Putting people first in Europe

By Jean-Paul Fitoussi and Khalid Malik
August 5, 2016 – *Project Syndicate*

The same type of populist discontent that fueled Brexit in the United Kingdom is on the rise throughout Europe, suggesting that policymakers have lost sight of the European project's central objective: to ensure the wellbeing of all Europeans. As the first United Nations Human Development Report put it in 1990: "People are the real wealth of a nation."

The best way to capitalize on the people of a country or region is through social equity. Amartya Sen, in his magisterial *The Idea of Justice*, concluded that true social equity requires not equal treatment for all, but rather unequal treatment in favor of the poor and most disadvantaged. Mere equity in public finance or in the eyes of the law is not enough if we don't also consider the different starting points for individuals and groups in society. Recognizing this, successive UN development reports since 1990 have made the case that both economies and societies are stronger when public policy puts people's wellbeing first.

However, this outlook hasn't yet taken root in the EU's elite policymaking circles, where well-meaning economists and politicians often believe they are doing the right thing by balancing budgets and reining in spending, usually by cutting health, education, and infrastructure budgets. These policymakers, with little empirical evidence, believe that fiscal prudence today will lead to a stronger economy tomorrow.

This is the thinking behind the current policy mix in Europe, where fiscal austerity is combined with "structural reform," meaning less spending on the social safety net and less regulation to protect workers. Obviously, the costs of these policies are mostly borne by the poor and the middle class.

But there are several other problems with this approach as well. First, it isn't good for most people's incomes. When the Oxford University economist Tony Atkinson looked at the UK's economic performance through the lens of inequality, the 1980s, generally considered a strong decade in terms of growth, appeared much worse; and the 1990s, regarded as a low-growth decade, appeared much better.

Atkinson's findings point to a central question: Who benefits from growth – the many or the few? If an economy can be said to be growing when a small minority receives most of the gains while everyone else's lot stays the same or decreases, the concept of economic growth loses much of its meaning.

This leads to a second problem with the prevailing paradigm, which is that it puts abstract economic indicators before actual people. Because gross domestic product is the preferred gauge of any economy's value, many factors that contribute to human wellbeing are ignored, and spending on fundamental needs, such as health and education, comes to be seen as an expense rather than an essential investment.

If policymakers viewed such spending as an investment, they could start thinking about how to maximize returns. Like all investments in human or fixed capital, there may be diminishing returns at high levels. So, rather than funneling economic benefits to the rich and assuming it will "trickle down," policymakers should assess whether investing in opportunities for the poor actually does more for economic growth. In the US, the 1944 Servicemen's Readjustment Act (better known as the GI Bill) was a success because it provided training for those most in need of it, enabling returning World War II veterans to re-enter the productive economy. The bill created a more educated workforce and ushered in a period of rising incomes for most Americans.

A third problem with the current approach is that its central objective is not full employment. It is time to return to the macroeconomic policies of the 1950s and 1960s, which recognized the benefits of full employment in fostering social stability and sustainable growth. As the Nordic model shows, high employment is good for the economy because it ensures adequate tax revenues to finance high levels of social investment, which creates a virtuous cycle.

Many European countries are now in a vicious cycle instead, with austerity policies worsening the problem of youth unemployment. This is not only unnecessary, but also wasteful, because it risks creating a generation that will be ill equipped to drive future growth. As John Maynard Keynes pointed out in 1937, "The boom, not the slump, is the right time for austerity at the Treasury." In the current slump, European countries should be investing in their human capital to spur their economies' potential growth.

The fourth problem is that European countries' fiscal policies do not emphasize creativity and innovation, which benefits not only from a conducive regulatory environment, but also from high-quality education and infrastructure. Governments need to reduce bureaucratic red tape so that entrepreneurs can take more risks. But breakthrough technology companies such as Apple, Facebook, and Twitter also depend on people who had access to well-funded education systems. And while there is a growing "tech for good" sector in Europe, it will succeed only if it is supported by up-to-date infrastructure, which generally requires public outlays.

Policymakers in Europe (and elsewhere) need to adjust their thinking – especially their fiscal thinking – to put people first. Governments that make it their central objective to maximize human wellbeing end up not only encouraging higher economic growth, but also nurturing healthier politics.

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