Economic Flexibility and Societal Cohesion

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Pressure on the social fabric of OECD countries is expected to grow over the next two decades as the rapid pace of economic, social and technological change continues. A recent conference organised by the OECD’s Forum for the Future considered innovative ways – including, and going beyond, social-policy remedies – of maintaining the cohesion of society in tomorrow’s highly flexible economy.¹

For over a decade OECD governments have been committed to a cluster of economic policies aimed at encouraging macro-economic stabilisation, structural adjustment and the globalisation of production and distribution. Although these policies have been generally successful in supporting economic growth, keeping inflation under control and reducing current-account imbalances, there is now pressure on many governments to take stock of the longer-term implications.

Beyond the already serious social stresses arising from more marked polarisation of income, persistently high volumes of unemployment and widespread social exclusion, there are the broader, societal challenges posed by profound technology- and competition-driven changes in the organisation of the workplace and everyday life. The result is a growing political disenchantment that threatens to undermine both the drive towards improved economic flexibility and the policies that encourage strong competition, open markets and technological evolution.

A number of clearly discernible long-term trends will have a strong influence on societal cohesion, the prospects for economic growth and the responses of governments. Perhaps most marked will be organisational and technological changes, many of which are already underway. A far-reaching re-organisation of work, likely to be characterised by teams and non-hierarchical structures, by decentralisation and telecommuting entrepreneurs, will be one of the fundamental forces for growth, demanding new ways of managing risk, whether individual, corporate or social.

Technological developments, not least in computers and telecommunications, will encourage growth but also help stimulate turbulent and unanticipated changes in what, how and where people produce and consume. If, for example, a large proportion of the population works at home rather than in an office or factory, the result might be a sense of isolation or inadequate attention to health and safety in the new workplace.

Continued globalisation, with the increased interdependence and boost to technology diffusion, trade and growth in general that comes with it, will also require considerable economic, social, even cultural adaptation. When Japanese car-manufacturers first established plants in the North of England, for example, workers and managers had to come to terms with each other’s working practices (and, in the end, did so quite rapidly).

Simultaneously, demographic pressures induced by aging and more diverse population structures will combine with stringent fiscal realities to push many OECD countries to rethink the traditional public-sector bulwarks of societal cohesion such as pension schemes and labour-market programmes (will, for instance, unemployment insurance always be provided by the state?).² As governments reduce the constraints on market forces and focus increasingly on framework policies instead of direct intervention, economic growth and societal cohesion will both come to depend even more on the diverse, innovative and often unanticipated initiatives of the private sector.

What Prospects for Long-term Growth?

Trends in underlying growth conditions could generate a fairly wide range of outcomes. The OECD economies might, for example, end up on a much faster growth trajectory twenty years from now if the diffusion of new technologies, market liberalisation and globalisation spur rapid increases in productivity. The opposite might occur if fiscal consolidation becomes even more difficult, or if international trade and investment come to be widely perceived as exacerbating disruption and dislocation, unleashing protectionist and anti-competitive sentiment. Or, perhaps most plausibly, OECD countries will continue to muddle through, with slow but positive productivity and economic growth (in the order of 1–2% per year), with virtually no in-

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crease in the size of the labour force, and with incomes rising only slowly. This modest trend-line is unlikely to provide a growth dividend capable of cushioning or overcoming the wide range of challenges to societal cohesion in OECD countries.

A trajectory of high growth would clearly be preferable. That raises the question of whether or not economic performance could be enhanced by abandoning the current mix of economic policies that generally target low inflation and sound fiscal balances; structural adjustment to improve the functioning of product, capital and labour markets; and the liberalisation of trade, investment and technology flows to enhance global economic efficiency. Proponents of a departure from the current mix generally fall into three broad categories.

In the first, there are those who believe that the ‘inflation mentality’ of the past has been conquered and that the monetary authorities can now afford to be less restrictive with the money supply. Increased activity, it is contended, would translate into real, non-inflationary growth because the highly competitive global economy would restrain the pricing power of companies, thus ensuring they would raise profitability by boosting efficiency. The result would be to lift OECD economies on to a higher plane of growth, potentially reducing unemployment, poverty and social exclusion. Critics of this school argue that in some economies, like the United States and the Netherlands, official unemployment is already low; inflationary pressures would be inevitable, not least because looser monetary policy would lead to a weaker currency in what is an increasingly open world economy.

A second camp would prefer to limit disruption in the domestic economy by slowing down adaptation to global competition and technological change. The risk in such an attitude is not only that protectionist sentiment would gain ground but also that structural adjustment would be merely postponed, thus prolonging painful re-adjustments.

A third group yet proposes a continuation of tight monetary and fiscal policies, coupled with even faster liberalisation, deregulation and privatisation. Yet here the problem comes full circle: the risk is of even higher transition costs and thus an even bigger threat of a backlash.

Overall, the balance of opinion seems to be that the current mix of economic policies is the most promising, even if it may not produce a growth rate capable of smoothing over all of the social and economic transition costs.

A Renewed Role for Governance?

Many of the difficulties expected to undermine societal cohesion are not directly linked to growth as such; instead, they stem from the profound nature of the demographic, economic and social changes that can be foreseen. In the future it seems less likely that there will be a repetition of the familiar patterns of ‘productivity catch-up’ and growth-driven change, exhibited by Europe and Japan after the Second World War and the ‘Asian Tigers’ more recently, as higher income and investment altered economic and social landscapes. Instead, most OECD countries will probably enter a period of change-driven growth, where economic dynamism will depend on embracing the flexibility demanded by intensified competition and innovation.

Adapting to the intensive and unsettling transformations that are likely to both accompany and spur economic growth will probably put more emphasis on the renewal of decision-making and participatory processes. Improvements will be required in systems of governance, not only in the democratic fora of the political sphere, but also in enterprises and communities where many of the crucial decisions will be made on a daily basis. The private sector is already pointing the way with organisational restructuring that moves away from hierarchical methods of command and control.

Improving the democratic infrastructure of OECD societies – by voter education, anti-corruption measures, decentralisation, referenda and so on – is expected to offer a three-fold dividend. First, better methods of governance are likely to both enable and sustain a respect for people’s differences – whether in wealth, cultural endowment and any number of other...

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factors – in an economic environment characterised by freer markets. Second, there is likely to be an indispensable synergy between, on the one hand, forms of governance that encourage social responsibility by sharing authority and, on the other, the personal engagement (that is, a combination of trust and commitment) that is essential for the success of a decentralised, flexible and innovation-driven society. Finally, the evolution of governance systems towards more sharing of responsibility at work and in the community through participatory decision-making practices could help to achieve win/win outcomes from the turbulence of the flexible economy.

Reorienting the Welfare State

Extensive renovations will likely prove necessary in the programmes and institutions of the welfare state, largely as a consequence of changes in the underlying requirements of client populations, in altered fiscal circumstances and in breakthroughs in production processes that promise increased efficiency in the delivery of social services. These developments are likely to be controversial.

Advocates of more dramatic change argue that today’s social programmes tend to aggravate rather than attenuate the friction between societal cohesion and economic flexibility. Modest reforms, they say, will simply continue to incite dependency while fiscal retrenchment reduces the resources available to that end. A more promising approach calls instead for efficient social-insurance schemes that align individual costs and benefits. Breaking with certain welfare-state traditions is viewed as probably the most effective way of introducing the supple and adaptable systems better suited to providing a sense of security in a turbulent, flexible economy.

Universal Rights and Free Choice?

In practical terms, the cultivation of societal cohesion will continue to occur outside the institutions and programmes provided by government. Families, workplaces, voluntary associations and the local community will maintain a central, probably growing, role in providing citizens with a sense of security, belonging and identity. Governments can encourage new approaches to managing economic and social risks, like investing in physical and human capital or becoming self-employed, by developing frameworks that extend universal rights (in areas such as health care, pensions, educational borrowing, access to investment capital, disability insurance, provision of a basic minimum income) while opening up the markets for these services in order to give individuals more discretion.

Policy will therefore have to foster both universal access and individual choice by encouraging a wide range of institutions that provide insurance schemes in the context of publicly backed guarantees or regulatory supervision. Perhaps the main difficulty will be in designing policies that neither blunt the signals and incentives of the market nor undermine the solidarity required for effective social co-operation and a sharing of basic aspirations. The balances attained across OECD nations and regions will differ considerably in accordance with their divergent values and traditions. The pursuit of mutually reinforcing policies and the avoidance of conflict with international obligations through (for example) trade and investment rules will call for special efforts to promote mutual understanding and co-operation.

Innovative Solutions

A wide range of innovative responses to the threats facing societal cohesion are now being explored, at the OECD and elsewhere. The proposals can be grouped roughly into four distinct areas.

First, changes will have to be made to the systems used for insuring citizens against such risks as unemployment, disease, disability and poverty. Some proposals envisage giving people the freedom to opt out of public schemes by turning to private suppliers, as is already the case for some pension and health-care systems. Others aim to enhance the functioning of investment in human capital or high-risk start-up businesses by developing new credit schemes perhaps...
backed by government guarantees. Such reforms would provide clearer incentives to save, work and invest and would also help avoid poverty traps (where earning income reduces benefits so rapidly there is little incentive to work) or ‘moral hazard’ situations that encourage excessive risk-taking behaviour because loss has been insured against.

Properly designed, a more diversified and transparent approach to economic and social insurance could also spur the development of more effective risk-reduction strategies, even for the chronically poor. An example from Canada involves local community-development initiatives that provide joint funding and organisational catalysts for starting up small businesses and not-for-profit services. Widespread introduction of such risk-sharing programmes will be particularly important if, as many segments of society insist, future societal cohesion will be unattainable, politically and operationally, when the sacrifices and transition costs demanded by a flexible economy are seen as falling only on the poorest and weakest.

A second set of vital changes concerns learning systems in general and the reform of state-dominated education in particular. One of the most fruitful trends is towards the wider recognition of lifelong learning and improvements in transparency of acquired human capital. In practice, this development should lead to easier validation of different types of learning throughout life (home, school, work) and clearer incentives for investing (even on borrowed financing) in the accumulation of knowledge and skills. In much the same way, indeed, as firms are re-organising work and business strategies, the sources and uses of learning could become more diversified, decentralised and consumer-driven.

A third group of changes that might help secure cohesion centre on what might be called ‘responsibility systems’, particularly in corporate and local-community governance. Methods for spurring commitment, involvement and long-term thinking are seen as being critical components of tomorrow’s more decentralised yet interdependent world. For managers, workers and the surrounding localities, not to mention investors, the evolution of corporate and local governance systems would attempt to compensate for the decline in traditional methods of encouraging commitment like life-time employment contracts and detailed, direct regulatory constraints.

An enormous range of institutional responses to such concerns can be imagined. Some companies offer stock options. Other institutions, private or public, devolve responsibility for budgets to the ‘front line’ – whether the assembly line, sales counter or local playground-planning committee – which is helping provide the appropriate knowledge and incentives for improving quality, productivity and so on. Tradable permits are another example of changing management and incentive systems for pollution abatement and rethinking of product life-cycles.

Lastly, and more controversially, some commentators have argued for the introduction of a universal citizen’s income to reflect the (non-market) value of the full range of human activities. Critics of this proposal express serious doubts about both the affordability and perverse incentive effects that might follow if the link between paid employment and income were broken. The proponents counter that, for many people, employment of any kind, let alone at wage rates that would lift them out of poverty, might be simply unattainable – particularly if long-run economic growth does turn out to be modest. A basic-income programme could then help to encourage both useful unpaid activity (like taking care of the young and the elderly or improving ecological conditions) and much more flexibility in pay rates and employment contracts for paid work since workers could afford to live even with below-poverty wage rates.

Barring catastrophes or a major policy reversal, the pace of change is unlikely to slacken: rapid technological progress and continuing liberalisation of trade and investment will continue to push towards an increasingly knowledge-based economy characterised by the growing influence of market forces and global competition. Uncertainty and unpredictability seem destined to increase. Market mechanisms will, in all likelihood, play a major part in managing and insuring against the risks arising from such turbulence, just as evolving social policies will continue to underpin economic performance. The challenge for the political process will be to find the policies that strike an effective balance.

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