

THE VIRTUE OF COALITIONS

About 'Polder Economics' in times of a cost-of-living crisis

By Bart Le Blanc

As a matter of context, I need to start by upsetting some of my institutional economics friends. In my view, there is no strong theoretical basis nor empirical proof that democracy creates economic prosperity or identifiably contributes to it.

Economics prefer clarity of purpose, stability, and predictability. How decisions are reached, and the quality of democratic representation or the protection of human rights do not seem to be determinant issues in economic modelling.

However, political science and historical evidence teach us that decisions become more sustainable once they receive broad-based support particularly if such support come from a challenging, contesting processes and emerges through compromise and consensus building.

Coalitions (political and non-political) are better for proactive crisis policies, and even economists prefer them over fear-based authoritarian regimes.

- "Why Nations Fail" (2012) is a provocative analysis by institutional economists Daron Acemoglu (MIT) and James Robinson (Chicago). It should be mandatory reading for today's class of politicians and economists trying to solve the current mess.
- The IMF World Economic Update of July 2022 can cause sleepless nights: it gives a nightmarish sketch of the combined threats of a lingering pandemic (not over yet), Russian aggression against Ukraine, global warming affecting daily life and food and energy supplies, rampant inflation, shortages in supply chains and imbalanced labour markets.
The IMF maps out urgent government action to avoid worse. Such action will require decisive government action.
- BUT many governments are facing weakened political support, popular unrest, and strike actions; trust in politics is at very low levels (see Edelman's Trust Barometer 2022). Growing inequalities are the breeding ground of political polarisation (read PEW's Annual Global Attitudes Survey of 2021).
- Could we see Nations Fail ... again??
Are there lessons to learn from the 'Polder-economics' with its traditional political and social coalitions?
YES, but it requires **grown-up politics** through
 - Avoiding short-term interventions without the rebalancing of structural inequalities.
 - Rebuilding trust in politics by bringing in local networks and NGOs (high trust scores in Trust Barometer) and by ditching 'identity' politics.
 - Standing up to political polarisation and promote media reporting on opposing views
 - Re-invigorating the stranded China-Western system convergence efforts without fuelling the tensions for *domestic* political audiences (e.g. *Ms. Pelosi visiting Taiwan*)
 - And coalitions can make it work, provided that

1. World Economic Update: "Gloomy and More Uncertain"

You need to have nerves of steel and a sturdy stomach to digest the meal that is served in the latest IMF World Economic Outlook Update of July 2022. The mix of ingredients is unpalatable and the recipes hardly edible for many.

The evil combination of war in Ukraine, uncontrolled inflation, lingering COVID pandemic with strong public health restrictions particularly in China, climate change creating food shortages, political and social unrest upsetting corporate investments, and continuing imbalances in supply chains and labour markets produce a devastating outlook for economic progress after several years of pandemic downturns.

The hoped-for post-pandemic recovery could clearly be blown off course.

Recent insights are pointing to a seriously impacted growth outlook for China (result of zero pandemic tolerance policies, but also underlying financial system failures e.g. Evergrande). The forecasts for major Western economies such as the US and Euro-zone is equally bleak driven by inflation-fighting monetary policies and labour shortages and supply-chain problems.

As a result, the GDP outlook for China is reduced to 3.3% for this year (-1.1%) for the US to 2.3% (-0.8%) and Germany to 1.2% (-0.9%).

A dismal picture for the expected first full year of 'post-pandemic recovery'.

Table 1. Overview of the World Economic Outlook Projections

(Percent change, unless noted otherwise)

	Year over Year						Q4 over Q4 2/		
	2020	2021	Projections		Difference from April 2022 WEO		Projections		
			2022	2023	2022	2023	2021	2022	2023
World Output	-3.1	6.1	3.2	2.9	-0.4	-0.7	4.4	1.7	3.2
Advanced Economies	-4.5	5.2	2.5	1.4	-0.8	-1.0	4.7	1.3	1.5
United States	-3.4	5.7	2.3	1.0	-1.4	-1.3	5.5	1.0	0.6
Euro Area	-6.3	5.4	2.6	1.2	-0.2	-1.1	4.7	0.7	2.1
Germany	-4.6	2.9	1.2	0.8	-0.9	-1.9	1.8	0.5	1.5
France	-7.9	6.8	2.3	1.0	-0.6	-0.4	4.9	0.4	1.1
Italy	-9.0	6.6	3.0	0.7	0.7	-1.0	6.4	0.6	1.6
Spain	-10.8	5.1	4.0	2.0	-0.8	-1.3	5.5	1.3	2.3
Japan	-4.5	1.7	1.7	1.7	-0.7	-0.6	0.4	2.4	0.6
United Kingdom	-9.3	7.4	3.2	0.5	-0.5	-0.7	6.6	0.1	1.3
Canada	-5.2	4.5	3.4	1.8	-0.5	-1.0	3.2	2.5	1.7
Other Advanced Economies 3/	-1.8	5.1	2.9	2.7	-0.2	-0.3	4.6	2.0	2.8
Emerging Market and Developing Economies	-2.0	6.8	3.6	3.9	-0.2	-0.5	4.2	2.1	4.7
Emerging and Developing Asia	-0.8	7.3	4.6	5.0	-0.8	-0.6	3.8	4.0	4.7
China	2.2	8.1	3.3	4.6	-1.1	-0.5	3.5	4.1	3.2
India 4/	-6.6	8.7	7.4	6.1	-0.8	-0.8	3.9	4.1	7.2
ASEAN-5 5/	-3.4	3.4	5.3	5.1	0.0	-0.8	4.7	3.4	6.1
Emerging and Developing Europe	-1.8	6.7	-1.4	0.9	1.5	-0.4	6.1	-7.0	7.7
Russia	-2.7	4.7	-6.0	-3.5	2.5	-1.2	4.8	-13.9	4.8
Latin America and the Caribbean	-6.9	6.9	3.0	2.0	0.5	-0.5	3.9	1.8	2.1
Brazil	-3.9	4.6	1.7	1.1	0.9	-0.3	1.6	1.5	1.5
Mexico	-8.1	4.8	2.4	1.2	0.4	-1.3	1.2	2.9	1.0
Middle East and Central Asia	-2.9	5.8	4.8	3.5	0.2	-0.2	...	...	...
Saudi Arabia	-4.1	3.2	7.6	3.7	0.0	0.1	6.7	6.9	3.7
Sub-Saharan Africa	-1.6	4.6	3.8	4.0	0.0	0.0	...	...	...
Nigeria	-1.8	3.6	3.4	3.2	0.0	0.1	2.4	2.1	2.3
South Africa	-6.3	4.9	2.3	1.4	0.4	0.0	1.8	2.2	1.7
Memorandum									
World Growth Based on Market Exchange Rates	-3.4	5.8	2.9	2.4	-0.6	-0.7	4.4	1.6	2.5
European Union	-5.8	5.4	2.8	1.6	-0.1	-0.9	4.9	0.9	2.8
Middle East and North Africa	-3.4	5.8	4.9	3.4	-0.1	-0.2	...	...	...
Emerging Market and Middle-Income Economies	-2.2	7.0	3.5	3.8	-0.3	-0.5	4.3	2.0	4.7
Low-Income Developing Countries	0.1	4.5	5.0	5.2	0.4	-0.2	...	...	...

Unsurprisingly, the effects of rampant inflation on consumption and investment have become very tangible. The loss of purchasing power of many consumers is seriously affecting the economies in many countries; a real *Cost-of-Living-Crisis*' is emerging.

In many cases we see increased levels of household savings built up during the pandemic, melting away in this high inflationary environment.

This has a depressing effect on the spending on non-essential goods such as electronics, furniture, and entertainment. Confidence in all main business sectors (e.g. PMI-index levels) has been dropping since the start of the year. And corporate investments - which were recovering after the COVID 19 pandemic - have been seen slowing down.

The IMF recipe for policy action is demanding and covers broad areas of government policies. In the WEO Update a series of concrete measures are presented such as:

- Monetary policy tightening to fight inflation coupled with targeted fiscal measures to protect the most vulnerable
- Increase labour supply to improve productivity levels and ease inflationary wage pressures for example by offering tax credits, child-care support, or selective immigration policies
- Introduce measures to ease the persistent food and energy crises through the removal of barriers to trade and push transformation towards a low carbon economy
- Action to limit economic disruption from lingering mini waves of COVID 19 pandemic; push vaccination levels to reach the UN recommended 70% coverage everywhere. Where vaccination levels are high: review of isolation rules and working practices.

These IMF *"Policy Priorities"* demand interventions in many areas for government. This is putting a heavy reliance on political decision making, just at the moment when political fragmentation is rife, and trust in politics is all-time low in many countries.

Is this challenge TOO BIG for governments and politicians of today?

2. Politics and economics are inseparable

The most acute socio-economic crisis of today is the cost-of-living crisis hitting all countries across the world: advanced, emerging and low-income economies.

The causes of this acute crisis are complex, multiple, and deep-rooted.

Politicians, central bankers, trade unionists, employers, economists, and many others need to look for solutions for the short term but they cannot ignore a number of major underlying issues.

Rising inequalities

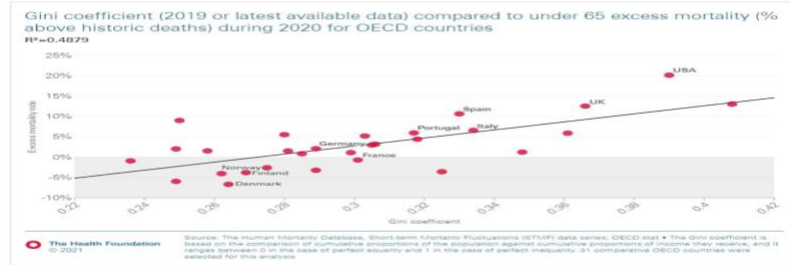
The COVID-19 pandemic has made inequalities much more manifest:

- Wealth and income inequalities have risen by generous monetary and fiscal policies
- Pandemic restrictions have made many jobs more flexible with greater work from home opportunities while other jobs required continued physical attendance or less pay
- Access to public health and social care facilities (including access to vaccinations) has shown to be very uneven and discriminatory for many poorer families and elderly people
- Inflation always hits the poorest and most vulnerable in society harder than the well to do
- The impact of climate change is devastating as the Summer and droughts of 2022 illustrates. Again, the poorest groups suffer the hardest which is particularly clear looking at a global impact comparison.

Last year, the independent UK health think-tank, *The Health Foundation* published a remarkable study (see: *"Unequal pandemic, fairer recovery, The COVID-19 impact inquiry report"*, July 2021). It confirms that income inequality feeds inequalities in access to public services and particularly public health and social care, which triggers in turn increased inequality in life expectancy.

Income inequality and excess mortality across countries

Gini coefficient (2019 or latest available data) compared to under 65 excess mortality (% above historical deaths) during 2020 for OECD countries



Countries that had higher levels of income inequality for people aged 0–64 in 2019 also tended to have higher levels of excess mortality for people aged under 65 in 2020.



The chart illustrates this link: where the gap between rich and poor is larger (measured by GINI coefficient) excess mortality resulting from COVID-19 is higher. Or to say it in a very rude way: rising inequalities kill people!

Trust in institutions and politics continues to ebb away

There is plenty recent anecdotal evidence of diminishing trust in government and politics. Just look at recent media headlines: after the 2022 presidential and parliamentary elections France is deemed “*ingouvernable*”. Italian the media see a “*chaos totale*” following break-up of Draghi’s coalition government. The American news website *The Daily Beast* calls the Republican-Democrat fights over policies, politics, and party’s politicians as a “*Shitshow on Steroids*”.

But there is more than just anecdotal evidence. I have earlier referred to the excellent surveys by the US consultancy Edelman in its annual *Trust Barometer* (see *Tears for Fears of August 2021*). This year’s Barometer Edelman is called: “*The Cycle of Distrust*” which summarises it shockingly.

NEARLY 1 OUT OF 2 RESPONDENTS VIEW GOVERNMENT AND MEDIA AS DIVISIVE FORCES IN SOCIETY

48% **46%**

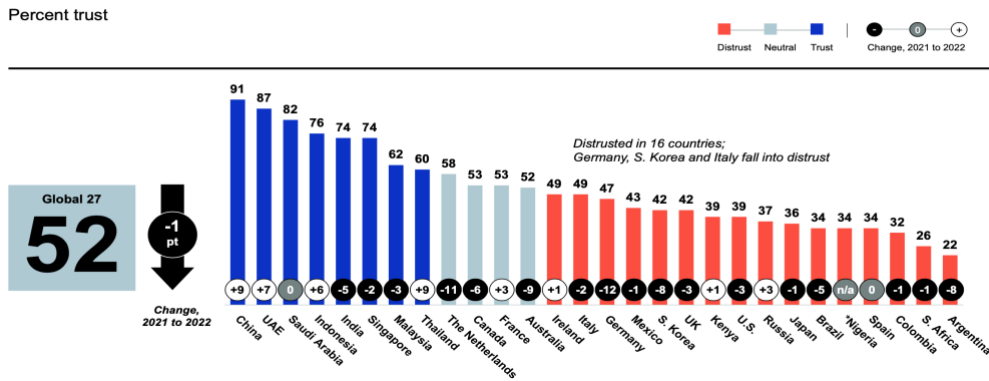
Government Media

“We find a world ensnared in a vicious cycle of distrust, fuelled by a growing lack of faith in media and government. Through disinformation and division, these two institutions are feeding the cycle and exploiting it for commercial and political gain.”

Source: Edelman 2022 Trust Barometer

In the Edelman 2022 Barometer we see major democracies such as the US, Japan and Spain classified in the ‘distrust’ category (below 50% trust level) together with new entries Italy and Germany! Noteworthy is the rapid decline in the Netherlands, but also the (surprising) progress made in China (+9).

TRUST IN GOVERNMENT FALLS IN 17 OF 27 COUNTRIES



Source: Edelman 2022 Trust Barometer

The Trust Barometer reports that on all major issues such as climate change, inequality, employment and work practices, public health people place more trust in local networks (neighbours, co-workers), businesses, and NGOs than in government, politics or media.

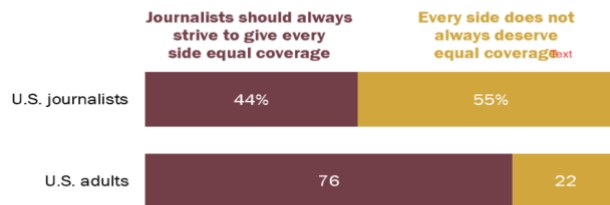
While political polarisation is rising

Political polarisation seems to occur in many democratic countries in the world and today's media are hardly the source of balanced information.

The Washington based PEW Research Center recently published a report on journalists' attitudes towards "balanced reporting". The graph below shows a growing gap between media and the expectations of their readers on "equal coverage" of opposing views.

U.S. journalists more likely than the public to say all sides don't always deserve equal coverage

% who say ...

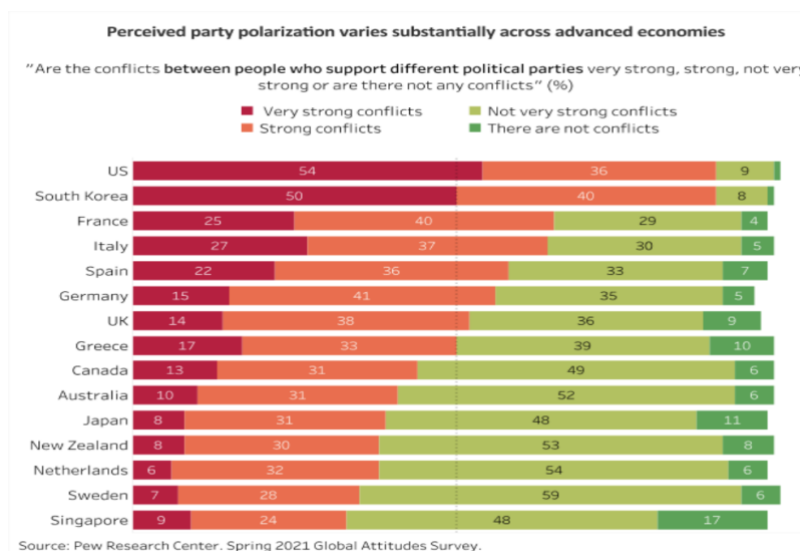


Note: Respondents who did not answer not shown.

Source: Survey of U.S. journalists conducted Feb. 16-March 17, 2022. Survey of U.S. adults conducted Feb. 7-13, 2022.

PEW RESEARCH CENTER

In PEW's Annual Global Attitudes Survey of 2021, the polarisation in politics in many countries is analysed. It shows remarkable and surprising differences across countries: the US and South Korea as well as bigger European countries such as France, Italy, Spain and Germany qualify as 'polarised countries' (>50% very strong or strong conflicts on political parties' views), contrary to countries such as Japan, New Zealand, Sweden, and the Netherlands (see graph below).



And it is all related...

In looking for the reasons behind the rising political polarisation, many studies point at growing social inequalities as the main breeding ground for political antagonism.

Recent research by the Universities of St Andrews (Scotland), Princeton and Pennsylvania (US) analyses political attitudes and identities in different countries using mathematical and computational models (*'Inequality, identity and partisanship: How redistribution can stem the tide of mass polarization'* December 2021). It concludes that the political divide is greater than at any time over the last 50 years.

This extensive research concludes that there is a clear relationship between inequality, the level of redistributive policies and political polarisation. The study concludes: *"To reverse polarisation, you must first remove the conditions that helped create it (for instance, reduce inequality) and then engage in 'coordinated efforts' to change attitudes such as signalling by political elites in the form of bipartisan cooperation or improved rhetoric about the 'other side'."*

A few interim conclusions

Institutional economics teaches us that politics and economics are inseparable.

With politics in a mess, and the economy crying for support, some lessons may need to be drawn from the above.

- The combination of a socio-economic crisis (inflation, cost of living crisis, labour market imbalances, recessive tendencies) and public health crisis (pandemic mini-waves, vaccination inequality, social care) requires urgent and short-term government action. However, ignoring the many underlying inequality issues that have become more prominent during and after the COVID-19 pandemic while developing short-term answers is doomed to fail and might trigger further social unrest,
- Any required comprehensive government action will not be easy in the current climate, as government and institutions face diminishing public trust. Media are seen to feed this as they seem to be turning away more and more from balanced reporting. In the search for regaining trust, local networks and NGOs could play an important role.
- Many research studies show that inequalities and diminishing trust feed party political polarisation and 'identity' politics. Identity politics feeds could destabilise healthy political debate and hinder necessary crisis solutions.

Can the new institutional economics help in solving these dilemmas?

3. *New institutional economics*

Democracy and economics

For many Western economists, democracy and economics are intrinsically related. See for example prominent Nobel prize winning economists such as the monetarist Milton Friedman (*'Capitalism and Freedom'*) and institutional economics pioneers Douglas North (*'Why are so few countries prosperous?'*) and Elinor Ostrom (*public choice and the common good*).

All argued that democratic countries create better opportunities for economic growth and social progress, than countries with authoritarian regimes. This was also the leading principle behind the creation of the European Bank for Reconstruction and Development (EBRD) following the collapse of the former Soviet Union in the early 1990s.

No wonder then that the economic development in China over the last decades has puzzled many Western economists.

'Why Nations Fail' and the China experience

The work of *Daron Acemoglu* (MIT economist and one of today's most cited economists in the world) elaborates North's new institutional economics. He argues strongly against authoritarian regimes which "... concentrate power in the hands of a few, who will then have incentives to maintain and develop extractive economic institutions for their benefit and use the resources they obtain to cement their hold on political power." (Daron Acemoglu and James Robinson: *'Why Nations Fail'* 2012, page 477).

Acemoglu finds that "Small State" approach favoured by Milton Friedman amongst others and still 'en-vogue' in many Western conservative/liberal economists' circles, cannot tackle today's problems. However, the need for a pro-active interventionist government needs to be balanced through a strong civic society! The new institutional economics need to look beyond the traditional institutional frameworks and include the resilience of social networks and their critical attitudes (also see his *"Competing with Robots" together with Claire Lelarge and Pascual Represpo*, 2020).

And what about China?

In an earlier paper I reviewed the China's *'Socialist Markets Economic Mode'* and its(stalling) development towards more open markets economics (see: *Economic Systems were Converging... Pity it Stopped*, February 2022). It was much inspired by the Atlantic Council's impressive *'China Pathfinder'* study.

Its recently published second quarter update of the Pathfinder study, is not very uplifting: new geo-political tensions triggered by Western sanctions against Ukraine's aggressor Russia, as well as new pandemic incidences, and China's zero tolerance policy, have created more reluctance on system convergence.

However, the Atlantic Council remains hopeful for the longer term: *"With the 20th Party Congress looming, we see little chance of a change in approach, even if the Chinese economy veers toward a hard landing. The challenges of steering China back to a market course are gargantuan, but they may be less insurmountable than telling millions of Chinese citizens that low growth is the most they can hope for".* This opinion is shared by Acemoglu c.s. *Chinese growth is likely to come to an end, particularly once China reaches the standards of living level of a middle-income country....*"(*Why Nations Fail*, 2011)

This might however be a too simplistic view on the inevitability of democracy/economic growth premise.

Let's look at a few facts.

The table below organises some indicators on democratic values and human rights in combination with a few economic data.

**Some indicative parameters on democracy and economics in selected countries
2021/2022**

	Democracy Index (Wurzburg) Human Freedom Index (Cato)	Political party landscape	GDP per capita 2022 In USD	Average GDP growth outlook for next 5 years
United States	36/15	2 party system, winner takes executive power	\$63,416	1.7%
Germany	5/15	Multi party parliament; coalition government	\$54,076	1.5%
United Kingdom	17/14	Two party system, winner forms government	\$44,117	1.7%
Japan	25/15	Multiparty democracy with dominant party (LDP) ruling	\$42,248	0.7%
Brazil	75/78	Multi-party system (opportunistic and fluid), majority rule	\$14,916	2%
Russia	144/126	Dominant political party ruled autocratically; closed political/economic oligarchy	\$27,903	1%
China	172/150	One party system: Communist Party of China rules on basis of 'democratic centralism' through the Central Congress	\$17,192	5%

Sources: University of Wurzburg: Democracy Index 2020, Cato Institute: Human Freedom Index 2021, World Population Review and IMF Data

In comparing China (low democratic/human freedom levels, but strong growth and rising income) or Brazil (medium democratic/human rights content, stagnating low-income levels and low growth) and many advanced economies (high democratic and human freedom levels, high income, but lagging in economic prowess), we cannot draw any firm conclusions on the supposed link between democracy and economics, even when taking 'path dependency' into account.

My conclusion is that economics prefer clarity of purpose, stability, and predictability. It is however not very interested in the quality of democratic representation or the extent of the protection of human rights. Political science teaches us that decisions become more sustainable once they receive broad-based support. Such support increases through cooperative political processes with contestation, the willingness to compromise and to build lasting consensus.

Coalitions (political **and** non-political) provide frameworks for such decision making. Autocratic and authoritarian regimes do not.

'Polder economics' and its 'Virtuous Circles'

The Dutch '*polder-model*' or '*consensus democracy*' is a darling subject for institutional economics. The already much referred to Daron Acemoglu is a strong advocate. He argues that prosperous democratic nations need to support and inspire a healthy interaction between competition and cooperation. Governments and politicians should appreciate coalitions to avoid concentration of power, and benefit from counterbalancing opinions and forces. Coalitions form society's '*virtuous circles*' and should not be limited to the political sphere only: "*Inclusive economic institutions remove the most egregious extractive economic relations, such as slavery and serfdom, reduce the importance of monopolies, and create a dynamic economy, all of which reduces the economic benefits that one can secure, at least in the short run, by usurping political power.*" (*Why Nations Fail*, page 379).

A very brief history of the Dutch polder-model takes us back to the creation of the Netherlands as a nation and its fight against the sea. For many centuries, the Dutch created new land reclaimed from the sea in below-sea-level 'polders' protected by sturdy dikes (remember Hans Brinkers?). This demanded significant cooperation between government at central and local level, enterprise, farmers, and the whole civil society. Although historically a religious country there was no room for fundamentalist views. Tolerance was a characteristically Dutch treat.

In a fascinating study about the '*consensus-democracy*' in the Netherlands, political scientists Hendriks and Toonen describe it as follows: "*The Dutch consensus democracy rests on a long tradition that can be traced back to the time of the Dutch Republic (1588-1695). The Republic of Seven United Provinces was highly decentralised federation with a weak centre. The political culture was one of improvisation, negotiation, discussion, and consultation between independent partners....*" (F.Hendriks and Th.Toonen: *Polder Politics: The Re-Invention of Consensus Democracy in the Netherlands*, 2011).

This consensus democracy model has remained dominant in the Dutch political landscape: today there are many political movements and parties, and no dominant political force, hence always a need for coalitions in government. In addition the polder provides a wide network of non-political cooperation systems (social, cultural, sector-specific, religious, etc.) which contribute to the societal debate about the big issues of today (Acemoglu's "virtuous circles").

Two more interim conclusions

From the 'polder economics' review, two further points can be distilled:

- However much institutional economics would love to see a strong relationship between democracy and economic prosperity, the science nor empirical data support this axiom. On the other hand, economics need direction, stability and predictability and those treats are well served by broad societal support. Coalitions (political and non-political) can provide the framework for robust consensus building provided that it is reached through contestation and a willingness to compromise.
- This means that coalitions should not be seen as just a practical vehicle for majority voting. 'Virtuous circles' of coalitions are broad based, need to go beyond politics and cover many corners of society. As the Edelman Trust Barometer 2022 reveals, local networks and NGOs are today's vehicles of gaining popular trust.

4. Grown up politics and economics

In its recent World Economic Outlook Update, the IMF prescribes urgent interventions in many areas for government policies ranging from monetary policy to fiscal policy action including measures of economic and social action and public health measures. To implement these requires a lot of courage and clarity from policymakers just at the moment when political fragmentation and polarisation is rife and trust in politics is at an all-time low in many countries.

The question was: Is this challenge TOO BIG for governments and politics of today?

Let's recap some of the lessons drawn from this review:

- Any short-term economic policy action needs to be bedded in a longer-term rebalancing of increased inequalities in the economic, social, health and other main policy areas.
- This will require to build coalitions, not just to ensure political majorities, but to assemble broad based support for progressive policies. These coalitions need to go beyond the political sphere and include social, cultural, and local networks.
- Trust in government and institutions needs rebuilding. Identity politics does not help. Trusted local associations and NGOs should contribute.
- Political polarisation demands counteraction, and balanced reporting on opposing views by media helps.

- Rather than stoking geopolitical tensions (particularly China-US) a concerted action to restart the East-West convergence debate would support peace, growth and help poorer countries
- There is no automatic link between democracy and economics. But building broad coalitions can make sustainable policies possible.

Polder economics and consensus democracy are not a thing of the past.

Bart Le Blanc, August 2022.

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