

Responding to the Crisis:
Economic Stabilisation Grants

by
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“The certainties of one age are the problems of the next.”

■ R.H.Tawney

“Insecurity is worse than poverty.”

“The easiest way out is through the door. Why is it that so few take it?”

■ Confucius

1. Introduction

The economic crisis may have been precipitated by a financial market failure, but it is one of *systemic uncertainty* that is being converted into a major problem of deficient aggregate demand. We are faced by the prospect of the first global depression. The solution must be to reduce the extent of uncertainty, by promoting sufficient economic security and stability to induce a recovery. The trouble is that globalisation and the neo-liberal agenda – the building of a global market society – rejected economic security as a goal. The Nobel Laureate economist seen as the father of globalisation and the economic policies of the era, Friedrich Hayek, scornfully dismissed economic security as a false goal in his *Road to Serfdom*. This was *the* error of the globalisation model. Society rejects the human need for security at its peril.

The policies and institutional reforms pursued since the 1980s, under the aegis of the Washington Consensus, dismantled the protective regulations and mechanisms of social democracy, including the solidaristic social security system that had hinged security on labourist contributions. For all its limitations, that system had an element of an automatic economic stabilisation, since as aggregate demand fell and unemployment rose, money was pumped out via state benefits, thereby tending to restore aggregate demand.²

Whether or not one liked the old social democratic model, one could argue that many of the institutions and policies that underpinned its variants had become obstacles in the way of responding to the growth of a global market society.³ By the 1980s, old-style social democracy

² The post-war “Swedish model”, or Rehn-Meidner model, deliberately set aggregate demand below full capacity, so as to moderate inflationary pressure, and then used ‘solidaristic wage policy’ and *active labour market policy* as a counter-cyclical stabilization strategy. Unfortunately, gradually active policy lost its counter-cyclical character, a point lost on many commentators who have continued to wax lyrically about the Swedish model.

³ I have argued since the early 1980s that it was a mistake of social democrats to defend the old system. The neo-liberal agenda and globalization demanded a new set of responses. See, for instance, G.Standing, Unemployment

was no longer a progressive or sustainable model. But the consequence of the neo-liberal strategy was not just a greater level of economic insecurity, sold as the necessary price for increased growth and flexibility. It was that the *character* of economic insecurity changed.

To understand the nature of the globalisation crisis and what policies are feasible and desirable, it is essential to understand the nature of the current economic insecurity. It has four aspects – risk, uncertainty, hazards and shocks. Briefly, in the post-1945 ‘Keynesian welfare state’ era, the main forms of insecurity in industrialised countries were labour-based *contingency risks*, involving what Beveridge famously called ‘temporary interruptions of earnings power’. For the majority of those in the labour market, the probability of unemployment was low and a solidaristic unemployment insurance benefit scheme worked reasonably well. This is no longer remotely the case.

In the Keynesian welfare state era, based as it was on industry and full-time regular employment, the main forms of insecurity were *idiosyncratic*, fairly random and relatively easily covered by social insurance schemes designed to respond to *contingency risks*. Nowadays, if you were to try to devise a system that provided *ex post* compensation for adverse outcomes of risk and uncertainty, you could not do so, because the global market society creates three distinctive features – systemic volatility, a secular long-term trend towards greater functional income inequality and systemic uncertainty associated with a greater propensity for all economies to suffer from periodic *shocks*.⁴ You cannot easily insure against shocks without very high premia and considerable moral and immoral hazards.⁵

Economic shocks are not just due to the series of events that led to today’s financial meltdown. In a comprehensive report on economic security around the world, we found that there had been numerous economic shocks since the onset of globalization, each being defined as a sharp decline of GDP in the country affected.⁶ Some of the statistical findings are reproduced

and Labour Market Flexibility: The United Kingdom (Geneva, ILO, 1985); *idem*, Global Labour Flexibility (Harmondsworth, Macmillan, 1999).

⁴ This shift in character of economic insecurity is even more threatening in developing countries, especially as it is combined with a growing incidence of ecological shocks and epidemics that affect whole communities. This paper is not about such cases, but policymaking should take that as its context, as argued elsewhere. The need is to create adequate *ex ante* economic security.

⁵ A *moral hazard* is where a scheme of protection produces incentives to unproductive behavior. For instance, the means-tested benefits favoured by the British Government, among many others, creates poverty traps and unemployment traps, whereby an increase in earned income can result in a decrease in actual income. Immoral hazards arise from the fact that, often precisely because of the poverty trap, it pays to be dishonest.

⁶ Thus, in 2004, I wrote that “*the global economy has become more prone to economic crises, involving deep sudden downturns that spread from one country or region of the world to others*”. ILO Socio-Economic Security Programme, Economic Security for a Better World (Geneva, ILO, 2004), p.27. It should be recalled that proponents

as an appendix to this paper, highlighting the fact that there was ample statistical evidence that the model over two decades was not functioning to produce economic stability. We also highlighted the sharply growing functional income inequality, which is due primarily (but not only) to the quadrupling of the globalised labour force, bringing with it a huge global surplus ready to labour productively for a small fraction of the labour costs in industrialised countries.

Since 2004, several other studies have documented the growth of financial crises in the past three decades. The most influential is the recent thorough analysis of earlier banking crises, showing that downturns after them are typically very long and deep.⁷

In other words, there was ample warning of the current global financial crisis, and thus no credibility should be given to all the current expressions of defensive surprise. And there is no evidence or theoretical reason for thinking the incidence of shocks will decline or that the growing functional income inequality will be reversed. That is the economic context. Sooner or later governments will overcome the toxic debt situation.⁸ What we all need to know is how to overcome the enormous systemic uncertainty and to reverse or at least halt the growing functional income inequality.

In short, it simply is not true that economists did not foresee the crisis of globalisation or that there were no warning signals. Unfortunately, the mainstream media and policymakers were

of financial market liberalization argued that it would produce more economic stability. As evidence accumulated showing this was not the case, proponents of liberalization, most notably the IMF, argued that short-term instability was the price for longer-term gain. This convenient rationalization looks odd in 2009, and should make one wonder why so many politicians and economists think an enlarged role for the IMF would solve many of the problems. Their diagnostic record has been less than impressive. See, for example, G.Kaminsky and S.Schmukler, Short-term pain, long-run gain: The effects of financial liberalization (Washington, D.C., IMF Working Paper 03/34, 2003); K.Rogoff et al., The effects of financial liberalization on developing countries: Some empirical evidence (Washington, D.C., IMF Occasional Paper 220, 2003). The IMF's own analyses concluded that financial liberalization did not benefit developing countries, and yet the IMF continued to advocate financial liberalization globally. One must ask, in all seriousness, whose interests has the IMF been serving? An argument for its reform could not be more strongly stated than in that rhetorical question.

⁷ C.Reinhart and K.Rogoff, The Aftermath of Financial Crises, paper presented at the Annual Meeting of the American Economics Association, San Francisco, January 2009; also issued as NBER Working Paper No. 14656, 2009. To those inclined to be sanguine about the current global crisis, one should point out that experience suggests that a financial crisis takes two years to reach its bottom, and unemployment reaches its peak almost five years after the crash occurs. No doubt neither of these need to occur. But it is worrying that the current crisis may be bigger than all previous, globally partial setbacks.

⁸ One should agree with George Soros on this. He pointed out that in 1929, toxic debt was about 160% of GDP, and it took three years before it was cleared. In 2008, the ratio was 365%, "without taking account of the pervasive use of derivatives". One hopes we have the means and the will to avoid a repeat of 1929-32. G.Soros, "*The game changer*", The Financial Times, January 29, 2009, p.10.

transfixed by the hegemonic model, epitomised by the fact that one Chicago economist could openly brag that he had personally trained a large proportion of the central bank directors of the world.

However, this is not the time for scorn. The interesting development is that the phoney war is over. There is no longer a fight between the pro-globalisation and anti-globalisation voices in what had become a tired dialogue of the deaf, to mix metaphors. The intellectual challenge is to identify the features of the globalisation model worth preserving and those that need to be reformed.

Essentially, a Polanyian Global Transformation is taking place. We have just passed through a period in which impediments to a global market society were eroded, strategically and deliberately. As Polanyi said of similar developments in the 19th and early 20th centuries, “*Laissez-faire was planned.*”⁹ In his terms, the globalisation era was one of ‘disembeddedness’, when the economy was largely outside the control of society. In the Polanyian framework, any attempt to create ‘self-regulating markets’ could not continue without bringing mounting dangers, social, economic and political. Insecurities and inequalities multiply, until a crisis occurs demanding a new system of protection, regulation and redistribution. That does not mean we should be deterministic and think a crisis will necessarily lead to a period of ‘re-embeddedness’, with moderated insecurities and inequalities. However, given the crisis, the challenge for economists and politicians is to sculpture new policies and institutions that will re-embed the economy in society. Whereas Polanyi was analysing the painful creation of national market economies – and was too teleological for comfort – today’s transformation is about the painful forging of a *global* market economy. We have yet to adapt to that paradigm shift.

In thinking of new policies, five further interpretative points, or premises, should be borne in mind.

First, the globalisation era was not one of deregulation. In the sphere of economic policy where I have most familiarity, namely the labour market, I can say with considerable confidence that more new regulations were introduced in the period than in any comparable period of

⁹ K.Polanyi, The Great Transformation: The Political and Economic Origins of Our Time (Boston, Mass., Beacon Press, 2001 edition). Polanyi’s book, originally published in 1944, should be required reading for all economics students as they seek out dusty copies of Keynes’ *General Theory*.

history.¹⁰ It was the nature of the regulations that changed. We have never had a period of deregulation.¹¹

One could say much the same about the role of the state and of government. It has not “shrunk”, as is commonly asserted. But it has undoubtedly changed. Fiscal and social security policy, for instance, have been transformed under the impact of globalisation and the neo-liberal model of economic reasoning, from being mildly progressive and solidaristic – thereby providing lower-income wage earners with dependable social protection – to being regressive and increasingly directional. The reduction in progressiveness has been rationalised by claims that greater incentives were needed for investors and merit-worthy individuals, who might go to other parts of the global market economy unless they were humoured.

The steady reduction in the social solidarity character of the welfare systems of most countries was rationalised by a desire to cut public social spending and a belief that in a well-functioning market economy unemployment was essentially voluntary, due to excessive protective regulations, “rigidities” and high reservation wages. Consequently, unemployment was seen increasingly as a consequence of personal failings. The shift to pervasive means-testing was followed by acknowledgement of poverty and unemployment “traps”, which was followed by tighter behavioural controls on those at or near the margins of the formal labour market.

Third, it would be folly if the new generation of policymakers tried to recreate the policies and institutions of some past “golden age” (sic). This is no time for atavism. History moves on. There were good reasons for dismantling the old social democratic architecture, even though for a period that had been a progressive and socially functional set of arrangements. The welfare state, in its various guises, was suited to an industrial society and a closed economy model. We now have a 21st century tertiary society and a system of increasingly open economies. Trying to opt for some sort of *de-globalisation* would be populist and doomed. We must move on, not wish for some imaginary past.

Fourth, while this is a transformative crisis rich with opportunity for improvement, it should be taken as obvious, and thus relatively uninteresting, that the national and international banking sector and financial markets should be regulated more effectively. This must involve

¹⁰ As I say to my students, anybody who thinks the period 1980-2000 was one of labour market deregulation should be encouraged to take up gardening instead, since they clearly do not know much about labour markets.

¹¹ One *might* argue that globalisation was an era of selective *anti-regulation*, in which many regulations were created but applied only selectively, usually for short-term political contingencies. This has continued. A recent case was the merger of Lloyds and HBOS, which might have been blocked by anti-trust competition regulations but which went through apparently because the Prime Minister opted to over-ride the rules, believing the merger to be in the national economic interest. Whatever the rights and wrongs of the merger, it was not the result of ‘de-regulation’.

international coordination, if only because financial liberalisation has made financial market integration a reality. A few decades ago, if one stock market declined investors could switch to another where ‘prices’ were rising. Then, by about 1980, movements on the US stock exchange were followed in the same direction by other stock exchanges in about 40% of the cases. Now, that happens in about 90% of the cases. This is merely an indicator of the extraordinary extent of global economic integration. It surely stretches credulity to imagine that this will be reversed.

Fifth, and most crucially of all, the crisis has emphatically punctured one of the presumptions of the globalisation model, that inequality does not matter. What has become far clearer is that there has been a maldistribution in economic security, for not only have earned incomes become more unequal but so have the sources of security.¹² Recent evidence has surely been enough to convince even hardened libertarians that inequality has a series of deleterious effects, bringing as it seems to do more anxiety, status frustration, stress and social illness for all groups in society, not just the poorest and most insecure.

The UK has achieved the unenviable status of having the third highest level of income inequality in the industrialised world, with the USA being the most unequal, followed by Portugal. A recent book has found that it is inequality rather than wealth that produces a high incidence of most of the social ills of society.¹³ The widening of income inequality in the UK since the 1980s was the greatest in the developed world, implying that the growth has been due in part to political decisions.

It has been said that part of the genius of Franklyn Roosevelt was his early recognition that the biggest problem in the Depression was the basic structural flaw in the economy that had produced a severe maldistribution of wealth, coupled with excessively low incomes and wages.¹⁴ It seems that Barack Obama has recognised that the biggest flaw in the globalisation model of market capitalism was its willing acceptance of rising income inequality. Income distribution is firmly back on the political agenda.

In the following, I will outline a policy that takes account of these contextual points. It is followed by a very brief review of some of the mainstream policies. In all cases, perhaps it would be appropriate to apply policy “stress tests”. All policies that are being sprung into action in the wake of an economic shock should be subject to critical scrutiny to determine whether they satisfy certain criteria. In the USA, the major banks are being sifted to determine eligibility

¹² Put bluntly: Wealthy members of society have access to more sources of income protection than low-income members.

¹³ R.Wilkinson and K.Pickett, The Spirit Level: Why More Equal Societies Almost Always do Better (London, Allen Lane, 2009).

¹⁴ A.F.Badger, FDR: The First Hundred Days (Hill and Wang, 2009).

for Federal assistance on the basis of stress tests. Government policies should be subject to similar quizzical gaze. The difficulty starts with deciding on the tests they should be required to pass. Perhaps the core questions should be:

- (1) Will the policy have a high probability of boosting aggregate demand in an ecologically sustainable manner?
- (2) Will the policy improve economic efficiency and resource allocation?
- (3) Will the policy have long-term inflationary consequences?
- (4) Will the policy be sustainable on the scale envisaged?
- (5) Will the policy reduce the extent of income inequality and poverty?
- (6) Will the policy advance positive as well as negative liberty, or restrict them by putting burdens and controls on some groups not applied to all others?

2. Stabilisation Grants as shock absorbers

If one accepts that this is the crisis point in the Global Transformation, then we need new forms of regulation, new forms of social protection and new forms of redistribution that are appropriate for a global market system. I will not try to outline those here.¹⁵ However, it does lead to the proposal I would like to make.

Bear in mind that the problem is systemic uncertainty, epitomised by a rising probability of economic volatility, insecurity and a widening functional income inequality. Citizens suffer stress and loss of wellbeing as a result, and consumption and investment are erratic and hyper-sensitive. In the circumstances, we need a stabiliser, not a recipe of cognitive behavioural therapy as the UK Government has just proposed to help the victims deal with their misery and anxiety, but an economic stabiliser that provides *ex ante basic security*. This should be a policy that acts quickly while also contributing to the solution of long-term structural problems thrown up the global market economy. To reiterate, to overcome systemic uncertainty, which is behind the decline of aggregate demand and the prospect of a Fisherian deflationary depression, a mechanism for providing *ex ante basic security* is needed. I believe the solution is quite easy, and in a few years time will be seen as such. However, it looks radical, and as such will entice the predictable reactions that Hirschman saw as the standard responses to any ‘new’ idea.¹⁶ I would urge those learning their economics, those practising economics and those commentating on economic policy to hold back on hasty judgment.

¹⁵ They were covered in my inaugural lecture, “Work *after* Globalisation: A progressive agenda”, University of Bath, May 28, 2009. They are also dealt with at greater length in G.Standing, Work *after* Globalisation: Building Occupational Citizenship (Cheltenham, Edward Elgar, 2009).

¹⁶ A.Hirschman, The Rhetoric of Reaction: Perversity, Futility, Jeopardy (Cambridge, Mass., Harvard University Press, 1991).

As far as possible, we need to *inoculate* the real economy (and its citizens) from the financial shenanigans. Because the primary problem is systemic uncertainty, there is a rising *ex ante* propensity to save and a falling *ex ante* propensity to invest, which through accelerator and multiplier effects, contributes to a cumulative decline in aggregate demand, made worse by a trend towards Fisherian deflation.¹⁷

So, how can we overcome or at least ameliorate the uncertainty? My proposal is that *every citizen should receive a monthly economic stabilisation grant*. Every person should be provided with an electronic ESG card, and be given a credit of, say, £30 a week in current circumstances.

Let us deal with the objections that such a proposal is bound to prompt, and then consider advantages of moving in this direction. Before doing either, it might be worth mentioning necessary conditions. It must be conceived as a stabilising device and as a means of responding to a inherent feature of the global economic system, its tendency to produce volatility. It must also be seen as a better basis for social protection in the emerging flexible labour market than old forms of social security conceived for an industrial society and much better than the highly paternalistic (if not coercive) policies currently in vogue for dealing with the unemployed. Furthermore, the monetary value of the ESG should be regarded as flexible and as a policy variable, just as interest rates are now.

There are likely to be five major objections. Let us consider them briefly.

First, it will be said that it is unaffordable. Roughly, a weekly credit payment of £30 would come to about £75 billion a year, or some 4% of GDP. This is the same as is being offered to the banking community in quantitative easing, merely as a first tranche.¹⁸ Moreover, the country – like most countries – is wallowing in government subsidies that are unjustifiable by any decent school of economics. Much of the money spent on those could be directed to market-strengthening and security strengthening stabilisation grants. The drawbacks of selective subsidies, most of which go directly or indirectly to relatively well-off individuals and firms, are reviewed briefly in the final section. Finally in this respect, while the ESGs should be universal and equal, to help in the legitimacy, transparency and ease of implementation, the money given to richer members of society could be clawed back in taxation, leaving the net cost well below the immediate cost.

¹⁷ Irving Fisher is back in fashion, even though he was spectacularly wrong in 1929 and impoverished himself in the process. His debt-deflation theory is creating an intellectual panic, understandably.

¹⁸ Actually, the IMF has estimated that that the UK had spent about a fifth of its GDP on bailing out the banking system by early 2009. This was much more than any other country; the second was Norway, which had spent 13.8%; the USA had spent 6.8%.

Another reason for believing that ESGs are affordable is that in the UK public debt as a percentage of GDP, at 58%, is significantly lower than in the USA (81%), Italy (102%), Germany (76%), France (72%) and Canada (63%).¹⁹ It would also seem to pass the IMF's proposed four-pillar stress test. The IMF in the paper just cited noted that the size of automatic stabilisers is smaller in the USA than in Europe because of the more limited array of state benefits. There are also grounds for believing that they have been shrinking in the USA and in Europe in recent years. We need better automatic economic stabilisers. The IMF argued, cogently, that a country's fiscal stimulus should be larger where the normal multiplier effects are lower, and in that respect noted that the USA and UK have relatively low multipliers.

A second likely objection is that ESGs would be giving something-for-nothing, and be likely to induce idleness. There are several retorts to this, including Tom Paine's remarkably modern argument laid out in 1795.²⁰ One is simply that many of the conventional policies have given something for nothing, and the mega-bail outs are being given largely to sectors and firms that have actually done harm in the recent past. But more germanely, the citizenry is being exposed to economic uncertainty that is unfair, since they cannot be expected to insure against the vagaries of the economic system. Moreover, we are constantly told that people want to work and are 'happy' when they are working. If that is the case, giving everybody basic security should at most induce only a tiny majority to be less hard-working than they otherwise would be. And that minority would scarcely be a drag on the economy, since they are likely to have low potential productivity. It would cost society much more in fiscal and other terms to seek to weed that minority out rather than just operate a universal rights-based scheme.

A third likely objection is that no such scheme has been introduced elsewhere, and therefore must be too radical and unrealistic. The retorts to this line should be loud and clear. First, we are being urged to think afresh. As Tim Geithner, the new US Treasury Secretary, pointed out on March 11, 2009, "*Lots of things that did not seem realistic in the past are not just realistic but compelling.*"²¹ He called for each G20 country to set a target of spending 2% of GDP in 2009 and in 2010 in fiscal stimulus. His companion in the White House, Larry Summers, has virtually pleaded for the same. The most transparent, easily-monitored, efficient and equitable way of doing this would be through economic stabilisation grants.

The ESGs would actually be far less 'radical' than seems at first glance. In the USA, as part of the Obama stimulus package, there are government-issued debit cards for food benefits.

¹⁹ International Monetary Fund, [The Size of the Fiscal Expansion: An analysis for the largest countries](http://www.imf.org) (Washington, DC, IMF, February 2009). www.imf.org

²⁰ One would like to think that President Obama's citing of Paine in his inauguration speech was prescient, although Paine was not mentioned by name.

²¹ Cited in Financial Times, March 12, 2009, p.6.

And the Obama ‘signature tax cut’ is the credit of up to \$500 for individuals and \$1000 for couples. This has been praised by the non-partisan Tax Policy Centre, which has pointed out that it was a measure that could be carried out quickly. It has criticised the measure because it gives to all groups. This is misplaced, since it would be easy to raise sales tax on luxury goods or raise income tax at the higher end to claw back the credit from the rich. A more substantive limitation of the Obama measure is that it only benefits tax payers, omitting the many outside the tax-paying mainstream. Before the Obama measure, Bush had introduced a one-off payment. It is generally agreed that this had little effect because it was a one-off rather than a coherent policy.

The problem with the Bush measure was that one-off tax rebates do not lead to a big jump in consumption spending: Only 30% of the rebate of mid-2008 was spent on consumption.²² The propensity to consume might be higher in 2009, because more people have run down savings or increased debt. But the important need is to make the payment modest and *continuing*, rather than a one-off ‘gift’.²³ People react more quickly and spend more if they perceive that a boost to income is “permanent”, rather than a one-off rebate. This is what would happen with economic stabilisation grants, which would be modest but continuing.²⁴

More generally, the ESG would merely continue with the long-established notion of an economic stabiliser. The problem is that the traditional instruments have ceased to be very effective.

A fourth objection might be that universal stabilisation grants would be inflationary. However, this is not really a major concern at the moment, since the fear confronting policymakers is deflation. In any case, the value of ESGs could be varied according to the state of demand and the economic pressures, just as interest rates are adjusted to respond to the state of the economy. And in many respects, what we are talking about is a reallocation of public spending, and cutting out selective subsidies.

A fifth objection is that ESGs would be distorted for political ends and thus become *populist*. Any monetary or fiscal policy can be distorted, and all are used for political ends, which is why monetary and fiscal policies are typically loosened in the run-up to general elections. However, the answer in this case would be to set up an independent Economic

²² The Economist, December 13, 2008, p.54.

²³ As one observer said of the Obama measure, “A higher share of the tax credit is likelier to be spent than last year’s rebate because it is paid out in increments rather than in one lump sum.” Len Burman, head of the Tax Policy Centre in Washington, February 2, 2009 (FT 4/2/9).

²⁴ This is one reason for arguing in favour of small continuing grants rather than any lump-sum ‘capital’ transfers, since the latter involve ‘weakness-of-will’ effects rather than longer-term rational behaviour. For a development of this argument, see my paper in E. Olin Wright (ed.), Redesigning Distribution: Basic Income and Stakeholder Grants as Cornerstones for an Egalitarian Capitalism (London and New York, Verso, 2006).

Stabilisation Policy Committee, analogous to the Bank of England's Monetary Policy Committee. Just as the MPC meets regularly to decide on changes in interest rates and quantitative easing, so the ESPC could sit regularly to decide whether the ESG rate should be modified up or down.

What about the advantages of an ESG scheme?

First, one could see that it would be transparent and relatively easy to implement. Most if not all alternatives have large leakages, high administrative costs and would take long to implement.

Second, ESGs would boost aggregate demand more efficiently and more equitably than the more orthodox route of selective industrial or employment subsidies. They would go primarily to people who have a high average and marginal propensity to consume.

In this regard, unemployment benefits have been touted as a sensible form of stabilisation spending. Undoubtedly, raising unemployment benefits would have positive effects, and in the USA the reforms to UB will have the triple benefit of helping the unemployed to survive, helping them pay for healthcare and helping them to hold on to their dwellings.²⁵ However, as argued later, advocates should be more realistic about their macro-economic potential and their distributional implications in the flexible open labour markets of today.

Third, and most importantly, ESGs would begin to redress what should be regarded as the biggest failing of the neo-liberal model of globalisation, namely income inequality. The introduction of ESGs would address the most worrying aspect of that inequality, the lack of economic security among lower-income groups who could be plunged into a cycle of impoverishment following the slightest shock or even changes in interest rates.²⁶

Fourth, a hidden set of advantages would flow from the ESG route. Having basic security is known to induce more rational decision making, so that, for instance, workers would be more inclined to invest in skill acquisition. Psychologists and others have shown that security induces

²⁵ This was the argument made by Joseph Stiglitz (among others) for preferring this to tax cuts. J.Stiglitz, "*Do not squander America's stimulus on tax cuts*", Comment, The Financial Times, January 16, 2009, p.9. He claimed that "*increased unemployment benefits have the largest multiplier effects – cash-strapped families spend every cent given – and meet vital social needs.*" He conspicuously ignored the moral hazards of giving special assistance to people because they are in a particular condition, and the fact that only a third of the American unemployed receive unemployment benefits.

²⁶ Consider the rather typical and topical case of an elderly couple who have put away savings to earn interest to pay for their nursing home care. They did as they were advised by economists and governments. Now they cannot increase their savings to compensate for the very low interest rates. They will have to run down the savings until a day of reckoning arrives when they have run out, which may precipitate a more final one. In present circumstances, one must just hope the cavalry, in the form of economic revival, arrives in time.

more people to display more tolerance and altruism, and “social responsibility”, helping others and welcoming strangers, precisely the traits that seem in short supply as a result of the breakdown of traditional networks of support and social solidarity, much of which is linked to the policies pursued in the neo-liberal model.²⁷ The use of universal grants to give everybody a greater sense of economic security would strengthen communities and help in giving confidence that would engender more local investment, pride and responsible behaviour. Having basic security would also induce more people to feel less stressed and frenetic – two of the deepest malaises of the consumerism that globalisation has encouraged. We can have too much security, but as a society we are far from that malaise at present.

In sum, economic stabilisation grants would help in making the market economy function more effectively and equitably. They would modestly help in reducing the growing income inequality. And they would help stabilise a system that is inherently unstable. One just hopes that the Government set up a group to consider the practicality of such a scheme. They have surely nothing to lose, and potentially a lot to gain.

3. Conventional Policy Alternatives

While this paper is about a policy proposal that would fit a global economic system with a highly flexible labour market and a systematic proneness to volatility, insecurity and inequality, let us be clear about what is actually taking place. I will be polemically blunt, before very briefly considering the main policy lines that have been proposed or implemented.

From the sidelines, as an economist and citizen observer, it appears that we have a lot of headless chickens running around the hen-yard. With their heads, they had designed or operated a system that has collapsed. Like chickens that have just lost their head, they are briefly running around before dropping into what we should hope will be a quiet retirement. A little silence from them would not go amiss.

Meanwhile, the global crisis is taking its toll of many, many millions of people’s lives, in factories, offices, farms, homes and shops. Citizens are encouraged to scowl at a token handful of individuals. Governments are desperate to keep failed institutions alive, and are prepared to suspend all their past reasoning in the quest to rescue them. If you were a real neo-liberal, you should presumably rule out rescue plans. Let the market do its job! What the current ‘plans’ imply is a new depth to the notion of moral hazard.

Far be it for me, a progressive economist, to say ‘good riddance’, although I feel the governance failure of shareholder capitalism should be punished more severely than it has been,

²⁷ For instance, the shift to means-testing and ‘targeting’ of social assistance, which has been strongly advocated in the neo-liberal model, has been linked to the spread of xenophobia and anti-migrant sentiment. See, for instance, G. Dench, K. Gavron and M. Young, The New East End, (London, Profile Books, 2006).

and that the future of global capitalism requires it to be punished in order to restore its credibility. Let us leave that to the conscience of those who claim to believe in the old model. Let us instead consider what seem to be the mainstream responses.

A. *Quantitative easing*

Clearly, the Government and the Bank of England are placing great faith in ‘quantitative easing’, a rather ungainly term for increasing the money supply. Clearly, it has been necessary. Quantitative easing is not a policy, it is a *reaction*. It was introduced by a group whose policy position had imploded. That surely cannot fill economists with confidence that the reaction has been thought through thoroughly.

Of course, the policy is being pursued elsewhere as well. Amusingly, Ben Bananke, the Federal Reserve Chairman, when advocating quantitative easing, referred to the metaphor of dropping money from helicopters, drawing from a famous essay of Milton Friedman and promptly earning himself the nickname of “Helicopter Ben”.

The intention of quantitative easing is to reduce the cost of borrowing and boost investment, partly by injecting a boost to confidence, in a context where interest rates were already practically zero. However, the amount is less than the headline total implies, for the initial £50 billion will be incorporated into the head-line total of £75 billion. So, the fanfare about £75 billion on March 5 was exaggerated. Nevertheless, the authorities are committed to a substantial creation of money.

There is historical evidence to support the general idea. Milton Friedman, in his book The Great Contraction, concluded that the Federal Reserve’s resort to quantitative easing after 1932, through purchasing Treasury bonds to keep yields low, was vital in dragging the US economy out of the Depression.

A downside of quantitative easing is that it further penalises savers, giving a twist to the notion of the liquidity trap. Cutting interest rates, and feeding money onto the path of borrowers, means that those who have saved for their retirement or to supplement low earnings, have a lower income flow and must run down their capital (savings). Since savers numerically outnumber borrowers in society by about six to one, this means the policy is *prima facie* inegalitarian. Savers have done nothing wrong, except to follow what successive governments and the mainstream economics community have urged them to do over the past two decades. The IMF, World Bank, OECD and numerous economists eulogised ‘private savings accounts’ and defined-contribution private pensions. Now those who went along with the dictates of that policy are to be penalised. Quantitative easing may help them in the medium term – for those who live that long – if it lifts economic activity. But the combination of zero real interest rates and an inflationary injection of money going to others, surely cannot make ordinary savers feel more secure.

There is also an underlying problem with quantitative easing. It is a reaction to a systemic lack of confidence, which may be exacerbated by lurches in policy. The European Economic Advisory Group declared in its 2009 Report on the European Economy that “*there is even the possibility that large interventions paradoxically exacerbate the fall in consumer and business confidence, by conveying the message that the crisis is far worse than expected*”. By contrast, stabilisation grants would have the effect of offering a mechanism for long-term stability and basic economic security.

In general, there is a rising constraint to the use of monetary policy to respond to the financial crisis, which is that interest rates have already been pushed to nearly zero, making it impractical to lower them to boost demand, especially as some economists have estimated that it would need to be negative to boost it. This is the essence of the Keynesian ‘liquidity trap’. There is also a problem with trying to adjust monetary policy in a hyper-active way, which Keynes identified: “*A large increase in the quantity of money may cause so much uncertainty about the future that liquidity preferences due to the precautionary motive may be strengthened.*” As The Economist concluded, “*people (and banks) may cling to cash more tightly if they are spooked*”.²⁸ There is something ‘spooky’ about quantitative easing. Somehow, it does not suggest that it is a policy addressing the problem, rather than a major symptom of it.

Andrew Haldane, the Bank of England’s executive director for financial stability, has recently said that banks did not understand the risks they were taking, which makes one wonder what the Bank did to make them understand or make them act as if they did. He cannot be blamed, for he only took up his position in January 2009. Anyhow, in an fascinating paper, he argues that the banks failed the ‘stress test’ of accounting for risk, by a mixture of “*disaster myopia*” (a tendency to underestimate risks), lack of awareness of “*network externalities*” (spillovers from one institution to another) and “*misaligned incentives*”.²⁹ One feels like metaphorically holding up one’s hands and asking whether this is the time to be putting great faith in the financial sector to revive the economy.

In short, monetary policy is an unreliable weapon in circumstances in which the primary problem is systemic uncertainty. It is one argument for economic stabilisation grants, which would feed liquidity into the economy while reducing the underlying uncertainty about the future, the essence of insecurity. It thus would help boost consumer spending, partly by reducing the *ex ante* propensity to save because of systemic uncertainty.

²⁸ The Economist, January 31, 2009, p.74.

²⁹ A.G.Haldane, “*Why banks failed the stress test*”, speech given at the Marcus-Evans Conference on Stress-Testing, February 9-10, 2009.

B. Subsidies

One policy that has become surprisingly popular is the greater use of selective subsidies. A typical argument is that in conditions of general collapse of demand, one should subsidise firms that are ‘otherwise viable’ until conditions recover. And governments are quietly making liquidity and other forms of support for banks conditional on their increased focus on domestic lending.³⁰

The world is in danger of slipping rapidly into an era of *subsidy protectionism*. The drift to protectionism has been misunderstood by some commentators. Thus, rather sanguinely, the Wall Street Journal (no doubt occasionally contemplating a change in title) stated in an editorial on March 5 that, by comparison with the 1930s, it is “*harder to be protectionist in the modern world*”, due to the existence of the WTO and EU law saying that all workers in the EU have legislatively protected rights.

This neglected the spreading use of subsidies in increasingly clever guises. Indeed, it is disingenuous to suggest that tax credits are not protectionist because they are not targeted on selected sectors. They effectively subsidise many labour-intensive sectors that tend to be among the low-paying sectors, thus reducing the cost of domestic production and making it harder for imports to compete. They are thereby trade distorting. The US Earned Income Tax Credit and its type of policy will eventually come up before the WTO.

Consider a few common policies, just as a matter of economic fact. Guaranteeing lending is a subsidy to lenders and to borrowers. It increases moral hazards – primarily, a lack of due care, because it reduces the cost of faulty decisions.

As part of its economic stimulus, the German Government, from January 14, 2009, allocated E1.5 billion for certificates each worth E2,500 (c.£2,360) for those who scrapped cars that were at least nine years old and who bought a new or almost new car. This boosted car sales sharply. In France, the Government introduced a bonus of E1,000 in December 2008 for people scrapping a car that was at least 10 years old and replacing it with a new vehicle with carbon dioxide emissions of less than 160 g/km. Car sales rose.

The UK has been urged to do something similar; it probably will. Meanwhile, it is only recently that Japan was furious about the US bail-out of its car manufacturers, since the Detroit giants had been uncompetitive with Japanese firms. The US authorities had lectured Japan on its ‘statist’ policies over the years. The US planned a \$25 billion bail-out. Japan responded by launching a subsidy scheme of its own, albeit convoluted, enabling banks to buy shares in

³⁰ J. Warner, “*Depression and the protectionist threat*”, The Independent, March 11, 2009.

strategically important firms. And so the tendency will rumble on, with one country after another complaining and resorting to similar tactics, defensively.

In this country, the Conservatives have proposed that firms should be given tax cuts for taking on extra workers. The Government has announced some “golden hallos”, which start in April 2009. The Conservative plan would give out £2.6 billion and they claim that this would create 350,000 jobs over the following year. Their estimates deserve scrutiny.

Another currently popular subsidy policy is wage assistance for short-time working as an alternative to redundancy. The scope for moral and immoral hazards with such measures is enormous. But it apparently has appeal. As one commentator put it,

“For countries with relatively high levels of social security benefit, it makes some sense. Paying workers to do nothing but to be ready to reapply themselves when the economy picks up may seem preferable to paying them dole and having their skills lost for ever to the ranks of the long-term unemployed.”³¹

An economist should be more sceptical. The experience of keeping workers on the books in the unwinding Soviet Union had disastrous consequences, as it did in China in the late 1990s. People kept idle on an enterprise’s books are less likely to acquire skills that might be needed in any pick up, and may actually become more prone to social illnesses than those who are obliged to come to terms with new economic realities while they still have the energies and savings.

Nevertheless, one increasingly popular reaction is for firms to put employees on short-time, and then lobby government for a top-up wage subsidy, as has been done in the Netherlands, where the Government agrees to pay most of the wages for a short period if workers are put on a three-day or four-day week. In the UK, this has been urged by union leaders such as Tony Woodley, joint general secretary of Unite, who has said it would be “the best way forward”.

Hardly. It would be impossible for governments to adhere to principles of justice and economic rationality if they opt for this strategy. All selective subsidies invite moral and immoral hazards. In this case, for instance, companies under pressure would be encouraged to take the easy option, putting workers on short-time and taking a subsidy, when they might otherwise take other actions that would prepare them for restructuring to take advantage of any upturn. Most subsidies fail the inequality stress test, tending to benefit median-income earners, while not assisting the poorest or least advantaged. And, if a government supports one sector it would be under tremendous pressure to support others as well.

The world is awash with subsidies, and we are likely to see many more. Even before the financial meltdown, there was a burgeoning ‘subsidising state’; now we are in danger of seeing a

³¹ Warner, March 11, 2009, op.cit.

rush to subsidy protectionism. Ironically, while the extent of special subsidies given to large-scale corporations in rich industrialised countries has been very large, it is even larger in proportionate terms in developing countries. By the turn of the century, subsidies to firms accounted for about 4% of global GDP, and in developing countries they may have comprised over 6% of GDP, or about a third of total government expenditure.³²

Subsidies have five common failings. They are cumbersome and costly to administer. They encourage and reward inefficiency. They induce huge *substitution effects*. They have major *deadweight effects*. And they are usually inequitable and regressive, often in ways that are concealed.

Perhaps the main subsidy that will be given more emphasis in the coming months is a *marginal employment subsidy*. Many economists have argued in favour of this, the leading advocate being the Nobel Prize winner, Edmund Phelps.³³ These are inherently inefficient, and contribute to protectionism via the backdoor. They have a huge *deadweight effect*, in that money goes to support many jobs that would have been created anyhow. One evaluation of a marginal employment subsidy scheme in Ireland found that it had a 93% deadweight effect. In other words, over nine in ten of the jobs receiving the subsidy would have been generated anyhow. Schemes of this sort tend to produce *immoral hazards*. One is what I have called *auntie effects*. Suddenly, auntie is employed, at a very low wage no doubt, and an application is in the post to obtain the subsidy.³⁴

Another drawback is the sheer unfairness of subsidies given for new jobs. Why should a firm that expands now be given a subsidy when another has been providing jobs for many years? After all, if the subsidy works as claimed, it will lower the cost of production for the newer firm, thus undermining the position of the older firm. It may even jeopardise the survival prospects of the older firm, which might actually be the more productive. This would be neither fair nor economically sensible.

Subsidies benefit middle-income and higher-income groups disproportionately. Paradoxically, the *leakages* are notoriously high. In other words, the boost to aggregate demand

³² C. Van Beers and A. de Moor, *Public Subsidies and Policy Failures* (Northampton, Edward Elgar, 2001). See also W. Ascher: *Why Governments Waste Natural Resources: Policy Failures in Developing Countries* (Baltimore, Johns Hopkins University Press, 1999); N. Myers and J. Kent: *Perverse Subsidies: How Tax Dollars can Undercut the Environment and the Economy* (London, Island Press, 2001).

³³ See, for example, E. Phelps, *Rewarding Work: How to Restore Participation and Self-Support to Free Enterprise* (Cambridge, Mass., Harvard University Press, 1997); for a critique, see G. Standing, *Beyond the New Paternalism: Basic Security as Equality* (London, Verso, 2002), chapter 9.

³⁴ An advocate of these schemes will be inclined to retort that aunties should be excluded. This prompts recollection of the famous Monty Python sketch of the bookshop and the book containing the gannet.

is much less than implied by the sum spent on them, partly because many of the recipients have a relatively low average and marginal propensity to consume and spend, and partly because this group has an above-average propensity to spend on imported goods and foreign services. So, to give a net boost to the national economy, the gross sum must be much larger. If, by contrast, the money was distributed in the form of economic stabilisation grants, it would be reasonable to expect that the overall propensity to spend would be larger and the propensity to spend on local goods and services would be higher, since lower-income groups have a higher average and marginal propensity to spend and tend to devote more of their spending to local goods and services.

Among the new subsidy schemes is one introduced by the Welsh Assembly to support jobs in small and medium-sized enterprises. Why should firms that have served their communities well over several generations and reached a 'large' size be penalised relative to newcomers who have not? In the Netherlands, a wage subsidy has been introduced for firms if they have suffered at least 30% sales decline over two months. This obviously penalises firms that have had a slower rate of decline, and could induce firms to make sure their sales decline passes the 30% threshold.

In sum, this is the ideal time to induce a major reassessment of subsidies. They are a bane of the age, economically speaking. It is time for some consistency in the economics fraternity. Let us have a campaign to curb the global economy of subsidies, everywhere. Mainstream economists should have been more critical of subsidies than they have been. Now, we should urge the G20 leaders to organise a high-level international assessment of the efficacy of subsidies. It may seem minor in global terms, but this would be one useful output from the G20 April meeting in London.

B. Active labour market policy

Particularly in a recession, a great deal of hope is placed in so-called active labour market policy. This is expected to boost employment, raise productivity, increase social mobility, strengthen social inclusion and reduce income inequality. More recently, its advocates have given the assurance that it will make people more 'happy'.

Policymakers like the sound of *active* labour market policy; it sounds macho, compared with its perceived opposite of *passive*.³⁵ Perceptions are coloured, because most of those who do econometric and other research on its various aspects are keen supporters. However, its current popularity amounts to the triumph of hope over experience.

³⁵ This writer believes the more policy is passive the better. For an irreverent critique of active policy and other euphemisms, see G.Standing, "*Social protection*", *Development in Practice*, Vol.17, Nos.4-5, Aug.2007, pp.511-22.

Recently, David Blanchflower, then a member of the Bank of England's Monetary Policy Committee, and one who had gained credibility for having forecast a financial setback, argued in favour of active labour policy. Because of his position and because his voice is likely to be influential, I will concentrate my remarks on his paper.³⁶

He begins by recalling the quip by Jim Heckman, the US Nobel Prize winning economist, who said in response to a question about how much labour market training schemes had helped the unemployed, "*Zero is not a bad number.*" Blanchflower then notes findings showing how subsidised employment schemes had been inefficient, even to the extent of having a negative effect on the long-term incomes of recipients.³⁷ I have argued the same over the past decade. What is hard to understand is how one leaps from such findings to advocating more active labour market policy. Blanchflower does so by citing recent research suggesting that participation in one scheme modestly raised the participants' probability of employment, and a study suggesting that those who participated in the New Deal for Lone Parents (NDLP) spent less time on benefits than those who did not.³⁸ He did not cite any other finding or argument.

The problem is that the arguments are irrelevant in macro-economic terms. They ignore the probability of large substitution and deadweight effects. The fact that those given more help than others do better than others does not mean that everybody does better. It is surely desirable to give help to those with intrinsic disadvantages. But this does not mean that the policy is advantageous as a macro-economic device. Perhaps it is, but Blanchflower gives no reason for thinking that such policies would generate more employment or economic growth (let alone happiness).

The main question for policymakers can be put bluntly: Would selective 'active labour market policy' have a greater or better effect on aggregate demand and economic security than

³⁶ Economics students should read it, since he is a deservedly well-respected economist.

³⁷ D.Blanchflower, "What should be done about rising unemployment in the UK?", Open lecture, University of Sterling, February 25, 2009. <http://www.bankofengland.co.uk/publications/speeches/2009/speech379.pdf>. The original research was: Dolton et al, 1994, showing that participation in an active scheme had lowered the probability of *subsequent* employment, and Green et al, 1996, showing that being in a scheme had a negative effect on *subsequent* income. P.Dolton, G.Makepeace and J.Treble, "*The Youth Training Scheme and the school-to-work transition*", *Oxford Economic Papers*, 46, 1994, pp.629-57; F.Green, M.Hoskings and S.Montgomery, "*The effects of company training, further education and the Youth Training Scheme on the earnings of young employees*", *Oxford Bulletin of Economics and Statistics*, 58, 1996, pp.469-88.

³⁸ Respectively, R.Blundell, M.C.Dias, C.Meghir and J.Van Reenen, "*Evaluating the employment impact of a mandatory job search assistance program*" (London, Institute for Fiscal Studies, Working Paper 01/20, 2001); I.Beale, C.Bloss and A.Thomas, "*The longer-term impact of the New Deal for Young People*" (London, Department for Work and Pensions Working Paper, No.23, 2008). For a more recent article, see P.Gregg, S.Harkness and S.Smith, "*Welfare reform and lone parents in the UK*", *The Economic Journal*, 119, February 2009, pp.F38-F65.

alternative, more ‘passive’ policies? In sticking with the orthodox belief in selective state-led active policies, Blanchflower implies that it does. He gives no evidence to support that presumption.

In the wake of the crisis, reconsideration of labour market policy should start from a fresh analysis of the changing character of the labour market and the changes that have reshaped policies dealing with labour market phenomena. Conventional labour market indicators point to a dire prospect in the UK, as Blanchflower documented. Unemployment is rising steeply, and wage freezes and cuts are becoming common. My expectation is that more of the decline in labour demand will be disguised in higher under-employment, thus curbing the rise in unemployment rate. This is one reason for arguing that it would be inappropriate to rely heavily on raising unemployment benefits (or jobseeker allowances) as an economic stabiliser. If emphasis were placed on that, it would give employers and employees an incentive to opt for redundancies rather than involuntary part-time employment.

The rise in unemployment lags economic shocks by some months. So, even if current projections (aka wishful thinking) of an economic upturn in 2010 were to be realised – and I am among the sceptics – then unemployment could be expected to peak in late 2010, at the earliest. We should also note that the already widely-cited study by Reinhart and Rogoff found that the rise in unemployment tends to be particularly large following financial market crises.³⁹

That issue aside it will be important not to focus too much on the headline count of unemployed. It is no longer a good indicator of the state of the labour market, let alone the extent of economic insecurity.

It may seem trite to say so, but the policy proposals we make should correspond to the nature of the labour market and the nature of the “class” structure, both of which are very different now from what typified the pre-globalisation era. The most immediately relevant aspects are that, first, a majority who labour and work are essentially detached from the old forms of state and enterprise benefits and, second, that the main group to have emerged is a global *precariat*. Policymakers and politicians would be well-advised to address the needs and aspirations of the latter, since its members may be the new ‘dangerous class’, the group most inclined to take to the streets or vote for right-wing extremists, as similar groups did in the 1930s. It should not go forgotten that youth demonstrations and riots have escalated in Greece, France and Italy already. Those aged 15 to 24 make up more than a third of all those in short-term jobs in Europe, even though this age group makes up only 10% of the Eurozone’s labour force.

³⁹ Reinhart and Rogoff, 2009, op.cit.

The problem is that the old economic stabilisers, such as unemployment benefits, do not reach the precariat. Many are in temporary or shadow-economy labour and do not qualify for state benefits. Many are immigrants or young labour force participants. Partly as a result of labour liberalisation in the globalisation era, many millions have joined the precariat. And they are the group being hardest hit by the global recession. Eurostat has estimated that short-term employees account for about 17% of all employees in the Eurozone. Since many people in the labour market margins are unregistered for various reasons, one would not be surprised if the actual share was well over 20%. On top of that, one should add all those counted as “self-employed” or “independent labour contractors”, groups plunging labour law into extraordinary confusion.

The precariat will bear the brunt of dis-employment. For instance, in Spain the number of officially recorded temporary workers fell by 12.7% between the last quarter of 2007 and the last quarter of 2008. In the USA, the number in temporary jobs fell by nearly 25% between February 2008 and February 2009, at a time when total employment fell by 3%.

A point here is that by comparison with the welfare-state era, while a major recession is likely to see a rapid decline in employment (even by comparison with the last recession, in 2001), much of the real decline will not show up in official statistics. At the same time, more of those in so-called ‘permanent’, or regular, employment contracts will be put on some form of short-time. This makes it questionable whether altering the level of unemployment benefits and increasing the duration of entitlement will do much as an economic stabiliser. There are reasons for doing both, but policymakers should not see this route as an effective economic stabiliser. For instance, in Germany a worker has to be in full-time employment for at least a year before becoming eligible for full unemployment benefits. In almost all industrialized countries, only a minority of the unemployed qualifies for and receives unemployment benefits. In effect, raising unemployment benefits may increase open unemployment and cause more seething among the precariat. This comment should not be interpreted as hostility to higher and longer benefits, merely as a reminder of the limitations of this route.

It is no news to state that the labour force of Europe and elsewhere has become more stratified than used to be the case. Now that we have entered a global recessionary phase, barriers to social mobility may become a greater source of social discontent. It is likely that the current popular anger directed at “fat cats” will lead to more demand for income redistribution. A virtue of going in the direction of economic stabilisation grants would be that they would help reduce income inequality and do so in a way that would give governments time to devise methods of moderating earned income inequality compatible with a dynamic market economy. The fact is that in a global market economy, the long-term trend is for the functional income distribution to become more unequal, so that over the longer term owners of capital will earn more relative to those who rely on labour income. That issue will have to be tackled at international level and by designing ways of sharing capital income without disrupting economic dynamism. To do that

effectively will take time. In the meantime, ESGs would moderate the inequality while enhancing economic security and helping the market economy to revive.

C. Industrial policy

Selective *industrial policy* is essentially a special form of subsidy policy. Basically, it amounts to identifying and chasing winners. It has been tried in many places at many times. It has failed. The Economist recently warned against it, recognising that manufacturing and export sectors have been among the hardest hit by the financial crisis.

Superficially, industrial policy always appeals to politicians because propping up jobs in sectors hit by a collapse of demand can be depicted as aiding constituents and voters. This is being done, and should not be done. It will contribute to the drift to subsidy protectionism.

We know that manufacturing has been particularly hard hit. But it should not be forgotten that actually this is merely accelerating the global de-industrialisation and global restructuring that has been taking place over the past two decades.⁴⁰ Globally, there will be fewer manufacturing jobs after this recession-cum-depression. Understandably, the crisis-induced recession and decline in employment have been more severe in countries that were relatively dependent on manufacturing exports, which ironically were depending on consumers in countries running current account deficits. Thus, Germany, Taiwan, Japan and Singapore have been hit very hard, along with Brazil, Malaysia, Turkey and southern China.

Now, we have a lot of special pleading, led by those myopic car manufacturers. Sectoral aid may prop up some manufacturing plants. But this will merely accentuate subsidy protectionism, as one country after the other does the same. Identifying which firms or sectors to subsidise and which to let decline will be arbitrary and inequitable. It could even weaken those sectors that are otherwise economically viable, and it will slow down the desirable reallocation of resources, including skilled managers and workers, from sectors that have no long-term future and those that would promise renewed growth in the medium term.⁴¹

One of the lessons of the crisis of the 1970s was that ‘selective industrial policy’ is like pouring money down selected drains, holding up necessary restructuring while fuelling inflationary pressures. It is unlikely to be any different in the near future.

D. Public works

⁴⁰ It is insufficiently appreciated that in spite of high rates of economic growth over a sustained period, ‘Chindia’ has not been generating large numbers of manufacturing jobs. The share in manufacturing has also declined.

⁴¹ I agree with The Economist. “*Leaders: The collapse of manufacturing*”, The Economist, Feb.21, 2009, p.11.

In every recession there is a lobby for *public works*, and usually this is fuelled by misty recollections of Roosevelt's New Deal. This global depression is certainly no exception. A recent advocate in the UK is Will Hutton.⁴² In this regard, one should differentiate between *infrastructural investment*, perhaps induced by deficit spending, and *public works*, the latter being primarily to absorb some of the unemployed. Infrastructural investment is undoubtedly required, particularly in the United States, where decay is palpable. The 'green' agenda is well-timed in this respect. But we should recognise that most of these initiatives are – and should be – slow working, in that they require proper planning and careful administration. When used in a recession, those basics tend to be neglected. It should also be recalled that Japan failed to kick start its economy via an infrastructure-based stimulus.

In any case, the case for public works is not so clear cut. Several countries have already resorted to them. The Spanish Government, for example, has placed a big emphasis on public works as its response to the crisis, planning an expenditure of E10 billion. The USA – not unexpectedly given its romantic adherence to the derring-do of the New Deal – has gone in the same direction. It will be recalled that the Eisenhower public works that President Obama cited with such enthusiasm when he launched the new package on February 17 in Denver, took three times as long as anticipated to roll out. The problem is that it is very hard to spend fast and to spend well at the same time.

As well as being slow, public works tend to crowd out private spending, and have high deadweight and substitution effects that, as with subsidies, make the net effect for the economy much less than their advocates believe.

One tendency displayed by the public works lobby is to slip effortlessly from saying that people 'want to work' to saying 'jobs raise the spirit', so justifying public works. Many jobs do not raise the spirit, and it ill-becomes middle-class writers to presume that people's spirits are lifted by having to labour on building sites, in sewers or in dead-end jobs that they want to leave as soon as possible. There is also a regrettable tendency to be selective, pointing out some outcome of 'beauty' as if most of the labour done in most public works are matters of joy and beauty. If there is to be a major public works programme, all adults should be involved in some way, as a sort of community service. Otherwise, the policy looks like an unedifying exercise in paternalism.

E. Paternalism, Nudges and Therapy

Finally, there is a generic danger that should not be overlooked in the rush to new policies. The creeping tendency of Third Wayism's response to globalisation has been to make the state more *paternalistic*. In other words, there has been a tendency to treat the symptoms rather than

⁴² W.Hutton, "We can replicate the beauty that came from the Depression", The Observer, February 8, 2009.

the causes of economic and social malaise. Social policy is being reshaped in order to reshape people. There is a state-sponsored spread of cognitive behavioural therapy (CBT). If a person becomes unemployed, he or she must be retooled and reshaped to behave according to norms. And so on. It was so predictable that the Government would rush out a policy of providing CBT for those made anxious by the recession. It duly did so in March, 2009. Make an appointment soon, since the queue might be long.

More generally, we are told that the market society throws up too many options, and therefore a kindly regulator will 'nudge' us to make the "right choices", by altering opt-in, opt-out schemes, altering incentives and making selective use of information.⁴³ This is not an exaggeration, for the new "behavioural economics" openly advocates this approach. It goes under the name of "libertarian paternalism" (which would have struck John Stuart Mill as an oxymoron).

In every major economic crisis, new personal adjustment institutions, professions and policies have emerged. In this electronically-driven age, the threat they pose should not be a matter for footnotes. They go to the heart of the new "behavioural economics" that is sweeping the economics profession, albeit being led by lawyers and psychologists. It would take a much longer paper than this to do justice to the relevance for the response to the global economic crisis of 2009. However, I will merely say that a policy of Economic Stabilisation Grants would help a little in holding back the state nudge.⁴⁴

4. Concluding Thoughts

The currently much-cited Harvard economist, and former IMF economist, Ken Rogoff, said recently, "*Europe faces a plain vanilla recession. It is a deep recession and it's coming with a vengeance. But it is not a paradigm destruction.*"⁴⁵ The respected Financial Times journalist, Phillip Stephens, has written much the same, asserting, "*Forget the guff about new paradigms.*"⁴⁶ His targets were economists who were re-inventing themselves, having earlier said that the times of boom and bust were past. Unfortunately, he overstates his case. There is a serious case for believing this is a transformative crisis. The world will not look or be the same afterwards.

⁴³ R.Thaler and C. Sunstein, *Nudge: Improving Decisions About Health, Wealth and Happiness*, (New Haven, Yale University Press, 2008). Cass Sunstein has just been appointed the 'regulatory czar' in the White House.

⁴⁴ This will be covered in my inaugural. See, also, G.Standing, Work after Globalisation: Building Occupational Citizenship (Cheltenham, Edward Elgar, 2009 forthcoming).

⁴⁵ Quoted in K.Bennhold, "*Is Europe's welfare system a model for the 21st century?*", International Herald Tribune, January 27, 2009.

⁴⁶ P.Stephens, "*Averting a slump: it's the politics, stupid*", Financial Times, February 3, 2009, p.9.

Major crises lead to major changes. None of us can be certain what will come of this one. Some of us hope and believe that a more just and gentler form of market economy will emerge. We must all earnestly hope that comes sooner rather than later, rather than after a ghastly period of political tension and extremism of right or left.

By contrast with many lesser commentators, Sam Brittan is an optimist. He believes that *“the recession will be over sooner than you think”*, taking his lead from an article of that title. He cites the decline in measures of stock market uncertainty. He also has an “intuition” that the USA will recover before other major economies, partly because *“the US is admirably free of concerns about budget and balance of payments deficits and Federal Reserve “printing of money”*.⁴⁷ I agree with his latter view, and hope he is right on the former one. Sadly, I think he is being too sanguine. It will take time to replace the old model. The lesson of paradigm change, as Thomas Kuhn taught us, is that a paradigm breaks down when it cannot answer the questions being raised and cannot offer answers within its logic. But it is only displaced when a new paradigm is ready to take its place.

I believe that the paradigm shift will not be back towards the old European ‘social model’, because in an open economy system labourist forms of social insurance would merely raise labour costs, induce unsustainable rigidities and erode competitiveness. Economic security must be promoted outside the labour sphere. That will be part of the paradigm shift.

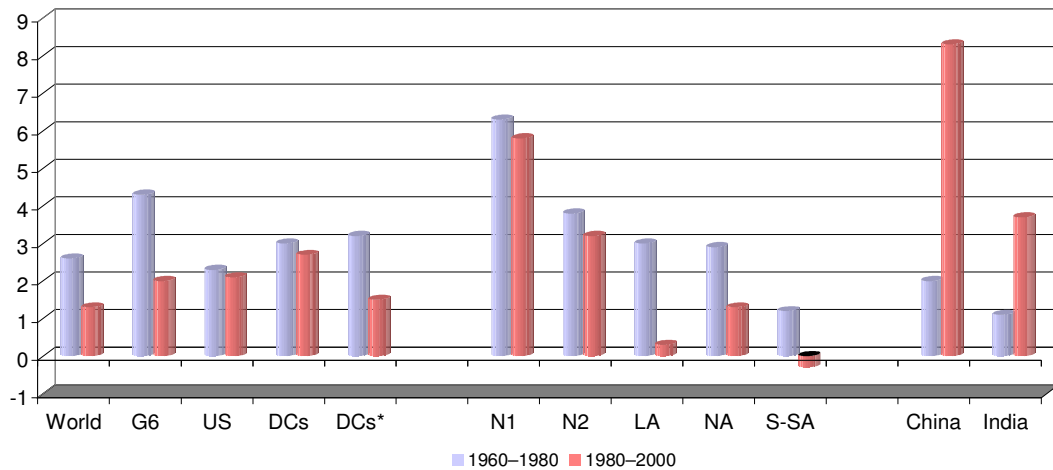
One modest recommendation is that the emerging generation of economists and social policy students should urge their peers, and particularly the political leaders, to match their rhetoric about being ‘radical’ by assessing genuinely radical ideas. Economics is a constantly unfolding body of thought, and we should see a demand on those charged with implementing economic and social policy to think afresh and commission serious evaluations of alternatives. Who knows, but perhaps the easiest way out is through the door. Usually, it is.

⁴⁷ S.Brittan, *“It seems that not all recessions are created equal”*, Financial Times, March 13, 2009, p.11.

Appendix: Globalisation brought economic volatility

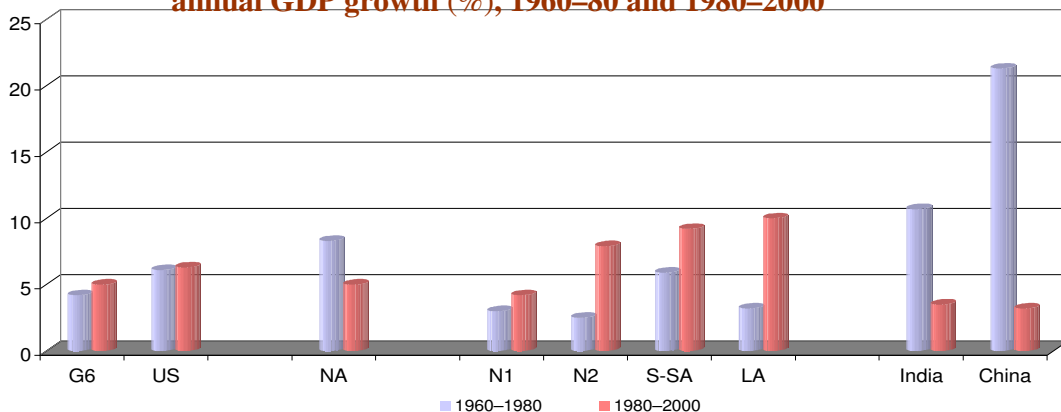
The question has been asked, “Why did nobody see this coming?” The fact is that many did warn that globalisation was producing greater economic instability. The tragedy is that the pro-globalisation interests were ‘hegemonic’. The following tables reproduce the statistical picture we presented in 2004. Table 1 shows that in the two decades before the onset of globalisation, as conventionally portrayed, annual per capita growth was generally faster than in the first two decades of globalisation, with the exception of Chindia. Figure 2 shows that the variation in growth rates – a measure of economic volatility – increased for all parts of the world, with the exception of North Africa and Chindia.

Figure 1. Regional diversity: Annual GDP per capita growth (%), 1960–80 and 1980–2000



G6 = Canada, France, Germany, Italy, Japan and UK; US=United States; DCs = total of 59 developing countries; DCs* = Developing countries, excluding China and India; N1 = first-tier NICs; N2 = second-tier NICs; LA = Latin America; NA = North Africa; S-SA = sub-Saharan countries, excluding South Africa. Source: World Bank: World Development Indicators 2003.

Figure 2 G6, United States and DCs (59): Average coefficient of variation of annual GDP growth (%), 1960–80 and 1980–2000



Source: World Bank: World Development Indicators 2003.