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PRINCIPLES FOR ECONOMIC RECOVERY AND FINANCIAL RECONSTRUCTION FROM PROGRESSIVE ECONOMISTS

December 22, 2008

Prologue

The global economic crisis is rapidly worsening, while the incoming Obama administration is intensively developing plans to ward off economic catastrophe. In this atmosphere of hope and tremendous uncertainty, a group of progressive economists met on November 21, 2008 at the New School for Social Research in New York for a discussion, sponsored by the Political Economy Research Institute and the New School's Schwartz Center for Economic Policy Analysis, with financial support from the Ford Foundation. The goal of the meeting was to develop macroeconomic and financial policies for economic revival that can solve the short term crisis and help put the economy on a sustainable path toward widely shared prosperity. The statement of principles below evolved from that discussion.

Statement

As of December 2008, the United States and the entire world face the prospect of an economic disaster unseen since the Great Depression. Swift and coordinated action by the Obama administration, other national governments and international financial institutions can stave off these crises if the action is boldly directed at serving the needs of people and communities, rather than protecting the failed institutions and practices of the past that helped create the crisis.

So far, the Bush Administration and Congress has spent over $1 trillion to protect bank and credit solvency, with the hope that these funds would trickle down to the rest of the economy. This represents an attempt to "hit the re-start button" and restore the economic trajectory before the crisis hit. But this policy has failed, as major financial institutions have hoarded much of the cash and used the funds to continue their decades-long policies of taking-over other banks and paying lavish salaries.

The Obama administration has signaled a desire to take swift action, and to do "whatever it takes" to restore economic health. We support many of these policies. But to succeed, Obama's program must promote a fundamental reversal of direction and reject financial bail-out policies. Instead, the prosperity of families and transition to a green economy should be front and center. The full set of economic policies should aim to reverse trends toward stagnating wages, extreme inequality and growing insecurity, and move our economy away from the debt-driven spending booms that have characterized the past decades. Only then will the U.S. achieve sustainable and widely-shared growth.

We reject the notion that President-elect Obama and his administration put on hold its plans to reform health insurance, reduce U.S. dependence on fossil fuels, raise the minimum wage and facilitate the ability of workers to organize into unions. While as economists we understand that there are often important trade-offs in economic affairs, we believe that embedding these longer term goals into policies for short-term economic recovery will not only make it more likely that the longer run goals will succeed, but will also greatly enhance the effectiveness of efforts for short term recovery. Plans for bailout or reconstruction that leave out most of the population are neither good economics nor sensible politics.

Many examples illustrate this point. Raising the minimum wage allows more households to spend on goods without going into more debt; investments away from fossil-fuel dependent technologies have greater employment impacts than other types of macroeconomic policies, such as tax cuts; dramatically reducing health care costs will go a substantial way to helping to make U.S. car companies and other American businesses more competitive and allow them to both weather the current storms and achieve competitiveness over the longer term.

Not only will delaying needed economic transformation make the recovery program less effective, it will undermine the possibilities for required transformations themselves. The costs of the economic recovery program will be large. Eventually, the government will have to moderate its spending on these programs relative to the size of the economy. If the initial money has not been spent on green investments, creating decent jobs, providing a social safety net for children and families, and investing in needed infrastructure, then budget demands might require that the money will never be so spent. For these reasons, it is necessary that the key investments and institutional changes be part of the recovery and reconstruction program from its inception.

Economic policy must aim to:

- End the downward global economic spiral and promote economic recovery by a massive, sustained and targeted spending program at home to create jobs.
- Assure that jobs created by the economic recovery package are good quality jobs that pay livable wages so workers can support their families and provide paid time off so that workers can care for themselves and family members.
- Strengthen automatic stabilizers such as unemployment insurance and transitional assistance to those losing jobs.
- Keep people in their homes by establishing a moratorium on foreclosures, consider allowing families to rent their homes rather than face foreclosure, and by directing existing institutions or create new institutions such as a Home Ownership Loan Corporation to restructure mortgages.
- Provide financing to state and local governments so they can maintain employment and continue to provide basic services central to the well-being of families such as education, police and fire protection and the maintenance of local infrastructure.
- Create jobs by investing in the transition to a green economy.
- Create universal health insurance available to help families prosper and businesses restore competitiveness.
- Provide a basic standard of living for all children.
- Use government powers and leverage to create a stable and efficient financial system that provides for the needs of people, communities and businesses, rather than a safe harbor for gambling, fraud and abuse that enrich a few while destroying the economy.
- Restore income, economic power and security to the vast majority of people (the bottom 80%) who have fared so poorly under decades of unjust and inefficient economic practices and policies, including supporting the passage of the Employee Free Choice Act.
- Re-build the nation's infrastructure with a large public works program.
- Promote economic cooperation, coordinated global expansion and aid to the poor countries who will suffer most from this crisis and whose prosperity can help restore long-run health to the global economy.

Managing the Financial Sector: Reforming the Bail-out process and Re-orienting Financial Regulation

The government must use this moment and the levers of regulation and control that governments are accumulating at high social costs to restructure finance so that it serves the needs of society and the real economy. Re-privatization of financial institutions taken over by the government (such as Fannie Mae and Freddie Mac) must not be the default option. Retaining government stakes and exerting more government control in financial corporations may be the best option for insuring that financial firms operate in the best interests of the society.

Global Coordination and Reform of International Financial Institutions

The arrangement where the U.S. serves as the buyer of last resort and the rest of the world serves as the dollar accumulator of first resort cannot any longer be the basis for the long-run trajectory of the global economy. During the economic crisis, implementing a recovery program in the U.S. in which the current account deficit remains large or even grows, will be necessary (though the program can only succeed, as we have argued, with coordinated global fiscal stimulus measures.) But in the long-term, it is neither feasible nor desirable for the rest of the world or the U.S. to continue playing these roles.

This means that:

- The surplus countries of China, Japan and Germany must play a bigger role as provider of global aggregate demand
- The IMF, World Bank and global approach to developing countries must fundamentally shift away from the high conditionality, export-led, free capital mobility approach embodied in the neoliberal philosophy, and towards an approach that gives developing countries more policy space, and more resources to bolster domestic demand and capacity.
- The Obama administration and other partners must initiate in the medium term a dialogue to implement a major reform of global institutions and practices to deal with these changing realities.

Establish Hearings on Causes of the Current Crisis and Regulatory Reform

Instituting these complex major changes in regulatory and economic structure require intense and structured public dialogue. To institute them, Congress should establish a set of comprehensive hearings and a select committee to organize the inquiry and discussion modeled, for example, on the "Stock Exchange Practices Hearings" conducted by the Senate Banking Committee between 1932 and 1934. Popularly known as the Pecora Hearings after the Committee's special counsel Ferdinand Pecora, this investigation looked into financial industry practices that helped trigger the Great Depression and provided a documentary record, a coherent narrative and a forum for public education that were critical to building the framework of financial regulation and supervision that emerged from the New Deal.

These hearings could tackle some of the longer run regulatory and management issues that must be addressed, including the following:

- Should banks be regulated like public utilities, ensuring they provide the key functions society requires from banking?

- Should financial conglomerates be broken up into functional sub-units so they are easier to monitor and regulate?
- Should government continue to have a major role in those institutions that have been bailed out?
- Should some institutions be fully nationalized?

This list only begins to address the outstanding questions that remain to be answered in order to get to the root of our financial system's devastating flaws and to provide the basis for a system that will be much more efficient, stable and fair.

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