grace doesn't automatically translate into rising public receptivity to a more active state. Anti-business and anti-government attitudes can and do co-exist easily in the American mind.

President Obama maintains, quite plausibly, that Washington's decisive intervention kept the economy from tumbling into the abyss. But unprecedented public deficits, the government's effective takeover of large finance and automobile companies, and, yes, Obama's push for comprehensive healthcare reform, also seem to have resurrected old fears about "big government."

One likely reason is the sheer, pharaonic scale of government spending to rescue the economy: nearly \$4 trillion when you add up the Federal Reserve's efforts to pump liquidity into financial markets, aid for failing banks, last year's \$787 billion "stimulus" plan, and another \$100 billion jobs bill for this year.

Many in middle America are barking mad that political elites have used tax dollars to shield economic elites from the consequences of their own greed and ineptitude. This is especially true of the independent voters

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who helped Obama to win a solid majority in 2008, but whose defection over the past year has fuelled Republican victories in elections in Virginia, New Jersey, and, most shockingly, the liberal bastion of Massachusetts.

Meanwhile, the US economy is growing again, by a gaudy 5.7 per cent of GDP in the last quarter of 2009. There's been little crowing at the White House, however, not when many small businesses still can't get credit, people continue to lose their homes, and unemployment remains stuck in double digits.

For Obama and the Democrats, the central economic challenge is not to sell some new model of state-managed capitalism to a public already worried about government spending and overreach. It is to rebuild the American economy's capacity for brisk innovation and job creation. That will require striking a careful balance between new regulation and entrepreneurial risk-taking.

With Wall Street again reaping huge profits (and dishing out fat bonuses), some sort of financial regulation is likely to pass soon. The key tasks here are reducing moral hazard by ensuring that no financial institution becomes too big or interconnected to fail, raising capital requirements to curb excessively leveraged speculation, and creating transparency in the trading of exotic financial products like derivatives.

But what the country needs even more is a progressive opportunity agenda that emphasises technological innovation, small business creation, American competitiveness, fiscal discipline, better schools and middle-class jobs. Such an agenda would include the following elements:

- An aggressive infrastructure initiative. Washington must reverse decades of neglect and double or triple spending aimed at modernising America's ageing and inadequate public infrastructure. Even that, however, won't be nearly enough, which is why progressives are calling for a National Infrastructure Bank to leverage private investment in high-speed rail, intelligent transportation systems, a smart electricity grid, and next-generation broadband.
- A big boost for clean and efficient energy. The United States needs to put a price on carbon, which would raise billions to invest in developing clean fuels and technologies. Unfortunately, Obama's "cap and trade" proposal is languishing in Congress, a victim of Republican obscurantism on climate change.
- More exports. Obama wants to double US exports, but the White House has not pushed Congress hard to pass the US-Korea trade pact. Nor has it confronted China and other Asian nations whose currency manipulations keep US (and European) goods at a competitive disadvantage.

- Fiscal restraint. America's heavy borrowing from abroad weakens the dollar and deepens our reliance on foreign creditors. To maintain the nation's fiscal integrity and independence, Obama must walk a fine line between winding down our enormous public deficits and debts and continuing to pump up domestic demand. The key is to reduce the unsustainable growth of public healthcare costs, which is why Obama is right not to give up on healthcare reform this year.
- An entrepreneurial climate. Over the last three decades, firms less than five years old have accounted for nearly all net job creation in the United States. US progressives should embrace policies that foster innovation and entrepreneurship: more public spending on research, a light-handed approach to regulating and taxing new enterprises, fiscal discipline to keep capital costs low, dramatic improvements in education and preferences for skilled immigrants.

In the ideological hothouse of Washington, it's natural for Democrats to argue that the financial crisis has discredited market fundamentalism. But the antidote isn't more government, it's a progressive model for innovation-led growth that champions individual enterprise and middle class aspiration.

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## A jobs programme? Keynes again

The hue and cry over deficits cannot side track us from our true goals of full employment and sustainable energy

James K. Galbraith

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“Now that the immediate crisis has passed,” *Policy Network* asks for “long-term strategies to shape our post-recession economies” and “to promote economic growth.”

But the immediate crisis hasn’t passed. It is not over for the jobless. It is not over for those losing their homes. It is not over for Greece, Spain, Portugal, or Iceland, facing ruin in the capital markets.

Europe has no plan for jobs. In America, President Obama has recently sent a jobs programme and a call for investments in transportation, clean energy, and education to a Congress in stalemate. No country has a credible plan for effective homeowner debt relief. To the plight of their own periphery, the countries of the European centre appear to respond with folded arms.

The right goal is not to shape “post-recession growth.” Growth is not assured; it cannot be assumed; and it is not even the highest priority. The right task is to find a fair, effective, and sustainable path out of crisis.

People need work. We face the challenge of climate change. This challenge must be met while also improving the quality of life, or it can never be met at all. The broad outline of a programme is therefore plain. There is no mystery about it. In 1929, Keynes wrote, “there is work to do; there are men to do it. Why not bring them together?” Today as then, it is that simple.

Do we need to “rethink the relation between the market and the state”? A futile hope! Those who once thought that the market could flourish without the state have either already “rethought,” or they cannot think. They are our own Stanley Baldwins and when they discourse on this subject, “it not only is nonsense... but it looks like nonsense to any simpleminded person who considers it with a fresh, unprejudiced mind.”

In the crisis, the financial sector collapsed. It hasn’t recovered. The big banks remain open, but they make few new loans, take practically no commercial risks, and their old customers – households without wealth, businesses without hope – make no effort to obtain credit. In this situation, the state must act. It can act *through* the banking system by mandate, as it does in China and as it used to do in Japan and France. Or it can

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*bypass* the banks and go to work directly – as it did in America in the New Deal and as Keynes proposed for Britain in 1929.

A jobs programme? Keynes again: “No, says Mr Baldwin. There are mysterious, unintelligible reasons of high finance and economic theory why this is impossible. It would be most rash. It would probably ruin the country. Abra would rise, cadabra would fall... No, cries Mr Baldwin. It would be most unjust... Unemployment is the lot of man... For the more the fewer, the higher the less.”

The question facing world leaders today is not what to do. It is whether to do it. There are two goals to meet: full employment *and* sustainable energy. That’s *technically* complex. But the complexities are complexities of engineering, organisation and politics. They are not complexities of economics or finance.

The question is posed as though it involved deep questions and high obstacles, whose true nature the uninitiated cannot be expected to grasp. Thus the hue and cry over public debt and deficits – projected to be unsustainable – for reasons never stated – in the long run. Our papers and our television speak of almost nothing else. But if they are right – as all the voices of Wall Street and the City say – then how come the long-term interest rate on the government bonds of the rich countries remains so low? In the United States, the federal government can borrow for 20 years at less than 4.4 percent. And it can borrow short term for practically nothing.

In truth, the deficit/debt uproar is a deliberate effort to sidetrack attention, to defeat the will of the electorates in the United States, as well as Greece among others, who stubbornly insist on effective action, economic recovery and financial reform. Those behind the uproar never foresaw the financial crisis. They never warned against the dangers of excessive private debt. Their interest is plain: they profit from private debts! So it pays to make believe that private is productive and public is sterile, that private is stable and public is not, when the reality is the other way around.

A final word from Keynes: “It may seem very wise to sit back and wag the head. But while we wait, the unused labour of the workless is not piling up to our credit in a bank, ready to be used at some later time. It is running irrevocably to waste; it is irretrievably lost. Every puff of Mr Baldwin’s pipe costs us thousands of pounds.”

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## Government as the ultimate risk manager

A social democratic response to the crisis must begin by reasserting the crucial role of the state in risk management

John Quiggin

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For nearly thirty years, from World War II to the early 1970s, economic and political debate was based on a broad consensus with three main elements: Keynesian macroeconomic management designed to maintain full employment, a mixed economy with a large government role, and a social-democratic welfare state based on a commitment to provide adequate living standards for all.

These ideas were not simply a compromise between 19th century models of capitalism and socialism. Rather they represented a genuine Third Way, achieving outcomes that both capitalists and orthodox socialists regarded as unattainable in a market economy.

The economic crises of the 1970s led to an abandonment of Keynesian macroeconomic policies and an acceptance of high levels of unemployment. This in turn paved the way for attacks on the mixed economy and the welfare state. Ideological support for these attacks was provided by a set of ideas variously called Thatcherism, Reaganism, neoliberalism and the Washington Consensus. I prefer the more neutral and descriptive term market liberalism.

The central claim of market liberalism was that low taxes, lightly regulated financial markets and a monetary policy based on judicious adjustment of interest rates can provide both macroeconomic stability and the most efficient possible allocation of capital investment. The resulting strong growth, it was claimed, obviated the need for the redistributive measures of the welfare state.

The case for market liberalism has collapsed with surprising rapidity, though in retrospect its unsustainability has been evident since the late 1990s. Meanwhile, free-market miracle economies have encountered catastrophes far more severe than those of the global economy as a whole. Striking examples include Iceland and the Baltic states.

Equally importantly, the theoretical underpinnings of market liberalism, centred on classical macroeconomics and the efficient financial markets hypothesis have collapsed in the face of overwhelming evidence.

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The global financial and economic system has been saved but only through massive government intervention and rescues undertaken by central banks.

The resilience of social democratic institutions and values in the face of a concerted neo-liberal attack has been striking. The time is now ripe for a shift from the defensive position of the last quarter-century, in which social democrats struggled mainly to protect the achievements of the past. Governments of all political persuasions are being forced to deal with a sudden and drastic increase in risk and insecurity generated by the collapse of the financial sector. But only a social-democratic analysis provides any coherent basis for a response.

Social democrats have long stressed the idea that we have the capacity to share and manage risks more effectively as a society than as individuals. The set of policies traditionally associated with social democracy may be regarded as responses to a range of risks facing individuals, from health risks to uncertain life chances.

Risk and inequality are closely linked. On the one hand, the greater the risks faced by individuals in the course of their life, including the risks associated with differences in initial opportunities, the more unequal society is likely to be. On the other hand, as the financial crisis has shown, radical inequality in outcomes, such as that associated with massive rewards to financial traders, encourages risky behaviour and particularly a search for opportunities to capture the benefits of risky actions while shifting the costs onto others, or onto society as a whole.

A social democratic response to the crisis must begin by reasserting the crucial role of the state in risk management. If individuals are to have security of employment, income and wealth, governments must act to establish and enforce the necessary legal and economic framework. The fact that government is the ultimate risk manager both justifies and necessitates action to mitigate the grotesque inequalities in both opportunities and outcomes that characterise unrestrained capitalism and were increasingly resurgent in the era of economic liberalism.

This entails both a reassertion of the role of government as a provider and guarantor of human services, and a restatement of the egalitarian values of social democrats. The radical changes in social conditions since the social democratic moment of the 1960s imply a need for a much more flexible approach than that of the postwar mass production era, with services tailored to the specific needs of individuals and families. But the idea that this job can be left to market mechanisms has been thoroughly discredited, hopefully forever.

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All of this essentially means higher taxes. By the time a global recovery is firmly established, the net worth of the public sector will have declined substantially as a result of a series of budget deficits. Deficits arise automatically during recessions as a result of lower tax revenue and higher payments for unemployment and other social welfare benefits. In addition to these automatic effects, substantial fiscal stimulus in the form of increased public expenditure and temporary cash transfers will be required to soften the impact of the crisis.

Some of the shift towards surplus may be achieved through reductions in spending on programmes designed to provide a fiscal stimulus, or to maintain employment levels in a declining economy. However, given a sustained increase in the risk-aversion of private investors, a permanent increase in the scope of government activity is necessary. The necessary revenue can only be produced by an increase in government revenue as a share of national income.

In the face of a global crisis of their own making, the advocates of economic liberalism have had nothing to offer. It is, therefore, up to social democrats to develop and guide both the response to the immediate crisis and the reconstruction of a social and economic order sufficiently robust to avoid such crises in the future.

In an environment as uncertain as that of the present, any attempt at forecasting future developments and proposing responses is inevitably going to be erroneous in important respects. But the task must be attempted, and the broad outlines of a social-democratic response can already be discerned.

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## The essence of recovery: investing in innovation

Investment in young innovative companies must be the central plank of a European recovery and growth plan

Reinhilde Veugelers

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Countries that have gone through a deep crisis demonstrate that the foundations of future growth performance depend on the particular recovery intervention chosen. In view of the weak fiscal and debt position of many countries, the opportunity cost of recovery measures is high. But at the same time, it is clear that a sustainable recovery needs policy intervention.

There is a real risk of ending up in a vicious circle of low-growth, or even jobless growth, where fiscal constraints block investments in those areas that future growth depends on, sustaining low economic performance which in turn leads to the continuation of weak fiscal positions. Recovery interventions therefore need to be extremely effective. In what follows, I will argue that a higher share of recovery spending should be allocated to stimulate innovation from small new firms, especially for breakthrough high-risk innovation projects.

Even before the crisis, Europe's poor growth performance had been diagnosed as resulting from an inappropriate industrial structure, where small firms, which provide the largest share of total employment, failed to play a significant role in the dynamics of the economy, especially in the high-tech sectors. The EU lacks an efficient Schumpeterian process of churning, where new firms enter, experiment with novel approaches, and simply exit if not doing well. Yet, if they are successful they are given the opportunity to quickly grow into leading positions in new markets; and even if they do not develop their new technologies themselves, these new firms incite the large incumbent firms to innovate.

These virtuous interactions have characterised the ICT and biotech revolutions in the US. They will also be at the heart of the new green technology wave. In the portfolio of technologies needed to tackle environmental challenges, radical technologies (especially backstop technologies that are completely emission free and not dependent on any exhaustible resource) are needed. These technologies are not yet available or are still a long way from commercialisation. Small young firms, not concerned with safeguarding existing "dirty" skill-sets and market positions, will be more inclined to introduce these radical innovations.

Young, highly innovative firms that are impeded from starting, surviving and growing, will directly and indirectly impact on the overall level of innovation in the economy and its growth performance. There are a

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number of plausible explanations for why Europe has been missing this virtuous growth enhancing churning process. Weak product market competition and segmented markets restrict European firms from accessing large markets and reaching an efficient scale. This is likely to be of particular importance in the service sector. Protection of inefficient firms through subsidies, bail-outs, and employment regulation that hinders exit, further slows down the churning dynamic. Access to finance for risky breakthrough projects is particularly a problem in Europe, due to the fragmented venture capital market, a problem which has been further exacerbated by the current financial and real economy crisis. Young firms with radical innovative projects yet missing the collateral and reputation are particularly threatened by the double whammy of constrained credit and higher bankruptcy risk.

Beyond the restoring of financial markets, a major effort should be devoted to addressing the structural problems in the EU which prohibit the virtuous Schumpeterian churning-growth nexus. EU member state recovery programmes pay most attention to large incumbent firms, ignoring the young innovators. This approach focuses on short-term impacts but jeopardises the long-term social benefits arising from breakthrough innovations. Beyond committing resources to young innovators, it is perhaps even more important to get the policy details right, particularly in light of the tight budgetary position of many countries and the high risk of government failure.

First, since young highly innovating firms require a complementary overall innovative environment within which to interact, a specific policy for this target group needs to fit into an overall innovation and growth strategy. Second, a specific policy approach requires dealing with financial constraints. Public funding (subsidies) for highly risky projects from young innovators is an obvious instrument to tackle financial market failure, but needs to be carefully designed to reward the risk-taking inherent in radical innovations.

These direct support measures will have to be taken at member state level. The new EC state aid rules for innovation support for member states allow for a more favourable treatment of young innovative companies (YICs). Having identified this group is a big step forward for targeting policies at member states level. It should also be used by the EC itself to target specific EU programmes. For example, a recent Bruegel Policy Brief entitled "A lifeline for Europe's young radical innovators" puts forward a concrete proposal for an EU wide green YICs programmes. The proposal fits the criteria for government intervention (i.e. passes the EU state aid requirements) as well as the subsidiarity principle for implementing it at the EU level.

The EU level is also a good platform for stimulating the broader framework conditions for improving the climate for innovation which YICs thrive in. This puts Single Market instruments in a pivotal position. Removing barriers to EU-wide venture capital markets, long on the EU policy agenda, is still an unattained objective.

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They remain a key area that requires further attention, as the efficiency of any public support scheme depends on its complementarity with a vibrant private venture capital market.

Interventions for young highly innovative firms on their own will not suffice in terms of ensuring a strong recovery. But they cannot be absent in any European recovery and growth plan. As they are focused on a small target group, they do not require massive taxpayers' money. But they carry the potential for huge returns, as they create the foundations for future post-crisis growth. The inherent high risk nature of this public investment should not be seen as a deterrent for governments. On the contrary, it is precisely the motive for policy intervention as financial markets are currently failing to support these new radical innovations.

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## Sharing the workload

Striking a balance between unemployment levels and shorter working hours can have positive social, economic and environmental benefits

Dean Baker

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Most projections now show that the OECD countries will have extraordinarily high rates of unemployment for several years to come. While there are differences across countries, in most the unemployment rate is not projected to return to normal levels until 2014 or 2015. Sustained levels of high unemployment are unacceptable, especially when we know how to bring the rate of unemployment down to normal levels.

However, there are political obstacles to the sort of fiscal and/or monetary stimulus needed to restore full employment levels of output. Given these obstacles to increasing output, governments can instead look to sustain full employment by reducing hours and dividing the required labour among the willing workforce.

This policy of work sharing has proven remarkably successful in Germany and the Netherlands. It has prevented their unemployment rates from rising in the downturn even though these countries both experienced substantial drops in GDP. In fact, the unemployment rate in the Netherlands remains under 4 per cent.

The logic of work sharing is simple. Instead of the government providing workers who lose their job with an unemployment benefit, the government effectively pays firms to keep workers employed but working shorter hours. In Germany, the standard framework is that if the work week is cut by 20 per cent, then the government picks up 12 per cent of the workers' pay and it requires the company to pick up 4 per cent.

This leaves the worker with 4 per cent less pay, while working 20 per cent fewer hours. Since a 20 per cent reduction in hours may mean working a four day week instead of a five day week, the worker may end up with almost as much net pay since they will save on commuting costs and other expenses associated with work.

A movement towards shorter hours as a way of addressing unemployment is consistent with other goals that progressives have long supported. Specifically, it can go along with improved parental and family leave policies, as this is one mechanism through which workers can be granted additional paid time off. This would be especially important in the United States, where most of the workforce still does not have paid parental or family leave, however there are few countries where workers could not be helped by making these benefits more generous.

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There is also a very important environmental aspect to this issue. There is always a trade-off between leisure time and income. As productivity has grown through time, workers have divided the benefits of this growth (insofar as it has been passed on to them) between higher incomes and more leisure with substantial variations across countries. In the United States, the average number of hours worked in a year by a full-time worker has changed little over the last three decades, even while it has fallen sharply for workers in most other wealthy countries.

There are strong environmental reasons for preferring that workers get more of the benefit of growth in leisure than income. There is a solid relationship between income and per person greenhouse gas emissions; in other words, insofar as workers have more money, they are likely to emit more greenhouse gases, other things being equal.

The logic of this relationship is straightforward. Additional income is likely to be spent on items, such as bigger cars, which lead to more greenhouse gas emissions. Also, if workers have less leisure, then they will place more of a priority on their time. This means that they will be less likely to take public transportation if it implies more time spent commuting. It also means that they will be willing to pay a premium for fast food and other products that may require wasteful packaging, but offer greater convenience.

The relationship between emission of greenhouse gases, other pollutants and income is a strong argument as to why progressives should support measures that encourage workers to get more of the benefits of productivity growth in the form of leisure time rather than higher income. However, the argument for shorter hours is especially powerful in the current downturn.

Most wealthy countries are experiencing high rates of unemployment and lack the fiscal and monetary tools to foster sufficient growth to restore full employment. In this context, the choice is between high unemployment and shorter work time. Workers would almost certainly prefer the prospect of a shorter working week and longer vacations to the risk of unemployment. This is a strong argument for promoting work sharing policies for both the current crisis and the longer-term future.

Dean Baker is co-director of the Center for Economic and Policy Research in Washington, DC and author of *False Profits: Recovering from the Bubble Economy*



## It's high time for Global Issue Networks

The clash between short-term electoral politics and long-term global interests has left us in a state of near paralysis

Jean-François Rischard

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The institutions that currently constitute our global problem-solving system appear utterly overwhelmed, and the list of pressing global problems – those that can only be addressed through international cooperation – is growing longer.

We now have no less than 20 such global problems on our hands ranging from dangerous climate change, the prevention of further financial crises and economic downturns, and tackling terrorism. Many of these problems, most notably climate change, must be resolved within the next 20 years or less, otherwise it may be too late to reverse their effects. At the same time, technically feasible, financially viable and politically manageable solutions exist for all of these problems. Yet none of them are being solved. Why is this the case?

At first glance, it is because the existing instruments and institutions of international governance are showing signs of age and are in need of reform. But this is a superficial explanation: merely reforming them would in no way address the root cause of the current paralysis. This root cause is the lethal clash between the territorial and short-term electoral perspectives of the nation-states and their politicians, and the non-territorial, long-term solutions necessary to address global problems - for example politicians running for election every 4 years may hesitate to embrace a global 100-year plan to reduce carbon emissions.

So what can be done? Many of the alternatives often put forward simply won't work - setting up a global government of the world's nation-states is just not feasible within the little time left, and relying merely on the reform of the existing institutions of the current international system would produce slow, incremental changes rather than the big and decisive ones which are necessary.

We must thus come up with something out-of-the-box. One such proposal, offered in my book "High Noon: 20 Global Problems, 20 Years to Solve Them" (Basic Books, NY, 2003), is that we must resort to systems that rely on pointed expertise, and stop deluding ourselves that some sort of representative system will work at the global level – not out of defiance for democracy nor in blind deference to experts, *but because we're running out of time.*

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The book's proposal involves setting up some 20 expert sets called global issues networks or "GINs". Each GIN would initially be kick-started by the international organisation most closely associated with the particular global problem. They would co-opt 60-90 knowledgeable persons from around the world who are most capable of setting out the solutions which the world could logically adopt – if the world was not cut up into 200 territorially-minded and short term inclined nation states – to deal with the problem in question.

These people, coming from different professional backgrounds and disciplines, would be selected solely on the basis of their capacity to contribute to the detailed specification of these solutions. They would not be selected on the basis of their nationality or which group they may represent, but would be drawn in equal thirds from governments, civil society and global firms.

In the first phase, the GINs would work for 1-2 years under a special methodology to ensure that their individual members represent the interests of humanity and in no way the country or background they come from. They would work not only to define global solutions for global problems, but would also translate them into a set of detailed operational norms designed to coax nation states into the direction of these solutions.

In the second and permanent phase, the GINs, having each issued these operational norms, would acquire a much broader membership and effectively become monitoring and rating agencies. That is, the 20 GINs would rate the world's 200 or so nation states through 20 league tables - each with gold medal countries at the top (those fully complying with the norms and, beyond that, actively contributing to the solution of the problem in ways that transcend their own interest), followed by the silver medal countries, then the bronze medal countries, then the brown medal countries (countries contributing to the problem without making any effort to mitigate it), and finally at the bottom the black medal countries (criminal or rogue states in terms of the problem in question).

The GINs would simultaneously release their 20 league tables once a year, providing a "dashboard" of how countries are performing in terms of addressing the most challenging global problems. The overall dashboard, and the individual league tables, would exert two effects on nation states and their politicians:

- Reputation effects would hit them from above in the form of embarrassment and "naming-and-shaming". Recent experience, for instance with respect to money laundering and egregious tax havens, has shown that even powerful countries will take decisive remedial steps when faced with the risk of being publicly blacklisted. The league tables would also produce positive incentives, by recognising and celebrating the gold, silver and bronze medalists' contributions.

- From below, the nation states and their politicians would be hit by voter information effects. Voters around the world would have, thanks to the media's annual relaying of the dashboard and the league tables, a better sense of what the major global problems are and for where their own country stands in the ratings both compared with others and compared with one year earlier. These voters, especially those from the younger generations in line to inherit the backlog of unsolved global problems, could then hold their national politicians to account in terms of how their country is performing compared with other countries around the world.

These incentives may well be potent enough to push nation states and their politicians towards thinking more about the global interest and the long-term, even when there is no global government to take the lead.

This innovation could be launched almost immediately and at a comparatively low cost – networks are not institutions. In addition, because GINs would not be concerned with making rules, but rather establishing norms and rating the performance of countries, they could be established even if some governments do not endorse the initiative. Finally, they would help get the best out of the world's existing institutions, even in their unreformed state.

Jean-François Rischard is an economist and former vice president of the World Bank. He is working on a forthcoming book which will describe the need for decisive global problem-solving frameworks in order to avert a series of interlinked global mega-crises over the next four decades. The book will propose three key innovations, focusing on global problem-solving methodology, education, and the role of business.



## Conceptualising a new politics of growth

Progressives need to explore the role of the state as market shaper and facilitator at home, and as a confident, responsible and compassionate player in its relationships abroad

Elena Jurado & Krystian Seibert

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Policy Network aims to support progressive governments with their role in shaping the future of our economies and societies. One of the most pressing long-term challenges confronting progressive policymakers is how to develop bold and innovative strategies to reform our economies as they emerge from the economic downturn. As is evident from the articles in this conference booklet, there is a lively debate among progressives about the direction this reform process should take. This diversity presents both an intellectual challenge and an opportunity. Now is the time to take the debate forward and forge a broad progressive coalition to shape the new politics of sustainable growth.

Across the OECD and within Europe, economies are supported by growth models which vary in their exact shape and emphasis. Notwithstanding this element of economic diversity, over the last two decades, there has also been a common trend towards underpinning growth through private consumption, high household and corporate debt, and with little regard for environmental externalities. Opening up markets has driven innovation and productivity improvements, but in their attempts to harness markets to raise living standards, governments have been reluctant to fully acknowledge and remedy the risks of market failure.

The global financial crisis has demonstrated the limits of this broad economic paradigm. It has also ushered in an era of policy uncertainty regarding the growth models we should now adopt. A number of questions flow from this. The decline of manufacturing over recent decades has been marked. How can a resurgent manufacturing sector form part of a strategy to deliver stable and sustainable growth? How can financial services be better geared towards supporting domestic growth industries? If governments decide to support sectors with growth potential, how can these be identified and which policy tools are most effective at nurturing initiative and enterprise? What role will regulatory innovation play in delivering economic stability?

Efforts by national governments to bring about a shift in focus from consumption to investment need to be implemented with careful consideration for the dynamics of the global economic system. This presents a further set of challenges, namely, the need to ensure greater compatibility between the economic policy frameworks of the world's major trading partners. No one now disputes that it will be necessary to re-adjust the huge trade and current account imbalances which exist between countries if future crises are to be avoided.

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The short-term speculative tendencies in financial markets, which contributed to the global financial crisis, were the result of a collective failure to manage the resulting capital flows.

The crisis has served to renew interest in developing alternative international mechanisms for coordinating macroeconomic policies and financial sector regulation. However, the flurry of G20 meetings which took place last year has since been overshadowed by a resurgence of nation state interests over global agendas. How do we align national and global interests to reflect both realities? While much of the difficulty has centred on the political pressures at home, governments are also held back by uncertainty about the consequences of new monetary and regulatory proposals, such as a global transaction tax or increasing the IMF's institutional capacity to monitor macroeconomic policies.

Deciding on the particular structure of our post-recession economies, and defining the shape of new growth models is a complex challenge. But an equally complex challenge concerns how such new structures and models are implemented. Governments have been credited with averting a deeper and more widespread economic downturn through the bolder use of fiscal policy levers. However this has not translated into an increase in the public's trust in government. Rather, governments are now experiencing a major challenge to their legitimacy. This is a critical issue because if governments are to change the direction of our economies, they will need to have the backing of the public.

After decades of unfinished economic reform, scepticism of political elites runs deep. The public seek a new direction, but at the same time they are not convinced that governments are capable of managing this process of change. In response, progressives need to devise a new model of interaction between governments and citizens. A number of questions arise from this challenge. What consultation structures and transparency mechanisms will ensure that there is effective public input and scrutiny with regards to reform processes? How can new forms of political language be developed to improve the level of dialogue between governments and the public?

These are some of the questions that Policy Network will examine in the coming year as we drive forward our cutting-edge programme of international research and debate. Our existing projects on the future of welfare reform and industrial policies in light of the global economic downturn; the future of European integration; and the implications of the new multi-polar world for global governance, are just some of the avenues we will use to explore the role of the progressive state as market-shaper and facilitator at home, and as a confident, responsible and compassionate player in its relationships abroad.

Elena Jurado and Krystian Seibert are, respectively, head of research and policy researcher at Policy Network

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\* Correct at the time of going to print.

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**Fran Sainsbury (UK)** is former senior policy adviser at the UK prime minister's strategy unit and the cabinet office.

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**Thomas Schieb (Germany)** is head of press for the German embassy in London.

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**Radu Şerban (Romania)** is minister plenipotentiary at the Romanian embassy in London.

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**Priya Shankar (India)** is policy researcher at Policy Network.

**Kathryn Skidmore (UK)** is head of operations at Policy Network.

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**Melanie Smallman (UK)** is national campaign director for SERA.

**Benjamin Smith (UK)** is head of international research at the UK Home Office.

**María Solanas (Spain)** is adviser at the international and security department in the Spanish prime minister's office.

**Clive Soley (UK)** is campaign director of Future Heathrow and a member of the House of Lords.

**Phillip Souta (UK)** is director of Business for New Europe.

**Oscar Stenström (Sweden)** is foreign policy adviser to the leader of the Swedish Social Democratic Party.

**Ernst Stetter (Belgium)** is secretary general of the Foundation for European Progressive Studies (FEPS).

**Jens Stoltenberg (Norway)** is prime minister of Norway.

**Jonas Gahr Støre (Norway)** is Norwegian foreign minister.

**Will Straw (UK)** is editor of Left Foot Forward.

**Eric Sundstroem (Sweden)** is editor in chief for AIP Media.

**Tibor Szanyi (Hungary)** is a member of the Hungarian parliament.

**Matthew Taylor (UK)** is chief executive of the Royal Society of the Arts.

**Robert Taylor (UK)** writes for the New Statesman and Tribune.

**Anthony Teasdale (UK)** is deputy chief of staff at the office of the president of the European Parliament.

**Sotiria Theodoropoulou (Belgium)** is policy analyst at the European Policy Centre.

**Elvira Thissen (The Netherlands)** is policy officer at Policy Network.

**Christian Thorning (Denmark)** is counsellor of European policy and financial affairs at the Royal Danish Embassy.

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**Sam White (UK)** is special adviser to the UK chancellor of the exchequer, Rt Hon. Alistair Darling MP.

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**Stewart Wood (UK)** is a special adviser to the UK prime minister Gordon Brown.

**Kirsten Xanthippe (UK)** is director of innovation at Aequitas Consulting.

**José Zapata (Chile)** is advisor to the Chilean Socialist Party.

**José Luis Rodríguez Zapatero (Spain)** is prime minister of Spain.

**Sotirios Zartaloudis (Greece)** is a PhD candidate at the London School of Economics.



# About Policy Network

Policy Network is an international thinktank dedicated to promoting progressive policies and the renewal of social democracy. Launched in 2000 with the support of the then heads of government, Tony Blair, Gerhard Schröder, Giuliano Amato and Göran Persson, it facilitates the sharing of ideas and experiences among politicians, policymakers and experts on the centre-left.

Policy Network's president is Peter Mandelson, UK secretary of state for business, enterprise and regulatory reform. The chair and director are Roger Liddle and Olaf Cramme, respectively.

## **Events**

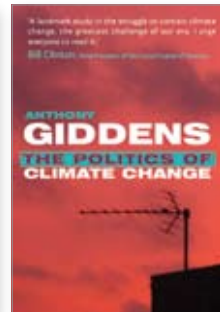
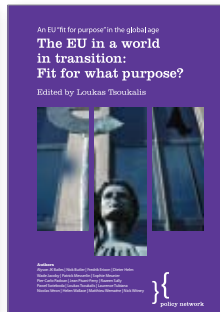
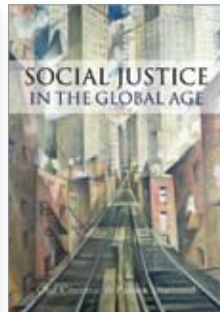
Policy Network encourages debate on contemporary social, economic and political issues by organising seminars, conferences and round-table discussions, bringing together senior policymakers and leading experts, and offering a unique international perspective on today's challenges and policy solutions.

## **Research**

Through its research and publications Policy Network seeks to have an impact on policy in Europe and internationally. It produces two types of publications: edited volumes which contain in-depth qualitative or quantitative research; and online papers and essays published on the website. Our current research programmes include: the ideological renewal of European social democracy – a new revisionism for the 21st century; Foresight: forging common futures in a multi-polar world; the politics of climate change; an EU "fit for purpose" in the global age; managing migration in times of economic turbulence; and globalisation and social justice.

## **Website**

Policy Network's website has become a leading platform for the sharing of ideas and experiences among politicians, policymakers and experts on the centre-left. The website provides access to information on all of our events and publications as well as online papers and comment pieces.



**New ideas for  
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