

Introduction

The conference at which these papers were presented occurred just months after the collapse of Lehman Brothers. It was clear, at that point, that the world was entering the deepest recession since the Great Depression seventy-five years earlier. Unemployment would inevitably rise. It was unclear how long and how deep the downturn would be—and years later, as this volume goes to press, those uncertainties remain. One out of six Americans who would like a full-time job still can't get one. In Spain, the official unemployment rate exceeds 24 percent, but youth unemployment is twice that.

The Great Recession affected almost every country in the world. Unlike previous crises that came from the periphery (the developing countries), with the developed world striving to insulate themselves from the impact, this was a crisis that came from the United States. It risked bringing down with it countries throughout the world, affecting poor people and countries far less able to withstand these economic vicissitudes.

The Great Recession gives a special poignancy to the papers and discussion of part 1 of this volume—the provision of social protection. The crisis raises questions about the basic capitalist model, and especially its stability, as George Soros emphasizes in his comment in chapter 3. It raises, too, questions about globalization, about how responses to previous crises and the global financial architecture and institutions had contributed to the making

of the crisis and its rapid transmission around the world. The policies of financial market liberalization and deregulation were based on notions of market fundamentalism, the view that markets were self-regulating; ideas that had little empirical or theoretical support before the crisis but that have since become thoroughly discredited. But the international institutions (like the IMF and the Financial Stability Forum) had pushed these policies, often on unwilling developing countries, telling them that such policies were necessary for long-term growth and stability. That they did so—and that in the aftermath of the crisis, there was no system of “social protection” in place either for those countries that were adversely affected or for their citizens—suggests some fundamental weaknesses in the system of global governance, a subject touched upon by several of the contributions to part 1. The international financial institutions have been dominated by the advanced industrial countries and by those in the financial sector within those countries. These are issues to which this volume returns in part 5.

Most of part 1, however, is concerned with social protection: how social protection is affected by and affects globalization. Joseph Stiglitz argues that globalization has increased the need for social protection, but that it simultaneously has reduced the capacity of nation-states—still the basic unit of governance in our global economy—to respond. Many of these consequences are not inherent, but are a result of the way globalization has been managed, bringing us back to the critical question of global governance. Of particular concern has been the asymmetric nature of globalization, where there has been greater liberalization of financial markets than of labor markets, weakening workers’ bargaining power, with resulting adverse effects on wages. Moreover, a race to the bottom drives tax rates down, with businesses threatening to move elsewhere unless taxes—especially on businesses—are kept low. Many claim that globalization *demand*ed the weakening of social protections and wages, leading to a curious contradiction: While globalization was being sold as bringing benefits to all, workers (in response to globalization) were being told that they had to accept these drastic changes that visibly made them worse off (Stiglitz 2006). Presumably, in the long run (the argument went), they (or their great grandchildren) would be better off. As Keynes pointed out, in the long run, we’re all dead. Blue-collar workers in the United States had seen their standards of living erode over a quarter century. It was no wonder that so many had turned against globalization. The power of the prevailing paradigm was so strong that most did not reject globalization directly—they only demanded a fair globalization.

Finally, liberalization combined with deregulation has exposed those in developing and developed countries to additional shocks.

Leif Pagrotsky, a long-time member of Sweden's social democratic government, argues that this interpretation underestimates the positive contribution of globalization: The competition to which it gives rise has provided a spur to innovation and economic restructuring that are essential to economic growth. How countries respond to this competition is, of course, one of the central questions addressed by this volume. They may respond by protectionism, closing themselves off, or they may reply by devising systems of social protection. The Scandinavian countries took the latter route.

The chapters in this section—and especially that of Karl Ove Moene—explain why Scandinavian countries took that route and why the system of social protection that they constructed was so effective. The analysis goes beyond narrow economics to a broader understanding of politics and society.

The prevailing wisdom in recent decades has argued for stripping away social protections, lowering taxes, providing greater reliance on individuals to protect themselves—a move away from the state toward markets. This was supposed to lead to higher growth, which would benefit all. Economists have typically depicted a trade-off: One can only get more equality and security by giving up on growth. The Scandinavian model challenges these presumptions. The Scandinavian countries have the highest taxes in the world and the strongest system of social protection; yet, in most metrics, they also have the highest standard of living, with lower inequality, better social indicators, and dynamic economies. They have embraced globalization perhaps more than any other region in the world.

These outcomes are not an accident; stronger social protections have been one key part of their economic strategy. The central message of part 1 is that equality (equity), economic security, efficiency, and dynamism (growth) can be complementary. Societies with greater social protection can be more dynamic and more open to globalization. Of course, it matters how one designs the social protection system. Globalization (and more broadly, the increased pace of technological innovation) should not lead to the stripping away of the system of social protection, but to its redesign.

The economic argument has several components. The first, and most traditional, has been especially relevant recently: Systems of social protection act as automatic stabilizers, sustaining aggregate demand in the face of an economic downturn, and thus contributing to economic (and social) stability.

Second, in countries with better social protection, individuals are more able and willing to undertake risk. Risk-taking is at the center of a dynamic economy. As Moene puts it, stronger social protection facilitates the economy's ability to engage in the Schumpeterian process of creative destruction.

Third, higher minimum wages and—more broadly—a compressed wage structure provide incentives for firms to upgrade the skills of their workers. It shifts comparative advantage toward more skilled sectors, and this too leads to a more dynamic economy. (As an example, some economic historians argue that the imposition of the minimum wage played a critical role in the transformation of the U.S. South from a backward region dependent on very low-wage workers.)

But probably more important than the economic argument is the political and social analysis, which highlights how economic policies affect social cohesion. Voters are more willing to support globalization (with its attendant risks) if good systems of social protection are in place. More broadly, in societies in which there is more equality, there is greater social cohesion and—accordingly—a greater willingness to make efficiency-enhancing public investments.

Moene also argues that there is an “equality multiplier.” More social cohesion results in greater support for policies that promote equality and social cohesion, including better social protection. As societies become more egalitarian, they become more sensitive to inequities and work to address them. In short, societies with greater equality do a better job at solving the collective action problem.

Although the success of these countries is widely recognized, there are those who talk of “Scandinavian exceptionalism.” These are institutional arrangements that work for these countries, with their high degree of homogeneity and broad social consensus. To the contrary: There are good theoretical reasons why we should expect these outcomes. Scandinavian countries did not always have the degree of social cohesion they have today. What one sees today in these countries results in part from the welfare state.

Of course, there are other aspects of the economic and social policies in Scandinavia that contributed to these successes. Moene emphasizes, for instance, the role of trade associations. Some of the complementary policies can, in fact, be thought of as part of a system of social protection. High investments in human capital (perhaps spurred on by the challenges posed by globalization) enhance the ability of individuals to move from job to job, reducing both private and societal costs associated with job loss. Gender policies—bringing women into the labor force—may have been driven by

broader views of what a good society should look like, but families with two wage-earners are far better able to withstand shocks. Moreover, the demand for efficiency, to which globalization gave increased impetus, means that one cannot underutilize half of a country's potential human capital. The Scandinavian countries recognized this and developed policies to ensure greater labor force participation while enhancing the capacity of families to respond to the inevitable strains that resulted. These countries recognized the problems and, in response, devised policies that worked remarkably well.

No country can simply adopt wholesale institutions from another. Each institution is part of an "ecology," and systemic change—altering the entire system—is no easy matter. The particular system of social protection that has worked so well in Scandinavia will have to be adapted to reflect the circumstances and conditions in other countries. The message that comes out of these papers is clear: One can design effective systems of social protection that enhance economic security—an important aspect of individuals' sense of well-being. Well-designed systems of social protection can contribute to a more dynamic and more stable economy—and to a society and economy that are more open to globalization.

These are ideas that should be adopted by the international economic institutions (the IMF and the World Bank) that play such a large role in shaping economic policies in developing and emerging markets. These institutions have been cheerleaders for globalization, but the policies they pushed for a quarter century under the Washington Consensus undermined support for globalization, and for good reason. The failure of these institutions is in part related to deficiencies in global governance and is one of the reasons that reforming global governance (including the governance of the international economic institutions) is so important—a theme we return to in part 5.

Reference

Stiglitz, J., 2006, *Making Globalization Work*, New York: W. W. Norton.