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Priorities for a new political economy: Memos to the left

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Preface

Olaf Cramme

If the social democratic family is to play a leading role in shaping the 21st century, it has to make itself the dominant force in any new progressive coalition – not just in terms of votes, but in terms of policies and ideas. Forging such coalitions indeed seems indispensable in an increasingly fragmented and polarising political arena. And, in different national political contexts, Greens, left parties, social liberals and progressive nationalist or regional parties may all constitute strategic partners.

But such alliances have their pitfalls. Giving priority to assembling the lowest common denominator of a progressive "rainbow" coalition risks ignoring the policy concerns of those voters who simply deserted social democracy for the centre-right. Equally, a lowest common denominator manifesto may neither be the most electorally convincing nor serve as a credible programme for government. In other words, progressive alliances may be necessary but it is delusory to think they are in themselves sufficient.

Social democratic parties will therefore have to show a far greater capacity for reinvention in order to sustain their political relevance. They have to reconnect with the contemporary zeitgeist and provide convincing answers to the most pressing questions of our times: how to ensure that capitalism works for the many not the few; how to secure recovery and prosperity in a changing world economy beset by global imbalances; how to ensure finance works to spur growth and innovation; how to spread life chances more evenly and counter the marginalisation and exclusion of certain groups; how to reign in the polarisation in the labour market; and how to cope with demographic change and migration – to name just a few.

These answers must be underpinned by a new social democratic governing purpose for the 21st century which is not only about winning back power but about delivering against expectations and building trust in the practice of democratic and accountable politics. Only then can we impede the violent mood swings between unrealistic hope and overly pessimistic disillusionment which too often preoccupy centre-left politics.

In a period of economic hardship, it is tempting for social democratic parties to align themselves with the politics of protest. It is of course imperative that we prevent an economic crisis from becoming a social crisis through mass unemployment, welfare retrenchment and deep cuts in public services. The left can best do this, however, if it is in government, able to engage with hard realities and tough choices.

By outlining the priorities for a new political economy, this collection of essays and memos provides an incisive guide to the road on which social democrats must now travel.

Olaf Cramme is director of Policy Network

DATA ANALYSIS

The quest for a new governing purpose

Policy Network

How can European social democracy lift itself out of its current malaise? The political pendulum over the last decade has swung aggressively to the right. In Germany in 2009 and Britain in 2010, social democrats suffered among their worst defeats since universal suffrage. In the recent Swedish and Finnish elections, the centre-left did not do much better, while the forecast looks bleak ahead of the upcoming Spanish and Portuguese elections. This stark backdrop is compounded by the fact that questions have emerged about the credibility of centre-right leaders in many of Europe's largest countries, but there are only occasional indications that social democrats have been able to capitalise on this vulnerability.

The predicament facing the European left has to be understood as a governing crisis, not merely an electoral crisis. There is little sense of a coherent ideological programme through which social democrats might govern in the future in a world transformed irrevocably by the global financial crisis. It is not simply that social democrats have failed to win elections at the national level. Rather, it is the lack of public confidence that social democrats have a clear idea of what to do with power when they win.

This is brought home by the striking results of unique comparative polling, commissioned by Policy Network for the Oslo Progressive Governance Conference, which assesses voters' views across the UK, the US, Sweden and Germany on a host of practical and normative issues central to centre-left politics[1].

The missed opportunity of the 2008 global financial crisis

Over the last two years, the recurring question has been why, in the midst of a crisis whose origins clearly implicate the neoliberal right, it is social democrats who appear battle weary and defensive. The cause of the left's malaise is now increasingly apparent. The economic crisis which began with a wave of sub-prime lending in the United States has hastily been redefined as a crisis of public debt and government deficits. In other words, it is the question of the state – its size, its role, its efficiency – that has become the central issue, not the inherent instability of markets and free-market ideology.

Some might argue that this represents a failure of nerve on the part of social democrats to define the crisis as the product of unbridled and nascent global capitalism. As electorates in Europe have rushed to embrace the false scapegoats and "no nonsense" banalities of the centre-right, leaders on the centre-left have often looked evasive and indecisive, unable to project either competent economic management, or a strategy for radical reform of the banks and the

1 Fieldwork was undertaken by YouGov between 18th and 22nd March 2011. Total sample size was 1063 British, 1086 US, 1010 Swedish and 1184 German adults. The full details of the poll can be downloaded at www.policy-network.net. Special thanks are due to Anita Hurrell and Simon Latham for their excellent contribution to this research.

global financial system in the vein of the Keynesianism and New Deal of the 1930s. History may conclude that the centre-left squandered a moment of unique opportunity.

In truth, however, many of the guiding assumptions of the prevailing pre-crisis social democratic governing model were shattered well before the onset of the crisis in 2007-8. New growth theory presupposed that investment in human capital would lift all boats. Despite the new opportunities created, the opposite has been the case for the "squeezed middle", as wage stagnation and declining living standards have afflicted large sections of blue and white-collar workers. Centre-left governments assumed a benign marriage of economic efficiency and social justice, investing the proceeds of growth from increased global market competition into the welfare state and public services. What followed was runaway wealth and income inequality that post-hoc redistribution could not possibly contain.

Coming to terms with the dilemmas of governing

The capacity of social democrats to seize the aftermath of the crisis and redefine it as the basis for a resurgent, radical progressive politics has to involve coming to terms with the dilemmas of governing. There is simply no substitute for hard thinking and engagement with uncomfortable realities and the structural challenges we face. This is a precondition for becoming a serious contender for power.

Policy Network's recent study, *Southern Discomfort Again*, which examines the UK Labour party's fractured electoral base, exposes the weakness of the centre-left in the key areas of economic competence and the politics of identity. This analysis is furthered and reinforced by the new international research underpinning the present publication. At the heart of it lies the question of *trust*: in state action, in the market economy, and in the opportunities provided by the workplace.

Trust is undoubtedly the single most important source of capital in politics. Faced with frighteningly low levels of trust in the state and the market, with widespread concerns about government redistribution and the role of corporations, as well as a high degree of cynicism towards the ruling elite (of which social democratic parties are now seen to be part), social democrats seem to be on the back foot like no other political contender.

Indeed, like no other political ideology, social democracy has – at least up to now – heavily depended on the levers of both state and market power to deliver its promise of shared prosperity. From this perspective, the critical verdict on centre-left parties and their political offer should not come as a great surprise. The following findings expose the depth of the social democratic predicament which must be tackled.

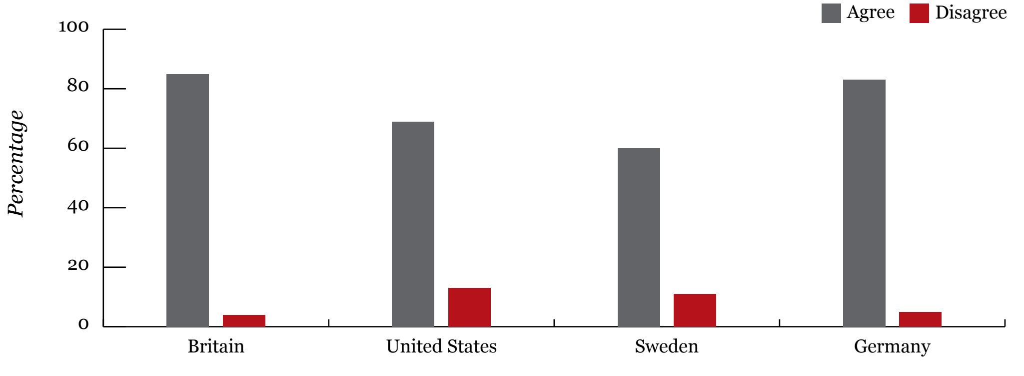
1. People are palpably frightened by the concentration of power in the market economy; yet the democratic deficit of the economic realm is mirrored by a lack of faith that the state and practice of politics can reflect the public interest.

Unease about concentrations of power is most visible in people's apprehensiveness about the dominance and practices of large, typically multinational, corporations in our societies. Majorities in the UK (85%), Germany (83%), the US (69%) and Sweden (60%) agree that large corporations care only about profits and not about the wider community or the environment. This perception is more common among social democrat voters, with a notable 30-point divergence between Democrat and Republican voters in the US.

The perceived domination of the market economy by large corporations that squeeze out small firms is seen in all four countries and by voters of all parties as the principal disadvantage of the market economy. This seems to suggest a move in Europe towards the American tradition of progressive populism, where standing up for the "little man" (and woman) against "special interests" has had strong political purchase. But if there is a need to democratise the economy, there is an equally pressing imperative to restore faith in the democratic legitimacy of political decision-making. In the contest between vested interests and the public interest, all too often people believe that they are losing out to the agendas of individual companies, politicians and lobbyists.

Thus, people have a very low estimation of government's ability to stand up to vested interests – ranging from a mere 15% in the US, 16% in the UK and 21% in Germany, to a more respectable but still worrying 27% in Sweden – when asked to compare the different strengths of state action. Moreover, the extent to which the state is hijacked by these vested interests is a matter of utmost concern to voters, especially in Germany (48%) and the US (47%). In the UK this perception is slightly less widespread (38%), while Swedish voters again are the least pessimistic (17%).

Concern over corporate power
Q. Big companies these days care only about profits - not about the wider community or environment.



This feeds significant scepticism about the efficacy of state action: significant numbers in the US (39%), the UK (29%) and Germany (27%) question whether there are, in fact, any advantages at all to government-led action to improve our societies, in contrast to a more optimistic view in Sweden (just 8%). Whereas in Sweden and Germany representing the democratic will of the people is viewed by at least a third of voters as the principal advantage of government action, US and UK voters are much more cynical about the capacity of politicians to represent their interests (with just 14 and 17% respectively citing this as an advantage).

2. Voters still see the advantages of the liberal, competitive functions of the market, but faith in the market economy's capacity to deliver other social goods – principally jobs and shared wealth – is at a low ebb; without reasserting the state's role in making the market work for all, confidence in the social market economy will remain fragile.

Voters value competition in the market because it keeps prices down and provides consumers with a wide choice of goods and services. Competition is cited by voters as the primary advantage of a market economy in the UK (50%), the US (45%) and Sweden (52%), while in Germany it also very important to voters (45%). The wide choice of goods and services that the market economy provides is highly valued by 44% of voters in the UK, US and Sweden, and 53% in Germany. It is apparent that people would be unwilling to see these advantages diminished or traded in.

However, voters are concerned by the harsh impact the market often has on vulnerable individuals – cited by 41% in Sweden, 29% both in the UK and Germany, and 20% in the US as one of the major disadvantages of the market economy. Moreover, positive effects of the market on jobs and opportunities do not feature highly: while in the US 35% highlight the contribution that the market makes to employment prospects, under a quarter emphasise this as an advantage in Sweden (24%) and the UK (21%), and only 15% in Germany. This suggests social democrats have to be much clearer in setting out how their support for the market economy and policies to generate growth will result in jobs and opportunities, in particular, for the "squeezed middle".

At the same time, voters do not regard the state as powerless in the face of increasingly globalised markets; this suggests voters still believe government can and should create mechanisms of intervention to protect citizens. Even while debate rages in the US about outsourcing and offshoring jobs, only 8% express the view that the state is powerless in an open economy. The task of ensuring that the market economy provides tangible social goods therefore hinges upon the effectiveness of the state in delivering change through its institutions.

Yet this will be made all the more difficult by voters' negative assessment of the levels of bureaucracy and inefficiency which presently hinder state action. This is a central concern across all four countries, cited by 45% in the US, 44% in Sweden, 41% in Germany, and 40% in the UK as one of the major disadvantages of government action. Social democrats need to come to terms with how the state reforms itself; crucial here will be to guard against mitigating the trade-off required between, on the one hand, harnessing the liberal advantages of the market, and, on the other, fostering a more sophisticated form of state interventionism to reassert the social dimension to the market economy.

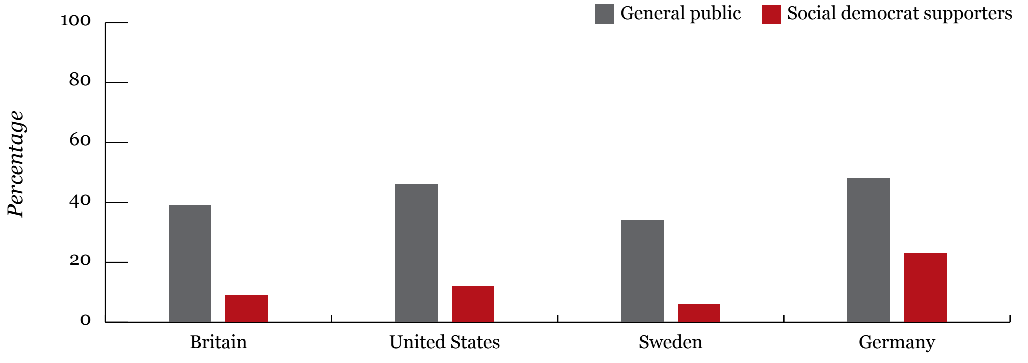
3. Non-social democratic voters believe centre-left governments tax too much with too little public benefit; social democrat voters, however, are more accepting of the role of taxation.

Overall, pluralities in all four countries believe that centre-left governments tax too much with too little public benefit – 39% in the UK, 46% in the US, 34% in Sweden, 48% in Germany. In marked contrast, centre-left voters are much more positive about the effectiveness of the tax-and-spend political economy pursued by centre-left governments – only 12% of Democrat voters in the US, 9% of Labour voters and 6% of Swedish social democrat voters agree that these parties' expenditure in government does not lead to tangible public benefits. Even German SPD voters believe this to be the case – 23%.

The task of persuading non-social democratic voters of our administrative competence is daunting: in the US, 89% of Republican voters agree with the notion that centre-left expenditure is too high relative to outcomes for the public at large; in the United Kingdom, even 30% of supposedly "progressive" Liberal Democrat voters and 68% of Conservatives agree with this; in Germany, 66% of people who voted for the ruling CDU party and 22% of people who support the increasingly popular Green party also subscribe to this view.

The politics of taxation

Q. Percentage of people who *agree* that social democratic governments tax too much with too little public benefit.



Yet there is support among voters of other parties for increased taxation, but only provided it would be *guaranteed* to improve benefits and services. In the UK, 51% of Liberal Democrat and 32% of Conservative voters appear supportive of this. This trend is borne out in Germany, where 47% of people who support the incumbent CDU and 41% who support the economically liberal FDP would also be supportive, while in Sweden this is the case among 37% of voters for the Moderate party, which has made so many gains by adopting key tenets of their opponents' social democratic agenda. Even in the US, 17% of Republican voters would tolerate increased taxes subject to the guarantee that extra revenue would be used to improve healthcare, increase pensions and provide more money to schools. This suggests that this issue does not necessarily relate to support for taxation *per se* but how people feel their taxes are spent.

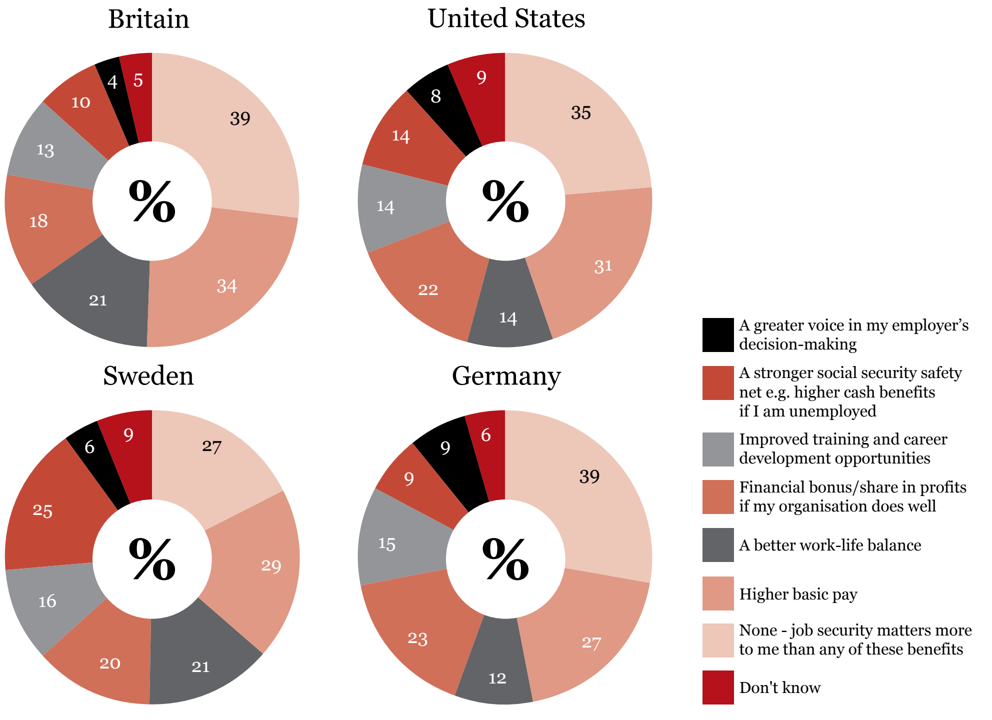
4. Despite social democrats' move towards social investment strategies, it is evident that people are still attached to an old-style welfare state which prioritises late-age redistribution and job security above all else

Job security remains people's absolute priority. This is the case in the UK, Germany and the US, and even in Sweden, where social investment strategies have been furthest developed, job security is still a crucial concern. People are unwilling to trade this in; there has been at best a lukewarm response to alternative strategies to boost their employment, including through improved training and career development opportunities. Across all four countries, only between 13 and 16% of people would accept less job security for improved training.

There is also a strong attachment to the pillars of the postwar welfare state, including public pension provision, healthcare and even – to a lesser extent – unemployment benefits. People seem to be unpersuaded by arguments that social spending should be in future concentrated on investment in early-age intervention to bring about long-term change. When asked which of the three areas they would find most acceptable to cut in the interests of spending more on nurseries, early-years schooling and financial support for families with young children, significant numbers would be unwilling to cut any (60% in Germany, 52% in Sweden, 49% in the United States and 34% in the United Kingdom). And very few would be willing to cut pensions or healthcare.

The primacy of job security

Q. Suppose you could have two of the following – but in return you would have to accept less job security (that is, a higher probability that you could lose your job), which, if any, would you choose?

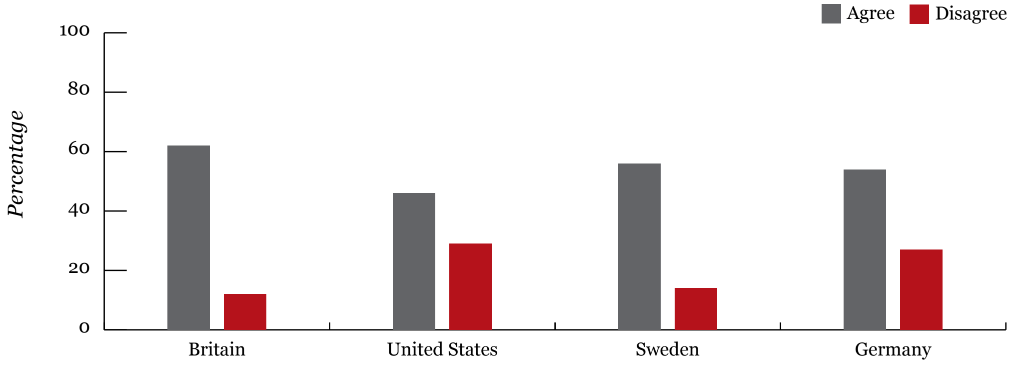


5. People's pessimism about the reality of equal opportunities confronts social democrats – as the traditional champions of social progress and mobility – with a particularly acute political challenge, especially among men and our own voters.

Today, most people believe that who you know is usually more important for getting on in life than hard work and playing by the rules. This sentiment is most pronounced in the United Kingdom (62%) followed by Sweden (56%) and then Germany (54%). In the US this feeling is somewhat weaker (46%), suggesting that belief in the "American dream" persists to some degree.

Significantly, it is the centre-left's constituencies that seem to be most affected by this pessimism. Democrat voters in the US are substantially less optimistic about opportunity than Republicans, with a 10-point divergence evident. In the UK, Labour voters, too, have a significantly more negative perception of opportunity than Conservative voters (67% compared to 57%).

Pessimism about opportunity
Q. Who you know is usually more important for getting on in life than hard work and playing by the rules.



Furthermore, at its heart, this malaise seems to be a predominantly male phenomenon. European men are substantially more pessimistic about opportunity than women. In the UK, 67% of men agree that who you know is more important than hard work compared to 58% of women. This is mirrored in Sweden (61% of men compared to 51% of women) and in Germany (59% of men compared to 49% of women). In the US, a similar effect is apparent but is negligible (48% of men compared to 45% of women).

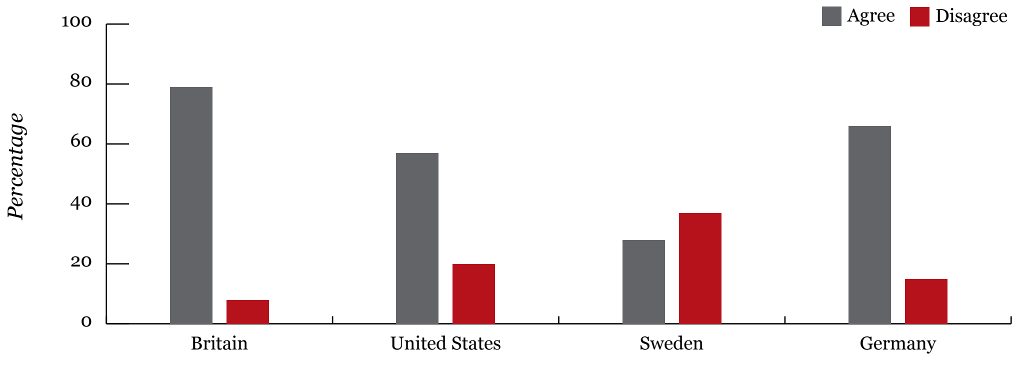
6. Social democrats have pursued education policies which presuppose that university degrees, accessible to as many school leavers as possible, are a pathway to employment and prosperity in a knowledge economy; a majority of voters, however, think they raise career expectations which ultimately cannot be fulfilled.

In the UK, Germany and, to a lesser extent, the US, pessimism about the current value of a university education is rampant. Scepticism is most prevalent in the UK (79%), followed by Germany (66%), and the US (57%). Sweden, however, offers an alternative picture with only 28% of voters questioning the worth of further education and 37% holding the opposite view.

The older people get, the more likely they are to believe a university degree today is not useful. The important exception here, however, is the UK, where one group, those aged between 18 and 24, display a distinctly negative perception of the current value of a university education. This reflects anxiety about entrenched levels of youth unemployment, as well as fears that increasing numbers of recent graduates will become part of a "lost", workless generation, fears which are likely to be further exacerbated in other European countries.

The broken promise of education?

Q. University degrees are less useful than they used to be. Today a university education often raises career expectations that cannot be fulfilled.



However, it is notable that social democrat voters are, today, overall more positive than others about the opportunities offered by a university education. In part, this may be explained by the fact that access to higher education has widened significantly in many countries, not least the UK. This has opened up opportunities for people from different social backgrounds to attend university. Yet, social democrats need to come to terms with the realities of the opportunities available in a globalised labour market and the need to concentrate on skills, education and training policy with a wider focus than just higher education.

A post-crisis agenda for centre-left politics

Coming to terms with these and other multifaceted dilemmas of governing is a tall order. It requires social democrats to radically rethink their political programme and present a credible alternative to the prevalent socio-economic discourse offered by an increasingly unsettled conservative or Christian democratic right. The essays and memos in this volume, written by leading international scholars and policymakers, attempt to do precisely this. They tackle the trade-offs head on, spell out difficult policy choices and provide perspicuous clarity on some of the big issues at stake – how to understand and make best use of state action; how to restore fairness in the market economy; and how to strengthen the employment and workplace agenda.

What the contributions illustrate is that nostalgia for the past will not help. Even if the health of our finances allowed us to return to more centralised planning, we know the outcomes of command economies are neither efficient nor fair. Similarly, the dogma of state-centrism offers little guidance to achieving a more dynamic, socially mobile and happier society – nor does some redistributionist appeal to an assumed commonality of class interest promise to turn around the centre-left's electoral fortunes.

But despair is equally misplaced. In most advanced economies social democratic achievements, ideals and principles still find widespread acceptance. In the EU, adherence to the European social model and way of life is the most striking example: the core institutional foundations of welfare provision have become inviolable. What the public actually want is an active government which is capable of preserving, adjusting and further developing this very model in the context of rapid changes in our society and the world at large. This belief in the "transformative capacity" of the state continues to be prevalent among pluralities in Germany (55%), the UK (53%), and the US and Sweden (both 44%). Social democrats should be emboldened by the strength of this support.

Europe has rarely been more in need of effective social democratic solutions. If the moment of the global financial crisis was missed, let us now capitalise on its aftermath: by devising a radical, forward-looking and innovative agenda for jobs, growth and shared prosperity.

Priorities for a new political economy

ESSAY

Markets, power and politics: Is there a liberalism beyond social democracy?

The liberal concern with challenging concentrated authority makes it a natural partner for social democrats; attempts to achieve this marriage have fallen short when economic power is neglected, but the unparalleled influence of corporate elites today makes this alliance more urgent than ever

Colin Crouch

Traditional social democracy became doomed during the 1980s, and needed a new charge of liberalism to move it forward. In trying to do this while retaining the form of the mass party seeking to win national elections in a global economy, the Third Way movement was able to produce only a liberalism that fell short of social democracy's fundamental values. Can there be a liberalism that "goes beyond" rather than "falls short" of social democracy? And can it be based on mass parties?

That is my argument in brief. Both the question in my title and that with which the previous paragraph ends are serious, not rhetorical. I try here to resolve the former; the latter is left open. The question in the title has three troublesome terms. By defining them I shall have gone some way towards answering it.

I am using "liberalism" in its most classic philosophical sense, to refer to an approach of never accepting authority as final, of constantly searching for alternatives, and of doing that through a constant process of extensive tolerance for new sources of ideas as well as conflict and contestation.

I am using "social democracy" to describe that form of politics that emerged in the mid-20th century, seeking both to guarantee certain collective goods and the egalitarian goal of redistributing wealth and power to maximise the quality of life and security of middle-and lower-income working people – but doing so in the context of a capitalist economy.

To a considerable extent liberalism and social democracy are allies. Social democracy's commitment to the interests of ordinary working people renders it critical of established elites. Less obviously, its attempt to pursue these interests and those of collective goods within a permanently accepted capitalist economy implies constant challenge and conflict, the restlessness that is fundamental to liberalism. It is this same unending search for new and improved solutions to problems that justifies liberalism and social democracy claiming the name of "progressive".

Given that political movements associated with liberalism came gradually to be associated with comfortable middle-class groups, social democracy could always claim to be a kind of liberalism "beyond" liberalism itself. The same cannot be said of socialism in any strict sense or, even more so, communism, which not only envisaged an end point to struggle in the achievement of an economic system, but also saw that end point in terms of an end to competition – a quality essential to striving through contestation.

But that is an idealistic account. In practice, social democracy often fought shy of the insecurity that is implied by liberalism's restlessness. As advocates of the cause of "ordinary" working people, social democrats understandably emphasised a need to reduce economic uncertainty and to protect such people from risk – primarily protection from workplace risks through employment law and trade union action, and from wider social and economic risks through social policy and stable demand management. Attractive compromises could be found. In particular, Keynesian demand management tried to produce stability and security at the macroeconomic level while leaving enterprise free at the micro level. Policies of this kind provided a shared ground between centre-left and centre-right, within which social democrats often wanted to go further. They sought various forms of economic planning, which served reasonably well for tasks of post war reconstruction, in a context of economies supplying staple goods to largely domestic markets.

It was far less helpful at working out what to do in globalising consumer economies based on rapid product innovation and marketing. Indeed, at times of major change to economic structure these priorities led social democratic movements to be more conservative than liberal, to use the term that the 19th and 20th centuries give us as the immediate opposite of liberal. These movements found it easier to try to resist disruptive change than to define changes that would be benign for their constituencies. As a result, when this resistance failed they were often left defending a kind of rump of the past.

Enter at this point the new approaches to social democracy generally known as the Third Way. In embracing economic change, including change that was disruptive, and by abandoning the traditional workplace agenda – but not the social policy agenda – of social democracy, the Third Way seemed to have reasserted social democracy's claim to be part of the critical, liberal, progressive wing of politics. Here, surely, was a liberalism beyond social democracy?

This brings us to the third troublesome word in my title: "beyond". I am using it to imply an approach to policy that in some way goes further in a desired direction than another. So a liberalism that goes beyond social democracy would be an approach that goes further towards social democracy's central priorities by reasserting typical liberal practices over those that had become characteristic of social democracy itself. This is to be contrasted with a liberalism that "falls short" of social democracy by giving up social democracy's egalitarian aims in exchange for a simple compromise with the current ruling form of liberalism, neoliberalism.

For example, a liberal industrial policy beyond traditional social democracy abandons the attempt at economic planning in exchange for deploying collective resources to provide strong physical and human infrastructures. The extent of public investment involved is unacceptable to true neoliberals, but its aim is to create frameworks within which competition, entrepreneurship and innovation can thrive; so it is a liberalism beyond social democracy rather than a relapse into simple neoliberalism.

These strategies have been seen at their strongest and most successful in the Nordic economies. We can contrast this with the strategy of New Labour in the UK, where the overwhelming weight of the financial sector in the City of London led to a concentration of infrastructure effort on that sector and that region at the expense of almost everything else. This merely embedded neoliberalism within economy and polity. Without intensive research it is difficult to determine whether this was because the sheer path dependency of the British economy on the City will prevent any kind of UK government from ever doing anything different, or whether it resulted from the general passive approach of New Labour to business interests in general.

The half-liberal Third Way

This brings us to the heart of the challenge. Third Way social democracy grasped half the nettle of the liberal challenge: the need to embrace markets and competition in economies that could not be planned, and where consumers of public services were demanding choice. But it did not grasp the liberal need for challenge and contestation aimed at concentrations of economic power. People were not encouraged to reflect critically on their working lives, as this smacked of trade unionism, seen as an element of social democracy's conservative qualities. The behaviour of great corporations was not to be a matter for public debate, as this smacked of anti-capitalism, seemed hostile to enterprise and (less honourably) might threaten corporate donations to party funds. As a result almost the entire emphasis of what we might call the "social democratic quality" of Third Way movements fell on the debate over the quality of public services. This became virtually the sole terrain where voters were invited to perceive political divisions of left and right.

This development had several consequences. First, and positively, in Europe (as opposed to the US) centre-right parties were forced to accept the terms of that debate and commit themselves to public service improvement rather than decline.

Second, also positively, spending on public services either increased or remained high wherever social democratic parties were either in government or competing strongly in elections.

But a third consequence was that public employees became virtually the only group (apart from criminals and immigrants) who could be blamed for anything going wrong in society, as private business interests had been declared *hors de combat*. This was unfortunate, partly because it encouraged the unfair scapegoating of large numbers of people who try to do their jobs well; partly because it generated a definition of what was wrong with society that was over-simple and ultimately helpful only to the political right; and partly because public service workers had become an important constituency for social democratic parties, giving them in particular their first strong links to women voters.

Repoliticising work and business

The adequacy of public service provision will long remain a social democratic priority, but it needs to share a place with other policy needs. While the main reasons for this are principled, there are also strategic reasons, given that a policy of promising ever more and better services is unlikely to be viable for a number of years to come. The new agenda is to be found in the repoliticisation of work and business. In terms of popular, electoral politics this means finding new combinations of security and flexibility rather than straightforward labour market deregulation; and making a political issue of the "time-poor" problems that afflict the lives of the two-job couples who are so important to the modern economy.

The social democratic approach to citizenship has long stressed that rights derive from participation in the workforce; the economy needs our work, and needs us to work to the best of our abilities. This is the basis of our claim to dignity at work, and guarantees that, in exchange for our commitment, we shall be protected from the uncertainties of the economy and therefore employment, but against which wages and salaries are unlikely to enable us to insure ourselves. Hence much social policy. This can be seen clearly at the heart of the various combined packages of labour legislation, social policy and union power in the Nordic countries.

There is a neoliberal version of the relationship between citizenship rights and work that is superficially similar, but which says simply: no work, no rights. This is the workfare model that originated in the United States and spread quickly to the United Kingdom and many other countries. Instead of being an active subject claiming rights in exchange for making a work contribution, the worker becomes a passive object of policy, confronting a set of largely negative incentives to ensure (s)he can get into the workforce somehow.

Government assists workers in this task, largely by reducing their employment protection rights so that employers are more willing to hire them. In practice this was supplemented by something else: workers might not be able to insure themselves against labour market risk, but they can fund their consumption through second mortgages and credit card debt, making them less dependent on their labour income. This unspoken part of the neoliberal model became implicated in the appalling behaviour of the financial sector that produced the crisis of 2008.

Although it usually retained something of the social democratic idea that public policy had an obligation to help workers improve their skills, Third Way social democracy went a long way down the path of a neoliberal interpretation of the relationship between work and citizenship rights. This followed inevitably from downgrading the role of trade unions as guardians of workers' active voice in the labour force, which was part of a wider trend within the Third Way of rejecting work as an area where working people were invited to make political demands. Shareholders were the only legitimate stakeholders here as in other parts of economic activity.

This approach must be challenged. The financial crisis has removed the prop of consumer debt on which the neoliberal approach to the problem of labour insecurity was based. Meanwhile, reasserting the importance of workers' dignity and active voice is one of those issue areas where the right finds it very difficult to follow social democracy. This is conditional on means being found for reconciling that voice with the flexibility needed by a modern economy; but various national experiences do provide examples of that reconciliation.

The issue of work-life balance is an aspect of the dignity of labour. It is also an issue capable of uniting the interests of middle-income "aspirational" families and those of routine workers at the bottom of the ladder – a unity that Third Way politics has always seen as deeply problematic. The two-career couple has become essential to both neoliberalism and social democracy, as well as to the general contribution that feminism has made to public policy. Neoliberalism needs the flexibility it brings, with periods of unemployment and short-time working being easier for people to accept when there is not a sole breadwinner in a family. Social democrats have come to appreciate the "femino-multiplier", as women's entry into the labour force generates more employment to replace the domestic and care work formerly done by now working women. But there is a cost in the timetabling strain on couples who are trying to bring up children while holding down two jobs. There is scope here for attractive policy initiatives for social democrats.

The problem of corporate power

But in this essay I want to concentrate on a more difficult issue: the problem of corporate power. Large, global corporations have today acquired a power that cannot be accommodated by any theory of democracy. No other interests can rival their lobbying, as the behaviour of the US Congress regularly reveals. They are often able to determine a country's fiscal or regulatory policies by threatening to relocate. Their claim to being acceptable within democracies rests on the argument that they exist solely within the market, where the consumer is sovereign. But this cannot justify the way in which they wield political power, which is completely inconsistent with the theory of the free market.

In recent years a new terrain has been opened up to corporate political power through the sub-contracting of many public services to private corporations. Usually the "customers" in these new public service markets are not the users of the services, but government departments; a tiny circle of commissioners work in a cosy relationship with a small group of oligopolistic corporations, determining how public services shall be delivered remote from both democracy and market. Not much market or choice reaches the ultimate consumers.

In the wider economy the essentially political nature of the giant corporation is becoming recognised through a circuitous route. While all sides of the political class have preferred to ignore the challenge this presents, many active citizens are concerned, and firms have taken note of the damage that this concern can do to their brands. The left complains about consumer society, but in such a society shopping can become a political activity. Many aspects of corporate behaviour are involved: environmental damage of many kinds; the exploitation of slave labour in global supply chains; banks that concentrate their activities on speculation in secondary markets, from the negative consequences of which the taxpayer has to rescue them.

Soon, once a small number of corporations have become responsible for delivering most public services, a new lively politics of challenge will emerge directed against them as well as the governments and parties that have indulged them. Corporations defend themselves from this new criticism through corporate social responsibility strategies (CSR). Initially public relations exercises, these have become serious matters, as corporate critics monitor firms' behaviour, and draw public attention to hypocrisy and continuing bad behaviour. This is true liberal politics, seeking progress through conflict and contestation rather than through the imposition of a master plan, forcing improvement in the process. And it goes "beyond" social democracy, because it takes up issues that are thoroughly consistent with social democracy's concern for egalitarianism and for collective needs.

This new politics has largely been ignored by Third Way social democracy, except in attempts at working collaboratively with firms to develop their CSR agenda. Mainstream parties are worried at incurring the displeasure of corporations and seek to avoid the liberal challenge of accepting conflict as a major route to progress. Social democracy is sadly trapped at the national level, because of the overwhelming importance of the nation state for democracy. Democracy is national; capitalism is global. That juxtaposition lays bare the weakness of democracy in its exchange with the large corporation. The new citizens' initiatives that challenge corporate power do not have these worries, and in many instances are becoming international themselves. The threat that "we shall take our investments elsewhere" does not work against campaigns which are also present "elsewhere", and which in any case do much of their work at points of purchase and consumption rather than production.

Of course, these campaign groups have pitifully small resources when compared with the corporations they are challenging. At certain points they can make no progress without support from governments or, better, international public bodies. But we are left with a very serious question. Are political parties, dependent as they are on global corporations for national economic success, at all capable of embracing a liberalism that goes beyond social democracy, requiring challenge and contestation aimed at those corporations? Or will the energy and vibrancy of the new politics pass completely from parties to looser, less nationally bound campaigning groups, with parties of all types picking up pieces of the new agenda only when campaigns have clearly so moved public opinion on an issue that they have to give in to them?

Making parties part of the campaign

Matters are unlikely to be as negative as this. Any policies that campaign groups eventually manage to achieve will have to be processed through party-based governments, so campaigns would be unwise to ignore parties in their own lobbying work. This in turn provides an opportunity for those in the parties who worry about corporate power to lend a willing ear and occasionally to take up a cause themselves earlier in the process.

This is not to try and write parties out of history, only to see things from their point of view. It was characteristic of "old" social democracy to see the party as the channel through which all causes should pass, because the party was the sole reliable representative of the class. Campaigning groups that refused to link themselves to the party were suspect as being part of a hostile bourgeois world. This tendency, which social democracy shared with communist movements, was always one of its less attractive, anti-liberal features, as it restricted the channels through which innovation could come. By the 1980s, when parties had ceased to represent classes in the old way, it even lost its original justification. A policy coming up through a party membership was likely to represent nothing more than the preoccupations of a few well-organised individuals. Third Way reformers had perceived this, and became rightly suspicious of anything coming through mass parties.

This continues to be the case. It would not be a sensible response to my arguments here about corporate power for party members to start processing resolutions calling for various actions unless they know that there are strong, mobilised bodies of opinion out there in the wider society caring deeply about the issue in question. And effort and energy should be directed outwards to that wider opinion, not inwards to manipulating a party machine.

Successful campaigns require complex interaction between parties and mass publics, given that parties cannot see themselves as direct and automatic reflections of those publics. The traditional left responded to these problems by ignoring the public; the Third Way by responding passively to what it was told was the message of opinion polls and focus groups. In place of these equally unappealing options there has to be active engagement. And interacting with campaigning groups is a major route to that.

The time is very ripe for this. New technologies have produced new communications spaces outside the control of the corporate mass media. This is providing possibilities for liberal debate similar to that generated by the early spread of newspapers in the 19th century. It will be a time-limited window of opportunity, as eventually the corporations will learn how to get control of new media as they did the newspapers. Another transient window is being provided by the very real popular interest in and anger at the behaviour of the financial elite. We are living at an important moment. Are social democratic parties capable – not of taking control of it, that would not be good – but of becoming part of it?

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ESSAY

Liberal social democracy, fairness and good capitalism

The left needs a new language to differentiate between good and bad capitalism; a radical, shared conception of fairness – based on equity rather than equality – can underpin an economy of reciprocity, proportionate reward and mutual ownership

Will Hutton

The European left is bewildered, in denial and in retreat. If electorates should have learned anything over the last two or three years it is that financial capitalism is a menace to itself and the economy and society beyond – and that governments are the peoples' friend. It is true that bankers are hardly popular, but opinion has not swung behind the liberal left. Instead, the enemy everywhere is government, debt and deficits – scant reward for being the saviour of the hour.

Opinion polls in Britain show that the majority believe that welfare cheats, immigrants and government waste are to blame for contemporary ills, with bankers a long way behind. It is not a dissimilar story across Europe. This is a tough climate in which to build any constituency for liberal left activism, and indeed the liberal left itself is not wholly certain what any such activism should be. What is socialism anyway? What would a good economy and society look like? And what would the popular values be that underpinned them? Does the left in any European country offer a convincing answer?

In this vacuum ugly nationalist movements are flourishing, and on the left one of the few dynamic elements are the greens. The conventional left needs to do a great deal better, not least for the working people it purports to represent.

I submit it needs to begin by thinking straight – and the task starts with addressing the left's relationship with capitalism. The European Parliamentary left is never going to socialise the means of production, nor should it aim to. There is no constituency or intellectual rationale for any such impulse, and even if there were the lesson of the twentieth century is unambiguous: socialisation does not work. It is economically inefficient and the handmaiden of authoritarianism. This does not mean there is no role for public ownership nor public action; far from it. But it takes place in a very different context – the struggle to create a good capitalism and an open society that has its roots in the European Enlightenment.

European socialism, properly understood as social democracy, is the descendant and custodian of the Enlightenment in an ongoing capitalist economy and society – not the shock troops of the European working class steadily taking over the commanding heights of the economy to transform economic and social relationships. It is a fundamental thought leap whose ramifications are profound, and is the dividing line between socialists and social democrats. Social democrats aim to deliver the best from capitalism; not transform it.

Good versus bad capitalism

The first opponent is, of course, capitalists themselves who like to claim that the avenue to economic dynamism is to let capitalism be true to its atavistic, red-in-tooth-and-claw instincts; that to make a distinction between good and bad capitalism is fundamentally to misrepresent its character. Intriguingly, the one thing that über-capitalists can agree on with traditional socialists is that capitalism cannot change its spots.

However both are wrong. There is good and bad capitalism. There is the capitalism that through permitting productive entrepreneurs their due rewards, through challenging incumbent businesses and taking calculated risks with the new create the churn, flux and energy that even Marx acknowledged transforms the world. There is the capitalism that recognises that firms are social creations, and what mobilises men and women over time to invent, innovate and deliver to their markets is a shared sense of purpose; to do something great from which they make profits rather than sweat assets any which way they can to make a turn.

Such capitalism is not a force of nature: it is a social construction that has been created by a series of political choices over time. It is not independent of the social and political; it is embedded in them. It requires governments to keep markets open so that incumbents face challenge but also to invest in the array of physical, knowledge and social assets – from science and roads to strong families, social mobility and independent law – on which capitalism depends. It is public authority, mandate by democracy, that sets rules for how business ownership obligations are discharged, finance relates to business and how ordinary people are helped to survive the risks of life – unemployment, poor health, old age and disability. All this creates good capitalism – and the good society in which such capitalism flourishes. Above all, it is underpinned by a value system – fairness, proportionality and mutual respect.

Bad capitalism is the obverse; it is a universe of bloated incumbents, politically fixed markets, productive entrepreneurs forced to the sidelines and too little public investment. It cares little for the condition and risks of the people. The United States, I would argue, is in the gravest of danger of moving from a country where good capitalism broadly won out to one in which bad capitalism rules. The future of the 21st century will depend on whether this great country can find it within itself to resist the self-interested business incumbents, and their army of lobbyists, ossifying the US economy.

In Europe, the same struggle is being waged but in different terms. Although the European economy is unashamedly capitalist, there are no political forces overtly arguing for a good capitalism. By distrusting and opposing capitalism but without anything to put in its place, the left cedes the field to the right – or is so forced to show its pro-business credentials to earn credibility, neglecting to critique the current economic order at all to the extent that it loses touch with its own political base. The working class without a political champion then becomes prey for nationalists and the extremist right.

Fairness must animate the liberal left

The left has to understand what capitalism properly managed can deliver: and then to demonstrate that the paradox is that only the left can provide the political tension that biases capitalism towards the good. While the right is the indiscriminate friend of all capitalism, the left's mission is to hold capitalism's feet to the Enlightenment fire – and thus make it work best to meet the ambitions and needs of ordinary people. But this does not mean protecting every aspect of the European social model to the last; a good capitalism will need flexibility, adaptability and openness from its workforce insiders whose entitlements and privileges, especially among trade unions, can gum up the capacity of insurgents to challenge the powerful incumbent no less than capitalist monopolists.

For capitalism walks a tightrope. Its success depends on its capacity to unleash productive entrepreneurship that will deploy knowledge to advance humankind's productivity and well-being. But it is always perilously balanced between the dangers of being captured by elites who want to use rigged and manipulated profits to sustain their status and position, and degrading into racketeering, exploitation and speculation. These can be bankers, infocapitalists and monopolists – but they can also be powerful trade unions. The paradox is that it is only a commitment to fairness that can keep it on the tightrope – and this is social democracy's essential and indispensable task.

Given what has happened over the last few years, to stress the role of fairness as capitalism's indispensable value in generating good capitalism may seem eccentric, even quixotic. The right hit back that only a saint or an innocent could be unworldly enough to call for fairness in capitalism. Of course capitalism, the survival of the fittest, is unfair. But then so is life. It is a lottery. Intelligence, talent, beauty and family background are all random. Some are born lucky and others are not. To demand fairness in any economy and society is an offence to how nature deals her cards. Fairness? Get real. This is more leftist moonshine.

But injustice is not a given, a fact of the lottery of life, or something that we simply have to accept to service the greater good of economic efficiency. It can be acted upon and reduced. The great secular – and, of course, religious – thinking has always been animated by the proposition that good things should happen to good people, and bad to bad. And they should happen proportionately and impartially. Human beings know that there is a link between intentions and actions, and they want to reward the good intentions and outcomes and penalise the bad. We passionately believe that one should receive one's due deserts in proportion to whatever good or bad one has contributed. It is telling that most civilisations have celebrated justice with a pair of scales, symbolising the proportional relationship of punishment for wrongdoing and just rewards for doing right. Fairness cast in these terms must be the value system that animates the liberal left.

Due desert and proportionality

The very foundation of morality is that all should get their due desert. A capitalism that tries to proceed as if these instincts are unimportant goes wrong very quickly – just as a socialism that finds no place for individual responsibility and human beings' powerful desire for just reward and just penalty also quickly descends into utopian impracticality. We cannot excuse individual conduct as the result of forces and structures beyond any individual's control. Social democrats should properly distinguish between the deserving and undeserving rich. They should also be prepared to distinguish between the deserving and undeserving worker – and the deserving and undeserving poor. Marx made this point to the French socialists in his critique of the 'Gotha Programme'. Too much leftism has migrated to a utopia where all bad outcomes are the result of "capitalism" – and never the result of individual indolence, cheating or lack of self-discipline.

Yet it is still true that capitalism without fairness becomes toxic. It fathers income and wealth that is vastly disproportionate to any accompanying economic and social contribution, and makes everyone beyond the gilded circle of insiders question why society allocates rewards so unfairly. People start to question whether vocational career choices – in farming, teaching, medicine or science – make any sense when society rewards them so lowly while rewarding finance so highly. The viral self-questioning at such unfairness percolates everything. The rise of single issue parties and political groupings – the English Defence League, True Finns, the Italian Northern League, the Dutch Freedom party or the Danish Folkeparti – organised in varying degrees around xenophobic suspicion of the foreigner cannot be explained by saying that Europe is suddenly more xenophobic, even more racist, than it used to be. It has happened because a sense of injustice has entered the bloodstream.

Europe lacks strong left-of-centre parties and accompanying bodies of belief to direct anger against the operation of capitalism because it has no language to differentiate between good and bad capitalism; instead anger is directed against the foreign other – the Muslim, the European or the non-white immigrant. They have not contributed to the collective pot: it might be folklore but immigrants are portrayed as having immediate access to schools, housing and healthcare without having contributed. They are in effect perceived as cheats. Trust dissolves and suspicion rules – creating an atmosphere that corrodes economic and social relationships alike.

But to argue for any conception of good capitalism and the good society we need a shared conception of fairness that underpins them. At present there is none. The rich argue that it is fair for them to be so wealthy. Europe's rich increasingly believe they owe little or nothing to society, government or public institutions. They accept no limit or proportionality to their wealth, benchmarking themselves only against their fellow rich – an attitude perfectly embodied by the bankers' self-righteous defence of their extravagant and disproportionate bonuses. They will even threaten to leave Britain or Europe if their bonuses are reduced! Against this background philanthropic giving is declining; tax avoidance is rising; and executive pay is rising exponentially. All three are justified by the doctrine that the rich simply deserve to be rich. Meanwhile, the poor, in their view – and that of a virulent right-wing media – largely deserve their plight because they could have chosen otherwise. The poor could work, save and show some initiative. So why should we indulge them by giving them state hand-outs?

Which is why bank reform, although vital for both the stability of the system and to lower bonuses, only addresses part of the problem. Banks could not have acted as they did without wider deformations in our business culture and practice. But before anything can stick, the moral edifice that justifies the business elite's resistance to change must be challenged. The principle of "just desert" is a key part of European culture; it needs to be reasserted. The majority of Europeans are not flat-earth egalitarians. But neither do we believe that wealth is a signifier of personal worth in its own right. We believe it has to be earned, and believe the rewards should be commensurate with the discretionary effort. Proportionality is a fundamental value. Its trashing by those at the top of the financial and business community risks an angry populist backlash fuelled not by envy, as they airily claim, but by a visceral human instinct.

Luck and circumstance

A definition of fairness does not stop with due desert – it extends to a consideration of the role of luck, which plainly plays a part in any individual's fortunes. Everyone understands the importance of good and bad luck. There is option luck, the luck we have made ourselves through our effort and diligence; if people have worked hard for their good fortune, then their success and attendant wealth is fair. One of the reasons the US is more tolerant of disparities of income and wealth than Europeans is that there is a general – if misplaced – belief that their society is sufficiently open and that great wealth is merited. The US's rich tend to be rich through their due desert. But Europeans, living in an older continent where accumulations of wealth through birth are more obvious, are more suspicious. European culture is more aware that circumstance plays an enormous part in the reality of being poor, just as it does in being rich. This is luck we have done nothing to deserve – brute good luck. We cannot indulge the rich for being lucky enough to have the right parents any more than we can blame the poor for their parents.

The categories of brute good and bad luck are much better vehicles to carry the case for collective interventions than invocations to equality – the habitual way the left argue for, say, social insurance or inheritance tax. Nobody is convinced that pure equality is deserved; it might fail to reward effort or fail to penalise the shirker – the point that Marx made. But brute bad and good luck transcend such considerations; they are palpably part of the human condition and palpably part of our social dimension is to act together socially to relieve them. Suddenly the argument for the public provision of health or social benefits is transformed. They are not "socialist", "liberal", or "leftist" but have much deeper roots – the mitigation of brute bad luck.

For example, nobody can know the character of their genomes or do anything about them even if they did; one's body's predilection for debilitating diseases – from cancer to dementia – is a matter of brute bad luck. Of course society should come together mutually to insure every member against the brute bad luck of poor health, just as it should the risks of unemployment, disability and old age. My own belief is that these benefits are entitlements, but to protect them from the right's charge that too many benefit claimants are making lifestyle choices or that public health provision is socialist I think it profoundly important that there should be a clear relationship between contributions and benefits. We pay in for our pension, health and unemployment benefit; it is our due desert to receive them – not a matter of state discretion to be means tested and screened.

Equally, using luck transforms the argument about tax. Inheritance tax, for example, is not a "death tax": it is a "we-share-in-your-good-luck-tax". Fairness also offers a means to lance the boil over immigration. Ordinary working class people react fiercely to the idea that the newly arrived immigrant immediately qualifies for the full array of social benefits – and especially housing – without having made a contribution. A fundamental canon of fairness is traduced. Immigrants should be given the opportunity to earn their benefits over time; full social citizenship rights are only an entitlement if they are earned by anybody of whatever ethnic background or religion. The argument is secularised and defused of its racial overtones.

But above all the mitigation of brute bad and good luck is why the left cares about social mobility – and why we make the case for the strongest and cleverest infrastructure of housing, education and training to help the disadvantaged live a life they too have reason to value. This may best be done by a web of intermediate social institutions – social housing trusts, independent colleges etc – rather than the central state; but the task must be executed as an act of social mobilisation.

Fairness and good capitalism

But if fairness principles – due desert, proportionality, good and bad luck – apply to the social realm, they also work effectively in the economic realm. Just as the social need is to create and sustain a web of social institutions built on reciprocal payments and benefits to mitigate risk, so there is a parallel economic need. The central weakness of the free market, über-capitalist case made by the economic and political right, especially in the US, is that it is wholly oblivious to the reality of risk and the unpredictability of the future. The genius of capitalism is its capacity to embrace the new in a constant process of experimentation, creating new modes of production from the advance of science and technology. But this is necessarily a highly risky process. Entrepreneurs can never know if their idea or enterprise is going to work. They are beset by risk and the knowledge that their hard work and innovativeness may not receive its due desert.

European economists from across the political spectrum – Hayek, Schumpeter, Keynes, Knight – have always been more keenly aware of existential uncertainty and how it creates instability and unfairness in capitalism than the US economic tradition which tries to abstract uncertainty from its theorising about capitalism. Economic agents hold rational expectations, for example, and markets always tend mechanistically to clear and to organise themselves in an optimal way. Markets are thus deified as near perfect – while even European pro-market theorists, like Hayek, would never make such an absurd claim. Keynes understood Hayek's point, that at heart capitalism was a brilliant discovery and experimentation process, very well: his point was that if as a result markets are unstable and beset by profound uncertainties, then perforce a democratic state has to act as a countervailing power to help capitalism deliver of its best.

Thus, the case not merely for active fiscal and monetary policy – especially in the wake of a credit crunch – but also for the state to be active in encouraging entrepreneurship and enterprise. Only the state can mitigate the risk that besets capitalist enterprise. Enterprise flourishes best if it can be nested in a web of institutions that mitigate risk – an innovation and investment eco-system – and the state has to make sure it exists, functions well and lubricate it with hard cash. Some of what is necessary may emerge spontaneously from the operation of markets – from venture capital to the insurance of high risk contracts. But much does not. Universities and research institutes that create new knowledge; technology transfer institutes; science parks; banks and financial institutions that support new ventures; institutes that provide workers with the appropriate skills; guarantees of prices far in the future that make vital investment in today's infrastructure economically worthwhile – all are necessary interventions in the so-called natural processes of capitalism to help enterprise better navigate risk and create wealth and jobs.

A good capitalism has thus two key properties – a system of business ownership in which the returns to owners and managers is proportional to the risk being undertaken rather than winners taking all, along with politically and socially constructed institutions that help mitigate risk, thus allowing more to be taken. The right's argument that successful entrepreneurship is about individualism, unconstrained property rights, low taxes and low regulation is baloney. Successful entrepreneurship occurs in good capitalisms where risk is mitigated and shared – and where owners acknowledge reciprocal responsibilities along with their rights.

The workplace and fair process

As the knowledge economy grows to dominate economic activity, there will be more risk and churn – and social institutions will have to change as well to accommodate it. The right is correct to argue that too strong entrenchment of workplace rights, like generous redundancy payments, creates yet more risk for enterprise. But their solution – to lower or abolish them – is too crude. It displaces risk onto ordinary workers. Instead the interconnected work, training and social security system needs to be redesigned – the case for "flexicurity". Workplace rights that deter new hiring and employment expansion may need to be curtailed, but only if substituted in three key ways.

Firstly, unemployment benefits must be increased so that workers in transition between jobs do not suffer damaging loss of income. Secondly, cash earmarked for redundancy payments should be spent on training every member of the workforce continuously; and lastly the government must guarantee work as an employer of last resort – rather as Roosevelt's Works Progress Administration did in the New Deal. Social democratic fairness demands no less – a good society in which good capitalism can flourish. Flexicurity is a fair way of managing and mitigating new risks – and the brute bad luck that will occur in a fast moving knowledge based economy.

And there is one last and perhaps most important dimension of fairness. People care enormously about fair process. They want voice; participation and impartiality of judgment – not only in the public realm, but also in the workplace. Democracy and the rule of law are of course crucial fairness processes – but so is effective workplace representation. The degree to which any country's political and media system allows the universe of opinions to be expressed and economic, social and political insurgents the possibility of challenging incumbents is the degree to which it is fair and legitimate. Few western democracies correspond to this ideal today – and the result is an economic and political silting up. Too much corporate power is going unchallenged, both by politicians and in workplaces. One of the best aspects of the European model is the system of workplace councils that at least obliges companies to consult and inform. Equally, too much of politics is predictable, as politicians balance entrenched interest groups rather than express moral purpose and offer leadership. The left is as guilty – perhaps more guilty – than the right. But to do better requires both a moral anchor and a political project.

The popular appeal of liberal social democracy

The definition of fairness offered here is radical. It is about equity rather than equality; but it is no less demanding for that. It challenges the economic and moral questions that have been ignored over the last two decades – the tolerance of towering disparities in wealth and power and the blind faith in individualism and markets. It is, in my view, the value system than underpins liberal social democracy. It is liberal because it recognises that individual actions should be duly rewarded or penalised – but is social democratic because it wants, with proper accountability, to use social, collective power to mitigate brute good and bad luck. I submit it offers a route map for Europe's left to reinvent itself and win popular appeal. To repeat: fairness is the indispensable value that underpins both good capitalism and the good society, and it will be the foundation stone of any sustainable new order.

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ESSAY

The institutional foundations of middle-class democracy

To protect and restore the hallmarks of a well-functioning market democracy, progressives in the United States and elsewhere must rebuild its institutional foundations and shift back the uneven organisational balance between concentrated economic interests and the broad public

Jacob S. Hacker

The financial crisis of 2008 seemed almost tailor-made to discredit the governing economic philosophy of the prior generation. Not only did it occur on the watch of an unpopular Republican president; it also laid bare the vast and growing gaps between ordinary Americans and the super-rich – and in particular between the economic travails of Main Street and the reckless behaviour of Wall Street. Yet, just two years after electing Democratic President Barack Obama in November 2008, American voters devastated the president's congressional majority. Within weeks, the political agenda shifted entirely from measures to create jobs and bolster economic security to big spending cuts, the expansion of favourable tax provisions for the affluent and corporations, and a state-by-state push for deregulation, programmatic cuts and anti-union rules.

The temptation is to see these developments in personal terms, as a reflection of the poor strategies of Democrats or the savvy tactics of their opponents. But the immensity of the gap between expectations and outcomes calls on us to dig deeper into the sources of American liberalism's contemporary woes. This digging suggests that the most fundamental problems are structural rather than personal. They reflect the way in which the "rules of the game" of the economy and polity have changed – changes that have played out distinctively in the United States but whose echoes can be seen in other English-speaking nations and, increasingly, in affluent democracies more broadly. Against the backdrop of these structural shifts, progressives cannot simply play the game with more determination or intelligence. They will need to reshape the rules as well.

The great reversal

The last generation has seen a remarkable turnaround in US economic outcomes. In the generation after the Second World War, the economy and the earnings of all income classes grew roughly in tandem. Since the 1970s, the economy has slowed modestly, but the big change has been where the rewards of growth have gone. In a word, they have gone to the top. Over the last generation, the share of pre-tax national income received by the richest 1% of Americans has more than doubled. The share received by the richest 0.1% has more than quadrupled, rising from less than 3% in 1970 to more than 12% in 2007 – the highest proportion since the creation of the income tax in 1913.

This is not a story of stagnant productivity or general economic malaise. It is a story of the decoupling of aggregate productivity and most workers' wages. Even a college-educated, entry-level male worker earns barely more than a worker in the same position did a generation ago. While the economic boom of the 1990s temporarily reduced the pay-productivity gap, the gap returned with a vengeance in the 2000s. Indeed, the expansion of the 2000s was the first on record in which a typical family's income was at the end lower than at the close of the prior business cycle.

As job security has eroded and gains have shifted towards the top, other pillars of security and opportunity have also come under strain. The first of these is education and social mobility. Class lines have hardened. American inequality is sky-high and American social mobility is below the advanced industrial norm. The United States has gone from the world leader in college completion to a middling performer. More and more of the skyrocketing college costs are financed through loans, placing a burden on students and their parents – except in the case of children of the rich, who gain a huge headstart.

The second pillar is pensions and social insurance. America's job-based framework of economic security has gone from basic to broken. Defined, secure pensions – once the hallmark of a good job – are vanishing, and tax-deferred savings accounts like the 401(k)s are not filling the gap. As medical costs continue to outstrip inflation, employment-based health insurance benefits are becoming rarer and less protective.

The third pillar is housing and economic assets. Beside their homes, most middle-class families have strikingly little in the way of private assets to cushion economic shocks or build their futures. And those homes look far less secure than they once did. The traditional strategy of gradually accumulating wealth through housing has taken a perhaps fatal hit, with implications for the economic security not just of the middle-aged but also of the young, aspiring middle class.

Winner-take-all politics and its discontents

Apologists for this staggering shift often attribute it to impersonal forces of technological change and globalisation. Along this view, computers and automation have reduced the rewards for routine skills while the entry of hundreds of millions of literate low-wage workers into the global workforce has undermined the earnings of less-educated Americans. Compared to these vast tides, the conventional wisdom suggests, American politics and policy have played only a bit role.

As Paul Pierson and I have recently argued in our book *Winner-Take-All Politics,* this view is profoundly mistaken. Politics and public policy have in fact played an absolutely central role. One clue that they have been central is the diversity of experiences among rich democracies. All rich countries have experienced the impact of technological change and globalisation and yet in many rich democracies increases in inequality and declines in economic security have been modest, and few have seen anything like the sharp upward shift of economic rewards, the implosion of unions or the breakdown of social benefits that have occurred in the United States. Moreover, in many nations where wage inequality has risen, policymakers have pushed back through active labour market policies and through taxes and public spending that are designed to reduce the remaining income gaps. Not so in the United States. According to the Congressional Budget Office, even after taking into account all public and private benefits and federal taxes, almost 40% of all household income gains between 1979 and 2007 accrued to the richest 1% of Americans – more than received by the bottom 90% combined.

Another clue that politics and policy have been crucial is that America's newly unequal economy developed hand in hand with a new politics. In the late 1970s, corporate America organised on an unprecedented scale to influence government policy, not just through campaign donations but also through vast lobbying efforts. At the same time, with campaign costs skyrocketing, money became a far more important resource for politicians – and, as we have seen, a far more unequally distributed resource in American society.

The rising role of money and the increasing imbalance between business and other organised interests fundamentally changed Washington. For the contemporary Republican party, these changes were welcome and encouraged the party to shift ever rightwards on economic issues. Democrats, by contrast, found themselves increasingly torn between their historical commitment to the little guy and the pull of money from the big guys, including, for much of the 1990s and early 2000s, the ascendant titans of Wall Street. The result was an ever more polarised economic debate in which a significant faction of one party, the Democrats, repeatedly proved willing to cut bargains that undermined the middle class's standing.

The recent US tax-cut deal extending huge tax reductions to the richest highlighted the long-term role of the American tax system in abetting inequality. Even as the pre-tax incomes of the richest have skyrocketed, politicians have slashed federal taxes on the affluent. The effective federal rate paid by the top 0.1% – that is, what these super-rich taxpayers actually pay in federal corporate, capital gains, income, payroll and estate taxes as a share of income – has fallen from over 60% in 1960 to around half that in 2004. Just since 1995, the top 400 US households have enjoyed a 45% cut in their federal income taxes (they paid 30% of individual income in 1995 and 16.5% in 2007). In 2007 alone, that saved the top 400 filers US$46m per household.

Far more important and less recognised, however, have been the ways in which Washington has remade markets to advantage the top. Failure to enforce policies supporting workers' organising rights has undermined labour unions as a force for good pay while corporate governance rules all but asked top executives to drive up their own earnings. Financial deregulation brought great riches for some while crashing the rest of the economy.

Perhaps the least visible policy changes have been passive-aggressive – deliberate failures to address changing economic conditions, such as the need to balance work and family. Entire categories of support that have become essential to middle-class life, such as good childcare, are simply not a public responsibility in the United States. Meanwhile, responsibilities once shouldered by corporations are shifting back onto families. Uniquely among industrial nations, the United States came to rely on employers to provide healthcare, pensions and other benefits that elsewhere enjoyed state sponsorship. But as employers have pulled back, government has not filled the gap.

It is not so surprising, then, that many middle-class Americans feel abandoned. Asked in mid-2010 whom government had helped "a great deal" during the downturn, 53% of Americans said banks and financial institutions. Forty-four% pointed to large corporations. Just 2% thought federal policies had helped the middle class a great deal.

The lessons of winner-take-all politics

Three key features of these developments are crucial for grasping – and overcoming – the challenges that progressives face today. The first feature is the role of pre-distribution. When we think of government's effects on inequality, we think of redistribution – government taxes and transfers that take from some and give to others. Yet many of the most important changes have been in what might be called "pre-distribution" – the way in which the market distributes its rewards in the first place. Policies governing financial markets, the rights of unions and the pay of top executives have all shifted in favour of those at the top, especially the financial and non-financial executives who make up about six in 10 of the richest 0.1% of Americans.

The moral of this story is that progressive reformers need to focus on market reforms that encourage a more equal distribution of economic power and rewards even before government collects taxes or pays out benefits. This is not just because pre-distribution is where the action is. It is also because excessive reliance on redistribution fosters backlash, making taxes more salient and feeding into the conservative critique that government simply meddles with "natural" market rewards. Further, it is because societies in which market inequality is high are, ironically, ones where creating common support for government action is often most difficult. The regulation of markets to limit extremes and give the middle class more voice is hardly easy – witness the fight over financial reform in the United States. But it is both more popular and more effective than after-the-fact mopping up.

The second feature is the problem of drift. Over the last generation, across a wide range of areas, public officials have deliberately failed to update policy in the face of changing economic circumstances, allowing outcomes to drift away from a more equal equilibrium. Although particularly pronounced in the United States, drift seems characteristic of many rich democracies today as they confront a rapidly changing economy and society. If this is so, preserving existing policies is not the only challenge. The welfare state traditionally understood remains deeply rooted. But the broader environment of the welfare state – a mixed economy characterised by a healthy civil society – is much more vulnerable.

To protect and restore these larger hallmarks of a well-functioning market democracy, progressives must preserve an effective capacity for robust governance. They should resist institutional reforms that abet gridlock. In the United States, this means altering the procedural rules that encourage the growing use of the filibuster, the Senate tradition of unlimited debate that has increasingly amounted to a universal supermajority requirement of 60 votes in the 100-member chamber. Progressives should also ensure that policies retain the capacity for over-time adjustment, whether automatically (as in benefits indexed to wages or prices) or structurally (through the preservation of basic regulatory, tax and spending powers that are too often sacrificed on the conservative altar of privatisation and delegation).

The third feature is the declining organisational might of the middle. The transformation of America's political economy over the last generation has far less to do with the shifting demands of voters than with the changing organisational balance between concentrated economic interests and the broad public. Indeed, the sharp shift of economic policy towards business and the affluent occurred despite remarkable stability in public views on many economic issues, including views of government redistribution, progressive tax policy and the importance of key programmes of economic security. The agenda disconnect that we see today, as politicians ignore Americans' concerns about the lack of jobs in favour of cutting programmes that the public likes and preserving tax reductions for the rich that it does not, is not new. It has characterised the politics of the last generation.

The root of the problem, once again, is organisational. Middle-class democracy rested on organisations, such as unions and cross-class civic organisations, that gave middle-class voters knowledge about what was at stake in policy debates as well as political leverage to influence these debates. Without this organisational grounding, voters simply have a very hard time drawing connections between what politicians do and the strains they face in their lives, much less formulating a broad idea of how those strains could be effectively addressed. So far, however, the most effective organising has taken place not among progressives but on the conservative side, with the rise of the loose organisation of conservative voters, right-wing media figures and corporate-funded ideological activists that travels under the "Tea Party" banner.

The Tea Party's success is instructive. It rests on a combination of champions inside government and organisers working at the grassroots level; it has a clear agenda (scale back government) and enemy (President Obama); and it has effectively utilised both old-style organising (through local chapters) and new communications technologies. While the Tea Party cannot and should not simply be emulated by progressives, its three key features – grassroots organising linked to national reform leaders, a forward-looking vision that is directed against a perceived contemporary threat, and the use of flexible participatory modes enabled by new media – are preconditions for effective progressive organising.

Rebuilding the institutional foundations of middle-class democracy

The diagnosis outlined here is both encouraging and challenging. It is encouraging because there is nothing natural about the harsh divisions that have arisen in the United States. They are rooted in politics and policy, not the inexorable forces of globalisation or technological change. In many cases, moreover, they require not major programmes of redistribution – never easy to enact – but rather measures to reshape the market so that it distributes its rewards more broadly in the first place.

Nor does popular opinion dictate that this sort of politics and policy must reign. If progressives are losing the public, it is not mainly because citizens buy into the free-market fundamentalism of the right or are so distracted by social issues or racial animosity that they cannot see their own interests. The hallmark of contemporary public attitudes is not public conservatism but public cynicism and distrust, fuelled by the economic trend of the last generation and a sense that government is out of touch. To rebuild the middle class requires rebuilding a sense that government can make a positive difference. And that means addressing the bread-and-butter concerns of the middle class while also calling for responses to long-term threats, such as global warming and runaway health costs, that jeopardise US society.

The challenge, however, is that progressive reform will require using a broken political system to fix a broken political system. The main obstacle to change and the main vehicle for change are one and the same. This catch-22 affords no easy resolution. But it does suggest where reformers' energies should be directed, and it points to opportunities that are too often missed by those narrowly focused on rhetorical messages and strategic moves. Perhaps the most important implication is that those seeking to achieve a new governing economic philosophy will have to rebuild the organisational foundations of democratic capitalism. An inspiring economic vision will be grounded in an institutional blueprint for using active democratic government to meet the challenges facing US society – challenges that, while frequently most pressing in the United States, are growing for all affluent democracies.

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ESSAY

Nordic hybrid power – politics with markets

In order to capitalise on the opportunity for change presented by the financial crisis, social democrats should be guided by an understanding of what they achieved, as well as what they got wrong; the Nordic recovery of the 1990s remains a vital blueprint for labour market and economic reform

Jon Erik Dølvik

The financial crisis and its repercussions have raised grand questions about the relationship between the states and markets shaping European social models. The aftermath of the crisis has also spurred self-critical debate among social democrats and centre-left forces about their visions and strategies for the future. Crises can open up opportunities for reorientation and innovation, including through processes of creative destruction. But when things go wrong there is also a tendency to overreact and dismiss everything that has gone before.

There are good reasons for rethinking the roles to be played by markets and the state in governing Europe – especially in the economic and financial domains – but such exercises should be grounded in a realistic reading of the state we are in. The crisis has raised doubts about the sustainability of many European social models, but this does not automatically imply that reform efforts proceeding the crisis were fundamentally misplaced or wrong. The past few decades of globalisation and European integration did in fact bring considerable improvements in many of our social models' contributions to work and welfare.

Using the Nordic recovery after the crisis in the early 1990s as an illustration, this essay argues that large ruptures of this kind can bring about positive change and that many of the mainstream policies embraced by social democrats during the past decades can work. A critical condition, however, is that they are framed by adequate institutions and power relations in the labour market and supported by economic policies that provide sufficient demand for labour. These prerequisites are decisive in determining the extent to which the European turn to activation, work-oriented welfare reform, investment in skills and human capital, and, if you like, "flexicurity", can bear fruit and not heighten the dualisation of income and employment as seen in many countries.

What matters in politics is not so much "right" or "wrong", but the sequence, coherence, balance and co-ordination of policy action. Small differences can have big impacts. The Nordic countries largely subscribed to the new European social policy "orthodoxy", yet, when compared to other countries following similar recipes, differences in labour market institutions and economic policies contributed to markedly more favourable mixes of efficiency and equity.

Nordic "hybrid" power

The adjustment of the Nordic models over the past decades can be seen as a move towards a new balance between market-based and institution-based co-ordination – between markets and politics. In these renewed Nordic "hybrids", the liberalisation of product markets has been accommodated through finding new ways to restore the old virtue of economic prudence, while also consolidating the traditional social models and the distributional structure. This is not a case of "politics against markets" but of "politics with markets". This has meant "more market" and greater efficiency in the sphere of production but at the same time a more active, enabling state in the realm of social policy, and a sharper "state hand" in economic governance, able to secure the necessary reserves to fend off the adverse effects of the financial crisis.

The key question concerning the relationship between the state and the market is not whether there should be more or less of one or the other, but how to achieve optimal interaction between the two. The state must ensure that markets are embedded in institutions, norms and regulations, geared in a fair direction, and provide balanced power relations and exchanges between market actors.

Re-embedding labour markets through the rebuilding of institutions and creating the conditions for balanced negotiations between employees, employers and the state is an uphill battle – not least because national regulations now only cover part of the growing European labour market. Equally, a shift towards more demand-enhancing economic policies can be hard to envisage in the current climate of desperate austerity. Nonetheless, both aims are viable and necessary elements in political strategies to make Europe work.

Crisis, consolidation and revival

In the context of rising globalisation and European integration, for many the Nordic crisis in the early 1990s confirmed that the allegedly sclerotic social democratic models were unsustainable. Once renowned for the pooling of risks through social insurance, extensive public services, coordinated wage setting, high employment and egalitarian income structures, in the 1990s the Nordics were facing a crisis. The very foundations of the Nordic social models were cast in doubt. However, by the turn of the century this had changed and the Nordic countries were rising to the top of international rankings for economic efficiency, employment and equality – even being embraced as role models for the European Union.

The Nordic countries had recovered, and returned from the abyss in a leaner, more competitive shape. In spite of significant adjustments, the pillars of good industrial relations and the welfare state were intact, with the latter expanding almost in line with economic growth, leaving room for improved standards and a host of new rights and services. Furthermore, contrary to predictions, social democrats bounced back into power.

But within this continuity and consolidation, there were also significant changes.

First, macro-economic regimes were modernised through the establishment of rule-based fiscal and monetary policies geared towards stabilisation and low inflation, although the specific modes of delivery eventually varied in line with currency regimes and links to the euro. This marked, in some respects, a return to traditional Nordic prudence by altered means, whilst also representing an adjustment to the economic orthodoxy of the day, which, alongside tax reforms, gained broad bipartisan support. Initially, Sweden cut budgets by 10% and in 1995 the social democrats won the election campaigning on a programme of further austerity.

Second, convergence towards the international economic mainstream prompted profound adjustments in the pattern of collective bargaining. Wage co-ordination headed by internationally exposed sectors and underpinned by the close observation of central bank policies, and wage growth among the European trading partners, became the order of the day. The main pillars of labour market regulation were (with the exception of incremental adjustment to EU rules) largely retained and eventually embraced even by the centre-right, suggesting that co-ordinated adjustment through bargaining served as a functional equivalent to deregulation.

Third, the old "working line" in Nordic social policies was reinvigorated to make more people work and invest in their human capital instead of simply receiving transfers. Though Finland was a laggard, the pension challenge was met with proactive reforms emphasising funded, two-tier pension systems designed to award those working for longer. Measures to upgrade labour supply were complemented by expansion of "free" education systems, life-long training and initiatives to boost female participation by reconciling work and family life. Furthermore, steps were taken to amass social, labour market and income security services under one roof, which was coupled by the centre-right government in Sweden with the lowering of caps in sickness and unemployment benefits and tax cuts especially on low-paid work.

Fourth, these changes proceeded in parallel with incorporation into the single market regime, deregulation of product markets, intensified restructuring and the continuing rise of service employment. Whereas most labour-intensive industries in the Nordic countries had been closed down in the 1970-80s, the acceleration of globalisation throughout the 1990s brought cheap Asian imports, lower inflation and rising demand and prices for the Nordic export of goods and raw materials. The expansion of education and favourable demographic trends produced an increasing supply of skilled labour and sharper drops in supply *vis a vis* demand in the market for unskilled labour, preventing the "post-industrial" rise in low-wage employment seen elsewhere.

Since the crisis in the early 1990s the Nordic models have been consolidated and renewed, with a stronger emphasis on work and public investment in social and human capital. Thus, with their egalitarian work-ethos and encompassing systems of social security, the Nordic models have demonstrated their capacity for flexible adjustment in the global economy.

The direction of reform was clearly influenced by the new orthodoxy of social and labour market policies emanating from the OECD, the European Union and New Labour, but the specific adjustments made were cautiously accommodated into the pre-existing institutional context and levels of benefits, services and equality. Even while subscribing to mainstream European policies such as low inflation and supply-side oriented activation, the reforms bore results that were much more equitable than in most other countries, where similar policy shifts under different institutional and macro-economic conditions led to severe social dualisation. Hence seemingly small differences can have large impacts, suggesting that the challenge for social democracy is perhaps less a question of grand reorientation than of providing the optimal conditions for market-state interaction.

Rising volatility in the new millennium

The economic boom in the 2000s brought new imbalances to the fore. Amid the general rise in affluence, the ascent of the nouveaux riches amidst a large financial bubble created new lines of disparity in wealth and lifestyles, spurring feelings of relative deprivation and disenchantment with the political classes among many of those lagging behind. As prosperity and productivity increased, certain groups struggled to keep up in the labour market and educational system. And although public services were expanding and improving, citizens' and clients' expectations were rising faster. The number of people struggling with life, health or drug problems as well as groups threatened by marginalisation was growing – particularly among the proliferating, multi-ethnic immigrant population. This growing sense of unease was not alleviated by the rising influx of migrant workers from the new EU member states, who were often offered jobs at conditions natives would never consider, adding to competition and the erosion of standards at the lower end of the labour market. As is often noted, unrest and upheaval are more often the result of rising, frustrated expectations – that is, relative deprivation – than of shortage or scarcity as such.

References to growth and steady progress therefore did not help incumbent social democrats much in the face of centre-right opposition parties and populists on the right and left fuelling discontent by attacking social democrats for failing to deliver on their own promises. The respite granted by the crisis consciousness of the early 1990s was over, and faced with various criticisms around the shortcomings of the "best welfare states in the world", the incumbents seemed unable to respond adequately. Hence, centre-right coalitions took power and were re-elected, except in Norway where they lost out to a red-green coalition.

The frequently reported international trend that governments in the current "virtual reality" tend to become worn down much faster than in the past should perhaps comfort the Nordic social democrats, suggesting they just have to prepare for the next pendulum swing (which may in fact already be underway in Denmark). But the challenges are evidently more complex than this.

The rise of the Swedish 'inner right' has exposed social democrats' difficulties in distinguishing and conveying a clear message of their purpose and mission beyond "steady course". The deft manoeuvering of the pattern-setting Swedish Moderates – the self-proclaimed "new and only labour party" who won a resounding re-election in 2009 in spite of the employment crisis – has caused uncertainty and bewilderment among Nordic social democrats. When attacked from 'within', it is hard to decide where to establish your main line of defence. The opposition's deliberate strategy of breaking the affinities between social democracy and union and welfare state constituencies by offering targeted tax reliefs, 'freedom of user choice' and in-work benefits aimed at marginalised groups, is a constant worry for the Nordic centre-left.

Another concern is that by undermining trade union run unemployment insurance and gradually building up and supporting (partly by tax subsidies) alternative service suppliers, education and risk-protection in the long term may undermine the support, trust and willingness to fund collective welfare state arrangements.

The financial crisis and beyond

After a decade of affluence and electoral swings to the centre-right the question now is whether the Nordic models and their social democratic bulwarks can repeat their previous success in the wake of the current crisis. The export-dependent Nordic countries were, except Norway, among the hardest hit by the recession following the financial crisis. Due to the lessons drawn from the 1990s, a banking crisis was averted, but GDP dropped substantially and severe job losses have occurred in manufacturing and construction. As a consequence, unemployment has risen considerably more than in most continental countries, especially in Denmark.

During the preceding bonanza, the Danish centre-right government's pro-cyclical policies fuelled a boom in housing and consumption. When the crisis hit, the result was a sharp drop in domestic consumption and declining public revenues, prompting cuts in public budgets and unemployment benefits, and a turn to austerity. In the other countries, things have worked out more smoothly. The combined impact of sizeable automatic stabilisers (due to the welfare state), low interest rates and fiscal packages – in Norway predominantly through public investment, in the other countries mostly by means of tax reliefs – contributed to stabilising domestic demand. Contrary to past recessions, however, no tripartite crisis pacts were enacted and Finnish employers even refused to take part in central negotiations.

Nonetheless, pay rounds were modest and entailed new ways of sharing the burdens of job and income losses at company level. Most spectacularly, in the absence of publicly funded temporary lay-off schemes in Sweden, the bargaining parties in manufacturing signed a "crisis agreement" opening the way for local negotiations of up to 20% working time reductions without pay compensation. In the other countries, various kinds of 'opening clauses' were seen in agreements, and new forms of rotating lay-offs and short-time work were tried out at company level.

However, the current recession has not created any crisis of consciousness comparable with the early 1990s. For the majority who have a job, real disposable incomes rose starkly during the crisis – thanks to exceptionally low interest rates and sizeable tax reliefs – implying that the crisis, except perhaps in Denmark, has bolstered the main governing parties and, to date, made minimal impact on the political landscape.

By early 2011, Sweden and other Nordic economies were recovering; companies were re-hiring and unemployment had started to fall. Thus, the flexible adjustment capacity of the Nordic models seems intact and even reinforced. This is in no small part due to the 1990s' shift towards sounder, rule-based fiscal policies and, in Sweden and Norway, the sharpened interest rate tool of the central banks. Nordic public finances are (with Denmark as a slight exception) in much better shape today than after the former crisis. The Nordic countries belong to the tiny group who are well within the criteria of the EU Growth and Stability Pact, showing minimal public deficits, low public debt, and rising current account surpluses.

The current recovery leaves no reason for complacency, however. The majority of Nordic exports are still going to a eurozone experiencing sluggish growth and other difficulties, and with clouds amassing on the domestic horizon, self-satisfaction can quickly boomerang. In contrast with the 1990s, the current ageing of the population will restrain labour force growth in the coming decades, and will – together with high unemployment and growing immigrant populations – engender rising structural expenditure, which is likely to magnify political tension over the funding and provisions of the Nordic welfare states. The sustainability of the Nordic social models is therefore crucially linked to the successful incorporation of the growing immigrant population into the labour market. If efforts in this regard fall short, pressures on the welfare state will increase; if they come together successfully, it may help rescue the welfare state. Besides the rise of the "inner right", welfare-chauvinist, immigrant sceptic parties have in recent Nordic elections attracted increasing shares of the former labour vote and conquered influential roles as government king-makers, leaving social democrats in a double bind.

Europe's future challenges

Apart from the obvious case of financial markets, an area that requires re-embedding in society is the labour market, which is not only characterised by inherent asymmetries between buyers and sellers, but has been subject to profound disorganisation and fragmentation over the past decades. The cross-border extension of the labour market, combined with the east-west welfare gap, alongside partial deregulation and institutional erosion, has hugely widened the gulf between the scope of the market and the reach of national jurisdictions, fuelling regime competition and social dumping. The growth in social inequalities and dualisation in Europe mostly arises from processes in the labour market. Even if these have been amplified by cuts in social benefits to make people accept even low-paid work – a case in point being Germany – the widened gap cannot be bridged by social transfers, but must be met with political measures to re-establish wage floors and restructure the functioning of the European labour market.

This will require a two-pronged strategy aimed, firstly, at rebuilding the self-regulating capacity of trade unions and employer federations by measures of state support and re-regulation; and, secondly, rebalancing power-relations between buyers and sellers of labour through economic policies securing sufficient labour demand, underpinned by a proper "reservation wage". In order to overcome the catch-22 situation of "semi-sovereign" national governments and labour market organisations in the European-wide market for labour, such a strategy will require co-ordinated political action at European as well as national levels in the fields of economic policies and labour market regulation, with the ultimate aim to empower workers and rebuild governance capacity on the ground. That is, quite the opposite of what the European Court of Justice did in the infamous Laval Quartet, where various national attempts to secure equal treatment of foreign workers were deemed incompatible with the free movement rules in the EU Treaty. Hence, an evident starting point for rebuilding the floor under European labour markets is to develop an effective, co-ordinated system of minimum wage setting governed by the social partners at the appropriate levels, supplemented by strengthened tools for monitoring and enforcement of the principles of equal treatment and social progress enshrined in the preamble of the EU Treaty.

Whatever reorientation European social democrats chose to strengthen their leverage, it is likely to be futile if they evade the arduous task of reconstructing European labour markets in the wake of the crisis – which was in fact the objective around which the labour movement originally gathered. As a "core business" issue for labour, this is a task which has the potential to link together action and interests across the multiple tiers of European politics – from the workplace and national associations to the European Council. If social democrats want to shift gear and style of play in response to the crisis, the unemployment aftershocks are the obvious place to start. It is here that renewal of the relations between the market, society and the state are most urgently needed.

The task is daunting, but it is worth noting that it was precisely their responses to the labour market fallout of the Nordic crisis and austerity in the early 1990s that brought Nordic social democrats back into the game after the wave of liberalisation and individualisation in the 1980s. It is not unlikely that the aftershocks of the current crisis and austerity period will make many diverse groups search for new and bolder answers – opening new avenues for political leadership on the left.

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* This essay is based on a chapter written together with Jørgen Goul Andersen and Juhana Vartiainen for a forthcoming book, European Social Models Facing Global Economic Crisis, edited together with Andrew Martin.

ESSAY

The new political imperatives of public spending

Balanced budgets and debt management must be embedded in a vision of the future of advanced societies; redesigning the structure of public spending is inevitable in the face of unsustainable sovereign debt, demographic change and conservative-led discourse

Rainer Münz

Three decades ago, unsustainable public debt and sovereign default were issues usually associated with developing countries and emerging markets – most notably in the case of the so-called Latin American debt crisis, but also in conjunction with many African nations. As a result, in the late 1980s debt restructuring for Latin America was sponsored by the then US treasury secretary Nicholas Brady. Private investors – mostly US commercial banks – were given a choice between suffering a haircut on the nominal value or accepting extended maturities and lower interest rates on the bonds that they were holding.

At the same time, a movement gained momentum advocating new tools of development assistance, including a call on donor countries to forgive the non repayable debt of developing countries. Several international conferences addressed this issue with substantial outcomes, not least in the run-off to the declaration of the Millennium Development Goals in 2000.

Today, it is the most developed economies that carry a considerable and partly unsustainable amount of sovereign debt. This is particularly true in the aftermath of the recent financial and economic crisis, where the worst case scenario has not taken place because of governments bailing out banks and financing stimulus packages to avoid the collapse of major financial institutions and a prolonged recession of the real economy. As tax revenues also fell during the crisis, the rescue and stimulus packages led to even higher sovereign debt both in absolute terms and even more in relation to GDP. In relative terms, Japan has become the most indebted country with a public debt to GDP-level of more than 200%. In countries like Greece, Italy and Belgium the debt to GDP-level is above 100%. The UK and Ireland are trailing just below 100%. In absolute terms, the US is the top-ranked country with a gross public debt in the order of US $14.3 trillion (2011) – almost the equivalent of the country's annual GDP.

Sooner or later the consequences of high sovereign debt affect all governments, but probably more so those led by social democrats than those led by conservatives. The reason for this is simple. The left relies more on the promise of universal provision of public services, universal social security and other ambitious social policy programmes, than other political movements. For conservatives, who do not necessarily share this view of the welfare state, it sometimes seems easier to ask for sacrifices.

Structural deficits are not just a post-crisis phenomenon

In many highly developed countries public debt rose not only during the recent crisis, but also during earlier boom years. The straightforward explanation for this is that government budgets are running structural deficits. Most of the time governments in Western Europe, North America and Japan are spending more than they raise in taxes, social security contributions and other income combined. A benign view would point to the fact that the difference might come from investments in science, education or infrastructure that will pay off in the future by strengthening the economy and, as a result, the fiscal position of the respective countries.

In most cases, however, a less favourable explanation applies: electorates are asking for more public goods, services and fiscal transfers than they are prepared to finance themselves as taxpayers; or, alternatively, politicians are promising their constituencies public goods, services and fiscal transfers without fully informing them about the price tags attached and clarifying who would be willing to pick up the bill. Occasionally, electoral manifestos even call for a combination of tax cuts and increased government spending. Under the imperative of vote maximising this is – at least in the short or medium term – a favourable solution as long as the difference can be financed by capital markets channeling individual and collective savings into sovereign debt in exchange for decent and predictable fixed income for private investors – including pension funds, life insurances and private household saving for their own old age, or even the education of their children.

In the long run, however, there are several risks. The most obvious is that economic growth seems to be negatively affected once public debt increases beyond a level of 90-100% of GDP. In the case of a loss of confidence in a particular sovereign debtor, the costs of issuing new and rolling over old debt suddenly become unsustainably high, forcing countries to ask for emergency assistance from the IMF – and in Europe also from the EU and individual member states. Usually, such financial assistance in the form of loans (with fixed interest rates well below the ones that struggling countries would have to pay otherwise) comes with a few strings attached. Countries that want to receive emergency loans to keep their public finances afloat usually have to agree on a variety of austerity measures, tax increases or more resolute tax collection, and measures to improve their competitiveness – including labour market reforms, the break-up of certain monopolies, higher competition and reduced targets, or caps on wage and pension increases. In the case of eurozone countries which cannot devalue their currency (without giving up the euro) some measures even aim at reducing existing wage levels in order to become more competitive *vis-à-vis* other countries – ideally by curbing labour unit costs in export-oriented sectors of the economy.

Creditors have all the power – as long as governments run deficits

There is a double irony (or tragedy) in this game. On the one hand, rating agencies, by downgrading the sovereign rating, and private investors, by asking interest rates well above long-term economic growth perspectives of a country, contribute considerably to the situation that at least the investors would most probably want to avoid: an unsustainable proportion of taxes going into interest payments, illiquid secondary markets for outstanding bonds (in case the European Central Bank or any other central bank is not intervening through "unorthodox" purchasing programmes), problems in the roll-over of maturing bonds and an eventual sovereign default in the form of debt restructuring.

The more investors run to the door, the more this door gets shut; and the higher the risk premium in the form of unsustainable interest rates, the higher the likelihood that this risk – sovereign debt restructuring or even default – will occur. As an unintended second round effect, completely illiquid secondary bond markets and sovereign debt restructuring leads to substantial problems for the commercial banks, insurance companies and pension funds currently holding these bonds. By the same token, financial institutions that have sold insurance against sovereign default (so-called credit default swaps) may not be able to honour this once such a default becomes reality.

On the other hand, in the case of a fiscal liquidity crisis, democratically elected governments and parliaments can be forced by not democratically legitimised institutions like the capital markets, the IMF and Europe's rescue umbrellas (EFSF/ESM), to accept sweeping cuts in public spending, sudden changes in labour and pension laws, tax hikes and the break-up of monopolies that have never before featured in their political agendas, party manifestos or coalition agreements, and that voters would hardly have approved in general elections if given half a chance. This is the flip side of governments unable to gain public support for reform agendas including similar steps in a milder or more incremental way.

Or – if you will – the flip side of a polity not willing to pay for the level of public services, transfers and social protection that they are expecting from governments or political parties that they voted for.

Recent European examples tell similar stories. In 2009, Giorgios Papandreou, the socialist PASOK party leader in Greece, campaigned for more government spending to overcome the recent economic crisis and managed to oust the previous conservative government only to implement the most radical cuts in spending and entitlements in the country's recent history. While showing seriousness of purpose to the IMF and EU member states that have come to Greece's rescue, these measures are at the same time prolonging the country's economic contraction which further reduces the likelihood that Hellenic sovereign debt will ever be fully repaid. Hungary's former government under Gordon Bajnai backed by the Socialist party agreed on an austerity package in exchange for a financial lifeline from the IMF and dramatically lost the 2010 elections only to be replaced by a nationalistic right wing government under Viktor Orbán no longer talking to the IMF.

In Ireland, Enda Kenny's Fine Gael and its Labour ally were elected not least on the promise to renegotiate the interest rate that the EU rescue fund had unilaterally set when bailing out the country. Once elected, Kenny got rebuffed by his EU partners. In Portugal, socialist Prime Minister José Sócrates had to call general elections as the conservative opposition no longer backed new austerity measures, which increased their electoral chances, but not the chances that the EU rescue fund will spare the next government from implementing the very same measures.

If all this looks like sheer crisis management, political maneouvring and a game of chicken between governments and opposition parties to the left and the right of the political spectrum, as a snapshot interpretation it, however, misses an important point: most measures have considerable social, economic and distributive implications. And by directly or indirectly letting rating agencies or rescue funds (IMF, ESFS) choose such measures, the countries involved lose control over the direction of their impact.

Balanced budgets and the decision to repay debt over a longer or shorter period of time must not be seen as political goals in their own right. They should be embedded in a vision about the future of advanced societies. Such a vision is ever more important, as Europe, North America and Japan are facing a prolonged period of low economic growth, stagnating or even shrinking native work forces and – most likely – higher public spending related to the retirement, health and care requirements as the baby boomer generation ages. All this comes at a time when the fiscal room for maneouvre (including debt financed government spending) is getting smaller as a result of previously accumulated debt as well as increasing scrutiny on the side of rating agencies, institutional investors and parts of the electorate. In this context, current budget deficits and debt levels need to be addressed with an agenda based on political priorities which should be made more explicit.

Social democrats must face up to the necessity of deficit reduction

Intuitively, the left believes in higher taxes – preferably targeting capital owners and rich people in general, but more often than not all sorts of taxable income or consumption. The right is usually more sympathetic to spending cuts as long as they do not touch agricultural subsidies and other vested interest of their constituencies. There are not only ideological but also electoral reasons behind this divide. On the one hand, in many advanced economies some 40-50% of the adult population does not pay income tax, but still receives or is entitled to some form of fiscal transfer. On the other hand, in countries with progressive taxation systems the top 10% of the income pyramid pays some 40-50% of all income tax.

In the United States, bringing taxes back to the level of the Clinton era – basically by allowing temporary tax cuts of the Bush era to expire – would make sense, as income and wealth is getting increasingly concentrated among the top 5% of the income pyramid. In most Western European countries, however, income taxes and social security contributions are not only fairly high today, but also contribute to the high cost of labour without increasing the disposable income of workers and their families. Taxes on consumption (VAT and special taxes on gasoline, alcohol, tobacco, and so forth) represent the other main income of Western governments. These taxes are regressive. In relative terms, poorer households pay more than richer ones as the former need to spend a larger portion of their disposable income to meet basic needs.

Rethinking and redesigning the structure of public spending is therefore inevitable, even if it is not very popular with electorates, not least for social democrats who consistently rely on extensive programmes of government expenditure to achieve their goals when in power.

The most obvious choice should be an increase in retirement age. It is only fair that today's working generation makes up for the fact that their life expectancy is increasing by a staggering six hours per day. There is "a fiscal quick win" in such a move as people remaining employed beyond age 55 to 61 (which is the actual retirement age bracket in most European countries) continue paying taxes and social security contributions while reducing the drain on public pensions. This option, however, demands a shift in attitudes both on employees' and employers' sides as well as on pension systems that do not favour early retirement. In this respect current adult education and training programmes, salary schemes, and pension systems must be reformed in order to make employment of older workers more attractive.

Beyond this, one basic challenge remains: should those who are already retired contribute to the costs caused by their increasing longevity via pension increases below inflation rate or higher taxes on their pension income? Or is it the duty of the active generation to shoulder all extra costs?

Health and care costs are a lot more difficult to tackle as, over decades, they have increased at rates well above GDP growth. This, in turn, hints at a potential for efficiency gains. For example, excess capacities of hospital beds could be slashed, health insurances within and even across countries could better leverage their combined purchasing power when negotiating prices with suppliers of prescriptive drugs and medical technology. It is doubtful, however, that such measures will be sufficient to counterbalance the costs of increasing demand for health and care services created by the ageing baby boomers. Of course, the tricky issue is: should those in need of old age care – or their children – at least partly bear the costs by using their accumulated wealth? Or is free, or even subsidised, care for the elderly in fact a kind of government funded "inheritance protection scheme"?

In the field of family policy, choices are made easier by empirical evidence. In rich countries, there is no positive correlation between the level of family/child allowances and the actual number of children per family. More funds should therefore be earmarked for institutional childcare facilities – crèches, preschools, afternoon classes for school children; but as such institutions are enhancing the earning capacities of parents, at least those with decent earnings could financially contribute to the costs of childcare provided by public institutions. And let us be honest about the impact on births and future employment: even lavish family policies will not lead to more potential mothers, whose number is shrinking in many countries as a result of constantly declining fertility. And in the short and medium term, however, shortages in the labour market cannot be met by means of family policy as children born in 2010 will not enter the labour market before 2030-2035.

Ageing societies with stagnating or even shrinking work forces and prospects of low growth rates cannot rely on fast increases of GDP and additional income from taxes to pay down public debt. The choice therefore is increasingly clear: it is between our current well-being, on the one hand, and the wealth of our children, on the other. Which will social democrats choose? And for what will their political competitors opt?

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Memos to the left

MEMO

Cut to the chase: 15 political truths for the centre-left

Andrés Velasco & Francisco Díaz

The world has just experienced the biggest financial crisis since the Great Depression. Over 80 million jobs were lost worldwide. The United Nations estimates that as many as 145 million more people are living in poverty. Scores of countries have emerged from the crisis with weakened financial systems and huge public debts. These nations may be condemned to slow growth and insufficient job creation for years to come.

Market fundamentalism, weak regulation and misplaced incentives for excessive risk-taking helped cause the crisis. Yet in the aftermath of the meltdown, reforms have been few and far between. Local financial systems remain prone to speculative bubbles and the world economy remains vastly unbalanced between surplus countries that earn far more than they consume and deficit countries that consume far more than they earn.

A crisis of global capitalism might have been an opportunity for the centre-left. Yet social democratic parties have taken more blame for the occurrence of this crisis than credit for their efforts to control it and prevent the next crisis from happening. Electorates in many countries have been swinging to the far right as an illiberal, inward-looking mood becomes a by-product of the crisis.

This all poses a tremendous challenge for the centre-left. The challenge, first of all, is to extract the right lessons from the crisis, and then to translate these lessons into a progressive political action plan. Here are 15 ideas to help leaders in that effort.

1. The world has changed – don't deny it.
The days when the phrase "the world economy" meant the United States and Western Europe are long gone. Today China is the second largest economy in the world; Brazil has a bigger gross domestic product than Italy; industry accounts for a larger share of output in the Republic of Korea than in France; more Volkswagen cars are made each year in emerging markets around the world than in Germany.

The International Monetary Fund forecasts that in 2011 the so-called emerging nations will grow 6.5 per cent, while developed countries will grow only 2.4 per cent. Expansion in the emerging nations has proven crucial to recovery from the crisis. Prosperity in rich nations is now inextricably linked to the fate of the not-so-rich nations. The sooner voters in your country understand this, the better.

2. Sometimes competition with emerging nations will hurt – don't deny that either.
There are things that poorer nations can make more cheaply. This is not because of unfair

policies in those nations; it is simply because labour is so much more abundant relative to capital. So some jobs will move south – and people working in those jobs will make things that will be sold in your supermarkets and that your citizens will buy for low prices, thus expanding the purchasing power of your citizens´ wages.

Some investments will also move south as capital seeks new, more profitable investment opportunities. This will be hard for some of your citizens to accept, but it should not be impossible for you to explain. Investment and growth in the South will create the necessary demand for your country's exports. It can be a win-win proposition for all nations, though not for all sectors within each nation. When sectors are hurt, they deserve your active help, not your indifference.

The way forward is not to tether capital and declining-sector jobs to the ground. Rather, it is to invest and create jobs in emerging sectors, precisely those where developing nations cannot make things more cheaply, mostly because they cannot make them at all. Green energy, biotechnology, the cutting edge parts of the digital industry – these are some of the areas where growth in the rich countries can take place.

3. Want to help the world's poor? Buy their products.
Aid is very necessary to keep the lowest-income countries afloat. But what most of the world's countries want is not so much your money as access to your markets. You can make a contribution to world equality by opening up your borders to developing nations' exports. When they tell you they want trade and not aid, believe them.

The Doha round of trade negotiations – also known as the development round – has now been going for nearly a decade. It could well die of old age and exhaustion. If the round fails, it will be the first time in the 70 years of the multilateral trading system that the world's trading powers have been unable to come to an agreement.

Pascal Lamy said recently that the time has come "[t]o reflect on the consequences of failure… In politics, as in life, there is always a moment when intentions and reality face the test of truth. We are nearly there today." Lamy is right.

4. The time to rebalance the world economy is now.
Imbalances in the world economy helped cause the recent crisis. To prevent another crisis, we must tackle the chief causes of those persistent imbalances: China's undervalued currency, weak demand in other surplus countries (Germany and Japan among them), and excessive fiscal gaps in the deficit countries (including the United States and the United Kingdom).

Persistent overvaluation is bad for the world and bad for China. It is bad globally because the recovery needs demand, and that additional demand cannot all come from the indebted nations of North America and Europe. And it is bad for the Chinese citizens on whom adjustment will be forced by inflation, as is beginning to happen already.

The world needs a new adjustment mechanism – and it needs it now. It needs a deal in which the surplus countries in Asia, Europe and the Middle East make a bigger demand effort to pull the world economy forward, while the deficit countries gradually correct their fiscal imbalances.

5. International capital mobility is good – in small doses.
One of the consequences of global imbalances is that surplus countries accumulate tremendous

stocks of assets, which have to be invested somewhere. Before the crisis much of this money was invested in real estate in Miami, Dublin or Spain's Costa Azul, and the consequences were disastrous. Now much of this money is trying to get into emerging markets – inflating the value of their currencies, equities and housing.

The world does not need another bubble, and policymakers in most emerging markets know it. That is why they will fight tooth and nail to discourage excessive or destabilising capital inflows. To do so they may use capital controls or prudential measures. In this effort they should receive the support of social democrats everywhere.

6. Welcome the huddled masses to your shores – they will help you prosper.
The tired and the poor yearning to be free will continue to arrive at your borders. Let them in. It is the right thing to do. It is also the self-interested thing to do.

It is the right thing to do because these people will have opportunities in your country that they would never have had at home. Having people move from capital-poor to capital-rich countries improves the world distribution of income, and that should elicit three cheers from any progressive. Let conservatives be lobbyists for the international mobility of capital. True progressives should advocate the free mobility of labour. Legal migration is far preferable to the black market in human beings that today operates in too many places, causing too much suffering.

It is the self-interested thing to do because migrants will give rich and ageing societies a dynamism they might not otherwise have. If you are European, be grateful. Inward migration is the one thing standing between your country and a massive pension crisis in just a few decades.

7. Fix your fiscal accounts – the progressive way.
There is nothing progressive about large fiscal deficits and high public debts: when public finances blow up and need to be fixed in an emergency, it is the poor and the vulnerable who end up footing the bill.

It is much better to strengthen fiscal accounts before a crisis – and to do it the progressive way. The first thing is to get the timing right. A weak recovery is not the time to tighten fiscal policy sharply. But if markets see no indication of tightening, they may abort the recovery themselves. The way out of this conundrum is to commit to adjustment, backload it, and make credible any promises of additional future tightening. This may require setting up fiscal rules and independent fiscal councils. Such rules have worked well in social democratic countries: Sweden is an example from the North and Chile is an example from the South.

If forced to choose between tax cuts and investment in education, innovation and infrastructure, progressives should not hesitate. Economies that do not invest do not grow. And without growth no fiscal tightening, however large, will fix fiscal accounts.

8. If you are European, stop pretending you can have monetary union without fiscal union.
The single currency has brought Europe many advantages, including increasing integration, trade and prosperity. But it has created some problems. Monetary union created the fiction that investing in all countries in Europe carries the same risk. It does not. As a result, too much money flowed to too many countries that were ill-prepared to receive it. In some of those countries, the money perpetuated unsustainable fiscal policies. In others, it fuelled property

and credit bubbles. Europe and the world are now suffering the consequences.

It was always understood that monetary union required prudent fiscal policies in all member states. The instrument for guaranteeing the prudence of those policies was the Maastricht Treaty. That instrument has failed spectacularly. It is time for a new approach.

A common European bond is the necessary first step – without it, today's fiscal crisis will not go away. But a new, single bond requires new, single-minded discipline. This will mean less national autonomy on fiscal matters – there is no point in denying that. But it is the price to be paid for monetary union.

9. If you are Latin American, stop pretending commodity wealth will last forever.

For decades Latin Americans thought that natural resources were a curse. Libraries were filled with treatises arguing that the region's dependency on a few primary products condemned Latin America to poverty and underdevelopment. Today, after a decade of booming commodity prices, many of those volumes look as if they may end up in the dustbin of history.

Natural resource abundance can be a powerful force for growth and prosperity. Nations such as Canada, Australia, New Zealand and Norway have proven the point time and again. But there is nothing natural about natural resource-driven prosperity. It requires sound thinking and prudent policies.

Politicians of all stripes will want you to spend the commodity windfalls up front. Resist their pressure. If you give in you risk not only wasting the money but also overheating the economy – witness the situation in many Latin American economies today.

And never forget that commodity prices can fall and exhaustible resources can run out. Begin preparing for that day today. Save a portion of the windfall. And invest the rest in an industrial policy 2.0, promoting sectors that have strong linkages with your natural resources. Critics will say you are picking winners. Never mind. Nature (or God, if you are a believer) already picked the winners for you.

10. Make competition policy stricter to keep firms from misbehaving.

Private businesses innovate and create prosperity not because they are generous and kind. They do so because they can feel competitors breathing down their necks, threatening to take their customers away. Innovation requires competition, but there is far too little competition in many modern markets.

Making markets work for ordinary people and not for a privileged few requires a competition policy with teeth – with fines large enough to serve as a deterrent and with prison terms for the worst offenders. Modern progressives can be pro-market without being pro-business.

11. Reform executive pay – the clever way.

Sky-high executive salaries can give rise to popular indignation and lower social morale. That is why compensation is an easy political target – perhaps too easy.

The problem is not limited to the large sums involved. After all, no one complains when football heroes or movie stars make very big money. The indignation comes from comparing how much financial executives were paid and how much trouble they caused. Put differently, the problem arises because bankers´ pay created incentives for them to take on too much risk – and that risk ended up being borne by ordinary taxpayers.

So reform should focus not on the amounts themselves but on the bad incentives they can imply. Bonuses at the very least should carry claw-back clauses: if a supposedly brilliant investment later turns sour, then the financier is revealed to have added no value. Any special rewards he or she received should be returned.

12. Reform the state – neither the right nor the old left will do it.
For progressives, democratic politics is the way to build a better society and the state is a key instrument in this task. But states are not in top shape. Over-staffing, inefficiency and rigidity affect states everywhere. All too often, public services are not what citizens deserve. But the solution is not the comprehensive cut-to-the-bone that the right advocates. To reform the state, you first have to believe in the state. We need a stronger state but also a more agile state. It is not size, but motion, that matters.

The problem is that reforming the state is politically difficult. Incumbents who have done things one way for decades refuse to do things differently now. Public sector unions are sceptical of reform, if not decidedly hostile. As a result, politicians of the right and the old left alike tend to change little, to do it slowly, and to focus more on cosmetics than on substance.

Progressives can do better than that. There is nothing more progressive than providing quality public services. There is nothing more forward-looking than to reinvent government. When you do it you will be criticised by conservatives and by the old left. Never mind. It is a sign you are moving in the right direction.

13. Get to know your voters – if you don't, someone else will.
Beginning in the 19th century, the left represented the underprivileged in their struggle against the privileged. The men and women of the left were those who suffered poverty and oppression in the flesh.

Things are dramatically different in the 21st century. In the rich world, the material needs that motivated class-based voting have mutated. In the emerging world, material and post-material concerns overlap in ever-changing and surprising ways.

Ethical voting is on the rise everywhere. New causes – the environment, gender equality, transparency and accountability in government – are now near the core of the centre-left agenda. Today progressives must lead by example. The *raison d'état* is being supplanted by citizens' common sense.

Get to know your voters. Understand that for them, good policies are not enough if they are not transparently applied. Increasing social spending is not enough if the politicians doing the spending and getting the credit are always the same ones – and are invariably men. Making the economy grow is not enough if it is at the expense of the environment. Today's voters want good government from politicians whom they pay to govern well. If you do not get this, your voters will go shopping elsewhere.

14. Populism has changed – now it's even more populist.
Populism is an old adversary of progressive politics. But the adversary is changing. When populists were a caricature of themselves, issuing crazy promises in flowery language from the proverbial balcony, it was easier to face them down. Today's populists are more subtle and sophisticated – and therefore more dangerous.

The old populism has been replaced by poll-driven populism. No politician can afford to ignore surveys of public opinion. But it is one thing to look at survey data and another to govern by people-meter. Progressives build political capital to invest it on difficult reforms; populists accumulate political capital to get even more political capital, to be used for making sure that they or their friends will govern.

The new populism is just as prone to demagoguery as the old one. The new populism does not attempt structural transformations, it relies on handouts rather than on social reforms, and it is not shy about manipulating voters´ fears. Progressives, by contrast, should come clean and say: progress comes slowly and it requires sacrifices from all. Do not worry about the consequences of such words. Voters can take the truth. They are grownups. They appreciate being treated as such.

15. Beware of conservatives – both on the right and left.
Conservatives believe that things are fine the way they are, and should stay that way. Progressives, by contrast, believe things can and should be better. Progressives fight for civil rights, because without freedom there cannot be progress. And progressives fight for equality of opportunity because without food, shelter and education freedom can be illusory.

But while most conservatives are on the right, there are also many conservatives on the left. What these conservatives have in common is paternalism – the belief that they alone know what is good for citizens. Modern paternalists want to tell citizens what they should read, eat, drink and with whom they should share a bed.

The 21st is the century of empowered citizens. The last thing they want is to be told is what to do. If modern social democrats fall prey to the conservative politics of paternalism, upset citizens will extract their revenge at the voting booth.

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MEMO

Resisting globalisation is a losing strategy

Robert J. Shapiro

For nearly a generation, none of the large, advanced capitalist economies have been able to both deliver growth and promote social justice at the same time. The United States produced generally strong growth from the early 1990s until the financial meltdown, but virtually all of the economic gains in that period were captured by the highly trained professionals and managers at the top of the skills ladder and by the wealthiest 1%, who hold about 45% of America's financial assets. Inequalities of wealth are less drastic in the major Western European economies. But the annual growth rate of the German, French and British economies averaged between 20 and 35% lower than that of the US economy over this period; and the incomes of moderate and middle-income Western European households largely stagnated, much as they did in the United States.

On both sides of the Atlantic, the challenges to fairness and growth come mainly from the signature economic developments of the time: the spread of contemporary globalisation and the economic impact of information and communications technologies. Reforms to restore the capacity of market-based economies to deliver fairness with growth have to address how these two developments are reshaping our economic lives.

1. The hallmark of contemporary globalisation is the large waves of foreign direct investments in developing nations by multinationals in advanced countries. Unlike foreign investments in earlier times, foreign direct investments (FDI) now involve huge transfers of the world's most advanced technologies, business methods and entire business enterprises to developing economies. Through this FDI, companies can deconstruct and redistribute their production and assembly operations across nations and markets in order to take advantage of the efficiencies, resources and domestic markets of each country. And much of this FDI now flows to developing countries which create an environment attractive to multinationals through large-scale public investments in their education, infrastructure and public health systems. This process has produced the most rapid gains in output, productivity and incomes on record, in countries as disparate as China, Hungary and Brazil.

2. However, the process of contemporary globalisation carries some significant costs for advanced economies. The United States and Europe continue to host manufacturing to serve their own markets and produce the most high-end components for worldwide manufacturing. But most production and assembly has moved to developing nations and will never return. The efficiencies of these global supply and production networks have cost advanced economies much of their manufacturing base, including thousands of firms that produce goods and services used by manufacturers. They have also created a new international division of labour, in which the United States and other advanced countries have, or soon will, become predominantly idea-based economies. Since 1995, US companies have invested more in intellectual property and other intangible assets than in physical assets; and two thirds of the current value of US public companies can be traced to those intangibles. This shift drives up the incomes of those who create ideas or operate well in workplaces dense with the technologies that organise, analyse and transmit ideas – mainly professionals and managers – and drives down the market value of everyone else's labour.

3. Globalisation squeezes average incomes in advanced economies in another way. The creation of thousands of new businesses in lower-cost countries, and of tens of thousands of new, more internet-enabled enterprises in advanced countries, has intensified competition. With greater competition, companies have less ability to raise their prices. The positive effect has been nearly a generation of historically low inflation and interest rates. The negative impact comes when companies that cannot raise their prices have to swallow the rising costs of energy or healthcare, for example, or payroll taxes. This squeeze forces them to cut other costs, starting with cuts to jobs and wages.

4. The big European nations sometimes try to resist globalisation, but that is a losing strategy. Less than 10% of the total stock of foreign direct investments made by Western European companies is located today in developing countries, compared to 30% of the FDI stock of large US firms. The result has been lower efficiency and shrinking global market shares. Not only has the United States experienced stronger growth. In addition, the world market share of Europe-based high-tech firms fell from nearly 25% in 1990 to about 18% in 2006, while the market share of US-based high-tech companies jumped from 24 to 41%. Remaining aloof from globalisation has not preserved European incomes: per capita incomes in Germany, France and Britain today average more than 30% less than in the United States.

5. The most powerful responses start with growth – and specifically with greater public and private investments to enhance the comparative advantages of advanced countries as idea-based economies. This means more government support for basic research and development and stronger incentives for private research and development. It also means new efforts to reduce barriers to creating new businesses, for example by providing greater access to financing and reducing red tape. Young businesses are not only the main source of new jobs in advanced economies; they also account for a large share of technological and organisational innovations. When they succeed, that produces strong pressures on established businesses to adopt those innovations, raising productivity and incomes beyond the original innovators.

6. To ensure that these gains are shared more fairly, the advanced economies have to make major changes to their education and training systems. Access to higher education should be every young person's right, so that anyone can build the skills needed to work productively in modern, technologically-based enterprises. Governments also have to help ease some of the cost pressures on businesses that are under intense competition, so more of their gains can translate into jobs and wages. This will mainly entail more serious efforts to slow increases in healthcare costs, for example through results-based reimbursements. The fast-rising costs of new treatments, along with the rapid ageing of the populations in all of the advanced countries, drive up these costs for employers – directly in the United States and indirectly everywhere through the taxes required to support healthcare. Ageing is also beginning to shrink the workforces of many countries, or at least slow their natural growth. To maintain workforce growth and the revenues based on it, advanced countries should prepare themselves for higher immigration.

7. The last generation's advances in information and communications technologies play a major role in all of these developments. They accelerate globalisation by providing an infrastructure to manage worldwide production and assembly networks. Through new software, they are creating new ways to deconstruct large-scale business services and distribute their parts across many countries, much like manufacturing a generation ago. Advances in ICT are also critical to innovation in many other areas, from biotechnology to internet-based goods and services. And broadband internet is vastly expanding global markets for the intangible goods and services which are now the hallmark of advanced economies. ICT's role in growth, therefore, is clear.

8. Much like globalisation, governments need new approaches to ensure that the gains from the impact of information and communications technologies across the advanced economies can be shared more broadly. First, broadband infrastructure should reach every business and every household. Next, governments should deliberately expand opportunities to form new ICT-based businesses, again by lowering barriers based on access to financing and bureaucratic red tape. The formation of new ICT-based enterprises will not only directly create more jobs; it will also increase incentives for workers to gain the skills needed to win those jobs. To give them the opportunities to do so, governments can provide grants to local educational institutions to offer all adults free training in computer and internet business skills.

9. Government should begin to address directly the increasing inequalities of wealth. In the United States, 93% of the value of all financial assets is held today by just 20% of Americans, and the top 1% hold over 40% of those assets. The wealth distribution is less skewed in the major European economies, but to only a modest degree. The hallmark of fairer growth should be greater opportunities to share in the wealth created in the world's most advanced, idea-based economies. Creating the conditions for stronger job creation and wage gains, as described above, will help. But it will not be sufficient for real fairness. Over the next generation, European and American companies can be asked to set aside 5% of their ownership in a pool for their employees. These ownership stakes could be distributed as pension assets through contributions of stock to private retirement accounts, for example, or grants of stock of the kind that executives claim regularly. In this way, governments can reduce the pressures on state retirement systems and help spread the wealth in the world's most advanced economies.

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MEMO

How to fulfil the promise of opportunity for all

Isabel V. Sawhill

Centre-left governments face a number of critical domestic challenges. This memo is written primarily from a US perspective and with a recognition that the problems differ from country to country. Indeed, in some areas the United States has a lot to learn from our friends in other advanced countries. In other areas, the problems are not necessarily so dissimilar, but the US political system seems almost uniquely hampered in its ability to deal with them effectively. A number of policy priorities are outlined in this memo, which are aimed at advancing the following three goals: first, job creation and economic growth; second, long-term fiscal stability; and third, creating an opportunity society in which more people have a chance to join the middle class. These issues overlap. Growth promotes opportunity (although not necessarily broadly shared opportunity); too much fiscal constraint destroys jobs (but not if we get the timing right); some policies serve multiple objectives (for example, education aids both growth and opportunity).

1. We face high levels of joblessness as a result of the recent economic crisis. Equally important is the sense that those jobs are not going to come back due to global competition and the pace of automation. What will take their place and sustain a middle class lifestyle remains highly uncertain. At the current time there is a need for fiscal stimulus or other measures to deal with current unemployment.

2. Even among those who are employed, families are struggling to get ahead in the face of stagnant wages. Even before the recession, young men in their thirties were earning no more than their fathers' generation did at the same age in the United States. Women's wages are still lower than those of comparably situated men, but they have made impressive earnings gains as their education and experience have expanded. Their widespread entry into the labour market has been the primary reason that middle-class incomes have not fallen over the last few decades. This trend has placed great pressures on family life, especially in the United States, where there is little social support for working mothers. Single parents and families dependent on two earners cannot survive without adequate substitute care for their children and time off when needed. We need more subsidised childcare, more paid leave and other policies that can help families to balance work and family life.

3. Education and healthcare systems need to be modernised. Both are high-cost, low-productivity enterprises that have not kept pace with other sectors in terms of innovation and change (for example, the use of technology, performance-based compensation, heavier reliance on evidence about what works). We should catalyse innovation in the delivery of both healthcare and education to reduce costs and improve quality. In both sectors it will take experimentation and efforts to make government funding conditional on innovation and performance. For example, teacher tenure and compensation should be based on classroom performance, and compensation for healthcare providers should be based on the effectiveness of the treatments and drugs prescribed.

4. Infrastructure, whether in the form of highways, broadband or high-speed rail, needs to be improved and new investments need to be made in science. In the United States, there is interest in turning over decision-making for such investments to an independent body or bodies to lessen political pressures on the process. There is also interest in involving the private sector through loans and loan guarantees. With these reforms in place, giving priority to investments in education, infrastructure, science and access to healthcare make tremendous sense. The size of government is less important than its effectiveness and especially its ability to spur growth. Leaders need to argue for "smart" or "pro-growth" government, not more government. Greater decentralisation of government functions may be part of producing greater efficiency and effectiveness, especially in large, diverse nations such as the United States.

5. Over time, greater productivity from these investments in education, health, infrastructure and innovation will allow wages to rise and the prices of everyday products to fall. Global competition, despite its obvious downsides, will help to spur innovation. Better systems for training and retraining workers (while giving them some support in the interim) are badly needed. Trade is beneficial to a society, on balance, but policies to help those who are the victims of economic change have not worked well thus far.

6. Ageing populations, combined with major medical advances, have improved the quality and length of life, but have also led to excessive government spending on healthcare and retirement. Current government obligations for these items are not sustainable or affordable without ever-increasing tax rates. In the United States, federal healthcare and retirement expenses currently absorb over 70% of all revenues. While revenues can and should be increased, this cannot be the entire solution. We need to reallocate resources from the more affluent elderly to the less affluent young. This can be done gradually and in a way that preserves current benefits for those who are retired or about to retire but slows the growth of benefits for future generations while investing more in them when they are young. Any society that invests in its old at the expense of its young does not have much of a future. By reforming these programmes now we can ensure that they will be there for future generations.

7. We must radically simplify the tax system to make it fairer, more efficient and less tilted towards special interests and the more affluent. We can reap additional revenues in the process. Eliminating just half of all tax expenditures in the United States would produce about $5 trillion over a decade and, along with the expiration of the so-called Bush tax cuts which would yield another $4 trillion, could plug most of the deficit hole for the coming decade (but not beyond this point when the costs of paying for the baby boomers' retirement loom large). To increase mobility and opportunity, and thus social justice, we should also increase taxes on large inheritances and on accumulated wealth, not earned income (except at the highest levels). We should dedicate any new taxes to high-priority public investments in education and healthcare so that the public know what they are getting for their money. Although disliked by economic purists, earmarked taxes have far more staying power than general revenues.

8. Inequality has increased to levels not seen in almost a century, with both income and wealth heavily concentrated at the very top. This is raising concerns that not just economic but also political power is increasingly skewed to favour the very rich and to favour the sources of their wealth, such as finance and energy. Below the top income ranks the kind of broad-based prosperity that was the hallmark of mid-twentieth century America has disappeared. These growing income gaps have many causes but the most important are the failure of the supply of educated workers to keep pace with demand, changes in family structure and changes in pay practices and norms.

9. Polls in the United States show unequivocally that the theme of opportunity resonates more with the public than the problem of poverty or inequality. Yet, as a result of inequality and demographic trends, we are headed towards divided societies in which on the one hand there is an elite that is well educated and well paid and forms intact families in which children are provided good opportunities from an early age, and on the other a rapidly growing group of less-educated young adults who are adrift. The latter group is not just floundering in the labour market; they are also not forming strong families. In the United States, half of all children born to women under the age of 30 spend their early years either in single-parent homes or in very unstable family environments. Meanwhile, Brookings Institution research shows that those who graduate from high school (or better), who work full time and who delay having children until they are married are almost guaranteed to escape poverty. A college education is the ticket to success in the United States but it should not be the only option. More emphasis on technical education at the secondary and post-secondary level, as well as more opportunities for young people to get on-the-job training and experience in new or under-resourced fields, could enhance job prospects, productivity and earnings for the many youth who either do not go to college or drop out before they graduate.

10. An opportunity exists to use the fiscal crisis to restructure social assistance. It should be tied to personal responsibility (for example through welfare for work) and provide more flexibility to local governments (for example through block grants). Government should only assist those who are helping themselves or those who are truly incapacitated. It should provide jobs and wage supplements to the poor, not unconditional assistance. At the same time, it is important to recognise that many of those who are disabled or long-term unemployed want to work and should be given an opportunity to do so, through subsidised private or public sector jobs if necessary, but on a temporary basis. That said, there is only so much restructuring and reform that can be done and there are political and economic limits to raising revenues. As argued above, gradually reallocating resources from more affluent seniors to less affluent working-age families and their children has to be part of the solution as well. The emerging consensus in the United States is that investments in high-quality early education and parenting programmes are the most cost-effective way to provide greater opportunity for the less advantaged.

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MEMO

Don't drop the social investment strategy but give it more bite

Frank Vandenbroucke

Social democrats are grappling with the question of whether it is possible to restore the state's capacity to transform society and generate higher levels of public goods in the current fiscal climate. The answer to this question is a qualified "yes, we can". Centre-left parties can transform society in the long term if the approach adopted satisfies a number of important conditions.

1. Transforming society is possible if the state's intervention is strategic. It must be focused, sustained over a sufficiently long time span and explicitly geared towards achieving long-term public goals. The politics of progress is the politics of the long term: in societies dominated by distrust in politics, and hence by short-termism and political instability, safeguarding the long term constitutes social democracy's principal challenge.

2. It must be recognised that "the state" is a multi-layered reality. In Europe, state power is wielded by national governments, regional governments and the European Union. Our capacity to deploy strategic policies in this part of the world will depend on our capacity to sustain strategic interaction between the European Union, national governments and regions. Social democrats will have to come to terms with the role of the European Union and overcome national and/or regional resentment towards supranational co-operation.

3. The idea of "social investment" is a long-term strategy par excellence. The social investment perspective, embraced by the centre-left in the 1990s, was developed with the dual ambition of modernising the welfare state to better address new social risks and the needs structure of contemporary societies and to ensure its financial and political sustainability, and sustaining post-industrial economic dynamics. The focus was on public policies that *prepare* individuals, families and societies to adapt to various transformations, such as changing career patterns and working conditions, the development of new social risks and population ageing, instead of simply generating responses to *repair* damage. By addressing problems in their infancy, the social investment paradigm aims to reduce not only human suffering, but also government debt and ecological degradation.

4. The fundamental societal trends that necessitated a social investment perspective are as relevant and important today as they were 10 years ago. However, we need a new social investment approach. There are three reasons for this. First, social investment is a supply-side approach and as such is incomplete; the financial crisis proved that we also need financial regulation and strategic macroeconomic governance (see point 5 below). Second, social investment has to be a consistent package (see point 6 below). Third, social investment must not be perceived as an elitist project (see point 7 below).

5. There is a real danger that social investment is left orphaned by the financial crisis and its consequences. Budgetary discipline will be an inevitable and hard reality but social investment must not fall victim to austerity. On the contrary, social investment priorities must be embedded in the budgetary and macroeconomic policies we pursue. Short-term macroeconomic and budgetary policy should serve long-term social investment goals. In an age of austerity, the quality of public spending will be crucial.

For that reason, the current debate in the European Union on new macroeconomic and budgetary surveillance is critical: macroeconomic and budgetary surveillance should serve the social investment aims that were, at least in principle, adopted in the EU2020 strategy. Reconciling macroeconomic and budgetary surveillance with the social investment imperative necessitates a new *EU social investment pact,* which must have as much bite and political clout as the so-called “Europact”.

6. Has the social investment paradigm delivered the goods so far? Is it really socially inclusive? Employment rates have been increasing in Europe, but the proportion of children and working-age adults living in jobless households (households for which the poverty risk is much higher than the average) remained stable. This signals a crucial failure in the implementation of the social investment paradigm. Poverty did not decrease. Policymakers who promoted social investment should examine this question seriously.

In the long term, the outcome of social investment strategies can be positive if structural unemployment and the proportion of work-poor households decrease, and if available resources are invested in quality childcare and education, in increasing net incomes for families with low-paid jobs, and in improving care (and where necessary also pension benefits) for the elderly. Although the jury is still out, we can identify a number of preconditions for a social investment strategy to be successful with regard to social inclusion.

First, equality seems to be both a precondition for a successful social investment welfare state and one of the important outcomes of social investment policies. We know that egalitarian societies are more successful in implementing social investment policies. If it is a precondition it urges us to remember the merits of traditional social protection and anti-poverty programmes, and suggests that reduction of income inequality should remain high on the social investment agenda. Hence we need a balanced approach, with an investment strategy and a protection strategy as complementary pillars of an active welfare state. Otherwise it will be impossible to turn vicious inter-generational circles of disadvantage into virtuous circles of inclusion and emancipation.

Second, in order for social investment to be a driver in virtuous circles of inclusion, the investment function itself should be egalitarian. Rather than exacerbating background inequalities, the impact of childcare and education should be to reduce inequality in society. Social services should be genuinely capacitating. Hence the quality of social services is part and parcel of the social investment strategy. Only high-quality childcare produces a long-term impact on children’s capacities and successes and on reducing social inequalities. Quality childcare is essential in making a difference and attaining the goals of the social investment perspective. Equally, active labour market policies can be seen as elements of social investment only if conceived of as an instrument of social promotion. Activation services of poor quality produce poor results. Education reform, too, with a view to enhancing real equality of opportunity, should be on the agenda in many countries.

Third, creating virtuous circles of inclusion and emancipation presupposes that policies are sufficiently ambitious and mutually consistent. The social investment perspective is a package and partial implementation may at best deliver a partial success.

Fourth, although the social investment paradigm has not "crowded out" traditional welfare programmes over the last two decades, a social investment strategy is not a cheap option that allows substantial budgetary savings. Simultaneously responding to rising needs in healthcare and pensions and implementing a successful transition towards fully fledged social investment strategies will require additional resources. The erosion of the tax base and the imperative of budgetary austerity in the wake of the economic crisis of 2008-2010 is a dangerous threat to the social investment strategy. Budgetary discipline must not destroy the social investment perspective: additional tax revenues may be a necessity to overcome the current crisis without destroying social investment. Simultaneously, and for the same reason, we will have to convince public opinion that the budgetary cost of ageing must be contained in order to retain leeway for investment in youth. Working longer (and reforming labour markets) is imperative. Moreover, given the scarcity of resources, efficiency is paramount. Intelligent selectivity and targeting of policies will often be necessary, in the areas of both protection and investment.

In short, social investment must be seen as a package. It is a package of reform, not of the status-quo. It is not a cheap option, nor an easy option. Therefore, social investment is a demanding strategy with regard to public support and trust. Trust is a key factor for its political sustainability.

7. The social investment imperative must be embedded in an attractive concept of social progress. Formulating a new concept of social progress is vital for social democrats, yet also a difficult task. Rhetorical tricks will not suffice. We need a substantive concept of progress that is sustainable in a dual sense: it must be ecologically sustainable and it must also be credible in the long term, that is to say, we must be able to deliver on it. Big promises will not convince a *fortiori* if they have a purely material content (for example big promises about increasing purchasing power).

The social investment strategy as it was often presented was a liability rather than an asset in this respect. It was associated with a one-sided, and therefore erroneous, understanding of the evolution to the knowledge society. As a matter of fact, jobs we consider as low-skilled or medium-skilled will remain very important in our societies, including notably jobs that encompass important non-routine tasks such as care, but also domestic cleaning, hair-cutting and so on. The non-routine competencies for these jobs require quality training. Rather than conflating progress with the notion of a high-skilled society, we should say that progress calls for a well-skilled society. Everybody should aspire and everybody has the right to be *well* skilled.

8. Successful reform requires strong and credible leadership and the restoration of trust. Our discourse should not shy away from the difficulties ahead, nor from the personal responsibility of each citizen, upon which social solidarity is based. Here is one important caveat. In the past I often argued for a responsibility-sensitive conception of equality. Invoking responsibility must signal, simultaneously, two normative ideas: personal accountability for personal choice *and* a sense of social commitment in economic behaviour. The egalitarian perspective that is the essence of social democracy requires *both*. This twofold ethos has to shape our society's institutions and the way individuals behave within those institutions. It calls upon the rich and the powerful as much as it calls upon the poor and the powerless. Social democrats must make that very clear, for instance in discussions about top incomes and bonuses, and they also must themselves behave accordingly. In order to regain the trust of “normal people”, the economic, social and political elites will have to deliver on moderation and responsibility.

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MEMO

End the self-destructive reliance on the state

Marc Stears

The limits to the power of the unreformed state have always been more extensive than we have admitted. This is true in relation to the limiting factors of globalisation and fiscal restraint. But it is equally evident in the state's frequent inability to respond to local particularities in need and desire; its reluctance to grant a democratic voice to the workforces of major industries or the recipients of major public services; and its unwillingness to open up its own decision-making procedures. The effects of all of these have been directly experienced by people in their everyday lives across Europe. They have played a frequent part in our electoral defeats. Yet they have been worrying overlooked by the major parties of the left.

1. The key question that faces us today should not just be about the capacity of the state. It should be about the left's reluctance to embrace the need for far-reaching democratic reform. In Britain there have been many historic efforts on the left to democratically reform the centralised, bureaucratic state. In the first two decades of the twentieth century, guild socialists insisted that a truly socialist society would require democratisation and decentralisation, rather than the expansion of central bureaucratic power. In the 1950s and early 1960s, the new left denounced the distanced, mechanical and elitist politics of post-war social democracy and sought to construct participatory alternatives. And in the late 1990s, in a very different vein, Tony Blair and colleagues attempted to dislodge the established orthodoxies of the British Labour party and instead to ally the party to what they saw as the raw energies of market and society.

Yet every one of these efforts failed. At each historical moment, the democratisers and decentralisers had a brief moment of success, with policy and programme shifting a little temporarily, but ultimately returned to a state-centric social democracy. The government of Gordon Brown is the latest, and one of the most dramatic, versions of this repeated story. Swept to power alongside Blair's self-described "modernisers" in 1997, Brown left Downing Street in 2010 having overseen Labour's almost total reversion to type. The Labour party that fought the general election under Brown was a party whose appeal lay almost entirely in its ability to protect vital social programmes and as a result was dependent for its electoral support almost entirely on public sector workers and on those who extensively relied on those public services. The additional, reforming zeal that has characterised the Labour party in its best historic moments was almost entirely absent, and it is unsurprising that electoral success proved elusive.

2. Social democrats have assigned too much priority to the ends rather than the means of change. Since the end of the Second World War, European social democratic and Labour parties have prided themselves on the flexibility of their thinking when it comes to the mechanisms of politics. Unlike their communist or free-market rivals, with their unshakeable commitments to particular approaches to political change – based in state or market, revolutionary vanguard or entrepreneurial bourgeoisie – the mainstream left has continually emphasised its openness. What matters, it has insisted, are the aims of politics and not its processes. The left has thus exerted far greater intellectual energy in discovering the true meaning of equality, identifying the right metrics of social justice and stipulating the proper balance between individual rights and social responsibilities than it has in considering the right way to bring these goals about.

Paradoxically, however, this unwillingness to engage with the mechanisms of politics has not resulted in a diversity of actual approaches. Instead, it is this reluctance that has always led the left ineluctably back to the unreformed state. This is for one simple reason. There has been a consistent, even if generally implicit, understanding that the centralised state is the best agent to advance the left's agenda; an understanding which has been left untouched by the reluctance to think about means as well as ends. The arguments are familiar and powerful: equality demands a standardisation of experience that only the state can ensure; social justice requires a redistribution of material resources that only the state can effect; the balance between rights and responsibilities requires a neutral arbiter between different social interests of the sort that only the state can offer. But the certainty with which these arguments are accepted often entails a failure to consider that it is also crucial to consider the means by which these goals are pursued.

3. It is, then, precisely because the political *means* themselves are not considered intrinsically important, and the *goals* are said to be everything, that the left is reluctant to reform the state. Worse than that, it is because of this that the left exhibits this trait with a self-confidence which often deters the broader public from supporting left political parties. Such a tendency was abundantly evident in Britain during Gordon Brown's period as prime minister. Because the values that underlay government policy were unquestionably appealing ones, Labour seemed entirely unable to understand that the British public resisted the excessively undemocratic, state-directive, managerial mechanisms that were being used to pursue them.

4. The challenge facing the left now is to find a way out of this recurring loop in which its important principled priorities allow it to slip into an unattractive and unsustainable reliance on an unreformed, bureaucratic state. It can begin to do so by reminding itself that the *means* do matter in politics. Indeed, they often matter independently of the ends that we set ourselves. The intellectual founder of European social democracy, Eduard Bernstein, once argued that for social democrats "the movement is everything and the ends are nothing". It would be helpful to remind ourselves of what Bernstein meant here. He was calling for a democratic politics within which people would be encouraged and enabled to come together themselves and exert a real influence on the decisions that shaped their lives, find solidarity with others, and build an associational and communal experience that would enrich their own lives.

This is the kind of left politics that places the *mechanisms* of political change right at the heart of the issue. What matters most of all is enabling and encouraging a politics of the common good. In such a politics, people are enabled to come together to face their own problems. It reminds us that we cannot have equality, social justice and human rights simply provided for us by someone else. Those crucial goals require us, the citizens, to be part of the process by which they are created. If we remember that single, simple lesson then we will not only have new and interesting things to say about political mechanisms, but we will also be reminded that the demands of democratic reform are as important as a reassessment of the state's capacity. If we do that, then our prospects will improve once again.

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MEMO

Building blocks for a new politics of production

Roger Liddle

In the immediate aftermath of the 2008 crisis, it was right for progressives to concentrate on classic Keynesian measures to avert depression on the scale of the 1930s; now, however, we need to combine credible advocacy of sustainable deficit reduction with a new politics of production. This should be based on a broader and more challenging critique of our pre-crisis political economy, with the explicit aim of fleshing out a new, progressive "variety of capitalism" which combines economic dynamism with new policies for inclusion and security in the labour market.

We have argued for years that progressives must not succumb to protectionism. This is still right in terms of both morality and self-interest. The dynamic of globalisation lifts millions every year out of dire poverty. For all the huge problems of urbanisation, environmental degradation and climate change that it brings in its wake, globalisation opens up possibilities for human self-fulfilment that were hitherto closed. And the maintenance of open trade is the most likely means of ensuring peace and stability in a world where the balance of power is changing at breathtaking speed.

Yet the growing polarisation in developed societies between "winners" and "losers", particularly the declining position of the lower skilled, creates a new imperative for the left to develop a less rose-tinted response to globalisation than the stance of the Third Way in the 1990s. Social democrats have to come up with new answers to the challenge of socially inclusive growth. New thinking is needed in three areas: a progressive approach to securing more balanced global trade; a domestic political strategy that puts as much emphasis on developing dynamic new sources of more evenly distributed growth as it does on redistributing the increasingly inegalitarian proceeds of our existing growth model; and a new social democratic theory of what makes firms innovative and successful in place of a discredited myopia on the maximisation of shareholder value.

1. A first step is much deeper thinking about our global trade policy. In Europe, this is conducted exclusively on member states' behalf by the European Union, which gives Europe enormous trading clout. So far, however, we have used this clout – rightly in my view – to advance our direct commercial interests through promoting wider market access for our goods and services. This is good for domestic growth, but primarily benefits the corporate elite of highly skilled "winners" in our societies. If we want to do more to help the potential "losers", then, we must in addition press harder for emerging country adoption of our rules and values. Three points are crucial:

• **Stronger dialogue with emerging countries** (drawing a distinction with the very poorest) about how their manufacturing processes live up to minimum standards of decency in terms of health and safety, environmental protection, hours and minimum wage regulation. No one can expect easy or quick results, but the existence of the International Labour Organisation gives these issues a legitimacy which our pre-crisis mindset was too reluctant to build upon.

• **Shifting the debate with China** on macroeconomic imbalances in the G20 and IMF from a sterile stand-off over exchange rate manipulation to the encouragement of surplus countries to expand public expenditure, build their own welfare states and thereby stimulate domestic consumption with lower need for savings. Countries like China have much to learn from European social models' experience and expertise in universal health, education and welfare.

• **Recognition that we are trading with huge economic powers pursuing a "state capitalist" model of economic development** – most notably but not exclusively in the case of China. Of course, there is nothing new about this – and it should not be used as an argument for national protectionism in Europe and the United States or blanket opposition to inward investment. Governments must, however, exercise discretionary judgment where inward investment would de facto lead to foreign government control of key strategic industries. The European Union needs to develop clear rules on these issues, otherwise member states, in the face of acute economic and financial pressure, will compete against each other to be the softest touch in detriment to the collective interest.

2. Progressives need a strategy to develop new sources of more evenly distributed economic growth. While no one should argue for a return to the failures of the industrial interventionism of the past, governments need to think strategically about how to develop the key competitive strengths of their economies. Several issues need more thought:

• **The need for smarter government.** It is self-evident that markets operate within a framework of regulation which only governments can shape, which is especially relevant in the provision of key aspects of modern competitive infrastructure such as digital access and high-speed rail. But how does government get this right? How can competitive public procurement be planned and managed? How best can a forward view be taken of the skills and competences an economy needs in the medium to long term, rather than leaving matters to the lottery of individual and company choice? What regional policies work best?

• **Make investment in science work for the economy.** Markets left to themselves cannot ensure that public support for research is concentrated on sensible strategic priorities, but how does government best organise itself to do better? How can we succeed in securing wider and more commercially successful exploitation of the developed world's remarkable scientific and technological base? How can Europe pool its presently inadequate R&D efforts to mutual advantage?

• **Recognition of the new "commanding heights".** We should not abandon high-tech manufacturing to China and other emerging countries. But the sectors with the greatest global potential also include universities, healthcare, creative and cultural industries. These are all hugely dependent on good public policy and sensible, non-ideological public spending priorities. Not to develop a strategic view of key sectors of the economy is attachment to free-market dogmatism of a high order and progressives should not allow themselves intellectually to be so cowered.

• **Accelerate low-carbon transition in the face of climate change.** We should aim to set a long-term economic and regulatory framework across Europe that will call forth a transformative wave of private cross-border investment in energy and transport as well as wide-ranging innovation in construction and hitherto undeveloped low-carbon goods and services.

• **Create national investment banks.** Finance should be the handmaiden of industry and commerce, not its master. Research studies have repeatedly shown the existence of a funding gap in the development of growing small- to medium-sized firms. Another need is finance for high-tech start-ups. Another is to provide initial project finance, with the private sector, to cover the construction risks of large infrastructure projects such as carbon capture power stations and high-speed rail development.

• **The European single market's rules need to be flexible** enough to allow for a legitimate new wave of industrial activism while maintaining firm control of state aid that is simply a way of avoiding necessary restructuring. In simple terms, progressives should reject a neoliberal ideology of markets, but not markets themselves.

3. As part of this process, progressives should also embrace a new "stakeholder" model of business, based on a new social democratic theory of the firm. We have to ask ourselves what kind of firm is going to be most successful in meeting the competitive challenges of the globalised world and think through what this means in terms of corporate governance rules, employee relations structures and the future of trade unions.

• **Companies should be seen as vital human organisms of commerce** to be developed in the interests of long-term growth and profitability, with boards that recognise a duty of stewardship, and manager and employee obligations of partnership, engagement and mutual commitment.

We should reject the free-market right's conception of the business corporation as a bundle of short-term, disposable contractual commitments to be chopped up and traded at whim.

• **Incentives within the firm should favour its long term development,** not be related to short-term share price performance and quarterly reporting figures. A stronger culture of long-term commitment and investment requires a more co-operative and open relationship between institutional investors and the corporate sector. Investors should be committed for the longer term and have the means both to assess company strategy and exert "voice" within the board if they want to see change.

• **Takeover rules should be tightened** to make it more difficult to disrupt these long-term investor-management relationships.

• **Within the firm, long termism may require a greater sharing of risk by employees and the acceptance of more flexible rewards.** There is a debate to be had here about public incentives for co-operative, mutual and profit-sharing models in the new economy.

• **The most successful innovative companies develop a modern culture** of non-hierarchical relationships within the firm and encourage openness to outside learning and the development of employee capacities at all levels. This requires us to think anew about the longstanding progressive goal of partnership at work.

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MEMO

Smart regulation to reap the benefits of the market economy

Layna Mosley

The market economy offers many benefits to citizens in Europe and beyond. But it also brings risks. These include volatility in domestic economies that result from fluctuations in global demand; a heightened possibility of job or income loss as domestic industries must compete globally; the danger of banking and financial crises, which now easily spread across countries; and the threat that inflows of investment will be reversed. It is no surprise, then, that the financial crises and recessions of recent years have left citizens doubting the benefits of economic integration. Many citizens also doubt whether their governments are able to govern the economy – or whether the forces of economic globalisation are too much for any government to resist.

Yet governments do have choices, and the nature of these choices has important effects on citizens and firms, and on economic growth and development. Indeed, the benefits of the market economy for citizens and societies are conditional rather than automatic. In order to reap the gains from a market economy, while also minimising the risks, centre-left parties must craft public policies that balance intervention with liberalisation, and protection with opportunity.

1. Protecting the vulnerable. On the whole, most countries gain from economic openness. But at the individual level, trade integration has costs, especially in the short and medium run. Governments must encourage students to acquire the skills they need to find success in the labour market. In wealthy democracies, where production has shifted towards skill- and knowledge-intensive activities, such skill acquisition is particularly important. All citizens should have the opportunity to acquire the skills that will best prepare them to compete in the market economy. For workers whose skills no longer match a country's industrial profile, governments must couple unemployment compensation with retraining (and perhaps relocation) programmes. Rather than provide permanent income support, these programmes should equip individuals with specific as well as general skills. The precise content of such programmes should vary with the structure of a nation's economy, as well as demographic and technological trends in that economy. More broadly, governments must continue, even in the midst of budgetary pressures, to provide social safety nets that protect the vulnerable from risks – including external economic risks – to incomes. These safety nets not only offer social protection, they also increase public support for continued economic integration.

2. Attracting multinational corporations. Multinational corporations are sources of investment, jobs and technology. Employees of foreign multinational corporations earn higher wages, and receive greater benefits, than do similar workers who are employed by domestically owned firms. Multinational firms often provide firm- and sector-specific training to their employees and, when employees change jobs, they take these new skills with them. Governments, aware of these benefits, compete to attract investment using a variety of strategies. The danger of this competition, which often involves reductions in corporate taxation as well as other benefits for firms, is that it generates a competitive lowering of standards. Additionally, many studies suggest that factors other than investment incentives – including the skill level of the workforce, the rate of economic growth, and a nation's trade policy – are most important to attracting FDI. Put broadly, it is the productivity, rather than the cost, of doing business in a given country that matters to multinationals. Moreover, not all foreign direct investment is created equal: the benefits of multinational activity are greater where foreign firms are more integrated with the host economy (for instance, purchasing more inputs from domestic supplier firms).

As a result of the global recession and rising transportation costs, many multinational firms are reducing the scope of their supply chains, locating their activities in fewer countries overall, and reducing some of their earlier offshoring decisions. This can be an opportunity for governments. A key way in which governments can make themselves more attractive to firms in knowledge- and capital-intensive industries is through investment in human capital formation. While this strategy will not yield immediate benefits, it will increase a country's longer-term attractiveness to multinational firms. Indeed, a recent survey of US multinationals finds that the offshoring of previously domestic activities, such as product development, is driven largely by a lack of highly skilled technical talent. Furthermore, governments should focus their investment promotion efforts on multinationals that are active in high-value added activities; investment incentives, if used, should be spread out over a longer time period, in order to encourage firms to develop a longer-term relationship with the host economy. Governments also can offer inducements to firms that reinvest their profits in the domestic economy, rather than pay them as dividends. Lastly, the continued pursuit of open trade policies will facilitate countries' involvement in multinational production.

3. Encouraging prudential behaviour. The unique role of the financial system in the economy makes financial regulation and governance a central issue. This issue is particularly salient today, given the public backlash against banks and the regulatory failures generated by government bailouts of "too big to fail" financial institutions. The financial crisis illustrates the dangers inherent in self-regulation (in which banks assess their own balance sheets and risk levels) or market-based regulation (in which private third parties, such as credit ratings agencies, are the sources of judgments about banks' stability). The crisis also demonstrates the difficulty, for government regulators, of implementing the letter as well as the spirit of the rules: private financial actors tend to innovate in response to regulation, moving their activities off balance sheet or creating new – and unregulated – financial instruments. Moreover, when private banks hold government debt among their portfolios, this creates mixed motives for governments – the failure of domestic banks can mean a loss of a source of capital for the public sector.

How, then, can governments effectively regulate? Doing so requires recognition of the need for greater expertise among regulators regarding financial innovation and products. This requires hiring individuals with backgrounds in private capital markets, and it may well require paying significantly higher wages. It also requires ensuring that these individuals are not subject to regulatory capture by financial institutions – something that is admittedly difficult to do. More importantly, national regulators must reassert their authority, preventing financial institutions from becoming either too big (in terms of importance to the economy) or too broad (in terms of the activities in which they engage) to fail. The protections offered by governments to commercial banks, for instance, should not extend to investment banks. Such limitations on financial institutions may decrease the efficiency of financial institutions in good times, but it also will guard against widespread crises in bad times. The underlying goal should be to ensure that financial institutions internalise the risks inherent in their activities: if banks are confident that they – rather than governments and the public – will bear the costs of failing to ensure against risk, then banks will have incentives to act more prudently.

Another aspect of addressing financial sector problems relates to the financial literacy of citizens. As consumers of financial services, all citizens should be educated regarding the frequency of financial crises historically, and the more general lesson that asset prices are prone to bubbles. While strong property markets and stock markets, as well as cheap access to credit, please consumers in the short run, they also expose consumers to risk. Citizens ignore these risks at their peril, especially if their homes are their primary means of saving. Yet, if citizens do not appreciate these risks, they are likely to reward governments electorally when asset prices are high and credit is cheap – the very features that can precede a crisis of the sort experienced in 2008 and 2009. Greater financial literacy can ensure that citizens learn how financial markets operate not after these markets collapse, but also while they are booming.

4. Managing public debt. Many investors in sovereign debt are currently pressuring national governments to pursue fiscal retrenchment – to reduce the size of budget deficits (and, therefore, public debt), either by increasing revenues or by decreasing expenditures. Many governments are loathe to increase taxation, so they are left to cut expenditures. It can be very tempting for governments to therefore avoid investing in human capital and infrastructure formation. Yet it is just this failure, over the longer term, which has contributed to economic stagnation in Southern Europe. Investors may care – and may care quite a bit more now, given debt problems in Greece, Ireland and Portugal – about how much in total governments spend and borrow. Yet it is still up to governments to decide how to allocate spending across functional areas. Governments need to offer citizens and firms an account of the importance of certain kinds of public spending; that is, they must be willing to argue that much government expenditure provides longer-term benefits, that increases in taxation are sometimes justified as a means of facilitating public investment.

Recent attention to public debt has focused on the general problem of indebtedness among governments. But the composition of public debt varies markedly across countries, and the differences in how governments structure their debt matter. Governments that must frequently refinance their debt, because their debt is at short maturities, are exposed to market pressures more often. Governments with longer debt maturities, however, can avoid refinancing their debt when market conditions are negative, and can avoid a certain amount of market pressure. Therefore, when times are good, governments ought to consider borrowing at longer maturities, even if this is more expensive in terms of interest rate costs. Slightly higher borrowing costs today offer the possibility of greater autonomy *vis-à-vis* capital markets tomorrow.

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MEMO

A practical proposal for an international tax on the wealthiest citizens of the world

Patrick Weil[1]

The recent financial crisis has not inspired confidence in our political leaders' ability to deliver global justice. On the contrary. In North and South America and in Europe a large majority of the population feels that even though states have successfully saved the banking system, bankers are now renewing risky practices in pursuit of profits and awarding themselves enormous bonuses. This has occured against the longer term backdrop of a huge increase in the gap between the wealthiest 0.1% of the population and the middle class over the last 30 years.

1. This situation favours populist reactions, with all their manifestations of xenophobia, anti-government backlash and racism. It encourages revolutionary discourses that might not prove beneficial to progressives since their advocates seem unable or unwilling to think about sustainable solutions. The lack of will, or at least the manifold constraints involved in taking bold, affirmative action, that impedes governing elites in today's world erodes the foundations of democratic regimes. At best it gives the impression that elected representatives have lost the power to act in favour of a fairer society; at worst, it reinforces the prejudice of solidarity and the complicity of elites against the majority of the people. A key political problem for the centre-left is the perception that pursuing justice by taxing the wealthiest part of a national population might lead to negative economic consequences. Wealthy individuals can always change their country of residence. When a state imposes taxes across national borders on its nationals wherever they reside, more and more frequently these individuals choose to change nationality. Recent research shows that while, for example, 28 billionaires live in Switzerland, only 11 are Swiss nationals; likewise, four live in Monaco but only one is a citizen of the principality.

2. Citizens in the United States and Europe simply expatriate to avoid or reduce tax. The United States is the only developed country that taxes based on nationality rather than domicile. This has inspired the ultra-wealthy to renounce their citizenship in order to avoid paying US taxes. The Heroes Earnings Assistance and Relief Tax Act of 2008 was an attempt to reduce this phenomenon by subjecting certain voluntary expatriates (citizens who give up their citizenship and permanent residents who give up their green cards) to a "mark-to-market" exit tax. This means the expatriate is subject to income tax on the net unrealised gain in her property as if she had sold it on the day before she expatriated. Since 2008 the number of Americans who have expatriated has multiplied by at least four (from 238 in 2008 to 1027 in September 2010).

European countries use a modified territorial system, under which income earned outside the territory is not subject to tax. "Thus, a resident of a country within the European Union can earn

1 Many thanks to Sarah Jordan Watson who was my assistant at the Yale Law School this past year for her intelligent and efficient contribution to this project.

income from sources outside his home country and will not be taxed on that income, regardless of whether the entity earning the income is a resident of the country or not." The incentive in this situation is therefore to become resident in a country with a low tax burden while retaining citizenship in whichever country you wish.

3. Efforts at international coordination exist but have so far had little effect. The members of the G20 have united to stop tax evasion, recently forming the Global Forum on Transparency and Exchange of Information for Tax Purposes, declaring that "tax avoidance and tax evasion threaten government revenues throughout the world" and that "globalisation generates opportunities to increase global wealth but also results in increased risks". It has begun investigating and publicly evaluating the transparency and information-sharing practices of member states that have reputations as tax havens; the first batch of reports covers Bermuda, Monaco and the Cayman Islands, among others.

The United Nations, in 2004, strengthened the mandate of the pre-existing Ad Hoc Group of Experts on International Co-operation in Tax Matters, renaming it the Committee of Experts on International Co-operation in Tax Matters. The committee's responsibilities include developing and updating a model tax treaty between developed and developing countries and providing a framework for dialogue to enhance and promote international tax co-operation among national tax authorities.

To tackle this problem, proposals should be made that respect the right of human beings to enjoy citizenship (not to be deprived of it), to shift citizenship, and even to enjoy multiple ones: this right has been conquered against statelessness, for example in the aftermath of the Second World War, and this conquest should be protected against further infringement. The following proposals have, therefore, been designed in respect of these considerations.

4. An international tax should be imposed on the world's wealthiest individuals independent of their citizenship. For example a 1% tax on the 1210 billionaires of the world in US dollars would represent in 2011 $45bn. This tax would be a contribution to the funding of international organisations, with priority given to UN development agencies, the World Bank and the International Monetary Fund. It could come as a deduction from the contribution owed by an individual state to the different international organisations to which it belongs. This tax would be levied by the state of residence or – in case of refusal or failure to levy the tax – by any other UN member state. In case of an individual changing nationality, the tax would be assessed on the basis of the states to which the individual has belonged or currently belongs, on a ratio derived from the number of years he or she has enjoyed each successive nationality. If the amount of tax levied exceeds the amount of the contributions due by the nation state to whom the individual has belonged or belongs, the surplus will go to the reimbursement of the debts of these nation states to these international organisations or to their direct funding.

5. As this tax could be deducted from the dues owed by states to different international organisations, it could be acceptable to the wealthiest states in the world. Such a tax would increase global justice while also benefitting the largest countries in the world and their citizens by reducing the expenses paid by their state. It would also reduce the incentive for an individuals to change their country of residence and/or nationality. It would benefit the poorest countries in the world by reinforcing international organisations in which they participate on an equal footing. The costs would be paid mainly by the world's wealthiest citizens and by tax haven countries which might become less attractive.

6. For the implementation of this tax, co-operation between nation states will be necessary: the level of tax will have to be decided and its allotment; all things which will encourage global and international debate about wealth, justice and development. It will help to reestablish confidence in our democracies and the legitimacy of their institutions. It will reinforce the community of nation states. But, in addition, it will also encourage the feeling of being part of a world and global community of human beings sharing values and principles and deciding to tackle together common problems with new instruments for global justice.

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MEMO

Redesign private ownership to create a truly generative economy

Marjorie Kelly

"Capitalism will inevitably change", economist Robert Heilbroner observed in 1965, "and in the longer run will gradually give way to a very different kind of social order". The intervening half century has brought us astonishingly close to the moment he foretold, when it is clear to many that capitalism must give way to something wholly new. It is a moment for which the left is ill prepared. Capitalism is such a totalising philosophy that it leaves little ground – intellectual, economic, political – where plausible alternatives might take shape.

So it is that we find ourselves at a moment when the global economy cries out for transformation, and the left is bereft of a coherent agenda for transformation. The left should be striding forward to assume the mantle of leadership. But the reverse has happened. Still, the ideas that today seem triumphant – cutting government spending, tightening the fiscal belt – will not suffice in the long run. We face unprecedented crises across our societies which signal that our economic system is in need not of patchwork fixes, but of redesigning.

It is only the left that can lead in this task. To do so, it must free itself from the grip of that overbearing economic patriarch, capitalism, which has crushed the ability to dream. It is time to begin a new conversation about creating an economy that embodies our true ideals – not through state ownership and control, but through the redesign of private ownership. Emboldening ourselves to this task means coming to grips with some uncomfortable truths.

1. The financial economy has grown too large; financialisation has become a social problem. As the US economy once manufactured and sold goods, in recent years it turned to manufacturing and selling debt. This process, termed financialisation, is often defined as the shift in an economy's centre of gravity from production to finance. Capitalism applied itself to this task with its usual fervour, imagining that the "wealth" it was generating was limitless. But financial wealth exists only as a claim against real wealth, in the form of homes, businesses, natural resources and family income. When the balance between financial claims and real wealth is lost, financial wealth becomes extractive. It begins to extract the vitality of the real economy. This is where we find ourselves today.

According to an International Monetary Fund analysis, in the early 1980s the financial economy and real economy were roughly in balance. The global sum of financial claims (stocks, bonds, loans, mortgages) was roughly equal to global GDP. But in the decades leading up to the meltdown, financial claims grew to nearly four times global GDP. There were more claims than the real economy could support. This was the underlying condition that set the stage for crisis.

2. Financialisation is the logical result of today's dominant ownership design. The worldview of capitalism takes tangible form in the design of corporations and capital markets.

The revenue of the 1000 largest corporations in the world equals two thirds of global GDP. These multinationals share a monoculture of ownership design – that of the publicly traded, limited liability corporation, where ownership shares trade on public markets. With deregulation, this design was set loose in the world. There is a particular logic to this ownership design, which has become the logic of the global economy. It is about maximising profits to boost share price and maximise income for share-owners, who are the wealthiest few. Because financial services are more profitable than manufacturing, the energies of the system gravitate there. The financial sector attracts the brightest minds, earning the highest salaries, whose job it is to "create" more "wealth" for their clients, the wealthy. The system becomes top-heavy with financial claims; this creates the potential for the global economy to enter a state of financial overshoot and collapse.

3. Financial profits do not fall from the sky; they are extracted from the real economy. In ordinary times, there may be little harm in the dividends, fees, interest payments and other charges finance collects. But when the economy is weakened, profit-seeking can become more extractive. Companies increase profitability two ways: growing revenues or cutting expenses. In a weak economy when revenues cannot easily grow, companies boost profits by cutting jobs, since wages represent the largest expense item for most companies. This is how it is that major US companies are today enjoying near record profitability. It contributes to unemployment, which means there is less spending in the real economy. A similar cycle is at work with governments. Having spent trillions bailing out financial institutions – shoring up income for the highest earners – governments balance budgets by cutting welfare payments. Wealth inequalities increase. The public sector shrinks. These outcomes are a natural result of system design that puts profits for the elite first – and the neoliberal ideology that seeks to set that design free.

4. There is another way to design ownership: it is already here, and working. It includes *cooperative banks,* the member-owned financial institutions found all over the globe that are run democratically in the interests of their customers. In Europe these banks hold 21% of all deposits, and in the Netherlands Rabobank holds 43% of deposits. In the United States there are growing numbers of *community development financial institutions,* designed to foster community well-being. Because all these financial institutions have a mission of serving borrowers, they did not make the kind of abusive loans that contributed to the crisis. Yet these banks remain largely invisible, and at the risk of being crushed by proposed new capital investments.

Around the world the *microfinance industry* is attracting billions in funding, used to make micro-loans to help lift small entrepreneurs out of poverty. In the United States and the United Kingdom, there is growing interest in social enterprises that serve a social mission while they function as businesses – like Greyston Bakery in New York, a profit-making, US$3m company started by Zen monks, with a mission to create jobs for the homeless. And there is *employee ownership,* succeeding even in large companies like John Lewis Partnership, the United Kingdom's largest department store chain, which is 100% employee owned, with a stated mission of serving employee happiness. Other large corporations have evolved *mission-controlled designs,* like the foundation-owned corporations common throughout northern Europe. Among these is Novo Nordisk, a major pharmaceutical company with a mission to defeat diabetes, where executives answer to a foundation that holds controlling power.

5. If the dominant ownership designs of today are *extractive,* these alternative ownership designs are *generative* and show the way to a profoundly different economy. Their aim is to generate the conditions for life – to create jobs, end poverty, enhance social cohesion, create renewable energy, preserve forests and serve human happiness. Generative design embraces a biodiversity of ownership forms. What makes them a single genotype are the life-serving purposes at their core, the ownership and governance designs that hold these purposes in place, and the generative outcomes that are created. These social architectures are harbingers of a profoundly different economy. They are not yet fully formed, not wholly ready to serve as the framework of a new social order, and all the designs we need have not yet been invented. But their growing profusion is a signal that we are entering one of the most creative periods of economic innovation since the Industrial Revolution. For what is at work is not economic innovation in its usual sense of better ways to make more money. This innovation is much more profound, as it is a reinvention at the level of organisational DNA. It is about creating ownership designs that bring the concerns of the human and ecological community into the world of property rights and economic power.

6. Achieving a generative economy starts with recognising a new role for the state not simply as regulator but as *designer* of the economy. That means creating policy approaches that shape the core design of enterprise, guided by a common vision of a generative economy. It is an economy built on social architectures that, in their normal functioning, tend to create fair and just outcomes, benefit the many rather than the few, and enable an enduring human presence on a flourishing Earth. It is a social order where concerns about the common good are not left to government alone, but are embraced by private enterprise, as well as being supported by national and international norms and institutions.

7. A core strategy for developing a generative economy is to create a pincer movement – one arm aimed at reforming corporate governance in existing large companies, another aimed at developing generative alternatives. Reforming corporate governance might mean partnerships between regulators, unions, public pension funds and socially responsible investors – aimed at winning board seats, creating designated public-interest directors, broadening fiduciary duties, limiting political contributions, and requiring greater transparency about companies' environmental and social impact. Longer range goals may encompass limiting executive pay by tying it to social and environmental benchmarks.

8. In creating generative alternatives, different strategies will apply in different sectors. Employee ownership allows founders to exit without going public and spreads ownership widely; it can be promoted through tax law. Co-operative ownership works well in sectors like banking and agriculture. Non-profit ownership may be the best model for healthcare and education, where a long-term policy aim might be to draw a line, prohibiting profit-maximising ownership models from operating in those sectors.

9. The aim should be to create designs for the future. Generative design is less about forcing than about creating the designs into which the future can flow. The major companies of today may seem eternal but it is useful to remember that just a few years ago among the world's 1000 largest companies, 12 of the top 13 were fossil fuel-based oil and auto companies. That has already changed, with the implosion of GM. In 50 years, as oil supplies shrink, every one of those oil and auto companies will be altered beyond recognition, or gone. A new economy is coming into existence all the time. Think of the recording industry, the newspaper industry, book publishing – all rapidly changing. Think of the rise of solar power and wind. Getting emerging enterprises into new ownership designs may ultimately be more important, and more doable, than battling the dinosaurs of today. We might aim for 20% of the economy to be generative within 20 years, 30% a decade on, and so on. One day we may reach a tipping point where a shift in the zeitgeist – perhaps a citizen uprising – makes generative design the new norm.

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MEMO

Protect the public interest from highly corrosive mergers and acquisitions

Hans Schenk

The market economy supposedly encourages firms to do the "right" thing at the least cost. The market economy supposedly generates firms that strive to eliminate redundancies and create advantages by being innovative in products, services or organisational processes. To use the economist's jargon, the market economy is, supposedly, "efficient". Most of us would like to see such a market economy in action. Unfortunately, the real world shows us time and time again that markets also allow firms to evade the purpose of the market, to transform the market into chaos and to successfully duck the consequences of such behaviour.

This is what undermines trust in the market economy. In particular, when firms succeed in allocating tremendous riches to a few people (executives) without providing proper justification, other people (workers and the public at large) get frustrated. When bank executives cause a financial meltdown only to find that governments bail them out with almost no sanctions at all, taxpayers get frustrated. And lost trust in the market economy can easily turn into something worse when such aberrations appear to be cumulative, for example when increases in executive wealth continue despite obvious underperformance while the taxpayer has to foot the bill.

1. Periodic waves of large acquisitions culminate in recessions. The market economy's focus on shareholder interests, or more correctly, perceived shareholder interests, is partly responsible for such aberrations as those described above. However, without such an explicit focus on shareholder interests, the market economy can cause, and has caused, frustration and failure as well. This is particularly true if firms operate in comfortable conditions, that is to say if they have gone through prosperous times and have therefore been able to amass substantial free cash flows, and subsequently are encouraged to revert collectively to speculative investments in mergers and acquisitions. The speculative side of mergers and acquisitions is mostly ignored in economic policy debates; instead, it is widely believed that mergers allow firms to generate the economies of scale from which society will benefit. For small and medium-sized firms this is a largely correct belief. However, mergers have by far their most significant impact in the domain of big and very big, mostly publicly quoted, firms. And we are talking big money; during the second part of the 1990s, for example, American and European firms alone spent approximately US $9000bn on acquisitions.

The performance of such mergers, or rather acquisitions, has been studied in dozens of research projects on both sides of the Atlantic (since approximately 90% of ownership transactions concern acquisitions or takeovers, we should avoid using the term "merger" as it may inaccurately suggest that a harmonious process is taking place between two firms in which both see economic benefits). The general conclusion of this research is that acquisitions do not, on average, generate wealth for acquiring shareholders and may even destroy it, and that productivity, profitability and innovation lag behind counterfactuals. Target shareholders gain wealth, but they become acquiring shareholders soon after their firm has been acquired, thus losing this wealth again. In order to understand this rather peculiar situation, it is helpful to note that most large acquisitions take place in an extremely concentrated form – in effect during volatile "merger waves" of which we have experienced six since the early 1900s.

Thus hundreds of large firms periodically invest in projects that are almost certain not to generate a positive return on investment. Since the total amount of annual acquisition investments during merger waves can easily top US $1,000bn, the economic loss to society must be enormous. It is certainly big enough to generate a temporary slow-down of real investment, which is what we call a recession. Indeed, all merger waves thus far have culminated in a recession (or worse, as the 1930s and the recent crisis testify).

2. The market economy thus allows firms to periodically act in a way that is contrary to its main purpose: generating wealth. Why firms would act in this way at all remains a mystery to mainstream economics. Understanding the so-called "merger paradox" requires abandoning equilibrium thinking and introducing instead behavioural and institutional concepts. Such modernised viewpoints make clear that it is entirely possible that firms wilfully engage in economically unsuccessful acquisitions, provided that peers do so as well and that they have sufficient means at their disposal for playing this so-called investment game when it starts, that is, following the prosperous part of a business cycle. If the nominal size of a firm's peer group is small, which is the case in a significant number of global markets and in the stock market, firms tend to imitate actions of peers that might jeopardise their own position. If things go wrong, players can hide behind the screen of the collectivity – they collectively share the blame attributed to them by investors, the public, the media or the government. But if things go right for a competitor whose actions have not been imitated, this competitor may well have created a competitive advantage that is difficult to match for non-first movers (the term that has been coined for this sort of behaviour is "minimax-regret" behaviour).

In normal parlance, however, this sort of investment behaviour is called speculative behaviour. It is the sort of behaviour that can only generate wealth in a minority of cases. In addition, it is the sort of behaviour that needs a recession in order to allow the players to reconfigure and restructure. Such restructuring involves divesting earlier acquisitions (some studies suggest that currently almost 60% of acquisitions will eventually be divested again). Private equity firms have learned to facilitate this stage of the restructuring cycle by acquiring sell-offs at substantial discounts.

3. It would be much better to prevent harmful speculative behaviour rather than cure its effects. Therefore the question is: can something be done that would lead to a substantial reduction in the economic costs of these developments? In Europe, dedicated merger and takeover policies were introduced in 1989 and in 2004 (in the United States similar policies were introduced earlier). The 1989 Merger Control Regulation was meant to help prevent those mergers and acquisitions that were likely to be harmful to the economy. It provided a substitute for the rather cumbersome ex post review of mergers contained in articles 81 (now 101) and 82 (now 102) of EU competition policy. As a result of the influence of mainstream microeconomics – which does not acknowledge the existence of something like the public interest, just producer and consumer interests – the goal of merger control came to be interpreted as preventing mergers that are harmful to the consumer rather than harmful to the economy.

Merger control therefore amounts to an ex ante assessment of a merger's effect on allocative efficiency rather than its effect on productive or dynamic efficiency – which are the areas where the real problems of mergers and acquisitions tend to be. Establishing allocative effects ex ante is an almost impossible task; it is therefore not surprising that only a handful of the more than 4000 mergers and acquisitions that have been referred to the Commission have been blocked.

The 2004 Takeover Directive was meant to reflect “modern” thinking about the proper relationships between owners (shareholders) and executive and non-executive boards with respect to takeover bids. The basic idea is that shareholders rather than the management and/or non-executive board must have ultimate decision-making powers with respect to mergers and acquisitions and that executives should not be allowed to build protective walls around the firm to prevent its acquisition. Modern thinking in this respect refers to the “theory of the market for corporate control”. This theory maintains that the market for corporate control is an efficient market, implying that well-off firms chase underperforming firms, motivated by the prospect of increasing the target’s performance by introducing their own management capabilities into the target’s configuration. If this theory were sound, we would find performance improvements after mergers, which is not the case. Instead, the performance evidence suggests that quite a few acquisitions may be perverse, running contrary to the fundamental assumption of the theory.

4. Merger control policy should include the public interest and potential effects on the economy as a legitimate concern. What needs to be addressed as soon as possible are the simplistic and justificatory assumptions underlying current merger and takeover policies. Current merger control regulations contain a promise to the layperson that the Commission will seek to prevent harmful mergers and acquisitions. However, the only criteria used in the Commission’s assessment concern the effects on consumer wealth, not the effects on the economy. Merger control should therefore be redirected in such a manner that the public interest would be established as a legitimate concern. One possibility would be to introduce a “full efficiency test”, rather than a test for allocative efficiency only, on those mergers and acquisitions that could potentially have a major impact on the economy. The Takeover Directive should be reformulated so that, under certain conditions (such as approval by shareholders and employees), firms would be allowed to protect themselves against takeover.

This change would certainly undermine the theory that supports the current set-up, but then this same theory also supported abandoning all sorts of financial market regulations and the move from rule-based to principle-based regulation – policies that significantly contributed to the depth of the financial meltdown.

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MEMO

Square up to conservatives on fiscal discipline

Carlos Mulas-Granados & Carmen de Paz

The last few years have demonstrated the need for a new social democratic narrative based on fiscal discipline. The post-crisis race to regain control of public finances through a series of fiscal adjustment packages has benefited the centre-right. Such austerity policies have traditionally been part of conservative economic recipes, putting centre-left governments on the back foot in communicating the need for fiscal adjustment.

However, this should not be met with despondency and despair. The electoral fortunes of centre-left parties will be linked to the economic agenda in the years to come – and they can win the economic and fiscal debate. There are two crucial arguments that should be made. First, social democrats are better managers of the economy than conservatives (since the 1960s, centre-left parties have overseen more years of economic growth than conservative parties). Second, social democrats offer the best policy options for reducing large public debts created by irresponsible bankers, while maintaining the capacity of the state to play its strategic role in forging more sustainable economies and more equitable societies.

1. Centre-left parties are as fiscally responsible as their centre-right counterparts. Contrary to popular perception, 51% of the fiscal adjustments that occurred in the OECD in the last four decades were implemented by centre-left governments. Although conservative parties have traditionally associated fiscal adjustments with their preference for a small public sector, the truth is that fiscal discipline is perfectly compatible with a larger state presence in the economy. In fact, the reluctance of many conservative governments to raise taxes generated public debts in advanced economies in the postwar period. These fiscal imbalances had to be rebalanced by progressive governments when they regained office, as demonstrated by Bill Clinton in the United States and Tony Blair in the United Kingdom.

2. Fiscal adjustments can be progressive if they are composed correctly. A fiscal adjustment is basically a reduction in the public deficit, which in turn accounts for the difference between public revenues and expenditures. A deficit reduction can therefore be attained through very different combinations of revenue increases and expenditure cuts; it does not need to be exclusively associated with painful cuts in social spending.

With respect to the composition of adjustments, the existing evidence shows that the main difference between progressive and conservative fiscal adjustments over the last 40 years in Europe is that those carried out by centre-left governments have tended to rely more on revenue increases than expenditure cuts. If forced to cut spending, governments of the centre-left have normally reduced public salaries and froze social programmes in order to maintain or even increase public investment in physical, human and technological capital. This is clearly related to the strategic role that progressive economists give to supply-side policies financed by the state.

Typically, therefore, centre-left governments have preferred to raise public revenues in order to maintain the pre-existing level of public spending and social transfers. There are different ways to increase revenues, and all of them can be used by social democrats as part of their fiscal adjustment strategies. Increasing the tax rate for upper-income levels is the traditional response. Nevertheless, in countries where wage-earners already bear a significant tax burden, it would be more efficient and equitable to tax property and wealth. In addition, social democrats should promote the transition from tax systems that tax "good behaviour" (such as work and savings), to tax systems that tax "bad behaviour" (such as excessive consumption, excessive waste and pollution and excessive speculation). Moreover, the fight against tax evasion should become a central pillar in the new progressive fiscal agenda (pushing for a co-ordinated response at the international level and for wider use of digital money at the domestic level).

3. Differences in the composition of fiscal adjustments become very clear when comparing the ongoing consolidation processes in the UK and Spain. The UK coalition government is carrying out a major fiscal adjustment focused on the largest expenditure cuts registered since the Second World War, amounting to around 5.6% of GDP in 2010-2014. The revenue side of the adjustment barely amounts to 20% of the overall deficit reduction (while in Spain it represents 55%). However, it is not the size but the composition of the cuts, and their long term consequences, that are most significant and in many ways worrisome.

In the UK, the welfare state will be profoundly affected by the cuts, with social spending decreasing by 1.3% of GDP. While David Cameron has reduced the levels of support to families in the lowest income sectors, the Spanish government has preserved and increased such support. This has been achieved through special benefits for the long-term unemployed, whose regular benefits were exhausted; maintaining lower-income pensions at the highest levels in Spanish history; and through special assistance and benefits for the most dependent in society. In fact, the share of social expenditure to Spanish GDP has significantly increased, even during the crisis, reaching 58% in 2011, up from 43.4% when the conservative People's Party left office. The Institute for Fiscal Studies has concluded in a recent study that the measures undertaken by the UK government in this regard could lead to an increase in long-term inequality since low-income and vulnerable families will see their incomes fall disproportionately.

In addition, access to the British higher education system has been altered, with an average increase in university fees of around 143% according to some estimate. Meanwhile, the Spanish government has even in the current period, increased both the number of scholarships, with an overall increase since 2004 of 107% in value and 30% in the number of beneficiaries, and the total expenditure on education, which has doubled in absolute terms in the seven years that Jose Luis Zapatero has been in office. Simultaneously, most public departments have seen their budgets significantly cut in the UK, by an average of 13%. As part of this plan, the massive dismissal of 600,000 public servants is being predicted. In contrast, the Spanish government has made adjustments to current expenditures, including a decrease in public servant salaries that is proportional to their incomes (15% for high-ranking civil servants and 5% for the rest), without affecting socially productive public investments that are the determinants of social capital and thus the future of society.

4. Progressive fiscal adjustments are the determinants of the transition towards a more "dynamic state". Conservatives are trying to use fiscal adjustments during times of crisis to reduce the role and size of the state, in line with confusing concepts and theoretical frameworks such as "the Big Society". In contrast, the centre-left should defend an activating, forward-looking and socially-efficient role for the state. Well-designed fiscal adjustments can help the transition towards a more "dynamic state", one that combines economic activation with effective protection for those who need it most, where all measures adopted serve several medium- or long-term objectives in building not a "bigger" but a "better society", and where social effectiveness remains a central decision criterion for decision making.

5. Progressive fiscal adjustments can increase economic potential and help the transition to a more sustainable economy. If fiscal adjustments raise additional revenues to finance additional investments in physical, human and technological capital, they can be economically productive. In fact, some of these additional resources should be used to finance new entrepreneurs in the sectors of the future (renewable energy, biotechnology, ICT, cultural industries, social services, etc). Some might argue that taxing the private sector to channel public credit to new sectors is not economically efficient. This may be so in normal times, but not in the aftermath of a credit crunch and a huge financial collapse. The public sector is the only source of financing available for risky projects in these circumstances, and it has to play this strategic role. If new revenues come from additional taxation on unproductive wealth and negative externalities (such as short-term financial transactions), the productive part of the private sector will benefit overall. And the whole strategy will accelerate the transition to a more sustainable economy, based less on real estate and financial speculation and more on new sectors that increase the quality of life.

6. Progressive fiscal adjustments can also increase equality. Fiscal adjustments that rely on deep tax reforms can redistribute income. But even in the absence of these reforms, revenue-based adjustments that help finance additional investments in education can have a positive impact on social mobility. And most importantly, all fiscal adjustments that manage to bring down the public debt-to-GDP ratio have a positive overall impact on intergenerational equality, since they reduce the debt burden on future generations and this increases their freedom to spend and invest future income.

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MEMO

Why austerity must not mean the end of active labour market policies

Chris Tilly

When it comes to improving workforce equity and efficiency, a winning strategy combines the application of new ideas with the consistent application of policies that are already proven. This memo errs in the direction of comprehensiveness, at some cost to depth, in order to more fully sketch out the context for each individual reform.

1. Aid the transition into employment. A precondition for decent work is to be employed in the first place. Thus, a central element of a job quality agenda are policies to move the unemployed into employment – in brief, active labour market policy. This should include assistance with job search and subsidised retraining programmes, universally available but especially targeted to workers with limited or narrowly applicable skills.

2. Raise the wage floor and compress the range. In any foreseeable labour market in today's world, the reality is that many workers will experience very limited mobility. Therefore, it is fundamental not just to enhance mobility but to ensure that even the lowest level jobs are adequate, and to counteract market-driven tendencies towards widening inequality.

One building block is government regulations setting minimum standards (including a minimum wage, pegged as a "living wage") and, equally importantly, consistent monitoring and enforcement. Recent research by Annette Bernhardt and others has spotlighted the alarmingly high incidence of non-enforcement of legally mandated labour standards in the United States, demonstrating that rich countries can also produce the informal employment long seen as a characteristic of poorer nations. It is important to multiply the reach of the inspectorate by mobilising worker, community and employer organisations to police standards.

A second instrument, to some extent substitutable with the first, is labour relations ground rules that facilitate unionisation and collective bargaining, since unions typically (though not invariably) play an equalising role. Evidence from the Nordic countries confirms that more centralised bargaining is typically more equalising, making a case for resisting current pressures for further decentralisation. Strengthening other channels of worker voice, such as works councils or health and safety committees, is also important.

A third tool is transfer programmes that constitute an alternative to rock-bottom or informal employment. For example, Brazil's dramatic expansion of its *Bolsa Família* programme clearly contributed to that country's significant upturn in labour market indicators. These three elements narrow income gaps, reduce businesses' options to undercut pay levels and conversely provide an incentive to increase productivity.

3. Support relevant and useful education and training. Many countries have expanded the availability of adult and continuing education. Such in-depth retooling for a new career, while employed or while between jobs, is an important supplement to the more short-term retraining referenced in point 1 above. Pedagogical research demonstrating the value of hands-on education points to other promising steps towards an effective education and training system.

The sharp division between vocational and academic tracks in secondary education, along with the increasing premium for a college education, has tended to draw young people away from the vocational system who would most appropriately be served by it. The "tech-prep" secondary education model, pioneered in the United States by High Tech High in the city of San Diego, combines vocational and academic tracks in a rigorous, analytical and hands-on education that serves as an excellent foundation for either continued vocational training (a two-year college course in the US context) or an academic pathway.

It is also important to strengthen incentives and frameworks for individual and collective firm-provided training, which often provides the most relevant skills of all. Refundable training taxes, industrial extension programmes and public-private partnerships between public education institutions and businesses can all help serve this purpose.

4. Enhance mobility through targeted interventions. Mobility is not just about providing skills, but also about helping workers and employers identify and strengthen career pathways.

Government can facilitate the wider use of broadly recognised skill certifications, including new certifications that become relevant as new technologies sectors emerge (for example in the green economy). Certifications represent a classic co-ordination problem so government can play a central role in bringing together the relevant social actors. Centralised, agreed-upon certifications trump an open and competitive market in which it is more difficult to assess the value of certifications.

Labour market intermediaries play a critical role, but not all intermediaries are equal. For example, in the United States Fredrik Andersson and colleagues show that for low-wage workers, use of temporary help agencies increases total earnings, but Chris Benner and co-authors add that, on average, workers using temp agencies earn lower wages and receive fewer fringe benefits. Public policies should especially support intermediaries that help workers move up, not just move.

While large firms still have significant career ladders, workers in smaller establishments typically must job-hop to move up. One potentially appealing model would link small firms with larger ones in "career consortia". Small firms would certify the quality of the workers they refer to larger firms, and larger firms would give some preference to workers channelled through the consortium. The small businesses would gain an upward mobility "carrot" that would serve as an incentive for employees to stay on the job longer and perform well, mitigating small business's scourges of high employee turnover and indifference. Larger businesses would gain a pipeline of work-ready, proven workers.

5. Encourage family-friendly flexibility. As two-earner and single-parent families become more common, work and family demands too often collide. While employers of professionals are increasingly flexing to meet employees' family needs, many employers still hew to traditional thinking about the importance of long hours in the office, and lower-end employers typically offer schedules that are less flexible or, what can be worse, schedules that are unpredictable. Major policy elements supporting family-friendly jobs are well known: paid maternity/paternity/family leave, large-scale provision of creches for the pre-school years (France's universal childcare is reflected in its historically high rate of female labour force participation), and incentives for employers to provide flexibility in the weekly working schedule. With the ageing of the population in many countries, accommodations for elder care will become increasingly important.

6. Pursue humane and economically sensible immigration policies. Rising aspirations of workers in lower-income countries and large-scale reliance of some regions on remittances render inhumane sharp reductions in immigrant flows. Ageing populations in richer countries and domestic workers' disinterest in many lower-level jobs (and in some cases, in particular technical fields as well) render such reductions economically unwise. The task is to manage immigration flows, not block them.

At the same time, historically high levels of migration raise social and economic challenges. It is important to ensure that immigrants do not become second-class economic citizens, subject in practice to lower labour standards than native workers, which can undermine overall labour standards. It also takes active policy measures to manage ethnic diversity, especially in historically homogeneous societies.

7. Bolster growth and economic development. Although environmental limits to sustainable growth mean that we must shift away from GDP per capita as the dominant indicator of economic success, in the short to medium term growth in traditional terms will continue to be critical, especially for those lower on the income distribution. At the same time, it will be increasingly important to improve the quality of life on other margins and to redistribute economic benefits so that all enjoy a decent standard of living.

The recent global recession forcefully reminded us, and in many parts of the world continues to remind us, of the importance of active macroeconomic management, with an ever greater imperative of co-ordinating these policies across countries.

In a world where product cycles have accelerated, industrial policy plays an essential role in nurturing new industries and revitalising mature industries. Industrial policy, infrastructure investment and other development assistance must be targeted to lagging areas in order to reduce geographic disparities. Moderating the unsustainable "growth imperative" requires more redistribution of economic bounty rather than relying on "trickle-down" processes to sustain those at or near the bottom.

8. This set of recommendations brings with it a set of associated political dilemmas. The chief political dilemma is that most of these recommendations fly in the face of neoliberal economic and political orthodoxy. There is broad scepticism about government's ability to successfully manage these aspects of the economy. Restrictions on business can be politically unpopular, not only with business but also with others who see business as the engine of the economy (though most would acknowledge that engines also need steering wheels to achieve the desired result). The conventional wisdom has shifted towards a view that ambitious government programmes are not affordable, rather than seeing this choice as a matter of social priorities – and in many cases a strategy for improving economic efficiency as well. Outcome-based conceptions of equity are under fire in the name of meritocracy, overlooking the structural barriers that hold back some populations.

On the other hand, nativism and fear of the unknown mobilise much public opinion against liberalised immigration. In addition, opposition to redistributive or safety-net policies is often heightened when it is perceived that benefits accrue disproportionately to ethnic minorities or immigrants. Given all of these ideological and political hurdles, the task at hand consists of persuasion at least as much as policy design.

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MEMO

Why we need a jobs-led strategy for economic revival

Kevin Doogan

In the immediate aftermath of the collapse of Lehman Brothers on 11 September 2008, many accounts compared the crisis to a “financial tsunami”. Whilst this was plausible in conveying the scale of the disaster, now, more than two years later, this metaphor appears more than a little ironic. We do have an understanding of the causes of tsunamis in the natural world, based on subterranean forces and shifting tectonic plates, but in the financial world the absence of a coherent explanation of the causes of the crisis is bewildering.

Lacking a cogent explanation for the origins of the crisis, a range of policy responses has developed without a unifying logic or a clear sense of purpose. This risks protracting the “Great Recession” and undermining economic revival. Having absolved themselves of the need to explain why the meltdown occurred, policymakers in the United States and Europe have shifted the focus from causes to effects, or from bailouts to fiscal deficits. Fiscal consolidation has become the order of the day and an end in itself, as governments seek to put the public finances in order so as to placate the bond markets and the financial institutions that have been restored to rude health by the generosity of the taxpayer. The following observations seek to present the direction of an alternative response.

1. Although large-scale state intervention to prevent economic collapse was initially seen by some as a return to Keynesian economics, a comparison with the New Deal policies of the 1930s reveals a policy trajectory moving in the opposite direction. In this respect the current crisis presents the mirror image of the 1930s. As Paul Davidson has shown, Roosevelt’s New Deal programme built or renovated 2,500 hospitals, 45,000 schools, 13,000 parks and playgrounds, 7,800 bridges and 700,000 miles of roads and planted billions of trees and constructed many airfields. The federal works programme supported 8 million households – or 22% of the population. Total welfare expenditures rose from $208m to $4.9bn and greatly increased federal involvement in welfare. Between 1932 and 1939 the federal share of public aid grew from 2.1% to 62.5%. In the United States of today the debate revolves around reigning in Medicare and Medicaid and deep cuts and caps on discretionary spending, coupled with tax breaks for the wealthy. While the 1930s gave birth to the American welfare state, the crisis of 2008 suggests unprecedented welfare retrenchment. The same pattern is replicated elsewhere, including in the United Kingdom and in Southern and Eastern Europe, in what might be described as an “antediluvian mindset” that has framed policy since the onset of crisis.

2. With all attention focused on tackling fiscal deficits, the labour market implications of the austerity regimes have been given scant regard. Macroeconomic debates have focused on the implications for market demand and consumer confidence and on the possible weakening of the long-anticipated recovery. Yet the bailout of the banks has relocated debt from the private sector to the public sector – with significant labour market effects that have yet to be considered. Most economic models take the private sector labour market as the starting point and assume that the public sector should respond to market shocks in a similar fashion. Yet the public service labour market articulates a different system of planning, co-ordination and finance and has a distinctive pattern of adjustment. To grasp this requires an understanding of its social function, which appears beyond the reach of neoliberal policymakers.

3. Those who advocate "welfare regime change" present the public sector as somehow dependent on the wealth created in the private sector. They argue that the balance between private enterprise and public welfare has got out of kilter. Welfare spending is seen as parasitic on the private sector and as interfering with market forces. The policy options served up are familiar refrains in the neoliberal repertoire: more privatisation, reduce welfare incentives to create jobs and increase deregulation.

Yet there is an inherent risk in implementing austerity measures 30 years after Reagan and Thatcher came into office, because there is not much family silver left to sell after the privatisation programmes of the last three decades. The utilities have been sold off, state-run telecommunications have been privatised, and the commercially viable semi-state industries have been transferred from the public sector. That is why the current public spending cutbacks fall so sharply on welfare services and social security.

4. There is little consideration of the employment risks arising from austerity measures in public services. Leave aside consideration of the social injustice of the sacrifices demanded of the poorest sections of society whilst ultra-wealthy financiers continue to enjoy riches beyond the dreams of avarice. Forget also the fact that the banks have been given a leisurely timetable up to 2019 to make very modest changes to their operations, whilst the huge public deficits must be made good within four or five years. Consider instead the inherent economic risks that arise with the implementation of austerity when there is such little concern with the employment impacts of budget reductions in health, in education and in social services.

These are sectors that have made major contributions to employment expansion during the growth years. Despite all the high-tech glitz of a new economy driven by Silicon Valley innovation, the key sources of job growth have more prosaic origins in the delivery of welfare services, in the education and training of the future workforce and in meeting the health needs of society. During the so-called new economy boom it was health services that made the second largest contribution to job creation in the United States. In the European Union, employment growth in health and social services was 10 times the European average and accounted for half of all additional jobs created during the growth years. Therefore one of the major risks that arises with fiscal austerity and welfare retrenchment is that critical sources of job growth are choked off and that the crisis is prolonged and economic recovery is further postponed.

5. One of the difficulties in assessing the prospects for this recession lies in the uneven nature of its employment impact. This is a global crisis with different transmission mechanisms – whether through trade or financial links – which have produced variable employment effects. This is a crisis that has assailed the heartland of the world economy, with the advanced countries among the principal casualties. If exposure to the downturn in construction and the bursting of the housing market bubble are also taken into account, it is possible to explain very significant rises in unemployment in specific countries such as Spain (20%) and Ireland (almost 15%) while in others, such as the Netherlands, unemployment is little changed at 4%. If labour market analysis further considers the current crisis in historical context by comparing it to the employment impacts of the recessions of the 1990s, 1980s and the 1930s, it is possible to draw broad conclusions about the labour market prospects of this and the austerity regimes that have been developed in response.

6. If at first sight this crisis looks comparable to the 1930s, look again: unemployment is lower but the recovery will in all likelihood be slower. The present crisis is comparable in scale to the economic downturn of the 1930s. However, it looks as if unemployment will not reach the levels of the slump of the 1930s, when the proportion out of work reached 25% in the United States, almost 30% in Germany, 27% in Canada and 20% in Britain. The impacts of the austerity measures have to work their way through the public service labour market which has its own systems and mechanisms of adjustment. Broadly speaking, the decline in employment in this recession will not be as severe as the slump of the 1930s, but the recovery will in all likelihood be much slower. In its *World of Work Report 2010: From One Crisis to the Next?,* the International Labour Organisation's (ILO) estimates of the pace of recovery have been scaled down significantly. In the previous year's report, employment in the advanced economies was expected to return to pre-crisis levels by 2013, but this has now been put back until at least 2015, with every possibility that this will be further postponed.

7. This recession will impact on the age composition of the workforce. While previous downturns saw workers of 50 years and older leave the labour market in droves, the current recession has seen a significant increase in the average age of exit for the older groups, as retirement ages are raised and pension entitlements deferred. One of the key changes in the age composition of the workforce is that the prospects for younger job seekers, and indeed the long-term unemployed, have deteriorated dramatically. The same ILO report compared the impact of previous recessions on youth unemployment across a range of countries that were able to restore youth employment. It showed that, on average, these countries took 11 years to reach pre-crisis levels, with Greece taking 17 years at one end of the spectrum and Mexico seven years at the other. But many countries did not even get back to pre-crisis levels and on average it took 17 years to attain a partial recovery in youth employment.

8. Overall, austerity-induced welfare retrenchment offers a very long and tortuous route to economic salvation and even this is not guaranteed. A jobs-led strategy for economic revival, as advanced by the ILO, is far more plausible, not only in repairing the damage to public finances brought about by the bank bailouts, but also in protecting a generation of young people from the hopelessness of a life without work.

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MEMO

Move on from flexibility and its diminishing returns

Paul Gregg

As economies became more productive through the 19th and 20th centuries, workers sought increased social protection, in terms of a social safety net and employment regulation, as well as shorter work time. Yet the loss of full employment in the 1970s, with a reduced rate of economic growth, saw the demise of the consensus around the Keynesian economic model. The new consensus model, amongst most economists, made a link between employment flexibility, reduced social protection and deregulation and increased efficiency, both in terms of faster growth and lower unemployment. The argument for this neoliberal model was mainly based on relatively rapid employment recovery and reasonable growth in the United States and the United Kingdom. Today, however, this new consensus is looking as shaky as the Keynesian one 30 years ago.

The US model has always been unattractive to the left but the poor performance of the United States on jobs and wages over the last decade has been less well noted than it should have been. US median real wages have been stagnant for a long period now and absolute poverty levels rose throughout the last decade, not just in the recent recession. The US employment record has also been poor since the end of the 1980s boom, such that on entry to the current recession the United States had below average employment rates among major OECD economies and then suffered a particularly severe employment loss in the downturn. Whilst the United States may well recover faster than Europe as a whole (though not the Northern European countries) the US as a model looks less attractive now than it ever has. At a deeper level, the dichotomous approach, adopted by many commentators, contrasting the United States and European models to exemplify efficiency/equity trade-offs is looking outdated as the United States struggles on both counts.

The left has largely accepted that, broadly speaking, social and employment protection comes with a cost, although the cost may be small in some cases where it leads to increased productivity and be worth paying for increased security, such that workers can choose, collectively, to take economic growth in the form of higher wages or increased protection or shorter hours. The evidence suggests that it is correct to suggest that this does not lead to lower economic growth.

This memo firstly looks at a number of policy conflicts in the design of social protection systems and labour market performance which appear still relevant to welfare reform thinking and where the left has made some accommodation to basic labour economics. It then surveys a number of problems and opportunities that are opening up in the context of the recession, globalisation and lifestyle and demographic changes.

1. Employment protection versus unemployment. Where countries operate strong employment protection they appear to adjust to economic shocks with more long-term unemployment and especially youth unemployment and this persists for longer periods. Countries with two-tier systems of employment protection (for example Spain) are particularly prone to this problem as the well protected insiders can feel isolated from economic risks.

2. Income security versus employment flexibility. A shift to emphasise income security in the face of economic shocks and to focus less on retaining jobs in declining industries (employment preservation) and enabling greater employment flexibility. At its heart this approach forms a major plank of the flexicurity model. It is worth noting that in the face of a sudden economic downturn, such as we have just experienced, employment preservation was both rational and wise, as the jobs are likely to be viable in the medium term. It is the subsidisation of declining industries (through cash or in-kind insulation) that appears unsustainable.

3. Aggressive activation versus transitional opportunities. A greater emphasis on activation of the unemployed (and other welfare recipients) through conditionality in the welfare system. This sets required and monitored activity, mainly focused around job search. At its most aggressive, this has been turned into a job guarantee: the state will require paid work activity and will find or create the jobs (for example in Denmark). The workfare variant of this model, which requires work, mainly community-based, in return for benefit receipt, has been widely found to be ineffective in helping people return to regular employment, as it inhibits job search. Transitional jobs designed to move people into regular jobs or default public sector jobs do seem to help move people off unemployment benefits.

4. Low earnings versus generous welfare. There is a conflict between low earnings (low wages or short hours) and generous welfare systems. Increased wage inequality, especially at the bottom end, from lower wage regulation, weak trade unions and high unemployment creates conflict with a reasonably generous social assistance system, as work incentives are weak, especially for families. Wage inequality has been rising across much of Europe over the last decade (though not in France and Spain) and is high in many Eastern European countries like Poland and Hungary. The result has been an interest in using the tax system or a separate tax credit system to increase the financial incentives to work and reduce the low-paid and short-hour job conflict rather than reducing the generosity of the out-of-work welfare support system. This is the accommodation of a highly deregulated flexible labour market through the design of welfare institutions rather than placing restrictions on employment offers. The United Kingdom has used tax credits extensively, mainly focused on families, and this is being developed further by the Conservative-led government, suggesting that the political right is taking this issue on board.

5. The policy conflict outcomes and new directions. These reform areas have aided employment growth over last decade but low real interest rates, benign inflation from cheap imports and lower wage growth have probably been more important. There have also been moves to enhance job flexibility for workers, particularly around family-friendly employment, maternity/paternity leave and childcare, which have definitely aided employment growth among mothers in Europe (such policies have been largely absent in the United States). This is a clear example of where regulation and strategic intervention by government, especially in childcare, have boosted employment.

Whilst the impact of the recession on employment has in Europe generally been unexpectedly modest, this does not appear related to increased flexibility in European labour markets, given the extremely poor US performance. There are, however, a large number of major problems and opportunities opening up.

6. Strengthened labour demand presents an opportunity to reduce wage inequality. The current eurozone problems clearly require a period of low inflation in Southern Europe and Ireland relative to Northern Europe. This can either come from prolonged stagnation of earnings and employment in those countries or can be accommodated to a degree by faster wage growth in the north, encouraging a competitiveness switch and more imports from the south. In particular, German real wages and consumption need to rise. With the large recent increase in wage inequality, the strengthened labour demand offers a serious opportunity and a need to reduce wage inequality, especially at the bottom where it has so markedly increased. The need to reduce low wages is driven by the need to raise labour supply and to promote moves off welfare.

7. Rising energy costs present a huge opportunity in Europe for technology and jobs. Commodity prices are extraordinarily high so soon after a major recession in developed countries. The reason is clear: the rapid economic development of India and China means that the developed world is no longer the major engine of demand for commodities. This is creating inflationary pressures very early in the recovery and reducing demand, as high oil policies generally do. But the deeper point is that when the developed world gets a major recovery under way, demand for oil and raw materials will rise substantially further than levels seen in the immediate pre-recession era. Demand is simply rising faster than supply. This bodes ill for resource-intensive countries, such as the United States and indeed China. Europe is more advanced in moving to less energy-intensive GDP but further moves in this direction are essential for a growth strategy in face of high material costs.

This creates opportunities for major new industries around renewable energy, electric cars, recycling etc. As energy becomes increasingly expensive relative to labour, more labour-intensive but low-energy production becomes relatively attractive at the margin (for example recycling and energy conservation). This agenda is both a challenge to existing demand patterns and growth but also a huge opportunity for technology and jobs. Related to this, the idea that manufacturing in Europe is in permanent decline due to competition from the East is proving misplaced. Rapid rises in living standards are creating demand for high-tech and niche quality products, which offers a serious prospect for manufacturing to maintain an employment share.

8. Population ageing challenges the welfare system but it also creates employment opportunities. The last major challenge is the ageing population. This is creating huge demands on the pension part of the welfare system and health expenditures and will in turn create huge demand for care services. The challenge is one of financing and of wages and productivity in these sectors but it also presents an opportunity as a major job generator over the next few years.

The threat to the welfare system is real, with a logic of reducing pension generosity as well as the working age population releasing funds for the growing aged population. There are three sensible alternative responses to this that should be developed. First, the pension age rises, probably close to 70 over time as life expectancy rises (there is a limit on this because age-related disability and hence low productivity set in). Second, raise employment rates among the working-age population. The two main areas here are the high levels of disability welfare dependence and the employment rates of mothers, which are still low across much of Europe relative to men. A related response is therefore about fertility. Reducing the conflict between motherhood and employment through improved maternity rights and childcare creates higher employment but also fertility, as has been the case in Scandinavia for a while, but has also been a very clear response to changes in the United Kingdom over the last decade.

9. The task now is to integrate marginal groups into the labour market. The insights of the last 20 years appear to be offering diminishing returns on the labour market problems we face. The main thrusts are now less about incentives and flexibility from an employer perspective, as these lessons have broadly been learned, but rather about reintegration of marginal groups. This will require an increased degree of emphasis on corporate social responsibility towards employment and the careful stimulation of new markets (for example around energy use and conservation) and the design of support services funded by the state.

The major need to expand employment into older, disabled and mother populations suggests a need to build a new model of part-time working. All three groups are likely to frequently want part-time and other flexible employment patterns but these forms of employment tend to be low paid and relatively unstable in most countries. The promotion of part-time work and other flexible working forms in ways that do not intrinsically link them to low pay and instability and a lack of training and career advancement is the holy grail here. Australia and the Netherlands have made some progress in making sure such forms of employment are mainstream rather than second class jobs.

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MEMO

Flexicurity 2.0 is the model for the 21st century

Jon Kvist

The welfare state needs an update; the combined impact of the debt crisis, globalisation and ageing populations calls for a rethink. Austerity packages roll back state responsibilities for welfare through benefit cuts and the loss of thousands of public sector jobs. Some of these cuts in social expenditure might come back to haunt governments later. Without a fundamental rethink of the European social model that goes beyond cost cutting, the future may bring governments not only less revenue and more expenditure but also more divided societies.

Flexicurity 2.0 is the approach which can revamp Europe's welfare models in the face of these threats. The goal is to include as many as possible in the labour market of today and years to come; to reduce the number of claimants of welfare benefits; and to ensure accessible and high quality education, social and health care. Activation, social investments, and ending biological age as the main entry point to an array of benefits, are the chief instruments to make the European social model economically sustainable and socially just.

1. European social models need activation beyond the labour market. Traditionally, the flexicurity model secured workers through unemployment benefits, made labour markets flexible through lax employment protection legislation, and secured mobility through active labour market policies, giving the unemployed rights and obligations to training offers and life long learning. Today, activation broadly understood should also include:

- **Making it obligatory to make use of better childcare and adult training courses.** The labour market has become more complex. People no longer move from one employer to another doing the same job. Jobs are becoming more skill specific. The future looks bleak indeed for unskilled labour due to the impact of technology, globalisation and labour market changes. The OECD expects that workers will have to change between jobs with new skill demands six times throughout their careers. Investments must be made in more and better childcare to optimize cognitive capacities to be used continuously as adults when re-skilling and in training courses for people in between jobs.

- **Reserving welfare benefits for the needy.** Research shows that in the face of activation strategies, the unemployed will try and find a job on their own accord and are successful to the extent that there are actual jobs available. Benefits and training courses can then be reserved for the most vulnerable and needy.

- **Alleviate popular fears of social tourism and benefit scrounging by resident ethnic minority groups.** The motivational effects of activation and its implicit demand of physical presence and activity in order to receive benefits may mitigate fears of welfare migration and benefit exportability and thus legitimise accessible, generous benefits. Although scarce, any empirical evidence supporting claims that welfare magnetism is growing tends to lead to a reduction in benefits likely to be taken up by newcomers and ethnic minority groups. This has the knock on effect of contributing to an overall less generous system than would have been the case without the fear of migration and misuse. Less accessible and generous schemes not only affect adults, but also children in their families; it also affects nationals in similar situations because EU legislation forbids discrimination on the basis of nationality. And if governments start underbidding each other to avoid welfare migration, this would ultimately lead to a race-to-the-bottom scenario in Europe. Activation thereby defends a social investment strategy.

2. Investments today mean less expenditure tomorrow – social investment must consolidate activation strategies. Activation is merely coercive if it moves people into bad childcare, schools, vocational training and so forth. In contrast, activation into social investment schemes has a preventive or enabling function. Investments today mean less expenditure tomorrow.

- **Social investments are needed for integration and rehabilitation into the labour market.** The interaction effects between activation and social investment are crucial for many groups that are currently difficult to integrate in to the labour market. Take the example of activating those on long-term sick lists: in many countries there is a growing problem whereby disability pensions are awarded to growing numbers of young people on psychiatric diagnoses rather than physiological grounds. These groups do not react along conventional lines to economic incentives and coercive activation. Social investment is therefore needed both in rehabilitative measures, and in organising work placements and job training.

- **Low skilled women should benefit from social investment and activation.** Another group with low labour market participation rates in general are groups of low skilled, especially women. Here three sets of measures involving activation and social investments are called for. First, children could be obliged to be in good quality crèche, childcare and primary school facilities for families to qualify for child family benefits. Children would thereby increase their cognitive capacities, language and social skills that in turn may help them later in life achieve more fortunate positions in the labour market than their parents. Second, activation of women to the extent that they have markedly low labour market participation rates may not pay off for the activated themselves but in the longer run as, especially, their daughters get other role models. Third, to reduce school drop-outs young people may be asked to be in education and vocational training to remain entitled to study grants, social assistance and the like.

3. More revenue and less expenditure can come from a rethink of the use of biological age as a means test for social needs. Social investments and activation should not stand-alone. Indeed in some cases social investments and activation is of little, if any, use. This is particularly the case for regulation of early exit from the labour market. In many countries the days are gone when old age means frail health and financial destitution. The same countries, however, have schemes favouring the elderly. In economic terms the elderly are often privileged through tax exemptions or lower tax rates, vouchers, subsidies and special fares to various social, health and cultural benefits. Benefits are granted by virtue of the biological age with little, if any, attention to the needs of the elderly or their income.

- **Early retirement through unemployment benefits, disability pensions or old age pensions need to stop using biological age as a filter for allocating benefits.** Instead more attention should be paid to activity over the life course. Elderly people who have been in the labour market for 40 years or so may be worn out and deserve a respectful exit from the labour market. Instead Nordic countries that are heavy on activation and investments, for example, let the elderly undergo activation and investment in the form of rehabilitation as a matter of principle. All are equal and therefore all should be activated and invested in. For the group with 40 or more years in the labour market, activation and investments, however, may simply give the persons the feeling of yet another personal failure while governments will find that efforts are rarely worth the economic costs of the schemes.

- **People who spend longer in education and have less physically and psychological demanding jobs must work longer.** In contrast, people with a long formal education prior to labour market entry may not have worked 40+ years when they reach the official retirement age. To avoid a socially unjust situation where people with few skills and thus many years on the labour market face tougher treatment than people with many years of (subsidised) education, we need to end using biological age when regulating exit from the labour market. This means we should allow physically and psychologically worn out people who have paid their dues through many years of being active in the labour market to retire gracefully.

- **Mid-life career shifts may help retain welfare workers for longer periods and reduce the highly gendered segmentation of labour markets.** Recalling that the number of years on the labour market gets larger, we may also consider that activation and investments take the form of possibilities of entire career shifts midway through the working life. Especially welfare professionals like nurses, childminders and social workers may be given the chance to take a Master of Public Administration or the like to enable them to move into less physically and psychologically straining jobs.

4. Some may label this call this Flexicurity 2.0 a filtering mechanism for "raw socialism". They should think of the alternative where sometimes cuts are made mainly to reduce public budgets and debts with less consideration of the social policy consequences. Privileged groups can and will protect themselves if the state withdraws its safety net; non-privileged groups cannot.

Others may say that the political challenge and the economic costs necessary to build and run a Flexicurity 2.0 model are insurmountable. They should recall that the initial costs are mostly more than compensated in the medium to long term. To illustrate take the issue of women, production and reproduction. The Flexicurity 2.0 model allows women to both have careers and have children. When women participate in the labour market at the same level as men, which the Nordic countries demonstrate can be achieved, they make a big contribution to increasing labour supply. When women participate in the labour market, but do not have more than one child, as we see in many Central and Southern European countries, then the European social model is weak. We need all – children, women, men, ethnic majorities and minorities, as well as elderly segments of the population – to be active to secure the European Social Model of tomorrow.

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MEMO

Strengthen labour market institutions over big finance

Stein Reegård

We assume that full employment and a more equal distribution of income are two of the main goals of social democratic economic policy. But, in the modern globalised economy there are countervailing pressures for higher productivity and economic restructuring. The challenge is to find a fair balance in the distribution of productivity, costs and benefits, tempering free markets with well designed economic institutions. At a time when many countries lack political alternatives, one distinctive message could be that there is a choice: more power to labour markets or financial institutions.

Social democrats have to be competent economic actors, balancing public finances and using state capacity in an optimal and efficient way. Sound public finances increase the state's ability to resist the influence and "attacks" of financial markets and liberalist economic policy. It makes the economy more robust by facilitating the use of automatic stabilisers and active stimulation polices, and it also facilitates the restructuring of the economy by giving workers confidence and safety in the form of social security arrangements. The size of the public sector also matters; it is an important vehicle for redistributing market income, and for reducing economic volatility.

The current downsizing of state capacity in many countries may therefore have an array of negative effects. It is important therefore to remember that the financial crisis was brought on by oversized and under regulated financial markets, not by an overstretched state. Financial institutions allowed the state to pay the price for their own risky behaviour. In this sense it might be said that financial institutions are the main challengers to social democratic policy; strong labour market institutions its best allies. The role of financial institutions, currently oversized, should therefore be reduced and the role of labour market institutions should be strengthened.

1. Strengthening Social Democratic Institutions (SDIs) over commercial financial institutions reduces both the risk and the power of overdeveloped financial markets. The financial crisis revealed the extent to which the strength of financial markets differs between countries. Countries with oversized or over-expanded financial sectors ran into the biggest trouble. This is illustrated by looking at the IMF figures for banking assets compared to GDP in 2009: Iceland, 1000% (2008); Ireland 600%; UK, 500%; Norway, Finland, Sweden and Germany, 100-200%.

Strengthening state entities or institutions based on labour market organisations over commercial financial institutions not only reduces the risk of future financial crises, it also offers viable alternatives in many areas which can deliver fairer distributional effects. For example, in credit markets, higher income earners are offered the best terms; SDIs try to equalise opportunities. In insurance services, higher income earners pay lower risk premiums; SDIs do not discriminate on the basis of income. And in the financial markets, the higher income earners have the means and access to tap into the soundest advice as institutions set out to avoid risky customers; SDIs try to help vulnerable customers.

2. The higher the degree of co-ordination in wage formation, the more equal the distribution of pay. One of trade unions' basic roles is to negotiate on behalf of their members for more equal pay, rather than relying on market forces alone. Coordinated wage bargaining from the centre reduces wage disparity and contributes to a more equal society. The financial sector tends to widen wage gaps compared to the labour market in general. This is so between top and bottom and between males and females. One illustration is the widening gender pay gap in financial institutions, compared to the levels of gender disparity in other sectors.

3. Co-ordinated wage formation contributes to a more favourable trade off between unemployment and inflation. Several studies show how countries with a higher degree of wage co-ordination outperform those with lower co-ordination. It is often countered that there is an inverse "U-shaped" relationship between unemployment and levels of co-ordination, whereby countries with the most decentralised wage formation do well in terms of overall employment levels. Yet, in such circumstances, there is higher disparity in wage and income distribution.

Furthermore, bargaining at the central level takes into account the outcome effects from a macro economic perspective, whilst also considering the policy responses of government. Externalities are to some extent internalised in the decision-making process as it becomes more obvious when higher wage claims might impinge on levels of employment.

4. There needs to be transfer mechanisms and tax incentives to boost union membership. Modern market economies need stronger collective mechanisms to balance markets. It is therefore a paradox that in many countries development has moved in the opposite direction. Financial institutions and markets have expanded whilst the role of organised labour has declined. Labour market co-ordination has been weakened as a result. The most important observation here is the overall decline in the share of workers that are unionised. Recent data from the OECD shows that in almost every country union density has been eroded. In the years 1995-2008 the decline was 10-15% in Sweden, Finland, Ireland, Austria and Germany; 5-9% in Netherlands, Denmark, UK, Italy and Portugal; and 1-4% in Norway, Belgium, Spain and France.

Furthermore, trends toward the decentralisation of collective bargaining have further weakened union co-ordination in many countries. Although it must be noted that union density is still above 50% in the Nordic countries and Belgium, and that several countries - in particular France with a union density below 10% - have significantly higher collective agreements coverage through legislative extension or other mechanisms.

The primary challenge for trade unions is to play a much more constructive role in the economy and boost membership. But there is also a role for politicians. To start with they can transfer the present indirect subsidies which financial institutions enjoy to labour market institutions. In addition to state rescue operations, finance has been a long term privileged activity, gaining exemptions from Value Added Tax (VAT) and receiving implicit state guarantees. The value of exemption from VAT in the financial sector in Norway (with a modest financial sector) has been estimated to around 25,000 euros per person year in the sector. Subsidies like this increase income and employment in the sector to unhealthy levels. Used in other parts of the economy, the resources could have increased employment in sectors paying normal tax and markets rates.

Some countries do stimulate trade union membership through reducing tax on union fees and through organising part of social security with a role for social partners. This mechanism contributes to high union density in the Nordic countries; though is now being reduced by the incumbent governments in Denmark and Sweden.

5. Unions need better co-ordination at the federal level. Effective decision-making across union branches and professions is required to co-ordinate wages. The best mechanism for facilitating this is a strong federation-level body that can represent larger groups of employees and decide on common priorities and action. It must have the resources and competence to deal with complicated negotiations and economic policy issues. In the Nordic trade unions (LO) the member fee may amount to 1 to 2% of earnings, with 10-20% of this going to the federation.

There is also a debate about the extent to which co-ordination is needed at the European level. In many political areas EU/EEA coordination has been very relevant. Yet, for wage coordination it seems somewhat far fetched. Given the lack of coordination mechanisms at the national level, it is hard to see co-ordination implemented at an even “higher” level. Unions who will not even give their national federation a mandate will hardly hand one to a European level body. In Europe such co-ordination will be complicated due to differing circumstances between countries.

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MEMO

Focus on labour market churning and the low-pay, no-pay cycle

Tracy Shildrick

Precarious working and labour market churning are as significant a problem as unemployment. We therefore need a greater focus on jobs rather than rather the characteristics of the jobless. There is a real need for policy to give greater recognition to “low-pay, no-pay” cycles if governments are to seriously establish conditions for working life which allow acceptable levels of social and economic security for citizens, their progress through employment, and avoidance of being poor yet in work.

1. Long-term unemployment affects fewer people than is often assumed. The Lisbon Strategy stated that the overall aim of employment and economic policies in Europe was to raise the employment rate of each member state to as close to 70 per cent as possible by 2010. Yet by that date only eight member states had reached the target, with some, such as Malta, Italy and Poland, falling far short. Overall employment rates are, of course, important and indicative in general terms of the health of an economy. Conversely, long-term unemployment is a sign of the social and economic failings of a society, as well as being a debilitating condition for individuals. Yet this is a condition that affects far fewer people than it is often assumed or asserted. In 2008, for instance, 2.6 per cent of the labour force in the European member states were experiencing long-term unemployment (defined as being unemployed for a period of 12 months or more).

2. Labour market churning is a widespread socio-economic problem. Whilst longer term unemployment is an important problem that rightly should be tackled by the social and economic policies of governments, too great a focus on it can detract from what is arguably the more widespread problem of “labour market churning”, which itself reflects an increasing experience of economic marginality. What is meant by labour market churning is the experience of workers circulating over time between unemployment and typically low-paid, low-skilled work. It has been argued that the precariousness – or précarité – of working life is a defining feature of social and economic life in advanced capitalist societies, especially for those workers who already suffer from well-known social disadvantages (for example as a result of ethnicity, gender, migrant status or social class). European sociologists and campaigners have gone as far as to argue that such workers can now be described as constituting a new social class: the Prekariat.

3. Existing policy might be accused of ignoring – or making invisible – young adults’ experience of cycling between low-paid, low-skilled jobs and welfare. Young people have been especially badly affected by the recent global recession. Eighty-one million young adults are unemployed globally. This presents serious challenges for politicians. Yet the policy orthodoxy that sees raising employment rates and tackling unemployment as the key response is problematic. Part of the problem can be demonstrated with reference to the difficulties of "young people not in education, employment or training" – the so-called "NEETs". Originating in UK social policy under the New Labour government, this acronym and policy focus has much wider currency now. Despite concerted efforts to tackle the NEET problem, there are currently around 1 million 16 to 24 year olds unemployed (or NEET) in the United Kingdom – one in five of all young adults. We are now hearing again from social commentators and politicians about fears of another "lost generation".

But simply counting how many people are unemployed, or NEET, at any given time misses what is arguably the more significant problem: the churning of young adults between low-quality jobs and unemployment, between "EET" and "NEET". In the United Kingdom, long-term youth unemployment is currently *not* a significant problem (for young people or for policymakers). Research shows that only 1 per cent of young people are continuously NEET at age 16 *and* 17 *and* 18. In other words, the simplistic, stable policy categories – employment versus unemployment, EET versus NEET – no longer capture the dynamism, complexity, flux and insecurity of young adults' working lives, particularly those of the most disadvantaged.

To be clear, précarité and labour market churning are not the sole preserve of the young. It should also be emphasised that there is growing evidence – counter to some policy positions – that young people do not experience insecure, low-paid jobs as a natural or normal part of the process of labour market entry, as stepping stones to more secure and better jobs. Recent research by the Joseph Rowntree Foundation in the United Kingdom has found that this pattern of churning – the low-pay, no-pay cycle – characterised, for some workers, their long-term experience of working life.

4. Too many workers, not enough (good) jobs. Despite what one hears and reads, there is no strong evidence that, normally, the workless prefer unemployment to being in a job. Anecdote and ministerial pronouncement sometimes take the place of grounded, convincing evidence about unemployed people's work commitment and practices. The view that unemployment is a "lifestyle choice" leads to policies involving heavier sticks (and fewer carrots) to encourage the workless into jobs.

If we understand that the more common experience of worklessness is one of intermittent and relatively short-term unemployment, interspersed with periods of time in insecure jobs, policy diatribes about the unemployed as workshy appear to be nonsensical. The Prekariat recurrently search for and get jobs. And they are recurrently displaced from them by the insecurity of much current employment.

To paraphrase Bill Clinton, the problem we face is "the economy, stupid". The number of jobs that might be available in local, regional and national economies is an important precursor to the discussion about low-paid and low-skilled jobs. In a masterly review of research evidence from recent decades, Professor Ken Roberts has cogently argued that the key determinant of patterns of youth transition to adulthood (and therefore of rates of unemployment and so forth) is the range and type of opportunities available to young people. Labour market imbalances are not due to a poverty of ambition on behalf of young people; young people today are excessively ambitious relative to the jobs that the economy is able to offer. Quite simply, the economy is not able to generate sufficient jobs, especially good jobs, for young adults.

5. Implementing stringent and punitive welfare-to-work measures is illogical. Ignoring labour market demand and working conditions at a time when job losses are likely to increase inevitably helps to perpetuate the popular myth that welfare claimants simply need shifting away from benefits and into work. Such beliefs rest on the assumption that there are adequate numbers of jobs available, and that the problem is simply one of motivating, helping or even *forcing* workless people into the available vacancies. Of course there are jobs, but recent evidence suggests that in most areas jobless people outnumber vacancies, and in some areas of the United Kingdom there are literally dozens of people chasing every job.

Implementing stringent and punitive welfare-to-work measures based on “activating” the unemployed in a context where job vacancies are declining, where they are outstripped by the numbers of unemployed, and where unemployment is likely to rise rather than fall in the short term seems at best illogical and at worst an attack on the poor and workless.

6. Tackling “poor work” and improving the pay and quality of low-skilled, low-paid jobs. To repeat the well-worn mantra, employment is the best route out of poverty for most people. Yet the problem of “poor work” remains largely unaddressed in current policy, sidelined in favour of the imperative of moving people from welfare to (any) work.

Building on the research that has been done in the United States on low-paid working, it is now becoming more widely accepted that low-paid work is widespread in most labour markets. Low-paid work is now often low-skilled and insecure as well. This kind of employment is what has been described as “poor work”, the sort that has burgeoned in deregulated labour markets and which now provides the basis of working life for many in advanced industrialised economies. Whilst the “up-skilling” agenda is important if economies are to compete effectively in the global marketplace and in the high-skill information economy, this is not the whole story. A ready supply of cleaners, catering staff, hospitality staff and care workers will always be needed to support, complement and allow the high-skilled economy to exist and to function. To ignore the preponderance of low-paid, unskilled employment is a fundamental error and negates any real chance of employment progression and routes away from poverty and, ultimately, any real prospect of social justice.

7. As skill levels rise, “under-employment” may well become the norm. In the United Kingdom, the IPPR recently reported that there are 2.8 million under-employed people, that the number of under-employed men has increased by over half during the recession and, significantly, that one in five of the under-employed are aged between 16 and 24. Ken Roberts has described under-employment as the new global normality for youth in the labour market but, as noted above, careers of under-employed “poor work” are not restricted to the young.

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MEMO

How to counteract the polarisation of the labour market

Luc Soete & Jo Ritzen

The polarisation of the European labour market is gradually warming up the political climate. European voters are increasingly showing their dissatisfaction at the ballot box. They are increasingly expressing the view, in marked contrast to the past, that the future holds little in the way of opportunity and betterment for themselves and in particular for their children. This stormy political climate is creating internal cyclones that are sweeping through Europe and often hurting new Europeans and, at the EU level, it is building up a strong wind against much-needed further integration.

The polarisation of the labour market is associated with a sharp increase in income inequality in OECD countries. In the United States, Raghuram Rajan and Robert Reich have questioned the sustainability of economic and social progress at a time of rising income inequality. For Europe, the same applies. Europe has always enjoyed reasonable intergenerational mobility, meaning that even if parents might not have been that well off, their children still had a good chance of becoming part of the meritocracy. Yet it is likely that this upward mobility is decreasing, as intergenerational mobility is strongly related to income inequality. Europe needs to seriously take issue with this development and recreate a culture of optimism and progress for its citizens. This should involve action on the following points:

1. Improve preparation for Europe's future meritocracy through a (Common) European Higher Education and Research Area. The course towards a better social and political climate needs to be embedded in ideas for a more vibrant Europe. Leftist thinking has often appeared in Europe in the form of repressing excellence and creativity, but there is every reason to think of a more vibrant Europe with less polarisation. One of the least exploited sources of vibrancy are universities and public research institutes. These have been pressured into a national policy straightjacket and are suffocating in national cellars with just a small window of fresh air in the form of international student and staff mobility, cut off by and large from finance and living off public dry bread.

A European Higher Education and Research Area would create a European meritocracy of graduates – with, say, 20% mobility of students across borders (as was originally mentioned in the Bologna agreement) and 10% mobility of university graduates within the European Union by 2020. National social security regulations (like pensions) stand in the way of increased mobility for the staff of universities and research institutes – just as one illustration that we consider to be the tip of the iceberg.

2. Revamp the effectiveness of European social systems, both in terms of labour regulations and social security. This involves questioning the universal applicability of such systems so that "social protection" for the top dogs disappears while social protection for lower and middle groups improves in such a way that it also increases the competitiveness of firms.

Europe still has labour regulations for the industrial era of the 1960s, with national industries and a national labour market. The fact that the labour market at the upper end has become globalised has not yet been translated into labour regulations – although it has been reflected in the decline of trade union membership. Firms would be far more globally competitive if current European social security and labour regulations would cease to be applicable above certain income levels.

At the other end of the labour market it would make sense to adopt the approach that was used in countries such as the Netherlands in the early 1980s and in Germany in the late 2000s. This approach involves partial lay-offs on a much larger scale in times of recession, including "recessions" in specific sectors or even specific firms, so that a temporary reduction in a firm's turnover does not have to lead to the kind of unemployment associated with the loss of firm- or sector-specific human capital.

3. Reconstruct education as an instrument for social mobility by increasing the commitments of parents and local communities. The Programme for International Student Assessment (PISA) results in Europe overwhelmingly show a widening of the variation in performance. Most worrisome is the finding that around 30% of 15-year-old second- and third-generation immigrant children in Europe perform below PISA level 2 (alongside around 10% of native children), with this group of children forming in many EU countries up to 50% of the population of 15-year-olds. Clearly, education needs to be reconstructed to effectively provide equality of opportunity for these children. Looking at the background of these children, their parents often have a low level of education; a reconstructed system of education therefore has to take into account the parents as well.

4. Activate the wealth created in banks and firms for social innovation, entrepreneurship and employment. This can be done through the development of new financial instruments, such as social impact bonds, aligning various financial resources (family capital, non-governmental organisations, co-operative banks, local authorities). There is an urgent need to harness private financial interest in social innovation through an alignment of corporate social responsibility policies with local development plans (social impact bonds, community investment bonds, etc.). New forms of corporate responsibility should be explored such that firms can retain part of corporate taxes for improvement of the internal labour market for lower- and middle-income groups.

Conspicuous wealth acquired from wages and bonuses that borders on legalised robbery – in banks but also in international industries where incomes are measured in thousands of euros per minute, rather than per year – are to be countered on a European scale by using the shareholder ship of institutional investors, by political campaigns and in partnership with industry. Note that we do not propose an extra marginal taxation rate above a certain income level as this instrument has turned out to be increasingly ineffective in a globalised financial world.

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MEMO

Have faith in the power of education

Gudmund Hernes

Most studies of educational achievement reach the same conclusion: inequality is endemic. In all countries, differences in social class or background are transmitted to the next generation – and much of this inequality is transmitted through the education system. Students who come from working-class families on average perform worse, drop out more often, more frequently opt for vocational training, more often end up in jobs with lower pay and lower status – and more often end up unemployed or on social security.

In spite of all the efforts to promote equality of educational opportunity – by increasing years of compulsory education, by expanding the number of students, by allocating more resources – social inequality seems ineradicable. One might conclude that the great project dating back to the Enlightenment – the idea that education for all is possible and that it would result in more egalitarian societies – has slipped away. The dreams of social theorists from Rousseau to Owens and Marx that education could serve not just as a bridge for individuals seeking social advancement, but also as a bridge to a transformed social structure might seem to have been a creation of the imagination that will remain just that – imagination.

These grounds for pessimism can be further elaborated. For if one looks at European societies that have experienced a large influx of immigrants from the developing world, it is fairly easy to demonstrate that public education systems (not to mention private ones) are not colour blind. Ethnic minority adolescents are even more of a minority in the education system, and increasingly so the higher up the system one looks. So the great education project might be considered a big failure. But this is only part of the story, a very selective account. There are stronger grounds for optimism, and here is why:

1. The importance of education is increasing. The reason for this is simple: in everything we produce and consume, and in all the services we use, the component of knowledge is increasing. Take a simple example: anyone can craft a wooden spoon but hardly anyone could construct the plastic spoon that we use to stir our tea in a cafe. The reason is that it contains too much knowledge – the long carbon molecules that go into the plastic (now also designed for ecologically friendly decomposition); the mechanical design which makes it both flexible and resilient; the advanced machines constructed for its manufacture; the information technology used to monitor the production process. This simple example is illustrative of the increasingly artificial world humans construct as their environment.

2. We can observe the growth of knowledge in everything. Food is not picked from the ground or from trees; humans are no longer hunters and gatherers. What we put on our tables is based on the development of high-yield varieties of seeds and plants; their yield has been expanded by irrigation, synthetic fertiliser and new technologies, as well as by methods for land rotation, pesticides for insect control, new management techniques and so on. Livestock has changed and been improved by breeding; chicken is more a factory than a farm product. Every generation of the iPhone incorporates more and more new knowledge. Indeed, what we call improvement is generally improvement in knowledge.

3. If the importance of education increases, the importance of being educated increases. Over the last century education has expanded to encompass more hours per day, more days per year and more years of life. Hence the more that nations become knowledge societies, the less they can afford to lose anyone's talent (for example, if girls are excluded from school or higher education, then half the talent of the population is lost). At the same time, the nature of societies and the relations between people has changed as education has expanded. Even where there are great social differences in educational achievement, the general tone of informal interactions between the members of a society becomes more egalitarian and based on mutual respect.

4. There have been great strides towards more educational equality in areas other than social class. The case in point is women. Take Norway as an example. Half a century ago, in 1960, only one in five university students was a women; today two thirds are women. A higher proportion of women now continue to graduate school. There has been an astounding change in gender gaps. In addition, there has been a very impressive equalisation of educational opportunity geographically as well as between rural and urban areas. And, perhaps even more impressively, in some areas immigrant youths are doing exceptionally well.

5. But the story is a mixed one; social inequalities persist even if the poor get more education than ever before as the stratification system is reproduced by the education system. And though women constitute a majority of students, they are the minority in fields traditionally considered to be male occupations, such as the natural sciences or the technical fields. The same pattern is found in secondary education.

6. The lesson to draw is not to give up on the liberalising and equalising power of education. Getting more is better – not only for economic reasons but also for political and cultural ones. An educated citizenry makes for a better polity and for personally richer lives. At the same time, a second lesson is that we should not count on permanent, durable victories in the area of educational opportunity. We must be aware that some victories have been more successful than others – for example, women's education as compared to decreasing the dependence of educational outcomes on social class.

7. We should be wary of talking about education as a single commodity or unitary resource, primarily counted only by amount or level reached. Different types of education provide different opportunities. Notwithstanding what was argued above, there is no simple relationship between advances in technology and the need for people with more education or higher education. As economists such as David Autor, Frank Levy, Richard Murnane and Paul Krugman have noted, routine tasks (whether cognitive or manual) that can be solved by following explicit rules can increasingly be done by machine, including computing machines or computers. Assembly lines are run by machines governed by computers. Part of the job of car mechanics can now be performed by diagnostic programmes. Software can be used to sift through millions of documents – and hence substitute for lawyers. Those of us who do research now rely more on Google than on librarians. Thus even many white collar jobs are exposed to innovation.

8. The key question is not the amount of education but the degree to which routine labour – whether clerical, academic, manual or physical – can be substituted by machines. Here the argument of David Autor, Frank Levy and Richard Murnane is instructive: "Within industries, occupations, and education groups, computerization is associated with reduced labor input of routine manual and routine cognitive tasks and increased input of non-routine cognitive tasks." But substitutability is not a given across all sectors. Those who have manual jobs that are hard to automate – say, as a plumber – may be in a better bargaining position than a research assistant who can be substituted by a research engine. Added to this, modern information technology and telecommunications mean that more tasks can be outsourced and moved overseas, not just call centres but also for example analyses done by radiologists. Globalisation thus also affects the role of education. Therefore, in analysing the role of education in reproducing – or generating – social inequalities, we cannot just focus on traditional measures of social class and social inequality. Rather, the focus both of research and policy must be on how the sources of inequality are themselves changing all the time as a function of technological change.

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