

The role of the state in the economy after COVID

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Based on joint work with Samuel Bowles,
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A Sicilian fresco from 1445. NYT May 11 2020 Credit...Werner Forman/Universal Images Group/Getty Images

A shifting rhetoric

“stagnating wages and a warming world and Hurricane Katrina and a pandemic virus proved that there were scarier words in the English language than ‘I’m from the government, and I’m here to help’, as Ronald Reagan famously put it.”

(Ezra Klein in the *New York Times*, April 8th 2021)

A successful policy paradigm addresses pressing problems that arise in the economy and combines ...

Policy paradigm	Normative foundations (Level 1)	Economic model (Level 2)	Emblematic policies (Level 3)	Vernacular economics (Level 4)
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Policy paradigm	Normative foundations (Level 1)	Economic model (Level 2)	Emblematic policies (Level 3)	Vernacular economics (Level 4)
Classical liberalism				
Keynesian social democracy				
"Neo liberalism"				
New paradigm				

Keynesian social democracy

Policy paradigm	Normative foundations (Level 1)	Economic model (Level 2)	Emblematic policies (Level 3)	Vernacular economics (Level 4)
Keynesian social democracy	Security, fairness	Aggregate demand, paradox of thrift, solidarity wages, theory of the second best	Demand management, tax, transfer and public goods redistribution, egalitarian supply-side policies	Well-paid workers sustain demand. Saving is prudent for a family but not for a government when the economy is in recession. 'Same boat' solidarity

Neoliberalism

Policy paradigm	Normative foundations	Economic model	Emblematic policies	Vernacular economics
“Neo liberalism”	Freedom from government coercion, procedural justice	Self-interest (individuals & government officials) and competitive markets. No interpersonal comparisons of utility. Pareto criterion.	Laissez-faire, school vouchers, “negative income tax”, buy your own council house, Privatize telecoms and utilities. Reduce barriers to international movements of goods and capital	“The government that governs best, governs least.” Labour unions are special interest groups trying to get a larger slice of a smaller pie. “There is no such thing as “society””.

Covid 19 messages: Abusive exercise of unaccountable power by private actors

Private exercise of power:

- may violate democratic norms
- only becomes salient in economics when the model recognizes that **information is limited** (Friedrich Hayek, 1945, Herbert Simon, 1950, Ronald Coase 1937)
- **information economics revolution**



▲ Workers at Tyson's Camilla, Georgia, poultry processing plant. Photograph: Tyson/AP

**'We're modern slaves':
How meat plant workers
became the new frontline
in Covid-19 war**

Messages: Prices cannot do the work of morals

Guidance

Critical workers who can access schools or educational settings

Updated 5 May 2020

UK Department for Education defines who can access schools during lock-down

Health and social care

doctors, nurses, midwives, paramedics, social workers, care workers,

Education and childcare

childcare
support and teaching staff
social workers

Key public services

those essential to the running of the justice system
religious staff
charities and workers delivering key frontline services
those responsible for the management of the deceased
journalists and broadcasters who are providing public service broadcasting

Food and other necessary goods

This includes those involved in food: production processing distribution sale and delivery

Utilities, communication and financial services

postal services and delivery
payments providers
waste disposal sectors

Ethical, generous and trusting norms:

- have been essential to successful anti-pandemic responses
- are absent from the economic model that complemented neoliberal normative foundations
- but are in the new benchmark model, because of the behavioural and experimental economics revolutions

navirus

South Korea sheds jobs at fastest rate since Asian financial crisis



Coronavirus latest: UK scientists join hunt to find genetic link to Covid-19



Asia stocks dented by pandemic fears and US-China tension

Opinion **The FT View**

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Virus lays bare the frailty of the **social contract**

Radical reforms are required to forge a society that will work for all

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Volunteers pull carts full of food donations in London.

Covid 19 messages:

A new paradigm must expand the state space for policies by drawing on ethical motivations of solidarity and duty that underpin community and go beyond material gain and compliance with governmental fiat.

Beyond market and state – private power and social norms

- Technological change (eliminating routine jobs) and the increasingly knowledge- and care-centered character of our livelihoods is **shrinking the share of work that can be effectively governed by hierarchically ordered and unequally rewarded positions**, and increasingly **require intrinsic or social motivations** to undergird a high-performance economy.

Problems

Key concepts

'New' economic theory

Wealth creation and innovation

Schumpeterian rents, disequilibrium, dynamics, “creativity of the market”

(Aghion and Howitt 1992, Hayek 1945, Makowski and Ostroy 2001, Romer 1990, Schumpeter 1934 [1911])

Environmental sustainability

Non-market social interactions, other-regarding preferences, positive feedbacks and tipping points

(Benabou and Tirole 2006, Camerer 2003, Jackson 2008, Ostrom 1990, Schelling 1978)

Inequality

Economic rents, power, games, institutions, inequality aversion

(Coase 1937, Hart 1995, Holmstrom and Milgrom 1994, Milgrom and Roberts 1990, Nash 1950, von Neumann and Morgenstern 1944)

Unemployment/ fluctuations

Incomplete labor and credit contracts.

(Akerlof 1982, Shapiro and Stiglitz 1984, Simon 1951, Stiglitz and Weiss 1981)

Financial instability

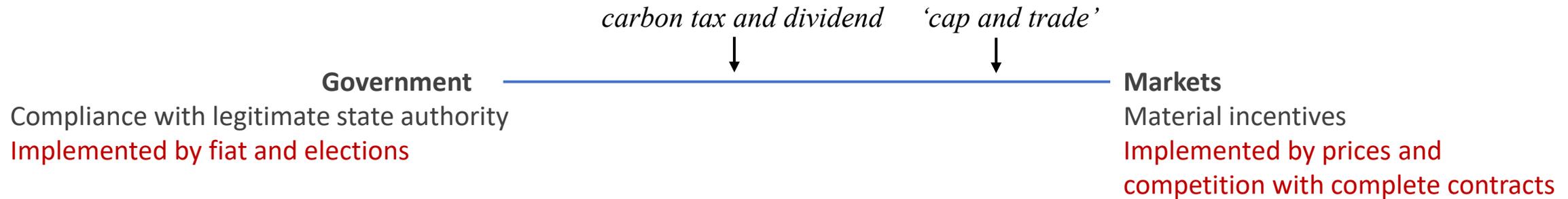
Prices as information, dynamics of price setting, positive feedbacks and tipping points

(Hayek 1945, Minsky 1986)

New problems - a new paradigm

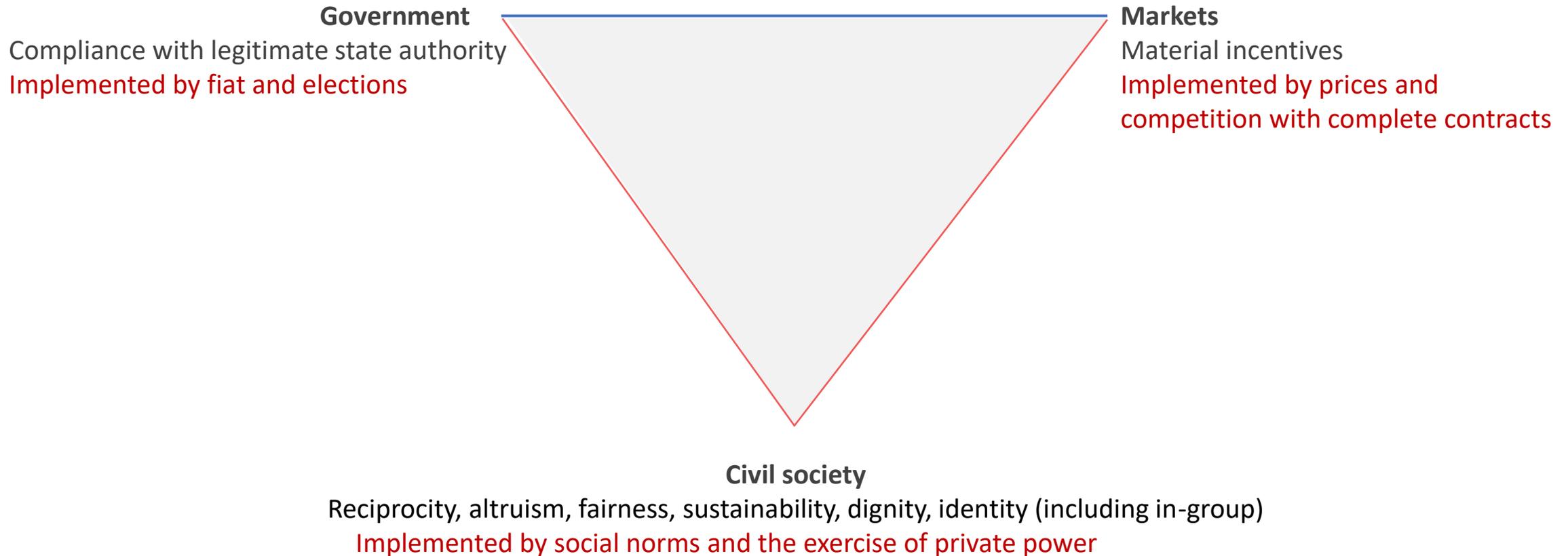
Policy paradigm	Normative foundations	Economic model	Emblematic policies	Vernacular economics
New paradigm	Social relations free from domination, voice, equal dignity, community, sustainability	Power in principal agent models; identity economics; increasing returns and multiple equilibria; Schumpeterian growth; cardinal utility; intrinsic motivation and cooperation as essential to a high performance economy	Wealth redistribution to support inclusive innovation. Home price insurance to reduce risk exposure Workplace rights and voice. Competition for the market via corporate governance reform.	'Real freedom for all' Cooperation works. Good morals is good economics. 'Voice'. Libertarians fail inequality; statists fail innovation.

The new paradigm is not limited to the “government – markets” continuum or to the “more state or less state” rhetoric

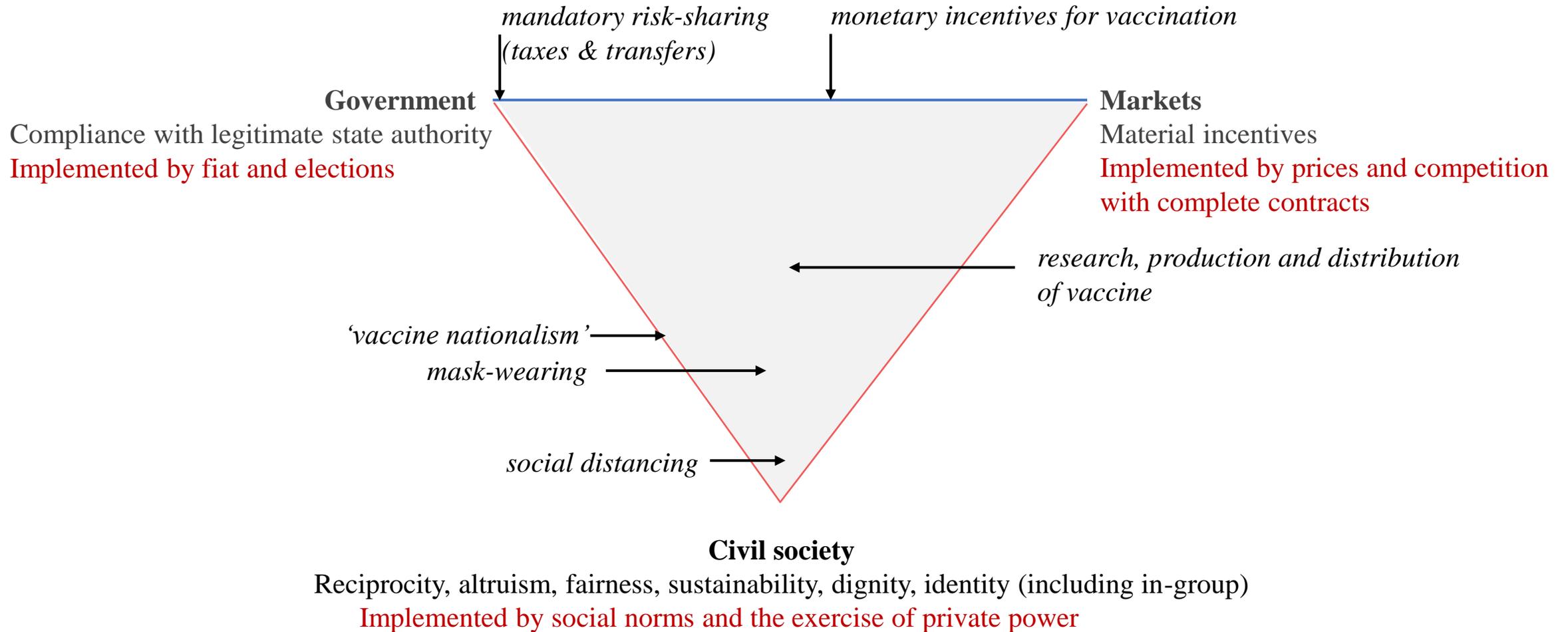


- A pole – here ‘government’ or ‘markets’ – refers to both the institution or ‘rules of the game’, and to the motivations that make those rules work well
- Policies like ‘carbon tax and dividend’ and ‘cap and trade’ use the **complementarity** of state capacity and market mechanisms differently weighted
- But, we know that the limited information available to both government and private actors means many problems cannot be addressed just by a combination of governmental fiat and private contract

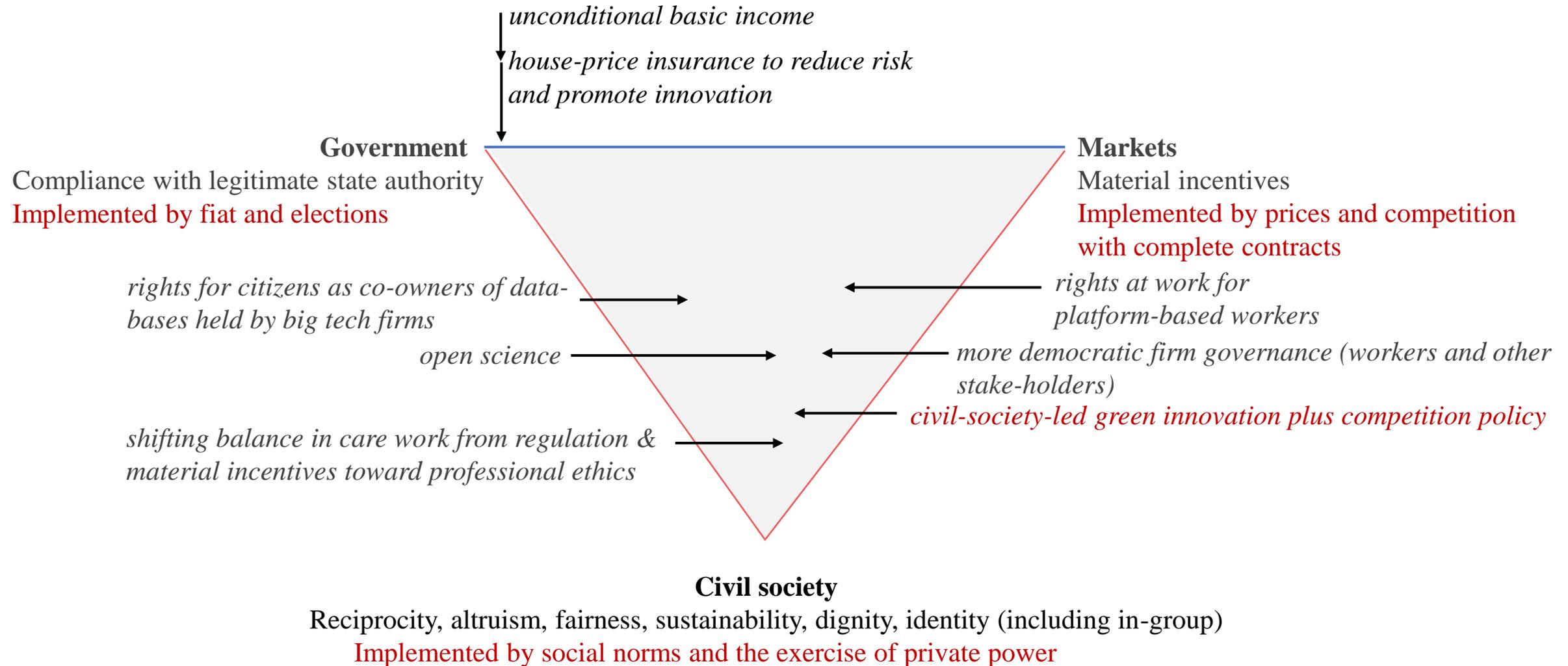
The third pole –
opens up a new space in which to represent the **levers for getting things done**



Using an expanded space for policy to map responses to COVID-19



State-market-civil society complementarities in a new paradigm



Bottom line - COVID-19 has ...

- made it harder to achieve shared prosperity goals (it has made us poorer, widened wealth, income and education gaps)
- added pandemics to the pressing problems we face (inequality, climate crisis, future of work, modern monopoly, financial instability)
- highlighted why more ambitious normative goals are required – to include dignity (as well as shared affluence and sustainability)
- clarified that effective policies to address the problems we face rest on mobilizing the complementary strengths of all three poles (market, state, and civil society)
- reinforced the potential of contemporary economics – thanks to the information, identity, behavioural and empirical revolutions – to contribute to policy design.

Based on joint work with Samuel Bowles

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<https://doi.org/10.1257/pandp.20201001>

Shrinking Capitalism[†]

By SAMUEL BOWLES AND WENDY CARLIN*

Journal of Economic Literature 2020, 58(1), 176–214
<https://doi.org/10.1257/jel.20191585>

What Students Learn in Economics 101: Time for a Change[†]

SAMUEL BOWLES AND WENDY CARLIN*



The image shows a dark blue navigation bar for the VoxEU and CEPR website. On the left, there are two logos: 'VOX^{EU}' and 'CEPR'. To the right of the logos is the text 'Research-based policy analysis and commentary from leading economists'. Below the logos and text is a horizontal menu with several items: 'Columns', 'Covid-19', 'Vox Multimedia', 'Publications', 'Blogs&Reviews', and 'People'. The 'Columns' item is highlighted with a light blue background. Below this menu is a secondary navigation bar with four items: 'By Topic', 'By Date', 'By Reads', and 'By Tag'.

The coming battle for the COVID-19 narrative

Samuel Bowles, Wendy Carlin 10 April 2020