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Economics and Politics in a Volatile World

Grzegorz W. Kolodko

The Emirates Center for Strategic Studies and Research

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Introduction

"Things happen as they do because many things happen at the same time." This sentence, repeated as the guiding principle, is the foundation of what I call the coincidence theory of development.[1] It essentially means a comparative and interdisciplinary explanation of the essence and mechanisms of social and economic development as a historical process. But this theory may also be very useful on other occasions, for example, to explain the causes and mechanisms of the great economic crisis of 2008–2010. More often the crisis is described within this timeframe, although its roots go back much earlier than 2008 and its consequences are going to be felt well beyond 2010.

The Specific Character of the Current Crisis

We are dealing with something far more serious than just a temporary slump in business activity and a decline in absolute production levels. Traditionally, these have been measured using Gross Domestic Product (GDP), and this measure should be gradually abandoned and replaced by the superior measures of sustainable social and economic development.[2] It is true that globally the current crisis is the most extensive in the post-war period—a time span of three generations. However, it is an intellectually and politically unacceptable simplification to identify the current crisis as a temporary recession. If it is averaged, which as economists we enjoy doing, then in principle the crisis could be deemed to be over, as already in the 4th quarter of 2009 world production was again rising. Unfortunately, the crisis continues since it goes far beyond this narrowly understood field of production.

We began the first decade of the 21st century with improving economic conditions and a decent rate of economic growth. During the first three years of this decade, Gross World Product (GWP) increased in total by 9.6 percent, with an average annual growth of 3.1 percent (respectively in 2001, 2002 and 2003 by 2.4, 3.0 and 3.9 percent). This acceleration was visible also in subsequent periods, particularly in the three years preceding the crisis. In 2005–2007, the GWP increased by 15.5 percent, which means an average annual growth of more than 4.9 percent (in 2005, 2006 and 2007 it increased respectively by 4.9, 5.0 and 4.9 percent). When averaged out across the global population (and we are already almost seven billion people—double the population in 1960 and three times the population two centuries ago) it is the highest rate in the recorded history of Mankind.[3] Later, there followed the slowdown and the crisis of 2008–2010 when GWP increased by barely 4.9 percent in total, which means an annual average of 1.6 per cent (in 2008, 2009 and 2010 it increased respectively by 3.0, –1.1 and 3.1 percent).[4]

During the three crisis years, the total GWP value corresponded to a one-year value of the years preceding the crisis. It should be noted that such an index indicates production *per capita* growth of only 0.5 percent per annum.

Someone looking from the sidelines might ask: why so much panic just because in 2009 the production level dropped by just one percent? In the context of the whole decade, during which it increased in total by as much as 40 percent, it seems to be a minuscule change of insignificant importance. Moreover, in mid-October 2009 the Dow Jones index had again risen above 10,000, so apparently the crisis is over as the stock exchange has responded accordingly. However, it is not over yet. Why? First of all, the quoted indices refer to the dynamics of GWP presented annually as average values for the whole world; and the world, as we know, is unusually diversified. It is sufficient to mention that in the first three years of the decade global production increased on average by 3.1 percent per annum, while for the group of rich countries (i.e., the most developed economies populated by barely one billion people),[5] the index was only 1.6 percent. In the case of the "developing countries"[6] inhabited by 5.8 billion people, the index was 4.3 percent. In the period from 2005–2007 the indices of dynamics were respectively 2.8 and 7.7 percent, and during the crisis of 2008–2010 the divergence is even more apparent—in the former case the dynamics of global production oscillates around –0.5 percent, while in the latter it is as much as +4.3 percent. The global economic order has changed and the change has been for the better, since it reduces the enormous divergence resulting from the historical development process between the production levels and living standards in the highly developed countries and in those relatively backward states. The crisis has accelerated the process of diminishing this gap, which should be deemed as favorable. It is worth considering that as long ago as 2000 the GDP *per capita* in China (calculated according to purchasing power parity [PPP]) constituted only 6.7 percent of the American level (2,377 $PPP and 35,252 $PPP respectively), while in 2010 this relationship oscillated around 15 percent (i.e., 7,200 $PPP and 47,400 $PPP).[7]

Secondly, the present-day crisis is more one of redistribution rather than of production. The fluctuations, including absolute slumps, of the consumption volume and investments in particular, are much deeper that those of GDP itself. There are also great differences per region or industry sector. Disturbances affected Western Europe more than North America, and in turn Eastern Europe suffered more than Western Europe. If we refer the disturbance concerning distribution to the US economy (although not exclusively), this time the crisis is much more severe for Wall Street rather than Main Street, i.e.

for the financial sector rather than for salaried workers. Or in other words, in comparison to the past it affected *white collar* workers relatively more than *blue collar* workers and the crisis is definitely more damaging to the automobile industry than food processing. On a larger scale, the redistribution effects are greatly diversified both globally and at the level of individual economies.

Thirdly, tendencies present in the financial markets, such as positive movements expressed in the increase of stock exchange quotations, are by no means a sign of the economy coming back to “normal” (if we assume that such a condition exists at all). Sometimes it happens the other way round; the speculation on financial markets may be an irrational response and, by excessive separation of the financial sector from the real economy, are sometimes in fact the symptom of a production crisis or may even be one of its causes.

Fourthly, following disturbances in production and trade there is a fall in employment, which is automatically followed by a rise in the unemployment rate and continues to increase during the phase when the global economy starts to emerge from recession. It is estimated that at the end of 2009 the number of unemployed in the world was 60–80 million higher than a year and a half earlier; and the number keeps growing, not only in the countries which were affected by the recession or are still in recession, but also in economies which avoided the phase of production slump due to other reasons. The unemployment rate has been rising in the United States, Germany, China and India and the unemployment rate in the United States alone is the highest in the last 25 years. Similarly, in the European Union the unemployment rate is close to the psychological threshold of 10 percent. In the case of the United States, if counted unemployment includes those people without work but not registered as unemployed and people which are employed part-time, it amounts to over 16 percent. In Poland the unemployment rate was higher by a staggering 700,000 two and a half years after the fall of 2007; i.e. the rate of unemployment jumped from 8 to 13 percent, although Poland managed to get through the crisis without falling into recession and its GDP in 2009 increased by 1.7 percent. The fluctuations in the employment rate are very chaotic and they severely affect different sectors to a greater degree than the economy as a whole, in particular industries producing for export but also the construction and automotive industries. In the labor market one may therefore also observe a far-reaching redistribution process, which affects not only the economic aspect but also the social dimension of the redistribution process.

The fifth, and I believe the most important factor, is that the present crisis is a fundamental one—i.e. a systemic crisis. It is not just another case – no matter how spectacular or interesting – that is simply related to the business cycle. It is a systemic crisis of modern capitalism and in particular of its neoliberal mutation, which has dominated the majority of the world during the lifetime of the last generation. If this is so, then it is by no means sufficient to talk about the end of the crisis by merely reversing negative tendencies in production or bouncing back from the bottom of recession and coming back to the growth path.

Was the Crisis Avoidable?

It is frequently asked whether it was possible to avoid the present crisis. Such a general question cannot be answered correctly since it is necessary to define the time frame it refers to; i.e. from which *ex ante* time perspective it would have been possible to avoid the current crisis. The answer to this question will be different if one asked about such a possibility three years ago, if we were to analyze the period 13 years ago, and different again if we looked at the future (which has already become the present) from the perspective of 30 years ago. An approach of three, 13 and 30-year periods emphasizes the essence of the current crisis by revealing its causes, mechanisms and consequences. Above all, it is extremely illuminating from the point of view of conclusions related to the future and proposals for actions to prevent similar disturbances in three, 13 and 30 years' time from now. It is worth remembering that the present is nothing more than the future of the past.

It is obvious that three years ago the world crisis was not possible to avoid. The scale of detachment of the speculative financial sector from the productive real economy, which provides all goods and services necessary for life as well as for further production, was so great that the required adjustment could occur only through a crisis shock. What politics could not fix *ex ante*, was achieved *ex post* by crisis. It is an extremely expensive way of making adjustments. Three years ago the values related to good economic practice were already devastated; even if it was not the case everywhere, it affected many segments of the economically inter-related world and particularly its epicenter, which is still the United States. The devastation was so advanced that there were no political powers within the existing institutions able to re-direct the economy to the path of non-crisis development. The imbalance in the world economy was also too large.[8]

However, despite well-advanced globalization[9] the planet's economy is still divided into almost 200 national economies rather than into several large integrating structures such as the advanced European Union (EU) or the institutionally backward Commonwealth of Independent States (CIS). The characteristic feature of all economies is the lack of external balance, which is expressed in the deficit (more often) or surplus (rarely) of the current account balance. If we pass over any accounting errors and omissions or extraordinary losses, on a global scale the surpluses and deficits balance each other and the final result is zero. However, if we sum up the values of all deficits and all surpluses of current accounts and refer such an aggregate to GWP, then in 2008 it oscillated around 6 percent![10] How is it possible not to fall into crisis when faced with this scale of structural imbalance?

And 13 years ago? Was it possible then, in 1997, to avoid the present crisis? In this case the answer is more complicated but some attempts were made. There was contentious debate between monetarism (which is the basis of neoliberalism) and neo-Keynesianism, which seems to be enjoying a renaissance in many circles,[11] but is not a panacea for contemporary complaints. In particular, there was a major battle between the advocates of far-reaching uncontrolled deregulation on the one hand, and the advocates of justified intervention of the government on the other hand; i.e. between the apologists of an unbridled market and supporters of the active role of government. In numerous countries it was possible to resist the neoliberal attack in total; for example, in large China or in tiny Slovenia. In other countries it was only possible periodically, for example in India or in the largest post-socialist country of Eastern Europe during the implementation of the "Strategy for Poland" from 1994 to 1997. In several Latin American countries (which, as an act of goodwill, trusted the Washington Consensus and allowed its imposition upon them) unorthodox actions were taken and continued to dominate in Brazil and Argentina. In the United States and the UK attempts were made to create a different concept of development. However, neither the "Clintonism" inspired by the Democrats nor the Labourite "Blairism" which was forced (quite unconvincingly and inconsistently) in the UK could control the neoliberal storm. Hence, at the turn of the century neoliberalism won the *mainstream* position in economics as well as in economic policies—the flight of the moth to the flame was not stopped.

What about 30 years ago? Was the present multi-layer crisis possible to avoid then? The answer is of course positive. Under the conditions of increasing globalization at that time (and a decade later also the post-socialist political regime transformations which gained momentum back then) it was enough not to follow into the traps of neoliberalism but instead to go forward into the future along the path marked out by the model of the social market economy. The characteristic features of the social market economy include the imperative of social cohesion and economic institutionalization, which allow for the development of private entrepreneurship while maintaining the state's supervision over the balanced distribution of output from increased work productivity and improved capital efficiency, as well as genuine care of the natural environment and cultural aspects of development. However, the world followed a different track due to a variety of reasons including: aggressive greed and increasing political short-sightedness; the relatively weak position of the Scandinavian countries on the international arena, which enjoyed a social market economy that functioned well; a newly reunited Germany and a Japan (during its structural crisis) that were busy with their own affairs; and the gullibility of intellectual and political elites in the countries of the so-called emerging markets (more so in the countries of post-socialist transformation than in other parts of the world). From this it is necessary to be able to draw conclusions for future; however, note that "to be able," implies the intellectual skill and political will, one does not have the guarantee that it is going to happen.

Neoliberalism as the Source of the World Crisis

The source of the crisis lies deeply in neoliberal capitalism.[12] It could not start in countries with a social market economy such as Scandinavia, but only under the conditions of the neoliberal Anglo-American model. Such an intense shock could take place only as a result of the coincidence of numerous political, social and economic circumstances (as well as technological, since it would not have been possible without the Internet). The overlapping of these conditions in a specific way, which caused the crisis-related phenomena and processes to accumulate, was possible only in the case of a unique combination of values, institutions and politics typical of neoliberalism.

Such values definitely overestimate individualism. They unnecessarily support greed by elevating this vice to the level of an economy-propelling virtue. They neglect the social cohesion aspects of the economy and they do not perceive a human being as the center of the production process; there is money instead. As far as values are concerned, neoliberalism leads to the translation of almost everything into monetary worth, since according to this doctrine it is possible and worthwhile to trade in everything that may bring real or expected profit; and of course there are irrational expectations of profit as well. From the institutional side neoliberalism converted the state and its regulations into the enemy. By using (quite brilliantly one has to admit) the media to manipulate public opinion and, unfortunately, by using the opinion-forming capacity of certain groups of social sciences experts (particularly economists) it imposed the idea of a small and therefore weak state with a diminished ability to intervene in spontaneous market processes. In fact the state, alongside the market, is the fundamental "super institution" of the modern economy. Far-reaching economic success is only possible with an intelligent synergy of the power of the invisible hand of the market and the visible head of the government. This applies particularly, though not exclusively, to the countries of the emerging markets. Institutional intervention is the necessity of contemporary capitalism, which is not accepted by neoliberalism because of its values and, above all, its attention to the specific interests of certain groups.

As far as neoliberal policy is concerned, it confuses its purposes with its measures. The purpose of economic policy is sustainable long-term development. It should be sustainable not only economically, but also socially and ecologically. Low inflation, positive interest rates, balanced budgets, rapid privatization, and currency exchange rates either fixed or fluctuating, taxes (low, of course)—all these are only instruments and tools of politics. It is not possible to subordinate any economic strategy or policy to indices, which only illustrate phenomena and processes from those areas. To improve the financial standing of narrow groups of elites at the expense of the majority of society, neoliberalism uses in politics such expressive liberal ideas as liberty, democracy, private ownership, entrepreneurship, competition and economic freedom. However, supporting such ideas as *pro bono publico* on the one hand and their usage for the benefit of the minority at the expense of the majority on the other hand, are two totally different faces of politics. On top of that, current disturbances in the world economy are not just symptoms of the financial and economic crisis. The difficulties started with a serious financial crisis, which rapidly advanced to a production crisis. Production dynamics crumpled and in many countries went into the stage of collapse. Now the crisis has spread to the social sphere of life from where it slowly starts to have an impact on the political sphere as well. If that were not enough, the crisis has entered the fifth sphere of principles and ideology. Therefore, the crisis rolls over five inter-related areas: financial, productive, social, political and ideological.

However, it is not a general crisis of capitalism, which has unique adaptive capabilities as shown on many occasions in the past and will be the case in the foreseeable future. Nevertheless, the current crisis is a fundamental breakdown of the neoliberal model. By the time the crisis had become evident, this model managed to function fairly well (at times even remarkably well) by manipulating public opinion and politics in practice—a process clearly noticeable wherever neoliberal tendencies have dominated such as the United States in the times of Reaganomics, the UK during the primacy of Thatcherism, Latin American countries after allowing the imposition of the Washington Consensus in the 1990s, Russia during Yeltsin's term of office, or Poland during the "shock without therapy" period at the beginning of the post-socialist transformation.[13] Now it is important to prevent the neoliberal doctrine – after minor cosmetic changes and adjustments – from imposing on the main trajectory of the world economy again.

Neoliberalism facilitated the creation of a peculiar “casino economy.” It means the detachment of the financial sector from the real economy and pulling increasingly larger economic and social circles into the whirlpool of speculative behavior. The process, which had already started in 1970s and intensified particularly in the last 25 years, inflated the speculation balloon to an unprecedented scale. Derivatives were created to allow speculations on a large scale. Their aggregate value engaged in transactions in the global financial market in 2007 may be estimated at over US$600 trillion—almost ten times the value of GWP for the whole planet. The current crisis was not caused by the breakdown of the sub-prime loans market in the United States (this was only the fuse for the crisis), but was a result of the pathological relationships typical of neoliberalism which had existed for many years.

Any interpretation that shifts the responsibility for the crisis to the crash on the US sub-prime loans market is either a neoliberal attempt to escape moral, political and intellectual responsibility for the crisis, or a simplification of the phenomenon. It was the gradual weakening of the position of the state and uncontrolled, destructive deregulation that increased the irrationalities in the world economy and ultimately resulted in the crisis witnessed.

Therefore, it was not possible to avoid the crisis three years ago. Moreover, the attempts made 13 years ago were not sufficiently powerful or consistent to change the course of events, but it was possible to avoid the crisis 30 years ago. This apparently general observation gives rise to fundamental conclusions for the future, since by no means is this the last large-scale crisis that will affect the world. In the short term, the reaction of the immediate policies (fiscal and monetary) to the financial crisis has to be evaluated positively. An increase in the money supply was the right move. Lubricating economies with non-inflation money brought positive results affecting the United States, Western Europe, China and Brazil. However, it is only a reaction to the symptoms of the crisis.

Development Triangle: Values – Institutions – Politics

Values, institutions and politics are indispensable to reach the systemic sources of the crisis. It is not possible to remove the primary causes without modifying the value system, re-orientating institutions (the rules of the economic market) and changing the way policies are conducted. In particular, greater attention must be paid in economics to cultural conditions and social surroundings. Therefore, the targets of development have to be redefined. It is necessary to introduce fundamental modifications to institutions within which an increasingly interdependent world economy functions. The current international institutional arrangement facilitates chaos rather than global order. The future world economy requires institutions enabling political coordination on a global scale. Considering the changing values and new goals emerging in our global development, it is necessary to apply a different approach to the manner of conducting politics and emphasis must definitely move to the layer of supranational coordination. Therefore, if we truly wish to avoid great crises in the future it is necessary to move skilfully within the specific triangle of socially, ecologically and economically balanced development.

A strategy of development and economic policy can be efficient only if it is based on a sound economic theory. The coincidence theory of development, in an unorthodox and holistic way, answers the question about mutual dependencies in long-term development processes. This new pragmatism is a normative approach, which demonstrates the possibility of creating a better future by following this theory. There are eight main constitutive characteristics of the coincidence theory of development:

1. Departure from the intellectual corset of dogmatism as a factor that unilaterally influences the search for answers to specific questions;
2. Avoiding blind subordination to any ideology or political line; instead, searching for objective truth without surrendering to conventional wisdom and consensual truth;
3. Abandonment of all "-istic" attempts to create a universal theory of economic growth; instead, paying attention to specific features of phenomena and processes integrally related to macroeconomic production;
4. Following an interdisciplinary approach in order to enrich economic thinking with input from other social sciences, particularly history, futurology, geography, law, sociology, psychology, management or information technology;
5. Wide application of the comparative method of economic analysis;
6. Moving in a multi-dimensional environment comprising historical, geographical, cultural, institutional, political, social and specific problem-related aspects;
7. Differentiation between targets and measures;

8. Instrumental flexibility open to a multidirectional search for remedies fitting a specific and precise situation.

Therefore, great pragmatism is needed and as little ideology as possible. It may be easily defined as “new pragmatism”, since it has to be based on a new approach resulting from the analytical and theoretical understanding presented above.[14] It is also new because it comprehensively takes into consideration the new conditions of running the economy – unprecedented in the past – which have emerged as a result of globalization. As soon as the coincidence theory of development is adequately developed on the one hand, and specifically focused on individual challenges of development on the other, it will create a proper structure for pragmatic activities to be focused on solving specific problems. Therefore, the new pragmatism is a formulating approach (normative), while the coincidence theory of development is an explanatory (descriptive) approach. In fact, we are talking here about an unorthodox theory of economics or, in a wider context, a theory of social sciences focused on practice. On the macroeconomic scale, which today is global, it is a policy or a global development strategy *sensu largo*.

Moreover, the new pragmatism is a logical consequence of the presented line of reasoning, which proves that it is also necessary to apply a new approach to state interventionism. It cannot mean interference in the production processes, but it must offer an intelligent manipulation of the recognized conditions of such processes. It must also be a modern institutional interventionism and not dependent only on the current economic situation. Therefore, I do not postulate the new interventionism as a separate feature, since it has to encompass all eight features mentioned above and be consistently supported by them. This is the fundamental alternative to the neoliberal trend, which has been so much discredited in the context of the present-day crisis. To make sure that neoliberalism disappears into history it is necessary to propose an alternative; something better theoretically and practically, and that is the purpose of the coincidence theory of development and the new pragmatism.

NOTES

1. Grzegorz W. Kolodko, *Truth, Errors and Lies. Politics and Economics in a Volatile World* (New York, NY: Columbia University Press, 2011).

2. In *Truth, Errors and Lies*. op. cit., there is a proposition for a different measurement of economic activity and economic development—an Integrated Prosperity Index (IPI), where GDP is weighted at only 0.4. The remaining 0.6 of weighting is composed of leisure time valuation, natural environment condition, income distribution, subjective valuation of cultural values and life standards, and the perception of own social capital. A similar approach was presented in the "Report by the Commission on the Measurement of Economic Performance and Social Progress," Sorbonne, September 14, 2009; (http://www. stiglitz-sen-fitoussi.fr/ documents/rapport_anglais.pdf), appointed following the suggestion of the French President, Nicolas Sarkozy. The report was presented publicly during the conference at the Sorbonne on September 14, 2009. Now it will take a generation to win the political, intellectual and methodological campaign for a gradual implementation of justified recommendations proposed as IPI and included in the 2009 Report.

3. By simplifying, it is possible to assume that *per capita* means this increased rate reduced by 1 percent, if we remember that the growth rate of world population exceeds slightly 1 percent.

4. Data according to *World Economic Outlook* International Monetary Fund, published in October 2004 and October 2008. Data for 2009–2010 see "World Economic Outlook. Sustaining the Recovery," *World Economic and Financial Surveys* (Washington, DC: International Monetary Fund, 2009).

5. According to the World Bank and IMF nomenclature they are referred to as the advanced economies.

6. In documents prepared by the World Bank and IMF the group of such economies is referred to as the developing economies, while since 2004 they have been called the emerging markets and developing countries. What the difference is between “developing” and “emerging”, is not clear. For example, Brazil and India are treated as developing countries by the Breton Woods organizations, and as emerging markets by global investors. Poland and Russia on the other hand, are treated as emerging markets both by these organizations and financial investors.

7. In the same period, the Chinese GDP *per capita* (according to Purchasing Power Parity [PPP]) reaches 46 percent of the Russian level and 39 percent of the Polish level, while a decade earlier the indices amounted to 31 and 23 percent respectively. GDP *per capita* estimates according to PPP World Bank data. See also “IMF Data Mapper”; (http://www.imf.org/external/datamapper/index.php).

8. Joseph E. Stiglitz, *Freefall: America, Free Markets, and the Sinking of the World Economy (*New York, NY: W.W. Norton & Company, 2010).

9. For more on globalization see, Grzegorz W. Kolodko, *The World Economy and Great Post-Communist Change* (New York, NY: Nova Science Publishers, 2006); and Joseph E. Stiglitz, *Globalization and its Discontents* (New York, NY: W.W. Norton & Company, 2004).

10. It means on a global scale the subtotal of negative and positive current accounts amounted to US$5 trillion while GWP was $78

trillion (as calculated in US$ according to current foreign exchange rates).

11. Robert Skidelsky, *Keynes: The Return of the Master* (New York, NY: Public Affairs, 2009).

12. On the essence of neoliberalism read more in the excellent study by David Harvey, *A Brief History of Neoliberalism* (Oxford: Oxford University Press, 2005).

13. On the issue of post-Communist transformation see Grzegorz W. Kolodko, *From Shock to Therapy. The Political Economy of Post-socialist Transformation* (Oxford: Oxford University Press, 2000); and Saul Estrin, Grzegorz W. Kolodko and Milica Uvalic (eds) *Transition and Beyond* (New York, NY: Palgrave Macmillan, 2007).

14. See more on this subject in Kolodko (2011), op. cit.

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About the Author

Grzegorz W. Kolodko is an intellectual leader and politician, a key architect of Polish economic reform and a renowned expert on economic policy. In 1989 he took part in the historical Round Table negotiations that led to the first post-Communist government in Central Europe. While Deputy Premier and Minister of Finance (1994–97) Prof. Kolodko led Poland to membership of the OECD, and in 2002–3 he played an important role in Poland's integration with the European Union. He is the founder and Director of Transformation, Integration and Globalization Economic Research (TIGER) at Kozminski University in Warsaw, and is a university professor, researcher, consultant to international organizations, and columnist.

Prof. Kolodko is the author of numerous academic books and research papers on development policy and systemic transformation published in 25 languages, including: *From Shock to Therapy: The Political Economy of Post-socialist Transformation* (2000); *Globalization and Catching-up In Transition Economies* (2002); *The Polish Miracles: Lessons for Emerging Markets* (2005); *The World Economy and Great Post-Communist Change* (2006); and a bestseller, *Truth, Errors and Lies: Politics and Economics in a Volatile World* (Columbia University Press, 2011).

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