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Post-crisis economic policies

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Following is the text of the letter that Edmund Phelps, the Director of the Center on Capitalism and Society at Columbia, sent to Canadian Prime Minister Stephen Harper on February 2010 to report to the G20 on the conference "Post-Crisis Economic Policies" that the Center held on 11–12 December 2009 in Berlin. The letter makes a special contribution to the topic of this Special Issue on "Growth or Stagnation after Recession?" and so it is reproduced in its entirety without any editorial change.

As Director of the Center on Capitalism and Society at Columbia University, I want to report to the G20 on the conference "Post-Crisis Economic Policies" the Center held on 11–12 December 2009 in Berlin. Last year I reported to the G20 on our conference "Emerging from the Financial Crisis" held 20 February 2009 in New York. At this recent conference, as at the previous one, a great many renowned policymakers, bankers, regulators and scholars joined forces with members of the Center to discuss key issues and come up with proposals on how to improve economic performance in the advanced economies in the aftermath of the financial crisis. Paul Volcker, chairman of President Obama's Economic Recovery Advisory Board, and Josef Ackerman, Chairman of Deutsche Bank, were dinner speakers. Lucas Papademos, Vice-President of the European Central Bank, Sir Howard Davies, Director of the London School of Economics and former Chairman of the Financial Services Authority, Dr. Joachim Faber, Member of the Board of Management of Allianz SE, and two Nobel laureates – Robert Mundell and I – each spoke in a panel as did the chair of the Center's Advisory Board Peter Jungen.

We convened to discuss ways to raise radically our post-crisis prospects – to boost our nations' normal prosperity levels and to buttress their prosperity from severe swings brought by speculative

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forces. A prosperous nation is one with adequately high employment in broadly rewarding jobs – jobs in which not only wages are good (relative to other income) but jobholders are flourishing: learning, exploring, creating and finding stimulation, engagement and self-discovery. For a nation to be *normally* prosperous, not just prospering for awhile thanks to some happenstance, its economy must possess adequate economic *dynamism* – a capacity and propensity for indigenous innovation – and adequate economic *inclusion* – wide access to jobs made rewarding by innovation are widely shared. Though the members of the Center present a range of views on the *ways* to generate prosperity and bolster it in cyclical troughs, we are united in taking a modern perspective on economies: The actors in an economy, particularly a dynamic one, face limitations in their economic knowledge – knowledge of the consequences of departing this way or that from past practice; these limitations create room for speculative excesses (and oversights too); yet such limitations make it possible for the business sector of an economy equipped for dynamism to conceive of plausible innovations without the *deus ex machina* of (exogenous) science; and innovation is the key to normally high prosperity.

This modern perspective is essential to constructing a satisfactory political economy, in particular a conception of the good economy, and it is now crucial to conceiving an economic policy adequate for the times. It is unfortunate, therefore, that a great many economists and policymakers still take the contrary neoclassical view that businesses are incapable of creativity, that the sole rewards of business are wages and consumption, and that innovation depends instead on the discoveries in basic science. They conclude that the world's innovation requires governments with the wisdom and wherewithal to support science. Schumpeter spelled it out in 1911 and Mussolini tested it in the 1930s.

The evidence is heavily against this old theory. Case studies of enterprises belie the myth that, in the modern age, innovation is still driven by external discoveries in basic science rather than by ideas in companies and markets.[1] Country studies belie the myth that "top-down" economies founded on statism and scientism succeed at innovation better than economies in which ideas bubble up from grassroots businesses. Household survey evidence belies the idea that people care only or predominantly about the money. Respondents report that they look for careers of initiative and exploration. And the job satisfaction they report is pronounced in economies of appreciable dynamism – ones buzzing with the challenges of the new. Apparently ordinary people value the experience it offers: the excitement from involvement in conceiving, developing, marketing and pioneering the use of new products.[2] (In addition, those who easily gain such participation may well value the inclusion of others. They may see best-effort inclusion as important if they are not to feel ashamed at the deprivations suffered by those left out. And they may see broad inclusion as essential if the institutions and values that nourish economic dynamism are to continue to earn broad-based political support.)[3]

In this view, the cost of the financial crisis – a crisis centering in the U.S., U.K., Spain, Ireland, and Iceland with fallout in all industrialized nations – is not just the lost output. The loss in

[1] A lengthy empirical study by Richard Nelson and long study by Amar Bhide, both members of the Center, give evidence supporting the modern view that most of the cumulative advance in techniques, products and productivity are the result of experimentation by producers or trial launch of new products in end-user markets.

[2] National job satisfaction averages and the international differences among them have been the subject of my research over the past 4 years in collaboration with Gylfi Zoega, Raicho Bojilov and Luminita Stevens. The findings suggest that higher dynamism tends to produce higher job satisfaction.

[3] None of the above denies that an economically advanced nation may gain relatively high productivity simply by copying from industrial leaders; and, with high productivity, a nation can pay high wages and pour out money for social insurance and even wage subsidies.