OECD NAEC Group Meeting – 10 Years After the Crisis
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Ten years ago this Saturday, Lehman Brothers filed for bankruptcy. Today growth is back. The crisis is fading into memory and the history books. While we should celebrate the return of growth, we should not forget the tremendous suffering the crisis caused: jobs lost, savings lost, houses lost, opportunities lost, dreams lost, dignity lost, and even lives lost.

A Failure of Ideas

The crisis was not just a failure of actions, but a failure of ideas. This is not surprising as it is our ideas that ultimately shape our actions. There were two major failures of ideas in the decades leading up to the crisis. The first and most obvious was that we did not properly understand the complexities of the global financial system, anticipate it's fragilities, nor respond quickly, forcefully, and globally enough to its collapse.

The second failure, which has only become clearer in recent years, was that we did not see how across much of the OECD, growth in economies and growth in the lives of citizens de-coupled. For decades before the crisis, rising GDP and rising productivity failed to translate into rising incomes, living standards, and well-being for large majorities of citizens. Economists now call the period from the mid-1970s to the 2000s the Great De-Coupling. In many OECD countries, most or even all of the gains of growth were captured by a small slice of the population, many geographic areas outside of major cities were left behind, social mobility declined, and wealth

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became concentrated in ever fewer hands. Dreams of rising living standards were only met with rising debt—and we know how that ended.

And while growth may be back today, and the financial system is arguably safer—though arguably still not safe enough—the structural issues that led to the great de-coupling have not gone away. And, as technology change continues its exponential acceleration and pressures from climate change grow, this de-coupling is likely to get worse.

Thus as Dennis Snower of the Kiel Institute and the G20/T20 Global Solutions Initiative have called for, we need a *re-coupling* between economic prosperity and human prosperity. We need an economy where the financial system, globalisation, and technology change deliver real benefits not just for some people, but for all people. And we must re-couple the success of our economy with the health of our environment.

<u>The Need for New Thinking, the Need for NAEC</u>

The OECD has rightly made these issues central to its work, as described in the Secretary General's "21 for 21" agenda.

But as Albert Einstein famously said "We cannot solve our problems with the same thinking we used when we created them." This is where NAEC plays such a critical role—we will not solve these problems without new thinking.

There were reasons why our economic ideas failed:

- If people are assumed to be rational and markets efficient then bubbles can't occur;
- If markets are assumed to be self-stabilising then a global collapse isn't possible;

- If we assume labour and capital markets are always efficient then we will fail to see how growth, productivity, and incomes can de-couple;
- If we only look at households and firms in aggregate and as homogeneous, then we can never understand rising inequality;
- If our models have no geography in them then we cannot understand why growth left so many areas behind;
- If we assume that the economy and environment are separate – an "externality" rather than mutually interdependent—we cannot properly understand the damage we are doing;
- And finally, if we assume that technology just magically rains benefits on the economy, then we cannot address growing concerns over automation and the future of work.

Since the crisis we have discovered that economics has some very big holes in it. And those holes are exactly where some of our greatest challenges are. Economists have the luxury of making assumptions in their models, but policymakers don't have the luxury of assuming away the problems of their citizens.

The good news is that there are new ideas out there. Economics is in a tremendous period of creative ferment and other fields are contributing as well. As the NAEC seminars and papers have shown, there is a wealth of new data, new methods, new models, and new approaches. It is a work in progress with many unanswered questions, but real progress is being made.

Now one could argue that all of this should be left to the academics, that the OECD should sit back and wait 10 years until the intellectual dust settles. But people in the OECD countries don't have 10 years to wait—these challenges are happening now. So NAEC is working in real time to bring this new thinking into practical policy as quickly as possible.

Towards a New Narrative of Growth

Much has already come out of NAEC in terms of specific ideas, policies, metrics, and approaches. But individual ideas are not enough. Real change requires that people see the bigger picture as well. People are story-telling animals. They need explanations for how their world works, visions for where they want to go, and shared narratives to help them work together to get there. That is why there has been a call for a new narrative of growth.

Such a narrative must be based on the best facts and science available, but it must also provide understanding and inspiration. Constructing a new growth narrative is also a work in progress, and inevitably the OECD will be one of many voices contributing to this broad project, along with national governments, business, and civil society. But the OECD is providing an important and useful voice.

So what might such a new growth narrative look like. I've proposed that it might have four stories: a new story of growth, a new story of inclusion, a new social contract, and a new idealism. In my remaining time I will briefly outline these four stories. I hope they will stimulate some discussion and debate.

A New Story of Growth

The first question a new growth narrative must ask is "growth of what?" We have learned that the answer is not just GDP alone. Rather we need to get back to basics. Growth needs to be redefined in terms of real improvements in the real lived experiences of real people.

In my view this does not mean we should focus on subjective well-being, or "gross national happiness" as it is sometimes called. The research says that the key drivers of this—for example the quality of one's relationships or whether one finds meaning in life—lie too far outside the realm of economics and policy.

But *material* well-being is a different matter. Do people have good quality housing, access to affordable and effective healthcare, efficient transport, physical security, entertainment, education and opportunities for personal growth? Do people have work where they are paid fairly and treated with dignity? Can people retire securely and can children do better than their parents? Are the benefits of the good life shared broadly across society? And finally, is this good life being created in a way that is both economically and environmentally sustainable?

These are questions that can be examined with facts and data, and they are questions that policymakers can do something about. The OECD, through it's Better Life Index and it's Inclusive Growth initiative has played a leading role in looking at growth from a multi-dimensional perspective, and re-connecting ideas of growth to real, broadly shared, and sustainable material prosperity.

A New Story of Inclusion

The next question then is how does such growth in real material prosperity occur? Our understanding of economic growth has gone through a real revolution over the past several years. In the models economists use to understand growth the biggest factor has always been this mysterious thing called knowledge—some call it the "dark matter" of economics. Today we know a lot more about how networks of knowledge grow and evolve and this work is turning a lot of traditional thinking on its head.

The most important point to take away from this new thinking is that economic inclusion is not just a "nice to have" in an economy, it is not just a matter of social justice, it is a "must have" for long-run innovation and growth. Inclusion is not something we do after we have growth, inclusion is a primary *cause* of growth.

Let me explain. Real increases in prosperity come from what my co-author Nick Hanauer and I call "solutions to human problems". The invention of antibiotics was a better solution to the problem of curing someone from illness. The car was a better solution to the problem of getting from point A to point B. On our own we can only solve simple problems. Solving any complex problem requires cooperation, and it requires pooling and sharing knowledge.

You might be able to make simple wooden tool by yourself, but no one person has the knowledge to build a modern jet aircraft. Rather doing this requires the cooperation of hundreds of thousands of people in an intricate dance across over a dozen countries. The story of economic development is the story of the evolution of ever more sophisticated forms of cooperation to solve human problems.

It is through cooperation that we increase the sum total knowledge in our society. There is only so much knowledge a single person can store in their own head—what Ricardo Hausman at Harvard calls a "person-byte". Solving a complex problem like building a jet aircraft requires harnessing together lots of specialised knowledge, lots of person-bytes into a network. As our networks of knowledge grow, we can solve increasingly complex problems in new and better ways. Our material prosperity grows when these networks of knowledge grow.

In order for networks of knowledge to form and grow they need high levels of trust and cooperation in a society, they require institutional stability and effectiveness, and they require incentives and freedom to innovate and explore. Historically, countries that have had those conditions became rich, those that didn't did not.

Markets play a critical role, but not in the way traditionally thought. The magic of markets is not their efficiency in allocation, but their effectiveness in innovation. Markets create an evolutionary competition amongst networks of problem solving co-operators.

Market capitalism works because it is an effective system for creating incentives to cooperate, and because it creates competitions to be the best co-operators.

Quite simply, a society that has high levels of inequality, that is atomized and has low trust and cooperation, and that systematically excludes large numbers of people, cannot build dynamic, growing, problem solving knowledge networks. In addition, such a society will also not have consumers with the wherewithal to demand new and better solutions to their problems. Such a society might be able to generate some short-term wealth exploiting and exporting natural resources, but they will not succeed longer-term.

This is not just true for modern knowledge economies or for knowledge workers. It has been true across time, across countries, and across sectors. Successful, long-term capitalism is powered by inclusion, trust, cooperation, and problem solving.

A New Social Contract

If this modern view of growth is correct, then de-coupling is very dangerous to our long-term prosperity. The social contract that links workers to employers, households to economies, and citizens to their leaders has broken down. Large numbers of people no longer see the current contract as fair, and they have been expressing their displeasure in elections across the OECD.

Much work needs to be done on what a new social contract might look like and the specifics will differ by country. But research into what people broadly view as fair such arrangements provides five guiding principles:

1. Inclusion – everyone has an opportunity to participate, contribute, and benefit

2. Reciprocity – those who contribute to the system will share in its rewards
3. Meritocracy – the process for determining how rewards will be shared is based on merit
4. Security – those who contribute but face adversity through no fault of their own will be helped and protected, and
5. Progress – those who work hard, play by the rules and do their part will see their lives and the lives of their children improve over time

A New Idealism

Finally, a new narrative must help inspire people. We change when we rise to a challenge and when we see a better place to go. There are many challenges that could provide sources for a new idealism, and again these will differ by country. But for young people two stand out: First, the enormous challenges and opportunities presented by AI, gene editing, nano, and other rapidly emerging technologies that will dramatically shape their world. And second, the existential challenge and historic opportunity of shifting to a zero carbon economy.

It is our generation's responsibility to show that a new model of capitalism can be created that can restore the trust that was so badly damaged 10 years ago this week, that can re-build the social contract, that can re-couple economic success with human success, and that can rise to these great challenges of our age.

Thank you.