Fresh Up Economics

TOWARDS ECONOMIC LITERACY IN EUROPE

Courses for citizens and trainers

by trainers and researchers from seven European countries

Co-funded by the Erasmus+ Programme of the European Union

FRESH-UP ECONOMICS

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Introduction

Economic principles are increasingly shaping European societies: Health, housing, pensions, social security, even education, are more and more regulated in favour of competition, efficiency and profit maximisation. At the same time, the **economy is present** in the form of crises, environmental degradation, insecure energy supply, unstable financial markets, a widening gap between rich and poor, and it is of course being felt in people's wallets. In contrast to the clear importance of economics, however, is the **low number of adult education opportunities** to analyse economic contexts and to provide background knowledge for discussion. The main obstacle, which is: "Economics? That's too complicated for me!" also seems to exist among adult educators themselves. Our learning platform "Fresh Up Economics. Towards Economic Literacy in Europe" aims to change this. In this document, you will find all of the contributions to the platform - hereinafter referred to as courses - in one place.

The range of topics is broad. The courses cover fundamental topics such as inequality, money, debt and taxes. They provide information on pressing and controversial topics such as climate change, growth and sustainable development, public goods and social welfare as well as migration and its impact on Europe. Questions are also raised about the economic policy design of the European Union. Put simply, should this be done according to principles of competition or cooperation? The course Introducing Feminist Economics raises awareness of the still existing (structural) inequality of women vis-à-vis men. Following on from this, another course presents considerations and proposals for women's economic empowerment. While the majority of the courses offer macroeconomic perspectives, this last one is microeconomic and focuses on individual actors, in this case women.

Economics and the science of economics, as well as public debates on economic issues, are political. If this is not made explicit, the way they are presented can favour a perspective that is sympathetic to one or the other, but whose political message remains hidden. In order to avoid this and to expose students to different perspectives on economic developments, one of the courses specifically introduces students to Economic Schools of Thought. This is done on the basis of the topic of "labour". Another course introduces possible economic policy strategies for a an ever-present topic: crises management. In almost all of the other courses, too, different theoretical assumptions and the resulting different answers to problems are taken into consideration. The courses also reflect multi-perspectivity as a "Gesamtkunstwerk". In addition to the thematic breadth, the different approaches taken by the authors on their respective topics is also evident.

Who are the courses for?
The materials are intended for citizens to engage with themselves and for adult education facilitators and trainers across Europe.

How are the courses structured?
They are structured in such a way that a) you can get a first **overview** of a topic. Those who have more time or who want to know more can b) study the **background information**.
By means of c) **interactive exercises**, they can go even deeper.
For trainers in adult education we also offer d) **training materials** for working with **non-formal methods** in groups. They can be used in adult education as well as in out-of-school youth education.

And who are we?
The courses have been developed by adult educators from universities (Austria, Poland), small companies (Czech Republic, Spain) and non-governmental organisations (Germany, Ireland, Estonia). Find out more about the participants, their organisations and the two-and-a-half-year cooperation project on our website: https://economic-literacy.eu/.

"**Economy - it's too complicated.**" Yes, some issues are complex (complicated, perhaps). But there is good news: You can still understand them. And you can also learn to cope with complexity in the process. With the learning platform and the courses, we would like to invite you to set out on your journey and we hope that you will find much inspiration along the way.

You are welcome to share questions, comments and feedback via the forum and the chat on the learning platform.

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FRESH-UP ECONOMICS

Inequality: what should be done?

by Magdalena Prieler, Sven-David Pfau and Andreas Novy

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1. Overview

What is inequality?

Inequality describes both measurable allocations of resources and concrete human experiences of marginalisation, oppression and disrespect. "*Inequality is said to exist when there is a **difference in the distribution of a resource (such as income) or outcome (such as mortality or educational achievement)** across groups of people or places (for example, by socioeconomic group or by gender).*"[1] In the field of economics, inequality is primarily approached from a monetary perspective. Socioeconomic approaches present a broader understanding of inequality. Göran Therborn (2013) offers a helpful distinction between three forms of inequality: **resource inequality**, (e.g. monetary inequalities, carbon inequality) **vital inequalities** (e.g. inequalities in health status, life expectancy) and **existential equality** (based on equality of opportunity and participation in a comprehensive sense, i.e. the absence of discrimination, stigmatisation and oppression such as racism, sexism, casteism or slavery). Inequality describes a social phenomenon, not a natural characteristic. As socioeconomic analysis points out, inequalities are created and driven by social institutions[2] and caused by power relations.

The trend: growing global inequality

Around the year 1500 the major world regions China, India and Europe were equal in terms of per capita material production. With the rise of colonialism, the "Great Divergence"[3] between these world regions began to unfold and has set the path for centuries of growing global inequality, from colonialism to imperialism to the current divide of the Global North and the Global South. Also in the last decades, most of the growing wealth went to those who were already very wealthy. Since 1995 the poorest half of the population together only captured 2% of the global wealth growth, while the richest 1% captured 38% of the total wealth growth.

Income and wealth inequality within countries and regions

While incomes are distributed quite equally in nations like Czech Republic, Iceland and Norway, the United Kingdom, the United States and Chile have very unequal income distributions. Comparing world regions, income inequality is the lowest in Europe, and the highest in the Middle East. In nearly all countries, income inequality within countries has increased in the last decades, however, at different paces. Wealth is in most cases distributed more unequally than income. Since the 1970s wealth inequality rose within most countries and on a global scale. Over the last decades, neoliberal globalisation has shifted power relations and led to a diminishing share of labour income as well as to increased inequality between different types of jobs. Another shift of power balance has taken place between private and public institutions through privatisation of public assets, reducing the possibilities to counter inequality through public prog**rams[4].**

[1] Shaw et al., 2017

[2] Institutions are an often misunderstood term, in common language associated with "organisations". Here, we use institutions more broadly as "...systems of established and embedded social rules that structure social interactions". Hodgson, 2006, p. 18

[3] Pomerantz, 2000

[4] Alvaredo et al., 2018

Carbon inequality

The (unequal) growth of wealth and the rise of material living standards over the last 200 years came hand in hand with an exponentially increasing use of biocapacity and particularly greenhouse gas emissions.[5] Today we are in the midst of a human-made climate crisis and of the sixth great mass extinction. The unequal responsibility for carbon emissions is an important form of resource inequality: the richer a country or an individual, the higher the use of physical resources that lead to carbon emissions. Historically, countries of the Global North are responsible for 92% of all excess carbon emissions emitted worldwide.[6] Currently the richest 1% of the world's population emits more than twice the combined share of the poorest 50%.

What can be done about inequality?

On a national level, welfare regimes can reduce inequality. The **liberal welfare regime** dominates in Anglo-Saxon countries such as the US, UK and Australia. It is a "residual" welfare state focusing on those who cannot take care of themselves in the market economy: the sick, people with special needs, the elderly, the unemployed. This regime holds that everyone else should care for themselves. The middle classes try to remain independent from welfare benefits - private solutions such as private schools, private pensions and private health insurance emerge. The **conservative welfare regime** dominates in continental Europe in countries such as Germany, Austria and France. Access to a large part of the social security benefits is linked to participation in the labour market and/or citizenship. This creates a welfare state for "insiders" and non-insured "outsiders". The **social democratic welfare regime** dominates in Scandinavia. It guarantees universal social rights and provides well-developed public social infrastructures, education, health, care and decent housing for all.

While these traditional welfare state types have (in all their differences) focused on social issues, 21st century welfare states need to provide new **answers that integrate equality with carbon budgets**. So far, the social achievements of welfare regimes were built on the use of an unsustainable share of global biocapacity, at the cost of other world regions and future generations. Tackling inequality in times of climate crisis means that equality needs to be achieved without transgressing the planet's limits. This requires new answers for socio-ecological welfare regimes. While monetary policies can effectively alleviate existential needs and strengthen individual self-determination, they are not sufficient. To tackle the climate crisis **structures that enable everyone to meet their needs with low resource consumption** are vital. Sustainably provided public transport and affordable access to sustainable energy, water, housing, health, care and education help to limit the importance of money and consumption in meeting needs. Social-ecological infrastructures encompass much of what individuals cannot afford with money: from greenery in the street and libraries to public swimming pools. Affordable socio-ecological infrastructures can provide security, offer space for individual lifestyles, strengthen social cohesion and create resource-saving structures. In the 21st century equality means that an ecological way of living is neither a privilege nor a sign of poverty, but simply becomes a routine, a new normal. Ultimately, it is a question of democratic deliberation what social protection floor should be provided for everyone in the light of a finite carbon budget. Reducing inequality is vital if all people are supposed to live a good life in times of reducing carbon emissions drastically.

[5] This trend is described as the great acceleration. Along with growing economic output the pressure that human activities have on our planet rose exponentially in the last decades. Now many so-called planetary boundaries are transgressed, for example when it comes to the loss of biodiversity, the climate crisis and the disturbed nitrogen cycle leading to polluted waterways and coastal zones. Carbon inequality is far from being the only or most dramatic environmental inequality. We use it as an example.

[6] Hickel, 2020

2. Background information

What is inequality

Inequality has seen a revival of interest in public debate and social science research alike. Behind this term are both measurable allocations of resources and concrete human experiences of marginalisation, oppression and disrespect. It offers a fruitful topic for learning, as much as it is prone to misunderstandings and conflict. This text starts with some clarifications before diving deeper into the (socio-)economics of inequality.

Defining inequality

First of all, inequality should not be confused with difference or diversity, and likewise equality does not imply uniformity or sameness. Evidently, all humans are equal, sharing the same biological needs, from birth to death. And at the same time on some level all humans are unique and therefore different. If humans are equal and unique, what does inequality actually refer to? Starting from a handbook definition, we learn that *"Inequality is said to exist when there is a difference in the distribution of a resource (such as income) or outcome (such as mortality or educational achievement) across groups of people or places (for example, by socioeconomic* ***group or by gender).***"[7] Inequality therefore describes a social phenomenon, not a natural characteristic.

Diverse (socio-)economic approaches to inequality

In the field of economics, inequality is primarily approached from a monetary perspective, but with considerable differences between the theoretical approaches. The neoclassical approach is based on an individualistic worldview in which individual income is the result of the productivity of a worker or owner of capital, i.e. what s/he adds to the produced market **value.**[8] Various schools of heterodox economics have criticised this approach and have brought attention to the importance of structural power on labour markets and the role of government in macroeconomic distribution (Keynesian). Marxist economists have argued that workers are in fact not remunerated according to their contribution but are generating a surplus value absorbed by the owners of capital. Feminist economists have stressed the gendered separation of unpaid reproductive work and paid "productive work", perpetuating economic inequality between genders until today. Ecological economists have emphasised how productivity growth actually results from the unpaid appropriation of fossil energy and natural resources and how parts of wealth building rests on systematic cost-shifting to other places or future gen**erations.**[9]
While economic approaches focus primarily on income and wealth, socioeconomic approaches are interested in a broader societal understanding of inequality. They shed light on the relationship of monetary inequality with socio-cultural, ecological and political inequalities. Göran Therborn (2013) offers a helpful distinction between three forms of inequality:

(1) **Resource inequality**, especially monetary inequalities, but also carbon inequality

(2) **Vital inequalities,** inequalities in health status, especially differences in life expectancy.

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[7] Shaw et al., 2017

[8] The underlying assumptions are based on marginal productivity theory.

[9] For a deeper understanding of different economic approaches to inequality visit https://www.exploring-economics.org/en/discover/

(3) **Existential equality**, based on equality of opportunity and participation in a comprehensive sense, i.e. the absence of discrimination, stigmatisation and oppression such as racism, sexism, casteism or slavery.

The following quote summarises a socioeconomic perspective on inequality. *"Inequality, then, is not just about the size of wallets. It is a socio-cultural order, which (for most of us) reduces our capabilities to function as human beings, our health, our self-respect, our sense of self, as well as our resources to act and participate* ***in this world."*** [10] This perspective links inequality to the issue of poverty - some human beings are deprived of their capabilities as a result of an unequal social order.

Resource inequality

Resource inequality can be considered in various dimensions: across time, different territorial scales (global, national, regional) and across social groups (i.e. race, gender, class etc.). We begin with the historical development of global inequality.

History and presence of global inequality

Global income and wealth inequality between individuals have two components: inequality between countries and regions (for example income differences between Indians and Germans) and inequality within countries (for example differences between rich and p**oor Italians).**[11] Around the year 1500 the major world regions of China, India and Europe were actually equal in terms of their per capita material production. With the rise of colonialism, the "Great Diver**gence"**[12] between these world regions began to unfold and has set the path for centuries of growing global inequality, from colonialism to imperialism to the current divide of the Global North and a **Global South.**[13] Since formal decolonisation, several development agendas have tried to decrease global inequality. And indeed the income inequality between countries started to decline in 1980 - however, as it had been growing continuously between 1820 and 1980, it is now only as low as it was in 1900. Inequality between countries still accounts for up to 80% of global inequality (depending on source) - i.e. the global birthplace explains a more significant part than the class differenc**es within a society.**[14] Furthermore, inequality within countries is at a historic high today. In total, global inequality rose between 1820 and 1910, and stabilised at a high level s**ince then.**[15]

Looking at the last decades and wealth shows a similar picture - most of the growing wealth went to the wealthiest. Since 1995 the poorest half of the population together only captured 2% of the global wealth growth, while the richest 1% captured 38% of the total wealt**h growth.**[16]

[10] Therborn, 2013, p.1

[11] Chancel et al., 2022

[12] Pomerantz, 2000

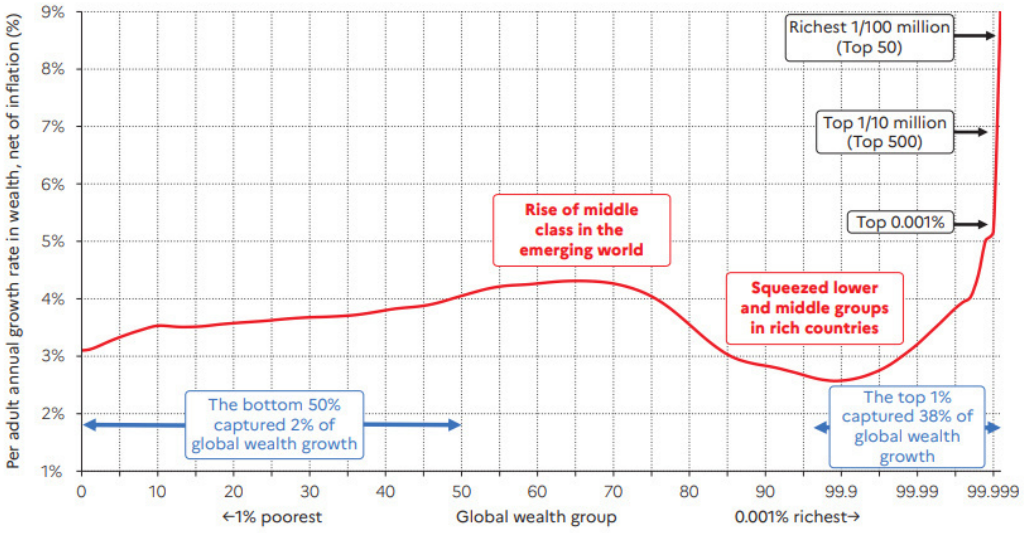
[13] More on the long-run history of global inequality can be found in Hickel, 2017

[14] Fischer, 2019, p. 221

[15] Chancel et al., 2022

[16] Chancel et al., 2022

Figure 9 *Average annual wealth growth rate, 1995-2021*



Interpretation: *Growth rates among the poorest half of the population were between 3% and 4% per year, between 1995 and 2021. Since this group started from very low wealth levels, its absolute levels of growth remained very low. The poorest half of the world population only captured 2.3% of overall wealth growth since 1995. The top 1% benefited from high growth rates (3% to 9% per year). This group captured 38% of total wealth growth between 1995 and 2021. Net household wealth is equal to the sum of financial assets (e.g. equity or bonds) and non-financial assets (e.g. housing or land) owned by individuals, net of their debts.* ***Sources and series:*** *wir2022.wid.world/methodology.*

In 2021 the poorest half of the global population owns only 2% of the total wealth - meaning on average €2,900 per person. In contrast, the richest 10% of the global population own 76% of all wealth, per person on average €550,900. The richest 1% alone owns 38% of all wealth.

Table 4.1 *Global distribution of wealth, 2021*

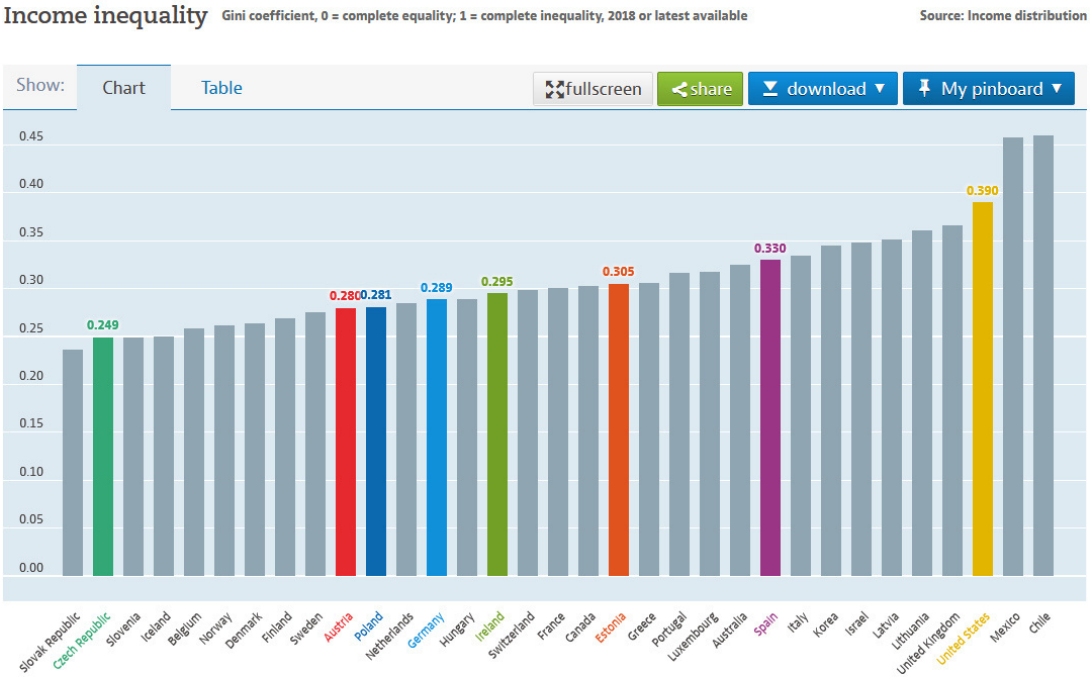
	Share in total wealth (%) (2021)	Avg. Per adult wealth (2021 €)	Threshold (2021)	Avg. annual growth rate (1995-2021)
Full population	100%	72,913		3.2%
Bottom 50%	2.0%	2,908		3.7%
Middle 40%	22.4%	40,919	11,954	3.8%
Top 10%	75.6%	550,920	124,876	3.0%
Top 1%	37.8%	2.8 million	893,338	3.2%
Top 0.1%	19.4%	14.1 million	3.6 million	4.0%
Top 0.01%	11.2%	81.7 million	18.0 million	5.0%
Top 0.001%	6.4%	469.0 million	119.4 million	5.9%
Top 1/1 million	3.5%	2.6 billion	674.7 million	6.9%
Top 1/10 million	1.9%	14.2 billion	3.7 billion	8.1%
Top 1/100 million	1.1%	77.4 billion	20.3 billion	9.3%

Interpretation: *The global top 1% own 38% of total household wealth, and have had an average annual growth rate of 3.2% since 1995. The global average wealth per adult was 72,910€ (at Purchasing Power Parity) in 2021. Net household wealth is equal to the sum of financial assets (e.g. equity or bonds) and non-financial assets (e.g. housing or land) owned by individuals, net of their debts. The top 1/100 million represents 52 persons.* ***Sources and series:*** *wir2022.wid.world/methodology, Bauluz et al. (2021) and updates.*

Income inequality within countries and regions

After having looked at global inequality, let's focus on inequalities within countries and how they evolved. The following graph shows the Gini coefficient for income inequality in OE**CD countries.**[17] The income distribution within countries is very different, with nations like Czech Republic, Iceland and Norway being amongst the most equal ones, and the United Kingdom, the United States and Chile showing very unequal income distributions.

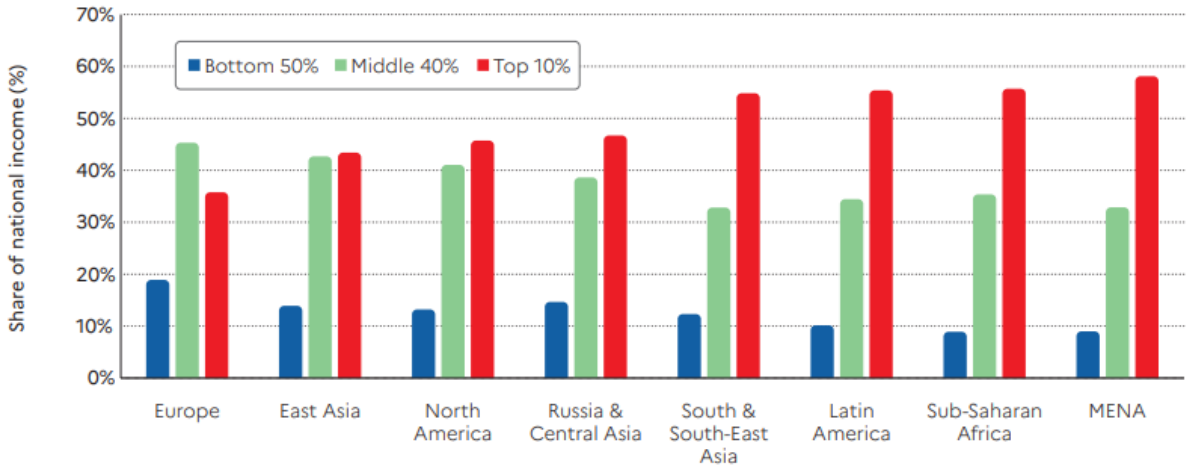
[17] The higher the Gini coefficient, the higher the inequality. It ranges from 0 (complete equality) to 1 (complete inequality).



https://data.oecd.org/inequality/income-inequality.htm

The following figure shows income inequality levels across the regions. Inequality varies significantly between the most equal region (Europe) and the most unequal (Middle East and North Africa i.e. MENA). In Europe, the top 10% income share is around 36%, whereas in MENA it reach**es 58%.**[18]

Figure 2 ***The poorest half lags behind: Bottom 50%, middle 40% and top 10% income shares across the world in 2021***



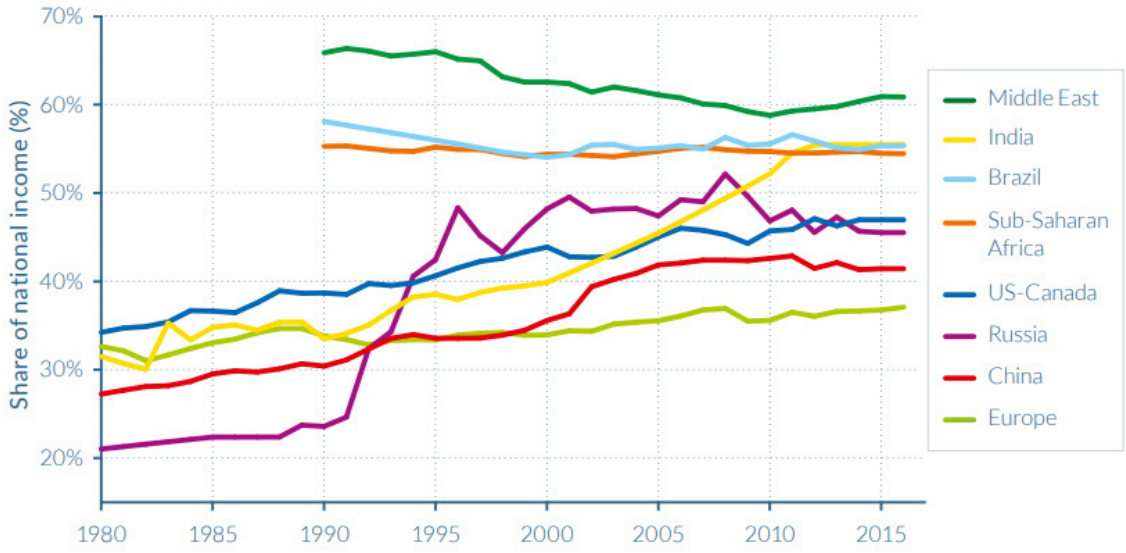
Interpretation: *In Latin America, the top 10% captures 55% of national income, compared to 36% in Europe. Income is measured after pension and unemployment contributions and benefits paid and received by individuals but before income taxes and other transfers.* ***Sources and series:*** *www.wir2022.wid.world/methodology.*

Nearly everywhere income inequality has increased in the last decades, however, at different speeds. This shows that national institutions and policies matter. The following figure shows that in North America, Russia, China and India inequality has grown rapidly, whereas it grew more moderately in

[18] Chancel et al., 2022

Europe. In countries and Regions with extremely high inequality, like Brazil and Sub-Saharan Africa, inequality has remained relatively stable[19].

Top 10% income shares across the world, 1980–2016: Is world inequality moving towards the high-inequality frontier?



Source: WID.world (2017). See wir2018.wid.world for data series and notes.

An important cause of rising income inequality is the changed relation of power between labour and capital in an open world economy. Capital is inherently more mobile than labour, which limits the bargaining power of wage earners: much of financial capital can "migrate" in a fraction of a second, while the mobility of workers is limited by national borders, but also by social factors such as family, friends and possibly a home of one's own. From the 1980s onward global financial flows and trade were deregulated, a shift in policy that was often labelled the “Washington Consensus”. Since then, many unions have lost power and the wage share, i.e., the share of earned income in national income, declined in most industrialised nations, while the share of capital income rose. For fear of locational competition, the average statutory corporate tax rate fell from 49% (1985) to 24% (2018**) worldwide.**[20]

Wealth inequality within countries and regions

Thomas Piketty, a leading economist working on inequality, stresses the importance of wealth in analysing inequality. In his book “Capital in the Twenty-First Century” he explains that capitalism, left to itself, deepens economic inequality, as the rate of return of capital is usually greater than the rate of economic growth which leads to concentration of wealth. Analysing inequality historically as well as in several countries, he concludes that economic inequality has risen over the last decades in Western societies, which in turn has increased social and economic in**stability.**[21]

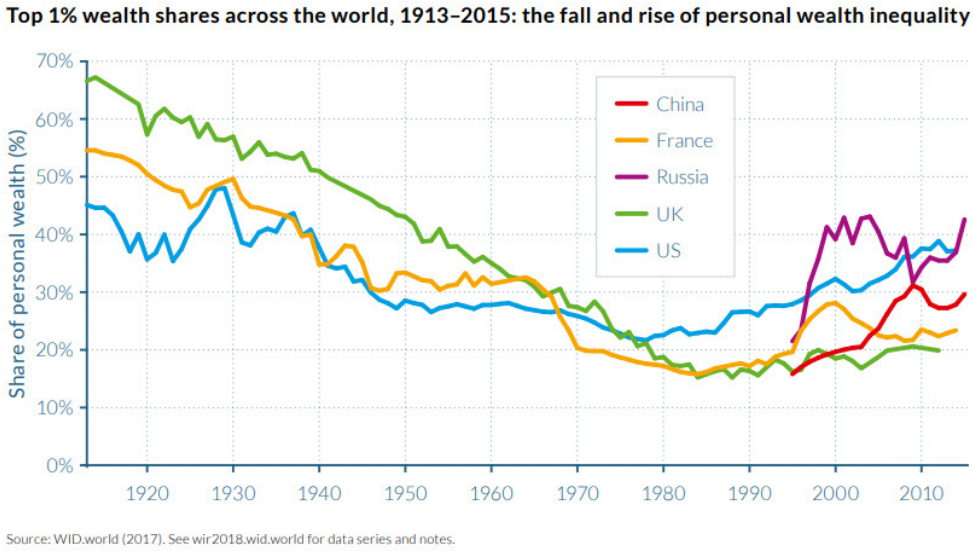
Wealth is in most cases distributed more unequally than income. Before World War I, 10% of the European population owned about 90% of wealth, primarily land and financial assets. These values declined until the 1970s, only to rise again thereafter. In the United States, China and Russia, the rise of wealth inequality in the recent decades has been even more dramatic than in Europe[22].

[19] Alvaredo et al., 2018

[20] Novy et al., 2020

[21] Piketty, 2014 - Find a short video (3 min) introducing his book here and a more in depth introduction (21 min) here.

[22] Alvaredo et al., 2018



Carbon Inequality

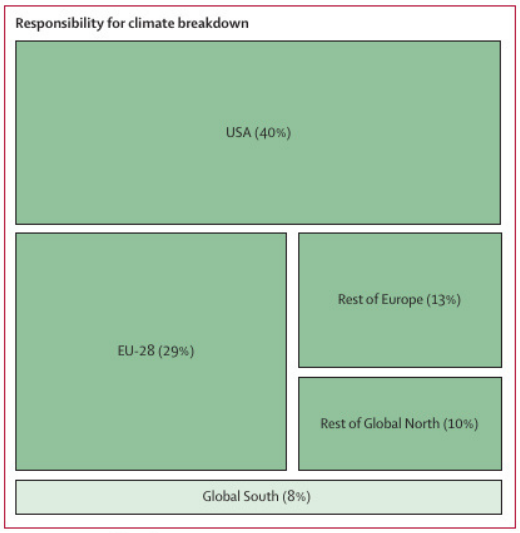


Figure: **Responsibility for excess emissions**
For the purposes of this analysis, the term Global North refers to the USA, Canada, Europe, Israel, Australia, New Zealand, and Japan, whereas the term Global South refers to the rest of the world: Latin America, Africa, the Middle East, and Asia.

The (unequal) growth of wealth and the rise of material living standards over the last 200 years came hand in hand with an exponentially increasing use of biocapacity and particularly greenhouse **gas emissions.**[23] Today we are in the midst of a human-made climate crisis (the concentration of greenhouse gases in the Earth's atmosphere is the highest in the last 800,000 years) and of the sixth great mass extinction (up to a million animal and plant species will be pushed to the brink of extinction within the next few decades by human impact). The unequal responsibility for carbon emissions is an important form of resource inequality: the richer a country or an individual, the higher the use of physical resources that lead to carbon emissions. The Figure shows the cumulative historical responsibility for excess carbon emissions by world regions (i.e the sum of emissions above an equal per capita amount)). 92% is caused by high-income countries of the Global **North.**[24]

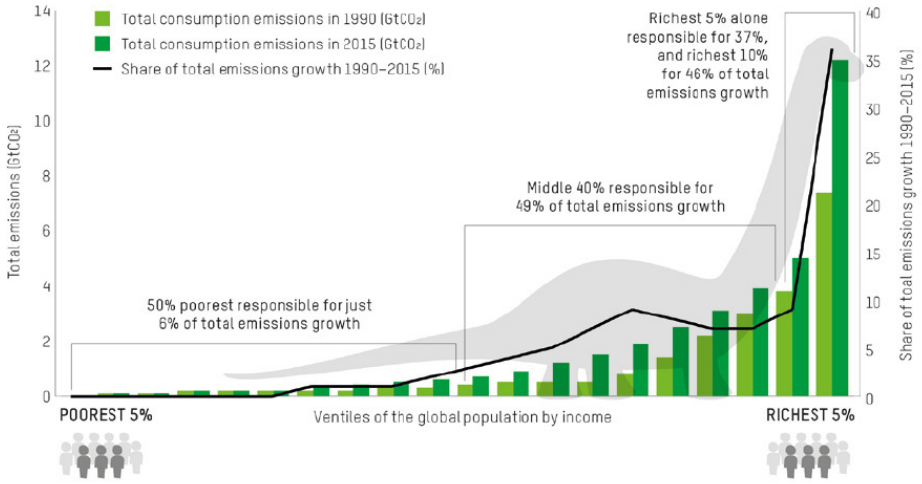
Despite environmental policies, movements and growing public awareness, carbon inequality has increased. The so-called "dinosaur graph" shows the unequal patterns of growing carbon emissions in recent decades. While the 50% poorest are only responsible for 6% of the total carbon emissions growth from 1990-2015, the richest 10% are responsible for 46% of the emissions gr**owth in this period.**[25]

[23] This trend is described as the great acceleration. Along with growing economic output the pressure that human activities have on our planet rose exponentially in the last decades. Now many so-called planetary boundaries are transgressed, for example when it comes to the loss of biodiversity, the climate crisis and the disturbed nitrogen cycle leading to polluted waterways and coastal zones. Carbon inequality is far from being the only environmental inequality. We deal with it as an example.

[24] Hickel, 2020

[25] Oxfam, 2020

Figure 2: The 'dinosaur graph' of unequal carbon emissions growth 1990-2015



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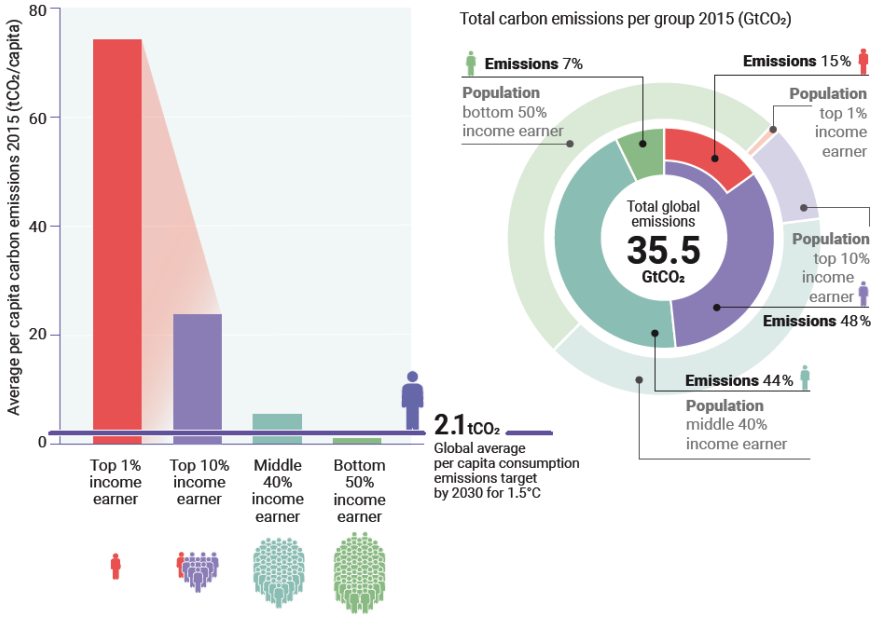
With respect to current carbon emissions, the richest 1% of the world's population emits more than twice the combined share of the poorest 50%. Meeting the Paris Agreement's climate target of 1.5°C requires reducing emissions to a per capita lifestyle footprint of about 2-2.5 tCO2e by 2030, which means that the richest 1% would need to reduce their current per capita emissions by at least a factor of 30 and the richest 10% **by a factor of 10, while the per capita emissions of the poorest 50% could still increase on average by a factor of three[27].** To put it in a nutshell, inequality of income, wealth and carbon emissions are related and the climate crisis is essentially a crisis of inequality.

Figure ES.8. Per capita and absolute CO_2 consumption emissions by four global income groups for 2015



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26 Oxfam, 2020

27 United Nations Environment Programme, 2020

28 United Nations Environment Programme, 2020

Vital inequality

Vital inequalities mean inequalities in health status and life expectancy. Over the 200 years of capitalism, based on fossil-fuel extraction, life expectancy has soared to levels, inimaginable in former societies. Poor people today live longer than kings and noblemen in earlier societies. However, while today a child being born in Hong Kong can expect to live 84.9 years, a child being born in Nigeria can only expect to live 54.7 years.[29] Life expectancy does, however, not only differ greatly among different countries, but also within different socio-economic groups within countries[30]. Resource inequality has a strong influence on vital inequalities, income can however not fully explain them. For example, life expectancy in Costa Rica is about 1.5 years longer than in the much richer USA[31]. As Wilkinson and Pickett show, many indicators connected to vital inequality, like obesity, mental health and child mortality, are better in more equal societies. When looking at the parts of the world most negatively affected by the unfolding climate crisis, we see that carbon (and other environmental) inequalities are social inequalities not only on the side of responsibility but also on the side of suffering vital consequences.[32] Furthermore, the recent Corona pandemic has revealed many examples of vital inequalities which can be used for a more in depth discussion.

Existential inequality

Existential inequality refers to forms of stigmatisation and discrimination. Racism, sexism, ableism or ageism (among others) describe systemic patterns of inequality based on ascribed group memberships, that are also effective as resource and vital inequality (i.e. women earn less, contribute less to and suffer more from the climate crisis). The concept of intersectionality highlights how these systemic patterns for different social groups are always connected and lead to multiple oppressions and privileges for certain groups of people at once. Although progress has been made in many countries over the last decades in anti-discrimination legislation, it remains a cause of profound inequalities. To fully understand the social reality of inequality, we need to look at existential inequality. People are facing discrimination and stigmatisation in everyday interaction with institutions and individuals, which oppress their capability for self-determination and social participation. Despite formally forbidden, structural discrimination persists in culture and institutions like housing or labor markets.

Drivers of inequality

Socioeconomic analysis insists that resource, vital and existential inequalities must not be reduced to individual characteristics, but that they are created and driven by social institutions[33] and caused by power relations. On a global scale, we have already described how neoliberal globalisation has profoundly shifted power relations and led to a diminishing share of labour income and rising inequality between different types of jobs. Another shift of power balance has taken place between private and public institutions through privatisation of public assets, reducing the possibilities to counter inequality through public programs[34]. Whereas net private wealth increased sharply, net public wealth is now close to zero or even negative in most OECD countries.

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29 Human Development Report Office, 2020

30 Mosquera et al., 2018

31 Human Development Report Office, 2020

32 This video depicts the unequal global responsibility for and suffering from the climate crisis: The carbon map

33 Institutions are an often misunderstood term, in common language associated with "organisations". Here, we use institutions more broadly as "...systems of established and embedded social rules that structure social interactions". Hodgson, 2006, p.18

34 Alvaredo et al., 2018

Zooming closer into the drivers of inequality within a society, many studies have documented that inequality is inherited over generations in families, reinforcing class differences. This is most pronounced with respect to economic resources but also plays out in more subtle ways by socialisation in the educational system and the social networks of everyday life, leading to unequal social and cultural resources (or "capital" in the terminology of French sociologist **Pierre Bourdieu[35]).** One can think of multiple vicious circles between unequal means and unequal outcomes: between lack of income and health status, available time and education or between education and political influence. That said, a socioeconomic perspective of inequality does not only look at "traditional" economic institutions such as tax and labour market regulations but also takes into account fields of education, housing or health systems as drivers of inequality.

What can be done about inequality?

As we have seen, inequality exists both on a global scale and within countries. There is a wide range of policies to combat inequality, focusing on different forms of inequality. The following table shows an overview of inequality policies put together by Olivier Blanchard and Dani Rodrik. They cluster different policies looking at the stages of the economy targeted (column headings) and distinguishing according to the bottom, middle or top of the distribution. For example, at the pre-production stage policies influence the endowments with which people enter the workforce, such as health, education and financial access policies. Amongst other policies, minimum wages, trade agreements, place-based policies intervene at the production stage. The post-production stage is all about redistributing income and wealth, for example through social transfers, progressive income taxation and we**alth taxation.[36]**

Table 1 Taxonomy of policies affecting inequality

		At what stage of the economy does policy intervene?		
		Pre-production	**Production**	**Post-production**
What kind of inequality do we care about?	**Bottom**	Endowment policies (healthcare, education); universal basic income	Minimum wage; job guarantees	Social transfers (e.g., earned income tax credit); full-employment macro policies
	Middle	Public spending on higher education	"Good jobs" policies; industrial relations and labor laws; sectoral wage boards; trade agreements; innovation policies	Safety nets; social insurance policies
	Top	Inheritance/estate taxes	Regulations; antitrust laws	Wealth taxes

[37]

The following overview of different measures to deal with inequality can be used as a printout for the exercise "Measures to tackle inequality in times of climate change".

[35] Bourdieu, 1987

[36] For more information on different policies see: https://www.piie.com/commentary/speeches-papers/we-have-tools-reverse-rise-inequality

[37] Blanchard and Rodrik, 2019

A **minimum wage** is the minimum amount of remuneration that an employer is required to pay wage earners for the work performed during a given period.	**Publicly funded healthcare** is a form of health care financing designed to meet the cost of all or most healthcare needs from a publicly managed fund. It ensures that either everyone or everyone insured gets the health treatments they need.
Free public transport refers to public transport funded in full by means other than by collecting fares from passengers. In 2020 Luxembourg became the first country in the world to make all public transport in the country (buses, trams, and trains) free to use.	**Unemployment benefits** are payments made by authorised bodies to unemployed people. The benefits are often funded by a compulsory government insurance system. Depending on the jurisdiction and the status of the person, those sums may be small, covering only basic needs, or may compensate the lost time proportionally to the previous earned salary.
A **wealth tax** is a tax on an entity's holdings of assets. This includes for example cash, bank deposits, real estate, assets in insurance and pension plans, ownership of businesses and financial securities. Typically, liabilities (primarily mortgages and other loans) are deducted from an individual's wealth, hence it is sometimes called a **net wealth tax**. Wealth taxes are in use in many countries around the world and seek to reduce the accumulation of wealth by individuals.	**Free public higher education** is higher education funded through government spending rather than tuition funding. Many countries provide free higher education for all its citizens or in the EU for all EU citizens, some also for international students.
The current supranational market order promotes global tax competition, which leads to falling corporate taxes. For example, the average statutory corporate tax rate worldwide fell from 49% (1985) to 24% (2018) for fear of relocation. 40% of the profits of transnational corporations are shifted to low-tax countries and tax havens every year. An international **minimum corporate tax rate** is a proposal to reduce tax competition between countries and the avoidance of corporate taxes. In 2021, 130 countries backed an OECD plan to set a global minimum corporate tax rate of 15 per cent. It is a worldwide effort to keep multinational firms from dodging taxes by shifting their profits to countries with low rates.[38]	**Free child care** is funded through government spending rather than directly by the parents themselves.
A **frequent flyer levy** aims at limiting aviation emissions while ensuring a more progressive distribution of flights. The levy applies a charge, starting at zero for the first flight, but increasing for every subsequent flight taken within a year.	**Debt cancellation** is a legal measure to cut outstanding loan payments. Legally, a debt cancellation *"...occurs when there is an agreement between the debtor and the creditor that an outstanding debt no longer needs to be*

[38] The Associated Press, 2021

	repaid."[39] Such a cancellation was recently demanded in the context of the covid-pandemic by several countries of the Global South who are significantly indebted in the North.[40] Debt cancellation can also concern private households and specific indebted groups (e.g. students).

The following chapter focuses on approaches to reducing inequality on a (sub-)national level in different welfare regimes and thereby puts a spotlight on the Global North.

How traditional welfare regimes deal with inequality

One answer to reducing inequalities are welfa**re regimes**[41]. Esping-Andersen distinguishes three ideal types of welfare regimes in the Global North: a **liberal, conservative and social democratic** welfare reg**ime.**[42] These offer different types and degrees of protection against social risks as they prevent the commodification of various social functions such as work, old-age provision, education, housing, health and care. They differ in the degree to which certain public services are considered social rights and therefore should not depend on ability to pay. The **liberal welfare regime** dominates in Anglo-Saxon countries such as the US, UK and Australia. It is a regime focusing on those who cannot take care of themselves financially in the market economy: The sick, people with special needs, the elderly, the unemployed. It is explicitly not a welfare state for all, but only for the ones in need. In market societies, people are responsible for themselves and are paid according to their market performance. This "residual" welfare state tries to prevent those who are capable of working from wrongfully claiming social benefits, leading to high bureaucratic costs and stigmatisation. The middle classes in these countries typically make an effort to remain independent from welfare benefits. Therefore, private solutions such as private schools, private pensions and private health insurance for the middle class and high earners emerge. The **conservative welfare regime** dominates in continental Europe in countries such as Germany, Austria and France. Historically, its origins go back to collective insurances that arose in occupational groups where certain risks were shared (i.e. miners are regular victims of mining accidents, farms are victims of extreme weather events). In conservative welfare regimes, access to a large part of the social security benefits is typically linked to participation in the labour market or citizenship, or both. This creates a welfare state that functions according to insurance principles: Insured people are "insiders", non-insured are "outsiders". The latter include migrants and many women. The **social democratic welfare regime** dominates in Scandinavia (Sweden, Denmark, Norway and Finland). It guarantees universal social rights and strives to provide well-developed public social infrastructures, education, health, care and decent quality housing for all. This leads to a (partial) de-commodification of these services, i.e. school attendance is not a commodity that has to be paid for; communal and social housing are publicly supported. Basic principles of this model are a policy of full employment (all people have a right to work) and the entitlement to access services and infrastructures of good quality for all residents (including those with higher incomes).

[39] https://stats.oecd.org/glossary/detail.asp?ID=551

[40] https://jubileedebt.org.uk/a-debt-jubilee-to-tackle-the-covid-19-health-and-economic-crisis-2

[41] Esping-Andersen, 1990. The described regimes are models describing ideal types. In various countries the welfare approaches have changed considerably, e.g. several scandinavian countries have taken more liberal policies lately. Nevertheless, the typology is still helpful to distinguish different pathways and underlying worldviews of welfare policies of different states and their link to inequality.

[42] This chapter is based on Novy et al., 2020.

The following table summarises the characteristics of the three welfare regime types:

	Liberal welfare regime	**Conservative welfare regime**	**Social democratic welfare regimes**
Countries	Anglo-Saxon countries	Continental European countries	Scandinavian countries
Understanding of the welfare state	Welfare state only for deserving poor; a good quality of social services is offered privately	Social benefits tied to participation in the labour market and/or citizenship	Welfare state provides good quality public services "for all"
Commodification	Markets for retirement provision, care, education, housing and health	Decommodification of social services for "insider"	Decommodification of social services for "all"

The different welfare regimes have different effects on inequality and related indicators of societal well-being. Exercise 2.1 allows participants to explore the social performance of countries with different welfare regimes.

Tackling inequality in times of climate crisis

Chapter one showed that resource, vital and existential inequalities are closely linked with carbon emissions. In other words: Inequality is a social and an *ecological* issue. While traditional welfare state types have (in all their differences) focused on social issues, 21st century welfare states need to provide new answers that integrate equality with carbon budgets. So far, the social achievements of welfare regimes were built on the use of an unsustainable share of global biocapacity, at the cost of other world regions and future generations. Tackling inequality in times of climate crisis means that equality needs to be achieved without transgressing the planet's limits when it comes to carbon sequestration. To limit global warming to 1.5 degrees (Paris Agreement), greenhouse gas emissions have to be reduced by 45% by 2030 (compared to 2010) and have to be net-zero by 2050. How the remaining carbon budget is used is a question of equality. There are scientific models arguing that the earth can sustain resources sufficient to meet the needs of 10 billion people if inequality were reduced drastically.[43] Should the super rich be allowed to continue to jet around the world? Should people living in poverty and deprivation be allowed to expand their currently very low share of emissions? And how could good living standards be mainstreamed for low-income households in Europe while simultaneously reducing their emissions?

To tackle the climate crisis, emitting carbon will become more expensive. Simply taxing resources, however, likely has regressive social effects, as it places a particularly heavy burden on the household budgets of low-income earners. Therefore, social-ecological welfare states require some kind of redistributive relief measure, such as an annual compensation payment for the lower income groups.[44] This shows: tackling inequality within a country and global carbon inequality are connected.

[43] Millward-Hopkins et al., 2020

[44] Another way to avoid regressive effects is to implement progressive eco-taxes where basic consumption is taxed less than excess consumption (i.e. a frequent flyer levy).

While monetary measures like a progressive income taxation, unemployment benefits or different forms of subsidies are important for a socio-ecological welfare state, they are not sufficient to address inequality, because they mainly look at the individual and her income. In times of climate crisis a profound change of perspective regarding equality is needed: what kind of infrastructures and institutions (that provide the context for people's everyday lives) would enable everyone to meet their needs with low resource consumption? Sustainably provided public transport and affordable access to sustainable energy, water, housing, health, care and education help to limit the importance of money and consumption in meeting needs. Such social-ecological infrastructures encompass much of what individuals cannot afford with money: From greenery in the street and libraries to public swimming pools.

Approaching the social-ecological welfare state through infrastructures has certain advantages over social policy measures solely based on cash benefits (which can effectively alleviate existential need and strengthen individual self-determination). Affordable socio-ecological infrastructures can provide security, offer space for individual lifestyles, strengthen social cohesion and create resource-saving structures. In the 21st century equality means that an ecological way of living is neither a privilege nor a sign of having too little, but simply becomes a routine, a new normal. For example, if local supply functions, everyday life can be organised without car ownership - as it is already possible today in densely built-up neighbourhoods. On the outskirts and in rural areas, public investment in socio-ecological infrastructures is still needed to enable new everyday practices: If there are convenient rail connections for commuters, car commuting can be dispensed and new routines can emerge that have a sustainable impact. Ultimately, it is a question of democratic deliberation what social protection floor should be provided for everyone in the light of a finite carbon budget. However, the data clearly shows that reducing inequality is indispensable if all people should have enough resources to be able to live a good life in times of climate goals.

Glossary

Carbon Inequality describes the unequal responsibility for causing the climate crisis, by comparing contributions of Greenhouse Gas (GHG) emissions of different individuals, classes, social groups or countries, at one point or accumulated over time.

(Social) Class "refers to divisions in society based on economic and social status. People in the same social class typically share a similar level of wealth, educational achievement, type of job and income."[45]

Existential Inequality is "the unequal allocation of personhood, i.e., of autonomy, dignity, degrees of freedom, and of rights to respect and self-development.[46]" It refers to everday reproduction of discrimination and stigmatisation like racism, sexism or ableism (among others) that oppress the above mentioned capabilities based on ascribed group memberships.

Global South and North are two terms to describe relative positions of power in a global economic system. It is a political-economic term that highlights the historical legacy of dominance and advantage of colonising countries over (formerly) colonised countries, and must not be understood as geographical (i.e. Australia as a country of the southern hemisphere is part of the Global North).

Intersectionality describes complex patterns of discrimination and privileges for an individual or a group resulting from their interconnected social group memberships such as gender, race, class, age or ability (referring to the image of an intersection). For example, a wealthy woman of color faces discrimination as a woman and as a person of color and is confronted with specific patterns of oppression targeting women of color. At the same time, the person can receive privileges from her class position in economic terms. The term was introduced by law scholar Kimberlé Crenshaw in the 80s.

Resource Inequality means **"**providing human actors with unequal resources to act."[47] It describes unequal distribution of monetary (income and wealth), physical and socio-cultural resources.

Vital Inequalities are "unequal life-chances of human organisms. This is being studied by assessing mortality rates, life expectancy, health expectancy (expected years of life without serious illness), and several other indicators of child health, like birth weight and body growth by a certain age."[48]

[45] Thompson, 2016 https://revisesociology.com/2016/08/04/social-class-definition-introduction/

[46] Therborn, 2013, p. 49

[47] Therborn, 2013, p. 49

[48] Therborn, 2013, p. 49

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3. Training Material

Activity 1: What is inequality?

Inequality Speed Dating

Activity title	**Inequality Speed Dating**
Overview	Participants discuss the connection of different topics with inequality
Objectives	To get in contact with one another and gain insights into the breadth of the topic
Materials	Watch or phone to stop the time
Time	10 - 20 minutes
Group size	Works for all group sizes
Instructions for trainers	1. Ask everyone to walk around in the room and to stop and pair up whenever they hear a signal (e.g. a phone alarm). 2. Give the pairs two minutes time to first quickly introduce themselves to each other and then discuss how the word you name them is connected to inequality. Words from which you can choose are: self-esteem, diversity, child-wellbeing, drug abuse, education, climate change, imprisonment, mental health, obesity, physical health, and teenage births. Tell them that each person should have one minute of speaking time and you will give them a signal as soon as one minute is over. 3. After 2 minutes signal the end of this round and then repeat further rounds, in total between 3 and 5 times.
Debriefing and evaluation	Let the participants know that the topics will be dealt with in more detail later in the workshop.
Tips for trainers	You can play music for participants to move as they like between the pair's discussions.

Corridor of Equality

Activity title	**Corridor of Equality**
Overview	The participants discuss a corridor of what everyone needs for a good life and what are maximum acceptable limits to inequality.
Objectives	• To reflect on what would be an acceptable "corridor of equality" • To reflect on links between inequality, deprivation and wealth
Materials	-
Time	45 min
Group size	5-25 participants
Instructions for trainers	<u>Discussing a corridor of equality</u> The group is split in two with different tasks (25 min) Group A: (Minimum floor) - Discuss: What does everyone need for a good life? What is not measurable in money? How are the minimum requirements linked to upper limits? Group B: (Maximum ceiling) - Discuss: When does material and immaterial wealth start to become a democratic, ecological or social problem? Can you agree on a threshold? If not, what are the criteria?
Debriefing and evaluation	<u>Plenary:</u> (20 min) The groups present their perspectives. Debriefing discussion: - How are the minimum floor and maximum ceiling linked? - What is the role of power and democracy in this?
Tips for trainers	Above group size of 12, one can have 2 groups for each task. There is no "right" solution for what is an acceptable corridor of equality. The goal is to open up the thoughts about the links of minimum and maximum rights and therefore it is crucial to keep the focus on the principles that come up in the discussion.

Estimating one's position in the income distribution and carbon footprint

Activity title	**Estimating one's position in the income distribution and carbon footprint**
Overview	Participants use two online tools to estimate their position in the income distribution and their carbon footprint. As a follow up, they discuss their learnings and what links both outcomes.
Objectives	● To get an understanding where oneself is located in the income contribution in one's country, in Europe and in the world ● To get an understanding of one's carbon emissions and reduction potentials ● To understand how income and carbon emissions are connected
Materials	Laptops or Smartphones
Time	30 minutes
Group size	Works for all group sizes
Instructions for trainers	1. Ask the participants to open https://wid.world/simulator/ and estimate with this tool where in the income distribution they are situated compared to people of their country, Europe and the world. 2. Ask the participants to open https://you.climatepartner.com/en/carbon-calculator/choose-footprint and calculate their carbon footprint.
Debriefing and evaluation	Ask participants to share with the group what surprised them and what they have learnt. Following, ask them where they see the connection between income inequality and carbon inequality. For the debriefing of the exercise read chapter 1.3 "Resource Inequality".

Conscious Inequality Walk

Activity title	**Conscious Inequality Walk**
Overview	Participants go out of the workshop room/their home to perceive and reflect about how inequality shows up in their surroundings
Objectives	• To sharpen one's view on visible and invisible inequalities through conscious exploration and open discussion
Materials	Pens and papers
Time	45-60 minutes
Group size	Works for all group sizes
Instructions for trainers	1. Ask the participants to individually (or in pairs) take a conscious walk to reflect about inequality in their immediate surroundings. Choose 3-4 of the following questions to guide them through their reflection and ask them to note them down: - Where can you perceive inequality? - For whom is the environment you perceive built? - Who is missing, for whom is it hard to be there? - Which role does money play? - Where can you spot carbon inequality? - Who might have decided and designed what the place looks like? - Where around you could be inequality which you do not see? 2. Give them (at least) 20 minutes time for their individual walk and reflection and tell them by when they should be back in the room. 3. Either in the plenary or in small groups ask participants to share "Aha moments" which they had during their walk and discuss (20-30 minutes).
Debriefing and evaluation	For the debriefing read chapter 1.6 "Drivers of inequality". Some optional ideas for in-depth conversations: - What does an observer's perception tell about him/herself? About her understanding of inequality? - Why did some people not recognise inequalities where others did? - Bring in additional ideas concerning inequalities that might not be visible in our surroundings or that we might not perceive.
Tips for trainers	A popular activity that uses the physical space to learn about privileges and inequalities is the so-called "privilege walk". One version can be found below. The method needs to be used with caution and shouldn't be applied in all contexts, as it can be triggering for people facing forms of discrimination https://peacelearner.org/2016/03/14/privilege-walk-lesson-plan/

Activity 2: What can be done about inequality?

Inequality - so what? Analyzing societal well-being

Activity title	**Inequality - so what? Analyzing societal well-being**
Overview	Participants analyse the relationship of societal well-being and inequality in small groups.
Objectives	• To understand how welfare regimes are connected to inequality and different indicators of societal well-being
Materials	Printouts of graphics showing different effects of inequality
Time	25 - 35 minutes
Group size	Works for all group sizes
Instructions for trainers	1. Ask the participants to build small groups of 3 to 4 people and let each group pick one or two out of the following topics: Child-wellbeing, drug abuse, education, imprisonment, mental health, obesity, physical health, teenage births. 2. Ask the group to analyse the figures and describe how three groups of countries are located? (Which country group shows the highest and which the lowest level of inequality? How do the country groups score on the indicator of the graph?) The country groups are as follows: Countries A: Sweden, Denmark, Norway, Finland; Countries B: Germany, Austria, France; Countries C: USA, UK, Australia. 3. Go around during the working time to assist the groups in case they have questions 4. Ask several groups to present the outcome of their analysis to the whole group and visualise the results for country groups A, B and C on a board. 5. Afterwards, ask about the common denominator of the countries within one group.
Debriefing and evaluation	For debriefing the exercise read chapter 2.1 “How traditional welfare regimes deal with inequality”. Tell the participants that the country groups were formed according to their welfare regimes. Introduce the welfare regimes and conclude by emphasising that different welfare regimes lead to different levels of inequality, which come along with the different societal well-being effects that were analysed.
Tips for trainers	Connects well with the Inequality Speed-Dating exercise. Alternatively to working with printouts participants can also work with the graphics online: https://www.equalitytrust.org.uk/resources/the-spirit-level *Challenges that might occur:* If participants are not used to interpreting graphs that might be challenging for them. If you think this is the case for several participants of the group, first introduce them to it by analyzing one graph for the whole group. Otherwise, go through the room and answer questions/help where needed.

Tackling Inequality in times of Climate Crisis

Activity title	**Tackling Inequality in times of Climate Crisis**
Overview	Participants discuss consequences of different measures on inequality in times of climate crisis.
Objectives	• Participants understand that different measures represent different approaches to inequality. • Participants get a feeling of the multiplicity of social and environmental outcomes that might result from different measures. • Participants gain an insight into how well different inequality measures are suited to reduce inequality *without* overusing the biocapacity.
Materials	Cards with measures and short explanations (cut them in rows as each group is supposed to analyse two measures (one row)) Make sure to not cut measures into two due to page breaks!
Time	80 min
Group size	12-25 participants
Instructions for trainers	<u>Introduction (5 min)</u> Introduce, using chapter 2.2. "Tackling inequality in times of climate crisis", three different categories of approaches to combat inequality: -> **Taxes or levies** are a form of revenue for the government which can be used to redistribute resources as well as to make social 'bads' more expensive. -> **Cash benefits** like unemployment benefits or different forms of subsidies mainly look at the individual and her income and can effectively alleviate existential need and strengthen individual self-determination. -> **Social-ecological infrastructures** enable people to meet their needs with low resource consumption. <u>Group phase (45 min)</u> Each group chooses one of the five measure pairs. They write the two measures on a flipchart and analyse them in four sequences of brainstorming using different colors. Instruct them to think of all possible answers when brainstorming questions b to d. a) Which of the three categories (taxes/levies, cash benefits, socio-ecological infrastructure) do the measures belong to? (3 min) b) How could the proposed measure affect inequality? (red color) (15 min) c) What could be its impacts on the climate? (green color) (15 min) d) How effective is the measure in tackling both: inequality and carbon emissions? (black color) (15 min)
Debriefing and evaluation	<u>Plenary harvesting: (30 min)</u> Each group has 5 minutes to present the results. They should thereby focus on the key learnings (20 min). Afterwards the whole group discusses which they think is/are the most effective measure/s in social-ecological terms. (10 min).
Tips for trainers	<u>*Challenges that might occur:*</u> If groups are overwhelmed by the task, help them in their brainstorming to come to new ideas.

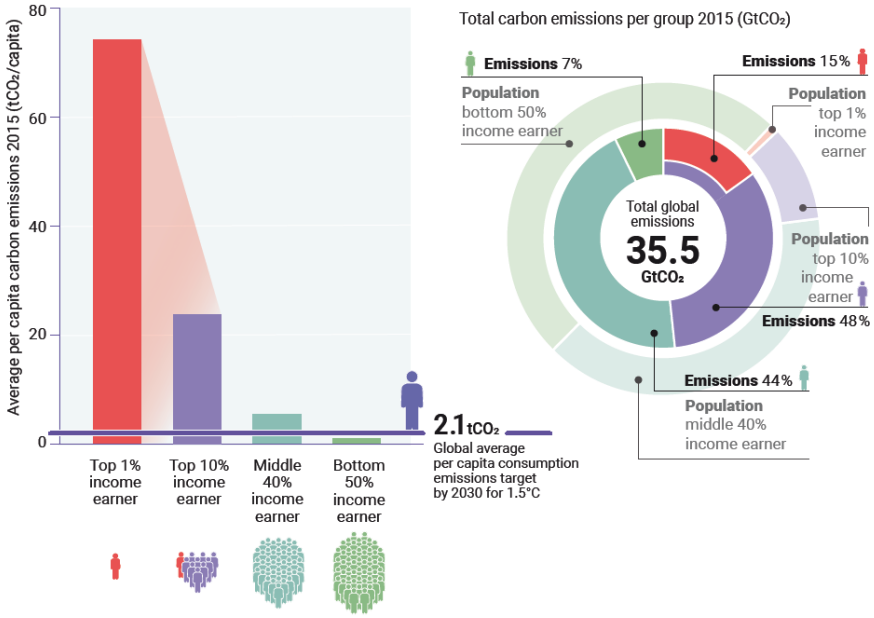
4. Interactive learning

Activity 1: Estimating one's position in the income distribution and carbon footprint

Activity title	**Estimating one's position in the income distribution and carbon footprint**
Objectives	● To get an understanding of where oneself is located in the income contribution in one's country, in Europe and in the world ● To get an understanding of one's carbon emissions and reduction potentials ● To understand how income and carbon emissions are connected
Time	30 minutes
Instructions	1. Open https://wid.world/simulator/ and estimate with this tool where in the income distribution you are situated compared to people of your country, Europe and the world. 2. Afterwards, open https://you.climatepartner.com/en/carbon-calculator/choose-footprint and calculate your carbon footprint.
Debriefing	Questions for reflection: What surprised you? What have you learnt? What do you think is the connection between income inequality and carbon inequality? Button: Want to know more? (Leads to the information below) **Incomes and emissions are strongly linked** In 2020, the richest 1% of the world's population emitted more than twice the combined share of the poorest 50%. Meeting the Paris Agreement's climate target of 1.5°C requires reducing emissions to a per capita lifestyle footprint of about 2-2.5 tCO2e by 2030, which means that the richest 1% would need to reduce their current per capita emissions by at least a factor of 30 and the richest 10% by a factor of 10, while the per capita emissions

of the poorest 50 % could still increase on average by a factor of three[49].

Figure ES.8. Per capita and absolute CO_2 consumption emissions by four global income groups for 2015



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[49] United Nations Environment Programme, 2020

[50] United Nations Environment Programme, 2020

Activity 2: #ShowInequality

Activity title	**#ShowInequality**
Objectives	● To sharpen one's view on visible and invisible inequalities through exploration of one's surroundings and to take a deliberate step to making them heard.
Time	30 minutes
Instructions	Participants are invited to explore and demonstrate inequality in their environment by taking a walk, taking pictures and posting them on social media. They are encouraged to link relevant institutions, community members or individual decision makers to learn voicing their own concerns. Impulse questions are the following: - Where can you perceive inequality? - For whom is the environment you perceive built? - Who is missing, for whom is it hard to be there? - Which role does money play? - Who might have decided and designed what the place looks like? - Where around you could be inequality which you do not see? Participants can use some of the following hashtags and create their own: **#ShowInequality #NotMyEquality #Unequal #InequalityIsReal**

Creative commons advice

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FRESH-UP ECONOMICS

Economic schools of thought: Labour perspectives

by Team itd

Table of contents

1. Overview

What are the different schools of economic thought?

Schools of economic thought, or simply economic schools, are groups of ideas that indicate how the economy works or it is supposed to work. The different schools (we are not talking about schools in the sense of colleges, institutes or universities but as lines of approach) have usually been named after the most prominent ideologist(s) that shaped its foundations and have later on added both supporters and detractors.

Since the origin of economics, many different kinds of economic schools have arisen. Undoubtedly, economic schools are continually changing and evolving. However, the main economic schools are commonly listed as: *Mercantilist school, Physiocracy, Classical school, Neoclassical school, Marxism, Austrian school, Keynesianism, Monetarism, Institutional Economics, Neoliberalism.*

In addition to these economic schools, there are many others of smaller size in terms of supporters and reach. At the same time, some schools have had offspring. Parallel schools have been developed on the foundations of previous ones with variations in some aspects, as Marxism builds on the Classical School as we shall see.

Which economics school is better?

While it is true that some economic schools have become outdated or incomplete over time, there are no better or worse economic schools. Ultimately, the affinity with an economic school depends fundamentally on the ideas of the author. An economist is not better or worse because he belongs to a particular school of economics. Some schools emphasise institutions, some on monetary or fiscal policy, some on growth, inequality, and so on. Some schools clearly have an ideological component. That is, they prefer one type of society to another. The most important thing, always, is to encourage debate between currents of thought in an argued and grounded way.

How does this article approach the study of schools of economics?

The main goal of this article is to present those theories that survived over time and that can inform us about current developments and economic policies. Thus, one cannot write on the issue of economic thought without focusing on the major economists of the past, that is, Adam Smith, David Ricardo, Karl Marx, and J.M. Keynes. The aim is to explore some general lines of their theories with special focus on the ideas regarding labour as the central axis to conduct the analysis. Based on these principal proponents the article also touches upon the neoclassic, monetarists, institutionalists and new schools of economic thought.

Pedagogically speaking it is much more interesting, and at the same time a deeper understanding of schools is expected to be achieved following a logical–historical approach. This means that each school is presented in the historical context of its emergence and analysed according to a logical rather than ideological criteria.

Why do we focus on labour?

Labour is one of the most important subjects discussed in economic theories. No less important, income from employment is the major source of individual income since the industrial revolution.

However, labour markets have been changing over the past decades. The rise in inclusion of women in the work-force has increased in unprecedented numbers, new technology has changed as well as income distribution, and labour conditions seem to be moving towards more insecurity, precarity and poor conditions of employment. In order to understand today´s labour dynamics our approach takes a historical perspective that helps us understand the evolution of the concept of labour and its value, starting precisely with the first men that put the discussion on the table.

Why is it important to study the (old) schools of economic thought?

While present economic theories are the ones that govern the current economic system and therefore our lives, these theories did not appear out of the blue. In general, new economic theories appeared as a product of the elaboration of existing theories, or as a better answer to the persistent failures of a previous theory, that may just simply become outdated. The thing is, economic theory has no other 'testing terrain' rather than reality to prove its points. Therefore, in the economic field there is no better way to understand the present than to look at the past, in order to see current economic affairs in a fuller and more precise manner, while also enabling us to confront the reality of the future in a more prepared way. Ultimately, this not only stimulates one's interest to explore further the subject and its historical development, but also provides the reader with the necessary background to deal with more advanced current developments in economics.

First quick game: find out who these guys are?

KEYWORDS

Invisible hand

Use value

Exchange value

Abstract human labour

Socially necessary labour time

Surplus value

Utility

Marginal utility

Monetary illusion

Aggregate demand

2. Background information

Introduction

Origins of economic theory

The origin of Economics as a science is linked to the development of a new form of social organisation, capitalism, a system that solves the organisation of production and distribution through the expanded functioning of the markets. Markets are therefore the epicentre of capitalism as they encompass the operation of the entire economy.

Capitalism was established through a long and slow process that started in Western Europe in the 16th century and gained momentum with the advent of the industrial revolution in the mid to late 18th century. This is not to say that the capitalist regime would have replaced feudalism because a group of "inspired" individuals found the key to invent the automatic loom, the steam engine, and the smelting of iron. On the contrary, it was the junction of three novel phenomena: the universalization of exchange, a more pronounced division of labour, and the appearance of numerous and substantial technical advances that let capitalism begin to dominate. This was the argument of Adam Smith in his book the Wealth of Nations (1776), where he established the bases of the economic theoretical system for which he is known as the father of modern economy.

In fact, it is the first of these three concurrent elements, exchange, that according to Smith is the central (natural) element present in the human DNA and becomes the engine that drives the entire process of social transformation; the other two appear as a consequence of its deepening. Considering exchange in the market as the main axis of economic activity, it became necessary to discover the source that determined the proportions of exchange and the circumstances that could provoke the apparently erratic evolution of the prices of goods. The answer was found in a fundamental concept, *value*, whose origin and measure, according to Smith, was in labour:

"Labour, therefore, is the real measure of the exchange value of all kinds of goods" (Smith, 1958, p. 31).

The differences in the consideration of labour as a source of value, even in the readings of Smith or Ricardo and of course in that of Marx, all labelled under 'the classics', is the axis around which this paper organises its analysis of the schools of economic thought. If capitalism's central virtue is to transform all productive resources into goods, those resources, such as capital, land and labour appeared, as well, organised in markets for the factors of production. This implied that labour, under the new wage-earning regime, was also transformed into a commodity. Thus, it was natural that questions about labour's value and price, its use and the conditions under which better it could contribute to the creation of wealth as well as how to distribute it, began to appear. All these issues were not easy to conciliate, especially for the blossoming economic science that developed in a context of a new type of social conflict characterised both by its potential and by involving social classes objectively defined by their position in the production process.

The analysis of labour as an entry point in the different schools of economic thought is presented as subsumed in that of the general historical contexts and conditions in which the different schools based and formulate their theories. After exploring the Classic School (Smith, Ricardo and Marx), we introduce the Neoclassical school of thought in which we deepen in the distinction between

marginalist and Marshall. Then we follow the critics and new proposals of Keynes, and later on the New schools segment under which we explore the different lines that have derived from the main schools. In the end, we propose some conclusions on the current situation in terms of dominant schools and ideologies and how that affects today's labour structures.

The classical school

Adam Smith

Historical background

The Wealth of Nations (1776) is the book that made Smith famous and established him as the Father of Economics. The content of the book is truly revolutionary if we take into account that it was written during a time period in which feudalism was still widespread and also quite strong, and that the part of the economy that was organised according to the market mechanism was extremely small, albeit rapidly growing. In fact, Smith's contribution is located precisely in the final stage of the transition from a mediaeval and feudal society into the modern and capitalist one. More specifically, it is usually identified at the end of the 18th century, especially when it comes to England (and, by extension, Scotland), with the beginning of the industrial revolution.

At the level of production processes it was manufacturing production that gave impetus to the consolidation of two of the social classes characteristic of modern society: the industrial capitalists, on the one hand, and the industrial proletariat, on the other. Nevertheless, despite its fully modern features (such as the new productive modalities in the labour fragmentation and specialisation) the manufacturing production that Smith witnessed was far from mature. The industrial revolution had recently started but was still unfinished.

The categorical break that Smith produced in the defence of the nascent capitalist system must be considered, more than anything, as a reaction and a critique of traditional, mediaeval, feudal and absolutist systems that governed until that time. Smith's intentions to discover the laws that ruled the new modern society definitely broke with the scholastic tradition fundamentally permeated by theology; while also rejecting some of the main propositions of the two economic currents that date from the immediately preceding centuries and that also belong to modernity: Mercantilism and the Physiocratic school. In other words, beyond Smith's class membership, modern society's apology can be interpreted as a result of its rejection of the hegemonic traditions of the time.

The first great question that Smith pursued was to reveal the mechanism through which a social system of the type outlined above would function over time and remain stable. In the next section we touch upon some of the ideas and the "economic laws" that Smith used as arguments in defence of the new social regime from a "scientific" perspective.

The invisible hand

By introducing the notion of economic laws and their operation, Smith placed economics on a scientific foundation. This is the reason why he is called the founding father of modern economics. In concrete, Smith intends to show that the economic forms of the capitalist system, not being governed

by traditional principles and norms, meaning by feudal regulations and restrictions, do not lead to a general disorganisation but, on the contrary, capitalism is governed by a set of laws that ensure the material reproduction of society and, furthermore, its progress. However, these laws have a particular nature.

First, Smith outright dismisses any immediate link between economic laws and divine laws. On the contrary, economic laws refer to a purely human phenomena, and more specifically to the ***self-interest*** of humans. Smith argues that self-interest, a socially unacceptable motive, gives rise, via complex social interrelations, to social cohesion and to growth.[1] Considered from a strictly individual perspective, if a certain way of acting is more profitable or satisfactory, and the same happens with each one of the individuals that make up society, then, by virtue of that individual convenience, such behaviour and its results are the ones that will be imposed as general economic laws. Smith described this spontaneous operation of objective laws that guide human action in a way that accords to the interests of society as a whole as the ***invisible hand***.[2]

While one would expect that self-interest would lead to a chaotic society, Smith instead argues that society does not collapse thanks to ***competition***. When each and every member of the society seeks to serve his or her own interest, without regard for social costs, his or her interest confronts with those of other similarly motivated individuals. If, for example, a producer charges a too-high price, then it is expected that the buyers will turn to other producers. If a producer underpays his workers, workers will seek employment elsewhere.

In addition, this system is based primarily on decentralised decisions of numerous individuals without the mediation of any central coordinating agency but only under the coordination of the market mechanisms that solve the problem of production. For example, if the price of a product is too high, this is an indication that society wants larger quantities of that product. High prices give rise to excess profits, which attract investment in this profitable activity; this accumulation of capital expands the supply of the product, something that society wanted in the first place and at lower prices. The converse process takes place in the case where the price is below normal. In the same line, the problem of distribution is implicitly solved, since the prices of the products incorporate the normal rewards of the factors of production, that is, normal wages, profits and rents.

In short, Adam Smith grounded his theory in the entwining notions of self-interest and competition which led by the invisible hand explain how the market mechanism is a self-regulated system, whose operation does not lead to chaos and to eventual breakdown, but rather to a system that manages to give rise to social cohesion and to hold together all centrifugal forces.

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[1] He grounded his the case in a previous publication, *The Moral Sentiments* (1759)

[2] *"As every individual, therefore, endeavours as much as he can both to employ his capital in the support of domestic industry, and so to direct that industry that its produce may be of the greatest value; every individual necessarily labours to render the annual revenue of the society as great as he can. He generally, indeed, neither indents to promote the public interest, nor he knows how much he is promoting it. By preferring to support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it"*. (WN, p. 423)

Division of labour

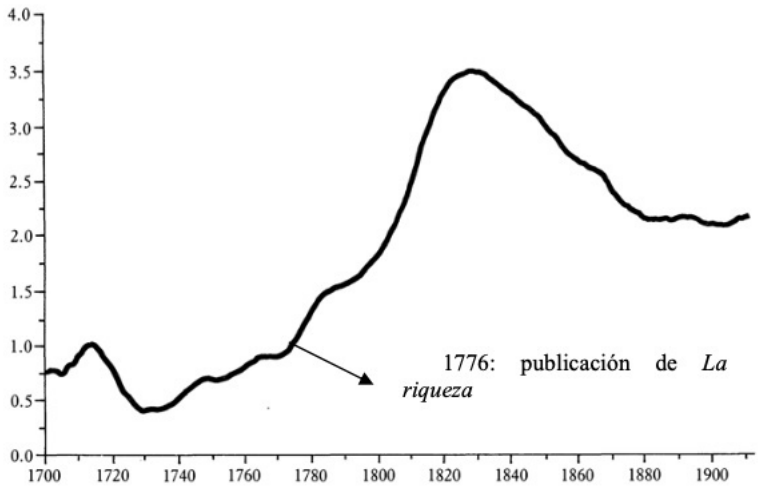
In *The Wealth of Nations,* Smith's search for understanding of the new dynamics of the 'civilised society', that is to say, of the nascent capitalism whose birth he was witnessing, is an intention to find an answer to the natural follow-on question: "what is wealth?". In fact, Smith's responses showed immediately, since in the first sentence that appears in the book's introduction he makes a brief statement that arguably would become the cornerstone of the entire classical theoretical system:

"The annual labour of each Nation is the fund that in principle provides it with all the things necessary and convenient for life, and that the country consumes annually. Said fund is always integrated, either with the immediate product of labour, or with what is purchased through said product from other nations."(WN [1776] p. 3).

Briefly, almost laconically, Smith brings essentially different two points of view from the two most important theories of his time. In the first place, he maintains that wealth is made up of goods, of products of all kinds - the "necessary and convenient things for life". And secondly, and even more importantly, he asserts that the sole and exclusive source of wealth is men's labour, or more precisely, the labour of the society taken as a whole - the "annual labour of the nation". He explicitly rejects mercantilist ideas that argued the origin of wealth should be sought in commercial operations and its preferential form is money; as the belief of the mercantilists stated. But neither is it created solely by agricultural work nor does it take shape exclusively in the primary products generated by nature and which will then undergo various transformations, as was defended by the Physiocratic version.

Continuing with this reflection, if it was true what Smith maintains - that is, that wealth is made up of things necessary and convenient for life and whose origin is labour, the next question that the author tried to answer was "how could a society increase wealth?". Smith's argument was a direct follow-on from the above, as he stated that the natural tendency of the market economy is the growth of wealth that is created from **the division of labour** with its consequent increase in productivity and reduction in cost. Here again, it is important to remember that Smith was describing an economy in transition from feudalism to the market system. Smith's time is characterised by the diffusion of manufacturing production and not by the appearance of the modern factory and its technological innovations. This implies that the increase in the volume of production should be unequivocally attributed to a growth in the "productive powers of labour", since it was not associated with either a substantial increase in the working population or the use of new machinery to assist the worker in his tasks. The cause of the increase of labour productivity must be then sought, according to Smith, in the deepening of the division of labour.

Gráfico 1. Tasa de crecimiento del producto industrial de Inglaterra 1700-1913



Fuente: Crafts y Harley (1992)

Graph: the growth of industrial production in England 1700-1913

With the purpose of explaining the division of labour, for which Smith uses the famous analogy of the pin factory, he explains that when the production process aimed at the manufacture of the same article is fragmented into numerous simple operations performed by different workers, an increase in labour productivity takes place for three reasons: First of all, the specialisation of the worker in a single repetitive task gives him greater dexterity; secondly, there is a saving of the "downtime" caused by the passage from one operation to another; and finally, by dedicating the whole day to a single task, the worker's creativity is stimulated, which helps you to devise new and more effective tools of work or to improve old ones.

This labour division theory adds two important elements. First, although the market society functions in a completely decentralised way, where each individual seeks to satisfy his own self-interest, yet this society creates internal mechanisms that bind people together in a cohesive totality. Far from establishing total independence among producers, a relationship of mutual dependence, of a new type, is established among all men: *"in a civilised society* - Smith says– *[every man] needs the cooperation and assistance of the crowd at every moment* "(WN [1776] p. 16). Secondly, Smith demonstrated that such a society is capable of economic growth, as the division of labour unquestionably leads to a rapid increase in productivity, which in turn leads to the growth of the economy. The next question is whether this growth of the economy will continue forever, an issue that Smith relates with the supply and demand of labour and its price, for which we need to understand Smith's theory of value more in depth.

Theory(ies) of value

It has already been established that civilised society is in its essence a commercial society, in which, as a result of the division of labour, each man specialises in a form of production and is therefore obliged to resort to the product of other men's labour through exchange. The line of argument drawn in the *Wealth of Nations* leads to the discussion about the forces that govern exchange relations, that is, the determination of the value of commodities.

The theory of value is the effort to connect the surface phenomena of economic life to some inner law. Smith affirms that the word VALUE has two different meanings, since sometimes it expresses the utility of a particular object value, and, at other times, the ability to buy other goods. We can call the first ***use value*** and the second ***exchange value***. The starting point of the investigation is precisely the question: how is the relative value or exchange value of goods determined? What Smith said is that exchange value is not quantitatively conditioned by use value (by utility), and that the magnitude of use value and exchange value are two independent factors of the commodity.

Smith argued in the first three chapters that labour is socially divided in such a way that for the owner of a commodity - dependent on the labour of others to obtain things necessary and convenient for life - the value of his commodity is equal to work of others that your merchandise allows you to acquire or "command" in the exchange. According to Smith, when an individual exchanges one commodity for another, he is actually acquiring someone else's work "embodied" in that product. Therefore, the value is, essentially, labour, and its magnitude is fixed by the amount of needed work. Nevertheless, here he faces one of the many difficulties in the race for discovering the real meaning of value. As much as it maintains that labour is the only true source of value, the truth is that labour cannot be observed by itself, which leaves a second question: how is this labour measured?

The simplest way to guarantee the result would be that the individuals involved in the exchange knew the quantities of labour contained in the commodities. For that, Smith takes the radical approach of describing a primitive society in which there is neither capital nor wage labour and where the worker-producer knows exactly the amount of work that each product of this society involves:

In the primitive and crude state of society, which precedes the accumulation of capital and the appropriation of land, the only circumstance that can serve as a norm for the reciprocal exchange of different objects seems to be the proportion between the different amounts of labour that it is needed to acquire them. If in a nation of hunters, for example, it usually costs twice as much to kill a beaver as it does a deer, the beaver will be naturally exchanged for or be worth two deer. It is natural that generally the product of the work of two days or two hours is worth twice that which is the consequence of a day or an hour (WN [1776] 1997: 47)

So in this context the law of value based on labour is fulfilled. Smith thus achieves his goal, only that he does it at the cost of making the law of value lose all its theoretical interest, since it would be a law that describes the behaviour of prices only in primitive society. What is, then, the law that governs exchange – the value exchange - in today's "civilised society"? To answer this question, Smith had to abandon the labour theory of value and proposed a completely new and different explanation, known as the *adding-up theory of value*, which maintains that the exchange value is determined by the sum of wages, profits and income, that is to say, the rewards obtained by all those who participate in the production process: workers, capitalists, landowners. This theory of value, known as well as the "theory of production costs", in fact, constituted a theory of price determination based on the cost of production, which was to play an important role in our days. This notion of value became the starting point for the development of theories of value that place labour, capital and land as equivalent factors of production and creators of value. This interpretation was supported by many economists of the nineteenth century, who include J.B. Say and J.S. Mill.

Ricardo, as we will examine in the next chapter, adopted Smith's first view of value known as the labour theory of value and made an effort to apply it to modern society and solved some of the riddles that made Smith abandon his first (and correct according to Ricardo) view.

Ricardo's value theory

David Ricardo's kind of influence on the history of economic thought was quite different from that of Adam Smith. In the first place, Ricardo managed in life to form a true school of economics of which he was the undisputed leader. To frame the context, Ricardo's time was four decades after Smith's contributions. Therefore, he was indeed able to witness the development of a capitalism moving rapidly towards maturity, where the forces of the industrial revolution had already been unleashed in an irrepressible way. Moreover, precisely as a result of his position in the history of ideas, Ricardo had a privileged point of departure for his own investigations: Smith's *Wealth of Nations*. He stands on the shoulders of a giant.

Ricardo's major contribution to the theory of value is his insistence on the acceptance of Smith's labour theory of value, according to which the relative prices of goods are approximately proportional to the relative quantities of labour that were spent for their production. Concretely, in Ricardo, the labour time is the primary regulator of natural prices, which in turn are the centre of gravity of market prices:

All the great variations which take place in the relative value of commodities to be produced by the greater or less quantity of labour which may be required from time to time to produce them. (Works, vol. I, pp. 36–37)

Ricardo's disagreement with Smith is clear. Smith was forced to abandon the labour theory of value in the face of the rise of a capitalist society in which he could not explain the reasons for the difference between the commanded labour (wage) and incorporated labour (product value). Ricardo's critique indicated that the salary is not - it cannot be - equal to the value of the product but is governed by other laws, since the salary, like the price of any other merchandise, is subject to permanent variations. The "value of work", that is, the amount of the salary, Ricardo maintains, does not contradict or invalidate the determination of the value for the working time and is not related to the magnitude of the value of the product.

If the determination of the labour value theory is fulfilled, a change in wages is incapable of modifying prices, as long as the labour time requirements of each product have not changed. However, the variation must be absorbed in some way, and in effect it is because profits are, according to Ricardo, an inverse relationship with wages. The value is determined by the amount of labour, but then this value must be "resolved" into wages and profits. As wages vary, the total magnitude of value does not change, says Ricardo, but its distribution between classes does. The consequences of this simple conclusion are big: on this basis it must be accepted that capitalist society is inexorably traversed by a distributive conflict between capitalists and workers. The opposing interests of one and the other face them fatally: any increase in wages necessarily implies a reduction in profits. When Smith came across the mutual relationship between wages and profit, he abandoned the theory of labour value to embrace that of production costs, which only nullifies the conflict since, according to this approach, increases in wages cause increases proportional to commodity prices, rather than determining a general drop in profits. Harmony reigns then - with the notes that we indicate - between employers and workers.

In spite of the lack of a perfect invariable measure of value, Ricardo accepted the principle according to which the exchange ratios of products (meaning goods prices) are regulated by relative labour times expended in their production not only in 'the primitive society' but also in capitalism. The difference is that in capitalism, the labour theory of relative prices needs several qualifications and modifications.

These modifications relate to the presence of factors such as capital–labour ratios and changes in income distribution.

On a final note, Ricardo showed particular interest in questions of international trade. He thought that his labour theory of (exchange) value could be extended to include not only domestic but also international markets. Added to that and by using the quantity theory of money, he derived the principle of comparative advantage, an idea that has survived (albeit modified) until our days and can be found in all books of international trade.[3]

Karl Marx

Introduction

From the point of view of the history of economic thought, at the end of the 1860s and the beginning of the 1870s, two currents that proposed to break with classical political economy were born. Two movements that, however completely opposed and simultaneously (with a difference of a few years -Marx, in 1867 and the Marginalists 1870), gave its almost definitive shape to the scene of contemporary economic theory.

Marx's perspective does not consist in rejecting exhaustively all theories formulated by the pillars of the classical political economy (Smith and Ricardo); but he takes them as its starting point. However, Marx's objective is to transcend the classical legacy, preserving in part its content but also pointing out its limitations. The importance that Marx himself attributed to the works of Smith and Ricardo is also manifested in the numerous quotations included in *Capital*, but also in the detailed analysis that he dedicates to them.

There are different interpretations of Marx, and this often gives the impression that his work is a political pamphlet. This is indeed connected to the history of the socialist movement, the origins of which were inspired to a great extent by Marx himself, more specifically by the political and philosophical writings of Marx and Engels (e.g., *The Communist Manifesto* (1848), *The German Ideology* (1845–1846). Nevertheless, this narrow interpretation would ignore Marx's major economic contributions, that is, the three volumes of *Capital*.

The commodities and abstract labour

The goal of Marx's economic studies was to "*lay bare the laws of motion of modern society*" (Capital, vol. I, p. 10), that is to say, to discover social regularities described mainly as long-run tendencies. Marx observes that capitalism is a historically specific system characterised by generalised commodity exchange, so, naturally, the starting point of his inquiry is the analysis of commodities, the most elementary form of the wealth of a capitalist society. As the classic school already pointed out, commodities have a dual property: they can be used to satisfy needs and they can also be exchanged. Adopting the established terminology in Marx's time, a commodity is at the same time a *use value* and *value*. Again the question posed is: what regulates that exchange?

If the commodities did not have in themselves "something equal", they could never be equal in exchange, and that something equal has nothing to do with their respective *use values*. This is because

[3] For more information about this, see the chapter on Competition or Cooperation.

their material bodies, their use values, far from making them equal, make them different from each other. When the use value of goods is abstracted, there remains a single common property: all of them are products of labour, but of labour considered as indistinct labour. Commodities are values because they represent the ***abstract human labour*** that produced them.

When Smith, originally, and later Ricardo, struggled to find what "created" value (the source of value), they came to a conclusion, as original as it was difficult to demonstrate: only and exclusively labour has the capacity to "create" value. Once this finding was established, they proceeded to postulate that there was a proportional relationship between the value and the labour "contained" in the commodities. In this field two crucial differences between the classics and Marx must be pointed out. In the first place, the classical authors always refer to the labour without making further clarifications. They thus confuse two aspects of labour: labour considered as human productive activity in general (what Marx calls abstract labour); and the activity aimed at manufacturing a certain product (useful and concrete labour). These are not two different activities, but two different ways of looking at the same job. In other words, Marx calls the total quantity of abstract labour time, that is, incorporated in a commodity the immanent measure of *value* of the commodity.

Secondly, classical political economy was confined mainly to how price, or in other words the exchange value was established. Unlike the classics, Marx has never said that this quantitative determination of value is immediately comparable with the relationship that exists between observable prices in the market. Remember that for both Smith and Ricardo the categories value and exchange value (or price) are confused until they become one, as if it were a single phenomenon. For Marx, value and exchange value are not the same, contrary to what Smith or Ricardo believed. Consequently, labour should not be confused with value just as value should not be confused with price.

Socially necessary labour time and the law of value

The value of a commodity is equal to the quantity of the abstract labour time that is socially necessary for the production of the commodity in question. Hence the notion of socially necessary abstract labour time is different from the homogenised labour time of Smith and Ricardo.

For Marx, the quantity of labour and, consequently, the magnitude of the value, is determined by the labour time required to manufacture any commodity, that is, by the labour time required on average to produce it or, in other words, by the labour time *"socially necessary required to produce any use value, under normal conditions of production and with the average degree of skill and intensity of work prevailing in society"*. For example, Marx (Capital, vol. I, p. 39) refers to a characteristic example that was observed in England when the introduction of power looms reduced the socially necessary labour time for the production of cloth by about fifty percent. The traditional producers who continued working with hand looms found out that the value of their commodity was slashed by one-half not because of the reduction of their own labour time but because of the reduction of the socially necessary labour time.

How does the magnitude of the value vary? If more work is required in the production of a certain commodity, the greater its value. And in the same way, the greater the productive capacity of labour, the smaller the magnitude of the value, since the amount of work invested in the production of each unit will be less. In short: "*the magnitude of the value of a commodity changes directly to the quantity of labour and inversely to the productive capacity of the labour invested in it*" (Capital [1867] 1986: 8).

Following this logic, the law of value – according to which the socially necessary labour time is directly embodied in a commodity – is the regulator of the movement of market prices. Prices are the means through which capitalists realise their profits and losses and regulate their behaviour accordingly. Socially necessary labour time constitutes the regulator of prices and profit and, therefore, of social reproduction. The operation of this dual relation is what Marx calls the law of value whose role is analogous to Adam Smith's "invisible hand", for it provides an explanation of how the capitalist society reproduces itself and the various scales of its reproduction.

Surplus value

Marx made the distinction between labour and *labour power*, a distinction that is absolutely crucial for the understanding of the concept of surplus value.

Labour-power or capacity for labour is to be understood as the aggregate of those mental and physical capabilities existing in a human being, which he exercises whenever he produces a use-value of any description. (Capital, vol. I, p. 186)

It follows then that labour is the utilisation of labour power, that is, of the useful labour that a labourer performs in a specific period of time. And, like any other commodity, the value of labour power is determined by the amount of labour that its production requires. In this case, the magnitude of value is equal to the labour time required to produce the worker's livelihood. In other words, the value of labour power is equal to the socially necessary labour time required for the production of commodities that a worker purchases with his money wage to reproduce himself and his family. But the labour time embodied in the commodities normally used by the worker for the reproduction of himself and his family in a day is less than the labour time that a worker actually offers to the owner of capital during the same time period. The result is that for any given time period, the worker produces more value than the wage equivalent which is paid by the owner of capital for the use of the labour power. This difference, Marx calls "unpaid labour" and "surplus labour".

This argumentative line, starting in the analysis of the commodity and continuing to the ideas of abstract labour, social necessary labour time and labour power constitute the theoretical cornerstone of Marx's political description of the modern society. For Marx, all societies require labour to reproduce themselves. So much so, that in all societies a particular social class performs more work than what is required for its own reproduction with the excess labour being appropriated by the dominant classes through property relations, traditions, the legal system and also force. Such exploitative relations are quite transparent in pre-capitalist modes of production (e.g., slavery and feudalism), whereas in capitalism they are embedded in monetary transactions that give the impression of equal, and, therefore, fair exchanges.

The difference between total labour time and that required to reproduce the workers' capacity to work is called surplus labour time and its monetary expression, the ***surplus value***, is appropriated by the propertied classes (capitalists and landlords) and the state. The wealth accumulated in a society is directly related to the amount of surplus labour time, which is inversely related to the necessary labour time of the labour power. The distinction between labour and labour power is Marx's greatest discovery and contribution to political economy, because through this distinction the source of surplus value can be explained.

Small final note on capital concentration

To obtain a complete picture of Marx's system, the full development contained in *Capital* should be explored, which is beyond the scope of this article. Nevertheless, apart from the theory of surplus value, one more thing is essential to take away from Marx's Capital, the idea of *capital concentration*.

According to Marx, the hallmark of the individual behaviour of capitalists is the pursuit of profit as a purpose in itself, which forces them into two kinds of competition: the first with workers in the labour markets over wages and conditions of work, and the second with other capitalists in the commodity markets over the expansion of market share at the expense of their competitors. Capitalists cope with these two types of competition through the introduction of more fixed capital. As a consequence, mechanisation of the labour process is used to raise the productivity of labour. The introduction of fixed capital both increases the scale of operation needed for minimum efficiency and reduces the unit cost of production. The latter implies that by reducing their prices, innovative firms are able to expand their market share at the expense of less efficient firms. Thus, the process of capital accumulation leads to a small number of top firms controlling an increasing share of the total market. This is the reason why concentration of capital is the expected outcome implied by the nature of capital and by the operation of competition, which by no means diminishes over time.

If there is a grand prediction that has been historically validated, it is Marx's law of increasing concentration of capital.

Final notes on labour for the classical school

Our goal here is to clarify the structure of classical theory and more specifically point out specific aspects of this line of thought that will later on be taken by the continuing and opposed schools of economic thought. To begin with, classical economics is a term invented by Marx and later on taken by Keynes. According to Marx, the shared common point of all the thinkers that could be grouped under the term of classical economist is the view that labour employed in production (in general) is responsible for the creation of value. Nevertheless, as we have seen, these common views still resulted in many differences between the classical thinkers.

Now, there are some other points about the classical economist and its methods of analyses that should also be mentioned. In the classical analysis there is no assumption about the full utilisation of the labour force. The unemployment of the labour force coexists with the normal utilisation of the economy's productive capacity (which is utilised at its full potential in the longer run). The existence of underemployment appears in Ricardo as well as in Marx in his notion of industrial reserve army. On the one hand, for the classic school the level of employment (or in other words the quantity of labour) was determined by the level of capital accumulation (and its capacity to demand labour) and by the variation of the population. On the other hand, wages (or in other words the price of labour) were determined by the idea of the cost of the worker's reproduction (meaning the basket of goods that workers normally purchase).

This is characteristically different from the neoclassical theory, as we shall see, for which this process is defined in the *labour market*, where the prices (level of wage) and quantities (level of employment) are determined by the demand and supply forces.

Neoclassical school (marginalists + Marshall)

Historical background & conformation of neoclassical school

During the first half of the 19th century a fierce confrontation developed between the industrial bourgeoisie and the old landed aristocracy. The political discussion was marked by the confrontation between the protectionists and the free traders, between the countryside and the industry, that is, by the brawls typical of the period of consolidation of capitalism. Gradually, along with the advance of capitalism, the axis of the conflict between the classes continued moving until it took the form of an increasingly open conflict that has the working class as one of its protagonists.

In its beginnings, the conformation of the factory system had found an almost inexhaustible deposit of peasants, serfs and vassals expelled from their lands and impoverished artisans to fuel the "deposits" of an eminently weak and disjointed proletariat. The so-called "original accumulation", the starting point of the capitalist regime, was marked by unlimited exploitation of the new salaried workers, whose associations were prohibited and their claims were persecuted and punished. It was not until the third decade of the 19th century that the working class began a resistance movement.

Arguably, economic theories were forced to accompany this system changing cycle. Indeed, in the field of economic thought, the period began with the agitated controversies between supporters and detractors of the Ricardian system, the one that has consolidated as the hegemonic orthodoxy.

Throughout the second half of the 19th century, from 1850 to 1870, the political economy seemed to stabilise, forming an orthodoxy with Ricardian roots and with John Stuart Mill, Ricardo's pupil, as the dominant figure. However, under the surface of broad consensus, the two new theoretical systems that would mark the theoretical terrain during the 20th century were developing: the Marginalist system and the Marxist system (parallelism already introduced in the first section of Marx). Marginalism became a new orthodoxy that devoted many efforts, especially at the time of its consolidation, to confront the ideas of Marx.

This initial stage was a genuinely revolutionary stage for Marginalism, as its promoters set out to dethrone and displace the orthodoxy of that time, that is, the classical school of "Ricardo-Mill line". With the difference of a few years, the three founding works that gave shape to the Marginalist movement were published. These books are the *Theory of Political Economy* by the British William Jevons (1871), the *Principles of Political Economy* by the Austrian Carl Menger (1871), and the *Elements of Pure Political Economy* by the French Leon Walras (1874).

The ideas of the 'marginal economists' gradually formed an integrated theory, which has been called neoclassical economics. The triumph of the movement, nevertheless, was not achieved by the three founders but came by the hand of Alfred Marshall. In 1890 Marshall publishes his *Principles of Economics*, giving a more mature and complete expression to the contributions of marginalism; but, this maturity was reached at the cost of smoothing out certain "rough spots" and attenuating - even making it disappear completely in some cases- the polemic argumentations of the three Marginalist predecessors. Marshall proposed a kind of synthesis between the Marginalists and the classics becoming, therefore, the architect of the neoclassical school of thought. Marshall argued that the ideas of the marginal economists are merely the evolution of the classical economists and in this sense they are *Neoclassical economists*.

From the labour value theory to utility theory

In our discussion of the structure of the classical theory, we found that the core of this theory is based on the theory of value based on the labour time, or in other words the labour value theory that explained the value-exchange (price) of commodities. In order to understand what led to the replacement of this theory by the neoclassical theory based on utility, we need to bear in mind the intellectual atmosphere that was developed in the middle of the nineteenth century. During this time period there was a rising concern with the labour theory of value as it was attracting discontent from the establishment that thought that the theory was bringing socially dangerous conclusions and finding strong support among a number of socialists and, in general pro-labour, economists. Looking backwards, we can understand how the new neoclassical utility theory's very purpose (stated or not) was to set aside the classical approach because of its disturbing political implications emanating from the labour theory of value and its association with Marxism and socialism. The idea that the value of commodities is determined by their labour content was too challenging for a system that underwent a structural transformation.[4]

Around 1870, the classical theory of value had, strictly speaking, two different versions: the determination of value by the quantity of labour (Ricardo) and the more widespread determination of value by the costs of production (Mill). Opposed directly to the production-value theory, the axis of Marginalist analysis consists in studying the determination of value exclusively at the moment of the exchange. The subsequent ideological and theoretical controversy crystallised by the marginalism, affected the theoretical consideration of labour. What Marginalist claimed was that, instead, the value of a commodity was determined by its ***utility, a concept*** that refers to the satisfaction of an individual that derives from the consumption of a good or the use of a service.

So what "gives value" to objects, is the way in which men "value" goods as objects destined for consumption, capable of satisfying their tastes and needs. A substantial difference, of origin, is thus established with the classical system, where it was assumed that the goods arrived at the exchange process with a "value" determined by the conditions of production (either by the amount of labour or by costs of production). By replacing the centrality of *value* in order to make it of *utility,* the centrality of labour in economic discourse was lost and theoretical analysis could ignore the problem posed by considering the distribution (wage/profits) of the surplus in the manner of the classics.

The major contribution of the Marginalists, and the reason that gave them that name, was the concept of ***marginal utility***, upon which the definition of the demand curve was shaped and remains until our days as the basis of the microeconomic line. For the Marginalists, the demand depends on the marginal utility, that is, the utility derived from the consumption of an additional unit of the good in

[4] Industrial capitalists, up until the middle of the nineteenth century, were directly involved in the production process in their incessant pursuit of expanding profits as a purpose in itself. The labour theory of value contributed to the understanding of the source of profit as well as the source of incomes for the merchant and the landlord classes. As a result, the labour theory of value was the product of, and at the same time contributed to, the intellectual atmosphere for about a century. However, the growth of corporations and the subsequent concentration and centralization of capital that took place during the depression of 1873–1896 changed the structure of the economy as well as the role of the capitalist. The capitalist's direct involvement in the production process and other related activities was limited and the management of the newly created large-scale enterprises was transferred to a small group of owners or professionals. As a consequence, the capitalist class was transformed, to a great extent, into a mere recipient of profit incomes by virtue of property rights in a way similar to that of landlords. Naturally, under these new conditions, it became clear that profit income could not find justification in a labour content explanation of equilibrium prices, other than some form of exploitation of labour.

question. It was claimed that as the consumption of a good increases, the satisfaction that a consumer derives from the consumption of successive units of the good in question progressively diminishes. Consequently, the consumer would be willing to pay a lower price for higher quantities of the same good. Thus, we may construct a typical demand curve, that is, a schedule between prices and quantities, with a negative slope precisely because it reflects the law of 'diminishing marginal utility'. Hence, the value comes entirely from marginal utility, which is a "measure" of the pleasure that its consumption provides, a pleasure that is reduced when the quantity consumed increases. The next step is to aggregate these individual demand curves to arrive at the market demand curve.

The Marginalist theory of value should have been complemented by a Marginalist theory of distribution, that is, by the set of laws that govern the determination of wages, profits and rent. The truth is that the first three Marginalists failed to reach an agreement on these new laws, as opposed to the unanimity reached with marginal utility theory. It is precisely in this less complete segment of Marginalist theory that Marshall comes to the rescue to offer us his theory of value (closer to Classic school) as we will see below.

Marshall value theory

When we examined the original "revolutionary" proclamations of the first three Marginalists (Jevons, Menger, and Walras), we reproduced some of the ideas with which they attacked the Ricardo-Mill school. As we mentioned in the introduction, for Marshall, the Marginalist and the classical are two partial and incomplete versions of the same theory of value. Marshall's goal was, then, to reconcile the classical school with the novel theory of marginal utility. For Marshall, the main contribution of the Marginalists is limited only to the study of the foundation of the downward sloping demand curve based on the marginal utility theory. However, he argues, the principle of marginal utility cannot be taken as a law of value.

Instead, Marshall affirms following the classical line, that to make the decision regarding the quantity to be produced and brought to the market, the producers do nothing other than estimate their profits calculated as the difference between the price of the demand (how much they would be paid) and the cost price, including wages and profits in the latter.

The principle of cost of production and that of final utility are undoubtedly component parts of the general law of supply and demand; each of them can be compared to a blade from a pair of scissors. (Marshall [1890] 1948a: 682).

Following this line, Marshall then faced the question of determining the "costs of costs", or in other words the *real costs of production.* Here lies the most profound content of Marshall's theory of value: hidden behind the prices of all commodities are, the two original types of "sacrifices" that men must go through to produce them, the *sacrifice of labour* and the *sacrifice of waiting*. The idea that labour is a source of value, as we saw, has a classical ancestry, although here the emphasis is not on work as a "cost" due to the physical exhaustion or to the expenditure of energy, but to the "psychological" sacrifice that means to work. More specifically, wages are no longer theorised as the cost of reproduction of workers – clearly, a classical idea – but rather as the "disutility" that a worker suffers by offering his labour services. Along with the sacrifice of the worker comes that of the capitalist. "The wait" to indicate that when a capitalist allocates his wealth to production and not to consumption he experiences suffering and, therefore, deserves a retribution (the interest rate). Then, profits are

viewed as the disutility of the entrepreneur, who by abstaining from consumption manages to save resources in order to invest them and profits are the compensation for this sacrifice.

Thus, according to Marshall, the "effort" of working and the "sacrifice" of waiting are the elements that ultimately provide value and price to objects. If the cost is expressed as disutility, then it can be balanced by the utility of demand. As a result, for the first time, an adequate interpretation of the equilibrium price through the forces of demand and supply was given, since both of these forces could be evaluated through utility (positive or negative). This scenery can be illustrated by a graph devised by Marshall and which will become another of his trademarks: the "cross" of supply and demand, which represents the bid price (increasing) and the ask price (decreasing) to each quantity, such as those that appear in Graph No 1.

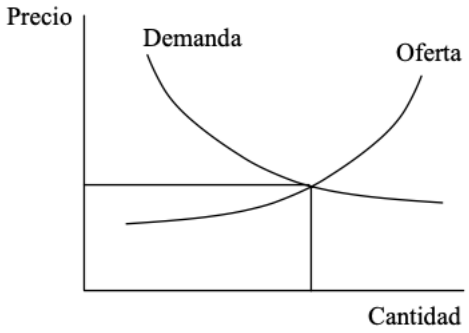


FIGURE 1. MARSHALL'S GRAPHICAL REPRESENTATION OF THE SUPPLY AND DEMAND CURVES

For Marshallian, the price of all products and all factors (wage/capital) was such that the respective markets always tended to an equilibrium position. Now, in equilibrium, supply equals demand, which means that the entire mass of the products and all the factors offered can be placed on the market. This means, in turn, that anyone who wants to sell their products or services at the prevailing equilibrium price can effectively do so.

Among the premises of the neoclassical theory is that there is an automatic and magnetic tendency that pushes the system to equilibrium and does not rest until it reaches that state. This tendency to the equilibrium in all the markets of the economy is known as Say's law of markets. Jean Baptiste Say (1767–1832) expressed an idea that was based on the principle that all individuals are both producers and consumers, since each producer intends to spend the surplus of his product on the purchase of other products. Thus, the production of each producer is essentially the demand for the products of other producers. Say's law appears quite frequently under the catch- phrase *'supply creates its own demand'*. Thus, equilibrium is synonymous with full employment. In this way, full employment becomes a true premise of classical theory as we shall see below.

The creation of a labour market

It is natural that Marshall, by relying on a theory of production costs, was forced to advance more decisively than the early Marginalists in the study of the laws of distribution, since prices of the factor of production become a central element of his value theory.

Marshall's solutions were based on his general idea that all prices are the result of the reciprocal action of supply and demand. Therefore, Marshall creates two different markets to solve the issue, the labour

market and the capital market, which operate in the image and similarity of the market of any other good.

In the labour market, the labour supply curve is upward sloping. This answers to the idea that the workers will offer more work the higher the salary, since for them working one hour more constitutes an increasing sacrifice, which is only compensated by the payment of a higher salary. The supply curve then meets the points where the wage equals the marginal "disutility" of working. In other words the supply curve is the representation of the decision made by workers between the utility reported by the salary obtained for their work versus that provided by the leisure to which they can dedicate their time if they don't dedicate it to work. Furthermore, the labour supply curve of the economy as a whole will not be more than the result of the simple aggregation of those of all workers.

The labour demand curve of entrepreneurs, on the other hand, has a negative slope because Marshall applies here the law of diminishing returns to the employment of all productive agents equally. The idea behind it is that the additional produced product is lesser as occupancy increases. The demand has then a negative slope and shows the points where the wage is equal to the productivity of labour. In equilibrium, the supply of labour is always equal to the demand for labour, and together determine the wage for which both the disutility of labour and the productivity of labour, are equal.

By considering labour as a pure commodity to be analysed in market terms of equilibrium as any other commodity, the problem of distribution was then formulated as a mathematic equation and stopped being on "social contingency". This change in approach resulted in three important new hypotheses:

a) Labour is a commodity and the amount in which it will be hired depends, as in other cases, on the supply and demand that exists for it in the market.

b) The labour market is, or should be achieved, under the conditions of perfect competition.

c) The functioning of the labour market under these conditions automatically leads to full employment of the labour factor at the point corresponding to the wage that balances supply and demand for it.

For Marshall, as long as the system is in equilibrium, there will be full employment. Moreover, his theory presupposes that there is an automatic and magnetic tendency that pushes the system and does not rest until it reaches that equilibrium state. Thus, equilibrium is synonymous with full employment.

The neoclassical understanding of unemployment

With the above general conditions, a completely decentralised decision-making process and an institutional framework of total flexibility that allows wages to rise or fall without restrictions will guarantee the achievement of full employment . And this situation will remain constant as long as the structural conditions of the economy, including general levels of productivity, do not change. A conclusion of this nature had and has, even at the intuitive level, obvious theoretical and normative implications:

a) The existence of a real equilibrium wage above which it is not possible, at the microeconomic level, for an individual to find employment and, at the macroeconomic level, for the employed population to increase.

b) Attempts to increase the demand for labour by other means that do not reduce wages will be doomed to failure.

c) The existence of an unemployed population can only be the result of workers voluntarily refusing to be employed at lower wages. Unemployment is always voluntary and therefore there is no room for permanent situations of massive unemployment.

Following Marshall's theory, unemployment is essentially a phenomenon that belongs to the labour market, because unemployment is by definition an excess labour supply, or in other words unemployment is a transitory disequilibrium state. The Marshallian theory of wages and unemployment predicts, however, that wages will fall to equilibrium, thus ending unemployment. From this it follows that unemployment can only be perpetuated if there is some obstacle that prevents the reduction of wages. It is not at all surprising that orthodoxy, relying on this explanation, has blamed for unemployment the workers unions that refused to see their wages reduced and the labour legislation that also placed limits on wage reductions. In short, only when the wage is "rigid", that is, when some extra-economic factor prevents it from being freely reduced, can unemployment be long-lasting.

Keynes

Historical background

The outbreak of the First World War ushered in what Hobsbawm rightly called the "age of catastrophes." The world had not yet recovered from the trauma of the war when on October 29, 1929, the stock market crash on Wall Street, known hereinafter as "Black Thursday", became the reference for the beginning of the longest depression of the world history of modern capitalism, which is renamed, in its own right, the "Great Depression." In the eight years from 1930 to 1938, the unemployment rate in the United States averaged 26%, in Germany 22%, and in the United Kingdom 15%. Strictly speaking, the recovery of production and employment would come much later and in circumstances that were not too pleasant, linked to the gigantic process of rearmament of the powers. Thus, the Second World War that broke out in 1939 and claimed more than 60 million lives was one of the main sources for industrial reactivation after the crisis of the 1930s.

In the field of economic theory, the Marginalist school in its Marshallian version, the Neoclassics, achieved hegemony, with the help of the so-called second generation of a legion of economists whose presence was felt in the major centres of world powers. The period during which John Maynard Keynes (1883-1946) developed his theoretical production was plagued, as can be seen, with great novelties in the field of economic debates, which lagged behind historical events. One of the major debates was associated with the problem of massive and prolonged unemployment during the Great Depression.

Thus, during the interwar period, a considerable number of economists expressed their dissatisfaction with the traditional theory since the Neoclassical theoretical system failed to account for the causes of inflation, deflation and unemployment, that is, it did not have answers to the dilemmas of the time. Keynes was part of this broad movement, but among all the theoretical efforts that were made, it was his *General Theory of Occupation, Interest and Money* of 1936, the work that managed to break with orthodox thought in the most influential way. In short, Keynes' claims pointed to the historical assumptions and premises on which the theoretical edifice of Neoclassics had been erected, which no longer corresponded to the new economic reality due to the profound transformations that had taken place at the beginning of the 20th century.

Keynes' critics to the (neo)classics

It is necessary to make a clarification, apparently purely terminological, which is in fact loaded with a deep theoretical content. Keynes intends to escape the old and anachronistic theories, but to which economists is his criticism specifically directed? In The General Theory he uses various expressions to designate his opponents: "orthodoxy", "traditional theory" or also, especially, "classical theory" or "classical economists". We already know that Keynes was opposed, first of all, to Marshall who was Keynes' professor and mentor. More specifically, Keynes calls "classics'' a group of economists made up of both the classics and the Marshallian-Marginalists.

What are the main criticisms that Keynes addresses to Marshall and "the Classics"?

Synthetically, his argument is as follows: the classical system has lost its prestige, fallen into disgrace, so that it must be replaced by a different one. Keynes argued that the most important errors are in the field of the premises, mainly:

a) the separation between the theory of value and the theory of money, a separation that carries strong conceptual contradictions;

b) the postulate according to which the economy is always in conditions of full employment;

c) unconditional adherence to Say's law, which through the labour market, the capital market and the goods market ensures that the economic system moves towards equilibrium in all markets and, therefore, towards full use of available resources.

As we have seen, classical theory presupposes that the economy is always in a state of equilibrium and full occupation, that is, that all the goods and resources that are offered can be placed on the market. For classical theory, then, unemployment is synonymous with disequilibrium. Unemployment should simply be considered an "excess supply of labour", an imbalance that occurs every time the real wage is above the level corresponding to equilibrium. The causes of unemployment are inexorably associated with the obstacles and difficulties that occur in any market that cause "rigidities" in the adjustment of wages; obstacles outside of economic reign, such as labour unions, laws, and the State. Unemployment is, for the (neo)classics, eminently "voluntary".

Keynes' General Theory, in contrast, tries to show that the system has multiple possible positions of equilibrium and not a single one that coincides with full employment. In other words, unemployment could also be a situation of equilibrium that could be stable in time. Keynes offers two strong criticisms to Marshall's labour market theory and its corresponding theory of wages and employment, one empirical in nature and the other theoretical. Both directed to the assumptions that are implicit in the construction of the labour supply curve. For this, Keynes introduced in his analysis the difference between ***nominal wages*** (wage measured in money) and ***real wages*** (defined as the nominal wage divided by the general price level).

Empirically, if it were true that the real wage is always determined by the supply of labour, each time there is an increase in prices, it should be observed that a portion of the employed workers abandon their work positions, since the new real wages reduced by the increase in prices, should not now be enough to compensate for the marginal disutility of their work. But this is not the answer that is typically verified in practice since, as a general rule, workers do not leave their jobs en masse when prices rise (in the face of inflation).

Theoretically, the critique of the labour market is of greater importance, since it aims to disrupt the adjustment mechanism towards equilibrium (and full employment) that takes place in the Marginalist conceptual framework. Based on the Marshallian theory of prices, in the face of a labour supply excess in which workers would effectively agree to cut their nominal wages in order to achieve full employment, for example a 10% reduction in all wages in the economy represents a fall in the marginal prime cost of all goods that will be approximately the same proportion. This is, according to the classical (Marshallian) theory of value (we explained above), a proportional reduction in all prices should be expected. Thus, a reduction in the nominal wage is accompanied by a reduction in prices of approximately the same percentage magnitude, for which it follows that the real wage remains fixed at approximately the same level as before the nominal wage reduction by the workers. If the real wage is the same, the supply excess, that is, the volume of unemployment, also remains the same. In Keynes's words*:*

"If nominal wages change, the classical school should be expected to hold that prices would change in almost the same proportion, leaving the level of real wages and unemployment practically the same as before" (Keynes [1936] 2005: 31).

The conclusion is lapidary: workers can reduce their nominal wages but cannot, even if they wanted to do so, cause a decrease in real wages through these consented reductions in money wages. This argument not only obliges us to reject the accusatory attitude of the marginalists towards the workers, but also entails, in addition, very profound theoretical consequences. Following the Marshallian theory of prices, it must be accepted that it is not in the power of the workers to reduce real wages to the equilibrium level with full employment. Then, it must be concluded that the labour market simply does not have an automatic way to reach a full employment equilibrium.

The conceptual consequences that accompany Keynes' criticism of Marshall's labour market turn out to be devastating, since the labour market is one of the pillars of the Neoclassical theory of distribution and also of the theory of value, as Marshall founded his theory of price on the production costs.

Keynesian new theories

As we have seen, Keynes attacked the idea that unemployment was only voluntary and approached the problem of wages from another point of view that was diametrically opposed. He considered, on the one hand, that nominal wages should be the ones taken into account and not, as the neoclassical model did, the real wages because, according to him, workers act under ***monetary illusion***. And, on the other hand, that in no way could it be considered that wages had the degree of flexibility required by the neoclassical model in order to achieve equilibrium situations of full employment.

After rolling out the classical labour market, Keynes was forced to offer new theories about wages and the level of employment, since these two variables had remained without explanation after his criticism. He starts by the analysis of the ***aggregate demand***. In his *The General Theory*, aggregate demand is not "subordinated" to the volume of supply (as the classic state under the Say's law), but rather other factors govern its behaviour. Aggregate demand is a completely different function that depends on other factors that can be modified in the short term to determine the equilibrium occupancy level. First, Keynes identified two components into which global demand is divided: consumer demand and investment demand. It is necessary to differentiate them because the laws that govern consumption and investment are different, and therefore must be studied separately.

Precisely, one of the main theoretical disruptions in Keynes' theory was understanding of the forces that govern demand dynamics. In his vision, the variations in consumption caused by the increase in income are always less than proportional to the changes in income, since there is a "psychological law" according to which "*when income increases, consumption grows, but not as much as income ".* Keynes calls this psychological law that governs consumer spending ***propensity to consume.*** By stating this, the transmission mechanism that was ensured by Say's law is again broken. According to Say's law, any increase in employment and production produced a rise in income and this in turn was channelled to demand. Now, according to Keynes, any time employment, production and therefore income grows, it can only be assured that consumer demand will increase less than the original increase in income.

Keynes' reasoning is simple: *consumption demand* is not enough to exhaust the increases in output, so, to reach equilibrium it will be always necessary a certain volume of *investment demand* that covers the difference. However, investment demand does not depend on changes in production; so such an increase is not assured. Therefore, two fundamental consequences can be deduced in Keynes's system:

a) the magnitude of investment demand is the one that “rules the game”, because once its level is determined, the corresponding equilibrium level of employment can be obtained;

b) if investment demand is small and insufficient, the equilibrium occupation volume may well be below that required to guarantee full employment. Hence, full employment is not the only state of equilibrium and towards which the economic system necessarily tends, as the classical system used to say.

The full employment situation is a special case that is only realised when the propensity to consume and the incentive to invest are in a mutual relationship. Investment must always "fill the gap" between the cost of any level of production (global supply) and consumer demand, always lower. As can be seen, unemployment could be then a situation of equilibrium. The global supply is determined by the technical conditions of production (the costs associated with each level of employment) and, in the short term, must be considered fixed.

It can also be concluded that from this explanation there is a shift with respect to the classical interpretation of unemployment, the identification of its "responsible" and the appropriate remedies to get the economy out of that state. Indeed, for Marshall unemployment was mainly due to the resistance of the workers (generally protected by a permissive state), who refused to reduce their real wages until reaching equilibrium with full employment. The image projected by Keynes's system is very different. Now, the main cause of unemployment becomes weak demand; more precisely, weak investment demand. Very far from the spirit of orthodoxy, the responsibility for unemployment falls on the backs of those who establish the volume of investment, that is, of the businessmen. The State, for its part, instead of appearing in the dock by preventing the proper functioning of the markets, now becomes an alternative source of demand, which comes to complement or replace the declining impulse of the entrepreneurs who invest less than enough to provide full employment. It can now be understood why *The General Theory* became an antidote to the stale medicine of classical orthodoxy that, in the face of unemployment, recommends reducing wages, reducing public spending, and making labour legislation more flexible.

To sum up, the political consequences of Keynes’s thesis clearly differ from the Neoclassical and are well known:

a) There may be equilibrium situations that imply unemployment.

b) Unemployment could be involuntary due to downward wage rigidity

c) Increasing employment in unemployed situations can be achieved by increasing induced incentives in investment demand, which means that exogenous market interventions are not negative, but are essential to achieve full employment.

The New Models

History strikes back

Over time, the Keynesian theses acquired great influence thanks to the fact that they immediately showed much greater capacity than the Neoclassical ones to deal with the economic phenomena of the time. However, none of the successive updates to the original Keynesian model provided sufficiently powerful answers, theoretically and politically, to the problems that emerged throughout the 1970s and 1980s.

Keynesian policies had provided satisfactory solutions during the expansionary growth years of the postwar period, but they would become truly ineffective in the face of a new type of recession of the last decades of the 20th century. The combination of high levels of unemployment brought into question the Keynesian use of economic policies. The internationalisation of economic relations collided with the analysis of demand in closed economies. The productivity crisis that forced the technological reconversion and the surge of a very deep distributive conflict that made it impossible to approach employment regulation as one more dimension of income policy, were obstacles that the original Keynesianism was not in conditions to solve. As happened to the Neoclassical model, reality also took a heavy toll on the Keynesian school of thought.

Friedman's return to (neo)classic

In the 1970s, high rates of inflation and unemployment appeared simultaneously. This necessarily resulted in an alteration of the bases of understanding of the phenomenon of unemployment and, with it, of the theoretical explanation of the functioning of the labour market. At the macroeconomic level, this explanation was transferred to the concept of the *"natural unemployment rate"* initially developed by Milton Friedman (1968), founder of the ***monetarist school*** whose main ideas stated the rejection of the basic relationships of the Keynesian model.

In the new economic conjuncture, ***stagflation*** (persistent high inflation combined with high unemployment and stagnant demand), became the new dominant paradigm. Friedman returned to the more radical implications of the Neoclassical model about the limited viability of expansionary demand policies (State's incentives to investment demand) to reduce unemployment below its equilibrium level beyond the short term. The existing unemployment rate will be the natural unemployment rate and the economy will always find itself in a general equilibrium situation of full employment. Understanding, again, that this effective unemployment rate, which does not necessarily have to be zero, will correspond to voluntary unemployment.

In reality, the concept of the natural rate of unemployment is just a renewed version of the neoclassical idea that there are certain equilibrium levels of real wages and employment in the economy that cannot be altered through alterations in prices. The normative proposition that derives from this is evident: to achieve increases in the level of employment it is only possible to act by reducing the wages of the workers.

Neoclassics' school revisited: the theory of human capital

With the progressive return of Neoclassical theory, there is an intense and parallel revision of its approaches to the labour market, whose limitations become more and more evident when confronted with reality. The lack of homogeneity both in the labour supply, that is, in the qualification of workers, and in the labour demand led to the elaboration of what can be considered as the main contribution of the Neoclassical school to labour economics: the theory of human capital.

This theory suggests that the heterogeneity of workers is the result of the different degrees of investment that they make in their training and qualifications improvement. Heterogeneity is, therefore, the result of an investment process: investment in human capital. The analysis is posed from the beginning, in the field of individual decisions, based on the hypothesis that the subjects have the capacity to choose both the amount of work they are willing to offer and the quality of that work, which will depend on their prior decision to invest in a specific type of training.

This revision leaves aside the traditional neoclassical conception of labour as a commodity without other specific connotations beyond being carried out by human beings, as Alfred Marshall would argue. The striking difference and the new neoclassic "miracle" is how on their journey back to the origins, this theory managed to make labour disappear, even as a commodity, turning it into capital.

In any case, unemployment comes to be understood as something that originated and resolved in the field of individual decisions, it is a specific problem for each subject, and not a social problem. The diagnosis of unemployment involves mainly insufficient or inappropriate investment in training, and therefore the regulatory proposals in this analysis refer to the field of educational policies rather than to those of the labour market.

Institutionalism and new Marxism

Following the logic that runs through all Neoclassical variants, institutions and regulations are nothing more than rigidities that keep markets away from perfect competition and cause situations in which the real wage is excessively high compared to the other conditions of the product and labour markets.

Confronting these ideas, the institutionalist current aims precisely at highlighting the importance of social and institutional influences on the behaviour of agents and, therefore, on the evolution of wages, employment and unemployment. Unlike what happens in the neoclassical model, this currently considers institutions as endogenous variables. From a much more descriptive than analytical perspective, the institutionalist authors consider that the forms of industrial organisation, the existing conditions in the goods market, the available technology, the strategies of business control or labour market regulations, play a determining role on the structure of that market. A market that, on the other hand, is neither unique nor competitive in nature, but rather has a fragmented and imperfect structure.

The labour market would thus be made up of various non-competitive segments and with differences in their remuneration levels and working conditions as a consequence of their "dual" nature and not only of the different levels of education and training of workers. According to this "dual" vision, the functioning of the labour market could be explained starting from the idea that it is divided into two large segments: the primary market (which would encompass the good jobs in the market, that is, those with high salaries, stability, opportunities for employment advancement, among others) and

the secondary market (jobs with low wages, instability, few opportunities for advancement, and so on) would be confined.

This theory is based on the idea that a series of social factors and, especially, demand factors, had caused, over time, a dualization of the labour market. At the same time the relationship between education and work is governed by this duality, where the institutional structures that are more or less stable over time (for example, barriers to access to the university, or the socio-cultural profile of the student, or family influence at the time of choosing the race) also condition the labour supply side. In short, this theory assumes that society is institutionally structured, that is, conditioned by habits and rules that govern the production and distribution of wealth.

Along with institutionalist theories, another set of different theories that derived with unequal fidelity from original Marxism, constituted the other alternative to (new)Neoclassicals. The fundamental point of confrontation between Marxist and neoclassical theories is the distinction between the concepts of labour as a commodity that is bought and sold in the market (neoclassic); and the concept of labour as a factor of production that is incorporated into the production process (Marxist).

Now, from the original Marxist approach, centred on the aforementioned distinction, different readings on labour and the dynamics that govern it have been drafted by neoMarxism. All of them agree, however, that in order to detect the determinants of the volume of employment or unemployment in an economy and the guidelines and rules that govern the distribution of income within it, contextual factors must be analysed and not only those that given in the markets: the specific working conditions, the hierarchy inherent in wage labour, the control mechanisms articulated to convert labour power into effective labour and, in general, the general conditions of the capitalist economy at a given moment. In short, labour relationships are not only a market relationship but a social relationship.

Feminist economics

Feminist economics is one of the current movements for pluralism in economics that has been acknowledgd by the mainstream of the profession. It highlights issues which affect women that have not traditionally been recognised in a field dominated by men. Moreover, it seeks to carve out a space for women in the discipline, for fairness and diversity reasons and because it means that women's issues are more likely to be considered. This theory rightfully argues that economic theory presents an historical male-centred bias.

Feminist economists argue that women perform a lot of labour which goes unpaid and unnoticed but which keeps the economy, society, and individual families afloat. Unremunerated household work is not considered present in the labour market, plus the gendered expectations which push women into certain tasks and occupations, has historically put women in positions which have not been rewarded as much as men's work both socially and financially. Furthermore, unpaid labour doesn't stop at home, though. The 'emotional labour' performed by women at work as women are expected to do less important, menial tasks that do not advance their careers but are necessary to keep the workplace going. These range from literally doing the housework in the office – keeping the place tidy, bringing in food – to taking minutes, supporting others, creating schedules and the like.

Women have historically performed large amounts of labour which is rendered invisible by social and financial conventions, and economic theories and schools have failed to recognise this. Better data

and an incorporation of these concepts into economists' and society's ideas of 'labour' would be a huge step forward. [5]

Ecological economics

Neither classical, neoclassical, Marxist or Keynesian schools of economy have acknowledged the problem of economic scale. All of them have always valorized economic growth, as at the time they were developed environmental problems were not of real concern. Ecological economics' most important contribution is the argument that the human economy is a subsystem of the finite earth's natural life-support system. Implied in this argument is a new metric of economic health, the life-value rather than the money-value of that which economies produce and distribute.

In recent decades we have understood that climate change and air pollution are major environmental issues which affect us all. The main tension point is that although regulations like green energy policies can lead to notable environmental improvements and health benefits, they also impose additional production costs on firms, especially in sectors exposed to trade and intensive in labour and energy.

However, ecological economics schools argue that the benefits of such environmental regulations are likely to outweigh any costs. Green growth policies aim at improving environmental quality and economic growth at the same time. A successful transition towards green growth can create new opportunities for workers, as job creation can be achieved in a number of economic sectors with low emission intensities, while job destruction occurs in emission-intensive sectors.

Most probably in most countries, job reduction in the central scenario will affect 'Blue collar and farm workers' the most. This job category is largely employed in energy sectors and energy-intensive industries, which are the most impacted sectors. Workers in the categories 'Service and sales' and 'Managers and officials' generally benefit most in terms of wage income, since these job categories are more represented in sectors that are the least affected by the policy (such as services).

The success of green growth policies depends on the capacity of the firms and workers to adapt to the changes in economic structures induced by the policies. Further knowledge of the job categories that are most vulnerable when implementing green growth policies is fundamental to adjust education and training policies, as well as redistributive schemes that will accommodate the green growth objectives.

[5] Our project contains an entire chapter on feminist economics, so we strongly recommend you check it for further information on these theories.

Conclusions

New context, same orthodoxy spirit

In order to globally assess the changes in approach that have been taking place in the economic theory and especially with regards to labour and employment theories, it is important to bear in mind the conflictive social environment in which they have taken place. In fact, history has shown that paradigm shifts always occur alongside important economic transformations derived from the different interests of different social groups and to which economic analysis can never be and has never been alienated from.

In recent years there have been very important transformations in the nature and organisation of labour and also in the general economic conditions that influence it: the technological base has been modified almost radically, the nature of the financial systems and their relationship with the real economy have changed, a new system of rights appropriation and different regimes for the use and mobility of resources have been established. The regulatory system and other institutions, conventions, and social values that structure society and economic relations in general have changed. Regarding work, the conditions for training the supply and demand for work have changed, the age pyramids, the composition of the active and inactive population, working times, levels and conditions of training, all of which have also changed.

All these changes are the result of various factors whose specific combination is different in each territory depending on the social conflict originated, and the degree of success or failure occurred from previous models of regulation and intervention. But what characterises the currently dominant approaches is not precisely the recognition of these differences but rather a view of a generality with which their main political-economic postulates are assumed.

The basic "consensus" that today dominates economic thought, or in other words the current orthodoxy is under the ideas of the “Washington consensus” a model that prescribed to the countries of the periphery a series of proposals that state what the greatest economic and political powers see that they need to be economically acceptable. These proposals are embodied in a series of postulates that constitute the essential referents of the Neoliberal doctrine:

1) The need to reduce the distorting intervention of the government as much as possible

2) Price stability should be the central objective of macro policies

3) The main task of the government must now be to make markets function as freely as possible, without regulatory constraints.

In the unique case of Europe, this consensus has also materialised in another relevant aspect from the point of view of work and employment. Since the monetary union is built with great limitations to the mobility of labour for very diverse reasons, the balance must be achieved through the flexibility of prices and wages, which has led to the strengthening of flexibility strategies, especially in the labour market, to promote competitive tax strategies and the progressive dismantling of the Welfare State.

The Theoretical Approach of the New Orthodoxy in Labour Economics

As we have shown, contemporary approaches have developed in different lines and magnitudes. Nevertheless, what can be understood as today's orthodoxy presents characteristics that have found global consensus regarding the instruments that should govern labour. The main ideas are:

1) employment or unemployment problems have more to do with the existence of inadequate individual strategies than with aggregate (social-collective) problems,

2) introduction of an ideological structure that makes labour disappear as a productive factor and transforms it into a specific type of capital and workers into capitalists. In this way, labour becomes capital in the purest neoclassical sense and the class conflict disappear,

3) that the level of employment is a constant and not a variable on which it is necessary to try to influence through the instruments of macroeconomic regulation. On the contrary, the level of employment (and therefore, unemployment) is given by the natural rate. The unemployment problem is once again seen as voluntary.

A final characteristic of the new orthodoxy is that it has acquired extraordinary political influence without its adherents having found the minimum empirical evidence that they should have to be considered scientific. It has not been possible to demonstrate that greater flexibility in labour reforms are effective instruments to influence the level of employment. Nor can it be demonstrated that increased influence from labour unions is the cause of unemployment, as the academic orthodoxy repeatedly points out or that which is pronounced by institutions such as the International Monetary Fund.

Considering all the above, it is urgent to question: to what extent does it make sense for the economy to ignore the problem of the effective welfare of workers or of society in general when it addresses the problem of unemployment? When the International Labour Organisation points out that in 2019 the lowest 20 percent of income earners – around 650 million workers – earn less than 1 percent of global labour income[6], and that currently we are reaching the highest unemployment rate of the last 30 years one should wonder: is it reasonable to maintain that this situation occurs simply because such workers have decided not to invest enough in themselves or that they are voluntarily unemployed because they insist on not accepting lower wages?

In short, the final balance about the knowledge that different schools of economics have added to the study of work and employment is quite frustrating. As we have seen, current dominant analyses prevent us from contemplating the necessarily more global-social nature of the unemployment problem. These limitations are precisely those that indicate, in turn, the great challenges that economic analysis faces in order to understand and explain the problems of labour. Challenges that definitely will be aggravated by the current health global crisis that started in 2020 and that is already showing main changes in the labour structures and organisation.

[6] Access: https://www.ilo.org/global/about-the-ilo/newsroom/news/WCMS_712234/lang--en/index.htmAnd https://data.worldbank.org/indicator/SL.UEM.TOTL.ZS

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3. Training material

Activity 1: Bingo!

Overview

The activity is designed for students to internalise the main characteristics of the different schools of economic thought.

Aims

• to stimulate thinking about the theoretical concepts explained

• to explore the main differences between the different economic systems

• to provide some basic facts about the Classic, Marginalist, Neoclassic, Marxist and Keynesian models

Materials and time

The bingo is designed as a Table as shown below, that could be printed in advance or be drawn manually by the instructor and the students. Time can be adjusted from 30 minutes to an hour.

Group size

10 minimum

Instructions for trainers

1. Break up the class into small groups.

2. The teacher draws/distributes the following empty table, explaining that the team that completes 3 X in a vertical column first should shout BINGO!

	Classics (without Marx)	Marginalist	Neoclassic	Marxist	Keynesian
The first school that placed economics as a science					
For this school the state should not intervene					
Founder of the Welfare State					
Strongest critic of capital concentration					
Invented the concept of the invisible hand					
Defined the concept of abstract labour and surplus					
Based in value theories					
Invented the labour market model					
Invented the Utility theory					
For this theory full employment is not guaranteed by market laws					

Table with results (for the instructor)

Theories/Schools	Classics (without Marx)	Marginalist	Neoclassics	Marxist	Keynesian
The first school that placed economics as a science	X				
For this school the state should not intervene	X	X	X		
Founder of the Welfare State					X
Strongest critic of capital concentration				X	
Invented the concept of the invisible hand	X				
Defined the concept of abstract labour and surplus				X	
Based in value theories	X	X		X	
Invented the labour market model			X		
Invented the Utility theory		X			
For this theory full employment is not guaranteed by market laws					X

3. After the first team shouts Bingo! The instructor must check that the answers are correct and facilitate a dialogue with the students in case of any questions.

4. If the first team answered all points correctly, the exercise would end there. Otherwise, the instructor will continue reading out the topics that remain on the table.

Activity 2: Quiz of value

Overview

The activity is designed for students to understand the differences between the theories of value explained in this chapter. As the concepts may be confusing, it is suggested to give a brief recap of specifically this topic before the quiz.

Aims

• to solidify the concepts explained around the theories of value and its connection with labour

Materials and time

No materials are needed. We suggest you use an online platform like myquiz.org (for free up to 25 students). Time can be adjusted from 30 minutes to an hour.

Group size

Individually

Instructions for trainers

1. The trainers should provide the students with the link of the quiz that should be prepared in advance.

2. The instructor reads out the questions for each round (see Quiz Questions below) and can pause the activities if students have any questions.

3. After finishing the quiz, the instructor can see who is the winner and provide the student with a prize (it can be symbolic!) . In total, this part of the activity should take between 20 to 30 minutes.

Questions

1. The first author to associate the value of commodities with labour is:
    a. Marx
    b. Adam Smith
    c. David Ricardo
2. For Riccardo, the primary regulator of prices is:
    a. The labour time to produce a commodity
    b. The exchange value
    c. The wages of the employees
3. Ricardo´s main addition to Smith's value theory is:
    a. A better determination of the `labour time`
    b. That wages are like the price of any other merchandise, and are subject to permanent variations
    c. An update of the ´primitive society´
4. Despite their differences, Smith and Ricardo agreed that:
    a. Commodities are exchange when the demand and offer price coincide
    b. That the addition of wages and benefits conform prices
    c. That only and exclusively labour has the capacity to "create" value

5. The crucial differences between the classics and Marx in the value theories are:
    a. The difference between abstract labour and concrete labour
    b. That value and exchange value are not the same
    c. Both of the above
6. According to Marx´*the magnitude of the value of a commodity changes directly to the quantity of labour and inversely to the productive capacity of the labour invested in it*´
    a. *True*
    b. *False*
7. Marx´s socially ´*the necessary labour time constitutes the regulator of prices and profit*´ is analogous to Smith´s
    a. Price theory
    b. Invisible hand theory
    c. Both of the above
8. Marx defined surplus value as…
    a. The difference between total labour time and that required to reproduce the workers' capacity to work
    b. The difference between unpaid labour and surplus labour
    c. Neither of the above
9. The school that came to replace *labour value theory* with *utility theory* was:
    a. Neoclassics
    b. Keynesian
    c. Marginalist
10. The main reason why *labour value theory* was abandoned was:
    a. To differentiate from Marxism
    b. It was attracting discontent from the establishment as it was leading to ´dangerous conclusions´ around issues of social redistribution
    c. Both of the above
11. For the Marginalist school, the value of a commodity is determined by its utility that refers to the satisfaction that drives from the consumption of a good. True or false?
    a. True
    b. False
12. Marshall's main contribution to theory of value is:
    a. The idea of marginal utility
    b. The ideas of *sacrifice of labour and the sacrifice of waiting*
    c. The dismissed of a law of value

Alternative note: if the instructor considers the exercise too difficult for the audience, it is suggested that instead of using the online MyQuiz tool, to facilitate it as an offline exercise (as it is basically a single choice exercise). In this case, the students won't be pressured by the online tool timing and could have next to them the information provided in this chapter to search for the answers in it.

Activity 3: True or false

Overview & Aims

The activity is designed for students to understand the differences between the theories of the Neoclassical school and Keynesian school.

Materials and time

The instructor is encouraged to write out the statements on a blackboard or in a PPT presentation in order for the students to have them visible during the whole exercise.

Group size

It could be carried out either in groups or individually. The activity could take 20/30 mins and it is ideally followed by a discussion.

Instructions for trainers

1. According to the number of people the instructor should decide how to divide the group.

2. The instructor presents the statements to be defined as true or false to the students and gives them 15 minutes for them to think/discuss in groups.

3. In the end each group shared their results, justifying only the False statements.

4. The instructor could decide to either reveal the result for each statement at the time or at the end of the exercise. Again, in any case, a discussion is encouraged.

5. The instructor can select from the following list the number of T/F to analyse according to the time the group has, and how difficult they found it.

Statements

1. In neoclassical theory, there is an automatic and magnetic tendency that pushes the system to equilibrium and does not rest until it reaches that state (T)

2. The supply curve is the representation of the decision made by workers between the utility reported by the salary obtained for their work versus that provided by the leisure and it has a downward slope (F: first part is true but the curve has an upward slope)

3. In neoclassical theory, the labour market automatically leads to full employment at the wage that balances supply and demand (T).

4. In neoclassical theory, unemployment is voluntary and can be solved by increasing the labour demand (F: first part is true, but it can't be solved by increasing the demand, the only way of solving unemployment for this theory is reducing wages).

5. In neoclassical theory, the economy is always in conditions of full employment and wage rigidity is the cause of unemployment (T)

6. In Keynesian theory, unemployment could also be a situation of equilibrium that could be stable in time, but workers can reduce their wages to come back to equilibrium (F: first part true, second part false: workers cannot reduce unemployment because they can't reduce real wages)

7. Disagreeing with Say's law, in Keynesian theory any increase in the production and income doesn't always increase demand as the latter establishes a distinction between consumption demand and investment demand. (T)

8. In Keynesian theory if investment demand is big, the equilibrium occupation volume may well be below that required to guarantee full employment (F: just the opposite, if the investment demand is small and insufficient it may lead to unemployment)

9. In Keynesian theory, investment must always "fill the gap" between the cost of any level of production (global supply) and consumer demand, always lower (T)

10. In Keynesian theory, the cause of unemployment is a weak demand, more precisely, weak consumption demand (F: it's a weak investment demand)

11. In Keynesian theory, exogenous market interventions (from the state) are not negative, but are essential to achieve full employment (T)

Activity 4: Grouping the groupies

Overview & Aims

The activity aims at connecting the most relevant author and scholars with each school of economic thought explained in this chapter. It also adds the distinction between orthodox and heterodox economic lines for the students to understand the positions of each line of argumentation.

Materials and time

The instructor could either use an online platform like Miro.com to carry out the exercise or do it offline by printing and cutting the forms shared below.

Group size

It could be carried out either in groups or individually. The activity will take 20/30 mins.

Instructions for trainers

1. According to the number of people the instructor should decide how to divide the group or whether to carry out the activity individually.

2. The instructor presents the different schools in an unorganised way (Figure 1) and asks the students to arrange them in an order as they see fit (it could be suggested to follow the historical orientation provided in the chapter). The instructor could ask which schools seem to belong more to an heterodox or an orthodox line of the economy based on students' general knowledge.

3. After the students have arranged the different schools they are then asked to locate the names of the authors around each of the schools to which they belong.

4. As this is an exercise designed to stimulate connections, there are no right or wrong answers. Nevertheless, what's shown in Figure 2 is the closest to what is considered convention. Again, in any case, a discussion is encouraged.

Figures

Figure 1. Unarranged schools

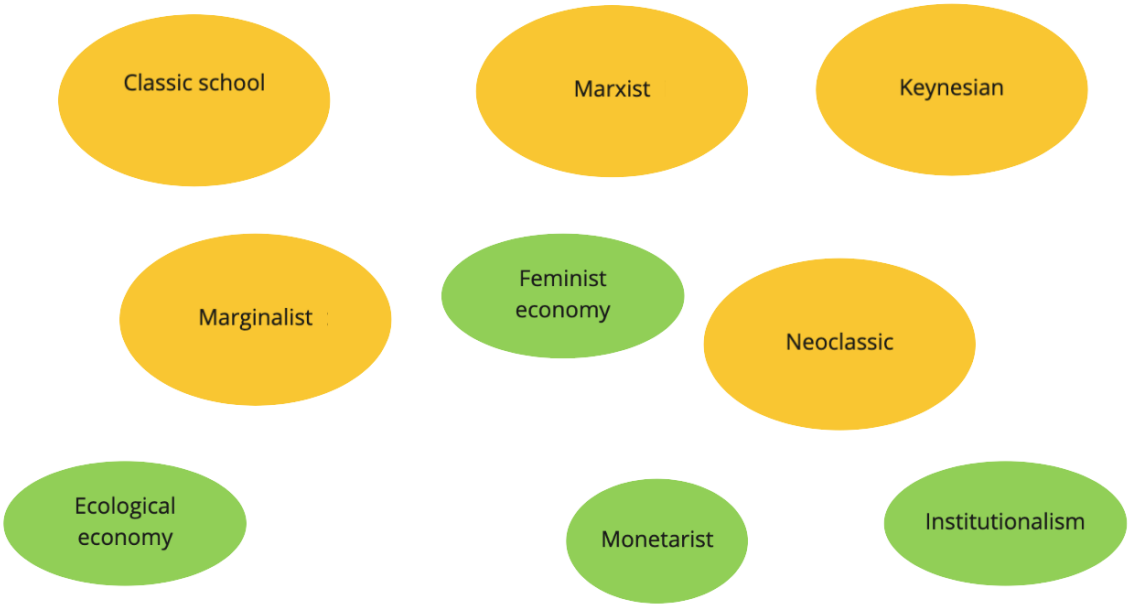
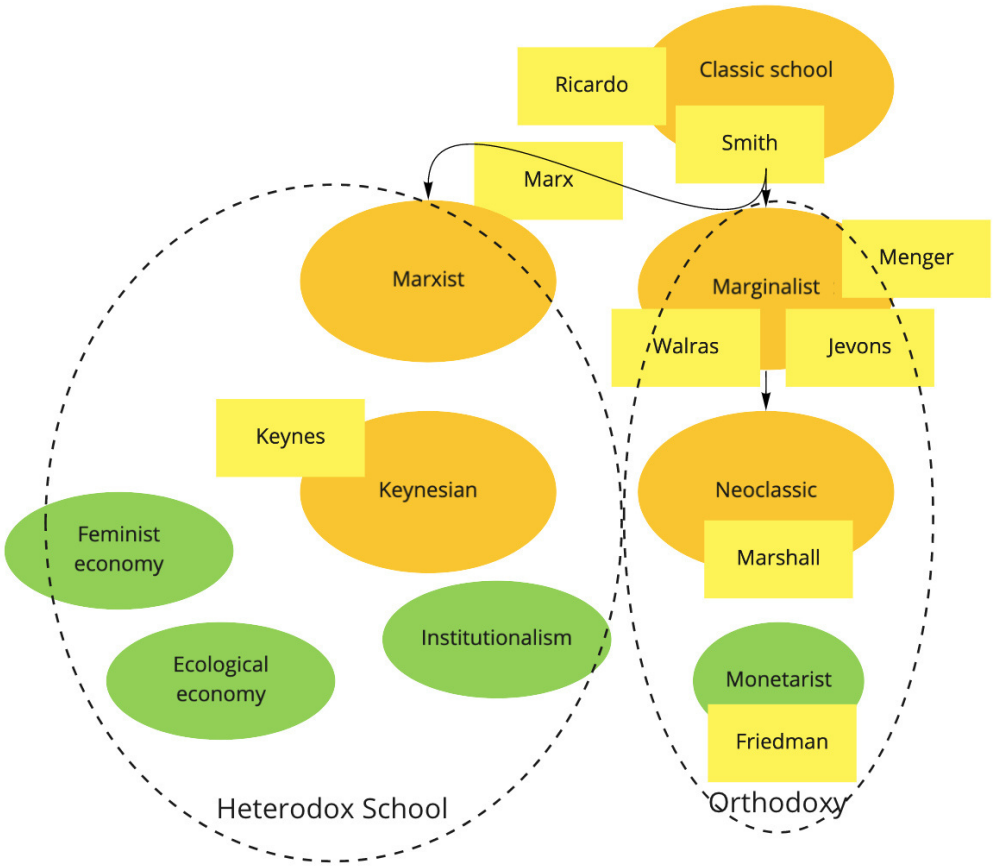
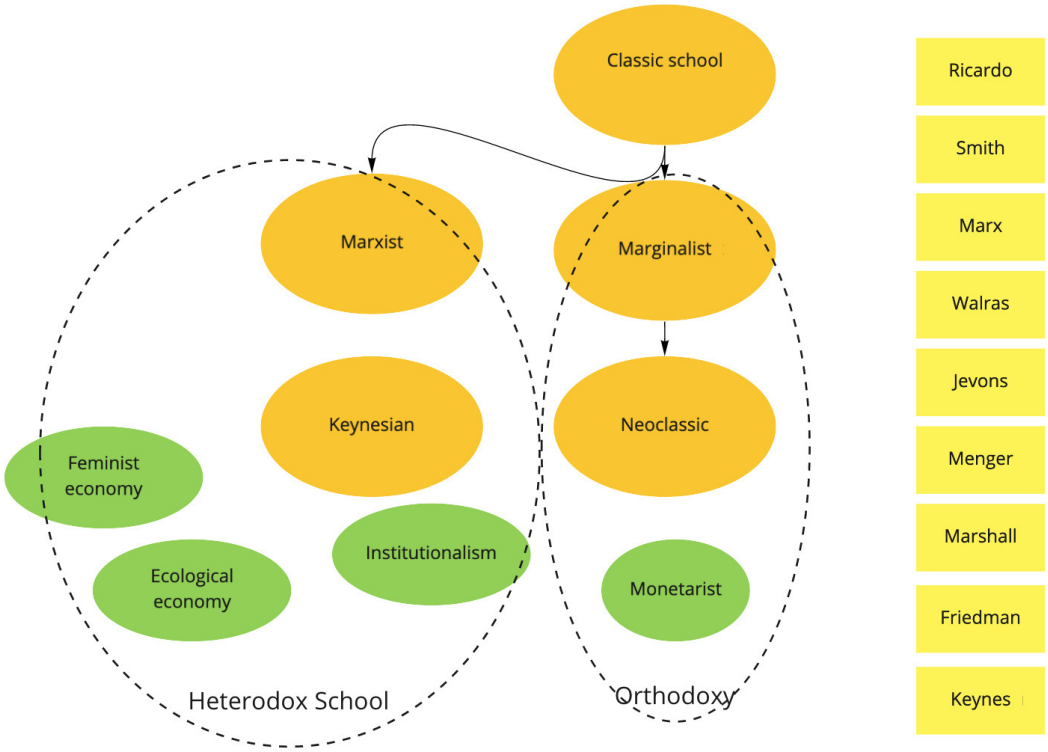
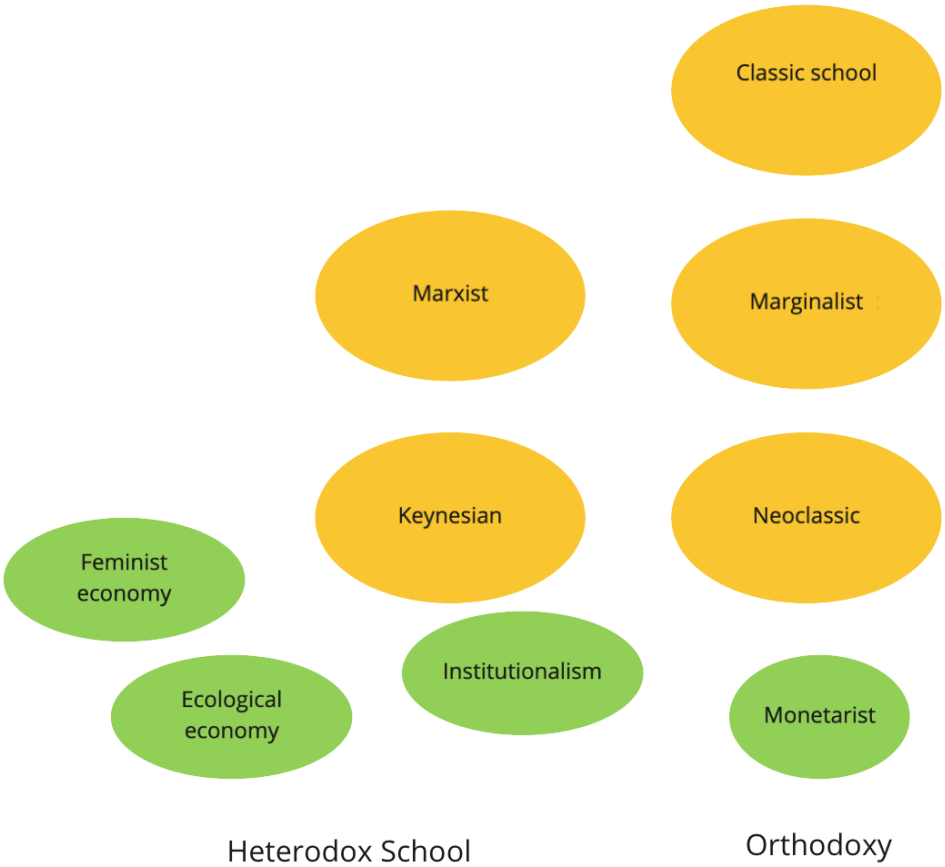


Figure 2. Final result



For the instructor to print:





4. Interactive learning

Activity 1: Quiz of value

Questions

1. The first author to associate the value of commodities with labour is:
   a. Marx
   b. Adam Smith
   c. David Ricardo

2. For Riccardo, the primary regulator of prices is:
   a. The labour time to produce a commodity
   b. The exchange value
   c. The wages of the employees

3. Ricardo´s main addition to Smith's value theory is:
   a. A better determination of the `labour time`
   b. That wages are like the price of any other merchandise, and are subject to permanent variations
   c. An update of the ´primitive society´
4. Despite their differences, Smith and Ricardo agreed that:
   a. Commodities are exchange when the demand and offer price coincide
   b. That the addition of wages and benefits conform prices
   c. That only and exclusively labour has the capacity to "create" value

5. The crucial differences between the classics and Marx in the value theories are:
   a. The difference between abstract labour and concrete labour
   b. That value and exchange value are not the same
   c. Both of the above

6. According to Marx´*the magnitude of the value of a commodity changes directly to the quantity of labour and inversely to the productive capacity of the labour invested in it*´
   a. *True*
   b. *False*

7. Marx´s socially ´*the necessary labour time constitutes the regulator of prices and profit*´ is analogous to Smith´s
   a. Price theory
   b. Invisible hand theory
   c. Both of the above

8. Marx defined surplus value as…
   a. The difference between total labour time and that required to reproduce the workers' capacity to work
   b. The difference between unpaid labour and surplus labour
   c. Neither of the above

9. The school that came to replace *labour value theory* with *utility theory* was:
    a. Neoclassics
    b. Keynesian
    c. Marginalist

10. The main reason why *labour value theory* was abandoned was:
    a. To differentiate from Marxism
    b. It was attracting discontent from the establishment as it was leading to ´dangerous conclusions´ around issues of social redistribution
    c. Both of the above

11. For the Marginalist school, the value of a commodity is determined by its utility that refers to the satisfaction that drives from the consumption of a good. True or false?
    a. True
    b. False

12. Marshall's main contribution to theory of value is:
    a. The idea of marginal utility
    b. The ideas of *sacrifice of labour and the sacrifice of waiting*
    c. The dismissed of a law of value

Alternative note: if the instructor considers the exercise too difficult for the audience, it is suggested to instead of helping by the online MyQuiz tool, to perform it in an analogic way (as it is basically a single choice exercise). In this case, the students won´t be rushing under the online tool timing and could have next to them the information provided in this chapter to search for the answers in it.

Activity 2: True or false

Statements

1. In the neoclassical theory there is an automatic and magnetic tendency that pushes the system to equilibrium and does not rest until it reaches that state (T)

2. The supply curve is the representation of the decision made by workers between the utility reported by the salary obtained for their work versus that provided by the leisure and it has a downward sloping (F: first part it´s true but the curve has an upward sloping)

3. In the neoclassic theory the labour market automatically leads to full employment at the wage that balances supply and demand (T)

4. In neoclassic unemployment is voluntary and can be solved by increasing the labour demand (F: first part is true, but it can't be solved by increasing the demand, the only way of solving unemployment for this theory is reducing wages)

5. For the neoclassic school the economy is always in conditions of full employment and wage rigidity is the cause of unemployment (T)

6. For Keynes unemployment could also be as a situation of equilibrium that could be stable in time, but workers can reduce their wages to come back to equilibrium (F: first part true, second part false: workers can´t reduce unemployment because they can't reduce real wages)

7. Oposing to Say´s law, for Keynes any increase in the production and income doesn't 'always increase the demand as the latter stablishes a distinction between consumption demand and investment demand. (T)

8. For Keynes investment demand is big, the equilibrium occupation volume may well be below that required to guarantee full employment (F: just the opposite, if the investment demand is small and insufficient it may lead to unemployment)

9. For Keynes . Investment must always "fill the gap" between the cost of any level of production (global supply) and consumer demand, always lower (T)

10. For Keynes cause of unemployment is a weak demand, more precisely, weak consumption demand. (F: a weak investment demand)

11. For Keynes exogenous market interventions (from the state) are not negative, but are essential to achieve full employment (T)

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Modern Money: The State Can Do It

An introduction to our monetary system according to Modern Monetary Theory

by Monika Stemmer, weltgewandt e.V.

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1. Overview

MMT describes our monetary system at its current state

Where does money come from? Why is it usually scarce, but in crises suddenly available, almost indefinitely? From where do some governments in the era of the coronavirus disease take hundreds of billions of euros, pounds or dollars from? And why are some governments in the Eurozone unable to do this? Governments, central banks and banks: who actually creates the money, and who lends it to whom? Will our children really have to pay back these national debts at some point?

This article strives to outline the basic mechanisms underpinning our monetary system, information we need in order to answer the aforementioned questions. It does so by using the lens of Modern Monetary Theory (also known as Modern Money Theory or in short, "MMT"). At the moment, MMT is being heavily discussed for two reasons: it highlights the state monopoly on money, and it provides an alternative perspective on sovereign debt. Often the discussions and critique concentrate on normative questions about what fiscal and monetary policy should or should not do. This article instead starts from scratch, explaining our monetary system as it is, employing the descriptive elements of MMT. They offer a solid foundation as MMT is the only monetary theory that empirically studies the practice of banks, central banks and finance ministries and follows the money on its way through the balance sheets. In fact, the latest central bank publications of the European Central Bank, the Bundesbank and the Bank of England confirm the fundamental conclusions of MMT, while at the same time explicitly contradicting basic assumptions of previous mainstream monetary theory.

The descriptive part of MMT will help us to understand the different methods by which money is created, the hierarchy of government and banks, and the inseparable relationship between money and debt. To start with, the fundamental rules of our monetary system will now be briefly presented. In the long version of this article, you will find answers to questions that may arise upon reading, including information on the supranational currency of the euro, which is a more complex case, but is still a state money system to which the rules below apply.

Modern Money – The 5 Key Principles

1. Our money is not guaranteed and limited by any other value, such as gold or silver. Our 50 Euro notes do not say: "The central bank promises you 1 ounce of gold for this note, exchangeable at any bank branch". We only can use the 50 euros to buy whatever is offered at the price of 50 euros. Additionally, we can pay our taxes with it because the state that issues the money will accept it for all payments. This kind of government money is called 'fiat money'. Since it is not tied to a scarce other material, theoretically it can be produced indefinitely.

2. The state has the monopoly on its own currency and determines its monetary value. The state gives itself the monopoly over money creation as a sovereign right. Only the state has the right to produce the state currency. This also means that the state first has to create its currency in order to spend it. Only then can its people have the money to trade between each other, as well as the money to pay taxes. Therefore, first the state has to spend, and then it can tax; not the other way around. In the current COVID-19 crisis we can see in real time that the state does not need to tax first to be able to spend. It can create the money that it needs for its political purpose. Parliaments and governments can decide on the necessary spending thanks to the state's monopoly on money creation. *(See long version for technical questions on bond issuing,*

the relationship between the government, central bank, and banking system, and the politically imposed limitations in the Eurozone – all of which do not change the listed key principles that stem from the state's money monopoly and accounting.)

But if the state can create money, then why does it need to tax its citizens? Taxation is necessary to avoid inflation, as there would be too much money and therefore demand in the economy if the state would create every year's budget without taxing money back. There are years when the state taxes all the money it has spent, producing a so-called 'balanced budget'. The state can also make a 'surplus', taxing more money from the people than it spends into the economy. But often – especially in times of economic crisis – the state decides to tax less and to leave a part of the spending in the accounts of the populace. On the balance sheet this part is registered as 'deficit spending' and over the years it accumulates to create what is called 'the national debt'. In a traditional understanding of money, the state debt is seen as a problem. However, in the MMT analyses, the state debt is not a normal debt, like a person's household debt, but instead represents the money created by the state that is registered as debt. It is the money that the state has spent and not taxed back – and which therefore still lies in the bank accounts of citizens, generating their savings. As long as that state deficits don't create inflation there is no problem with national debt.

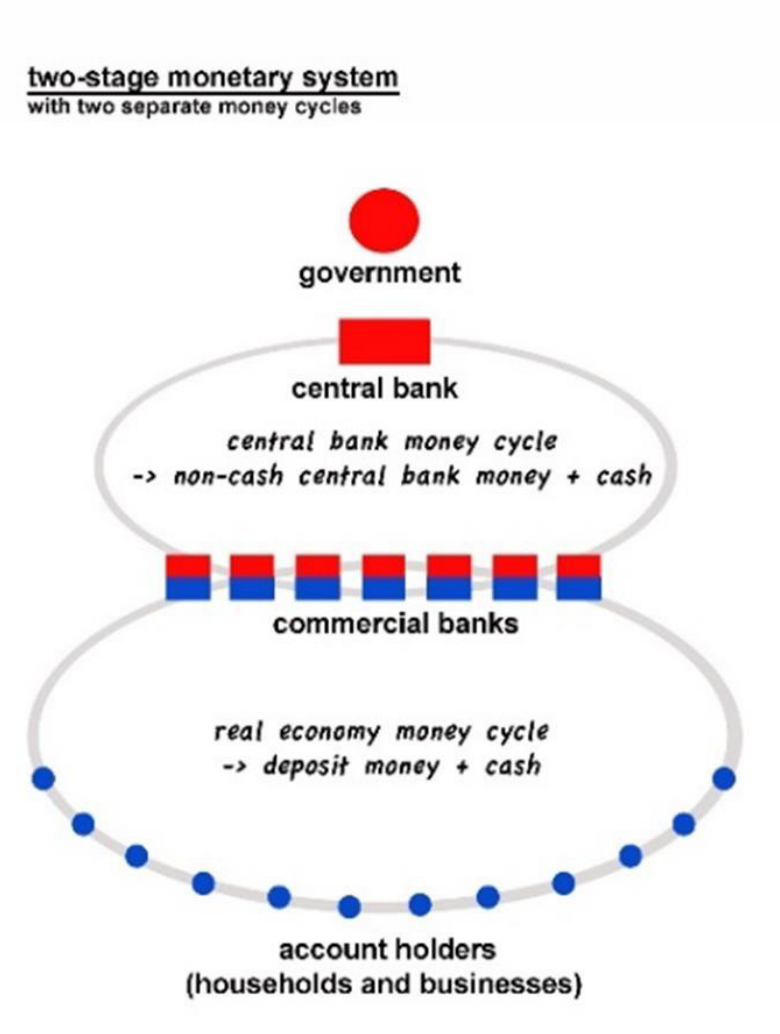
3. The state creates its currency with the help of the central bank, either on the initiative of the government for the benefit of the citizens, or on the initiative of the central bank for the financial system. The state institution that technically produces the currency is the central bank. In a fiat money system, it can theoretically create unlimited amounts of money. Technically, it cannot go bankrupt. There are two methods by which states create money. The first we have seen above: government and parliament decide via the democratic process on expenditures that then are sent to households and businesses. Here the central bank collaborates according to the relevant national or supranational law.

However, the central bank can also use its own initiative to create currency. As the central bank has much less democratic legitimation, this money is designed only for the functioning of the banking sector and in exertion of the central bank's monetary policy. This money will stay in the banking system and not spill over into private banking accounts. (See also point 4. and chart). In moments of economic crisis, we can observe how these two different types of state money creation tend to increase. The central bank itself creates large amounts of money to stabilize the banking system, and the government operates a deficit in favour of households and companies, thereby directly stimulating demand and the economy.

4. We live in a two-stage monetary system. It is not only the state, but also commercial banks that are permitted to create money. Although the state has a 'currency monopoly', it also allows private banks to create one kind of money. It is the deposit money in our checking and savings accounts that we use for transfers. This bank money is not the real currency, it is only second-order money. The deposit money is a promise to pay. The bank promises to us that they will cash out the deposit money at any time we want, or to transfer this promise on our behalf to a third party. We, ordinary members of society, trust this money because we can always receive state cash for it, and furthermore, because the state guarantees it through laws.

The money that the banks create is called 'bank money' or 'deposit money' (or sometimes also cheque money, bank deposits or more technically, 'giral money'). Only the private sector (which are households and companies) utilizes it for their money transfers. The state money on the other hand, is called 'currency', 'central bank money' or 'reserves'. It comes in a very material form as cash, but also in a virtual form, as numbers in central bank accounts. The state, banks

and central banks use only central bank money for their transfers between themselves. The non-cash central bank money can only be found in central bank accounts, and the bank money only in accounts of commercial banks. Therefore, the two types of money do not mix, but circulate in separate monetary circuits. Only cash flows in both cycles and guarantees the exchangeability for us citizens (see chart).



5. Money is always produced in balance sheets and always in the form of a loan, i.e. it is registered with an equally high debt. Generating money is simple: it is entered into the balance sheet of a central bank or a commercial bank together with a corresponding debt. The medium of our money is the balance sheet, so it is virtual by its very nature, regardless of whether the balance sheet is administered in a bank book or in a computer. Nevertheless, this way of creating money has very real implications, as the party to whom the money is credited is simultaneously obliged to repay it in the future, bound by all of the corresponding legal consequences of non-repayment. The bank must now pay out the newly created money in cash or transfer it to the client.

Technically, newly created money is accounted for as 'the exchange of two receivables and two liabilities. If money is paid back to the money creator, i.e., the loan is paid off, all mutual liabilities and claims expire – and the money disappears again from the balance sheet. Money is thus created and expired in balance sheets, according to accounting regulations, within the

framework of contracts, under the applicable laws. And it produces legal consequences itself. It can therefore be stated that our money is a creature of the legal system. Furthermore, our accounting system implies a fact that is often ignored but unavoidable: there must always be as much debt as money. For one party to have money, another party must have debts.

If you extrapolate these inevitable accounting rules onto the macro level, you can study the distribution of money and debt on a state or global level. For every country you can define three so-called 'sectors', with every economic agent belonging to one of them: 1. The private sector (households and companies), 2. The government, 3. The so-called 'rest of the world' (all agents in all foreign countries). Each of the three sectors as a whole can either have more assets or more liabilities in total, thus, be net savers or net debtors. If for example, the private sector in Germany wants to have net savings, the German government and/or foreign countries must have debt of the same amount. If in Germany the government does not want to take on new debt, but the private sector wants to have higher net savings, the rest of the world has to raise their debt level. If one party wants new savings, another party has to have more debt, on an individual as well as on a sectoral and global level. This is not theory, but accounting.

2. Background information

15 questions for diving deeper into the topic

1. What is fiat money and why is it so stable?

Fiat money is not guaranteed and limited by any other value, such as gold or silver. Since it is not tied to a scarce other material, it can theoretically be produced indefinitely. We have had pure official fiat money since 1971, when the US abolished the last indirect remnant of the gold standard. Up to that point, the US central bank, the Federal Reserve or 'Fed', still promised one ounce of gold for every 35 dollars. But the guarantee only applied to foreign central banks that belonged to the Bretton Woods monetary system – and only until European central banks threatened to exchange all their dollars for gold. When that happened, the USA simply withdrew the gold cover for foreign dollars, instead of risking to lose their gold reserves. Even without the gold, the currencies retained their value. At that point it became obvious that it was not the gold standard that made the monetary system work.

According to the MMT-analysis, the worth of the currency is established and maintained by taxation. The state taxes its population and will only accept its own currency for payment. Thus, people will accept the currency also from each other, knowing that they themselves will find others who will accept the money for payment as everybody needs it to pay taxes. Furthermore, taxation makes sure that enough money returns to the state so that the state can spend new money every year without creating inflation over the time. If the risk of inflation were to emerge however, the state could simply raise taxes to take away money and therefore reduce demand from households and companies.

The big advantage of fiat money is that the state always has the money to fulfil its tasks. It can always pay people to work as teachers or judges and buy the necessary materials to construct schools and courts. The state can use its own currency to pay for all available goods and labour in its own jurisdiction – at best for the benefit of the general public. In a democracy, fiat money is created in the course of the democratic processes, when government and parliament decide on a Budget Act in order to implement political and social goals. The thereby enabled expenditures end up in the accounts of the beneficiary households and enterprises.

The term fiat money has its origins in the Latin word "fiat", which means "let it be done". Just as God says: "Let there be light" at the beginning of the Bible, the state says, "Let there be money". And there it will be. Even though unlimited fiat money may seem crazy and unsound at first glance, it effectively increases the state´s stability and independence. Not only does the state always have the money required to fulfil its tasks. Furthermore, it does not make promises it cannot or does not want to keep in case of emergency, as was often the case in the times of the gold standard. The state guarantees nothing else than that it will always accept its currency for tax payments. And so it does. What's more, if the state issues government bonds, then it commits to returning them in its own currency when they mature. Since it can produce the currency limitlessly via its central bank, the refund is always possible. Thanks to fiat money, the state central bank can also provide unlimited guarantees for the banks. During a bank crisis, it is sufficient most of the time to lend the banks large amounts of non-cash central bank money. In a worst-case scenario, facing a large bank run, the state would simply have to keep printing bank notes until everybody calms down again.

According to our accounting system all money is always registered with an equal high debt, and this applies also to the state money creation. But this must not mislead us. Debt in a country's own currency is not like normal debt. It is the debt of the money monopolist, and it can always be repaid. It is the registration of the state money production, as in our accounting system all money is always registered with an equally high debt. And there is a counterpart to the debt of the government in the form of assets: thanks to government debt, other (sub)sectors such as households can have net savings.

2. What are the advantages of a fiat currency and what are the limits?

Of course, fiat money cannot work wonders. It does not mean that a state, being able to produce infinite money, can afford and realize everything. A state can only employ its own currency to buy and utilize the resources that its country effectively owns. For example, if there is insufficient national construction industry and a lack of trained local teachers, the state will soon exceed its capacity when it comes to building schools. This means that the resources positively available within the country are the limit, not the national currency. If the state produces more money than there are resources available, it will create inflation. On the other hand, if there are still resources available, including labour, the state could still create the fiat money to deploy these for the public good.

When it comes to buying products from foreign countries, things become more complicated, as a state can only guarantee the internal value of its fiat currency through taxation. The external value of a currency, in contrast, depends on different factors, the most important of which is export. A country with sufficient exports can use the earned currency to buy products that it cannot produce itself. On the contrary a poor country with little exports will find itself in difficulty when needing to import. It cannot earn the foreign currency through export and its own national currency will have a low exchange rate and little international buying power. Therefore, it might feel constrained to borrow currencies such as Dollars or Euros from foreign lenders to import necessary products. In this case the state will have external debt in a foreign currency. And now what is said in this article about fiat currencies and sovereign debt no longer applies. A state with debt in foreign currency becomes an ordinary debtor that is dependent on its creditors, for now it owes a currency that its central bank cannot generate. It is therefore crucial to always distinguish between debt in a country's own currency and debt in foreign currency, as these are fundamentally different types of debt. When analysing the debt crisis of the last decades, you will almost always find debt in foreign currency being involved. Or as in the case of Greece, the key factor was the new construction of the Eurozone, a currency area that had not yet decided how to treat its own member-countries; as foreign countries or as a part of a common currency area for whom the central bank will use their unlimited privilege to generate fiat money.

Fiat money will not resolve existing global disequilibrium, power structures and the dependencies of poorer countries. To resolve global injustice in the long run, a different international trade order is necessary; one that allows the global south to protect and develop its own economies and that discourages export surpluses, recognising this as the other corresponding explanation of the global debt-crisis. Because when it comes to accounting on a macro-level, inevitably and by definition, one country's surpluses are another country's deficits, one raising net-savings and the other raising net-debt. MMT analysis can help to understand this, as well as the dangerous nature of debt in foreign currency. And it can highlight the chance for all states to strengthen the cycle of fiat money, government spending and taxation to harness

most effectively the resources that a country effectively owns, including unemployed labour.

To keep the pattern simple, in the following passage we will leave out the third sector of foreign countries, and instead we will concentrate on the relationship between government and the private sector. We will begin by exploring the case of a national currency, which will lay the foundation for understanding the more complex, supranational currency that is the Euro. But first of all, we will deepen our understanding of what it means to live in a two-stage monetary system.

➔ *On the topic of strategies against global injustice, see also the article "Sovereign Debt, Europe and the Global South" on this website.*

3.Why do we have two kinds of money and why are private banks allowed to make money?

One can say that bank money creation is an historical remnant. Since the Renaissance, private banking has existed in Europe. In Venice, the technique of book-keeping was invented and does not fundamentally differ from today's methods. Northern Italian bankers developed bank accounts, book money and remittances. London banks later added credit money creation and paper money. Finally, the states reacted and began to take control. The state claimed the monopoly on issuing paper money, organised the foundation of a central bank, the central bank began to create its own central bank money, then the banks were put under the control of the central bank, and in a final step the central banks officially switched from partial gold backing to pure fiat money, that they can create infinitely. The only thing that the states never touched at its core is the banks' right to create deposit money.

A two-stage monetary system was therefore created with two types of money and the following division of labour. Firstly, the state central bank produces the actual currency, the central bank money. It is used in four ways: by the government for its spending, between the banks as a means of accounting, by the central bank itself to hedge the banking system, and finally as cash which is used by the people.

The banks, on the other hand, may derive a second-order form of money from it by creating deposit money for the private sector. This is due to practical reasons; commercial banks have always been keeping the accounts for households and companies, they had branches all over the country and when granting loans, they benefited from their long familiarity with the local economy and profit prospects. At the same time, the bank-users are protected, because the bank money is subordinated to the central bank via cash and other mechanisms and regulations. Also, the interest rate is controlled by the central bank via the key interest rate. This division of labour between the state and private banks seems justifiable – as long as banks do nothing more than keep accounts and hand out loans to the private sector, as was the case in the first decades after the Second World-War.

Since the 1980s, however, a phase of financial deregulation has been taking place. Since then, banks have used their money-creation privilege and privileged access to central bank money for highly speculative and risky business models in order to generate high profits. Such business models led to the global financial crisis of 2008, from which, in particular, many European countries still have not recovered. You can find many descriptions of the damage and risks that

the global financial system brings to the general public, with institutions such as certain banks, hedge funds, and shadow banks, methods such as exorbitant derivatives trading, high frequency trading, and even business models such as cum-ex or cum-cum, all of which explicitly exploit state funds.

However, proposals for sensible countermeasures do exist. Therefore, regarding the banking system, this piece emphasizes that re-regulation is not only necessary, but also possible. This is because although the financial sector has grown and differentiated over the past decades, the systemic hierarchy between the state and the banks has not changed; the state still has the currency monopoly. Therefore, in purely technical terms, banks always need central bank money from the state for their business models. By contrast, the state does not need the banks' bank deposits. In fact, for the state, a private banking system is not indispensable. As money is a public good, it should be self-evident that the state at least ensures with sufficient control and regulation that the banks do not use their derived money creation privilege to harm the greater public good. All the more since in any major crisis it is the government that has to save banks by assuming their debts and the economy with new deficit spending, inevitably, as the state must guarantee a functioning financial and economic system.

4. How does deposit money emerge through lending? And how does it disappear again?

Banks create their bank deposits primarily by granting loans. Let us have a look how this works, with the help of simplified T-accounts. Basically, the following applies: on the left, all asset items of a party are entered, which in the case of a checking account is the deposit money. On the right side, the liabilities are entered, that is the debts. In our example below, we assume that Marta takes out a loan for a racing bike. First, Marta's T-account is empty – she has neither money nor debts. Once Marta´s loan is granted, the bank will credit money to her account (on the assets side) and just by registering it, the money comes into existence. However simultaneously, a debt of the same amount is registered in Marta´s account (on the liabilities side). This represents money that Marta has to pay back in the future.

+ Marta	-

T-account: Marta before loan granted

+ Marta	-
deposit money 1000	debt to bank 1000

T-account: Marta after loan granted

Marta now has freshly created money in her account which she can transfer to the bicycle dealer. This creates demand and revenue for the bicycle dealer, who will probably also pass the money on. Consequently, the money does not disappear, it simply continues circulating. At the end of the year statisticians will count it as additional savings in somebody else´s private checking account. Thus, Marta's loan facilitated demand, revenue and money savings for other people in the economy. Marta herself now owns a bicycle, but as far as her account is concerned, the money is gone and only the debts remain. Her net assets are now -1000 euro.

However, a few months later, Marta has an income of 1000 euro. Now again her account looks

like in figure 2. When she uses the 1000 euros to pay back her loan, both entries disappear from her account, just as they appeared together initially: The 1000 euro she gained vanishes from the credit side because she uses the money to pay back the debt to the bank, and of course, the debt of 1000 euros is also cleared from her liabilities because it has now been paid off. And we are right back to the situation shown in figure 1.: here is again 1000 euro less in the world, but also 1000 euro less debt.

5. Is the bank rich because it can create an unlimited amount of deposit money?

From the bank's point of view, the ability to create deposit money is not as impressive as it seems to private individuals. When we have a look at the bank's simplified T-Account, we soon see why. First, we see that both parties each get two entries, which mirror each other, as the asset of one is the liability of the other.

+ Bank	-
receivables from loan 1000	deposit money 1000

T-account: Bank after loan granted

+ Marta	-
deposit money 1000	debt to bank 1000

T-account: Marta after loan granted

When we now concentrate on the banks T-account, we see, that on the asset side, the bank has received a claim for repayment against Marta. But the deposit money that it created for Marta is a debt on the bank. This is because by registering this new money in Marta's account, the bank promises to pay it out to her in cash or to transfer it to another bank for her. In both cases, the bank needs central bank money, which it cannot produce itself. The bank must borrow it from the central bank against the key interest rate. For the bank, deposit money is therefore a debt to its customers and represents a real cost. For the bank, creating deposit money results in two equally high items on the right and left side of the balance sheet. This is called a 'balance sheet extension' and it leaves the equity, i.e. the own capital of the bank, unaffected. So how does the bank benefit from creating money? It is the interest that is earned on a loan that makes all the difference for the bank and its equity. We have omitted that piece in our example in order to keep the entries as simple as possible and to focus on the money creation process.

When Marta finally repays her loan, the bank's balance sheet shortens again, as in the bank's T-account both entries expire, as they did in Marta's. This is because the claim for repayment on the assets side is now settled. And as Marta used her income to repay her debt, the bank no longer has the liability to cash out or retransfer the money for her. Thus, the bank does not "get" the deposit money from Marta, instead it loses a debt – as well as a claim.

And here is what we want to keep in mind at this point: in a credit-based money system, the money is entered as a debt in the balance sheet of the money creator (the bank). And if money is paid back to the money creator, then their debt disappears again – and with it the money.

6. If there are two separate monetary cycles – how does government spending make its way into the real economy?

In a two-stage monetary system the following problem arises: the government uses only central bank money for government spending. But government spending is to be sent to households and companies which do not have an account with the central bank and therefore cannot receive *central bank money*. They only have accounts at commercial banks, i.e. they can only receive *deposit money*. So how does government spending reach private banking accounts in a two-stage monetary system? It is the bank's task to solve this problem by translating the central bank money, so to speak, into deposit money. When the government wants to transfer her pension to Ms. Sophie, it sends central bank money to the central bank account of Ms. Sophie´s bank. The bank then keeps the central bank money itself on the asset side of its balance sheet, and in return creates the same amount of deposit money by crediting it to Ms. Sophie´s account (which again means a balance sheet extension for the bank, that does not change the equity). However, this necessity to translate one kind of money into the other leads to a double money creation: First, the central bank money supply increases in the course of government spending, and then the amount of deposit money increases as a result of the translation. When people pay taxes, the same thing takes place in reverse. The bank erases the money from the person's bank account and instead transfers the corresponding amount of central bank money to the state. In this case the bank's balance sheet is shortened and both types of money expire when being paid back to the issuer.

With this translation in the middle, government spending and taxes overcome the boundaries of the two separate money cycles. In contrast, the deposit money created by banks remains in the deposit money cycle and central bank money created by the central bank for the financial system remains in the central bank money cycle (see chart). This money cycle issue seems quite technical, but it lets us understand why the different ways of money creation have such different effects. Additionally, it is also very important for the understanding of government bonds, as we will see below.

7. What part do government bonds play in deficit spending?

Government bonds are promissory notes issued by the state. The state turns its debts into securities and sells them to banks and private individuals. Why does it do so? In the orthodox understanding of money, it does so to acquire the money it needs for government spending. From the MMT point of view this is a misapprehension due to a lack of technical understanding of our two staged monetary system. If the state is the one with the currency monopoly and an inexhaustible central bank, then why would it need to get money from private agents that don not have this currency creation privilege? And on top of that, from where would banks and investors have the money to finance the state? Especially considering the fact that one cannot buy government bonds with the banks' deposit money. Government bonds are exclusively available with the state currency, which is the central bank money, that nobody but the central bank can create.

Government bonds lead us on the wrong track. In fact, government bonds do not have the purpose of raising money for the state, as the state is the one with the money monopoly. Government bonds have technical functions in the financial and economic system. Most importantly, the central bank needs bonds to regulate the amount of money in the central bank money cycle. We have seen above (in question 6) that in a two-stage monetary system, government spending must be translated by the banks into deposit money, resulting in double money creation. In the case of government deficit spending however, this money is not expiring through an equal amount of tax paying. Deficit spending therefore results in a permanent rise of money in both money cycles; but only the rise of deposit money in the accounts of households and companies is intended. On the contrary, the increase of central bank money in the banking system is an undesirable side-effect that interferes with the central bank's ability to set its targeted positive key interest rate. If banks could keep the central bank money they receive in the course of their 'money translation service', they would cease to depend on constant short term credits from the central bank at the current key interest rate. To avoid this result, deficit spending is accompanied by the issuance of government bonds. Sold to the banks they function as a "money sponge", absorbing the excess central bank money created in the banking system throughout the translation process. Thanks to this detraction of liquidity the banks are forced to continue to regularly ask the central bank for loans at the current key interest rate.

The key interest rate has long been the primary instrument for pursuing the monetary policy of central banks. In a zero-interest rate phase, like the current one in the era of COVID-19, government bonds would be dispensable for the central bank. However, many stakeholders are still hoping for a return of positive interest rates in the future and the comeback of a "normal" monetary policy. Even more so as it is hard to imagine the financial system without government bonds. They are the safest possible form of investment and an indispensable part of the business model of institutional investors such as banks and insurance companies.

Private savers also appreciate bonds as they represent a safe investment; and this is where another aspect of the story comes into play. In economically prosperous times, government bonds which are sold to private individuals help to prevent inflation by reducing demand. Private individuals will buy them with their deposit money from the government, again with the 'translation' of the banks in the middle of this transaction. In this case, the bonds absorb the extra central bank money as well as a part of the deposit money created by the deficit spending. The ordinary people exchange their liquid deposit money for a permanent asset, thereby postponing their consumption for a predictable time, keeping the demand in the real economy stable, counteracting the risk of inflation.

8. What does the government's money creation look like in the simplest case? For example, in Canada?

In Canada, the Ministry of Finance and the Central Bank can organize the state's money creation directly among themselves. Let's look at how this works in a somewhat simplified form, as a vivid two-person play. Imagine the Canadian Finance Minister needs 50 billion Canadian dollars for government policy. In this case she can directly communicate with the Bank of Canada. She issues government bonds worth 50 billion dollars and hands them over to the central bank. She then receives a credit of 50 billion brand new Canadian dollars in central bank money into the government account in return. In the form of simplified T-accounts, this money creation process

would look like this:

+ central bank	-
government bonds 50 Billion	central bank money 50 Billion

+ government	-
central bank money 50 Billion	government bonds 50 Billion

T-accounts after money creation through sale of government bonds to central bank

These T-accounts look very similar to the ones in the example of Marta's bank loan for a racing-bike. Again, new money is created as the creator and the recipient exchange assets and liabilities in a mirror-image manner. In this example, the central bank creates 50 billion Canadian dollars by registering them on the assets side of the government's central bank account. To balance this, on the government's liabilities side a debt is registered, which is represented by the bonds. The government commits to return 50 billion Canadian dollars at the end of the government bond´s term.

In the central bank's T-account, the same items are entered the exact other way round: the government's debt in form of the bonds are registered on the assets side, as for the central bank they represent a claim to demand money from the government at the end of the term. But the central bank now also has a debt. It has assured to provide the government with 50 billion Canadian dollars and pay it out in cash if necessary or, more likely, transfer it on behalf of the government. Again, the money created is a debt to the money creator. And again, both parties have exchanged liabilities and in doing so are turning the debt of one into the asset of the other.

The figures show the initial balance sheet extension for both parties: plus 50 billion on the left, minus 50 billion on the right. The net assets stay exactly the same before and after the bookings. For the central bank, the balance sheet extension remains in place until the government bond has been paid back (or the central bank sells the government bond off to the banking sector). Then the balance sheet is shortened again. In the case of the government, the balance sheet extension is only a snapshot since the new money on the assets side will soon be transferred to the recipients of the government spending. The money, translated by the banks, will become income and savings in the accounts of citizens and companies and circulate in the real economy.

On the government balance sheet remains the new debt of 50 billion Canadian dollars that the government now owes to its own central bank – or to the banks to which the government bonds were resold in the meantime. For it is likely that the Canadian central bank will resell the government bonds so that they can perform their function as a "money sponge" within the banking system.

9. From Canada to the Eurozone – is government money creation really that easy?

Countries have a certain amount of freedom in organizing their currency monopoly and their fiat money system, without affecting the underlying basic principles. In particular, the

relationship between the ministry of finance, the central bank and commercial banks can differ, as can the order in which money and bonds are exchanged between them. Often, unlike in Canada, governments are not allowed to sell their government bonds to the central bank. Instead, they must sell them directly to *commercial banks*. This has the advantage that right from the beginning, the bonds are placed in the financial sector to fulfil their function as a "money sponge". In fact, this change of the order does not make as big a difference as might seem on the face of it. In the US for example, firstly deficit spending occurs, executed by the central bank which thereby creates the money. Then, in an independent move, the government sells bonds to the banks amounting to the amount of the deficit spending. In other countries however, first the central bank makes the necessary money, which it creates by giving loans to banks. With this new money, the *commercial banks* buy the bonds from the government.

What always stays the same is this; it is the central bank that makes the new money to pay for the deficit spending and to buy the newly issued bonds – nobody else could do that. And it is always the state institutions that control this process. When governments are legally obliged to only sell their bonds to the financial system, this does not give banks power over governments, as one might think. In countries with a national currency, the central bank can control the behaviour of the banks very precisely. In fact, the central bank has not only one key interest rate, but a set, and by manipulating these it can make sure that the banks play their designated role in the process and absorb the bonds at the interest rate the central bank dictates. Thus, the central bank does not need the right to buy bonds directly from the government to guarantee the government's solvency. It can also pull the necessary strings in the background to make sure that the money will arrive with the government via the banks, indirectly creating a "money sponge".

However solely in the Eurozone, things are much more complicated. Nineteen countries of the European Union share one fiat currency and one central bank, the European Central Bank (ECB). It is an experiment without a model and therefore the treaties establishing the rules for the euro and the ECB are a compromise. They reflect the mutual mistrust that other states might over-use the money-creation privilege of the central bank in their own favour and end up creating inflation for all.

To make the euro possible, the Eurozone members committed themselves to a number of obstacles that make deficit spending by national governments more difficult or prevent it altogether. Debt ceilings were set, especially severe ones for states with high historical debt. Additionally, an artificial market has been implemented in the state money creation process. Governments must sell their bonds to the banks – which in itself would not be a problem, as we have seen above, as the central bank makes the necessary money and gives it to banks anyway to buy the bonds. But the unique problem in the Eurozone is that banks take the money, and without any exchange rate risk, they can choose between 19 different national government bonds. This exceptional situation allows banks to drive up the interest costs of individual states – a scenario which would not be possible in the usual case of "one currency equals one government bond". Subsequently, Eurozone countries with high debt levels, suffer not only from the debt ceilings, but also the risk of paying interest rates to commercial banks to levels that are no longer sustainable, as the interests make the debt rise as by itself.

These inherent problems with the common currency area have manifested since the euro crisis in 2010 which followed the financial crisis. The starting signal was that Greece, as a part of the Eurozone, was not saved by the ECB but was declared 'defaulted', like a state of the global south, indebted in foreign currency. With this unexpected possibility of a national bankruptcy and default appearing, the confidence in the reliability of the euro-project was shaken. The banking

sector started to speculate against states with high debt levels, and the ECB allowed the spread in interest rates of bonds to proliferate. Only in 2012 did the EBC finally start to intervene, after debt levels in some Eurozone-states had further risen as a result of uncontrolled interest rates. In the economic crisis, the rules of the Eurozone translated in practice to an austerity program that inhibited investment and recovery in great parts of the Eurozone.

The strange situation of a market created specifically for bonds combined with the hesitation of the ECB to exert control over ensuing interest rates consolidated the misunderstanding that Eurozone states are financed by banks. To reiterate: The Eurozone still remains a fiat money system, with the euro being the common state currency, whereas the deposit money of the banks is only second order money that can buy no bonds, let alone finance states. The lack of money and investment stems from the self-imposed restrictions the euro-states signed up to in the Maastricht-treaty. These rules can be only changed unanimously, and this is what makes changing them extremely difficult. As a result, some politicians and parties in disfavoured countries advocate for leaving the Eurozone, opting for the uncertainty of the process rather than remaining constrained by the rules.

10. How does the vulnerable Eurozone manage the COVID-19 crisis?

The COVID-19 crisis has created new momentum for changes within the Eurozone, but the longer-term outlook is still unclear. The fundamental rules underpinning the Eurozone have not been changed. But there has been improvisation as well as innovation in order to react to the COVID-19 induced need for higher investment and therefore higher debt levels. Some Eurozone rules, such as the debt ceilings, have been temporarily suspended. The ECB backs the deficit spending of the states. With its Pandemic Emergency Purchase Program (PEPP), the ECB has stabilized the interest rates of government bonds by guaranteeing to buy the country's bonds from the banking sector. This is a clear break with the policy towards Greece, Italy and others in the euro crisis after 2010. This time there is no risk of default of single states and the spread in interest rates has not proliferated any further.

Still, there is a spread that disadvantages the already more vulnerable euro-states in fighting the crisis. And as long as interest rates are higher than growth rates, public debt will grow – in relation to GDP as well as in absolute numbers. This is an issue because many states have the substantiated fear that after the acute COVID-19 crisis the Eurozone will go back to punishing high debt levels. So, the already heavily indebted Euro-states do not dare to spend as much as the economic crisis would demand. States such as Germany on the other hand have decided upon releasing huge fiscal stimulus packages in order to save their economy. Under these conditions, however, even greater economic inequality in the Eurozone is the logical consequence.

The most effective change that would make the vulnerable Eurozone as resilient as any other country with its own fiat currency would have been the introduction of a sole bond, called a Eurobond or a “corona bond”. All the specific Eurozone problems would have been solved once and for all: the loss of trust caused in the euro-project since 2010 when Greece was sent to default, the resulting spread of unsustainable interest rates, a financial system that since then has speculated against certain states, and the necessity of the ECB to stretch its mandate to defend the euro under the conditions named. But politically it has been impossible to implement common debt in the form of common bonds – because of diverging interests in the short term,

but also because this fundamental change probably would need more democratic legitimation, potentially including changes in the European contracts, institutional changes, and referendums.

Thus, instead of resolving the problems on the Eurozone level where they stem from, the European Commission took over and came up with an idea. For the first time ever, the European Union itself would take on a considerable amount of debt. This is how it works. Firstly, the Commission releases bonds that banks and investors can buy with money created by the ECB. Then, the Commission will give this money to the EU governments, partly as non-repayable aid, and partly on favourable credit terms. The states can invest and try to save or restart their languishing economies. In doing so, from a monetary point of view, the European Commission acts as a federal government that creates currency for its states as some of them are no longer able to do so sufficiently for themselves under the euro-regime. This solution also results in common debt, which the Eurobonds would also cause, but the advantage is that the European Union with its institutions of Council, Parliament and Commission, has more democratic legitimation and can move faster. The disadvantage is that the agreed amount of money is not big enough for the dimension of the crisis and the intervention is meant to be unique. No changes to the architecture of the Eurozone have been made, so the member states still have to find a long-term perspective.

The institutional problem of the Eurozone is that democratic legitimation, spending and possibly negative results of inflation no longer conform – as would be the case with a national currency. In the Eurozone, national parliaments and governments are still the most legitimate democratic agents and therefore the ones who should decide on spending and money creation. But in case of serious overspending in some of the states, inflation could then also occur in more parsimonious states that did not profit from spending and also cannot vote against the negative consequences of another state's profligacy. The Eurozone on the other hand, has no governmental institution with democratic legitimation that could decide on direct spending in favour of households and companies. The unproductive solution in the European contracts consisted of restricting spending altogether – which also constitutes an infringement of democratic policy space. The latest provisional answer to this dilemma is the European Commission taking on debt. It remains to be seen how the institutions will further adapt. From an economic point of view it is easy; on the national or on a supranational level, some governmental institution has to be allowed to take on the debt, create enough money, and spend it into the real economy, to overcome crisis and at best, make our continent 'future fit'.

➔ *On the topic of future and sustainability, see the article "Climate and Economy" on this website.*

11. Why are government debts not comparable to other debts?

All types of money creation are accounted for in the same way, with mirrored claims and liabilities for both parties. And all debts look the same on the balance sheets, whether the government owes money to the central bank or Marta owes money to her bank. Yet, in reality, not all debt are the same. The debt of the Canadian government and the debt of an individual like Marta have very different implications. If we as private individuals have debts and cannot pay them back, we face serious legal problems. We are threatened with lawsuits, bailiffs, foreclosures, legal enforcement. We owe money that we cannot create and therefore we have to find a way to procure it when it is due. Even the commercial banks, which can create deposit money, are only users of the actual currency and dependent on the credits of the central bank. They go bankrupt when their equity goes into the red. Then it is up to state institutions whether

to close, rescue or nationalise them.

Government debt, however, is of a different nature. Because the state has a monopoly on currency, it has the right to produce the kind of money it owes. The state's own central bank, unlike a normal commercial bank, cannot go bankrupt. And if the government owes money to the central bank, then the state ultimately represents both roles. You can see this difference very well in our Canadian example. When the term of the government bonds matures and the Finance Minister has to pay back the money – will she be in trouble? No! Because unlike normal debtors, the Finance Minister does not have to desperately find a source of money to settle government debts. She can simply issue a new bond and make the central bank create new money to pay off the old debt. Thus, old debt is just replaced by new. The amount of debt and bonds stay the same, only the due date is postponed. No trembling, no uncertainty for the Finance Minister – the Canadian central bank is legally obliged to cooperate (and even the interest that the Finance Minister pays to the Bank of Canada returns to the government budget at the end of the year). Therefore, although the government's money creation is properly recorded in the balance sheets of both parties with debts and claims, it is basically a business of the state with itself. Because of its currency monopoly, it is both creditor and debtor at the same time; it creates the money.

This story does not change much if the central bank has sold the bonds to banks and private investors or even foreign investors in the meantime. When the bonds are due, the Finance Minister will do the same: she will replace old debt with new by selling new bonds to pay off the holders of the expiring ones, whoever they are. The Canadian Finance Minister can sell the new bonds again to the central bank – or directly to the banks as in most countries. If she sells to the banks, she can count on the central bank to create and lend the necessary money to the banks, manipulating them with the key interest rates to buy the newly issued bonds. This ensures that the state can always place new bonds. Thus, there is no risk that the government cannot pay back a due bond, independently from who is holding it. The only difference with the private sector holding the government bonds is the interest and whether there is a positive interest rate. The Finance Minister then will have to pay interest to banks and private investors and will not get the money back at the end of the year (as it does if the central bank itself holds the bonds). But also, in times where the central bank has to set high interest rates to control inflation, if the interest creates too big a cost for the state budget or is having undesired effects with regards to distribution – the government could always tax the beneficiaries of high interests and thus provide compensation.

12. Do public debts need to be repaid? Should they be repaid?

Of course, the individual government bond must always be returned when it matures. But as we have just seen, if the bond is denominated in a country's own currency this is no issue for a state with its own central bank. In contrast, the government debt as a whole does not have to be repaid but can simply remain on the balance sheets and be pushed further into the future. This is because there is no original creditor waiting for the money to be paid back. The origin of the money is the balance sheet of the national central bank, where the money came into existence by being registered. And the central bank is not like a normal creditor who urgently needs their money back. On the contrary, the central bank can produce new money indefinitely. It creates money by a simple balance sheet extension – and no harm is done to anyone. As long as the government does not overdo it with money creation and does not provoke inflation, public debt

is not a problem and can simply remain peacefully on its balance sheet. It can even continue to grow moderately – as long as there is no sign of inflation.

To allow the national debt to peacefully exist is also in the self-interest of households and companies. For in fact, public debt on the balance sheet is only the flip side of private savings. National debt rises when the state makes expenditures and does not tax them back in the same amount. The money corresponding to the public debt is therefore still out there on private checking accounts, constituting the savings of the private sector. If the state now wanted to reduce the public debt in absolute numbers, it would need to tax these private deposits. The state would have to have budget surpluses for a long time, meaning that the government would always tax more than it spends, thus reducing private savings year on year. Only then parts of the national debt would disappear from the balance sheet it originated from. Is it worth it, though? Disregarding the individual inconvenience, there is a high probability that the economy as a whole would react badly to this strategy. Households and companies will respond to the pressure of a high tax burden and little government investment by feeling pessimistic and by saving more. Very soon not only would the state try to save money and reduce investments, but the private sector would too. Demand would decrease and therefore production and employment would suffer. When a recession sets in, the experiment of public debt repayment would probably come to an end, and the government would decide on new deficit spending to support the economy, beginning the cycle all over again.

Actually, government debt has generally *not* been repaid. Only the so-called 'government debt ratio' has regularly fallen. The government debt ratio is a way to represent government debt relatively, as a percentage of gross domestic product (GDP). This means that it is enough for GDP to rise for the public debt ratio to fall. By contrast, government debt in absolute terms almost never decreases. Contrary to all the good intentions expressed, it is not being repaid, as in practice any serious attempt would soon lead to recession. After all, returning the national debt equates to reducing the amount of the existing money. And as a final consequence, the repayment of all public debt would mean taking all the money from the accounts of private individuals and banks and making it disappear from the large public balance sheet from which it originally came. All debts would be gone and with them all savings, and all money.

13. When does inflation rise? And why is deflation a problem?

Inflation means that money loses value, or in other words, that goods and services become always more expensive. One typical situation that leads to inflation is when demand rises more than the quantity of goods and services available. The money supply is only one of several factors involved. It also depends on how much money people save. As long as the money supply increases, while people simply hoard the additional money in their accounts and do not spend it, nothing happens. Just as important is whether the production of goods and services increases or decreases. If the production of real values increases in tandem with the money supply, the value of money remains stable.

Leaving external shocks aside for the moment, inflation occurs in boom times, when production reaches its limits because all factories are working at full capacity and full employment prevails. Then wages rise, which drives prices up. In such cases, the central bank tries to slow down the banks' money creation by means of its key interest rate. A high interest rate aims to discourage companies and private individuals from taking out more and more loans in the boom situation.

In fact, it is the banks' own money creation that increases automatically in good times and therefore tends to have an inflationary effect.

The state basically has two ways of reacting to inflation and reducing demand: first, the central bank can raise interest rates sufficiently to reduce the demand for credit and, thus, the commercial banks' production of giral money. In an overheating economy, where considerable credit is demanded and invested, raising the key interest rate can cool things down. But the central bank must proceed cautiously so as not to trigger a recession by stepping on the brakes too hard. Modern Monetary Theory points out that excessive demand can be reduced more sensibly by raising taxes than by raising interest rates. But even here, the government must consider the risk of a collapse in demand.

The dangers of a recession must not be underestimated by any means. For when unemployment rises, demand soon collapses. Since there is less demand, less is produced and even more people are fired. The problems of too little demand and unemployment are mutually reinforcing. This case is usually accompanied by deflation. Prices are lowered to find consumers willing to purchase and falling prices make production even less profitable. Deflation, once it starts seriously, leads to a downward spiral against which the central bank's key interest rate will be powerless. For where demand and profits no longer exist, even a loan at zero interest is too great a risk for a company. In such a situation, households, companies, and banks save and thus exacerbate the situation. Now it is only the government that can save demand and the labour market. Since the state does not have to make a profit, it does not have to pay back its debts and is therefore the only one that can act anti-cyclically and swim against the tide.

But now we are experiencing inflation that is not driven by rising investment and rising wages, but by external shocks. The Corona crisis and Ukraine war have affected global production and supply chains, so that fewer goods and services are available. During the Corona crisis, states have expanded their money creation to cushion the recession and avoid unemployment. Now, the states need and create additional money for the Ukraine crisis. Global demand has thus potentially increased. In addition, the Ukraine war is pushing up one of the most important prices - that of energy. Some increase in inflation seems inevitable in this situation. This is because external circumstances prevent production from adjusting to demand by expanding. The current inflation situation is based on global events and price developments that Western central banks cannot change. There is therefore a high risk - especially in the fragile Eurozone - of triggering a recession by raising key interest rates without solving the inflation problem. In the end, the government could be forced to create and distribute even more money to avoid social hardship.

It is important to realise that in certain situations moderate inflation can be the lesser evil compared to a severe recession. For while inflation mainly threatens savings, recession threatens labour income, which is the more crucial factor for most people. While the purchasing power of labour income is also reduced by inflation, there is the possibility of targeted support for those who can no longer afford the cost of living due to rising prices.

Fundamentally, the current inflation is about too much demand for resources that have become scarcer due to international developments. To fight inflation and ensure a fair distribution of what is available, a political cap on consumption is also conceivable, for example by limiting the consumption of fossil energy or relieving the rising grain prices by limiting meat consumption, which of course requires democratic majorities.

➔ *On the topic of economic crises see also the article "Economic strategies to manage the crisis: Austerity*

or government investment programmes?" on this website.

14. What is the neoclassical take on this topic? And why does credit money make such a big difference?

Economic textbooks usually still hold money models based on neoclassical theory. Banks are still described as "financial intermediaries" and the formula of the "money creation multiplier" is still taught - even though central banks now explicitly contradict both concepts and state that they are inconsistent with the practice in the banking system and the accounting rules.

The notion of "banks as financial intermediaries" assumes that banks lend customers´ savings to borrowers. Banks would therefore only channel the money to where it is needed. In this way, money becomes a commodity like any other, which is offered and demanded, and it is from this market process that it derives its price (the interest). This premise allows neoclassical theory to regard money as 'neutral', as not causing any effects out of itself, and most of all, having no influence on consumption and unemployment whatsoever. At the same time, this theory stresses the importance of saving. Somebody needs to put money aside first, so that somebody else can invest. This concept of money can be used to justify, for example, austerity policies and the idea that saving could be a 'cure' in a financial crisis.

The money creation multiplier, in turn, is a formula designed to calculate how much banks can reproduce money by further lending savings. According to the formula, the ability to multiply savings is determined and limited by the supply of central bank money. This would mean that the supply of deposit money could be controlled by the central bank and would not depend on real economic demand. In fact, however, the central banks cannot control or even regulate the money supply via their central bank money. On the contrary, increased creation of deposit money by the banks and the implied higher demand for central bank money lets central bank money supply rise (see Bundesbank 2017). Whilst the banks are indeed dependent on the central bank, because they always need its central bank money, the central bank cannot refuse the required central bank money for a bank loan, that has been properly granted. It can only externally define the key interest rate (which therefore is not a market price for money) and thus try to indirectly slow down the growth of deposit money creation.

These questions initially seem abstract and technical. But they have far-reaching implications. If bank money is understood as purely loan money, as this article shows, there is no initial need to save money in order to later invest, since investment can be covered by a loan. This facilitates demand and therefore the savings of third parties, which otherwise would not have been possible. The banks´ credit money therefore is anything but neutral, as in good times it enables momentum and growth, but because its production is dependent on the demand for loans, it is also extremely vulnerable to crisis. In a crisis, no one wants to take up a loan - and even if they do, the bank will not grant it due to poor repayment forecasts. Instead, more and more loans are being returned, and therefore money supply and demand decline even more. Credit money needs profits, and thus has a pro-cyclical effect. In a crisis it becomes part of the problem and cannot recover by itself. And even a zero percent key interest rate and the flooding of banks with central bank money does not lead to more lending in a proper recession.

Against this backdrop, it is all the more important to focus on government money creation through deficit spending. The MMT analysis proves deficit spending to be much more than just

government debt. It is also “the mother of all money creation” the democratic creation of money for politically useful purposes as well as the only countercyclical money creation that can supply people with money when no one else can.

15. More about Modern Monetary Theory?

Since the 1990s, MMT has been developed by economists and financial market practitioners in the USA such as Randall Wray, Warren Mosler, Stephanie Kelton, Pavlina Tcherneva as well as William Mitchell in Australia. The most important German representative is Dirk Ehnts, whose book "Geld als Kredit" (“Modern Monetary Theory and European Macroeconomics”) was instrumental for this article and is also the source of the T-account presentation. MMT-economists refer to the following historical predecessors and their ideas: Abba Lerner (inflation and unemployment are crucial, not the national debt), Georg Friedrich Knapp (money derives its value from state taxation), Alfred Mitchell Innes (credit money forms with equal debt), John Maynard Keynes (the expenses of one, always constitute the revenues of another), Wynne Godley (revenues equal expenses also on a sectoral level), and Hyman Minsky (credit money leads to crisis susceptibility of the financial system).

MMT is to a large extent purely descriptive and analyses the current state of our monetary system. The methodology consists of empirically tracking practices in the financial system and ministries of finance, as well as accounting transactions between all private and state participants. It applies an additional analysis of the balances of different sectors (private, government, foreign), which corresponds to accounting at macro level. According to this methodology, MMT results are also falsifiable, which is unique in monetary theory. As far as this descriptive part is concerned, no scientific objections exist. It is exactly this descriptive part of MMT that this article tries to summarise.

Aside from that, there is also a normative part, in which MMT economists draw conclusions from their analysis. They present different ideas for the sensible management of monetary and fiscal policy that could initiate far-reaching changes. Understandably, this part of the theory often leads to opposition and polemics, for the profound political implications. However, the objections are usually generalised, and compensate for the lack of valid arguments against the descriptive part. For the sake of achieving a complete picture, what follows is an overview of the normative element of the MMT. MMT economists agree that the amount of public debt is in itself insignificant and does not deserve further attention. They advise to consider the figures of unemployment and inflation instead, because these are the two real phenomena that should actually be controlled. The focus on government debt is thereby pointless, as there is no empirical evidence of causality between government debt and inflation. MMT economists thus come to the provocative conclusion: as long as there is no significant inflation, the state can exercise its monopoly on money creation and spend money on its democratically decided policies. Preferably, it should do this through the creation of work. MMT-economists sometimes put it bluntly by saying that if unemployment is too high, then the national debt is too low. With regards to monetary policy, MMT-economists recommend coping with inflation by adjusting taxes rather than the key interest, since a high key interest rate often slows down the real economy to an extent that triggers the rise of unemployment. The key interest rate as an instrument would thus turn dispensable and the payment of interest would become a political matter.

Besides, MMT-economists have come up with a very concrete and socially far-reaching

proposal, which can only be touched on here. The so-called MMT job guarantee would work to solve the two most important problems of monetary and fiscal policy at the same time: unemployment and monetary stability. The job guarantee advocates the right to a state-assured job for everyone who is able to work, wants to work and can't find a job. This program would act as a strong automatic stabiliser for the economy. In recessions, many people would transfer from the private to the public sector of the job guarantee – demand would therefore decrease slower than in other cases, and deflation would be avoided. The necessary deficit spending would not lead to inflation, since on the one hand the additional work would create extra services and on the other hand, employees in the public sector would be remunerated at a state-approved pay rate, which anchors the price of labour to counteract inflation. Once an economic recovery occurs, more people would return to the private sector. Private employers could draw from a pool of educated workers from the public sector, so that even in boom periods, the rise in wages and prices would be delayed. Nevertheless, should inflation occur, the state could increase taxation to remove demand from the system.

Regardless of one's opinion on the job guarantee, MMT extends the democratic scope in general. The state possesses money because it can create money. Government debt is not a problem in and of itself but is instead the flip side of money creation. By adopting this mindset, we could focus on *which* political projects to finance instead of discussing *how* to finance political projects. This theory is encouraging, especially regarding upcoming transformational processes in the context of climate change and future crises. It demonstrates that we have the means to shape our future.

This text is based on decades of studies by economists of Modern Monetary Theory (MMT) and makes particular use of the balance sheet perspective that Dirk Ehnts uses in his book "Modern Monetary Theory and European Macroeconomics". There is overlap between this text and the author's book on modern monetary theory, which is expected to be published by Westend Verlag in spring 2023.

Glossary

Cash: money in its material form, that is, notes and coins. It is issued by the state and is the official legal tender. Cash is a part of the central bank money. Only the exchangeability into cash gives the deposit money its value. Cash is the only type of money that circulates in both money cycles.

Central Bank: the bank of the state and the institution that practically carries out the creation of the state fiat money. The central bank creates money for the financial system on its own initiative and can, in a banking crisis, stabilise it with unlimited credit, acting as the so-called 'lender of last resort'. But the central bank also creates the new money that is needed for the government's deficit spending, although in many states the central bank and government won't collaborate directly but instead use banks as intermediaries. The most important instrument with which the central bank pursues its monetary policy and tries to influence the banks' money creation activities is the key interest rate.

Central bank money (currency or reserves): the actual national (or supranational) currency. The central bank creates it as cash and as non-cash money in central bank accounts. Government, central bank and banks use only central bank money among one another. The banks' deposit money gets its value only by being exchangeable into central bank money. Banks always need central bank money: for cash withdrawals to their customers, for settlements and transactions with other banks and for minimum reserves. The banks get it from the central bank at the key interest rate.

Deficit spending (deficit expenditure): the part of the annual government budget, which is not covered by tax revenues of the same amount. Deficit spending leads to money creation by the state and the newly created money ends up as credit on the accounts of households and companies. The deficit spending of all the years sums up to the sovereign debt.

Deposit money (bank money, bank deposits, giral money): the deposits that we citizens have on the assets side of our current and savings accounts. Deposit money is generated by the banks whenever they grant loans to households and companies or buy value from them. For the banks deposit money
represents a debt to their customers, as they have to cash it out or transfer it on their behalf – therefore, it is on the liabilities side of the bank balance sheet. Together with state cash, deposit money is the money that households and companies use for their financial interactions.

Fiat money: money issued by the government that is not covered by any material equivalent, such as gold or silver. Fiat money has been the international norm for money at least since 1971, when the USA abolished the last remnant of the gold standard. It has the advantage that each state can freely create its own money and technically cannot go bankrupt as long as it is indebted exclusively in its own currency.

Government bonds: government promissory notes. They have a term, are denominated in a currency and usually offer an interest rate. Government bonds are very popular with investors as the safest possible investment, and they are indispensable for institutional investors such as insurance companies. Contrary to common belief, government bonds do not serve to raise money for the state (as it has the money creation monopoly and the central bank). Technically, government bonds rather serve to absorb liquidity out of the banking sector, and thus guarantee

the effectiveness of the key interest rate. Government bonds which are resold to private individuals shut down demand and thus also have an anti-inflationary effect.

Key interest rate (base rate, prime rate): the interest rate that the central bank charges commercial banks for the central bank money they lend. In the case of a national currency, the interest rate for government bonds is only slightly higher than the key interest rate, as these are as safe as the currency itself. The banks pass on the rate to their private customers with respective risk surcharges. With these mechanisms, the key interest rate influences all interest rates in a currency area. For the central bank it is the most important instrument. When the economy is running hot, with the banks granting more and more loans and inflation is threatening, the key interest rate is raised and acts as a brake. In a recession, lowering the key interest rate is less effective, as even a loan at zero interest is too expensive if demand and profit expectations are lacking.

Public debt (national debt, government debt, sovereign debt): the sum of all annual budget deficits, minus budget surpluses in other years. The public debt also corresponds to the money that the government has created in favour of the private sector over the course of its existence and has not taxed back, and thus (disregarding inflows and outflows of foreign money) mirrors the net savings of the private sector.

Public debt ratio (debt to GDP ratio): the public debt not in absolute terms but in relation to gross domestic product (GDP). This means that the public debt ratio decreases automatically when GDP increases. Even if government debt is rarely actually repaid, the public debt ratio has been able to fall repeatedly in many countries during good economic times, a process also known as "growing out of debt". On the other hand, the public debt ratio rises automatically when GDP declines - even if no new debt is taken on.

Sectors (private sector/public sector/foreign countries): the private sector is formed by households and companies (including private commercial banks, if not specified otherwise) and it is opposed to the public sector i.e., the federal state. The third sector are the foreign countries (also named ‘rest of the world’). In the analysis of an economy, each economic agent inevitably belongs to one of the three sectors.

Sectoral analysis: Taking into account that in a credit money system every credit balance has inevitably arisen with a debt, by means of the division into sectors one can answer the following question: If a country's private sector has net savings of 10-billion-euro, and the public sector of the same state has only 4-billion-euro debt - who has the other 6-billion-euro debt? It has to be the foreign countries – as someone has to have it.

Resources

For further reading:

Bank of England, Money creation in the modern economy, Quarterly Bulletin 2014 Q1, 2014 public-friendly explanation of the different types of money, such as fiat money, credit money, cash, non-cash central bank money, bank deposits; confirmation of the bank's creation of deposit money through loans.

Binswanger, Mathias (2015), Geld aus dem Nichts: Wie Banken Wachstum ermöglichen und Krisen verursachen, Weinheim: Wiley-VCH Verlag only on the creation of money by commercial banks and the relationship between banks and central bank; a nice description of the historical development of the banking system.

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3. Training material

Activity 1: Founding a state together

In short:

The group establishes a democratic state with its own currency. It plays, and balances three household years with public spending and taxation. The group observes and later discusses how public deficits and private savings develop in relation to each other.

What is learned:

- The state has the monopoly on the currency, money creation being a sovereign right of the state.
- The state's currency monopoly is exercised democratically through budgetary legislation.
- Government money creation must be accounted for as debt according to reigning accounting rules.
- Government money creation accounted for as government debt ends up in private accounts.
- Government debt and private net savings rise and fall in parallel (leaving out the rest of the world sector).

Materials needed:

Blackboard, coloured paper (to make the money), coloured paper (to record the results of the small groups and missing elements to post on wall.

<u>Game Part I: The State is established, government and name of currency are chosen</u>

1. The group forms the parliament of the new state and elects Head of government and Finance Minister. Finance Minister appoints head of central bank.

2. The parliament decides on the name of the currency. Head of government collects the name suggestions on the blackboard and calls a vote. (In the Example attached: *the Modern*)

3. Policy decisions and the first budget law are made. Head of government asks parliament for policy goals. Each parliamentarian names a goal which is noted on the board. The Finance Minister writes behind each goal e.g. *10,000 Modern* and then adds up the budget. Parliament approves the budget by majority vote, thus passing the first budget law of the new state. (In the example attached: 10 participants pass a budget

of *100,000 Modern*).

4. A tax law is passed. Parliament decides how much of government spending should have come back to the government through taxes at the end of the year. (Tip for trainer: do not explain too much but go ahead with percentage suggestions. Government notes three percentages on the blackboard (e.g., 10%, 50% 90%). A vote takes place.

Game, Part II: First year with deficit spending and taxation – and a first balance of government and private sector

1.Money creation and spending. Head of the Central bank crafts as many banknotes as needed for this year's government spending. The Finance Minister spends the money to realize policy goals. In this case, the group plays the population and receives the government spending as social security or payment for goods and services.

2.Balancing. Minister of Finance notes the government money creation as debt on the board. Trainer explains the universal accounting rule: money creation is legally and traditionally always noted as debt of the money creator.

3. Tax collection and final balancing. Minister of finance collects taxes, notes tax revenue on the blackboard and draws a balance sheet for the first fiscal year. (Example in the appendix: Tax law of 10% taxation, thus, the government has *10.000 Modern* tax revenue, and therefore *90,000 Modern* debt at the end of the first fiscal year).

4.Head of government counts the savings of the group representing the private sector and writes them on the blackboard. (Example attached: *90,000 Modern* new savings of the private sector at the end of the first year).

Game Part III - Two more budget years: a balanced budget and a surplus budget. Comparison of the evolution of public debt and private sector savings.

See balance sheet examples in the appendix.

Appendix: Balance sheet examples for 3 game sessions

1. Year (example for deficit budget)

Government spending:	**-100.000 M**
Tax revenue:	**+ 10.000 M**
Deficit:	**- 90.000 M**
Total state debt:	**- 90.000 M**
Private sector savings:	**+ 90.000 M**

2. Year (example for balanced budget)

Government spending:	**-100.000 M**	
Tax revenue:	**+100.000 M**	
Deficit:	**0 M**	
Total state debt:	**- 90.000 M**	**(stays the same)**
Private sector savings	**+ 90.000 M**	**(stays the same)**

3. Year (example for government surplus):

Government spending:	**100.000 M**	
Tax revenue:	**+120.000 M**	
Surplus:	**+ 20.000 M**	
(Private sector deficit:	**- 20.000 M)**	
Total state debt:	**- 70.000 M**	**(shrinks)**
private sector savings:	**+ 70.000 M**	**(shrinks)**

Activity 2. Discussion and summary of results

Discuss in small groups (in twos or threes) the following questions and record results on coloured slips of paper.

- What is government deficit spending? What does it mean for the savings of households and companies?
- What does a balanced budget mean for the private sector's savings?
- What does a government budget surplus mean for savings of households and companies? What are the government's two options, when inflation is imminent?
- Which two possibilities does the government have to strengthen demand when there is an economic crisis?
- What else did you notice? What connections did you observe?

Organize results on the wall

The small groups hang the slips of paper on the wall and sort them thematically.

If the group has come up with questions and objections about the missing elements (bonds, separation central bank, Eurozone-limitations et cetera) theses collected observations can be posted on a different wall with the trainer briefly sorting them and explaining the answers.

Final discussion in the whole group

- What did you think about public debt before? What do you think now?
- Is government debt good or bad?
- Is government debt a real debt? How is it different from debt owed by a private individual?
- What is the role of taxes? To what extent can they prevent inflation?

Tips for trainers:

1. Always point out to the group that it changes roles twice during the game. It alternates between playing a) the voting population, b) the parliament that elects the government and makes laws c) the population as an economic actor, the so-called private sector consisting of households and businesses that receive government benefits and have to pay taxes.

2. Clarify from the beginning: this is a simplified but nevertheless very insightful example on state money creation. Invite learners to note missing elements on coloured pieces of paper as they come to their mind and then turn back to the game. The missing elements can be posted on a selected wall in the discussion and the trainer can sort and add.

Elements of our Money system that are missing:

- Commercial banks/the money creation of commercial banks when granting loans
- Two stage money system (government currency + banks' fiat money)
- Sale of government bonds to commercial banks and other investors
- Separation of the two state institutions, the Ministry of Finance and the Central Bank/ prohibition of direct cooperation of both in many states, detour via financial markets
- The legal self-restrictions the states of the Eurozone signed up to
- Foreign states (= the third sector foreign countries) and the money that flows in, from, and out to them.

Conclusion with regards to the missing elements:

These factors make the processes more complex, but none of them abrogates the state monopoly on currency and with it the democratic power to create and spend money in the budgeting process. When it comes to the balancing of government debt and private savings, only the inclusion of the foreign sector can actually change this parallel movement. Instead of two, we then have three sectors whose net savings and net debt must correspond. The deficits of two sectors (e.g., government and abroad) must then be arithmetically equal to the net savings of the third (in this case the private sector).

Additional task for ambitious learners:

Ambitious learners can be invited to peruse the long version of the article by themselves or in small groups to find out about the missing elements and why they do not change the results on the money monopoly as experienced in the play. They can present their findings to the whole group.

4. Interactive learning

Modern Monetary Systems – The Quiz

Several answers can apply per question.

What types of money are part of our monetary system?

- Cash as notes and coins (governmental).
  Correct
- Central bank money in accounts at the central bank (governmental).
  Correct
- The money in our bank accounts, called deposit money (non governmental).
  Correct

See overview, key principles 3 and 4.

Who creates our money?

- Commercial banks.
  Correct (the deposit money)
- The state.
  Correct (the cash as well as the central bank money in the accounts at the central bank) - The cash cow.
  Wrong (unfortunately)

See overview, key principles 2, 3, 4 and background information questions 4 and 8.

What gives the state money its value?

- The gold backing.
  Wrong
- The state legal system and especially the tax system.
  Correct
- The goods and services produced in the country.
  Correct (especially as regards the external value of the currency).

See overview, key principles 1, 2 and background information, questions 1 and 2.

Can we ordinary people get an account with central bank money?

- No, because only banks and the government can have accounts with the central bank.
  Correct
- No, we ordinary people can only open an account with deposit money at a commercial bank. If we want to have state money, we can have our deposit money paid out in cash. Correct
- If the central bank were to introduce the digital euro, also ordinary people could have an account with central bank money.
  Correct
  See overview, key principle 4 and background information, question 3.

What gives the banks' deposit money its value?

- The fact that we can exchange it for state cash at any time.
  Correct
- The banks' equity capital.
  Wrong (The banks' equity capital only covers a minimal part of the bank deposits.)
- The legal framework, banking supervision, statutory deposit insurance and additional state guarantees in the event of a crisis.
  Correct

  See overview, key principle 4 as well as background information, question 3.

We live in a two-staged monetary system, what does that mean?

- There is state cash and non-cash central bank money.
  Wrong
- On the one hand there is state money (cash and in central bank accounts) and on the other hand there is the banks' deposit money.
  Correct
- The state issues the actual currency and banks issue second-order money that derives its value from the state money.
  Correct

  See overview, key principles 3 and 4 and chart.

What is the special business model of banks?

- They create deposit money by granting loans.
  Correct
- They pass on savers' money to borrowers.
  Wrong
- They can operate irresponsibly, because in case of doubt they are rescued by the state.
  Well, you might think so, given the financial crisis of 2008.

  See background information, questions 3, 4 and 14.

What happens the moment a loan is repaid?

- The deposit money with which the loan is repaid to the bank expires.
  Correct
- The bank can keep the repaid deposit money.
  Wrong
- New deposit money is created.
  Wrong

See background information, questions 4 and 5.

We live in a credit money system, what does that mean?

- Money is created when a loan is granted, i.e. with an equal amount of debt on the part of the borrower.
  Correct
- For someone to be in the black ink (savings), someone else must be in the red ink (debt).
  Correct
- There must always be as many debts in the world as there is money.
  Correct (For specialists only: small deviations may occur because money is also created and extinguished in purchases and sales between banks and non-banks).

See overview, key principle 5 as well as background information, questions 4, 5, 11 and 14.

Why is the state not a debtor like everyone else?

- Because the state has the monopoly on currency and can afford debts. It alone may and must make the actual currency.
  Correct
- Because the state central bank can create unlimited amounts of money and cannot go bankrupt.
  Correct
- Because even a eurozone state could leave the euro and reintroduce its own currency, which it can then create indefinitely.
  Correct

See overview, key principle 2 and background information, questions 11 and 12.

Who creates the money with which government bonds are bought?

- The banks. They finance the state with the deposit money they create.
  Wrong (deposit money is only second-order money for which you cannot get government bonds and with which you cannot finance states).
- The central bank, as government bonds can only be bought with government central bank money.
  Correct
- The citizens with their tax payments.
  Wrong (citizens pay taxes but cannot create money).

See overview, key principle 2 and background information, questions 6, 7, 8 and 9.

What is the function of government bonds?

- The state sells government bonds to take superfluous central bank money from the banks.
  Correct. (Without government bonds, there would be too much central bank money in the banking system, hindering a positive key interest rate).
- Banks and insurance companies rely on government bonds as safe investments.
  Correct.
- Government bonds are essential for the government to raise the money it needs to function.
  Wrong. (The state has a monopoly on currency and can produce it with its central bank. Government bonds are part of the complex procedure in the financial system, but not indispensable).

See background information, questions 6, 7, 8, and 9.

What is the Eurozone's problem?

- The states in the Eurozone have contractually neutered their money creation privilege.
  Correct.
- The Eurozone itself has no institutions empowered to spend money and stabilise the economy in crisis.
  Correct.
- There are 19 different government bonds, which is why the ECB cannot control the interest rate as easily as a normal, national central bank.
  Correct.

See background information, questions 9 and 10.

What problem would there be if the state actually repaid its national debt?

- The repaid money expires.
  Correct.
- The money supply falls and with it, sooner or later, demand and economic output. There would be a recession.
  Correct.
- There would be no problems, in fact there would be a considerable economic upswing without government debt.
  Wrong.

See background information, questions 11 and 12.

How can inflation be fought?

- Inflation is an uncontrollable force and can befall us at any time, even in peacetime.
  Wrong.
- The central bank can raise the key interest rate so that the demand for loans and thus the money creation of the banks decreases.
  Correct.
- The state can raise taxes. In this way it reduces the demand of the private sector and thus the pressure on prices.
  Correct.

See background information, questions 11 and 14.

Why is deflation - a rising value of money - so dangerous?

- In the case of deflation, investment and consumption are postponed. Demand collapses.
  Correct.
- There is a downward spiral in which collapsing demand and unemployment become more and more intense.
  Correct.
- The central bank is powerless with its key interest rate in the case of deflation. Only deficit spending by the government and thus new public debt can break the trend. Correct.

See background information, question 13.

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FRESH-UP ECONOMICS

Sovereign Debt, Europe & The Global South

by Éilis Ryan, Financial Justice Ireland

Table of contents

1. Overview

Sovereign debt - how it accumulates, how it is managed, and how sovereign debt crises are avoided or tackled - is at the root of many of the global structural injustices and financial crises which have caused and exacerbated economic inequality both within and between countries in the last 50 years, in both the Global North and Global South.

Meanwhile, debates - academic and political - continue to rage about how much sovereign debt governments should hold, who is responsible for un-repayable debts and for causing debt crises, and what is the appropriate way to respond when governments are unable to repay their debts - i.e. face debt crisis.

Despite being so fundamental to accurately understanding the roots of social and economic justice and equality, debt remains a knotty concept, whose complexity often puts educators and learners alike off deeper engagement with the issue. This resource aims to address this problem.

The purpose of this resource is to give educators and facilitators who wish to provide training to adults on the subject of debt justice the tools to do so. It includes the following:

1. **Debt: A Short Introduction for Adult Learners,** a two-page introduction to debt and debt justice, which can be used as a handout or introductory reading for adult learners.
2. **Debt: A Deeper Guide for Facilitators,** an in-depth ten-page look at the main issues and debates relating to debt and debt justice, in the Global North & the Global South. This is intended to strengthen the confidence and knowledge of facilitators who wish to carry out workshops or trainings about debt with adult learners. A guide to further reading is provided for those who wish to delve deeper.
3. **Debt: Suggested Activities for Adult Learners,** a series of four activities, to be used together or as standalone sessions, which introduce adult learners to the topic of sovereign debt & debt justice, using a range of active learning methodologies.

Debt: A Short Introduction[1]

Every year countries of the Global South spend $300 billion on debt repayments. Debt causes poverty in the affected populations and undermines economic, social, and cultural rights. This introduction will describe how debt crises happen, why debt is a justice issue, and what needs to change to achieve debt justice.

Who is the money owed to, and who controls global finance?

Countries borrow money from other countries (bilateral lending), multilateral institutions (e.g. the IMF, World Bank, African Development Bank), and private lenders (e.g. commercial banks and funds). Lenders dominate in setting the rules and definitions surrounding debt issues, especially the International Financial Institutions (IFIs), the World Bank and the IMF.

1. **The World Bank**
   Aim: To end extreme poverty and boost shared prosperity

[1] Many thanks to Aideen Elliott for her contribution to this part.

Activities: Gives loans for specific projects with conditions, or policy advice, to countries in the Global South.

2. **The IMF (International Monetary Fund)**
   Aim: To create global financial stability and sustainable economic growth
   Activities: Gives loans to countries who are in financial trouble. IMF loans come with strict conditions.

Power and decision making at the World Bank and IMF

189 countries are members of the World Bank and 190 countries are members of the IMF. Ireland is a member of both. At both the IMF and the World Bank the size of each country's vote is linked to the size of its economy and how much money it pays into the institution. This means that both the World Bank and IMF are controlled by the richest countries in the world. The countries of the Global South, who borrow most, have the least say in decisions. The president of the World Bank is always American, and the president of the IMF is always European. The World Bank and IMF work together. A government often has to agree to IMF policy conditions before it can get assistance or a loan from the World Bank, and vice versa.

Debt is a Justice Issue

Illegitimate Debt includes loans that

- Exploit the vulnerability or impoverishment of the borrower
- Are so unsustainable that repaying them undermines human rights by making it impossible for the state to meet obligations / fulfill core aspects of economic, social and cultural rights
- Were given for obviously useless or overpriced projects
- Caused harm to people or to the environment

Odious debt describes loans

- Given to a despotic power (i.e. a ruler or regime with unlimited power over other people, and often using it unfairly and cruelly) or authoritarian regime
- Given by a creditor who knew (or should have known) that the money would not be used to benefit the people
- Used against the interests of the population, for instance to fund military regimes that deny people their fundamental rights

The Impact of Debt on Communities

Money for debt repayments is diverted from vital services. For some countries, their debt repayments are such a big portion of the budget that it does not leave enough money to adequately fund basic services. In 2019, 64 countries were spending more on debt payments than on health, 45 countries were spending more on debt payments than on social protection and 24 countries were spending more on debt payments than on public education.

When countries are in, or on the brink of, economic crisis they go to the IMF for a loan. IMF loans come with political and economic conditions. The IMF says that by meeting these conditions the government will make their economy more stable. However, history has shown that when governments have

implemented IMF policy conditions, the country has not become more financially stable. Policy conditions of IMF loans have been bad for equality. Conditions have included; cutting the public budget by reducing welfare including pensions, freezing or reducing minimum wage, increasing the price of basic products via VAT, and reducing trade union rights. These 'Structural Adjustment Programmes' increase poverty and inequality and undermine democracy because important policy changes come from the lender, not the democratically elected government.

A Brief History of Debt Crises

Between the 1940s and 1960s, countries in the Global South became independent from colonial rule. These newly independent countries were left with weak economies and needed to borrow money. Rich countries gave loans, often irresponsibly.

In the 1970s, because of the increase in the price of oil, western banks were rich in financial deposits, and decided to invest this money in giving loans to countries of the Global South. In the late 1970s, the interest rates on these loans went up (more than doubling between 1979 and 1982). At the same time, the price of goods (commodities) that countries of the Global South trade went down. This made it more difficult to repay the loans.

In the 1980s, global recession meant rich country lenders wanted to collect debts. Countries of the Global South were unable to repay these loans to private banks and so the IMF and World Bank gave them more loans, equating to 'borrowing from Peter to pay Paul'. The loans came with strict conditions, especially about spending less on public services like health and education. These were the 'Structural Adjustment Programmes' mentioned above. This had such a damaging impact that it has led the 1980s to be called the "lost decade of development".

In 2008, with the global financial crash, the debt crisis reached countries of the Global North.

Debt Justice

The Debt Justice Movement goes back to the 1970s, when people around the world protested the impact of the IMF's policies on their countries, including in Argentina, Egypt, Costa Rica and South Africa. Throughout the 1980s and 1990s the international movement calling for debt cancellation continued to grow. In the late 1990s the Jubilee 2000 petition collected over 24 million signatures. A debt jubilee is **when a country or large organization cancels debt and clears it from the public record**. Today, the movement continues to push for debt justice initiatives, including:

- A UN based debt resolution mechanism: an independent, international, legally-binding mechanism for negotiating debt write downs of illegitimate and unaffordable debt.
- Debt audits: both government audits and independent citizens' audits to examine the terms and conditions, purpose, actual use and impacts of these loans.
- The establishment of an international taskforce on tackling historic illegitimate debt.
- Cancel debts that are illegitimate or odious.
- End policies that build up more loans. In particular, use grants, not loans, for managing the cost of climate change.

2. Background information

What is debt? What is sovereign debt?

We are entering a period with unprecedented amounts of debt in economies right around the world. Global debt hit $255 trillion in 2019, reaching a historical high of 320% of GDP. This includes all of the debt held by corporations, financial institutions such as banks, governments, and households. Since 2010, total debt has risen in 80% of emerging and developing economies.

In 2019, approximately a quarter of all debt in the world was held by governments. This debt is known as sovereign debt. This resource concerns itself with sovereign debt in particular. Sovereign debt - how it accumulates, how it is managed, and how sovereign debt crises are avoided or tackled - is at the root of many of the global structural injustices and financial crises which have caused and exacerbated economic inequality both within and between countries in the last 50 years, in both Global North and Global South.

Sovereign debt is further divided into internal (domestic) sovereign debt and external (foreign) sovereign debt. External sovereign debt is debt owed by a government in a currency other than its own, in a currency it does not have sovereignty over. That is the form of debt which this article and these activities broadly focus on. For further information about the differences between domestic and external sovereign debt, see the FreshUP article on Modern Monetary Theory.

Meanwhile, debates - academic and political - continue to rage about how much sovereign debt governments should hold, who is responsible for un-repayable debts and for causing debt crises, and what is the appropriate way to respond when governments are unable to repay their debts - i.e. face debt crisis.

The highest growth in debt globally in the past decade has been in corporate debt - the debts of private companies, excluding banks and other financial institutions. While in theory the risks associated with this debt lie with private companies and shareholders - and therefore don't impact on the general public - in reality, often when companies face difficulties repaying their debts, they turn to governments (and, therefore, taxpayers) for support. Although in low-income countries non-publicly guaranteed external private debt has remained a small portion of their total external debt, it has substantially increased in a decade, from US $3.99 billion in 2008 (5 % of total external debt in low-income countries or LICs) to US $14.25 billion in 2018 (9.49 per cent of total external debt in LICs). In middle income countries, private debt makes up a third of all external debt.

Is having high levels of sovereign debt always a bad thing?

Opposition to high levels of sovereign debt is often associated with the neoclassical and neoliberal school of economics. According to this school of thought, the fundamental job of a government is to maintain a balanced budget; to ensure that government spending does not exceed revenue. Where borrowing is required, these debts should be repaid quickly, including by cutting spending in other areas where necessary.

By contrast, Keynesian and Marxist economists view debt as a useful counter-cyclical tool, with borrowing and high government spending being used to invest in an economy which is sluggish or in recession.

Moreover, they view the *ability to repay* debt as the key issue - and understand that ability to repay is not simply down to the size of the debt, but also to the strength of the economy.

However, in many cases, excessive sovereign debt, and debt repayments, are problematic from a social justice perspective.

The first reason is in cases where the debts which a country now owes were not accumulated fairly. The reasons for this can vary from a lender lending irresponsibly (knowing a country cannot afford the loan), to lenders lending to leaders who are undemocratic, and known to use loans to fuel things such as war, weapons or personal enrichment, or loans which originate in colonialism. More detail on this is provided below in the section on debt crises.

Debts also become problematic when their repayment inhibits governments from investing in public services and economic development. At least 20 governments in the global south spent more than 20 per cent of their revenue to service external debts in at least one of the last five years. In some cases, such as in Angola, Djibouti, Jamaica, Lebanon, Sri Lanka or Ukraine, more than 40 per cent of government revenue was destined for external public debt service at some point between 2014 and 2018.

In 2018, 46 countries spent more on servicing sovereign debt than on their national healthcare budgets. Low income countries (LICs) spend on average 28.5% of their public revenues on debt service, and on average only 2.5% on healthcare services. According to the IMF, government spending on public services in Sub-Saharan Africa will reach a historic low of only one fifth of GDP in 2024 - even though overall debts are projected to increase.

Finally, some kinds of loans, in particular bonds, increase countries' exposure to the fluctuations of international currency markets, meaning that countries are vulnerable during times of international recession or economic downturn.

Different types of debt create greater and lesser problems. Countries with high debts denominated in their own currencies have more options available as to how to manage it. These options are explored in the FreshUP article on Modern Monetary Theory.

What causes a debt crisis?

The mainstream economic explanation for debt crises is that they are caused by governments spending more money than they can "afford" to - i.e. that their total revenues are lower than their total expenditures. This explanation of debt crisis lies within the neoclassical school, which views balanced budgets as the epitome of good economic governance.

Global debt justice campaigners take a different view about how debt crises happen. They believe that sovereign debt crises cannot be simply blamed on excessive government spending; after all, many countries with high sovereign debts - and high government spending - never enter a debt crisis, for example, the United States.

Instead, debt justice campaigners believe that sovereign debt crises happen for complex and varied reasons. For example:

- Much debt - especially in the Global South, has its origins in **colonialism**, and the enforced uneven development of the Global South.
- Much debt originated through lending by official lenders - the IMF, the World Bank, rich governments - **to corrupt leaders** who were known to be using loans for personal enrichment, or funding wars. These governments were often kept in power by rich allies such as the United States.
- Much debt originated because of **irresponsible lending** - by multilateral, bilateral and private lenders - to countries who were clearly unable to afford the loan repayment terms. This happens because lenders have a ***financial incentive*** to lend because they earn interest from these loans. Without the threat of debt write-downs when countries cannot repay, there is a **moral hazard** that lenders will lend irresponsibly.
- Often, debt burdens increased as a result of the **failure of economic reforms** which were imposed on countries in the Global South as a condition of lending.
- Sometimes, sovereign debt results from the state **nationalising private debts of corporations,** as happened when governments in countries such as Ireland took on the debts of bankers. The rise in public debt globally since 2010, for example, can be traced back to government bailouts of private corporations in the last financial recession.
- If a country develops an unsustainable debt burden because of one of the reasons above, often the only way for the country to avoid bankruptcy is to **take on even more loans.** This leads to a vicious cycle of **snowballing debt.**

Modern Monetary Theory (MMT) provides additional explanations and theories about the causes of sovereign debt crises, which are explored in the FreshUP article on that topic.

A history of sovereign debt crises[2]

"We think that debt has to be seen from the standpoint of its origins. The origins of debt arise from the origins of colonialism. Those who lend us money are the same who colonized us before. They are those who used to manage our states and economies."

– Thomas Sankara, former President of Burkina Faso (1987)

The Bretton Woods decades

The 1980s saw the first widespread global sovereign debt crisis. Understanding the roots of this crisis requires examining how the economies which entered into this crisis had developed.

After World War 2, the upheaval which the world had seen since 1914 meant that proposals for a more stable international economic order won the day. The Bretton Woods Institutions were established in 1944, with the International Monetary Fund intended to maintain currency stability and act as a lender of last resort when needed, and the World Bank established to provide development loans to lower-income countries. An agreement was also reached to link the value of the US dollar to the price of gold. Along with a number of other political and economic developments, these measures successfully ensured that

[2] For further detail, a number of country-specific case studies, together with a timeline of the history of debt crises in the Global North and the Global South, are provided as part of the activities in Section 3.

the period from 1945 to 1970 saw unprecedented increases in quality of life, workers rights, and social services.

The first global sovereign debt crisis

This post-war settlement started to unravel when, in the early 1970s, the United States decoupled its currency from gold, allowing greater currency fluctuation, and the US, soon followed by other wealthy countries, began to remove the restrictions which were in place to limit the free movement of money around the world. This liberalisation of capital flows coincided with the 1970s oil crisis, in which oil producing countries coordinated cuts to oil production, which in turn drove up their profits. These profits were recycled into western banks, and, coinciding with rapid financial deregulation during the same period, were used to fuel a lending boom which precipitated the first major global sovereign debt crisis.

In almost all cases, these economies, under colonialism, had been developed to depend heavily on the export of raw commodities - on terms highly beneficial to the colonising power. As well as having a low 'added value' in economic terms, reliance on commodity exports also meant that, whenever commodity prices on international markets fell, the economies of many postcolonial countries were deeply exposed. In some countries, the colonial roots of debt are even more stark. For example, following the slave rebellion and Haiti's independence from France in 1804, Haiti was forced to pay millions of gold frances as reparations for the slaves and land France "lost" because of independence, beginning two centuries of debt.

Many postcolonial countries saw a significant drop in commodity prices from the beginning of the 1980s, which continued for almost two decades, and took a dramatic toll on many postcolonial economies. Their debts became harder and harder to repay. Of the 57 countries which faced difficulties repaying their debts in the 1980s, all were former colonies.

A sustained campaign by debt justice campaigners led to debt cancellations for some of the poorest countries, from the mid-1990s to the present day. This was known as the Heavily Indebted Poor Countries Initiative (HIPC). However, the amount of debt cancelled has been small. And, even more importantly, many of the conditions attached to debt cancellation pushed the same economic model onto economies, a model which had itself contributed to the debt crisis.

Sovereign Debt Crisis in the Global North

In 2003, debt economist Ann Pettifor wrote a article titled "The Coming First World Debt Crisis"[3], which preceded a 2006 book by the same name. Pettifor, who had been a leading economist working for the campaign to cancel third world debt in the 1990s, argued that the world's richest countries, in particular the United States, showed all the major signs of a forthcoming debt crisis.

In 2008, she was proved right. As the US subprime mortgage market began to unravel, the Lehman Brothers bank collapsed in 2008. Soon, banks across the world's wealthiest countries began to seek guarantees from governments in order to avoid collapse. In countries like Ireland, the government guaranteed all of the debts of the major banks, including commercial debts, meaning that any losses were transferred from the private shareholders, to the state's citizens.

[3] https://www.open https://www.opendemocracy.net/en/article_1463jsp/

The nationalisation of bank debt led to a surge in sovereign debt across many rich countries. Over the next few years, it became clear just how much bad debt had been nationalised, and countries like Ireland faced the prospect of not being able to repay the bank debts they had guaranteed. Instead of defaulting on these debts, the Irish government sought loans from the IMF, European Commission and other lenders totalling €67.5 billion. The loans came with stringent conditions imposing harsh austerity on the country - public spending cuts and tax increases - something which the IMF itself has admitted slowed the recovery of the economy.

The New Debt Crisis

Since 2010, both sovereign debt and private, corporate debt have reached new all-time highs globally. Much of this rise can be traced back to the large financial crisis post-2008. After 2008, governments in a number of rich countries chose to nationalise the debts of private corporations and banks. Additionally, the policy of "Quantitative Easing" (QE) by the European Central Bank, the US Federal Reserve and other central banks released $11 trillion into the global economy - effectively increasing government debt in order to buy up corporate debt - and provide cash to those corporations. There was little control over how this cash release was used, and much of it was lent on to countries in the Global South, who are now exposed to corporate lenders. This is similar to the pattern of lending in the 1970s and 1980s.

These factors combined meant that annual lending to countries in the Global South more than doubled from $185 billion in 2007 to $452 billion in 2018. The profile of lenders has also shifted, with over 55% of all interest paid by Sub-Saharan African countries on sovereign debt going to private lenders (whose interest rates are far higher). An increase in private loans exposes countries to fluctuations in international currencies and bond markets , meaning that, as debt spirals in the Global South, so too does their exposure to any coming global financial crisis.

And in the Global South, instead of this new debt being used to invest in economic development, or in achieving the Sustainable Development Goals (SDGs), the evidence shows that many times, the new debt was simply used to repay existing, escalating debts.

Over the last decade, debt in Lower Income Countries (LICs) has increased from an average of over 40% of GDP in 2009 to 49% in 2019 - meaning that the levels of debt in poor countries are well outstripping growth in the 'real' economy. The real economy concerns the production, purchase and flow of goods and services within an economy (in contrast, the financial economy is where financial services account for an increasing share of national income relative to other sectors). Meanwhile, over the last five years, the number of countries at high risk of debt crisis or already in debt distress has increased from 37 to 51.

Between 2010 and 2018, external debt payments as a percentage of government revenue grew by 83 per cent in low- and middle-income countries, from an average of 6.71 per cent in 2010 to an average of 12.56 per cent in 2018. In Sub-Saharan Africa specifically, the proportion of government revenue destined for external debt service payments more than doubled, from 4.56 per cent in 2010 to 10.8 per cent in 2018.

This growing debt crisis has been compounded further by the emergence of the Covid-19 pandemic. Eurodad estimates that a debt moratorium for 2020-2021 for 69 low-income countries who are in some way at risk of debt distress, could free up anywhere up to $50.4 billion in additional funding to tackle the

Covid-19 outbreak.[4] Meanwhile, as the financing needs for mitigating and adapting to climate change increase, a full two thirds of funding available for low income countries to tackle climate change is in the form of loans - adding further to debt bubbles. Falling commodity prices are worsening the crisis.

Resolving debt crises (1): what are the options?

When it comes to personal debt or corporate debt, there exist rules in many countries (albeit highly flawed rules in some cases) for what happens when a person or corporation can't repay a household mortgage, or can't service its debts. These range from debt restructuring procedures, to personal insolvency, to examinership, receivership or bankruptcy. In many cases, it is also set out in law which creditors are paid first, and what obligations creditors may have to accept write downs on the debts they are owed.

There are many flaws with these systems. But there is generally, at a minimum, an agreed system which all creditors (and debtors) are obliged to follow. When it comes to sovereign debt, however, no such set of rules exists.

Instead, sovereign debt crises and debt distress are handled in an ad hoc rather than systematic manner, following norms and customary practices which have developed in response to past sovereign debt crises. However, the ad hoc approach shouldn't mislead us into thinking debt crises and debt restructurings are a rare occurrence. There have been over 600 restructurings of sovereign debt, involving 95 debtor countries, since 1950, so restructurings happen, albeit in a particular manner.

A: The Neoliberal Approach to Resolving Debt Crises

This **ad hoc response to sovereign debt crises** can be said to follow the neoliberal or neo-classical model of understanding sovereign debt, which, as we saw above, believes debt crises are seen as happening as a result of excessive government spending. As such, the solutions it emphasises also follow this neoliberal school of thought, and generally features some or all of the following characteristics:

- New emergency loans to cover short-term debt repayments to creditors, rather than negotiating debt write downs.
- Debt restructuring but only in forms which ensure creditors are eventually paid.
- The implementation of austerity measures to decrease public spending on public sector workers, healthcare, education, social welfare supports etc.
- Economic reforms (often in the form of conditions attached to emergency loans) which emphasise the privatisation of state-owned companies, assets or public services, the removal of protections for indigenous industry or agriculture, and the introduction of liberalised trade - often called 'structural adjustments'.

Additionally, the neoliberal school believes that, while there is a need for greater coordination between creditors when a country faces a debt crisis, responsibility for this should lie with the IMF. However, the IMF is itself a lender, and so it is not in a position to be a neutral arbiter. Even the IMF, however, recognises that, because the sovereign debt is increasingly complex, with more and more lenders involved, and many

[4] This figure includes $8.6 billion (for a moratorium on all World Bank and IMF debts), to $38.2 billion (for a moratorium on all bilateral external creditors, i.e. bilateral country-to-country loans), to $12.1 billion (for a moratorium on all private external creditors, i.e. non-government lenders).

different types of loans, there are "new challenges for potential debt resolution, including difficulties in ensuring the creditor coordination needed to produce comprehensive agreements acceptable to all major creditors."

Under this approach, only the borrower is responsible for their debts. It is implicitly assumed that all lending is carried out responsibly, with proper due diligence as to the ability of the borrower to repay the debt. Debt sustainability assessments (DSAs)- the way in which lenders like the IMF take into account whether a borrower country can afford to take on more debt - do not pay sufficient, or indeed in many cases any, attention to the sorts of implications for healthcare or education which increased debt repayments might have. Sustainability is considered solely as 'ability-to-repay- sustainability; rather than sustainability in terms of reaching the Sustainable Development Goals.

The absence of a coordinated debt moratorium mechanism has also been keenly felt during the Covid-19 pandemic. Although governments and international financial institutions agree in principle about the need for debt writedown, there is no clear forum where this can be negotiated.

Without a coordinating forum, for example, if one country grants a debt moratorium but others don't, the money which is freed up for the debtor country could just be used to repay other creditors - borrowing from Peter to pay Paul. Only a co-ordinated and enforceable mechanism to resolve the sovereign debt crisis, requiring the participation of all creditors, can be effective.

Moreover, without an international legal mechanism for negotiating debt moratoriums, private creditors in particular can at any point sue debtor countries for breaching the terms of their loans.

The absence of a clear mechanism for handling sovereign debt crises has not meant creditors have gotten off scot free. Indeed, *because* of the lack of a restructuring mechanism, suspension of debt repayments has often taken place unilaterally, rather than through negotiation or according to agreed rules. Since 1980, nearly a third of sovereign debt payment suspensions have been adopted through negotiations with creditors. In the rest of the cases, especially during the debt crisis in the 1980s, debt moratoriums were implemented without the approval of creditors.

B: The Alternative: Challenging A Sovereign Debt Restructuring Mechanism, Responsible Lending, & Better Debt Sustainability Assessments

Debt justice advocates take a more holistic approach to debt crises, and believe action to prevent debt crises is required in three areas;

1. **Prevent debt crises** through better rules about lending and assessing whether debts are genuinely sustainable. This would mean that all lenders are obliged to undertake careful assessments of whether the loans they are giving can be repaid without compromising human rights. Currently, "debt sustainability assessments" only examine whether a debt can be repaid - and if it can't, suggest cutting spending on areas like social welfare or the public sector. It would also mean that the IMF would not give loans for the sole purpose of repaying debts owed to other, reckless lenders - since this practice simply encourages further reckless lending.

2. **Deal with debt crises fairly** by establishing a new international debt resolution body. This body, known as a multilateral Debt Workout Mechanism, would be a part of the United Nations, and independent of both creditors and lenders. This body would have the legal power, at the request of a borrower country which faces a debt crisis, to investigate the debt crisis and propose a resolution to that crisis. Once the Mechanism's operation had been requested, creditors would not be allowed to sue borrower countries for repayment. The Mechanism would be tasked with considering the validity of all claims for repayment made by creditors, including which were reasonable and which were, potentially, unjust. It would engage in unbiased negotiation with creditors and borrowers, and come to an impartial and enforceable proposal to restructure a country's debts. A UN-based Debt Workout Mechanism has significant support; in 2014, a majority of countries at the UN General Assembly backed a motion supporting its creation. But without the backing of rich countries, work to establish it has not progressed.

3. **Help countries avoid greater debt** by enabling them to grow their economies sustainably, and without enforced neoliberal policies. This includes international measures which help governments raise money in their own countries (domestic resource mobilisation), by, for example, collecting taxes from big corporations. Currently, international corporations pay far less tax in poor countries than they should, because of many loopholes used to minimise tax payments, and illicit financial flows. It also includes removing harmful austerity conditions often attached to loans, or encouraged by big donors.

Resolving debt crises (2): conditionalities, structural adjustment & economic recovery

Even where debt relief *is* offered - in the form of restructuring, cancellation or a moratorium - it is often done so with stringent conditions attached to it. The conditions attached to loans are based on the neoliberal model, under which excessive debt is caused by excessive government spending, and a failure to maintain a 'balanced budget.' However, there are many cases where countries cut public spending - often as a result of loan conditions - but debt continues to increase. Between 2014 and 2016, in 39 low- and middle-income countries, government expenditure on healthcare decreased, while expenditure on debt repayments increased.

Because women rely more on social protection programmes, conditions which cut these programmes have a disproportionately large impact on women. Women are also more often employed in the public sector, and so they are disproportionately impacted by cuts to wages or jobs in this sector. See the 'Women and Economic Empowerment' FreshUp article for more on this topic.

Although there is official recognition that these conditions have not worked in the past, in reality conditions continue to be attached to even the most minor forms of debt relief. As recently as March 2020, David Malpass, the President of the World Bank, stated in relation to possible debt moratoriums for developing countries affected by Covid-19, that "Countries will need to implement structural reforms to help shorten the time to recovery and create confidence that the recovery can be strong."

Many civil society campaigners for debt justice object to demands for conditionalities, and some have argued that it would be better for countries facing humanitarian emergencies because of Covid-19 to

declare unilateral debt moratoriums, than to accept debt moratoriums from lenders with 'strings attached' which would further weaken their public services, and therefore their ability to tackle the virus.

A Guide to Further Reading

The politics of quantitative easing: A critical assessment of the harmful impact of European monetary policy on developing countries SOMO Rodrigo Fernandez & Pablo Bortz & Nicolas Zeolla Amsterdam, June 2018

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- See also 2017 update jubileedebt.org.uk/wp-content/uploads/2016/11/New-debt-trap-briefing_10.17.pdf

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The politics of quantitative easing: A critical assessment of the harmful impact of European monetary policy on developing countries SOMO Rodrigo Fernandez & Pablo Bortz & Nicolas Zeolla Amsterdam, June 2018

UNCTAD's 2012 Principles on Promoting Responsible Sovereign Lending and Borrowing

UN Guiding Principles on Foreign Debt and Human Rights

UN Guiding Principles on Human Rights Impact Assessments of Economic Reforms

3. Training material[5]

The following activities use active learning methodologies to introduce the concepts of debt and debt justice to adult learners. The activities can be used in any order, or as standalone activities. For example, the debt diamond (Activity 3) works well as a short standalone activity following a presentation about the history of debt, to introduce a participatory element to the class. However, if a trainer or facilitator has multiple sessions available (4-6 hours in total), the activities are best used in sequence, in the order that they are presented:

1. **Teaching each other: debt justice in four countries (the jigsaw method)**
2. **Building a timeline of debt crises in the Global North & Global South**
3. **The Debt Diamond**

In general terms, as an ice breaker, it is useful to begin by talking about the concept of debt at a personal or household level, and asking learners to discuss in pairs, and then in the larger group, how it makes them feel when they owe money, and who they feel has power when somebody lends them money.

[5] Many thanks to Jubilee Debt Campaign, whose invaluable website provided much of the material for the timeline and case studies used in the following activities. www.jubileedebt.org.uk

Activity 1: Teaching each other: debt justice in four countries

Overview: In this activity, students are separated into small groups and groups are assigned one of four country case studies about debt, to read and discuss together. After this, they are given an opportunity to discuss and reflect on some of the main concepts in the case study. Finally, students are reallocated into new groups, with one person who has studied each country in each group. The students then 'teach' their peers what they have learned about their assigned country.

Objectives: This activity uses peer learning to enable students to first absorb, secondly discuss, and thirdly teach, a case study of one country's experiences with sovereign debt. It also enables each student to get a flavour of three other countries' experiences with sovereign debt, and to become familiar with some of the basic 'jargon' and concepts associated with debt and debt justice.

Materials: Multiple printed copies of four case studies. Debt "key concept" cards (see below). Blu-tac. Small stickers (enough for three per learner).

Time: 1 hour

Group Size: 4 - 30

Instructions For Trainers:

Before the class, place the following "Key Terms" on post its or coloured card on the wall around the room:

- Debt restructuring
- Debt cancellation
- Conditionality
- Illegitimate debt
- Colonialism
- Debt audit
- Irresponsible lending
- Vulture Funds

(A) 15 minutes
Divide your group into four smaller groups, and assign a country to each group. Hand copies of the relevant country case study (attached below) to each member of the group. Explain to the class that you want them to read the case study in silence.

(B) 10 minutes
Give everybody three small stickers (anything will do). After they read their case studies, ask everybody in the class to place a sticker beside the three "Key Terms" they thought were most important in their case study. Ask for a volunteer from the class to speak about why they picked each "Key Term" (one person per term is fine). Make sure everybody understands each of the terms.

(C) 15 minutes

Next, ask everyone to return to their small groups, and discuss the following questions in relation to their case study:

- What was the cause of the debt crisis in the case study?
- What were the consequences of the debt crisis in the case study?
- Who had to pay for the debt?
- What did you think was fair or unfair in this case study?
- What role did these organisations play (if any)
- What might have made things better in this case study?

(D) 20 minutes

Finally, move the groups around so that one person from each of the original "country groups" is now sitting in each new group. In the new groups, instruct the learners to take turns introducing their country's case study to the group, by giving an overview of what happened, and the main points discussed in their group.

Ecuador - Country Case Study

Ecuador joined the Republic of Gran Colombia, and became a separate republic in 1830. Like many Latin American countries, it went through political turmoil with consecutive juntas and dictatorships. The country had a military dictatorship under Guillermo Lara (1972-1976) and then that of Alfredo Poveda (1976-1979). During the oil boom, the administration borrowed extensively from Western banks, which at that point provided large amounts of money at low rates. When the US interest rates rose from 6% in 1979 to 21% by 1981, Ecuador's debt payments grew.

Over the years, Ecuador has made debt payments that far exceed the money it originally borrowed. Only 14% of all money loaned between 1989 and 2006 was used for social development projects. The remaining 86% was used to pay for previously accumulated debt. Between 1982 and 2006, the country paid foreign creditors $119 billion, while receiving $106 billion in new loans. Yet the total debt increased from $8 billion to $17 billion. In 2007 Ecuador's government spent more on debt payments than on health care, social services, the environment, housing and urban development combined, all areas where money was badly needed.

In 1980, the Ecuadorian government spent 30 percent of its revenue on education, as well as ten per cent on healthcare and 15 per cent on servicing its debts. By 2005, this situation had been reversed, spending 47 per cent of its government income on servicing debt and only 12 and seven per cent respectively on education and healthcare. Meanwhile, poverty increased – especially in rural areas – from 55 percent of the population in 1995 to 60 per cent in 2003.

Years of mismanagement by former regimes and irresponsible lending by international creditors left Ecuador with a foreign debt stock of $17 billion, 40% of the country's GDP in 2007.

In 2008 Ecuador became the first country to officially examine the sources and legitimacy of its foreign debt. Social movements had pushed strongly for an audit, and had it adopted as part of the platform of Presidential candidate Rafael Correa. The independent audit commission was launched with a presidential decree by president Correa and the former Economy and Finance Minister, Ricardo Patiño in July 2007. Its main goal was to scrutinize all lending deals from 1976 to 2007, including lending from Western governments and private creditors. The commission was composed of a broad array of government officials, domestic and international academic experts in economic, law, social and environmental issues. Creditors were identified and the terms of the loans were assessed. Debt restructuring and the conditions attached to this were also assessed. The audit concluded that overall the borrowing, debt restructuring and resulting conditions had caused "incalculable damage" to society. Many examples of predatory lending were found including loans which violated international law and domestic laws, in both the borrowing and the lending country.

The conclusion was that the biggest part of the debt was a result of corruption, lack of transparency and 'shady' deals that did not benefit the people of Ecuador. A series of contracts were pointed out as illegitimate; the Brady bonds. The IMF and World Bank involvement was deemed inappropriate, mainly the SAP, poverty reduction programmes and strategy proposals that liberalised and deregulated the economy during the previous decades. The report also raised concerns about the percentage of public funds allocated to debt repayment, especially in relation to public spending for health and education.

Results showed that only a small percentage was used for useful development projects from the money loaned.

On the basis of the findings of the debt audit commission, claims were supported and documented that a considerable amount of debt is illegal, and thus should be unilaterally revised with the country's initiative. Under presidential decree, payments for global bonds that matured in 2012 and 2030 were suspended. By using the assumption of the auditing commission this debt was branded illegitimate and thus ineligible for repayment. In late 2008 Ecuador announced to the IMF that it would pay US$33 million owed to it and will seek no further funding from it.

However, a new government came to power in Ecuador in 2017, and sought an IMF loan of over $4 billion. The loan was granted on condition that significant austerity measures be implemented. This has led to sporadic, serious public protest against the IMF loan and terms since 2018.

Source: Jubilee Debt Campaign

Haiti – Country Case Study

The slave rebellion in 1804 gained Haitians independence from France, but France forced the new country to pay millions of gold francs over the following decades as reparations for the loss of their property and slaves. Fearing invasion, Haiti agreed to pay back a sum of 90 million gold francs over the following 122 years.

In 2004, soon after elected President Aristide demanded reparations of $21 billion for the money extorted after independence, he was overthrown in a military coup supported by the United States. After being kept out of the debt relief process, in 2006 Haiti was allowed in. In 2009, after following IMF and World Bank prescribed policies, the country qualified to have some debt cancelled. More was cancelled after the 2010 earthquake following a campaign by Haitian NGOs. However, the country remains impoverished and vulnerable to disasters and climate change. Loans have continued to be given, and the IMF ranks Haiti as at high risk of another debt crisis.

Debt accumulation

Between 1964 and 1986 Haiti was ruled by the corrupt and oppressive Duvalier family. The western world strongly supported the Duvaliers because they were anti-communist, and on the US's side during the Cold War. For years the money used to prop up this corrupt regime was repaid at the expense of those who suffered at its hands. The Duvalier regime was overthrown in 1986, after which popular civil society organisations began to emerge. Long-postponed grievances were raised by these movements, including the unjust debt burden.

For many years these calls for debt justice fell on deaf ears. Despite being the poorest country in the Americas, Haiti was not even considered for debt relief when the Heavily Indebted Poor Countries (HIPC) initiative was first launched in 1996. At the same time loans continued to be given. A 2002 evaluation by the World Bank of its lending to Haiti from 1986 to 2001 concluded, "the development impact of [World Bank] lending had been negligible".

Debt relief

In 2006 the World Bank finally accepted Haiti was poor enough and indebted enough and allowed it to enter HIPC. Haiti finished the HIPC and MDRI programmes in 2009 and subsequently had $1.2 billion of debt cancelled.

However, campaigners argue that whilst HIPC is better than nothing it is not good enough, for Haiti or any other country. Firstly, to enter and complete the scheme a country must accept harmful economic policy conditions imposed by the IMF. Secondly, many debts are not included in HIPC. After getting debt relief Haiti still 'owed' $900 million. Nowhere in the debt relief process did rich countries accept their role in creating Haiti's unjust debt, instead regarding debt relief as charity.

In January 2010 a devastating Earthquake struck Haiti killing up to 300,000 people. In the aftermath it seemed the state could collapse, and survivors were left vulnerable to disease and without homes or livelihoods. Soon after the disaster twenty six Haitian NGOs together called for debt cancellation. This message was taken up around the globe, and hundreds of thousands of people signed petitions.

Haiti's debt had already increased to $1.15 billion following debt relief the previous year, and rose to $1.3 billion as new loans were given in the wake of the disaster. The public outcry led governments and the international financial institutions to drop Haiti's outstanding debt.

Loans, not grants

Even as Haiti's debt was cancelled, new reconstruction funds were being offered in the form of loans rather than grants, storing up problems for the future. In 2017, the IMF ranked Haiti as at high risk of another debt crisis. Meanwhile, Haitian NGOs have condemned their exclusion from donor conferences following the earthquake. The twenty six NGOs behind the campaign for debt cancellation have endorsed a call for the population to mobilise a Haitian People's Assembly, which will address these challenges and define strategies for the alternative reconstruction of Haiti.

According to the Centre for Economic and Policy Research, the United States interfered in 2010's elections, effectively banning one party, preventing Aristide's return, and influencing the vote counting process. Haiti has been freed from some foreign debt but has not been spared foreign domination.

Source: Jubilee Debt Campaign, https://jubileedebt.org.uk/countries/haiti

Liberia - Country Case Study

Liberia's large debt was first created in the 1970s as part of the boom in lending due to deregulation of finance in Europe and the US, and the high levels of 'petro-dollars' in Western banks due to oil price spikes. Liberia's debt to private banks increased from $30 million in 1970 to over $150 million in 1979.

At the end of the 1970s the US hiked up interest rates and the price of commodities collapsed causing a bust across Latin America and Africa. From growing quickly in the 1970s, Liberia's economy stagnated with these shocks and the debt increased from 50 per cent of national income in 1979 to over 100 per cent by 1986. The new lending was effectively bailout loans from foreign governments and international institutions to pay-off private lenders. The percentage of debt owed to foreign banks fell from 35 per cent in 1979 to 20 per cent by 1985, replaced by debt owed to the IMF and World Bank.

In the early to mid 1980s Liberia's debt repayments were the equivalent of 30 percent of the country's earnings from exports; a huge burden of money flooding out of the country.

In 1980 Samuel Doe headed a military coup. An ally of the US during the Cold War, the US gave significant financial and military backing to Doe, whilst corruption and political repression increased. In 1989 Charles Taylor launched an insurrection to try to overthrow Doe's government, which created Liberia's first civil war. A peace deal in 1995 led to Taylor becoming president in 1997. Under Taylor Liberia became seen as a pariah state internationally. In 1999 a second civil war began, ending in 2003 when Taylor fled into exile. In 2005, Ellen Johnson-Sirleaf was elected president and later received the Nobel Peace Prize.

Liberia defaulted on its debt payments for much of the civil war; the notional debt stood at 300 per cent of national income in 2003. There were sporadic repayments, especially of tens of millions of dollars in the mid-1990s.

Liberia was admitted to the Heavily Indebted Poor Countries initiative in 2008, leading to it having much of its debt cancelled in 2010. To qualify for debt cancellation, Liberia had to start making payments on debts it had previously been defaulting on, leading to a huge increase in payments. Normally under HIPC's rules, Liberia would have had to take out new loans to pay defaulted old debts, and the new loans would not have been cancelled. International campaigning led to this largely not happening in Liberia's case, and the debt was cut to 10 percent of national income in 2010.

In 1978 the US Chemical Bank had lent Liberia $6.5 million. The 'ownership' of this debt was sold many times, especially once repayments on it stopped during the civil wars. Traders effectively saw it as unlikely that the debt would ever be paid. It ended up in the hands of two vulture funds – Hamseh Investments and Wall Capital. In 2009, the two funds sued Liberia in the UK for $20 million and won the case. In 2010, an Act of Parliament was passed thanks to Jubilee Debt Campaign which limited payments to vulture funds in cases such as Liberia. In late 2010 an out-of-court settlement was reached for just $1 million.

Reacting to the passing of the Act of Parliament, President Johnson Sirleaf said: "Bravo! We've been waiting for a parliament or an assembly to take this kind of hard decision to be able to bring these funds into consideration. Maybe the US Congress … will pick up this gauntlet and will follow the example of Britain and move that — because it's just so unfair to poor countries."

The IMF estimates Liberia's debt in 2012 is 13 percent of national income, but predicts it will increase rapidly to 25 percent of national income by 2016 and 30 per cent by 2020. Debt payments are predicted to use up 2 per cent of government revenue a year over this period. This assumes the economy will grow by more than 7 per cent over the next few years.

The IMF says even if Liberia is hit by an extreme economic 'shock' (such as drought, flood, world wide recession or change in important commodity prices) debt payments would only use up 5 percent of government revenue. However, over recent years, 12 percent of countries analysed by the IMF have had more extreme economic shocks than the IMF's predicted extreme. Most of the lending to Liberia in recent years is from the IMF and World Bank.

Source: Jubilee Debt Campaign

Ireland – Case Study

Reckless lending and borrowing by banks fuelled an unsustainable boom in Ireland, which crashed when the global financial crisis began in 2008. The Irish government guaranteed all the debts of the banks, transferring a huge amount of debt onto the public. Before the crisis, the Irish government had an annual surplus, but after, its total debt increased from 10 percent of GDP to 100 percent. In 2010 the overly indebted Irish government was lent more money by the IMF and EU in order for it to keep paying the foreign banks; effectively yet another banking bailout. Unemployment shot up rapidly, to 15 per cent, and austerity hit the most vulnerable groups the hardest. Campaigners and unions called for debts to be declared illegitimate and repudiated, such as the debts of Anglo-Irish bank which were taken on by the State.

Ireland gained its independence from the United Kingdom in 1922. One of the most infamous episodes in the country's colonial history was the potato famine in the mid-1800s, when 1 million people died, and 1 million emigrated. Potato blight destroyed much of the crops that peasants depended on. But throughout the famine, the country remained a net exporter of food to England, with meat exports actually increasing. But the poor could not afford high prices, and food was shipped under armed guard from the most famine-stricken parts of Ireland.

For several decades, Ireland remained one of the most impoverished countries in Western Europe. A major economic expansion began in the late 1980s, as the country shifted from being dependent on agriculture to new digital technologies, and then banking and finance.

In 2002 Ireland adopted the Euro, effectively fixing the country's exchange rate with other Euro members, and giving up any control over interest rates. The boom continued, with economic growth averaging over 5 per cent a year between 2002 and 2007. The boom was increasingly driven by foreign banks lending money to Irish banks. Borrowing by Ireland's private sector led to the foreign debt of the country as a whole reaching 1,000 per cent of GDP by 2007. Large amounts of foreign owned assets were also claimed to be owed to banks, supposedly partially balancing this huge figure. Much of this money flowed into house prices, which doubled between 2000 and 2007.

In contrast to the reckless lending and borrowing of the private sector, the government had a budget surplus during this time, and its total net debt – owed to both Irish savers and foreigners, was down to just 11 per cent of GDP by 2007.

The boom rapidly turned to a bust in 2007/2008 when banks, starting in the US with the sub-prime crisis, had to start writing off loans they were due to be paid, and so stopped lending to each other. Irish banks both lost out on assets they claimed to be owed through complex derivative contracts, but also stopped being lent new money. This quickly led to falls in house prices, down by a third by 2010, which cut the amount banks could get back on housing loans which had gone bad.

The Irish banking sector was bust. In September 2008, unlike the Icelandic government, Finance Minister Brian Lenihan guaranteed the debts of the six main Irish banks, transferring obligations directly from the private sector to the state. At the same time, the Irish economy crashed; by 3 per cent in 2008 and 7 per cent in 2009. This drastically reduced government tax revenues. Unemployment increased from 5 per cent to 15 per cent, increasing the need for government spending on welfare payments.

The Irish government's net debt increased ten-fold to over 100 per cent of GDP by 2012. The IMF estimates that Ireland's (public and private sector's) net foreign-owed debt (so taking account of assets held abroad) was 90 percent of GDP at this time

One of the banks guaranteed was Anglo-Irish. Anglo-Irish could not afford to meet payments to its bondholders; the creditors, primarily foreign, which had recklessly lent money to the bank. The Irish government agreed to make sure these payments would be made. To do so, it got agreement from the European Central Bank for the Irish Central Bank to create Euros with which to pay the debt. However, it only did so on the basis that the Irish government 'repay' the Central Bank over 20 years. When these payments are made, the money is effectively deleted at the insistence of the European Central Bank, supposedly to stop an increase in inflation.

The Irish government will make almost €50 billion in payments on this Anglo-Irish debt between 2011 and 2031. Much of the money to meet these payments will be borrowed, rolling over the illegitimate banking debt for many decades to come.

Having taken on the banking debt, and with the collapsing economy, the Irish government was rapidly heading towards not being able to meet its debt payments. In December 2010, the EU and IMF agreed to lend €85 billion over three years to prevent the Irish government defaulting, and hence potentially bankrupting various western banks, particularly in large lending countries such as the UK. The loans are effectively another bank bailout, with the debt remaining with the Irish state. These loans came with harsh austerity conditions, mandating the Irish government to cut social welfare programmes, privatise a number of state assets, and reduce spending on the public sector and the public sector wage bill. The IMF has since recognised that these austerity conditions further damaged the possibility of an economic recovery in Ireland - let alone a fair economic recovery.

Activity 2: Building a timeline of debt crises in the Global North & Global South

Overview: In this activity, students use prior knowledge, teamwork and logic to build a timeline of the history of global debt crises on their classroom walls. In pairs, they choose 3 key events and estimate where on the timeline to place the cards. They then hold a discussion about the timeline.

Objectives: This activity aims to build students' understanding of the historical roots of debt, by drawing attention to hidden factors such as colonialism, commodity markets and geopolitics. It aims to increase students' awareness of the complexity of sovereign debt, and the instances when debt may be illegitimate.

Materials: Timeline date cards. Paper/card to create a timeline. Blu-tac. One set of historical event cards (see below).

Time: 1 hour

Group Size: 4 - 30

Instructions For Trainers:

(A) Pre-class: Using the walls of your classroom, create a large 'timeline' stretching from 1850 to 2021 (or the current year!). To do this, place the below dates across each wall, in a line, in large writing so they stand out well. Leave plenty of space between each date, and if possible link them with a narrow strip of paper and a 'line.'

1880-----1900 --------- 1910 ---------- 1920 -------- 1930 --------- 1940 ------ 1950 ----- 1960 ----- 1970 ---- 1980 ------ 1990 ------2000-----2010------2020

(B) 10 minutes: Place each of the event cards (cut from below) randomly on a table. Do not distribute the dates - this is just for your reference! Tell students to work in pairs, and to select 2 to 3 cards per pair (or more, depending on the size of your group). Ask them to guess the correct date of the events they have been assigned, and use blu-tac to attach the card to the approximate location on the timeline of that date (i.e. for 2011, it should be placed just after the large '2010' sign on the wall). Explain to the students that some of the cards represent events which are 'common knowledge,' some may require them to just guess, while others feature in the case studies they have already learned about. Ask them to think about the history they know and think when the event might logically have taken place.

(C) 15 minutes: When the timeline is complete, correct any errors (it might be useful to take a break in the session at this point). Ask the students to take ten minutes to read through the entire timeline, including noting any changes that have been made to their cards.

(D) 15 minutes: Facilitate a discussion with the entire group about the sequence and logic of the events on the timeline. For example:

- Highlight the period from 1944 - 1971; from when the Bretton Woods Institutions were established to the end of the Gold Standard. Highlight the fact that very few currency

fluctuations or debt crises took place in this period. Ask what students know about what happened in Europe in this period (expansion of the welfare state, increase in workers rights, European reconstruction).

- Draw attention to the lending boom which took place after the 1971-73 oil crisis; lending is often fuelled by a surplus of cash looking for a profitable home in the economy, rather than by the needs of borrower countries.
- Ask students what more they know about colonialism. What sorts of economies were in place in the Global South when colonialism ended? How were they able to raise money for development? Draw attention to the fall in commodity prices that happens at various points in the timeline, and how that links to debt crises / ability to repay debts.
- Draw attention to who the borrowers and lenders were - for example, rich countries lending money to Ferdinand Marcos in the Philippines. Ask students what they know about the politics of Latin America in this period. Who were the rulers? Who were the rich countries lending those rulers money? Was this fair? Who benefitted from these loans? Is it just for those debts to be passed on to the people?
- How should we view issues such as the privatisation of Tanzania's water system? Who had power in that situation? Did the decision strengthen democracy in Tanzania?

(E) 10 minutes: It might be useful, after this discussion, to use a powerpoint to run through the entire timeline from start to finish, to reinforce students' knowledge.

Event / Fact	**Date**
The Berlin Congress divides Africa up amongst European powers.	1878
The Treaty of Versailles imposes a $32 billion debt on Germany, the equivalent of $442 billion in today's money.	1919
Large lending by banks fuels speculation in stock markets in the US and around the world. The London and New York stock exchanges crash in value, starting the Great Depression.	1925 - 1929
The US, UK and France agree to a one-year moratorium on Germany's debt payments. France and the UK then agree to fully cancel Germany's Versailles debts, if the US cancels the French and British debts from the First World War. The US Congress refuses.	1931 - 1932
Latin America's export revenues collapse leading to widespread government debt defaults, including by Bolivia, Brazil, Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Mexico, Nicaragua, Panama, Paraguay, Peru and Uruguay	1931 - 1938
World War II breaks out, ending in 1945	1939
The Bretton Woods Conference in the US creates a system to regulate loans between countries, whilst the dollar is pegged to the price of gold, which is designed to stabilise currency exchange. The conference creates the International Monetary Fund and the World Bank.	1944
Half of Germany's outstanding foreign debt is cancelled including by the US, UK and Greece.	1953
Dictator Ferdinad Marcos comes to power. For two decades in power, he takes on enormous foreign currency loans. The most notorious is a $20billion loan to build a power plant called Bataan, which, because it is located on an earthquake fault line, never produces a single watt of	1965

energy.	
The US abandons convertibility of dollars into gold and begins to remove regulations on the movement of money between countries.	1971
Due to the US role in the Arab-Israeli war, oil producing countries cut production and announce an embargo against the US, doubling the oil price. Profits (petro-dollars) are recycled into western banks, who then lend them on.	1973 - 74
Loans to Latin American governments increase more than fourfold in four years, from $8 billion to $33 billion. Similarly, loans to governments in sub-Saharan Africa increase from $2 billion to $8 billion in the same four years.	1974 - 1979
Prices for raw materials begin to fall, and continue to do so for the next twenty years. Advice from the World Bank to produce more just causes prices to fall further.	1980s
Following an increase in interest rates by the United States, the Mexican government announces it can't pay its debts. Following Mexico, 57 countries in the global south have difficulties paying debts to private lenders.	1982-1989
The IMF lends $60 billion in this decade to help payments to be made, up from $15 billion in the previous decade. The World Bank also starts such bailout loans. In return, the two institutions demand that a series of policies are followed (called structural adjustments), including cutting government spending, privatisation, trade liberalisation and deregulation.	1982 - 1989
Dictator Ferdinand Marcos is deposed. The Freedom from Debt Coalition is founded in the Philippines to argue for an audit into the Philippines debt, and adjustment of debt payments to ensure economic growth and poverty reduction.	1986-1987
The G7 group of rich countries create the Heavily Indebted Poor Countries initiative to cancel some of the debts of some of the most impoverished countries, if those countries implement more IMF and World Bank free market economic policies.	1996
The Jubilee 2000 petition calling for debts to be cancelled for the millennium receives more than 20 million signatures globally.	1999
Tanzania qualifies for debt relief under the Highly Indebted Poor Countries (HIPC) Initiative, after meeting the condition to privatise the water system in Dar es Salaam. The privatisation collapses in 2005.	2001
Malawi enters a food crisis just a year after it is made to sell off its grain reserve as a condition to qualify for debt relief.	2002-2006
Argentina announces it risks defaulting on its debt. A few years later, it reaches an agreement with over 90% of its creditors to pay 33 cents on every dollar owed. However, some vulture funds buy up other debt cheaply and refuse to take part in the debt restructuring.	2005-2008
Having had $6.7 billion of debt cancelled by public institutions, Zambia is sued in UK courts by vulture fund Donegal International for $42 million on a debt it paid $4 million for. The British judge rules a debt is owed, but only $20 million.	2007
Fears over securitised debt linked to sub-prime mortgages leads banks to stop lending to each other. Lehman Brothers goes bust in September. In the UK, US and Ireland, governments begin to bailout banks.	2008

Countries like Ireland begin to seek new loans from the IMF and the EU, in order to cover the costs of the decision to bail out banks. In Ireland, this eventually costs €64 billion, as so much bad bank debt has been nationalised.	2011
After campaigning by the Jubilee Debt Campaign, the UK parliament passes an Act to prevent vulture funds suing Heavily Indebted Poor Countries for more than they would have got if they had taken part in the debt relief scheme.	2011
London-based banks Credit Suisse and VTB secretly lend $2 billion to state-owned companies in Mozambique, under UK law.	2013
In countries across the Eurozone, IMF & EU loans come with conditions to impose austerity and cut government budgets. The IMF later recognises these conditions prevented economic recovery.	2008-2012
The UN votes for new principles for debt restructuring by 136 votes in favour to six against, but those against include the key countries which decide how global debt is regulated, including the US, UK, Germany and Japan. The vote comes as campaigners warn of a new global debt crisis, due to a boom in lending, falling commodity prices, and rising costs of debt repayments in poor countries in particular.	2015
A new Argentinian government agrees to pay off the vulture funds, in what could represent a profit of over 1,000% for some of them.	2016
Over $11 trillion of cash is released into the global economy because of Quantitative Easing policies of rich country governments, who buy up large amounts of corporate debt. This increases the amount of cash being lent by companies in rich countries to the governments of countries in the Global South.	2010-2018
Global debt reaches a historic high of $255 trillion, or 320% of GDP.	2019

Activity 3: The Debt Diamond

Overview: In this activity, students work in small groups to debate different concepts and arguments relating to sovereign debt, and to come to an agreed consensus about the importance and validity (or lack of importance) of these concepts.

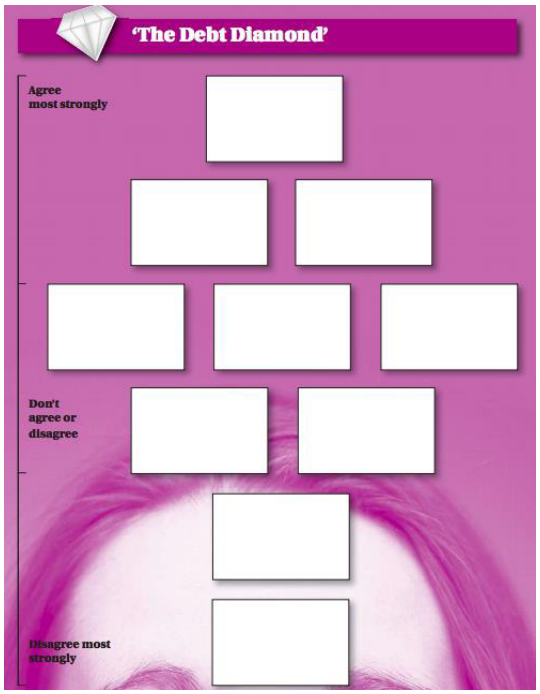
Objectives: This activity aims to deepen students' understanding of the causes of debt crises by enabling them to use information they have learned in discussion with their classmates. It also aims to enhance their ability to argue a case, and to listen to and engage with differing opinions.

Materials: Debt diamond cards (multiple sets, cut up, see below - enough for 1 set for every group of 4 students).

Time: 30-45 minutes

Group Size: 4 - 30

Instructions For Trainers:
(A) 5 minutes: Start by encouraging the group to discuss debt on a personal level. Ask them: Have you ever been in debt or has anyone been in debt to you? How does it feel?Why did you take the loan? What would happen if you couldn't repay or be paid the debt? Separate the group into small groups of up to 4 people each. Give each group 1 set of cards.



(B) 10 minutes: Ask students to examine the statements on the cards together. Ask them to identify which ones they agree with or disagree with. Ask them to arrange the cards in a diamond, with the one they most strongly agree with at the top, and the two they feel next strongly about on the next line, and continue until the statement they most disagree with is at the bottom. Show them the 'debt diamond' graphic as a guide. It is important that all the people in the group have a say about where the cards go. Where there is disagreement, this should be discussed in the group.

(C) 15 minutes When everyone is finished arranging their cards, they should present their diamond to the whole group, explaining why they ordered their cards in this particular format. Encourage students to debate between groups about why their order was 'correct,' and to come up with reasoning for the choices that they made.

Debt Diamond Cards

It is always morally wrong not to repay a debt.	The world's poorest countries should pay off their debts regardless of the consequences for their peoples.
Debt is the result of mismanagement and corruption, and those in charge shouldn't be allowed to get away with it.	Today's generations of poor people in poor countries should not be held responsible for the mistakes of those who went before.
Rich countries should be able to give loans to maximise the profits of their own corporations, without having to consider all possible long-term effects.	Poor country debts are particularly harmful to women.
Debt is a cause of environmental damage	The debt crisis is a major cause of war and terrorism
We can't get rid of poverty without debt cancellation	If poor countries adopt the economic policies of international experts (such as the International Monetary Fund), their problems will be solved.
Add your own card...	

4. Interactive learning

Debt Justice Quiz

1. At the International Monetary Fund and the World Bank, the size of a country's vote is related to its:
   a. Population size
   b. Its vulnerability to climate change
   c. Its income and how much money it pays into the institution

2. In 2019, how many more countries of the world were spending more money on debt repayments than healthcare?
   a. 64
   b. 14
   c. 34

3. What is a debt jubilee?
   a. When a country or large organization cancels debt and clears it from the public record.
   b. When loans are made to despotic regimes, even though it is clear the money won't be spent on what is best for the country.
   c. When the interest rate on a debt doubles.

4. What is external sovereign debt?
   a. Debt owed by a government to its Central Bank
   b. Debt owed by a government in a currency other than its own

5. In which of the following circumstances are high sovereign debts problematic from a social justice point of view? Tick all that apply.
   a. When debt repayments prevent public spending and investment leading to a negative cycle in which debts continue to increase as investment decreases
   b. When debt is used as a counter-cyclical tool to invest in the economy
   c. When debts were not accumulated fairly
   d. When loans increase a country's vulnerability on international markets

6. The _____ school of thought sees balanced government budgets as inherently good, and advocates minimal government spending and accumulation of debt, and that contravention of these principles is the reason why debt crises happen.
   a. Keynesian
   b. Marxist
   c. Neoclassical / neoliberal

7. Which of the following are reasons why some governments might have very high debt?
   a. Colonial legacy, odious lending, irresponsible lending
   b. Nationalising private debts, snowballing debt, economic reforms/conditions that affect ability to raise revenue
   c. Tax collection, debt write-downs, profligate spending on public services

d. A and b
e. B and c

8. Which of the following former French colonies was forced to pay reparation to France when the country gained independence, as a payment for France's 'lost' slaves?
a. Canada
b. Algeria
c. Haiti

9. Most interest on sovereign debt is paid by Sub-Saharan countries to which type of lender?
a. Multilateral
b. Bilateral
c. Private

10. Debt justice advocates want to see a multilateral Debt Workout Mechanism hosted by:
a. The World Bank
b. The UN (United Nations)
c. The IMF

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FRESH-UP ECONOMICS

Tax Injustice in the Global South

– Causes, Consequences & Solutions

By Meaghan Carmody, Financial Justice Ireland

Table of contents

1. Overview

Tax is a crucial part of the story of global injustice. Unfortunately, many people hear the word tax & recoil - it seems dense, boring & perhaps a topic best left to the 'experts'! This guide will help you understand just what tax is, why it is so important, what global trends threaten fair tax collection, & what might be done to help solve tax injustice globally. Read on for the short version, & keep note of the sentences written in red. These are questions or reflective prompts to help you dive deeper into what you're learning about!

So what do we mean by tax? A tax is a compulsory contribution made by people in a country to the state of that country. Taxes are also paid by businesses, again to the state. In general, the state then decides how to use the tax to 'defray' or mitigate some of the expense of running the country. Importantly, tax isn't a transaction. One person or business cannot say to the government, "I gave you ___ in tax, & I now want a road/hospital/street light in return". It is not an exchange, rather it is a duty that we all pay. It has even been described as the price paid for having a government!

Specifically though, tax has a number of functions, & surprisingly, not all are directly related to the impact of the extra money that the state has at its disposal. These functions can easily be remembered with the handy mnemonic - 'the 4Rs of taxation'. Firstly is **revenue.** This funds essential public services that are critical for the smooth functioning of a country, like education, healthcare, transport infrastructure etc. This revenue allows governments to plan into the future, something not always possible with aid or grants. The second function of tax is to **redistribute** wealth in order to reduce inequality in society & protect those most vulnerable & in need. However, redistribution can be done in more or less just ways, & this depends on how *progressive* or *regressive* the tax system is. The third function of tax is in the **repricing** of goods, whereby social 'bads' might have an extra tax put on them, & social 'goods' might get tax relief. What might an example of a social 'bad' be? & a social 'good'? Finally, tax can actually increase the extent to which citizens feel **represented** by their elected representatives, & so can actually encourage democratic participation. Think about it; if you pay tax to an authority, but that authority does not listen to your views about what is needed in your community, what might happen…? That's right, they may not get your vote again! It's in their interest to listen to you, & one of the reasons you get a say is because you pay tax. This unwritten agreement between citizens & elected decision-makers is what's known as the **social contract.** Finish the anti-British slogan at the time of the American Revolution, "_____ without _____ is tyranny!"

Tax is a key tool for ensuring what is known as 'distributive justice', meaning that the benefits & burdens of social cooperation (e.g. tax) are shared fairly. But why is *this* important? Distributive justice is important because ensuring global justice requires that all states have the capacity to secure a *just* distribution of advantages between their citizens. However, because of the global tax rules & in particular the exploitation of loopholes in tax systems, many governments are prevented from having enough revenue to meet the needs of their citizens. And it's not just that the tax rules prevent many governments from receiving their fair share of tax, it is also that the lack of tax revenue triggers a self-reinforcing cycle, whereby state institutions such as those to collect tax are degraded so much over time by insufficient tax revenue, that the task of collecting tax becomes increasingly difficult! This has knock-on effects on all of the public services that governments need to provide to their citizens in order to ensure human rights are not breached. Can you think of some human rights that could be negatively impacted without sufficient revenue to provide public services?

The story doesn't end there however. Reflect on what governments might do if they foresee a deficit in their balance sheet. In these situations, they may continue to cut their spending on public services, or even increase taxes on the everyday person, for example Value Added Tax or VAT which is the same for everyone regardless of their incomes (it is 'flat'). Now consider who may be more impacted by cuts to public services, & by increases in 'flat' taxes? That's right; those already poor & vulnerable, & even women & girls, especially if extra VAT is placed on sanitary products, something which has happened frequently.

It does not stop there however. We must ask, what role does the global financial system have to play in this scenario? You may think that in situations where human rights are at risk, global organisations would swoop in to support countries in need. Well many 'International Financial Institutions (IFIs) do, such as the WB & IMF. Can you find what these acronyms stand for? Individual countries can also help. However, most of this financial support is given in loan format, rather than as grants, or aid, or even interest free loans. What is the difference between a loan & aid or grants? & with the IFIs, they have actually used the threat of withholding financial support in the form of loans as a way to promote certain ways of doing things economically around the world. For example, 'tied' to this support are conditions around removing trade barriers, increasing VAT, reducing taxes on foreign investors & more. There are some reasons for this; such as remaining neutral towards business, not hindering competition, & leaving companies with as much profit as possible so that this profit either flows down into our pockets or is transformed into higher wages, better machinery etc. However, these assumptions do not hold when put under the microscope. This suite of policy 'recommendations' is called the **tax consensus**.

The fundamental problem is that our global financial system is replete with loop holes & escape hatches, like a giant game of snakes & ladders. Not even 100 years ago, companies were fixed to where they had a factory, their raw materials, their employees. But today, companies are complex, with many tentacles stretching out all over the world. A company's headquarters might be in country A while raw materials accessed from countries B & C & manufacturing happens in country D. The world is not a single country, & tax laws differ across borders. 'Aggressive' tax planners & 'creative' accountants exploit these mismatches in rules to allow companies to shoot up a ladder, bypassing fair rules, or to use an escape hatch (research what 'capital flight' means), leaving to somewhere more favourable when the rules no longer suit them. As a result, instead of *companies* competing for market share, we increasingly see *countries* competing with one another on tax laws in order to attract investment, resulting in a **'race to the bottom'** on corporation tax.

This tax dodging can be legal (called tax avoidance) or illegal (called tax evasion). Do you think something that is legal is always ethical or moral? Shockingly, this tax dodging costs developing countries more than they receive in aid. Corporate tax is more crucial in these countries than Global North countries because in the Global South, a large portion of the population don't make enough money to earn tax. If multinational corporations (MNCs) paid their fair share of tax in these countries, it could make a huge difference.

There are some solutions however, which if implemented would make a significant difference & help to alleviate global poverty by giving **fiscal sovereignty** back to developing countries. One solution is for tax authorities around the world to automatically share information about what's in bank accounts in their countries with other relevant countries. This prevents companies & wealthy individuals from hiding their money in tax havens, where tax rates are very low. Another solution is to uncover the person at the head of companies that actually benefits from owning the company. Many people are surprised to learn that companies can actually pay people to be the public face of their company, so that the real owner stays

hidden. This needs to change, & the names of the **beneficial owners** (who have to be human!) need to be made public. Next, companies with many tentacles (subsidiaries) should be taxed as if they're one company, not many. Finally, the UN should be responsible for global tax regulation, not the OECD. This is because the OECD is actually more so a club of rich countries, whereas the UN is the only global institution where governments participate as equals. Surely this is then the best forum with which to determine global action to reduce inequality.

2. Background information

What is tax?

"Taxation is key to the character & functioning of the state, the economy & society as a whole."

- Solomon Picciotto[1]

Before facilitating any session to do with tax, it is important to ensure a common understanding of 'tax'. Taxes have been described as the price paid for having a government, paid by anyone who benefits from the existence of the state & the public services it provides. The formal definition of a tax is "a compulsory contribution levied upon persons, natural or corporate, made to the public authorities in order to generate revenue to help defray the expense incurred in conferring common benefits upon the residents of the state[2]". In more simple terms, a tax is compulsory, increases government revenue/income, is placed upon those *incorporated* which means both people & corporations[3], & is used for the purposes of offsetting some of the costs that are incurred by governments in the process of providing public services to their population. Tax is a core element of what is known as fiscal policy, or government policy concerning in particular public revenues & taxation.

Even though it is a payment from one party to another, tax differs from a regular transaction as it is not paid with the expectation that a specific output is given on payment, in the way that we may exchange money for food or clothing. In other words, there is no *quid pro quo* (direct return) in the case of a tax. Instead, taxes are paid to the authorities & it is they, along with councils etc. (depending on the decision-making structure of the country's public institutions) who ultimately decide (with more or less input from & responsiveness to the population) what tax revenue should be used for & how it should be apportioned between services.

In contrast however, some argue that tax is a way for governments to deprive citizens of their hard-earned money. The Neoclassical school would be of this approach, arguing that low tax rates allow the private sector to flourish[4]. This analysis of tax ignores the reasoning behind tax systems, namely that their existence supports the fulfilment of economic, social & human rights. The human rights legal framework states that the minimum requirements needed to fulfil economic & social rights include providing sufficient foodstuffs, essential primary healthcare, basic shelter & housing, & the most basic forms of education[5]. Tax is crucial for ensuring that these rights are fulfilled.

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[1] Lecturer, author (book *International Business Taxation*, 1992, & *Regulating Global Corporate Capitalism*, 2011) & co-founder of the Tax Justice Network

[2] Investopedia

[3] Note the existence of "corp", in Latin meaning anything to do with the body.

[4] See here for a useful & interactive resource explaining this perspective https://courses.lumenlearning.com/wm-macroeconomics/chapter/supply-side-economics/

[5] Unicef

What are the purposes of tax? 4Rs & 2Ss.

Revenue

Tax has four key purposes, which are often referred to as 'The Four Rs of Tax'. The first of these is generating revenue, or government income. This revenue provides three functions:

1) It is used to fund **essential public services** like education & healthcare, as well as infrastructure like roads, street lights, & bins.

2) It is also related to the **strengthening of the democratic process**, because when governments receive revenue via tax, it places the citizens of that country in a position whereby they can demand to have an input into how the revenue is spent. Tax is therefore related to democracy.

3) It provides governments with the **predictability** needed to be able to make financing decisions into the future. For example, if a government was using only aid to pay the salaries of all nurses, doctors & teachers, what would happen if that aid were to be removed?

Redistribution

The second purpose of tax is to support the **redistribution** of wealth. Redistribution refers to redistributing the country's resources from the wealthy towards the poorest & most vulnerable people, which can help to reduce inequality in society. This is seen as an 'active' fiscal policy and is in line with the Keynesian school of economic thought.

However, redistributing wealth via tax can be done in a number of ways, & not all are equally just. In fact, the way a country's citizens are taxed can either lessen or increase equality. Therefore the already existing income inequality means that it is not solely enough to increase the *amount* of tax, instead governments must decide *how* to tax its population in order to ensure an equitable burden that does not worsen existing inequality.

Specifically, there are two ways in which tax can be applied on individuals in society that can lessen or increase income inequality. These two ways are **progressive** or **regressive**. A reliance on consumption taxes like sales tax or value added tax (VAT), for example on food or fuel is seen as regressive as everybody is taxed the same amount regardless of their financial status. In contrast, an example of a **progressive** tax is income tax in some countries, as index bands change the tax rate based on how much income is earned, & the more people earn, the more tax they pay (to a point). This is because the marginal utility (i.e. the usefulness of the surplus) is lower as one earns more money . For example, when a person has less money, each unit of that money becomes more valuable. Think about it; the marginal utility of €10 to a person earning €4,000 per month is much greater than to a person earning €10,000 per month.

Repricing

The third purpose of tax is the **repricing** of certain goods. Items may be taxed according to whether they constitute a public 'good' or public 'bad'. Tax can be applied to create a price that accurately reflects the benefits & costs to society. For example, higher taxes on cigarettes & alcohol may discourage their use, both of which are negative for people's health, while tax breaks on the price of bicycles or electric vehicles

may incentivise people to choose these modes of transport that are better for the environment & human health. In this way, tax can be used to deter behaviours that are considered socially undesirable, & can be used to incentivise behaviour that is considered desirable to society.

Representation

The final R of taxation is **representation**. Citizens & other entities are generally only required to pay taxes if the taxing authority provides them with a political voice via elected representatives. The relationship of taxation to representation goes back to the time before the American Revolution. At the time, the anti-British slogan "Taxation without representation is tyranny" reflected the resentment of American colonists at being taxed by the British parliament, a political body to which they elected no representatives. Tax can therefore build healthier democracies, because as populations are taxed, they tend to demand stronger political representation & governance. This dynamic has contributed to the emergence of what is known as the **'social contract'** or '**fiscal contract'**, whereby tax-paying members of society vote for certain candidates & in doing so expect them to raise & spend the taxpayer's revenue in a way that benefits the voter. A study found that in 113 countries between 1971 & 1997, introducing or increasing taxes without simultaneously increasing or improving service delivery led to citizens demanding their rights, & to subsequent democratic reforms[6]. This trust given to authorities by citizens when paying tax is important for building a shared accountability between citizens & governments. However this trust is threatened by a perception of unfairness, which tends to increase when ordinary citizens feel that they are paying too much, while the richer players are not contributing their fair share.

Stability

Another purpose of tax is (**macroeconomic) stability**. Tax provides macroeconomic stability by being used as a fiscal lever in times where there is too much demand & not enough supply of certain goods or services in the economy. This situation can increase inflation, defined as the general price of goods & services as measured by the Consumer Price Index (CPI). Imposing a tax on the scarce goods or services can reduce demand, & therefore reduce inflation.

Sustainability

Finally, tax is a more **sustainable** source of finance for southern governments for a few reasons. Firstly, it is less likely to be vulnerable to the sudden removal of money or capital from a country, so called '**sudden stops'**.

Secondly, tax from revenue isn't subject to interest repayments, unlike debt. Financing projects via debt can result in the tax raised domestically going towards paying off the debt, reducing the revenue available for public services. Debt servicing can thus swallow tax revenue. For example, in Nicaragua in 2008, debt servicing swallowed one quarter of the entire annual tax take, which was equivalent to 36% of total public spending & was more than the country's entire health budget that year. Another example can be found in the Philippines where the debt service from 1986 to 2008 for interest payments averaged just over 25% of the country's national budget. This was without paying off any of the principal of the loan; it was solely paying the interest. More recently in 2010, just under 25% (24.34%) of the Philippines' budget was spent

[6] Ross (2014)

on interest repayments & just under 30% (28.95%) went towards paying off the principal. In contrast, 28.5% total was allocated to public services like health, education & housing[7].

The third reason that tax may be preferable to debt as a financing tool is that with loans, external donors (that don't necessarily understand the needs of the country) can dictate how the loan is spent, rather than the domestic government. Increasing the domestic tax take reduces a country's reliance on external loans & the debilitating repayment of these loans into the future, & affords them increased agency & space to determine their own national policies (fiscal sovereignty) rather than having them dictated by donors.

What about aid?

There is a role for foreign aid, however there are a number of issues attached to relying on aid rather than tax revenue as a source of national finance. Firstly, aid can encourage rent-seeking behaviour in the political elites in the country receiving aid, an economic concept referring to when an entity seeks to gain wealth without any reciprocal contribution of productivity. Secondly, it can make rulers accountable to foreign donors rather than their populace, increasing government *responsibility* to donors, while sacrificing their ability to be genuinely *responsive* to their citizens[8]. Thirdly, aid is volatile, as its amounts can change rapidly over a short period of time. This reduces the ability of the government in the aid-receiving country to plan accordingly into the future. Finally, aid is unable to match the revenue-generating potential of tax. In fact, some have estimated the revenue loss of corporate taxes of low-income states due to to be greater than the combined foreign aid budgets of high-income states in 2007[9]. "We calculate…that the loss of corporate taxes to the developing world is currently running at US$160bn a year (£80bn). That is more than one-and-a-half times the combined aid budgets of the whole rich world – US$103.7bn in 2007." (p. 2)

A note on Modern Monetary Theory

Another part of the story of tax has to do with Modern Monetary Theory (MMT). From the perspective of MMT theorists, spending and taxing in a country's own currency creates a cycle that allows money to be created, and so gives worth to currency. Money is spent into the economy and then taxed; i.e. revenue is not always required to be sent to the government before it can be spent. This is a little challenging to get one's head around as it is fundamentally different to the way most people are taught to think about the economy! Please see the FreshUp article on Modern Monetary Theory for more information on this concept and how it relates to tax. It's also important to note that many countries around the world cannot issue their own currencies. What's more, in order to trade on international markets, dollars must be used as it is to the dollar that all other currencies are pegged.

[7] All examples cited can be found in Action Aid, Tax Justice Advocacy Toolkit (2011)

[8] The concepts of responsibility & responsiveness in politics can be attributed to the political scientist Peter Mair

[9] Death & Taxes (2008)

Framing: What is distributive justice & what does it have to do with tax?[10]

This guide to tax approaches tax from the perspective of distributive justice. Distributive justice is an approach that concerns the fair distribution of the benefits & burdens of social cooperation, such as taxation. Global justice requires that all states have the capacity to secure a just distribution of advantages between their citizens[11]. States must, therefore, have the capacity to design their legal & economic institutions in such a way that they reflect the concepts of distributive justice. Distributional justice also means an ability to determine the size of the government budget & the level of redistribution, important elements of fiscal policy[12]. However, many low-income countries face difficulty in raising revenue which affects their ability to pursue redistributive programmes, a core component of fiscal self-determination. This guide will outline some of the ways that this happens, & some of the policy solutions offered.

Tax is a key tool used to redistribute resources, & so the tax policy debate is one of the few areas of law in which discussions of distributive justice are considered appropriate. Most other economic regulation is oriented towards *maximisation* of wealth, rather than its *distribution*. What is different about discussions of tax in law is that tax is a tool used *after* productivity has been maximised, entering afterwards to set about rearranging the wealth distribution in society.

How is tax an issue of Global Justice?

Tax is necessary to fund essential services. This is particularly relevant to countries in Africa, Asia, & Latin America (southern countries) for a number of reasons. Firstly, southern revenue authorities already tend to be under-resourced, for many reasons but one of which is the issue of sovereign debt (see FreshUp guide on Debt). This creates a vicious cycle whereby with less revenue, the tax authorities struggle to improve their tax-collection capacity.

A key issue found across the board is the association between tax justice & development. In the 2000s, Christian Aid began to link tax to global inequality & development issues by publicising the fact that developing countries lose more money through the tax evasion practices of large corporations than they receive through official aid[13]. Moreover, global tax rules that facilitate tax dodging are exploited by corporations & wealthy individuals to deliberately deprive countries of the resources they need to meet their country's needs & fulfil human rights obligations. Tax justice advocates frame tax malfeasance or bad practice as an issue of concern to human rights, because without government revenue from tax, it is much more difficult for a government to fulfil obligations relating to health, education, security, climate change & other issues.

Additionally, insufficient tax from corporations & wealthy individuals has knock-on effects domestically regarding the burden of ensuring sufficient tax revenue is generated, as when governments don't have

[10] Content in this section is sourced from the book Tax Justice, the Ongoing Debate (2002)

[11] Appeldoorn (2016)

[12] Dietsch (2015, p.35)

[13] See report, 'Death & Taxes' (2008)

sufficient tax revenues from a variety of sources to meet the country's needs they are encouraged to place the tax burden on the everyday person.

Furthermore, when governments cut public spending or increase everyday taxes to plug the revenue gap, this burden falls disproportionately on certain social groups. One of the ways they do this in the absence of corporation taxes is by increasing indirect taxes such as Value Added Tax. This disproportionately affects women & girls[14] because they spend most of their income on household goods. Additionally, flat-rate personal taxes are more likely to increase the tax burden on those with lower incomes. In many countries, this is disproportionately women.

What's more, according to the International Labour Organisation (ILO), women perform more than 76.2% of the total hours of unpaid care work, so when governments cut public services through austerity measures to increase revenue, women act as 'shock-absorbers', taking on the care & educational work that must be done regardless of public support.

The tax consensus: How have tax-policy recommendations impacted developing countries?

Some would argue that taxation without representation still occurs today, as global tax rules are developed without input from impoverished countries, making them by definition unrepresentative. Rather than being accountable to their citizens, many southern governments are in fact more accountable to donors & international financial institutions (IFIs) that provide them with aid & debt, especially as many southern country governments depend on aid & debt for a high percentage of their revenue. Donors & IFIs can impose conditionalities with their aid (called '**tied aid'**) or conditions with debt (i.e. loans). The policies demanded by these conditions can actually make it *more* difficult for the government to raise revenue via tax.

The 'tax consensus' refers to this general set of principles which multilateral donors in particular have adhered to in their tax-policy recommendations to developing countries[15]. Christian Aid examined the role of the IMF in promoting particular tax policies in 18 Sub-Saharan countries to find patterns in their recommendations, & found that the IMF tries to impose a 'one-size-fits-all' tax policy on countries, regardless of their specific situation[16]. For example, a key element of the tax consensus has been the focus on indirect taxes – in particular a shift toward a Value Added Tax, which is a regressive tax as it is applied equally to everyone regardless of their income, & as aforementioned, can disproportionately impact on women & girls.

Debt was used as a vehicle for this conditionality throughout the Debt Crisis in the 1980s & 1990s in the Global South. This debt crisis led to more loans towards the Global South from IFIs such as the World Bank & IMF [See FreshUp article on Debt]. The conditionality required to access loans included minimising the taxation of foreign investors However prior to this, taxing foreign investors was an important lever for increasing government revenue.

[14] Details found on Global Alliance for Tax Justice website

[15] See Cobham (2007)

[16] See Marshall (2009)

A study exploring IMF recommendations for 18 Sub-Saharan countries between 1992 & 2008 found that one of the most heavily recommended tax changes was to introduce VAT.[17] The use of 'sin' taxes has proved popular in the tax consensus. However, this strategy can have negative impacts on both poor consumers & producers. An example is in India, where regressive kerosene & paraffin taxes targeted poor Indians.

What is the logic behind the tax consensus?

Tax neutrality

A key principle of the tax consensus is **tax neutrality**, which means trying to avoid changes that may distort the market. As a result, tax neutrality manifests in an increase in consumption taxation over trade taxation or direct taxation on income. The key issue with tax neutrality is that it assumes that as long as distortionary taxes are absent, for example taxes that would affect business practice, the economy will deliver an efficient & optimal allocation of resources. Tax neutrality also assumes that governments have a range of other instruments at their disposal to tackle inequality, however in the case of many countries, but in particular developing ones, these assumptions do not hold. This is because due to already weak tax collection systems, weakened by debt burdens for example, the pre-tax economy will *not* be efficient, & governments typically will *not* have available to them a range of instruments to mobilise revenue & redistribute wealth.

Trade liberalisation & its relationship to tax

The tax consensus also supported trade liberalisation, in other words the reduction of both export & import taxation. According to the neoclassical school, trade liberalisation increases market efficiency. The logic behind import-tariff reduction is that if a small economy reduces its tariffs, it increases the flow of imports which will have domestic consumption taxes placed on them. An accompanying well-administered rise in the consumption tax that is equal to the drop in the tariff will therefore leave prices at the same level while raising greater revenue from a broader tax base[18]. However, the revenue response has proved to be very weak, particularly so in the poorest countries where trade taxes had constituted a significant proportion of revenue. Many southern countries rely heavily on the taxation of imports, as these taxes are relatively easier to collect & less costly to administer than other forms of taxation, in particular tax on informal economic activity which is prevalent in southern countries. Removing this option has meant the removal of a key method of generating tax revenue for many countries. Despite this situation, many countries have progressively lowered trade tariffs during the last few decades because of World Bank & IMF conditionalities.

Supply-side fiscal policy

According to the neoclassical school, lowering taxes & enacting tax consensus policies is that by doing so, the economy is stimulated. The argument is that by being 'pro-business' (i.e. by lowering corporate tax), the financial benefit will trickle down to all individuals in society. This theory is known as supply-side

[17] See Investopedia, 'Supply-side Economics'

[18] What's more, it was rationalised that the investment would help to develop the country, bringing jobs, infrastructure etc. & that the resulting competition with European imports would be best for consumers.

economics or supply-side fiscal policy. The theory is as follows[19]: By lowering individual tax, people will have more money in their pockets & therefore more money to spend, encouraging production & economic growth. By lowering corporate tax, businesses have more profit, & will have more funds to hire more labour & invest in improving their service, benefiting society as a whole. As they employ more & increase wages, they continue to add more money to consumers' pockets. This cycle continues (it is surmised), resulting in more economic growth, compensating for the lost tax revenues. Supply-side economists believe that high tax rates strongly discourage efficiency of resource use & they have historically focused on promoting corporate income tax reductions rather than personal.

This theory does not always hold however. For example, Bill Clinton's tax increases on top earners caused economic growth to *increase* for 8 years & created over 20 million jobs. In contrast, in 2001 & 2003 George W. Bush lowered the top tax rate & cut top rates on capital gains & dividends. Despite the forecast in line with supply-side economics, the economy *barely grew*[20]. Additionally, in Kansas in 2012, tax cuts on top earners & business owners were drastically cut, while in California taxes were raised on top earners to the highest rate in the USA. Kansas has now fallen behind most other states in terms of economic growth, while California has progressed in the rankings. However, that said, there are many related factors & it can be difficult to pinpoint effects with a high level of confidence & to determine the exact outcome of any one theory or set of policies.

A further argument against supply-side fiscal policy is that there is a growing trend among corporations to engage in stock buybacks rather than reinvesting in line with the theory's assumptions. Buybacks occur when companies place the cash they may gain from lower taxes back into the pockets of their shareholders rather than investing in new plants, equipment, innovative ventures, or their workers. According to the Tax Policy Center, in 2018, US corporations spent more than $1.1 trillion to repurchase their stock rather than invest in new plants & equipment or pay their workers more.[21]

Competition is good for the economy

Further neoclassical rationale for the tax consensus is that increased competition is good as it encourages companies to make better products & drives the cost of goods down to attract consumers. However, in recent decades there has been a shift from *companies* competing, to *countries* competing. The globalised nature of mobile capital means that tax systems that exist in one part of the world can influence economic activity in another. The result of this is that even if sovereign tax laws tend to be within the remit of one country, the tax laws that exist in country A can influence the economic activity that takes place within the borders of country B. Governments are now competing with one another to attract private investment. There are many ways they do this; via reduced regulations so that companies can operate more freely without so-called 'red tape'. Or tax concessions, tax breaks & tax 'holidays' are used to attract investment. For example, 'maquilas' in Latin America can, in some countries, be exempt from import duty, income tax, taxes on the repatriation of profits, VAT, asset taxes & municipal taxes.

The logic behind cutting corporate tax rates is that by doing so, it is surmised that countries can attract capital, which therefore will make workers more productive because of the increase in machines, plants & equipment, resulting, it is theorised, in increased wages for workers. As a result of this logic, between

[19] See Investopedia, 'Supply-side Economics'

[20] See video, The Failure of Trickle-Down Economics | Robert Reich, 2017

[21] See CNBC (2018)

1985 & 2018, the global average corporate tax rate fell from 49% to 24%[22]. Since the 1980s, the corporate income tax rate, the top inheritance tax rate & the top personal tax rate have all been in decline. Examples abound globally of corporation tax being reduced. For example in the UK, the rate dropped from 28% in 2010, to 19% in 2017, to 17% in 2020. In the US, it dropped from 35% to 21% with the Tax Cuts & Jobs Act of 2017. This reduction has been even more significant in southern countries. The logic & laws which initially were used to attract investment in order to develop certain countries, have now transmogrified into mechanisms that firms can exploit to avoid paying taxes. In Guatemala in 2005 for example, the fiscal *losses* due to the existence of maquilas was almost 16% of total tax collected that year[23].

As a global trend, when corporation tax decreases, VAT increases, which is a regressive tax which tends to impact women & girls disproportionately. In low-income countries, two thirds of tax revenue is raised through indirect taxes like VAT. While high-income states have by & large been able to protect their revenue flows by shifting the tax burden to relatively immobile economic factors such as labour, income & consumption (with predominantly regressive effects), low-income states have generally been unable to offset the decrease in corporate income tax revenue[24].

Despite arguments for tax competition claiming that lower tax regimes are essential for attracting investors who will in turn provide jobs, revenue, infrastructure, & increased wages, a number of cross-country studies have concluded that the costs of tax incentives in terms of lost revenue frequently outweigh the benefits in terms of increased productive investment. The winners of tax competition are the MNCs that can play governments off one another as they vie for investment by continuously lowering their tax rates. Those who lose in this dynamic are the citizens whose governments are deprived of revenues with which to fund public services.

How is the world different today than when the dominant tax rules were created?

Most of the existing country-to-country tax rules were created in the 1920s, in a world where tangible capital was paramount: factories, warehouses & physical goods. Two major developments have combined with a situation whereby the current tax rules have not kept pace with said developments, and because of this, companies can now take advantage of global tax rules in order to minimise how much tax they pay & maximise how much profit they earn.

The first development was the removal of capital controls in the 1970s & 1980s. This allowed corporations to easily move their operations & capital between countries. For the first time after WWII, corporations could threaten sovereign nation states with their departure if the terms were not favourable, threatening a sudden stop to that flow of revenue & the associated employment etc. They were able to hit two birds with one stone; they could get the highest profits possible without regard for the needs of the country in which they were based, & they could dictate the terms of their investment to the nation-state. This

[22] (Tørsløv et al.)

[23] (Tørsløv et al.)

[24] Avi-Yonah 2000, Dietsch 2011a, as cited in van Apeldoorn, 2016

reduced & continues to reduce the state's policy space, resulting in diminished revenue via corporation tax for the state.

The removal of capital controls also sparked the emergence of the 'race to the bottom'; competition between countries on the rate of corporation tax they charge corporations. Since capital became more mobile, nation states have tried to attract Foreign Direct Investment (FDI) through low tax rates, financial incentives & even financial secrecy. The IMF, the WB, regional development banks & the EU have all been part of promoting this developmental strategy known as the 'tax consensus'.

An outcome of capital mobility is **capital flight**. Capital flight denotes money leaving a country rapidly, & is defined as the transfer of assets abroad to reduce loss of principal, loss of return, or loss of control over one's financial wealth due to government-sanctioned activities. This can be in response to many stimuli; & is not always illegal. However one key reason capital flight takes place is for the asset-holder to escape paying tax. As Nicholas Shaxson summarises "To *escape* rules you don't like, you take your money *elsewhere*, offshore, across borders."[25]

The second development is that today in our highly digitised & financialised world, MNCs can conduct their business in a jurisdiction in which they have little or no physical presence. The existing rules[26] say that the profits of a company can only be taxed in a country different to that in which it is headquartered if the company has a *physical* presence there. However this is often not the case when it comes to intangible items, for example intellectual property. What's more, a country which headquarters a particular company, for example country A & the global HQ of Tech Company Inc., does not tend to tax the income on *foreign* activities of that company, as it assumes that the country in which the company is operating, i.e. Country B will receive the tax. However that is not always the case, in particular for intangible goods.

Corporate tax dodging in the Global South

Calling countries that suffer from tax dodging 'poor' does not accurately reflect the situation. They are often rich in resources, but poor in revenue by virtue of exploitation of global rules in order to dodge tax. They are not inherently poor; instead they have been *made* poor. The OECD report in 1998, 'Harmful Tax Competition: An Emerging Global Issue'[27], is credited with first putting the issue of tax avoidance on the political agenda. By showing how wealthy individuals & MNCs are facilitated by states that are competing for foreign direct investment (FDI), the OECD was prescient in its warning that this may affect states' fiscal sovereignty. It may 'erode national tax bases', 'alter the structure of taxation' & 'hamper the application of progressive tax rates & the achievement of redistributive goals'.[28]

Tax dodging costs developing countries more than they receive in aid. The IMF estimates of long-run revenue loss for developing countries from corporate tax evasion is $200 billion[29]. Corporate tax is more

[25] https://www.imf.org/external/pubs/ft/fandd/2019/09/pdf/tackling-global-tax-havens-shaxon.pdf
[26] As of 2021
[27] See OECD (1998)
[28] OECD (1998,. p. 14)
[29] See Shaxson (2015)

crucial in these countries than Global North countries because in the Global South, a large portion of the population don't make enough money to earn tax. If MNCs paid the tax in these countries, it could make a huge difference. For example in Zambia, public services have lost an estimated US$27 million as a result of Zambia Sugar's tax avoidance schemes & the special tax breaks given to it. This is enough money to put 48,000 Zambian children in school. In 'lower income countries' tax losses are equivalent to nearly 52 per cent of their combined public health budgets'[30].

What are the impacts of tax dodging?

Tax dodging increases regressive taxation in the Global South

The reduction of tax from corporations, combined with weak tax collection systems (which are themselves further weakened by inadequate revenue) means that southern countries have limited options with which to raise revenue. One of the only methods left is therefore to tax ordinary people. Due to the nature of many southern societies in which the informal sector is large & the rural populations also tend to be significant, hindering smooth collection of tax, governments implement regressive taxes on the population via VAT in order to ensure maximum revenue-generation. A **regressive** tax is a tax imposed in such a manner that the tax rate decreases as the amount subject to taxation increases. These generally have a regressive effect on income equality[31]. This is despite the rural populations & those in the informal sector being those least able to afford to pay VAT. It is those populations that end up spending a much higher percentage of their minimal incomes on essential goods & services that carry VAT than those with much larger disposable incomes. Compounding this is the fact that progressive property & other wealth taxes are difficult to implement for political reasons[32], and progressive income & capital gains taxes are relatively easy to avoid or evade[33].

Tax dodging reduces revenue predictability

In countries that don't have a stable tax base, tax revenue is diminished & unpredictable, making it difficult to carry out the functions mentioned in part one, as well as having the revenue required to spend on infrastructure & public services. Without this predictability of revenue into the future, the capacity to plan for the future development of their country is somewhat eroded. For example, issues such as tackling HIV, responding to malaria, & addressing high maternal & infant mortality rates all require reliable long-term funding from governments. This principle has been displayed in Bolivia since 2005, where since 2005 the Bolivian government has been reversing a privatisation policy contained within an IMF-imposed structural adjustment programme (loans with conditions). The government sought to change the royalties & tax structure applied to multinational corporations (MNCs), a move which generated increased government revenue from oil & gas extraction. This gave the government increased fiscal space & allowed it to increase spending on social services including pensions, healthcare & education.

Tax dodging affects domestic compliance on tax

[30] Mansour (2020)

[31] Ahmad & Stern, 1989 (p. 1021, as cited in van Apeldoorn, 2016)

[32] Ahmad & Stern, 1989 (as cited in van Apeldoorn, 2016)

[33] Bird & Zolt (2005, p. 933)

Tax dodging can also influence tax compliance. This is because the perception that the taxes of citizens are being put to good use & that other economic actors aren't unfairly dodging their tax responsibilities is crucial to ensuring tax-paying compliance.

Classic studies on tax compliance found that compliance depends positively on (i) the perceived or expected level of redistribution, & (ii) individuals' expectation of others' compliance levels[34]. It has already been shown that tax dodging reduces available revenue in Global South countries, reducing the capacity for redistribution, & then likely influencing the tax compliance in affected countries. Additionally, levels of compliance are dramatically weakened by the absence of international measures to tackle evasion through tax havens & by multinational firms. This highlights a flaw in the existing tax consensus that does not allow for direct redistribution of wealth, & so promotes a self-reinforcing cycle of diminished tax compliance. Indeed, evidence exists to show that the size of the shadow economy depends directly on the level of 'tax morale' - that is, the belief in contributing to society by paying taxes[35].

What strategies are used to avoid paying tax?

Base Erosion & Profit Shifting (BEPS)

Base erosion (diminishing the amount of government revenue accrued via tax by deducting payments such as interest or royalties from taxable profits) & profit shifting (shifting profits to low or no-tax jurisdictions or where there is no or little economic activity by that company) refers to the suite of tax strategies used to exploit mismatches & gaps in tax systems between countries. Developing countries' higher reliance on corporate income tax means that they suffer disproportionately from BEPS. The first comprehensive view of the cost of profit shifting for governments worldwide found that governments of the EU & developing countries are the prime losers of this shift[36]. Over $200 billion of the $500 billion lost globally due to BEPS is lost from the Global South; more than those countries receive in aid from the Global North.

Close to 40% of multinational profits are shifted to tax havens each year. Based on reports filed by the biggest multinationals to OECD members, the tax lost each year to international corporate tax abuse & private tax evasion costs countries altogether the equivalent of nearly 34 million nurses annual salaries every year – or **one nurse's annual salary every second**. The OECD estimates conservatively[37] that 4–10% of global corporate income tax revenue (100–240 billion USD annually) is lost to BEPS[38].

More recent figures from the Tax Justice Network analysing OECD data track US$467 billion worth of corporate profits shifted into tax havens, leading to a loss of US$117 billion around the world annually[39]. However this is only a collation of data from just 15 countries. By using higher quality data from 2017, the Tax Justice network estimated that profit shifting for US data is likely in the region of $US840 billion, & by extrapolating to the global picture they arrive at US$1.3 trillion a year. Including indirect effects from the

[34] Bosco & Mittone (1997)
[35] Torgler & Schneider, 2009.
[36] Tørsløv, Wier & Zucman (2020)
[37] See OECD (2017)
[38] OECD (2015, P.4)
[39] See Tax Justice Network (2021)

race to the bottom, the annual losses imposed by the use of tax havens by MNCs is likely in excess of US$500 billion[40].

Transfer (mis)pricing, or 'Creative Accounting'

International regulation requires companies to price goods & services as if they were selling them in the open market & as if they are not selling between subsidiaries. This is supposed to ensure that they are taxed accordingly. This rule is called '**arm's length principle**' i.e. goods & services should be sold 'at arm's length'.[41] There are valid reasons why transfer pricing exists, for example if a company has a subsidiary in France that makes vinegar & one in Ireland that bottles it, then there are reasons you want to be able to sell between different subsidiaries. However, when this doesn't take place using the arm's length principle & instead reduces the company's declared profits & therefore taxable income, it is called transfer mispricing. Put simply, they sell a resource or item to a subsidiary company at a price different to the market price in order to report lower profits & therefore pay lower tax.

Let's take an example. Imagine a company's headquarters is in country A where the corporate tax rate is 35% (of pre-tax profits). They may set up a subsidiary in country B which has a lower tax rate, for example 5%. The company may then tell Country A that their pre-tax profit is lower than Country A thinks it is because in fact, they need to pay the subsidiary to use the intellectual property (IP). For example, on US$1 million pre-tax profits, the company may send $800,000 to the subsidiary in royalties & licensing, drastically reducing the amount of profit on which the higher (35%) corporation tax may be charged; US$200,000 instead of US$1 million. By moving pre-tax profit offshore to a lower tax rate jurisdiction via an IP subsidiary, the company pays significantly less tax overall than it would have done had it not had the option of creating offshore subsidiaries in lower tax rate jurisdictions.

For tangible goods (as opposed to IP) it is very possible to monitor & regulate transfer pricing. But what happens in a scenario where the item(s) traded between subsidiaries have no easy comparison on the market, & so the price can't accurately be determined? For example, how can the worth of this logo be determined? It can be powerfully argued that much of Apple's value comes from its reputation, so it does not make sense to compare the value of Apple's IP to that of a brand new company that has no societal reputation. So then the question arises, at what price should Apple sell their IP to Apple subsidiary companies? This question is becoming increasingly relevant in today's digitised world, however the rules for monitoring & regulation transfer pricing in the realm of IP have not kept pace with global technological developments. Since for many such transfers no comparable market transactions exist that would allow

[40] This estimate was arrived at by using a methodology created by researchers at the International Monetary Fund.

[41] The OECD article which refers to this principle is as follows:

> Article 9 of the OECD Model Treaty Provision:
>
> "Where A) an enterprise of a contracting state participates directly or indirectly in the management, control or capital of an enterprise of the other contracting state, or
>
> B) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a contracting state & an enterprise of the other contracting state,
>
> And in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise & taxed accordingly."

for an accurate price determination, MNCs will likely continue to be able to manipulate the system for tax purposes[42] until a system for accurately determining market prices in IP exists.

The victims of trade mispricing are often poorer countries where the revenue authorities are often under-resourced & unable to monitor or prove what is happening. The Mbeki Report revealed that African countries lose over $50 billion/year in illicit financial flows (IFFs), transfer mispricing being a significant cause of this. According to research by Action Aid, 20 developing countries could be missing out on as much as $2.8bn in tax revenue from Facebook, Alphabet Inc. (Google's parent company) & Microsoft due to global tax rules. This is unjust, especially considering how developing countries offer tech businesses new markets, increased global brand recognition & billions of new users' data, which translate into continuing revenue growth.

Ironically, some of the methods that countries are taking to regain lost tax revenue are in fact affecting the use of apps such as Facebook. In 2018, the Ugandan, Zambian & Benin governments announced or imposed new taxes on mobile internet customers to use certain apps[43]. These taxes, (which are also an effort to protect national telecom industries), are partly a result of the diminished tax base due to the activities of corporate actors.

Secrecy Jurisdictions

The impact of transfer mispricing is compounded by global secrecy & lack of transparency in financial reporting. Secrecy jurisdictions, more commonly known as tax havens, facilitate the opacity of financial holdings & transactions. They allow companies & wealthy individuals to hide assets & so avoid paying tax. Their refusal to share information on these holdings with other countries prevents other countries from knowing if their residents or companies which operate on their shores are holding more assets than declared. In 2015, close to 40% of MNC profits made outside of the country where their parent company is located were shifted to tax havens.

Aggressive Tax Planning

After 4 decades of economic globalisation whereby companies have increasingly been facilitated to operate across borders, it is evident that many of these companies have adopted what are known as 'aggressive tax policies' in order to avoid paying tax. This has allowed them to lower their **effective tax rate** to jurisdictions with very low rates & sometimes 0%. These companies are allowed to move their operations, but the citizens of the countries which they deprive of tax are unable to move, & are burdened with consumption taxes to plug the '**tax gap'**.[44]

What can be done?

Principles underpinning solutions

[42] Avi-Yonah (1995, as cited in van Apeldoorn, 2016).

[43] Uganda has since rescinded the tax (2021) & the tax in Benin was revoked shortly after its introduction due to popular protest.

[44] OECD Podcast (2021)

As the world has become increasingly globalised economically, certain principles have emerged to explain the fiscal relationship of corporations to nation-states, & these have inspired policy proposals to help ameliorate the situation. The **principle of economic allegiance**[45]"requires anyone that obtains significant benefits from an economic community to pay tax to that community"[46]. Dietsch terms this principle the '**membership principle'** because it determines in which country or countries an individual or corporation is liable to taxation & thus a 'member'. The membership principle states that 'individuals & companies should be viewed as members [and pay tax] in those countries where they benefit from the public services & infrastructure'[47]. The principle of economic allegiance, if followed logically, should rule out tax competition as MNCs are prevented from conducting economic activities in a high tax country while shifting profits to low or zero-tax jurisdictions or 'tax havens'. However, as we have seen, that is not always the case because of mismatches & loopholes in tax systems between countries.

The second principle is the **national rental principle[48].** Since, from an internationalist position, states are entitled to the productive economic factors they control like capital, natural & technological resources, they are then also entitled to benefit from the productive use of those factors. They may do this by charging rent, in other words by taxing individuals & MNCs who create value by making productive use of the economic factors in their territory. By this logic, profit shifting, for instance by means of transfer mispricing, prevents states from taxing the economic value derived from the resources to which they are entitled.

Finally, there is a principle that says that **taxes should be paid where value is created**. However, it is not enough to say that activity is taxed where value is *added*. Due to the nature of global value chains, the distribution of value-added in GVCs is skewed against low-income countries, since if MNCs are taxed where they create *value*, they will mostly be taxed in high-income OECD countries where *manufacturing* takes place, rather than sales. Low-income countries, generally engaging in low value-added economic activity, are only then allocated a small share of the tax base if any, while high-income OECD countries, generally engaging in high value-added economic activity, are allocated a large share of the tax base[49].

Solutions

Three of the key solutions to global tax dodging are the 'ABCs'; Automatic Exchange of Information, Beneficial Ownership & a Common Consolidated Corporate Tax Base.

Automatic Exchange of Information (AEI)

Automatic exchange of information (AEI) is a method of data-sharing that prevents both corporations & individuals from using bank accounts they hold abroad to hide the true value of their wealth. By obscuring the extent of their wealth, they pay less tax at home. With AEI, country A will take all of the information it has on person A & corporation A, & if they are normally resident, i.e. living or headquartered in country B, then country A will automatically exchange information on their financial holdings with country B.

[45] OECD (2013, p. 8).

[46] Pinto (2003, p. 196), in van Apeldoorn (2016)

[47] Dietsch (2015, p. 82,83)

[48] Musgrave & Musgrave (1972, p. 73) in van Apeldoorn (2016)

[49] van Apeldoorn (2016)

The goal of AEI is to increase tax transparency. However, many solutions attempt to do this, so AEI is not unique in that regard. The crucial element of AEI however is the *automaticity* of it; if in place, information is exchanged with the 'home' country automatically. This means revenue authorities are alerted immediately about their residents' (individual or corporate) financial holdings in other countries, & don't have to engage in lengthy & sometimes expensive negotiations with other countries regarding the release of the financial information.

Today, nearly 100 countries are automatically exchanging information with each other. The information shared covers over 84 million accounts containing a total of $11 trillion. Unfortunately this does not cover all countries. This state of affairs means that money is still flowing to secretive jurisdictions that continue to withhold information on the financial holdings in their country. 'The Price of Offshore, Revisited' report looked at 139 low & middle income countries to find details on their unreported capital flows. It found that roughly one third of offshore financial assets can be attributed to so-called 'developing' countries; countries in the Global South. Tax transparency is therefore only as strong as its weakest link.

Interestingly, countries that are seen as debtors are actually creditors when capital flight & tax flows are taken into account. Nigeria is classified as a 'debtor' country as on aggregate it owes the rest of the world more money than it is owed. However, when the capital outflows from Nigeria are scrutinised, it is clear that it is actually a net-creditor!

What's more, the lack of complete AEI increases capital flight. The 'Capital Flight from Sub-Saharan African Countries, 1970 – 2010' report found that the 33 Sub-Saharan countries covered by this report lost a total $814 billion dollars of taxable income from 1970 to 2010 because of capital flight, for an accumulated capital stock of $1.06 trillion in 2010. This far exceeds their external liabilities of $189 billion, making the region a 'net creditor' to the rest of the world. This shows how issues of debt are related to issues of tax.

Global Asset Register & Beneficial Owners

A Global Asset Register has been touted as a tool to create a registry of all international wealth & assets & their real 'beneficial owners'. A beneficial owner is the human that ultimately benefits from the profit accrued due to the ownership of a company or legal body. The legal owner of a company could be another company (like a 'shell' company), or it could be an accountant, or somebody else altogether. This *legal* owner generally must be registered, however the *beneficial* owner usually does not have to be registered. Oftentimes, the legal owner may not even know who the beneficial owner is! Financial globalization has made this process opaque, as one company can have another company as its legal owner, & that company can have even another company as its legal owner, & so on, obscuring the beneficial owner(s) via a long & complex chain of legal ownership. This makes it very difficult to track & tax profit, & ensure that no laws are broken throughout the chain.

The crux of beneficial ownership is that the beneficial owner must be a human. By requiring beneficial owners to be registered just like legal owners, beneficial ownership registration laws make sure the wealthiest are held to the same level of transparency & accountability as everybody else. However, because of the nature of global capitalism & the ability of capital to move freely across borders, this won't work for everyone unless *all* countries register beneficial owners. Until that happens, profits will continue to be able to be relocated to the place most amenable to paying low or no tax by those who wish to hide their identities from the rule of law globally. In order for this to work effectively, governments must drop

the threshold from owning 25 percent of shares to owning at least one share in a company, so that true beneficial owners cannot escape being categorised as beneficial owners.

Most countries already have national registries, however these alone cannot account for the assets held abroad. By providing a public & centralised global resource showing who owns what & where, the register would provide a way to record, measure, & understand the distribution of global wealth. This would increase transparency, & give regulatory authorities the power to develop effective tax policies to reduce the exploitation of secrecy jurisdictions.

Common Consolidated Corporate Tax Base (CCCTB)

There are two ways to approach the taxing of a company that operates across multiple borders with subsidiaries nested under a parent company. The first method is via the 'Arm's Length Pricing Principle'.

The second is to have a 'Common Consolidated Corporate Tax Base'; a single set of rules to calculate the taxable profits of companies. The EU is in the process of one within its parameters. With the EU CCCTB, cross-border companies would only have to comply with one, single system for computing their taxable income, rather than many different national rulebooks. The CCCTB seeks to apply a universal tax code for all MNCs operating inside the EU earning in excess of €750m. Companies earning above this threshold will file one tax return for all of their corporate EU activity. The EU claims that the CCCTB will contain robust anti-avoidance measures in order to prevent BEPS to non-EU countries. If so, this will eliminate mismatches between national systems that are exploited by those seeking to avoid paying tax.

Unitary Taxation

A similar method of allocating pre-tax profits is called 'Unitary Taxation', & it suggests that governments treat an MNC as one group made up of all its local subsidiaries. This is instead of treating each subsidiary as an individual entity separated from the global chain, which as seen in the transfer pricing example, allows a company to apportion some of its profits to an offshore subsidiary in a lower tax rate jurisdiction.

With unitary taxation, the countries in which *sales* take place are identified, not just the location of manufacture or company headquarters. The pre-tax profits that the multinational corporation declares as an entire group are then apportioned to each country where it operates, based on how much of its *real economic activity* took place in that country. The apportionment formula looks at where the sales take place, where employees are, & where the physical assets are. The pre-tax profit is then split into thirds between these three categories. This profit is then taxed in the respective countries accordingly depending on the percentage of the overall sale which that country accounts for[50]. This same process takes place for apportioning the pre-tax profit assigned to 'employees' & 'assets'. With unitary taxation, countries have the ability to set the tax allowances or credits as well as the tax rate & have full transparency over the profits a company makes & in what countries that profit-making activity is supported. All of this greatly increases national agency over tax collection.

[50] For example, if a company's pre-tax profit is $1 million, then one third of this will be allocated to 'where the sales takes place; sales'. This is $333,000. If country A accounts for 30% of the sales, it will tax 30% of $333,000. If country B has 60%, it will tax 60% of $333,000 & country C will take 10% of $333,000.

Civil society proposal: UN body for global tax regulation

The current global tax system which consists of a complicated web of bilateral trade treaties & differing regulations across regions & countries results in inconsistent policies across the world, leading to the emergence of policy mismatches which are amenable to exploitation by those seeking to dodge paying tax. In this world of globalisation & capital mobility, there remains no international body tasked with ensuring tax rules are applied fairly, making it deeply challenging to regulate this area. A global problem requires a global solution. That is why the Group of 77 (G77), representing more than 130 developing countries, has repeatedly proposed the establishment of an intergovernmental tax body under the auspices of the United Nations (UN) to plug the gaps & fix the loopholes in the global tax system.

Why the UN?[51] The UN is the only global institution where all governments participate as equals, & so it is a good forum to seek to achieve a global commitment to action. Because of this, it is the only body that can legitimately claim to be in a position to create a level playing field. In order for this to happen, all countries must feel that if they change their tax policies, they will not be negatively impacted to the advantage of another country. Otherwise, it will contribute to hesitancy due to the perceived '**first mover'** disadvantage, whereby more stringent tax policies may simply result in businesses & wealthy individuals registering themselves in other jurisdictions.

A UN tax body would also allow for stronger cooperation between tax administrations, facilitating an increase in transparency via AEI. It would also likely result in governments needing to rely less on unilateral (one-sided) action. It would also contribute to the creation of a better global environment for business due to the increase in certainty regarding policies around the globe, reducing perceived risk & increasing investment. Crucially, it would also likely speed up an end to the race to the bottom, as governments would no longer have reason to fear capital flight due to the existence of lower-tax jurisdictions or more favourable tax policies elsewhere. Additionally, a globally coordinated system of tax regulation is likely to see increased buy-in from governments because, as aforementioned, all governments are equals in the UN so it is unlikely that a government will be hesitant to adopt policies because they are seen to have been created without the participation of said government. What's more, if the world's poorest countries were able to participate effectively in the development of global tax rules & standards, they would be able to ensure that the global system also works for their countries.

Negotiations regarding global tax rules impact citizens all over the world, & disproportionately those in developing countries. That is why many suggest that negotiations should take place in a neutral forum where all countries are on an equal footing; as opposed to in the OECD where some countries are members & others are not. What's more, it is suggested by CSOs that all countries should be allowed to participate in setting the agenda; not just the OECD members & G7 countries.

[51] See Eurodad; Financial Transparency Coalition (2019)

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Further resources on tax justice

Books	• Treasure Islands by Nicholas Shaxson • The Triumph of Injustice: How the Rich Dodge Taxes and How to Make Them Pay (with Emmanuel Saez), WW Norton, October 2019. [Tax policy simulator]. [Slides]. [Data & Appendix]. • The Hidden Wealth of Nations, University of Chicago Press, 2015. Second edition updated and extended, 2017, Le Seuil.
Articles	https://gabriel-zucman.eu/policy-debates/
Videos	Financial Justice Ireland, 'Tax Justice' - search on YouTube
Podcasts	The Tax Cast Planet Money - Episode 390: We Set Up An Offshore Company In A Tax Haven https://www.npr.org/sections/money/2016/03/16/470722656/episode-390-we-set-up-an-offshore-company-in-a-tax-haven?t=1628768695927
Websites	missingprofits.org taxjusticenetwork.net Eurodad Afrodad Latindad
Key thinkers (perhaps follow on Twitter)	Gabriel Zucman Emmanuael Saez James S. Henry Ann Pettifor Grace Blakely

3. Training material

Overview

This document constitutes enough material for a short workshop on an introduction to tax for adult learners. Each activity can also be stand-alone, but Activity 4 requires more prior knowledge on the part of the participants. All of them can be facilitated online or offline. Ideally participants will have read the short article about tax before the workshop, but it isn't essential.

Activity 1: What is tax?[52]

Session objective: To draw out existing knowledge in the room, come to a shared understanding of tax, set a baseline conceptual foundation that will be used in upcoming activities and feel comfortable operating as a group.

Learning objective(s):

- Definition of tax

Time required: 30 minutes

Group size: 24

Materials required:

- Flip chart stand / wall
- Prepared flip chart sheet [1] with 'what we know about tax' written on top (to prevent needing to remind the group if they go off topic)
- Prepared flip chart sheet [2] with tax definition on it (keep hidden until end of activity)
- 'Bicycle rack' on wall for questions and comments that come up that can be addressed later (this is important so learners know they have been heard, but the activity stays on track)

Methodology:

1. Explain to the group the learning objectives of this activity.
2. Ask the group in plenary (in a circle) to share anything they know about tax, and jot down key words on flip chart [1]. To ensure the key words and concepts are captured, the facilitator may need to prompt the participants by asking questions such as; Why do we pay tax? How do governments collect tax? Who pays tax?
3. After 10 minutes of this, split the whole group into smaller groups of 3. If you like, you can do this by numbering them to ensure that friends are split up and the group mingles.
4. Give them 5 minutes to come up with a definition of tax based on the words, concepts and ideas on the flip chart. Give each group an A4 piece of paper or card, and ask them to write their definition clearly in marker on this card. This should be fun and they should feel under pressure timewise.
5. After 5 minutes, ask each group to stick their card on a wall (each card on the same wall).
6. Definition gallery: Give the entire group a couple of minutes to read and reflect on the definitions given by their peers.
7. Convene a discussion for 10 minutes. Ask the group; what patterns do you see? What is common to all definitions? Is there anything you agree with from other groups? Anything you don't agree with?
8. Reveal this definition, "a tax compulsory contribution levied upon persons, natural or corporate, made to the public authorities in order to generate revenue to help the government defray the expense incurred in conferring common benefits upon the residents of the state" on the flip chart sheet [2] that you prepared before the workshop.
9. Ask the group to pick out key terms from the definition.
    a. Facilitate an understanding of compulsory; persons, natural or corporate; revenue; common benefits; and residents of the state.

[52] Activity written by Meaghan Carmody, Financial Justice Ireland (2021)

b. Tell them you are now going to look more deeply at one element of this definition; revenue.

More detailed information and guidance for trainers:

This activity should contribute to building the confidence of learners as they are facilitated to realise that they already know a lot about tax, and that it's not as complicated as they may believe. To achieve this, try not to tell anyone they are wrong in this activity, and let them do most of the talking. Additionally, to increase confidence, make sure everyone has a chance to contribute. In part 4, walk around and remind the group to make sure everyone is being given a chance to contribute before beginning to draft a definition. Also, try to encourage those who didn't speak up in step 2 to speak up in step 7, by saying gently 'maybe now let's hear from somebody we haven't heard from yet'. Make sure to be clear on the system you're using to manage the oral contributions as this makes it easier for quiet or shy people to speak up. Can learners just shout out, or should they raise their hand? Be explicit.

Activity 2: Tax - what is it good for?[53]

Session objective: Learners build on the last step of the previous activity, and have an opportunity to connect personally with the purposes that tax serves in their community. They also get to do some outdoor learning.

Learning objective(s): Learners will -

- Understand deeply one of the 4 Rs of tax; revenue.
- Have identified at least 3 services in their local community that tax revenue provides or supports.
- Have identified a public service that is unavailable in their community.

Time required: 1.5 hours

Group size: 24 overall is ideal , 8 x small groups of 3

Materials required:

- Camera-phone, one per group
- Projector and screen if doing step 9 [optional]

Methodology:

1. Ask the group to think of a public service that they are personally grateful for in their community. The more personal it is, the better, for example: "The time my partner got help to give birth safely" or "A good road for me to take my goods to market", or "the school I was educated in."
2. Distribute sheets of paper and ask participants to write the words 'tax pays for' followed by just one public service that they have named as most important to them, for example "Tax pays for healthcare so that people close to me can give birth safely."
3. Give everyone blu-tak and ask them to stick their sheet on a wall around the room.
4. Ask everyone to go around the room and read everyone else's contributions.
5. Give each person 3 sticky dots and ask them to place their 3 dots on the services that mean the most to them, placing one on their own one.
6. Ask them to get back into their groups of 3 from earlier.
7. Give very clear instructions for the next few steps, including what time they should be back. Make sure at least one person per group has a camera phone with enough battery. If not, rearrange the groups.
8. Give groups 5 minutes to make a plan for what streets they want to go to and what types of public services they want to find. Encourage them to think broadly and try to notice things on their walk that they might usually take for granted.
9. [Optional] Tell groups they need to send all pictures to the facilitator - easiest is via WhatsApp and then download them via WhatsApp Web. Alternatively, use email. The facilitator, while the group is out, creates a powerpoint presentation of the pictures. If doing this step, you need a projector, laptop and connector.
10. Groups leave for outside the venue to take photos of public services that are funded at least in part by government revenue.
11. Take a short break after they return.

[53] This activity is adapted from Action Aid's Tax Justice Reflection Toolkit: 24 participatory tools to learn and act on tax injustice (2021) https://actionaid.org/sites/default/files/publications/Tax%20Justice%20Toolkit_English.pdf

12. On returning from the activity, the facilitator organises a sharing session with participants, asking them:

- What did you find?
- Are you satisfied with the level of service provision in this area and/or your home area? Why/why not?
- Which services are missing in your area?
- Which services in your area are public and which private?
- What would you do about the missing public services?

More detailed information and guidance for trainers:

The facilitator should be very sensitive to accessibility needs and mobility constraints of participants. Make sure not to put anybody on the spot by asking the whole group 'is there anyone here with mobility issues?' or similar. Some disabilities are invisible. Ensure that they are aware that this activity is optional, and for anyone who doesn't want to or isn't in a position to take part, facilitate them to stay back and do remote research instead.

Activity 3: The global tax take[54]

Session objective: To facilitate an insight into the global nature of taxation and how companies can exploit the mismatches and loopholes in these rules to shift profits to low-tax jurisdictions and therefore make more profits.

Learning objective(s): By the end of the session, learners will -

- Have a basic understanding of tax havens
- Have a basic understanding of transfer (mis)pricing

Time required: 45 minutes

Group size: 24

Materials required:

- Projector (if in person)
- Screen/wall (if in person)

Methodology:

1. Explain the learning objectives of the session.
2. Think, pair, share: Ask the group to reflect individually on what they understand by the term 'tax haven'. Then ask them to, in pairs, discuss their understanding.
3. Facilitate a discussion, getting a few contributions from the group, to get a shared understanding of this term. Supplement where necessary.
4. Share the following quote from Nicholas Shaxson with the group on a pre-prepared flip chart sheet, "To *escape* rules you don't like, you take your money *elsewhere*, offshore, across borders."
5. Watch the video 'Transfer Pricing and Tax Havens' with the group https://www.khanacademy.org/economics-finance-domain/core-finance/taxes-topic/corporate-taxation/v/transfer-pricing-and-tax-havens

Preparation in advance by the trainer:

The trainer should be able to explain clearly what a tax haven is, and be able to explain in simple terms how companies exploit global tax rules to shift profits.

[54] Activity written by Meaghan Carmody, Financial Justice Ireland (2021)

[55]Transfer pricing allows corporations to shift profits from high-tax jurisdictions to low-tax jurisdictions. Thus, a corporation is trading with different subsidiaries rather than with external companies. This artificial shift, when performed by multinational corporations that produce up to 80% of the world's trade, will result in lower taxes.

This transfer pricing policy resulted in a U.S. Senate investigation of Apple Inc. The Senate found that an Apple entity in Ireland received $74 billion in global receipts from 2009 to 2012, on which Apple paid a tax of less than 2% to Ireland. Another entity received $30 billion and paid nothing. The European Commission has said Ireland gave Apple undue tax benefits and must recover 13 billion euros in unpaid taxes.[678]

This was since appealed by Ireland, and Ireland won the case.

Multinationals can manipulate the transfer prices of transactions between these affiliates/subsidiaries to shift profits from high- to low-tax jurisdictions. For example, a firm's affiliate may hold a patent in a low-tax haven and charge exorbitant brand royalties to affiliates in high-tax countries, thus maximizing profits in the low-tax jurisdiction. In theory, transfer prices are meant to reflect market prices that would prevail in arm's length transactions between two unrelated parties. But such prices often cannot readily be established: try valuing a unique widget for a jet engine that isn't sold on the open market, or a drug patent. In practice, the value is often what the company's accountants say it is.[56]

[55] https://www.investopedia.com/ask/answers/060316/why-ireland-sometimes-referred-tax-haven.asp

[56] https://www.imf.org/external/pubs/ft/fandd/2019/09/tackling-global-tax-havens-shaxon.htm

Activity 4: A Taxing Subject[57]

Session objective: Using 'Read and Explain' pairs, students become experts on tax havens and transfer mispricing and explain what they've learned to their partner

Learning objective(s):

- Tax havens
- Transfer mispricing

Time required: 45 minutes

Group size: 24

Materials:

- Tax haven sheet x number of pairs in half of the group
- Transfer mispricing sheet x number of pairs in half of the group

Methodology:

1. Explain the learning objectives of the activity.
2. Begin by explaining that there are a number of ways that companies can dodge or evade paying taxes. In fact, paying as little tax as possible, regardless of the social consequences, has for many become an acceptable way of doing business. Through this activity participants will examine some of the practices and systems that allow tax dodging such as trade mispricing and tax havens. Some of these are illegal, some are technically legal but involve the use of 'loopholes.'
3. Split the whole group into two and name one half A and one B.
4. Tell each group to get into pairs. Give each pair in A 'Tax Havens' below and B 'Transfer Mispricing'.
5. To begin with, each person in each pair **skim** reads the entire text in silence to get the gist of it. Give enough time for this.
6. Then they take turns reading and orally **summarising** *each* paragraph. They both read the first paragraph. Then one person summarises it (without looking at the text) while the other checks the paragraph for accuracy and offers prompts to help if anything is left out. The person checking should be holding the sheet.
7. They then read the next paragraph and change roles until they have completed the entire text.
8. Take a short break and then repeat the process for the other worksheet, with group A and group B swapping worksheets.

[57] Activity adapted from Financial Justice Ireland's From Grassroots to Government resource

Tax havens – so what's the problem?
Tax is the foundation of good government and a key to the wealth or poverty of nations. Yet many places allow big companies and wealthy individuals to escape their responsibilities in relation to paying fair taxes.

Tax havens offer not only low or zero taxes, but something broader. What they do is to provide facilities for people or entities to get around the rules, laws and regulations of other jurisdictions, using secrecy as their prime tool.

The offshore system is a blind spot in international economics– which helps explain why so few people have woken up to the scandal of tax havens. Yet tax havens are one of the structures that enable billions of dollars to be robbed from poorer countries.

How big is the problem, and what is its nature?
Assets held offshore, beyond the reach of effective taxation, are equal to about a third of total global assets. Over half of all world trade passes through tax havens. The amount of money lost by developing countries due to tax havens is far greater than annual aid flows.

Using secrecy and tax loopholes to avoid tax does not only happen in islands and small states. The largest financial centres such as London and New York, and countries like Switzerland and Singapore, offer secrecy and other special advantages to attract foreign capital flows. As corrupt dictators and other élites strip their countries' financial assets and relocate them to these financial centres, developing countries' economies are deprived of local investment capital and their governments are denied desperately needed tax revenues. Countries that lose tax revenues become more dependent on foreign aid.

So what have tax havens got in common?

- Secrecy
- Allow non-residents to open bank accounts
- Low or no corporate tax rate
- No disclosure of information to other countries

Where are they?
Many locations around the world are considered tax havens, though there is no list everyone agrees on. The following are tax havens according to the Tax Justice Network, in order of how much they facilitate tax dodging (2021):[58]

- British Virgin Islands (British Overseas Territory)
- Cayman Islands (British Overseas Territory)
- Bermuda (British Overseas Territory)
- Netherlands
- Switzerland
- Luxembourg
- Hong Kong
- Jersey (British Crown Dependency)
- Singapore
- United Arab Emirates
- Ireland
- Bahamas

[58] https://cthi.taxjustice.net/en/

Transfer mispricing

Transfer mispricing, also referred to as 'cooking the books' may at first glance seem like a matter that's only of interest to accountants or lawyers. However it is relevant to anyone who cares about tackling global poverty and inequality. It is about the manner in which businesses, in particular multinational corporations, shift billions of pounds of profits between countries to reduce, or even dodge completely, their tax bill.

With multinationals, a system called transfer pricing works when a subsidiary of a parent company sells something to another subsidiary in another country – it could be anything from nuclear reactors to cornflakes. It may also apply to the sale of things such as management services and insurance. As long as the subsidiaries of the same multinational charge each other a fair market price – known in regulatory circles as an 'arm's length' price such transactions are perfectly legal.

So what's the problem?

In practice, transfer pricing means that a subsidiary of a company can charge a vastly reduced, or inflated, rate for goods and services to another subsidiary elsewhere in order to minimise their tax liability. So goods are exported and sold to a sister company at knockdown prices from the country where they were produced, and this keeps the profits low - which means the tax paid in that country is also low.

The company buying them then sells them on at their true market value from a country where the tax rate is much lower. This practice is usually not possible where there is a rival product to provide a price comparison – e.g. cornflakes made by another manufacturer - but it often works is when the company has a unique product, e.g. its own trademark, which is harder for revenue authorities to place an independent value on, or in some cases where it claims that the original product has had value added in some way in the second, lower-tax country.

In other situations, goods from wealthy countries are sold to developing countries at hugely inflated prices to enable the company that is the buyer to shift large amounts of money abroad while at the same time reducing its tax bill at home.

The OECD introduced global tax reforms to address the abuse of transfer pricing called the BEPS process. However, many activists are concerned that it doesn't go far enough, and that developing countries weren't involved in writing the rules.

With 60 per cent of world trade now taking place within, rather than between multinational companies this practice has been called 'the ugliest chapter in global economic history since slavery' by businessman and author, Raymond Baker.

4. Interactive learning

Tax Justice Quiz

1. Which one of the following is NOT one of the ***4 R's of taxation***:
   a. Revenue
   b. Redistribution
   c. Royalties

2. Who is likely to be more impacted by increases in ***'flat' taxes***?
   a. Those already poor and vulnerable
   b. The wealthy in society
   c. Public Servants

3. What do we mean by a ***'race to the bottom'*** between governments?
   a. When governments decrease taxes and reduce regulations to make themselves more attractive to foreign companies than other countries.
   b. When a company moves its profits from one country to another in order to pay less tax.
   c. When interest rates are increased in order to combat inflation

4. True or False? ***Tax dodging*** by large companies costs developing countries more than they receive in aid.
   a. True
   b. False

5. Fill in the missing word. Taxation without _____ is tyranny.
   a. Redistribution
   b. Revenue
   c. Representation

6. ***Tax neutrality*** results in an increase in which kind of taxes?
   a. Company royalties
   b. Tax on trade
   c. Tax on consumption

7. Which African country has lost an estimated US$27 million as a result of a sugar company's ***tax avoidance*** schemes & the special tax breaks given to it?
   a. Algeria
   b. Zambia
   c. Kenya

8. Numerous cross-country studies on ***tax incentives*** have concluded that:
   a. The costs of tax incentives in terms of lost revenue frequently outweigh the benefits in terms of increased productive investment.
   b. The winners of tax competition are the multinational corporations that can play governments off one another as they vie for investment by continuously lowering their tax rates.
   c. Both a & b

9. Which of the following are impacts of ***tax dodging***:
   a. An increase in regressive taxation in the Global South
   b. A reduction in revenue predictability
   c. A reduction in domestic compliance on tax
   d. All three

10. Which of the following are solutions being proposed for reforming the tax system from a global justice point of view? Tick all that apply.
   a. Tax authorities around the world should automatically share information about what's in bank accounts in their countries with other relevant countries.
   b. Large companies should be allowed to move as much money as they like freely and anonymously between different countries.
   c. Companies with many tentacles (subsidiaries) should be taxed as if they're one company, not many.
   d. The UN should be responsible for global tax regulation, not the OECD

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FRESH-UP ECONOMICS

Economic strategies to manage the crisis: austerity or government investment programmes?

by ITD -Innovación, Transferencia y Desarrollo

Table of contents

1. Overview

What is a crisis? A crisis is a concept that in general terms refers to a severe disturbance, and in economics, it is no different. Economic crises are those moments in which, for a wide variety of reasons, the economic variables become destabilized.

How to identify a crisis? The most common indicators of a crisis are the economic imbalances that manifest as increasing levels of unemployment, inflation, business inactivity, poverty, etc. In this sense, crises may occur as a natural moment in the economic cycle; or they may be the consequence of specific shocks, most commonly in the last decades as a product of globalised economic dynamics.

How to manage an economic crisis?
In these situations, when the imbalances come to produce a crisis in an economy, public policies have the responsibility to stabilize the countries' economic growth. How to do it in the best way is the question that economists and policymakers ask themselves, and, as it is easy to imagine, the formulas for action are not always consistent with one another. Each school of economic theory formulates different hypotheses, and therefore different conclusions and practical recommendations.

The two models of general reference in economics are the **Neoclassical** school on the one hand and **Keynesian** on the other. To face economic imbalances the recommendations of the two models and the economic policy suggested would be different due to the fact that they depart from different assumptions of how the economy works[1].

The economic policy of the Neoclassical school rejects employing incentives to increase public spending - or in economic terms, 'the incentive on the aggregate demand that is managed mainly by the fiscal policy' . This is because this school believes that public spending would produce price increases as it assumes the economy is always at its full employment level -and therefore supply could not increase-. According to neoclassical theory, situations of imbalance are rectified by the flexibility of prices and by the automatic mechanisms of the market.

On the contrary, for the Keynesians, the main instrument with which to intervene in the economy is indeed the fiscal policy. This is because it is the most effective instrument for counter-cyclical measures, directly impacting the aggregate demand. The variations in public spending (by granting subsidies, lowering taxes, etc.) lead to an increase in people's income which is considered to surely lead to an increase in consumption. Increased expectations leads to a further increase in investment. These series of chain reactions take place in a way that, in the end, the increases in income and GDP are greater than those initially generated by the public spending, due to what Keynesians call the 'multiplier effect'. Therefore, managing the fiscal policy and with it, the aggregate demand, is how this model

[1] For more details on the different economic schools, check the chapter "Economic schools of thought: Labour perspective".

suggests generating the necessary changes that an imbalanced economic situation might require.

Are those the only schools/lines of action?

Economic science does not constitute a homogeneous and generally accepted body of knowledge. The concerns and the answers to economic problems differ according to the schools of thought and, naturally, according to the position or the interest that explicitly or implicitly is assumed by the researchers. The two lines presented above (Neoclassical and Keynesian) and under which we will erect this dossier, constitute the opposite points of a wide spectrum that includes other economic schools that are distributed closer to one or the other.

For example, the monetarist school (also known as the Chicago school) is an important current that strongly criticized the weight of the State in the economy, as well as the use of fiscal mechanisms as the main instrument for dealing with economic imbalances. Led by Milton Friedman, this anti-interventionist current supported the autonomous logic of the market and an economic policy centred on monetary policy instruments. Therefore it is clearly situated on the spectrum next to the neoclassical current.

On the other end of the spectrum, the post-Keynesian economy has given more strength to four elements in Keynes' initial analysis: income distribution, financial institutions, and trade unions and multinational companies. According to this school, which is logically closer to Keynesian theories, in times of crisis fiscal policy should be used to ensure that the level of aggregate demand is such as to ensure full employment. So far this aligns with Keynes' original position, but differs in that it advocates designing an economic policy mix that combines wage policy with a robust redistribution mechanism, and adds a recognition of the need for a downsizing and restructuring of the financial system.

Apart from these two schools, and without forgetting the classical and Marxist roots, alternative currents have not ceased to proliferate, calling for a different reading of economic problems. Among them we can find the structuralist school, the institutionalist school, the ecological economy and the feminist perspective. All these pathways are located closer to or further from the Neoclassical or Keynesian political choices of crisis management depending on their similarity to the aforementioned, and will be the subject of our chapter on economic theories.

Why is it important to understand how crises are managed?

1) ***To understand different interests.*** It is important to bear in mind that these two opposing models (the Neoclassical and the Keynesian together with the other many in the middle) respond to a debate that is not only regarding different economic theories, but also ideologies and political options. Neither ideologies nor political options are tethered to specific economic interests. Rather, ideologies and political options are directly framed by the interests of different groups and their power capacity. This means that the real battle is one of redistribution: who bears the burden of loss in a crisis?

   The impacts on the different social sectors might be quite different if, for example public policies chose to stabilize the countries' economic growth by means of counter-cyclical measures while using instruments to protect the most vulnerable sectors; or if instead governments decide to let the market arrange the imbalances by its own while bailing out the bankrupted banks and financial creditors. Understanding this will be useful to

anyone who is concerned about who is harmed and who benefits from the different possible strategies. In the end, all economic policy measures are conditioned by value judgments and ideological assumptions and, above all, by the dominance of one or the other interests in the social system.

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Nick Anderson

2) ***To recap what we have not learnt so far***. In general, the overall approach of formal education (mainly via textbooks) bases its response to the economic concept of crisis on the neo-liberal economic paradigm. The market is seen as the basic self-balancing instrument which contains rational agents seeking to maximize profits and income, encouraging individualistic, utilitarian behaviour.

   In this context, crises always tend to be explained in a mechanical way, framed within various thematic concepts linked to growth and economic cycles, macroeconomics and public sector intervention, without explaining the causes of the crises or the point of contact with reality. That is, without exploring the direct effects that one or another crisis management strategy may have on our daily lives, nor questioning who benefits and who suffers in each situation. Therefore, this dossier aims to challenge that pattern of learning, hoping to awaken the student's critical view of the different ways of dealing with economic problems that exist in today's world.

3) ***To understand the past.*** All throughout the 20th century, the empirical evidence portrays a highly unstable evolution of capitalist economies over time, where economic crises have occurred consistently and with increased frequency. The Great Depression after the crash of 1929, the oil crisis of the beginning of the 1970s and the 2008 financial crisis are some examples of global economic crises, albeit with different triggers (interest rate movements, changes in the costs of production, the explosion of speculative financial bubbles). What's more, each lasted for a different period of time.
   A conservative policy response was what came to dominate political economy management of economic crises since the 1970s. Policies focused on reducing public deficits, cutting public spending, controlling wages and devaluing the national currency

have constituted the basis of austerity plans implemented in many European countries after the 2008 crisis.
Austerity means the cessation or reduction of public spending. Ultimately it means the retreat of the State as a social benefactor that injects resources into the economy. The problem is that these austerity policies have not been able to guarantee enduring stability and well-being, nor have they avoided major economic problems, such as mass unemployment, the waste of resources, poverty and inequality. Therefore, it is worth questioning to what extent austerity is the correct strategy to use in a crisis.

4) ***To understand the future.*** Currently, while this dossier is being produced, an unexpected and abrupt change in the role of the State is taking place as a result of the exceptional crisis generated by the COVID-19 virus. Governments in almost every country of the world have been and continue to be faced with difficult trade-offs between the health, economic and social challenges that arise as result of the pandemic. Many national and subnational governments have reacted quickly to address the economic and fiscal consequences of the crisis, and countries are spending significantly more than they did in 2008-2009. Two-thirds of OECD countries have, for example, adopted measures in support of subnational government finance (OECD, 2020).
The use of public investment across all levels of government to support a COVID-19 recovery over time represents a completely different scenario to the one promulgated by advocates of austerity that supported a reduction in public spending and a targeting of inflation above all else. Although it is still too early to deeply understand how this crisis was managed and whether the increased presence of the State as an investor in the economy is here to stay, it is encouraging to witness how in some countries, the objectives of economic recovery are being tied to social and climate goals.

KEYWORDS

- Crisis
- Economic Policy
- Regulation
- Aggregate Demand
- Welfare State
- Public investment
- Neoliberalism
- Austerity

2. Background information

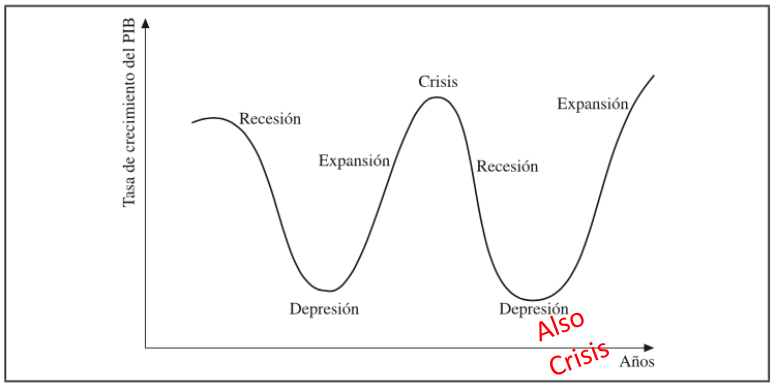
Introduction

What is a crisis? A crisis is a concept that in general terms refers to a situation of disturbance, and in economics it is no different. Economic crises are those moments in which, for a wide variety of reasons, the economic variables destabilize.

The most common indicators of a crisis are the imbalances that manifest in increasing levels of unemployment, inflation, business inactivity, poverty, etc. In this sense, crises may occur as a natural moment in the economic cycle, or they may be the consequence of specific shocks, most commonly in recent decades as a product of globalised economic dynamics.

What is the difference between a crisis and a recession?

The capitalist dynamic has been qualified as the cyclical process of fluctuations of diverse signals of different magnitudes. It is normal to find phases of expansion and accelerated growth following phases of depression and stagnation, as shown in Figure 1.



An economic cycle is that period of time in which expansion of the economy (GDP growth) is followed by a crisis in the rate of accumulation which then becomes a recession, which bottoms out at a given moment reaching the trough or depression, from which economic expansion begins again.[2]

A recession is the phase of slowdown in economic activity in which consumption is reduced, leading to a decline in production, real income and employment. This recessionary phase can be more or less extended in time, but is generally considered to be of shorter duration than the depression.

While the graph shows that the crisis is a disruption that changes the trend of the expansionary phase as commonly explained in textbooks, in our daily understanding, the crisis is often associated with the depression phase.

The depression is the moment when the recession bottoms out or in other words when the recession is sustained over time and becomes more severe. What follows a trough is

[2] It is important to emphasize that the idea of economic crisis as a phase of a cycle is one of the ways to approach its concept, but not the only one. In general, the concept of crisis is framed within various thematic blocks linked to growth and economic cycles, macroeconomics, current crises and/or public sector intervention.

necessarily an upturn phase where the economic variables start to recover. In these situations, when the imbalances come to produce a crisis in an economy, it is necessary to try to reverse the situation to regain the equilibrium. Precisely, the chosen strategy and beneficiaries of that recovery depend on political economical decisions, and these aspects are the ones we will try to illustrate in this dossier.
How to do it in the best way is the question that economists and policymakers ask themselves, and, as it is easy to imagine, the formulas for action do not always agree. Each school of economic theory formulates different behavioural hypotheses, and different conclusions and practical recommendations. To understand the different positions, the two models of general reference in economics are posed, mainly the Neoclassical school on the one hand and the Keynesian analysis on the other, and the different propositions that each one of them follows.

The theory: two opposed models

All the macroeconomic relations have a quantitative dimension that must be closely followed and recorded in order to manage or intervene in them. The potential policy responses available represented by the myriad economic theories present discrepancies, as will be shown.

The neoclassical model

The neoclassical model assumes that, at a given moment, there is a productive capacity (which we will call total or aggregate supply) determined by the number of factories, machines, equipment, etc. (physical capital) and workers (human capital). Further, it assumes that prices are always flexible. This flexibility is what would allow supply and demand to always return the economy to equilibrium at full employment. When there is an oversupply of a resource that results in its surplus, its price would drop (the wages would drop) and then its demand would increase, thus automatically correcting the existing unemployment.

The main idea of this so-called *liberal* model is that to achieve equilibrium with full employment it will be enough to make prices completely flexible and allow markets to function freely. Exogenous interventions of any kind would be useless to correct imbalances, since imbalances are supposed to resolve on their own as a function of the freedom of markets and flexibility of price. According to this model, iInterventions will only lead to economic inefficiencies by causing either price increases (inflation) or displacement of individual spending. The latter might happen as rational private agents, who realize the State's increasing deficit, foresee that taxes will be higher in the future and therefore would rather save than consume.

The Keynesian model

The starting hypotheses of the Keynesian model present a different vision of the operation of the economy and reach very different conclusions. The main difference is that for Keynes, prices are rather rigid, that is, that they would not respond to changes in demand. And he thought that this rigidity especially affected wages because workers are usually not willing to accept lower wages than they receive at any given time.

If we are standing on a level of production that does not have the capacity for full employment, it means that the demand of employment is lower than the supply. The capacity to achieve full employment could be propelled by increasing the aggregate demand which would result in the creation of more employment opportunities. Therefore, according to this model, the State's interventions aimed at increasing aggregate demand would be very useful and necessary in order to increase production when the economy is below full employment. Only when the economy has reached its full employment level could any further intervention increasing the demand cause an increase in prices.

Instruments to respond to economic imbalances: fiscal and monetary policies

The final aim of economic policymaking is to intervene in the general imbalance. To try to achieve this objective, the State's two main instruments are its fiscal and monetary policies.

Fiscal policy: this is the most relevant State intervention when trying to influence the aggregate demand. It can be defined as the policies employed to balance public income and spending. Public spending is defined by the sum of:

- The current expenses: those destined to the remuneration of the personnel working to service the public sector, the acquisition of goods and services, and current transfers.
- Public investment: those with which the public sector contributes to gross capital formation in the economy or capital transfer resources to other sectors.
- Financial expenses: those destined to meet the interests and the burden of public debt.

Naturally, public expenditures must be financed. Public income can be gathered in three ways:

- With the income from the sale of goods and services produced by public companies,
- Through coercive measures (mainly through taxes),
- Raising public debt.

By managing the variations in the two components of the fiscal policy (income and spending), Governments generate changes in economic activity in different ways:

- Aggregate demand can be expanded by increasing public spending.
- Personal disposable income can be increased —and with it, consumption and aggregate demand— by lowering taxes.
- Investment can be incentivized through tax credits or by reducing the tax pressure on profits.

Monetary policy: this is the set of interventions carried out by the Central Bank of a country to influence the existing amount of money creation and thus contribute to the achievement of the general objectives that have been set. Governments control the monetary policy by determining the key interest rates to stimulate or slow down the deposit money creation of banks and thus the investment and consumption enabled by loans.

The starting point of monetary policy is to influence the amount of money in circulation by making changes in interest rates in the money market: when the money supply increases, the interest rate decreases and vice versa. The interest rate fluctuations influence, on the one hand, the money creation of the banks (with low interest rates banks have more incentives to give loans) stimulating the real economy by increasing investment or consumption; and on the other hand, rates influence individual behaviour (as low interest rates discourage saving already existing deposit money) also with the purpose of impacting the real economy once more by stimulating consumption.

In both ways (directly influencing consumption, saving and investment, or facilitating credit), changes in interest rates can affect aggregate demand and, consequently, the level of production and income and employment. However, the fiscal policy is considered to be the most direct option as it intervenes directly in the real economy while monetary policy intervenes initially in the money market and only afterwards in the real economy, resulting in a less direct and therefore less effective impact on the economy. Furthermore, monetary policy is considered as a less direct instrument since the intention to stimulate the economy by lowering the interest rate in order to stimulate the private sector to ask their banks for loans (that would – for sure – be used for investment and consumption), leaves the decision on the somewhat recalcitrant private sector. For companies and households the interest rate is only one factor among others which determines spending choices – and not even the most important one.

The fiscal policy in contrast is directly creating new money to be spent into the economy. It's transferred directly from the government to the bank accounts of the private sector, ready to create demand. No other decisions are needed from the private sector. And above all, it works when the key interest rate is no longer able to help the situation (for example when they can't be lower than zero) and the whole private sector acts pro-cyclical.

How do the two models suggest responding to economic imbalances with the policy instruments?

To face economic imbalances the recommendations of the policy avenues aforementioned would be different essentially because they are departing from different assumptions regarding how the economy works. Therefore, the economic policy of the Neoclassical school rejects the use of incentives to increase the aggregate demand because doing so would produce price increases as they believe the economy is always at its full employment level. As a consequence, this line of analysis would avoid using fiscal policy, as the main

objective of this policy is to affect the aggregate demand. For neoclassical theory, the imbalance situations are rectified by the flexibility of prices and the automatic mechanisms of the market. These are the adjustment mechanisms in this neoclassical model that results in the rejection of any other public intervention.

Regarding monetary policy, although in the long term the variations in the money supply do not have much effect on income (since once the level of full employment is reached, it then cannot be exceeded), in the short term they are an adequate means to expand or contract the aggregate demand as the variation of the interest rate control consumption, investment and credit. In sum, the neoclassical model predicts that expansionary fiscal policy will only procure price increases, so the defenders of this model suggest monetary policy as the main instrument to intervene on the imbalances of the macroeconomic variables.

On the contrary, for Keynesians, the main instrument to intervene in the economy is fiscal policy due to its direct impact on aggregate demand. The variations in public spending lead to an increase in aggregate demand and income. Surely, this increase leads to a new increase in consumption opening up better expectations that, once again, lead to a further increase in investment. Thus, a series of chain reactions take place that, in the end, increases in income and gross domestic product (GDP) are greater than those initially generated by original expectations, due to what Keynesians call the multiplier effect. Therefore, managing the fiscal policy and with it, the aggregate demand is how this model suggests generating the necessary changes that an imbalanced economic situation might require.

For Keynesians, the mechanisms of monetary policy do not differ from the neoclassical model. In other words, if the interest rate is high the agents have more incentives to save, and if the interest rate is low, they have more incentives to invest and consume. The difference lies, however, in the effectiveness of the monetary policy. First, Keynesians question the actual effect of for instance lowering the interest rate as an instrument for stimulating the economy, considering that investment is such a volatile variable that depends rather on other circumstances: on the expected benefits, on the general conditions of the economy and of the expectations of the entrepreneurs. Secondly, Keynesians question the impact of monetary policy in times of recession. If the economy is on an expansive trajectory, many loans are requested and granted, stimulating the creation of bank money. In contrast, in a recessionary economy, the supply of bank money will even be reduced as more loans are repaid than taken out. Here, the private sector acts pro-cyclically and therefore makes the crisis bigger. In this situation, only the creation of money by deficit spending can help. The chain by which variations in the quantity of money transmit monetary impulses to the economy would be broken. For this reason, Keynesians argue that monetary policy is not effective in achieving increases in production, income, and employment.

Based on the main ideas in which each model bases their theories and their assumptions, we could simplify the suggestion of each theory as follows:

Assumptions\Model	Neoclassic	Keynesian
Prices	Flexible	Rigid
Employment	Full employment	Underemployment
Adjustment mechanism	Prices	Interest rate, Income
Public intervention	No, markets can regulate themselves automatically	Yes, the economy needs regulation
Fiscal Policy	No, it will only produce price increments because the economy is already at full employment levels	Yes, it will help the economy to recalibrate, affecting the aggregate demand thanks to the multiplier effect
Monetary Policy	Only efficient in the short term – mechanism used to intervene in imbalances	No, it is not efficient to affect growth, income or employment

Consequences of each economic policy choice

The models we have just analysed involve different points of view when making decisions about economic problems. Those issues are complicated and constitute for the economic authorities a decision regarding what measures to take when imbalances occur. Nonetheless, macroeconomic problems can be approached with sufficiently good knowledge thanks to theoretical proposals and empirical research. However the final decisions inevitably respond not only to scientific data but also to the preferences and ideologies of those who adopt them.

And this shows that the question of the effectiveness of the different economic policies depends not only on the framework of theoretical models as on the objectives that they want to achieve as a priority. If the fiscal policy and monetary policy were equally effective, models can predict that the same effect will be achieved by increasing the money supply or public spending. However, there is an obvious distributional effect that is not taken into account: although an increase in production and global income can finally be achieved, it is not the same if it is enjoyed by, for example, the holders of profitable assets or by the unemployed or pensioners.

The different institutional framework within which these two policies are implemented must be considered. While the fiscal policy is subject - or at least should be - to the direct control of Parliaments, which are the seat of popular sovereignty, monetary policies are designed by central banks, institutions that are much less influenced by democratic control, especially since they have become independent. In short, it turns out that all economic policy measures are conditioned by value judgments and ideological assumptions and, above all, by the pre-eminence of one or the other interests in the social system.

Crisis: The World Economic Disorder and opposing responses

After having studied the theoretical problems of economic imbalance and the analytical instruments that allow economists to understand and respond to them, in this section concrete crisis examples are explored which place in the foreground the reality in which they occur, and the political measures adopted to face them.

Throughout the 20th century, the world economy was subject to great instabilities in the growth process. Three major global crises shocked the world economy while the models that planned their recovery varied throughout time.

The Big Depression and the Keynesian model

At the break of the century, after a phase of expansion favoured by the appearance of new technology and global markets, the First World War gave origin to a new phase of economic depression. The war mobilized millions of people, who were subtracted from production; but when the war ended and all the economies recovered, a major crisis of overproduction originated, aggravated by insufficient demand. Temporarily, the economy flourished during the roaring Twenties, but the short-term affluence could not hide the deeper structural problems in the most important developed countries. The disorder created by the disappearance of the gold standard and the lack of monetary regulation of subsequent international exchanges caused a new crisis in 1929, known as the Big Depression.

Until then, the ideas of the liberal model reigned in the economic policy of the industrialized countries. Following this theory, liberal ideas recommended that governments should not intervene to try to correct economic imbalances. However, markets showed an inability to resolve mass unemployment and crisis on their own. It was precisely in this moment that seeing that the market did not guarantee equilibrium by itself, Keynes proposed that the State would take a new active role with an economic policy model that corrects the imbalances and compensates for the insufficiencies of private spending. During the 1930s, several governments started spending on public works or any type of activity to create jobs. This increase on public spending and the consequent expansion of the aggregate demand (expansive fiscal policy) was what allowed families to increase their consumption, which, in turn, made it possible for companies to sell their goods. Therefore, thanks to State intervention and the multiplier effect, it was possible to create employment and make productive activity recover. In fact, during World War II governments' intervention in the economy increased tremendously all over the world.

After the war the Keynesian economic model became more and more popular as it fitted well in the new reality. The combination of post-war long term and unpreceded economic growth and the consolidation of what was called the Welfare State (characterized by the wide range of social needs covered by public spending), sealed the Keynesian school victory. Challenging the neoclassical model by pointing to its imperfections and the necessary new

intervention mechanisms, Keynes became the guide for the execution of economic policy for more than thirty years in most developed economies.

The oil crisis and the end of the Welfare State

The end of World War II opened a new period of growth, practically uninterrupted from the late 1940s until the mid-1970s. World exports went from 60,000 million dollars in 1948 to two trillion in 1980, which is a good indicator of the magnitude of the accumulation process and the internationalization of the economy of those years. The consolidation of the Welfare State and with it the rise in the standard of living in Western economies and the expansion of international investments was seen as such a permanent phenomenon that the world economy was considered to be on a stable and definitive path of economic growth.

However, throughout these years new economic disturbances appeared and the general growth, as well as the Welfare State model, were severely weakened. The stable upward trend in consumption (expansion of the aggregate demand) put pressure on prices and companies continued to rely on the cheap credit (low interest rates) to ensure that the increase in their productive capacity compensated for the wage increases that workers consistently claimed. The growth in public spending (fiscal policy) and money supply (monetary policy) added to the overheated economy in the West. All these factors led to a crisis in 1973 when the oil prices skyrocketed and the world economy entered a phase of disorder and acute crisis that lasted well into the 1990s.

As a consequence of a decision by the oil-exporting countries (OPEC) to, in an unprecedented manner, increase the price per barrel, the Western economies who were net oil importers, saw their trade balances deteriorate almost instantaneously. At the same time, governments continued to face enormous expenses. The first responses were to continue to carry out Keynesian policies to increase public investment: increasing social benefits as unemployment grew and helping companies in crisis. However as the crisis provided less and less public revenue, it turned out that the public deficits were getting higher, increasing public debt incessantly. All this brought with it the economic recession in Western countries, combined with a large drop in production and employment, a rise in prices, and the expansion of the money supply that attracted financial speculation and the financialization of the economy as a whole.

The neoliberal model and the 2008 financial crisis

All the above gave rise, in short, to a world economic panorama dominated by unemployment, inflation, public and foreign deficits and the increase of social unrest that came with it. A general crisis of these dimensions required very forceful responses that began to occur, as early as the 1970s, in the military dictatorships of Latin America, which were the first regimes to apply liberal measures that would later spread throughout the

world. The fall of the Berlin Wall in 1989 and that of the entire former socialist bloc together with the generalization of unemployment that greatly weakened the working classes, created the political conditions for a recovery aimed primarily at benefiting the regain of business profit. The theoretical support would come from the hand of neoclassical principles that were now reformulated in what has been renamed as neoliberalism.

The incorporation of new information technologies and the establishment of regimes of full mobility for movements of goods and capital made it possible to globalize a large part of productive activity. This was the new economic stage of planetary interconnection and predominance of neoliberal ideas that gave a response to the great crisis of the 1970s and opened the door to a new era of practically unencumbered financial disturbances. There were117 systemic banking crises in 93 countries and 113 episodes of financial stress in 17 countries from 1970 to 2003, shortly before the last major crisis in 2007.

In this context, a deregulatory process that had been established since the end of World War II allowed banks to spread low-quality, high-risk financial products that ended up contaminating the entire international financial system. With very low interest rates, banks in the United States granted hundreds of thousands of mortgage loans to people in very precarious financial situations. They were the so-called *subprime* mortgages, also called junk mortgages or NINJA loans, because they were granted to people "No Income, No Job and No Asset". Such *subprime* mortgages were transformed and combined into new assets that the banks called Residential Mortgage Backed Securities (RMBS), that is, obligations guaranteed by residential mortgages, or Commercial Mortgage Backed Securities (CMBS) if they were commercial mortgages. They were acquired by investment funds (often owned by the banks themselves), which in turn derived them into new products, thus generating a perverse chain, because if the initial mortgage stopped paying, all subsequent products would immediately lose value.

When these mortgages stopped being paid, as it was easily foreseeable that sooner or later, some banks would begin to record losses or even declare bankruptcy, already at the beginning of 2007. Little by little the contamination was spreading all over the world, the credit tap was closing and with that investment stopped, unemployment multiplied and governments were all facing another global crisis in 2008. What started as a financial crisis became a crisis in the real economy. Without clear recipes to deal with it, everything indicated that massive state intervention would be necessary, but that clashed with the dominant neoliberal thinking.

The conservative response: austerity

The response to the crisis since the 1970s, including the latest one of 2008, have been inspired by the economic policy launched by the conservative revolution that started almost at the same time that Margaret Thatcher in the United Kingdom and Ronald Reagan in the United States won the elections in 1979 and 1980, respectively: a conservative, neoliberal, market-driven response to economic, social and political problems. Both leaders started

their terms by formulating two new economic policy objectives: the reduction of inflation and the reduction of the public deficit while placing confidence in the market as a mechanism for providing maximum efficiency in automatic balances and individualism instead of cooperation.

The implementation of this conservative response involved the application of a series of structural adjustment policies that removed the blockages that affected private initiative, enabling companies to recover profits and change the balance of social power. These adjustment policies focused on reducing aggregate demand, and specifically aimed to reduce the external deficit by using the traditional instruments of demand now in a restrictive sense: control of the money supply and credit, cuts in public spending, control of wages and devaluation of the national currency. Simultaneously, this model was accompanied by measures that relaxed the labour market rules, liberalized the financial markets and limited state intervention.

These structural adjustment measures have been applied with more or less intensity in almost all the countries of the world as the macroeconomic correction mechanisms. Especially after the great crisis of 2008, the European Union responded with an intensification of the so-called austerity policy with the implementation of the Troika. The Troika was a programme imposed together by the European Commission, the International Monetary Fund and the European Central Bank to certain countries (Greece, Ireland, Portugal, Cyprus, Spain, Hungary, Latvia and Romania) establishing austerity instruments in exchange for financial assistance. To deal with the debt that the crisis had left as the states took over the huge invoice that resulted from the rescue of the banking sector, very large cuts were imposed in public and especially social spending, thus trying to ensure that governments did not have to face such a large bill. However, these cuts in public spending entailed a negative multiplier effect much greater than expected, which instead of improving it produced a re-emergence of the recession in almost all of Europe, with the inevitable aftermath of more unemployment and more debt. At the same time and paradoxically, Germany, the country that made the strongest enforcements of these austerity measures in the above-mentioned countries, countered the crisis by setting up stimulus packages to incentive its domestic demand.

Austerity measures were applied in less developed countries as well. As analysed before, economic crisis problems were followed by external debt problems. Following the conservative response, the main target of which has been the reduction of public deficits, international organisations 'came to the rescue' by granting loans establishing strict conditionality clauses. In this way, the agencies that granted them ‘aid’, the World Bank and the International Monetary Fund (IMF), ensured that emerging countries' governments responded to the principles and interests of the great creditor powers. To respond to the payments, governments were forced to reduce consumption and imports, as well as public spending, which, according to the prevailing liberal beliefs, was always understood to be harmful.

The consequences were dire everywhere but even more severe in the poorer countries where the reduction of the welfare state meant a huge increase in poverty, unemployment

and social unrest with record levels never before reached. In short, so far, austerity policies have enabled companies to recover profits and change the balance of social power, but they have not been able to guarantee lasting stages of stability and well-being, nor have they avoided major economic problems, such as mass unemployment, the waste of resources, poverty and inequality.

Counter-cyclical response: what government investment could look like

The primary economic policy applied in several countries to manage the crisis has followed the austerity policies described above. However, there are some examples of countries who decided to make a daring stand in casting aside the harshest austerity measures its European creditors had imposed. In this context, the recent experience of Portugal seems to be one of the first examples of this kind of counter-cyclical economic policies.

The aftermath of the 2008 crisis found Portugal at its worst recession in 40 years. Between 2011 and 2014 tens of thousands of businesses went bankrupt, unemployment soared above 17 per cent and hundreds of thousands of young skilled people emigrated, generating a loss of over 4% of the working population. In 2011 the government of Passos Coelho negotiated with the IMF a bailout following the typical austerity plan of cutbacks to welfare state services, cutting labour costs and pensions and privatising public assets, all measures leading to an aggregate demand collapse. Antonio Costa, by then the Lisbon mayor, signalled these measures as a submission to the neoliberal agenda which was exploiting the nation and expelling capital, rather than attracting it.

After being elected Portugal’s prime minister in 2015, Anotonio Costa went against the norm by reverting the austerity measures that had affected working hours, holidays and taxes, as at the same time increasing the minimum wage by 20 per cent in two years. Interestingly, this policy was managed while keeping at balance the public spending and even reducing the fiscal deficit. Costa's policy raised people's income by lowering taxes, especially for those with lower wages, helping to revive the domestic economy and with it lifting public investment and reducing unemployment , while still not overstretching the fiscal capacities. In short, he combined fiscal discipline and income distribution.

Nevertheless, whereas for many this counter-cyclical response showed that crisis can be overcome without destroying jobs and living standards; for others, Costa merely introduced a few changes in the economy and has had the good fortune of being lifted by the European general recovery, falling oil prices, an increase in exports and the tourism boom. Therefore, critics argue that the expansion of the domestic demand was small and overcompensated by the amelioration of the balance of payments which allowed for catering to the economy without increasing the external financing need. Further, the lack of a long term investment plan for the country aiming at increasing productivity and the fragility of the banking sector have raised some concerns about the future path of the country.

It is still too soon to understand if these sorts of comebacks of counter-cyclical instruments are successful measures in the face of a crisis. In the case of Portugal, the country might, in the end, have simply benefited from the improvement of its macroeconomic situation thanks to the recovery of Europe. However, the underlying belief of Costas' government, namely that by reducing unemployment and increasing people's income confidence is strengthened, may be the beginning of a new change in the global political economy, as according to his ideas, confidence is a great driver of economic recovery.

The role of Political Economy: further advice

In recent years, globalization inspired by neoliberal adjustment policies has resulted in a consistenttransfer of wealth from labour to capital, from the peripheries to the centre and from the poorest population groups to the most favoured, according to reliable reports on the distribution of income and wealth.[3]

Given all the considerations, it is surprising that the economic policies applied in recent years, sometimes imposed without excuse by international organizations, have been based on measures (mainly the radical control of inflation and budget deficits) that do not have sufficient theoretical or empirical support in the literature when presented outside of simple rhetoric.

All this makes it possible to suspect that economic policy is not carried out based on objective criteria or neutral interests, but rather from a very significant social conflict and in a context of great inequality, so that only the most powerful subjects and institutions can influence governments to adopt the policies that interest them most. These actors do so to ensure that the applied economic policies are those that best safeguard their economic, financial and political interests.

Therefore, we must understand the functioning of this most conservative economic science, the one which has the approval of the status quo, powerful means of dissemination and which reduces societies to the field of individuality and rational behaviour is in fact exclusively in the interests of profit. It is urgent for everyone to understand that behind every economic policy decision there is an interest in making the choice.

[3] According to the World Inequality Report 2018: in recent decades, income inequality has increased in nearly all countries, but at different speeds, suggesting that institutions and policies matter in shaping inequality. Since 1980, income inequality has increased rapidly in North America, China, India, and Russia. Since 1980 up to 2018 the global top 1% earners have captured twice as much of that wealth as the 50% poorest individuals.

Glossary

- **Macroeconomy:** Macroeconomy is the line of the economic theory which instead of approaching the problems from the individual point of view it contemplates them by considering the economy as a set of economic relations, or in other words, the aggregations of the parts. Therefore, when we talk about the economy of a nation-state and the most important issues that can be managed concerning the aggregate functioning of the economy we are talking about: full employment, economic growth, price stability and equitable rent distribution.

- **Neoclassical model:** The neoclassical model is based on the hypothesis that the economy automatically reaches full employment and for this reason, the aggregate supply is fixed at a certain quantity completely inelastic to prices. Furthermore, it establishes that prices are completely flexible so that they can go up or down as necessary to automatically correct the inequality that may occur between aggregate supply and demand. Under these conditions, intervention through demand is rejected because it would only lead to price increases.

- **Keynesian model:** The Keynesian model is based on the consideration that prices are very rigid, so they cannot guarantee equilibrium by themselves. Therefore, a situation of equilibrium with unemployment can occur. When the latter happens, it is useful to resort to increases in demand to achieve more income and employment.

- **Aggregate demand:** The aggregate demand is a macroeconomic measurement of the total amount of demand for all finished goods and services produced in an economy. Aggregate demand is expressed as the total amount of money exchanged for those goods and services at a specific price level and point in time. In other words, it is the sum of the aggregate consumption, the aggregate investment and the public expenditure.

- **Aggregate supply:** The aggregate supply is the amount of production of goods and services that companies in an economy as a whole are willing to bring to the market at different levels of existing prices. Many factors influence the aggregate supply: the availability of an economically active population, the capital in stock, and the technology. All of these factors, once aggregated, determine the level of production of an economy.

- **Inflation:** Inflation, or in other words the instability of prices, is one of the causes of very negative disturbance in the economy of a nation. Combating inflation and not affecting growth and employment is an unresolved challenge. Traditionally, there have been three main explanations for inflation: push of demand-side which occurs due to an excessive pressure on spending; push of costs, a pressure that comes from costs, mainly from wages; and structural inflation, which explains the increase in prices which is part of the general nature of the economic system.

- **Pro-cyclical and counter-cyclical policies:** they refer to a strategy applied by the government that is positively (procyclical) or negatively (countercyclical) correlated with business cycle fluctuations in the gross domestic product (GDP). A pro-cyclical fiscal policy occurs when governments choose to increase public spending and reduce taxes during an economic expansion, but reduce spending and increase taxes during a recession. A counter-cyclical fiscal policy on the other hand, operates by reducing spending and raising taxes during a boom period to control inflation and debt, and increasing spending and cutting taxes during a recession to create a demand that can drive an economic boom.

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3. Training material

Activity 1.1: Quiz THE MODEL

Overview
The activity is designed for students to internalise the differences between the two models regarding the type of intervention they suggest. It is accompanied by a follow-up activity to continue at home or in the next class.

Aims
• To stimulate thinking about the theoretical concepts explained
• To explore the main mechanisms of the fiscal and monetary policies
• To provide some basic facts about the Neoclassical and Keynesian Model

Materials and time
No materials are needed. Time is adjustable from 30 minutes to an hour.

Group size
10 minimum

Instructions for trainers
1. Break up the class into small groups.

2. The teacher reads out the questions for each round (see Quiz Questions below) - there are 3 rounds with 3 questions in each round.

3. According to the level of understanding of the audience, the teacher could decide to proceed with the activity as a quiz or to share the answers in cards that students should pick to 'fill in the blanks' of each question. See below the answers in the two different formats.

4. After each round, the teacher gives the answers to the questions and encourages discussion. In total, this part of the activity should take between 20 to 30 minutes.

5. The activity could be complemented with the follow-up segment described above to fill one hour of activity.

Questions

1. Indicate at least two differences between the starting hypotheses of the neoclassical and Keynesian models.

2. For the…..model the State should intervene in trying to offset the economic imbalances.

3. Fiscal policy affects the .... and monetary policy affects the ...

4. The neoclassical model understands that the best policy to use in the face of economic imbalances is the ...

5. The Keynesian model understands that the best policy to use in the face of economic imbalances is the ...

6. What is the multiplier effect?

7. Is tax reduction an element that defines fiscal or monetary policy?

8. Who determines the money supply?

9. Could monetary policy influence consumption?

Answers

1.

	Neoclassic	Keynesian
Prices	Flexible	Rigid
Employment	Full employment	Underemployment
Public intervention	No, markets can regulate by themselves automatically	Yes, the economy needs regulation

2. Keynesian

3. Fiscal policy affects the **aggregate demand** and monetary policy affects the **money supply**

4. Monetary

5. Fiscal

6. A series of chain reactions that happen after the aggregate demand is expanded by the public spending (fiscal policy) and that in the end increases private income and product growth in a greater way than that initially generated by the original stimulus.

7. Fiscal

8. Government/Central Bank

9. Yes, in a secondary effect. When the money supply increases, the interest rate decreases and real variables such as consumption and investment expand as people have fewer incentives to save on the one hand, and more incentives to get bank credit as their cost is low (the low rates) on the other hand, therefore generating incentives for financing consumption or investment with credits.

Quiz cards (to print)

Flexible prices	Fixed prices
Full employment	Underemployment
Markets can regulate by themselves automatically	Markets can't regulate by themselves automatically, they need regulation
Keynesian	Aggregate demand
Money supply	Monetary
Fiscal	A series of chain reactions that happen after the aggregate demand is expanded by the public spending (fiscal policy) and that in the end increases private income and product growth in a greater way than the initially generated by an original stimulus.
Fiscal	Government/Central Bank
Yes, in a secondary effect. When the money supply increases, the interest rate decreases and real variables such as consumption and investment expand as people have fewer incentives to save on the one hand, and more incentives to get bank credit as their cost is low (the low rates) on the other hand, therefore, generating incentives for financing consumption or investment with credits.	

Activity 1.2: Quiz Follow up.

This activity may be used as a follow- up to the quiz activity as an in-class activity or given as homework.

Aims

• To extend the learning from the quiz activity

• To help students to understand how macroeconomic variables operate in the real economy.

Steps

1. During the answers review, the teacher records the correct ones on the board.

2. Each quiz group chooses a model and a policy to defend as the best one to solve economic imbalances. Students may be allowed to have the learning material (the table) with them for orientation.

3. Invite students to discuss them in their groups, including discussion of assumptions and impacts.

4. Invite each group to present their argument to the wider group. Departing from an overview of each model, they should explain how they understand how the fiscal and monetary policies of that model affect the real economy and how each model predicts their impact.

Activity 2: Media exploration

Overview

A media exploration on economic topics that intends to help students make these publications more reachable. It is suggested that students search for media examples from different countries and find those with different perspectives, in order to make it clearer to the students how the news could be biased.

Aims

• To familiarise students with reading about economic news and to develop their skills in media literacy
• To teach students that the way we receive information about economy is biased
• To try to identify austerity or public stimulus measures applied by countries

Materials and time

Newspaper articles that discuss economic crises. The teacher decides if this could be a global or a local crisis; any of the crises above explained or a different one. Ideally, the articles would be based on the same crisis but from different sources. The material should be provided by the teacher.
The activity should take between 45 minutes to one hour.

Group size

Any

Instructions for trainers

1. Ask the students to divide into groups. Photocopies of the media reports are placed facedown on the tables and numbered. In turns, each group chooses an article.
2. Each group should read and discuss the piece, trying to identify any possible bias. For example, they should identify facts, opinions, speculations and so on.
3. Some questions that could guide the analysis of the article might be (the teacher could decide to modify this):
    a. Are the students familiar with the source?
    b. Can the students identify where the article could be written?
    c. Is it providing facts or opinion?
    d. Is the article discussing only the economic perspective or also the political and social spheres?
    e. Does this material help them better understand the crisis it discusses, or was it making it more confusing?
    f. Were there different perspectives from the different sources?
    g. Are the students able to spot some of the keywords studied?
        - Economic Policy
        - Regulation
        - Welfare State
        - Public investment
        - Neoliberalism
        - Austerity
    h. Is the article defending any position about government intervention?

4. After some time each group reports back, explaining their answers to the questions, and anything else that they discussed. They can be respectfully questioned by the other students. Record the findings of this activity on the board.

Suggested sources:

- Financial Times
- The Economist
- The Wall Street Journal
- International newspapers as well (El País, The Guardian, etc)
- Local economic/political economic media is strongly encouraged
-

Examples:
Chris Giles for Financial Times : *Global economy: the week that austerity was officially buried.* Link
The Economist: *Beyond crisis management, Bold ideas for solving America's financial mess.* Link

Activity 3: Role Play

Overview

An interactive activity that sets the classroom floor for debate.

The two different models (austerity vs. stimulus) should be used in their 'pure' representation, however explain that in reality governments decisions are more nuanced and not black or white.

Aims

• To enable students to become knowledgeable in the different political economy theories
• To promote skills of debate and analysis
•To generate interest and discussion around different ways to manage a crisis

Materials and time

Photocopies of the cards (below) with the different situations of economic imbalance. Explanation and group activity is estimated between 20 and 30 mins. The final discussion should take 30 min approximately according to the number of groups.

Group size

16 minimum

Instructions for trainers

1. Divide the students into pair groups that later will be divided again in half.

2. Number the cards below and ask the students groups to each pick a card. Each card contains different economic imbalances.

3. Ask the groups to read and discuss each problematic situation and think about which recommendations would be taken by each model (neoclassical or Keynesian). For this, each group should be divided in half and take the role-play of representing one of each of the two economic schools.

4. After the discussion in their groups, each group in turn takes to the stand and presents their argument. For this, arrange the room to allow the speaking contestants to get a central position in the classroom, arranging the seats for the rest of the students around to listen and observe.

5. Following each group discussion the teacher should ask the audience (the rest of the students) to vote for which solution they would support and why.

6. To guide the students into what role each should take, they should clarify their positions by trying to answer WHAT, HOW and WHOM. Here there are some questions to guide the analysis:

    a. Should the State intervene or not?

    b. If yes, how?

i. Fiscal policy: expanding public spending (granting subsidies, reducing taxes, etc); or reducing it (rising taxes, privatising public assets, etc)

ii. Monetary policy: expanding money supply and with it lowering interest rates encouraging consumption and investment; or reducing the money supply and with it raising the interest rate, therefore encouraging saving and the removal of money from the economy.

c. If not, how?

i. Leaving the market to regulate by itself, allowing prices to increase if there is a demand excess, or reduce if there is an oversupply.

ii. By automatic mechanisms: depletion of the existing capital stock that requires its replacement and therefore rising the labour demand

d. Are the actions taken more similar to an austerity plan or to a public investment one?

e. What might the social impacts be? / Which sector of the society will benefit the most?

Problem cards

Inflation: prices rise faster than wages and nominal interest rates. As prices rise faster than wages, consumption decreases; investment also decreases due to the high process volatility and uncertainty.

Recession: a period of negative economic growth or in other words a decline in the size of the economy. As the economic activity is slowing down, consumption is reduced and companies' inventories increase.

Debt crisis: government increases their expenses while at the same time incomes fall

Unemployment: an imbalance between demand and supply of workers. It is due to swings in the business cycle, as costs have increased and companies need to reduce the number of employees in order to not lose benefits.

Inequality: enlargement of inequality as a result of the increasing concentration of wealth at the already high levels of the wealthy population, resulting in the deterioration in the living standards of the majority.

Activity 4: Choose your crisis

Overview
An activity to learn about crisis and economic history.

Aims
• To provide a historical perspective on the contemporary crisis.
• To equip students with the tools to investigate issues of economic crisis and the events that led to them.
• To encourage students to think critically about the commonalities and differences between the crises.

Materials and time
Photocopy of the crisis timeline. This activity should be planned to happen over two days. On the first day, the teacher presents the activity (15 minutes); on the next session students give their presentations (time depends on the number of students and the group arrangements but it could take from one hour to two hours).

Instructions for trainers
1. After reading through the contemporary crisis timeline, according to the crisis of interest, arrange students into small groups (no less than two, no more than four if possible).
2. Each group is asked to do in-depth research on the crisis they choose. Try to avoid two groups doubling up on the same event.
3. After researching at home, each group makes a presentation about the crisis event they chose. The presentation should be around 15 minutes. Supporting material as power points or posters are welcome.
4. Students should bear in mind the following items to take into account in their presentations:
    a. What were the causes of the crisis?
    b. Which sector was affected the most?
    c. Did the government take any action? If yes, which one(s)?
    d. Was there intervention from international organisations?
    e. What were the economic policy decisions applied? Austerity or Public support?
    f. Did the country better its situation? / Was a solution found?
    g. Is it possible to identify if any income redistribution occurred?

Crisis timeline
The late 1970s, early 1980s Latin America Debt Crisis: known as the 'lost decade', Latin American countries borrowed huge amounts of money from international institutions accumulating a foreign debt that later they were not able to repay.

1997 Asian financial crisis: the crisis started in Thailand, as after acquiring the burden of a huge foreign debt, bankruptcy produced a contagion effect which spread to their closest neighbours.

1998 Russian financial crisis: the Russian government's devaluation of the ruble fell into an impediment to repay their debt. The crisis had severe impacts on the economies of many neighbouring countries.

2001 Argentinian great depression: The impact of Russian and other regional depressions combined with the economic instability caused by the unstable pegged from the peso to the dollar caused a terrible economic crisis of high unemployment, riots, the fall of the government, and a default on the country's foreign debt.

The early 2000s the dot-come bubble: stock market collapse caused by excessive speculation in Internet-related companies in the late 1990s.

2009 Greek government-debt crisis: sovereign debt crisis faced by Greece in the aftermath of the financial crisis of 2007–08.

2008-2014 Great Recession in Spain: took place in the aftermath of the 2008 financial crisis. The main cause of Spain's crisis was the housing bubble and the accompanying unsustainably high GDP growth rate.

2020. Global health crisis due to Covid-19.

Potential sources

- Britannica Encyclopaedia
- IMF
- UNCTAD
- The World Bank

4. Interactive learning

Quiz: THE MODEL

Overview

The activity is designed for students to internalise the differences between the two models regarding the type of intervention they suggest. It is accompanied by a follow-up activity to continue at home or in the next class.

Questions

1. **Indicate which of these starting hypotheses of the neoclassical and Keynesian models are true:**
    a. Prices: the neoclassical model assumes they are flexible, Keynesian assumes they are rigid
    b. Prices: the neoclassical model assumes they are rigid, Keynesian assumes they are flexible
    c. The Keynesian model assumes that markets can regulate themselves automatically
    d. The Neoclassical model assumes that the economy is at a level of full employment
    e. The Keynesian model assumes that the economy is at a level of full employment

Correct answers: a) and d)

2. **For the_____model the State should intervene in trying to offset the economic imbalances.**
    a) Keynesian
    b) Neoclassical

Correct answer: a)

3. **Fiscal policy affects the _____ and monetary policy affects the _____**
    a) Money Supply / Aggregate demand
    b) Interest rates / Aggregate demand
    c) Aggregate demand / Money Supply
    d) None of the above mentioned

Correct answer: c)

4. **The neoclassical model understands that the best policy to use in the face of economic imbalances is the _____**
    a) Fiscal
    b) Monetary

Correct answer: b)

5. **The Keynesian model understands that the best policy to use in the face of economic imbalances is the _____**

   a) Fiscal
   b) Monetary

Correct answer: a)

6. **The multiplier effect refers to a series of chain reactions that happen after aggregate demand is expanded by public spending (fiscal policy) and that in the end increases private income and GDP growth in a greater way than that initially generated by the original stimulus.**

   a) True
   b) False

Correct answer: a)

7. **Is tax reduction an element that defines fiscal or monetary policy?**

   a) Fiscal
   b) Monetary

Correct answer: a)

8. **Who determines the money supply?**

   a) Consumers
   b) Private Banks
   c) Government/Central Bank

Correct answer: c)

9. **Could monetary policy influence consumption?**

   a. No, consumption is not influenced by monetary policy, as it does not influence prices

   b. Yes, although via a secondary effect. When the money supply increases, the interest rate decreases and real variables such as consumption and investment expand. This is because people have fewer incentives to save on the one hand, and more incentives to get bank credit as their cost is low (the low rates) on the other hand, therefore generating incentives for financing consumption or investment with credit.

Correct answer: b)

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FRESH-UP ECONOMICS

Economy and Climate

by Magdalena Prieler and Andreas Novy

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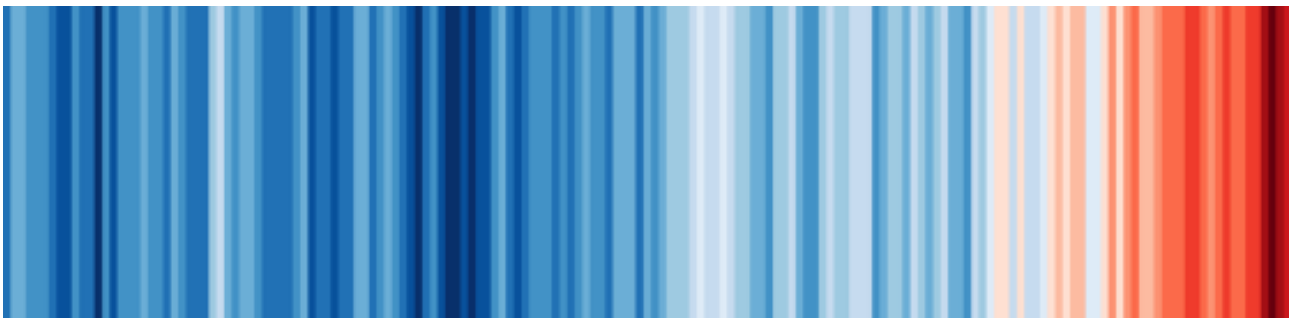
1. Overview



Graphic 1 Warming stripes depicting annual mean global temperatures (1850-2018)[1]

What does sustainability mean?

The term sustainability originally comes from forestry: One should only fell as many trees as will regrow through new plantations, keeping tree population and yield constant. The concepts of weak and strong sustainability provide different answers to the question of what it means to maintain a sustainable stock.

Weak sustainability is applied in environmental economics and is based on the principle of interchangeability: natural capital (natural resources) can be replaced by physical capital (e.g. machines or material infrastructure) and human capital (e.g. knowledge). The three areas of environment, society and economy exist separately and interact through the exchange of resources. Physical capital is included in the economic sphere, human capital in the social sphere and natural capital in the ecological sphere. Sustainability means **keeping the total value of the capital stock** (the sum of the three types of capital) constant and increasing it where possible. Natural, physical and human capital are comparable and mutually substitutable, i.e. interchangeable, by means of one measure, namely money. In order to carry out this exchange, methods of comparison are needed, for example a cost-benefit analysis.

Markets, in which the three forms of capital are traded, can be created. This leads to commodification, meaning that free goods, like air and water, which are foundational for life, are turned into commodities, which can be traded like any other good. It is therefore not seen as problematic if natural capital is shrinking today as regions turn into deserts, as long as at the same time physical capital is increased, for example by building roads. Due to interchangeability, environmental damage can be compensated financially. Who flys can “offset” the emissions caused with compensation payments, for example into reforestation projects.

The key concept of weak sustainability is **optimization** - the neoclassical concept of the best possible allocation of scarce resources. In order to allocate resources optimally, externalities have to be considered and calculated. Externalities are caused by actors without them bearing the resulting costs: for example, when a company emits polluted air from a chimney without installing filters or paying compensation to those negatively affected. If externalities are not included in the price, the market optimum does not correspond to the social optimum, which results in market failure due to false price signals. The **internalisation of external effects**, such as monetary

[1] Hawkins 2018

compensation for environmental damage, is therefore the central instrument in the concept of weak sustainability: By means of "right prices", environmental burdens which have been externalised up to now are internalised, i.e. included in prices. Examples are levies or taxes on polluted water or air as well as emission certificates. Weak sustainability follows the **polluter pays principle**: Whoever generates ecological and social costs should also bear them. However, what the “right” price for the extinction of a species or degradation of ecosystems should be is not so clear.

Strong sustainability is at the heart of the debates in ecological economics, which go beyond discussing an optimal allocation of resources. Strong sustainability is based on the principle of embeddedness: the economy is a subsystem, embedded in society and the biophysical sphere. Strong sustainability assumes that economic and social life is based on **irreplaceable, interwoven ecosystems** that **must be preserved**. Economic activities are confronted with ecological limits. The substitutability of nature with other types of capital is limited. Instead of the idea of optimisation, strong sustainability requires a holistic and systemic view of social-ecological systems and a reasonable **deliberation** between alternatives. From this point of view, the three areas of environment, social affairs and economy are in many respects incommensurable, meaning not comparable with a measure, and therefore not mutually interchangeable.

In the understanding of strong sustainability, nature is not a stock of resources (capital), but a complex ecosystem that provides mankind with vital functions. Nature has an intrinsic value because there are qualitative differences between produced capital and nature: the former is reproducible (e.g. new bridges can be built), the destruction of nature is often **irreversible**. "The fish in an aquarium can be made into a fish soup, but fish soup cannot be made into fish for an aquarium".

Strong sustainability is based on the **precautionary principle**: possible damage or pollution to the environment that could become dangerous for people must be avoided or reduced, even if it is not 100 percent certain that it will occur. Also the UN Framework Convention on Climate Change builds on the precautionary principle. Therefore, economic action should be based on the findings of climate research.

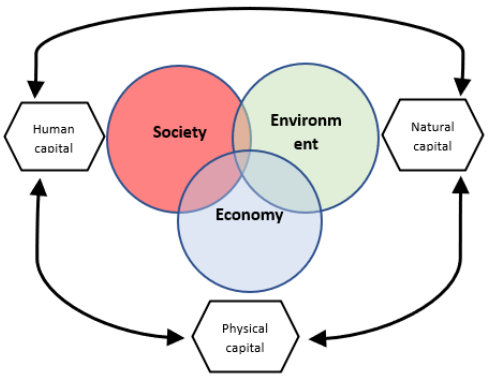
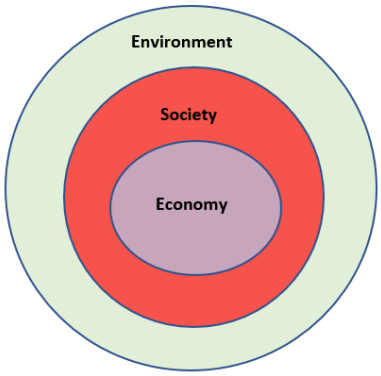
	Weak sustainability	Strong sustainability
Meaning of Sustainability	Maintaining or increasing the overall value of the capital stock	Maintaining irreplaceable 'stocks' of critical natural resources and ecosystems
Key idea	Interchangeability of natural capital and other types of capital (machinery, human capital, money)	Embeddedness; Substitutability of nature with other types of capital is limited
Key concepts	Optimisation (best possible allocation of scarce resources) Internalisation of external effects (polluter-pays principle)	Incommensurability (not comparable with a common measure, e.g. money); Deliberation between alternatives Precautionary principle
Graphic representation		
Consequences	Monetary compensation for environmental damage (compensation payments)	Human activity can have irreversible consequences
Economic disciplines	Environmental Economics, Resource Economics	Ecological Economics

Table 1 Comparison weak and strong sustainability[2]

Strategies to make economies future fit

How should a transformation towards a climate-friendly, sustainable economy look like? The following ideal-typical strategies differ in their basic assumptions and approaches.

The **market-liberal strategy**, based on Friedrich von Hayek's and neo-classical ideas, sees the **market** as the institution that combines individual action and social welfare. This is represented by the image of the "invisible hand", which is an example of action that unintentionally **leads to a social optimum**. It regulates supply and demand by means of the market mechanism. Thus, pursuing one's own interests can serve the common good better than any economic planning. The state is a coercive apparatus whose influence on concrete economic action must be minimised. Free market economy and free trade are the best prerequisites for sustainable economic activity. If there is a functioning market and property system, one can trust that the upcoming **transformation will succeed spontaneously** with the help of market processes. The task of market-liberal policy is soley to ensure the appropriate legal framework. Within this model, the spectrum ranges from libertarian positions that seek to minimise state intervention (in the

[2] Own representation on the basis of: Novy, Bärnthaler, Heimerl, 2020, p. 27-30

tradition of Hayek) to neoclassical positions that opt for correcting market failures (for example, through a CO2 tax). Market failures can be avoided if ecological goods, such as good air and water quality, are given a price, since scarce resources and production factors are thereby optimally used. The associated expansion of markets is commodifying more and more aspects of life that previously had no price.

The strategy of a **socio-ecological transformation** results from the huge environmental challenges of today. It is inspired by Karl Polanyi, various socio-economic theories, socio-ecological transformation research and partly also Keynes. According to this strategy, a fundamental transformation is needed, which opens new paths towards a **sustainable and just economy**. Within this strategy, the spectrum ranges from pragmatic to radical ideas of socio-ecological transformation. A **pragmatic** position is, for example, that of the German Advisory Council on Global Change (WBGU), which proposes a new global social contract for a sustainable global economic order. This approach to **ecological modernization** combines social and systemic innovations. A strong public sector, a good public technology and innovation policy and public infrastructures create opportunities for transformation by design. However, economic growth remains important for solving distribution conflicts by distributing an ever larger "cake". Economic, social and ecological sustainability can be achieved by **decoupling economic growth from resource consumption and emissions**.

Amongst others, the degrowth movement calls for a **radical socio-ecological transformation**. It stresses two main obstacles to sustainability, that have to be overcome: the growth imperative and the tendency towards commodification of all areas of human life. As absolute decoupling is not happing and is not a viable strategy for the radical reduction of material use and emissions needed, it calls for turning away from the imperative to grow the economies. Instead of growing material prosperity and consumption, the focus should be on **human well-being and sufficiency**. Therefore, **decommodification** is needed, as many areas are not suitable to be traded as goods on the market. If fundamental basics of a good life, from fresh air and water, to good education, public health and public transport are provided to everyone, rather than traded on markets, well-being depends less on (growing) income and consumption. The vision is a profound transformation, leading to a sustainable and equitable economy. The approaches are political and strongly rely on social movements - such as Fridays for Future - to build up pressure "from below", coming from civil society, in order to initiate systemic changes. It involves resistance to undesirable developments (e.g. lignite mining) as well as new forms of sustainable economic activity such as the Commons movement, social entrepreneurs or cooperatives.

The following table compares the principles of the different strategies:

	Market-liberal strategy	Pragmatic strategy of a socio-ecological transformation	Radical strategy of a socio-ecological transformation
Inspired by	Hayek, neoclassical economics	Polanyi, Keynes, socioeconomics, environmental economics, ecological economics	Polanyi, socioeconomics, ecological economics
Goal	Securing market organisation, competitiveness, growth	Decoupling economic growth from increasing consumption of resources	Moving away from growth imperative, socio-ecological alternatives
Commodification	Yes	Partly	No
Transformation	Spontaneous transformation	Transformation by design	Social innovation aiming at systemic change

Table 2 Strategies for sustainable economies[3]

[3] Own representation on the basis of: Novy, Bärnthaler, Heimerl, 2020, p. 55.

2. Background information

The following text is based on the book 'Zukunftsfähiges Wirtschaften' written by Andreas Novy, Richard Bärnthaler and Veronika Heimerl.[4]

Multiple ecological crises

Since the 1970s, scientists have warned about growing ecological problems caused by growth-oriented industrial production and the Western mode of living. In the meantime, we are in the middle of **multiple ecological crises**, first and foremost the **climate crisis**. Energy systems, transport infrastructure and industrial agriculture which are based on fossil fuels emit greenhouse gases, which prevent the heat of the sun from escaping the earth´s atmosphere. Today the atmospheric greenhouse gas concentration is the highest in the last 800,000 years. As a result, the global average temperature has risen by more than one degree Celsius since the pre-industrial era. This also radically changes the water cycle, as the Earth's atmosphere absorbs water faster. Precipitation becomes more irregular and more intense. Weather extremes like floods, long dry periods, snow chaos, forest fires and hurricanes are the result.

Climate change is particularly dangerous as the earth's systems don't function linearly. When so-called **tipping points** are exceeded, unpredictable and sometimes mutually reinforcing changes occur. These tipping points cannot be precisely determined and exceeding them is usually irreversible. One tipping point is the melting of ice in the arctic. As global warming leads to the thawing of permafrost in the Arctic, this enables the decomposition of bacteria that release methane which further accelerates the warming. Furthermore, the melting of Arctic ice can lead to radical periods of heat and cold, as it affects the Gulf Stream. Unusual hot or cold periods can cause crop failures and reduce food yields. Heat and drought also promote forest fires, which in turn result in the loss of CO2-storing forests. The earth system and climate are complex - they cannot be completely regulated.

At the same time, **biodiversity is shrinking** at an alarming rate. Already today there are around 20 percent fewer species than at the beginning of the 20th century. And worldwide, one-eighth of our animal and plant species are threatened with extinction. Especially industrial agriculture contributes to the extinction of species to an unprecedented rate through deforestation and the use of pesticides and machinery. Additionally, the increasing concentration of **air pollution** from industrial and car exhaust gases, particulate matter and heating and cooking with wood or coal causes serious problems. Next to accelerating climate change, air pollution leads to heart diseases, strokes, lung diseases and cancer. Air, water and soil pollutants cause nine million deaths worldwide, three times as many as AIDS, tuberculosis and malaria combined.

In order to prevent a further escalation of the climate crisis, the member states of the United Nations have agreed to keep the rise in the global mean temperature 'well below 2 degrees Celsius' compared to the pre industrial era, with a target of 1.5 degrees. In order to limit global warming to two degrees, greenhouse gas emissions have to be reduced by 40 to 70 percent by 2050 compared to 2010 and have to be zero by 2100. If this trend reversal does not succeed, large parts of the earth will become uninhabitable for humans before the end of this century. Natural disasters hit poorer countries and marginalised groups harder. While the Netherlands is protected from rising sea levels by cost-intensive dams, Bangladesh has no comparable protection. Extreme climatic situations are accompanied by major flight movements. According to the World Bank, by 2050 more than 140 million people could be forced to flee due to climatic changes. Nevertheless, the consequences of the climate crises are still not recognized for granting asylum.

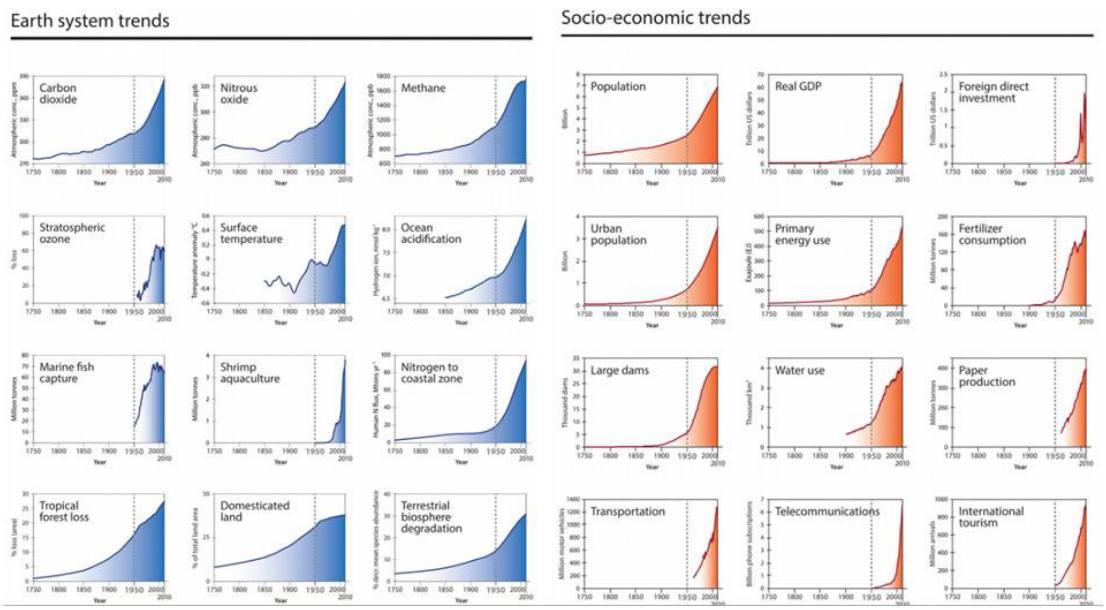
[4] Novy, Bärnthaler, Heimerl, 2020

Historically, the early industrialized and now rich countries of Europe and North America are responsible for most of the emissions and therefore the crossing of planetary boundaries. Looking at the emissions per capita, as before it is the wealthy few that stress the planet. While the poorest half of the world´s population emits only about 10% of total global emissions, the richest 10% are responsible for around 50%.[5]

Ulrich Brand and Markus Wissen speak of an '**imperial mode of living**' in Europe and the US, a non sustainable lifestyle at the expense of others. It is built on global inequalities and exploitation. The current production and consumption model of the West benefits mostly oil and car companies as well as consumers in rich countries. Europe's population can access raw materials and consumer goods from other parts of the world at low cost. In order to respect planetary boundaries, resource consumption must be limited, which will exacerbate distributional conflicts. Until recently, the costs were mainly passed onto future generations and the Global South. The latter is becoming increasingly difficult however, as the West's supremacy is wavering.

The great acceleration

The starting point of the multiple ecological crises can be traced back to the Industrial Revolution, which brought about a fundamental transformation: a uniquely productive mode of production and massive increases in material wealth were made possible by an equally massive increase in the consumption of natural resources and emissions. These exponential growth dynamics are called '**the great acceleration**'. The following chart illustrates some important biophysical as well as socio-economic indicators, which begin to rise with the Industrial Revolution. From the middle of the 20th century onwards, the trend towards **exponential growth** becomes apparent. A life-friendly climate is thus threatened by the prevailing resource intensive economic model. Its problems are not capitalism's failing, but are in fact the unintended consequences of capitalism´s success. Starting from Europe, captitalism has brought prosperity, social achievements and cultural emancipation to ever larger parts of humanity for two centuries. However, the drastic human impact on our planet is also reflected in ecological crises such as climate change, species extinction, over-exploitation of natural resources and high pollutant levels, which together begin to threaten our very existence.



Graphic 1 The great acceleration[6]

[5] Oxfam, 2015

[6] Steffen, Broadgate, Deutsch, Gaffney, Ludwig, 2015, on the basis of Global IGBP Change – International Geosphere-Biosphere Programme, 2015

Economic growth

The Western model of civilization is based on growth. Historically, economic growth provided the basis for avoiding distribution conflicts by increasing the 'cake', in other words promoting economic growth as a method of achieving prosperity rather than redistribution. It was a democratic compromise that ensured social peace during welfare capitalism in North America and Western Europe. Nowadays, the world's economy is almost five times the size it was half a century ago. If growth would continue at this rate, the economy would be 80 times that size by the year 2100[7].

Also the concept of the **green economy** remains firmly committed to growth. The goal of green growth is to combine increasing production and income with reduced resource-intensity. It strives for changing production patterns without questioning the underlying expansion-oriented logic of the economic system, in order to leave the existing way of life unaffected. Theories of a green economy assume that natural resources (natural capital) and produced goods (physical capital) can be substituted. The idea is that technological progress and increased productivity can raise the standard of living today, and with the increased wealth, the lost environmental quality can be restored at a later stage through 'green' investments. Environmental destruction is seen as reversible. Economic growth according to green growth theories can and should be decoupled from material consumption and emissions by increasing efficiency. Hereby, a decrease in material or emission intensity per unit (e.g. less emissions per vehicle produced) is called **relative decoupling**. In order to meet the two-degree target, however, **absolute decoupling** would be required, whereby emissions and material consumption would decrease in absolute terms despite continued economic growth. Absolute decoupling has so far only been achieved in selected periods and for individual countries, mostly because these countries (like Denmark) have outsourced their resource intensive production processes to other countries (like China). Globally, no absolute decoupling has taken place. The technological requirements for absolute decoupling would be enormous. On top of this, the savings potential of efficiency increases is in most cases only partially realised, as reduced consumption in one sphere leads to increased consumption elsewhere. This is called the **rebound effect.** Products may become cheaper through technological progress, which in turn creates more purchasing power for additional consumption. For example, if cars use less fuel, people save money on refuelling, which they may spend on driving longer distances or flying.

[7] Jackson, 2009

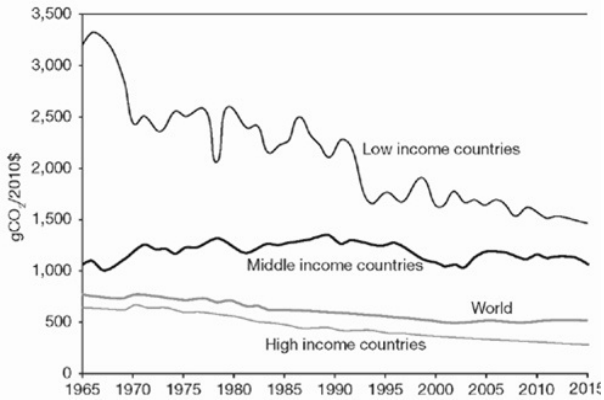


Figure 1 Annual carbon dioxide emission intensities, 1965-2015[8]

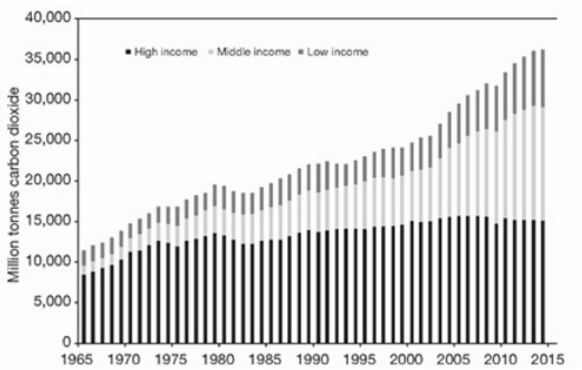


Figure 2 Annual carbon dioxide emissions by world region, 1965-2015[9]

The two figures above show the carbon dioxide emission intensity per dollar as well as the absolute carbon dioxide emissions. The falling emission intensity (figure 1) depicts the relative decoupling happening during the last decades, especially in low income countries. Globally, relative decoupling has been minor. Despite that trend, the world is far away from an absolute emissions reduction. The second figure shows that no absolute decoupling has happened - emissions are still rising along with economic growth.

Empirically, no trend towards sustainability can be identified. On the contrary, global energy demand rose more than 40 percent from 2000 until 2017. Eighty one percent of this demand is still met using fossil fuels. The fossil fuel industries continue to dominate the global economy; eight of the world's ten largest companies in 2018 were from the oil, automotive and energy sectors. Together with like-minded politicians, unions and the media, these companies form an influential **fossil power bloc** that defends the status quo.

The coal, oil and automotive industries have so far successfully defended their ownership (of fossil resources) and their markets (for motorised private transport and 'cheap' energy). Without addressing issues of power, it will be difficult to combat the climate crisis.

Although the fact that the world as we know it is threatened has diffused into mainstream media and reached the political agenda, thanks to movements like Fridays for Future, ambitious climate action is still missing. We are in what Tim Jackson calls a '**growth dilemma';** giving up on growing our economy seems to result in economic and social collapse, while further pursuit of growth risks destroying global ecosystems that form the very base of our existence.[10] It is evident that we cannot rely on economic growth any longer. Business as usual is no longer an option. Another mode of production, consumption and living is indispensable. But what on earth might this look like?

[8] Jackson, 2016, p.142

[9] Jackson, 2016, p.144

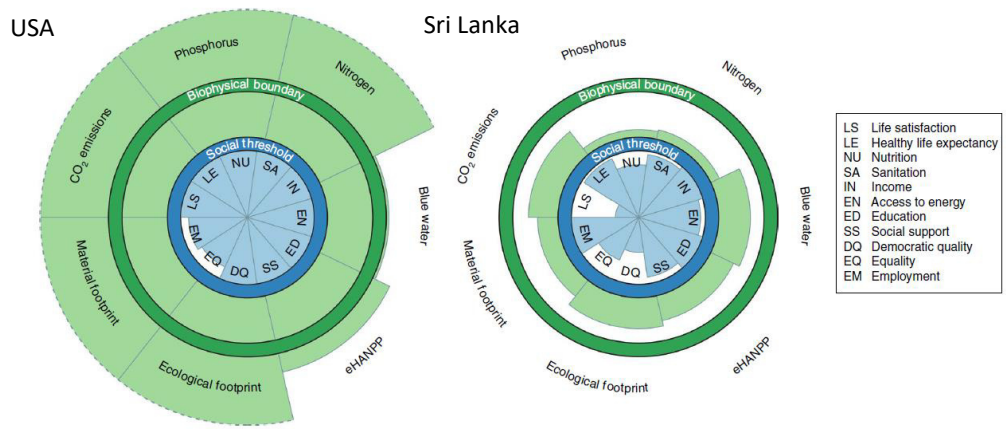
[10] Jackson, 2009

What would a good life for all within planetary boundaries look like?

There are not enough resources for all people to enjoy the material standard of living of an average European. Therefore, the Western resource-intensive standard of living cannot be generalized worldwide. In the current way of provisioning it is not possible to reach well-being for all within the ecological limits.

Kate Raworth proposes in her book *Doughnut Economics*[11] that the aim of economies should not be the growth of GDP, but ensuring that everyone has what is essential for life while simultaneously ensuring that critical planetary processes are not endangered. She uses the image of a doughnut shape with an inner and outer ring as a **safe and just space**, in which humanity should operate. Inside this 'doughnut', the resource use is high enough to reach a social foundation of wellbeing (inner circle) but low enough to not transgress planetary boundaries (outer circle). Building on the 'safe and just space' framework, O´Neill et al. suggest the adoption of a 'human needs-based' approach. Nutrition, sanitation, income, access to energy, education, social support, equality, democratic quality and employment are the needs which should be satisfied.

Furthermore, they include two measures of human well-being, namely self-reported life satisfaction and healthy life expectancy to measure 'the good life'. For measuring the safe space at the national scale they combine national consumption-based environmental footprints (ecological footprint, material footprint) and planetary boundaries (measures: CO2 emissions, phosphorus, nitrogen, blue water, eHANPP) which they downscaled to the national level.[12] This approach gives us an idea of what a good life for all within planetary boundaries could look like, and makes us realise just how far we are from achieving this. Currently, no country fulfils all basic needs whilst not transgressing sustainability thresholds. Strategies to improve provisioning systems so that needs can be fulfilled more sustainably are needed. Both sufficiency and equity play an important role in that. Climate policy which strives for a dignified life for all people requires **redistribution policies** and depends on collective decision making and collective provisioning.



Graphic 2 National performance relative to a 'safe and just space' for the United States and Sri Lanka[13] Ideally, a country would have blue wedges that reach the social threshold (nothing is white inside the social threshold) and green wedges within the biophysical boundary (nothing is green outside the biophysical boundary).

[11] Raworth, 2017

[12] O'Neill, Fanning, Lamb, Steinberger, 2018

[13] O'Neill, Fanning, Lamb, Steinberger, 2018, p. 91

What does sustainability mean?

The term sustainability originally comes from forestry; one should only fell as many trees as will regrow through new plantations, keeping tree populations and yields constant. The concepts of weak and strong sustainability provide different answers to the question of what it means to maintain a sustainable stock.

Weak sustainability is applied in environmental economics and is based on the principle of interchangeability: natural capital (natural resources) can be replaced by physical capital (e.g. machines or material infrastructure) and human capital (e.g. knowledge). The three areas of environment, society and economy exist separately and interact through the exchange of resources. Physical capital is denoted by the economic sphere, human capital by the social sphere and natural capital by the ecological sphere. Sustainability means keeping the total value of the capital stock (the sum of the three types of capital)
constant and increasing it where possible. According to this principle of interchangeability, natural, physical and human capital are comparable and mutually substitutable, i.e. interchangeable, by means of one measure: money. In order to carry out this exchange, methods of comparison are needed, for example a cost-benefit analysis.

Markets, in which the three forms of capital are traded, can be created. This leads to commodification, meaning that free goods, like air and water, which are foundational for life, are turned into commodities, which can be traded like any other good. It is therefore not seen as problematic if natural capital is shrinking today as regions turn into deserts, as long as at the same time physical capital is increased, for example by building roads. From the point of view of interchangeability, environmental damage can be compensated for financially. Those who fly can make a compensation payment into reforestation projects, which 'offset' the emissions caused.

The key concept associated with weak sustainability is **optimization** - the neoclassical concept of the best possible allocation of scarce resources. In order to allocate resources optimally, external effects, so-called externalities, have to be considered and calculated. Externalities are caused by actors without them bearing the resultant cost. For example, when a company emits polluted air from a chimney without installing filters or paying compensation to those negatively affected. If externalities are not included in the price, the optimal market outcome does not correspond to the optimal social outcome, which results in market failure due to false price signals. The **internalisation of external effects**, such as monetary compensation for environmental damage, is therefore the central economic policy instrument in the concept of weak sustainability: By means of 'correct prices', environmental burdens which have been externalised up to now are internalised, i.e. included in prices. Examples are levies or taxes on polluted water or air as well as trading emission certificates. Weak sustainability follows the **polluter-pays principle**: Whoever generates ecological and social costs should also bear them. However, what the 'right' price for the extinction of a species or degradation of ecosystems should be is not so clear.

Strong sustainability is at the heart of the debates in ecological economics, and goes beyond discussion of optimal allocation of resources. Strong sustainability is based on the principle of embeddedness, not interchangeability: the economy is a subsystem, embedded in society and the biophysical sphere. Strong sustainability assumes that economic and social life is based on irreplaceable, interwoven ecosystems that must be preserved. Economic activities are confronted with ecological limits. The substitutability of nature with other types of capital is limited. Instead of the idea of optimisation, strong sustainability requires a holistic and systemic view of social-ecological systems and a reasonable

deliberation between alternatives. From this point of view, the three areas of environment, social affairs and economy are in many respects incommensurable, meaning not comparable with a measure, and therefore not mutually interchangeable. For example, compensation payments for flights can never compensate for flight emissions, as the two systems of ecology and economy cannot be offset against each other. As soon as emissions are emitted, they unfold biophysical effects such as the greenhouse effect, which can never be reversed one-to-one due to their complexity. Even if trees are planted as a compensation, they do not bind CO2 as long, as the life span of the emitted C02 in the atmosphere - several thousand years.

In the understanding of strong sustainability, nature is not a stock of resources (capital), but a complex ecosystem that provides mankind with vital functions. Nature has an intrinsic value because there are qualitative differences between produced capital and nature: the former is **reproducible** (e.g. new bridges can be built), the destruction of nature is often **irreversible**. 'The fish in an aquarium can be made into a fish soup, but fish soup cannot be made into fish for an aquarium'.

Strong sustainability is based on the **precautionary principle**: possible damage or pollution to the environment that could become dangerous for people must be avoided or reduced, even if it is not 100 percent certain that it will occur. Environmentally protective government action is therefore required in situations of uncertainty, in order to prevent possibly disastrous damages. Accordingly, it is irresponsible to put forward incomplete knowledge as justification for non-action when there is a risk of irreversible, dangerous damage. Among other agreements and regulations, the UN Framework Convention on Climate Change (UNFCCC) established the precautionary principle for the protection of the environment at international level. The precautionary principle provides justification for the assertion that sustainable economic action should be based on the findings of climate research.

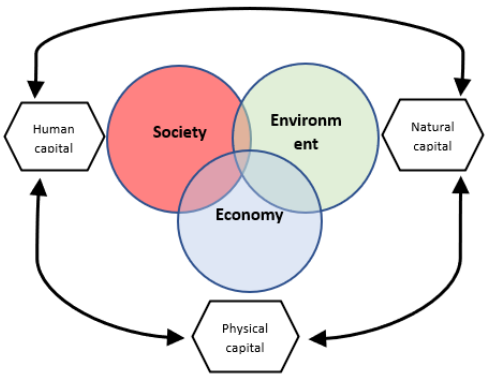
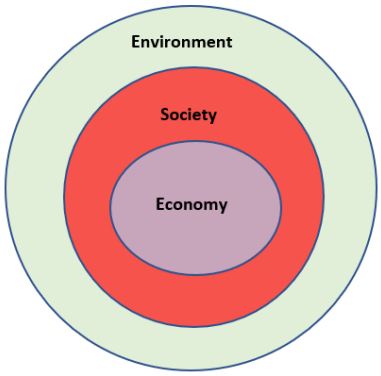
	Weak sustainability	Strong sustainability
Meaning of Sustainability	Maintaining or increasing the overall value of the capital stock	Maintaining irreplaceable 'stocks' of critical natural resources and ecosystems
Key idea	Interchangeability of natural capital and other types of capital (machinery, human capital, money)	Embeddedness; Substitutability of nature with other types of capital is limited
Key concepts	Optimisation (best possible allocation of scarce resources) Internalisation of external effects (polluter-pays principle)	Incommensurability (not comparable with a common measure, e.g. money); Deliberation between alternatives Precautionary principle
Graphic representation		
Consequences	Monetary compensation for environmental damage (compensation payments)	Human activity can have irreversible consequences
Economic disciplines	Environmental Economics, Resource Economics	Ecological Economics

Table 1 Comparison weak and strong sustainability[14]

Strategies to make economies 'future fit'

Evidently, business as usual is not an option. But what should a transformation towards a climate-friendly, sustainable economy look like? The following strategies differ in their basic assumptions and approaches.

The **market-liberal strategy**, based on neo-classical ideas as well as those of Friedrich von Hayek, sees the market as the institution that combines individual action and social welfare. This is represented by the image of the 'invisible hand', which represents action that unintentionally leads to an optimal social outcome. It regulates supply and demand by means of the market mechanism. Thus, pursuing one's own interests can serve the common good better than any economic planning. The state is seen as a coercive apparatus whose influence on concrete economic action must be minimised. Free market economy and free trade are the best prerequisites for sustainable economic activity. If there is a functioning market and property system, one can trust that the upcoming transformation will succeed spontaneously with the help of market processes. The task of market-liberal policy is solely to ensure the appropriate legal framework. Within this model, the spectrum ranges from libertarian positions that seek to minimise state intervention (in the tradition of Hayek) to neoclassical positions that opt for correcting market failures (for example, through a carbon (CO2) tax). Market failures can be avoided

[14] Own representation on the basis of: Novy, Bärnthaler, Heimerl, 2020, p. 27-30

if ecological goods, such as good air and water quality, are given a price, since scarce resources and production factors are thereby optimally used. The associated expansion of markets is resulting in the commodification of more and more aspects of life that previously had no price.

The strategy of a **socio-ecological transformation** results from the huge environmental challenges of today. It is inspired by Karl Polanyi, various socio-economic theories, socio-ecological transformation research and partly also Keynes. According to this strategy, a fundamental transformation is needed, which opens new paths towards a sustainable and just economy. Within this strategy, the spectrum ranges from pragmatic to radical ideas of socio-ecological transformation. A **pragmatic** position is, for example, that of the German Advisory Council on Global Change (WBGU), which proposes a new global social contract for a sustainable global economic order. This approach to ecological modernization combines social and systemic innovations. A strong public sector, good public technology and innovation policy and public infrastructure together create opportunities for 'transformation by design'. However, economic growth remains important for solving distribution conflicts by distributing an ever larger 'cake'. Economic, social and ecological sustainability can be achieved by decoupling economic growth from resource consumption and emissions.

Amongst others, the degrowth movement calls for a **radical socio-ecological transformation**. It stresses two main obstacles to sustainability, that have to be overcome: the growth imperative and the tendency towards commodification of all areas of human life. As absolute decoupling neither has happened until now, nor is a viable strategy for the radical reduction of material use and emissions needed, it calls for turning away from the imperative to grow the economies. Instead of growing material prosperity and consumption, the focus should be on **growing human well-being and sufficiency**. Therefore, is needed, as many areas are not suitable to be traded as goods on the market. If fundamental basics of a good life, from fresh air and water, to good education, public health and public transport are provided to everyone, rather than traded on markets, well-being depends less on (growing) income and consumption. This is a vision of a profound transformation, leading to a truely sustainable and equitable economy. The approaches are political and strongly rely on social movements - such as Fridays Future - to build up pressure 'from below', coming from civil society, in order to initiate systemic changes. It involves resistance to undesirable developments (e.g. lignite mining) as well as new forms of sustainable economic activity such as the Commons movement, social entrepreneurs or cooperatives. The following table compares the principles of the different strategies:

	Market-liberal strategy	Pragmatic strategy of a socio-ecological transformation	Radical strategy of a socio-ecological transformation
Inspired by	Hayek, neoclassical economics	Polanyi, Keynes, socioeconomics, environmental economics, ecological economics	Polanyi, socioeconomics, ecological economics
Goal	Securing market organisation, competitiveness, growth	Decoupling economic growth from increasing consumption of resources	Moving away from growth imperative, socio-ecological alternatives
Commodification	Yes	Partly	No
Transformation	Spontaneous transformation	Transformation by design	Social innovation aiming at systemic change

Table 2 Strategies for sustainable economies[15]

[15] Own representation on the basis of: Novy, Bärnthaler, Heimerl, 2020, p. 55.

Glossary

Commodification: Process of turning formerly free resources or public services, like fresh air, water or education, into commodities (products that can be bought and sold). As a result, the market logic of optimisation is applied to more and more areas of human life.

Decommodification: Reverting the trend of commodification by withdrawing resources or services from being traded on markets like commodities.

Decoupling, absolute: Emissions and/or material consumption decreases, while economic output grows.

Decoupling, relative: Emission intensity or material intensity per unit decreases (e.g. less emissions per vehicle produced) relative to economic output. However, in absolute terms, emissions may rise (e.g. if more vehicles are produced).

Great acceleration: The exponential growth dynamics of biophysical as well as socio-economic indicators. It shows the unintended consequences (due to drastic human impact) of capitalism´s success story.

Imperial mode of living: Non-sustainable lifestyle of Europe and the US built on global inequalities and exploitation of the Global South.

Sustainability, weak: Maintaining a sustainable stock means maintaining the overall value of the capital stock. Natural capital, physical capital and human capital are thereby interchangeable and can be substituted by one another.

Sustainability, strong: Maintaining a sustainable stock means maintaining irreplaceable 'stocks' of critical natural resources and ecosystems, on which the economy and social life depend. Those must not be substituted.

Tipping points: Point at which a previously linear development changes abruptly due to a strong acceleration, certain feedback loops or changes of direction

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3. Training material

Activity 1: Multiple ecological crises

Climate Crisis Table Quiz

Activity title	**Climate Crisis Table Quiz**
Overview	Participants sit together in small groups (3-4 people) and answer questions about the climate crisis, which the trainer reads out. Afterwards, the groups discuss the answers to the thought-provoking questions.
Objectives	● To gain an insight into some of the core issues of the climate crisis
Materials	-
Time	10 - 30 minutes
Group size	Works for all group sizes, or online with programs like Mentimeter
Instructions for trainers	1. Break up the class into small groups. 2. Read out the questions for each round. 3. After each round give the answers to the questions and encourage discussion. What answers surprised them? Why? Round 1 1. Which percentage of the global primary energy supply comes from fossil fuels? A) Around 30% B) Around 55% C) Around 80% 2. True or false? Climate change is a linear process that is currently becoming faster and faster. 3. True or false? Deforestation and habitat destruction can cause the outbreak of new diseases. 4. True or false? Since the beginning of the 20th century, around 20 percent of the species on earth have become extinct. 5. A half degree difference: A how much greater loss of insects is forecasted if the average rise in temperature is 2 degrees instead of 1.5 degrees? A) Twice as big B) Three times as big C) Five times the size Round 2 1. True or false? While the poorest half of the world´s population emits only about 10% of total global emissions, the richest 10% are responsible for around 50%. 2. True or false? The 100 companies and organizations responsible for the highest emissions have been the source of more than 80% of the world's greenhouse gas emissions emitted since 1988. 3. True or false? Already today, more people lose their means of existence due to extreme weather events than due to violence and war.

	4. True or false? Worldwide, air, water and soil pollutants cause nine million deaths, three times as many as AIDS, tuberculosis and malaria combined. 5. True or false? In 2016 air pollution caused nearly 30.000 premature deaths in Europe.
Debriefing and evaluation	Answer Sheet Round 1: 1. **C.** Of the total primary energy supply 28% comes from coal, 22% from gas and 32% from oil.[16] 2. **False.** The climate crisis is even more dangerous, as temperatures do not simply rise linearly. If so-called tipping points are exceeded, entire subsystems of the global climate system can collapse. 3. **True.** Many newly emerging pathogens are of animal origin. Habitat destruction brings wildlife closer to human settlements which can lead to the outbreak of diseases. For example, Ebola (origin bat species) is more common after large scale deforestation, and also mosquito-borne diseases are more common in deforested areas.[17] 4. **True**. Particularly industrial agriculture contributes to the extinction of species to an unprecedented extent through deforestation and the use of pesticides and machinery. 5. **B.** Due to a global warming of 1,5 degrees it is forecasted that 6% of insects lose at least half their species range. For a global warming of 2 degrees even a loss of 18% of the insects is forecasted, which means a three times as big species loss.[18] Answer Sheet Round 2: 1. **True**. 2. **False.** The 100 companies and organizations responsible for the highest emissions have been the source of 71% of the world's greenhouse gas emissions emitted since 1988.[19] 3. True. Furthermore, if the climate goals of the Paris Agreement are not met, large parts of the earth will become uninhabitable for humans before the end of this century. 4. **True.** 5. **False.** In 2016 air pollution led to nearly 500.000 premature deaths in Europe.[20]
Tips for trainers	The activity can be shortened by playing only one round or by leaving less time for discussion.

Follow up activity: Climate Crisis Quiz Inquiry

Activity title	**Follow up activity: Climate Crisis Quiz Inquiry**

[16] IEA

[17] Shah, 2020

[18] IPCC, 2018

[19] Griffin, 2017

[20] European Environment Agency, 2019

Overview	In small groups participants find creative ways of communicating the climate crisis.
Objectives	● To deal with one aspect of the climate crises more in depth ● To jointly discover ways of effectively communicating the climate crisis
Materials	Paper, Pens, possibly other material
Time	30 – 60 minutes
Group size	Works for all group sizes
Instructions for trainers	1. Record the correct answers from the quiz on the board. 2. Each quiz group chooses a fact on which to focus. 3. Invite each group to discuss their fact, including its causes and consequences. 4. Invite participants to devise a creative and effective means of communicating these facts to the wider audience. Participants could e.g. devise a mini-drama, a news report, a series of images, a poem, a comic, or something else. 5. Each group is invited to present their fact to the wider group.
Debriefing and evaluation	Honour every group's creative contribution. Option: Together you can try to find out, which were the key elements that helped in effective communication.

A fair share?

Activity title	**A fair share?**
Overview	Participants estimate climate related regional inequalities, and on the basis of the correct answers, discuss those inequalities.
Objectives	● To get a feeling of how disproportionately different areas contribute to climate change
Materials	6 sticky notes (Europe, North America, Central and Latin America, Asia, Oceania, Africa)
Time	25-40 minutes
Group size	Works for all group sizes, ideally at least 10 participants
Instructions for trainers	1. Mark out 6 areas in the room to represent each of the following regions: Europe, North America, South America, Asia, Oceania and Africa. 2. Explain to the group that 10 of them should split up and stand in the marked ‘regions’ to represent the regions share of a) population b) production based emissions c) historical emissions d) the people at risk (see explanation of terms). 3. When the participants have settled into place let them know the actual break down so they can rearrange themselves according to it. Explanation of terms:

Production based emissions: annual CO_2 emissions from fossil fuel use and cement production (2013). This is the conventional way to view national emissions, but it ignores imports and exports of fossil fuels and goods and services.

Consumption based emissions: carbon footprint of all goods and services consumed in a nation (2012), including imports and excluding exports. Compared to the production based emissions, major exporters such as China show lower emissions, while net importers such as the UK have higher ones.

Historical emissions: CO_2 emissions from energy use 1850–2011. These historical (or 'cumulative') emissions remain relevant because CO_2 can remain in the air for centuries. People at risk: people injured, left homeless, displaced or requiring emergency assistance due to floods, droughts or extreme temperatures in a typical year. Climate change is expected to exacerbate many of these threats.

Debriefing and evaluation

For the different rounds the 10 people should be spread as follows:

	Population	Production based emissions	Historical Emissions	People at risk
Europe	1	2	4	0
Africa	2	0	0	1
Asia	6	6	3	9
North America	1	2	3	0
South America	0	0	0	0
Oceania	0	0	0	0

Discuss with the participants: Are you surprised? How do you feel about your vulnerability to climate risks and your share of emissions? Optionally also discuss: How should emissions be counted: production based, consumption based or based on historical emissions? Why? What have we learnt from the activity?

Tips for trainers

In case you have less time you can also show the carbon map video http://www.carbonmap.org (2 min) and afterwards discuss the questions (8min).

Activity 2: The great acceleration

Growth simulation

Activity title	**Growth Simulation**
Overview	Participants simulate linear growth and exponential growth.
Objectives	• To get a sense of the dynamic of exponential growth
Materials	-
Time	According to the group size, between 5 and 15 minutes
Group size	Works for all group sizes
Instructions for trainers	1. For this exercise participants must sit in a classroom setting (in rows). In the case that participants are sitting in a circle, ask them to put their chairs into a classroom setting (rows next to AND in front of each other). 2. Explain to participants that you will now simulate linear growth. Therefore, the first student should stand up and tap the participant next to them on the shoulder. After being tapped on the shoulder, this and every further participant stands up and taps the next person, until the whole group is standing. Meanwhile you time the group. 3. Tell the group how long the linear growth simulation took. 4. Explain to participants that the group will, in a few moments, simulate exponential growth. Explain that the participant in the middle of the middle row (i.e. the most central participant) should start by standing up and tapping two other participants on their shoulders. Those two and all other participants continue the process by standing up and tapping two further participants until they are all standing. 5. Ask the participants to guess how long it will take the group until all participants are standing. 6. Carry out the activity to simulate exponential growth (the simulation is only an approximation of exponential growth, it is a bit slower than exponential growth). 7. Conclusion: Whenever we talk about how much an economy grows (in percentage points) we talk about exponential growth. This is because the basis from which the growth is calculated does not stay the same (as with linear growth), but itself grows every year. This growing basis leads to a completely different dynamic than linear growth.
Debriefing and evaluation	Exponential growth describes a process in which the size of stock always changes by the same factor in equal time steps. Therefore, the rate of increase itself increases dramatically with time. A well-known example of exponential growth in biophysical processes is the spread of water lilies. If there are 10 water lilies on the surface of a pond in one week and 20 in the next, many intuitively assume that one week later there will be 30, then 40 and then 50. This is the linear view of the world which is familiar to us. In fact, there will be 40, then 80, then 160, and in the week before the pond is completely covered with water lilies, they will have only covered half of the pond. Whenever we

	speak about economies that grow e.g. 3% yearly, we are speaking about exponential growth. Therefore, a yearly growth of 3% leads to an economy being double the initial size in only 24 years.
Tips for trainers	This video shows how it works: https://www.youtube.com/watch?v=1_SwKG4Zt60 *Challenges that might occur:* If participants sit very far from each other and cannot really reach each other the simulation might not work that well, or it is at least slower. *Remark:* If participants have tables with water bottles, laptops, etc. in front of them, warn them to take care of their items when standing up, so that nothing breaks.

Input: The great acceleration

Activity title	**Input: The great acceleration**
Overview	Trainer gives an input on chapter 1.2 'The great acceleration'
Material	PowerPoint slide or print out of the graphic 'The great acceleration'
Time	3 - 5 minutes
Instructions for trainers	1. Show the graphic and explain it 2. Conclusion: we cannot go on growing like that, business as usual is not an option. We need another mode of production, consumption and living.

Activity 3: Economic growth

The efficiency challenge

Activity title	**The efficiency challenge**
Overview	In two rounds, participants build boats which should carry as many coins as possible. In the second round, they are instructed to increase efficiency in construction. Afterwards participants discuss the possibilities and limitations of decoupling.
Objectives	• To deal with the possibilities and limitations of decoupling in a playful way
Materials	1 cent coins, Paper, Cardboard, Glue stick, Sticky tape, additional material of your choice Optional: PowerPoint slide or print out of figures 1 + 2 'Annual carbon dioxide…'
Time	30 minutes
Group size	Works for all group sizes
Instructions for trainers	Preparation: Prepare a set of building material for every group. Make sure to have every set in the same composition twice (for round one and round two). The resources included in the set of materials for the different groups should not be the same. One group might for example only get one paper and glue stick, while another group might additionally get a piece of cardboard and sticky tape. Give the groups rather limited material, as the aim is not to keep on building forever. 1. Ask participants to form small groups (e.g. 3 – 5 people). 2. Tell the groups that there will be two phases of 7 minutes of construction. 3. Hand out one set of materials to every group. 4. Instruct the groups in the first round to use the material they have in order to build boats that can carry as many 1 cent coins as possible. 5. Seven minutes of construction time. 6. Tell the group to monitor their building success. 7. Hand out the materials for the second round and instruct the groups to again build boats that can carry as many coins as possible. However, this time the boats need to be able to carry more coins than before, and less material than in round one needs to be used. Challenge the groups to construct their boat as efficiently as possible. 8. 7 minutes of construction time are followed by again monitoring the building success.
Debriefing and evaluation	The additional carrying capacity and the saved materials are the efficiency gain. Start a discussion around the following questions: How much more efficient were you able to get? In how many rounds do you think you could get every more efficient? How much more efficient do you think our economies can get? How did the different sets of resources, influence the size of the efficiency gains your group could realise?

	Introduce participants to decoupling as the aim of the green economy, where increasing efficiency should lead to sustainability. Discuss the aim of green growth, that through decoupling economic growth from emissions and material resource use, sustainability can be reached. Sticking to the boat example, relative decoupling would mean that the groups would manage to build a boat, which can carry the same amount of coins as in the first round, with less material. If that succeeded (very likely), ask the participants if they think that they could build twice, or three times as many boats with less than the material used for the one boat in the first round. Absolute decoupling is only reached in the case of a growing output (economic growth) where less material is used than for the initial, smaller output. Can we keep on growing endlessly while ever using less material and emitting less greenhouse gases? Should we use efficiency gains for 'making up' for growth or to (faster) reduce the pressure on our planet? End the activity with a short input about empirical observations on decoupling: relative decoupling has happened, but globally no absolute decoupling has happened. Relative decoupling does not help us to reach climate goals, as emissions need to be drastically reduced and not only increased at a lower rate which is what happens when economies grow and emissions decline but only relative to the economic growth. Optional: show the trends of absolute and relative decoupling with the ppt slide or print out of figures 1+2.
Tips for trainers	For the debriefing of the exercise read chapter 3, 'Economic growth' An additional, interesting layer of reflection could be about the output of carrying coins. This exercise shows growth in 'more of the same' (capacity to carry coins). However, did anyone consider constructing the new ships for a different purpose? Did anyone think about deviating from 'the rules of the game'? Efficiency is about input and output. Who determines what a good output is? What is efficiency geared towards?

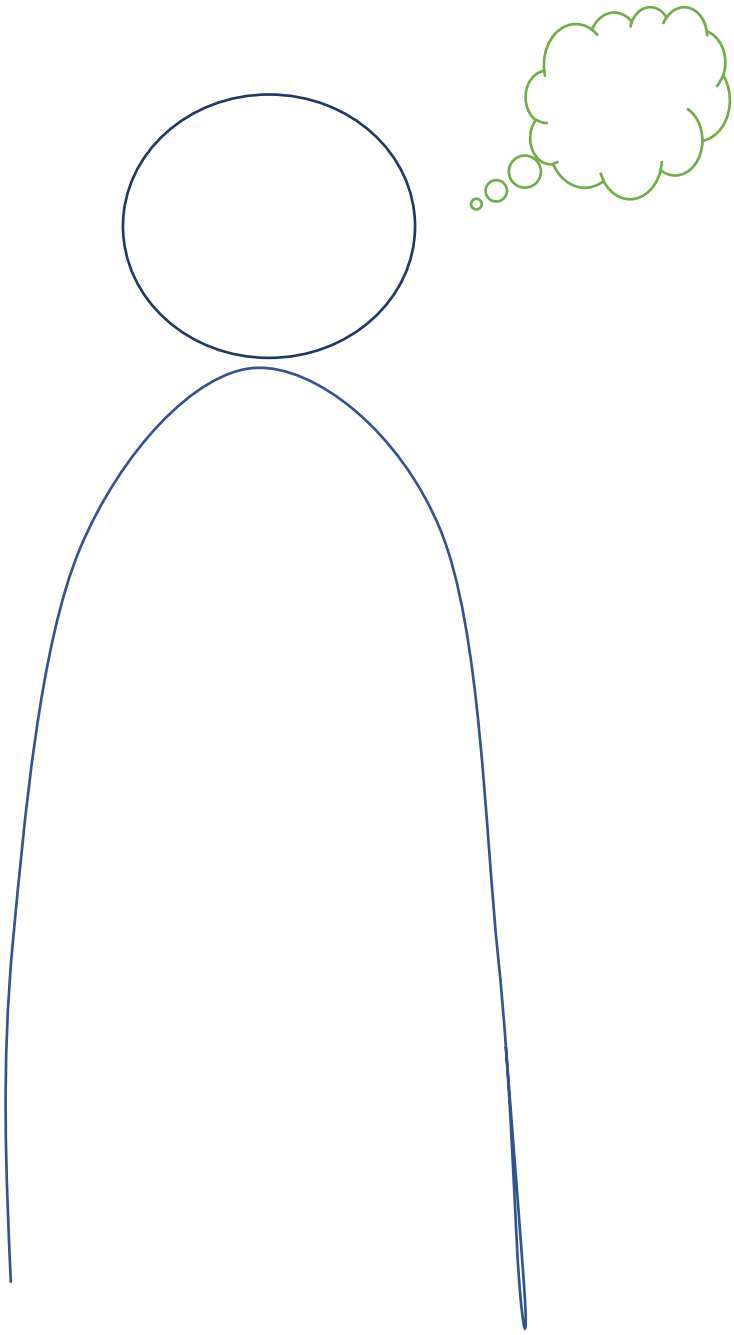
Obstacles to sustainable action

Activity title	Obstacles to sustainable action
Overview	Participants reflect about inner and outer obstacles towards acting in a sustainable way.
Objectives	• To reflect upon one´s personal connection to the topic • To realize where sustainability is systemically disabled and cannot be reached through individual (consumption-based) choices
Materials	Handouts, sticky notes in two colours, pens, or online with tools like Mural or Padlet
Time	20 - 55 minutes, according to which option is chosen
Group size	Works for all group sizes

Instructions for trainers	1. Ask the participants to reflect upon what it is that hinders them from acting in a sustainable way. They should thereby distinguish between inner or internal and outer or external obstacles. 2. Give every participant the handout (next page) and ask them to note down the inner obstacles (those within the person) and the outer obstacles (those around the person). Alternatively they can draw a person themselves. (10 - 15 min) 3. Optional: Ask participants to go together in small groups (3-4 people) and discuss what they have concluded (15 min) 4. Ask participants to note down their inner obstacles on sticky notes of one colour and outer obstacles on sticky notes of a second colour. This can be also done as a result of the small group discussion (3) together as a group. (5 min) 5. Gather and discuss the obstacles as well as the connections between the factors. Try to find general patterns. Categorise the types of obstacles. If desired, that can happen on a big poster that looks like the handout, where participants can add their own obstacles or, if identified, the general pattern behind it. (According to group size and version: 5 – 20 min)
Debriefing and evaluation	Conclusion: many of the obstacles stem from factors outside of ourselves and our control. Even if we want to act sustainably, it is very difficult to do so in many fields and impossible in other regards. If systemic factors disable us from sustainability, individual consumption choices cannot change that system. E.g. If you live in the countryside without public transportation you cannot choose a sustainable mode of transport as an individual. Sustainable and feasible infrastructure solutions would be needed. We need to establish and strengthen sustainable modes of provisioning human needs.
Tips for trainers	*Remark:* Be aware of different social positions and the potentially connected feelings (e.g. shame) related to the incapacity to act in certain ways. Ensure you explore the question: for whom is acting sustainably more easily achievable? You may also discuss the many perceived internal obstacles (such as habits, lack of motivation, lack of skills…) which have deeper roots in socialisation.

What hinders me from acting in a sustainable way?

Note down inner and outer obstacles that hinder you from acting in a sustainable manner.



Input: Exponential growth on a finite planet?

Activity title	**Input: Exponential growth on a finite planet?**
Overview	Trainer gives an input on the growth dilemma (last part of 1.3 Economic growth)
Material	Optional: PowerPoint slide with quote 'Anyone who believes exponential growth can go on forever in a finite world is either a madman or an economist.' Kenneth Boulding
Time	3-5 minutes
Instructions for trainers	Economically, we are in what Tim Jackson calls a growth dilemma. Giving up on growing our current economy means the risk of economic and social collapse. Maintaining growth brings the risk of destroying the planet and with it the basis of our existence.

Activity 4: What could a good life for all within planetary boundaries look like?

How do we envision a good life for all?

Activity title	**How do we envision a good life for all?**
Overview	Participants use the activity of freewriting to get a better understanding of how they envision a good life for all to look like.
Objectives	● To imagine and write down what a good life for all could look like
Materials	Pens, paper Optional: PowerPoint slide or print out of graphic 2 'National performance relative to a 'safe and just space''
Time	20 - 40 minutes
Group size	Works for all group sizes
Instructions for trainers	1. Hand out a pen and paper to all participants. 2. Introduce the participants to freewriting. Freewriting is a practice that helps us to liberate our writer's voice and connects us to our own creativity. It helps us to write down ideas from our unconscious. Freewriting is simple, flexible and forgiving – you can't do it incorrectly. When we freewrite, we try as much as possible to suspend judgment about what we are writing. It is an exercise in getting out of our own way. Some guidelines to achieve that are: ● Use a prompt. If you run out of ideas during writing go back to the prompt. ● Set a timer. Write until the timer rings. Finish your thought afterwards, if you want to. ● Keep your pen moving. Don´t stop writing until the time is over. ● Write quickly, a bit faster than you would write normally. As if you had a lot to note down but only a little time. ● Write a draft, not a text. Use the first word that comes into your mind. Don´t worry about how something sounds or about spelling or grammar. ● Independent of how ridiculous a thought is, go for it! See where it goes. There is no need to filter any idea. 3. Let´s together imagine that instead of plenty of social and ecological problems there could be a good life for all people. What does your vision of a good life for all look like? 4. Write the following prompt on the board: 'There it is! I can see the good life for all. It looks like…' 5. Tell the participants that they have 10 minutes for freewriting whatever comes into their mind in response to the prompt. Time them. 6. Invite participants to share their ideas for a good life for all with the group. This should be voluntary. Participants can either read out what they have written or introduce others to some core ideas.

Debriefing and evaluation	For a good life for all, we need to put the essential things into the centre of our economies. Optional: show video 'Change the Goal: Doughnut Economics': https://www.youtube.com/watch?v=Mkg2XMTWV4g Introduce the framework of a safe and just space for humanity (chapter 4). Optional: use graphic 2 on a ppt slide or print out to explain the framework.
Tips for trainers	For the debriefing of the exercise read chapter 1.4, 'What could a good life for all within planetary boundaries look like?' **Alternative A: Freewriting to questions instead of prompts:** instead of freewriting in response to one prompt you could also ask participants the following three questions, one after each other, and give them 3-5 minutes time per question for freewriting: How do I want to work? What should my relationships look like? What role should money play in my life? **Alternative B: Reflection on what constitutes a good life for oneself:** additional material: if wanted, board or flipchart and calm music for the reflection, 1. Invite participants to reflect individually about what they need for a good life. Ask them to note down some key points. Tell them how much time they have for this reflection (e.g. 10 minutes). If wanted, play calm music during the reflection. 2. Invite participants to share with the group what it is that they think constitutes a good life. If you want, take notes on a board or flipchart (5 – 25 min).

Activity 5: What does sustainability mean?

Input: 'Strategies to make our economies 'future fit'

Activity title	**Input: Participants read the handout 'Strategies to make our economies 'future fit'**
Material	Handouts
Time	10 minutes

Activity 6: Strategies to make economies 'future fit'

Different world views, different policies

Activity title	**Different world views, different policies**
Overview	Participants analyse by which strategies different climate policies are inspired.
Objectives	• To understand the basic assumptions that underpin the market-liberal strategy as well as the pragmatic and the radical strategy of a socio-ecological transformation • To understand by which understandings of sustainability and which strategies certain policies are inspired • To understand the strengths and weaknesses of different strategies
Materials	Handout 'Strategies to make economies 'future fit'' (1 per person) Printouts of Case A and B (1 per group)
Time	30 - 45 minutes
Group size	Works for all group sizes
Instructions for trainers	1. Ask participants to form small groups (3-4 people) 2. Each group can choose to either analyse case A or case B and picks the according printout with the short description 3. Instruct the participants to analyse, for each policy, which understanding of sustainability it is predicated on and which strategy (market-liberal strategy, pragmatic strategy of a socio-ecological transformation, radical strategy of a socio-ecological transformation) it is inspired by. They can use the handout as a help and conduct further research on the policies online if they wish. 4. Afterwards, ask one group that analysed case A and one group that analysed case B to introduce what they have discovered. Use the additional information (section debriefing and evaluation) to add crucial points if missing. 5. Case A) There are different approaches to **lower greenhouse gas emissions in the field of industry**. Discuss with your group which understanding of sustainability and which strategy for sustainable economics underpin those approaches: • **Emissions trading** Within emissions trading systems a cap on the amount of greenhouse gases that can be emitted is set. Companies receive or buy emissions allowances, which permit them to emit certain amounts of greenhouse gases. If a company reduces emissions it can sell allowances which it no longer needs. • **Taxing emissions** Individual governments or the European Union can tax carbon intensive activities. Instead of trading emissions, they could increase the tax on greenhouse gas emissions from industry every year in order to steadily increase the cost of emitting greenhouse gases.

	• **Setting emissions reduction targets for industries** Individual governments or the European Union can also set absolute emission reduction targets for the different industries and thereby make lowering emissions mandatory. Case B) In order to **protect climate and biodiversity** in general, different approaches are put forward. Discuss with your group which understanding of sustainability and which strategy for sustainable economics underpin those approaches: • **REDD+** The United Nations REDD+ program on 'reducing emissions from deforestation and forest degradation' in developing countries creates a financial value for the carbon stored in forests by selling emission reduction units. Those units stand for one ton of CO2 emissions which is avoided by not cutting down the forest. • **Protected areas** Around the world, 11.9% of all terrestrial land is protected area, half of which is explicitly dedicated to biodiversity protection.[21] The definition for a protected area is: 'A clearly defined geographical space, recognised, dedicated and managed, through legal or other effective means, to achieve the long-term conservation of nature with associated ecosystem services and cultural values'[22].
Debriefing and evaluation	**Feedback: Reducing greenhouse gas emissions in the field of industry** Emissions trading is rooted in the core assumption of weak sustainability that natural capital is comparable to other forms of capital and can be substituted by money. Companies which do not reduce emissions can buy themselves out by acquiring emission allowances. Hereby, for example in the EU emissions trading system (EU ETS), it is also possible to buy international credits from emission-saving projects, whereby the global north can hand over its climate protection duties to the global south. The EU ETS was the world's first major carbon market. Emission markets do not 'naturally exist'; they get created by regulation. Establishing markets where emissions are tradable means making a stable climate a tradable commodity. Market-liberals, especially neoclassical economists, support the creation of emission markets, as they see them as a means to correcting wrong price signals by including the previously externalised cost that emissions have for society into the final price. Also some pragmatic proponents of a socio-ecological transformation support emission trading schemes, arguing that they can make emission-intense production more expensive and thereby support less polluting alternatives. Radical proponents of a socio-ecological transformation are against commodifying emissions. They criticize that a stable climate should not be determined by how prices on markets evolve. In contrast to taxing emissions, where the governments earn the tax money and can reinvest it to make a transformation socially just, within emission trading systems, corporations earn by reselling permits which they mainly got allocated for free based on historical emissions and lobbying efforts.[23]

[21] Hoekstra, Boucher, Ricketts, Roberts, 2005

[22] Dudley, 2008, p.8

[23] Spash, 2010

Taxing greenhouse gas emissions can be part of all three strategies. While libertarians like Hayek would not suggest setting up such taxes, for neoclassical economists these taxes can be a means leading to 'right prices'. Proponents of both strategies of socio-ecological transformation would argue that next to making emission-intensive activities more expensive, the tax money can be used to boost green innovations (primarily in the pragmatic view) and to solve inequality issues by redistribution (primarily in the radical view). Instead of making it more expensive to pollute the environment, environmental degradation can also simply be prohibited. An example was the prohibition of CFC in refrigerators, which until then harmed the ozone layer. Prohibiting unsustainably high greenhouse gas emissions is not seen as an option by market-liberals, as this would interfere with the free market.

Proponents of a socio-ecological transformation, on the other hand, regard regulatory interventions as necessary to sustain a stable climate and thereby protect the environment and society in which the economy is embedded. While the concept of weak sustainability favours market instruments and correcting prices, the concept of strong sustainability in many cases calls for strict regulatory intervention in order to protect irreplaceable ecosystems, reflecting the principle of incommensurability.

Feedback climate and biodiversity:

REDD+ builds on the concept of weak sustainability, since it explicitly assumes that nature can be attributed an objective and quantifiable value. Through the price mechanism in the REDD+ scheme, healthy and intact forests compete with other, destructive land uses[24]. This implies that for the mechanism to effectively protect forests, these forests must be valued with a higher price than the potentially different utilizations. As the assessment is subject to larger macroeconomic influences and trends on capital markets, the valuation mechanism might fail when economic conditions change. Proponents of strong sustainability criticize that the average time horizon of REDD+ projects are 20 years, whereas carbon emissions from burning fossil fuels stay in the atmosphere for several thousand years[25].

What's more, within REDD+ programs primary forests can be cut down and substituted by industrial tree plantations.[26] In the concept of weak sustainability, this isn´t a problem as long as the value (in this case for storing carbon) stays the same. In the concept of strong sustainability, complex ecosystems should not be replaced by industrial tree plantations: even though the carbon storing capacity might stay the same, biodiversity and the ecosystem itself would be lost.

Market-liberals welcome programs like REDD+ as they regard market solutions to be the most efficient. As do many pragmatic proponents of a socio-ecological transformation, as cheap options to 'reduce' emissions. However, radical proponents of a socio-ecological transformation criticize REDD+ programs, as they allow countries in the global north and 'their' companies to pay for the 'right to pollute' and thereby maintain their current level of production and pollution, instead of actually meeting emission reduction

[24] The REDD desk, 2016

[25] Phelps et al., 2011

[26] Cabello, Gilbertson, 2012

	targets.[27] Commodifying the storage of emissions allows them to consume more energy from fossil fuels without actually increasing the carbon sequestration, as forests are not even replanted, but only not cut down. Furthermore, they criticize REDD+ as a colonial mechanism that encloses land and forces Indigenous Peoples and forest-dwellers to give up control over their land, resources and traditions.[28] Strong sustainability calls for protecting areas. In the understanding of strong sustainability certain ecosystems are irreplaceable and therefore have to be maintained, e.g. through prohibiting that forest can be logged. This can be understood as applying the precautionary principle of avoiding the risk of irreversible, dangerous damage. Market-liberals would be against prohibiting economic activities like logging in general, as they see it as more efficient to let price signals dictate what should happen. The only regulatory interventions they suggest creating and securing are a property regime and markets. Both pragmatic and radical proponents of a socio-ecological transformation would support establishing protected areas in which certain economic activities are prohibited.

[27] Cabello, Gilbertson, 2012

[28] Cabello, Gilbertson, 2012

4. Interactive learning

Activity 1: Climate Crisis Quiz

Activity title	**Climate Crisis Quiz**
Objectives	• To gain an insight into some of the core issues of the climate crisis
Time	15 minutes
Quiz questions	Round 1 1. Which percentage of the global primary energy supply comes from fossil fuels? A) Around 30% B) Around 55% C) Around 80% 2. True or false? Climate change is a linear process that is currently becoming faster and faster. 3. True or false? Deforestation and habitat destruction can cause the outbreak of new diseases. 4. True or false? Since the beginning of the 20th century, around 20 percent of the species on earth have become extinct. 5. A half degree difference: How much greater is the loss of insects forecasted to be if the average rise in temperature is 2 degrees instead of 1.5 degrees? A) Twice as big B) Three times as big C) Five times the size Round 2 1. True or false? While the poorest half of the world's population emit only about 10% of total global emissions, the richest 10% are responsible for around 50%. 2. True or false? The 100 companies and organizations responsible for the highest emissions have been the source of more than 80% of the world's greenhouse gas emissions emitted since 1988. 3. True or false? Already today, more people lose their means of existence due to extreme weather events than due to violence and war. 4. True or false? Worldwide, air, water and soil pollutants cause nine million deaths, three times as many as AIDS, tuberculosis and malaria combined. 5. True or false? In 2016 air pollution caused nearly 30,000 premature deaths in Europe.
Correct answers and debriefing	Answers Round 1: 1. **C.** Of the total primary energy supply 28% comes from coal, 22% from gas and 32% from oil.[29] 2. **False.** The climate crisis is even more dangerous, as temperatures do not simply rise linearly. If so-called tipping points are exceeded, entire subsystems of the global climate system can collapse. 3. **True.** Many newly emerging pathogens are of animal origin. Habitat destruction brings wildlife closer to human settlements which can lead to the outbreak of diseases. For example, Ebola (whose origin was in a species of bat) is more common after large scale deforestation, and also mosquito-borne diseases are more common in deforested areas.[30]

[29] IEA

[30] Shah, 2020

	4. **True**. Particularly industrial agriculture contributes to the extinction of species to an unprecedented extent through deforestation and the use of pesticides and machinery. 5. **B.** Due to global warming of 1.5 degrees since the pre-industrial time it is forecasted that 6% of insects lose at least half their species range. For a global warming of 2 degrees, a loss of 18% of the insects is forecast, which equates to three times as big a species loss.[31] Answers Round 2: 1. **True**. 2. **False.** The 100 companies and organizations responsible for the highest emissions have been the source of 71% of the world's greenhouse gas emissions emitted since 1988.[32] 3. **True**. Furthermore, if the climate goals of the Paris Agreement are not met, large parts of the earth will become uninhabitable for humans before the end of this century. 4. **True.** 5. **False.** In 2016 air pollution led to nearly 500,000 premature deaths in Europe.[33]

[31] IPCC, 2018

[32] Griffin, 2017

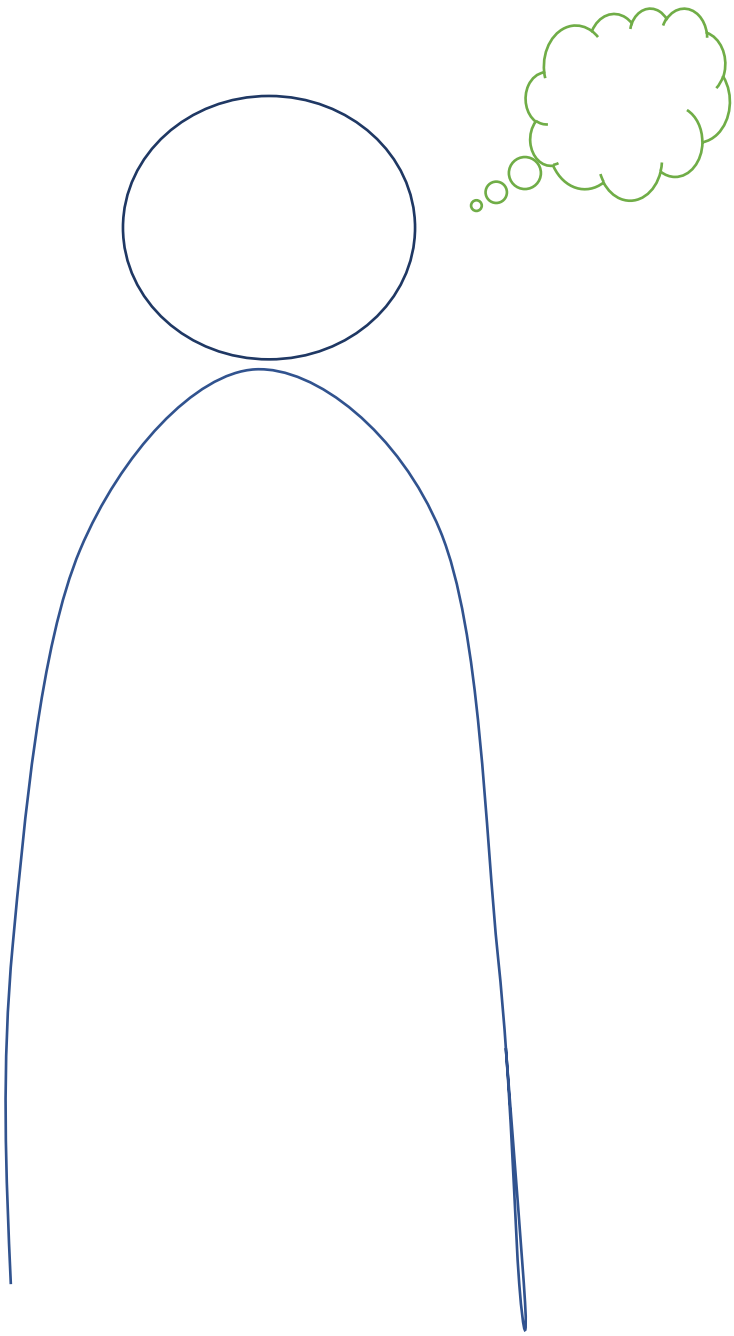
[33] European Environment Agency, 2019

Activity 2: Obstacles to sustainable action

Activity title	**Obstacles to sustainable action**
Objectives	● To reflect upon one´s personal obstacles for living sustainably ● To realize where sustainability is systemically disabled and cannot be reached through individual (consumption-based) choices
Time	20 minutes
Instructions	1. Reflect upon what it is that hinders you from acting in a sustainable way, distinguishing between inner or internal and outer or external obstacles. 2. In the diagram below, note down the inner obstacles (within the person) and the outer obstacles (around the person).
Debriefing and evaluation	Many of the obstacles stem from factors outside of ourselves and our control. Even if we want to act sustainably, it is very difficult to do so in many fields and impossible in other regards. If systemic factors disable us from sustainability, individual consumption choices cannot change that system. For example, if you live in the countryside without public transportation, you cannot choose a sustainable mode of transport as an individual. Sustainable and feasible infrastructure solutions would be needed. We need to establish and strengthen sustainable modes of provisioning human needs.

What hinders me from acting in a sustainable way?

Note down the inner and outer obstacles that hinder you from acting in a sustainable manner.



Activity 3: How do we envision a good life for all?

Activity title	**How do we envision a good life for all?**
Objectives	• To imagine and write down what a good life for all could look like using the method of freewriting
Time	15 minutes
Instructions	1. Freewriting is a practice that helps us to liberate our writer's voice and connects us to our own creativity. Therefore it helps us to write down ideas from our unconscious mind. Freewriting is simple, flexible and forgiving – you can't do it incorrectly. When we freewrite, we try as much as possible to suspend judgment about what we are writing. It is an exercise in 'getting out of our own way'. Some guidelines to achieve that are: • Use a prompt. If you run out of ideas during writing go back to the prompt. • Set a timer. Write until the timer rings. Finish your thoughts afterwards, if you want to. • Keep your pen moving. Don´t stop writing until the time is over. • Write quickly, a bit faster than you would write normally. As if you had a lot to note down but only a little time. • Write a draft, not a text. Use the first word that comes into your mind. Don´t worry about how something sounds, or about spelling or grammar. • Independent of how ridiculous a thought is, go for it! See where it goes. There is no need to filter any idea. 2. Let's imagine that instead of the current situation replete with social and ecological problems, there could be a good life for all people. What does your vision of a good life for all look like? 3. Take 10 minutes for freewriting whatever comes into your mind in response to the prompt: 'There it is! I can see the good life for all. It looks like…' 4. If you want, you may share your ideas for a good life for all in the forum. **Alternative: Freewriting to questions instead of prompts.** Instead of freewriting in response to a prompt you could answer the following three questions, one after each other, and take 3-5 minutes time per question for freewriting: How do I want to work? What should my relationships look like? What role should money play in my life?
Debriefing and evaluation	For a good life for all, we need to put the essential things into the centre of our economies. If you want to, watch the video 'Change the Goal: Doughnut Economics': https://www.youtube.com/watch?v=Mkg2XMTWV4g

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FRESH-UP ECONOMICS

Economic growth and sustainable development

by Aija Kosk

Key words: Economic growth, economic development, limits to growth, linear economy, circular economy, decoupling, sustainable development, sustainable development goals.

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1. Overview

All countries are monitoring their economies very carefully. In the market economy system, the economy is expected to grow steadily. Despite expectations, according to the World Bank, the slowdown in economic growth started in the 1960s.[1] Based on this information the members of the Club of Rome began to doubt whether endless economic growth is possible at all. In the early 1970s, researchers at the Massachusetts Institute of Technology, commissioned by the Club of Rome, developed a model of economic growth that looked at changes in the five determinants of economic growth (population, agricultural output, natural resources, industrial output and pollution), analysing past global developments and projecting changes up to 2100. The analysis concluded that the use of the above listed resources has increased exponentially throughout human history. The number of people, the area of arable land, the amount of minerals extracted and also the economy as a whole, cannot grow indefinitely on a finite planet Earth.[2] A report published in 2012 to mark the 40th anniversary of this study confirmed that the world economy has so far followed the projected growth trend in all aspects.[3] These studies showed clearly that the linear economic model, used for centuries, is unsustainable, and economic growth must decouple from the use of natural resources. But what could the new economic model look like?

From the second half of the 1980s, the United Nations (UN) started to present the idea of harmonious economic, environmental, and social development or sustainable development. Sustainable development is defined as balanced development that meets the needs and aspirations of the present generation without compromising the analogical interests of future generations. This concept, presented at the 1992 Rio de Janeiro Conference on Environment and Development, drew worldwide attention and 193 countries approved it.[4] Sustainable development has been seen as a process that decouples economic growth from the use of natural resources and aims at economic well-being and quality of life of a nation, region, local community, or individual. This process also provides an answer to the question: what could the new economic model look like?

In 2015, the 193 countries of the UN's General Assembly adopted the Agenda 2030 that consists of 17 Sustainable Development Goals (SDGs). The 2030 Agenda is a holistic plan for action on all fronts – social, economic and environmental. The universal nature of the Sustainable Development Goals (SDGs) calls for a profound transition in the way we look at – and work for – development: from a focus mainly on the needs of poor countries, to one that emphasises well-being and sustainability in all countries. Putting the world on a sustainable and resilient development path requires bold and transformative steps underpinned by new tools, new data, and new ways of working and new resources." [5]

The aim of this training material is to draw students' attention to the fact that a classic market economy based on the idea of continuous economic growth is unlikely to bring us closer to the goal

[1] Oja, K. (2017)

[2] Meadows, D.H., Meadows, D.L., Randers, J., Behrens, W. W. III (1972)

[3] Randers, J. (2012)

[4] The World Commission on Environment and Development (1987)

[5] Ibid

of increasing the well-being of society. This material introduces the idea of economic growth and explains the factors that drive economic growth; it reviews a report where scientists conclude that on a finite planet Earth unlimited economic growth is impossible; it gives an overview of the concept of economic development and sustainable development; it also gives an overview of Agenda 2030 and SDGs. UN member states approved the SDGs in 2015, which means that actions to achieve these goals have already been taking place for the past 7 years. During this training, we are looking for evidence that our country is working to achieve the goals of sustainable development.

2. Background information

Introduction

Director of the research publication '*Our World in Data*' Max Roser (2021) has explained in his article that with the advance of economic growth, a history of global poverty reduction has begun. In his opinion, the last two centuries have been the first in the history of mankind, when societies have achieved sustainable economic growth and the reduction of global poverty has been one of the most important achievements in history. Nevertheless, 62% of the world's population lives on less than $10 a day and 86% on less than $30 a day. From the facts above, it can be concluded that continued economic growth is a way to reduce poverty.[6] The United Nations Department of Economics and Social Affairs explains that worldwide consumption and production (a driving force of the global economy) rest on the use of the natural environment and resources in a way that continues to have destructive impacts on the planet. Economic and social progress over the last century has been accompanied by environmental degradation that is endangering the systems on which our survival depends.[7]

Is it possible to enjoy both economic growth and environmental sustainability? One of the main objectives of the OECD Environmental Strategy for the First Decade of the 21st Century, adopted by OECD Environment Ministers in 2001, is decoupling environmental pressures from economic growth. Decoupling can be defined as reducing the amount of resources used to generate economic growth while decreasing environmental deterioration and ecological scarcity. In 2014, United Nations Environmental Program (UNEP) carried out a study on technological possibilities and opportunities to accelerate decoupling and reap the environmental and economic benefits of increased resource productivity. The study concluded that it is not possible for a global economy based on the current unsustainable patterns of resource use to continue into the future. Results are already visible in three areas: increases in resource prices, increased price volatility, and disruption of environmental systems. The environmental impacts of resource use are leading to potentially irreversible changes to the world's ecosystems that have direct effects on people and the economy (for example health damages, water shortages, loss of fish stocks, increased storm damage). But there are alternatives to these scary patterns. Many decoupling technologies and techniques that deliver resource productivity increases are already available.[8]

This report showed also that much of the policy design "know-how" needed to achieve decoupling is present in terms of legislation, incentive systems, and institutional reform. Many countries have tried these out with tangible results, encouraging others to study and where appropriate replicate and scale up such practices and successes.[9]

Under the auspices of the United Nations (UN), the sustainable development plan Agenda 2030 has developed. Agenda 2030 includes 17 Sustainable Development Goals (SDGs) including 169 targets for the development of the global economy and society in balance with the environment. The ultimate

[6] Roser, M. (2021)

[7] United Nation (2021)

[8] UNEP (2014)

[9] Ibid

goal of this development plan is to end poverty, protect the planet, and ensure well-being for all. Achieving these goals includes, but is not limited to, decoupling, the transition from a linear economy to a circular economy, and much more that is not sensitive to measure by economic growth indicators.

The aim of this training material is to draw students' attention to the fact that a classic market economy based on the idea of continuous economic growth, is unlikely to bring us closer to the goal of increasing the well-being of society. This material introduces the idea of economic growth and explains the factors that drive economic growth; it reviews the study report where scientists conclude that on a finite planet Earth unlimited economic growth is impossible; it consists overview of the concept of economic development and sustainable development; it also gives overview of Agenda 2030 and SDGs. In 2015, UN member states approved the SDGs, which means that actions to achieve these goals have already been taking place for the past 7 years. During this training, we are looking for evidence that our country is working to achieve the goals of sustainable development.

Economic growth and economic development

Economic growth is one of the most important issues for entrepreneurs, households, and politicians. Economic growth is defined as the increase or improvement in the inflation-adjusted market value of the goods and services produced by an economy over time. This growth creates more profit for businesses and gives companies capital to invest and hire more employees. More jobs create incomes. If consumers have more money they buy additional products and services and these purchases drive higher growth. Better access to economic goods and services means improvement of material standard of living. Politicians watch economic growth to discover what stage of the business cycle the economy is in. The best phase is when the economy is growing steadily. If growth is too far beyond the steady growth level the situation is called the overheating of the economy. This is what happened to the housing sector in 2005-2006 for example. If there is too much money and too few goods and services on the market, the situation is called inflation. At some point, confidence in economic growth dissipates, people prefer to sell rather than buy and the economy "cools down". When that phase continues long enough, it becomes a recession. One of the longest economic recessions occurred in 1929 and is called the Great Depression.[10]

The most widely used indicator to measure economic growth is gross domestic product (GDP). Gross domestic product is the total value of final goods produced in a given territory during the year. It includes all goods and services that businesses in the country produce for sale. It doesn't matter whether they are sold domestically or overseas. Most countries measure economic growth as the percent rate of increase in real GDP. As the economy actually grows only if its growth rate exceeds the population growth rate, the country's population is also taken into account when assessing economic growth. GDP per capita makes it possible to compare economic growth not only over time but across countries too. [11]

[10] The balance (2021)

[11] The balance (2021)

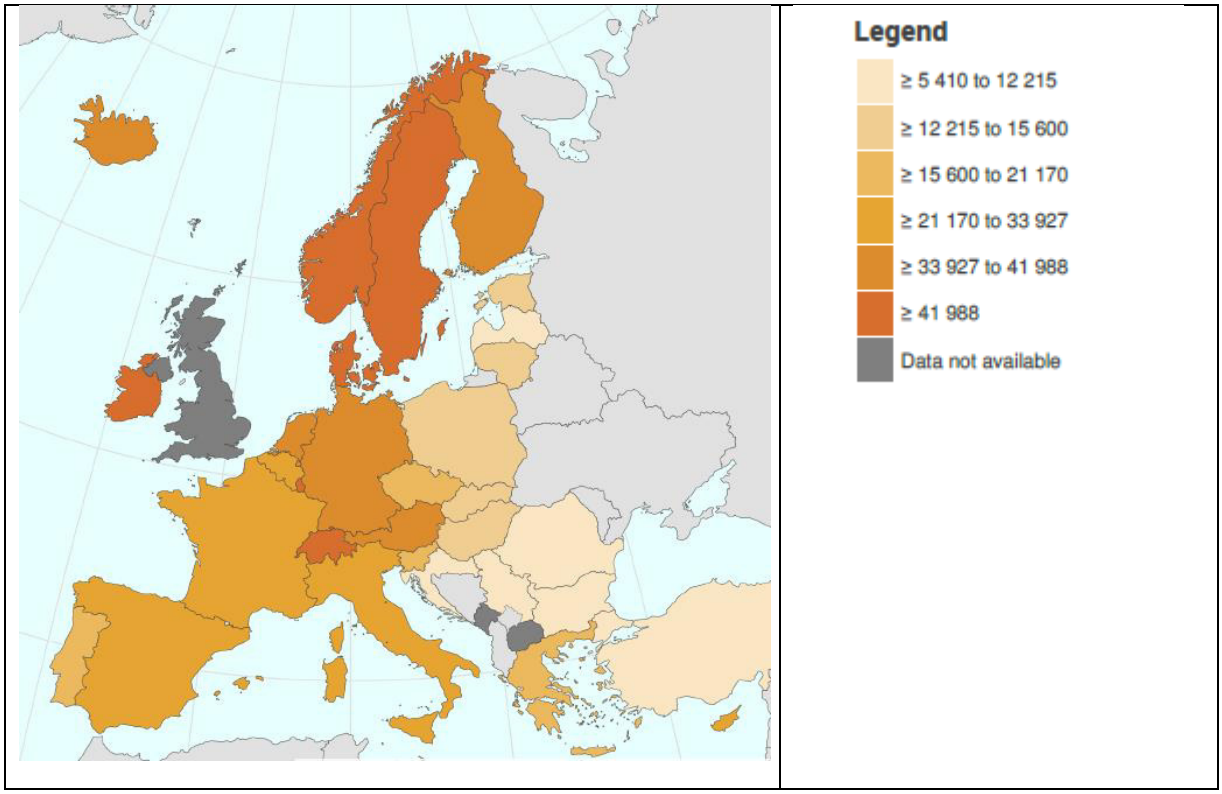

Figure 1. Gross domestic product of the European Union member states per capita in 2021.[12]

GDP is a proper indicator to measure economic growth as it takes into account the country's entire economic output. Figure 1 shows the GDP per capita of the EU Member States in spring 2021. The indicator in the figure is calculated as the ratio of real GDP to the average population of a given year and includes economic goods and services as well as products produced in a governing sector and non-profit institutions. [13]

The factors of production on which a country's economic growth depends are land, labour, capital and entrepreneurship.

The 'land' also includes other natural resources. Natural resources are parts of the natural environment that human society needs to exist and use in production. Examples of natural resources are rocks, minerals, liquids, gases and organic matter worth extracting. Natural resources are also water (especially groundwater), as well as natural forests, marine fish, game, in other words anything that is not created or made by man but is used in economic activities. Managed forests, domestic animals, cultivated land and other things that grow and develop under human care are not natural resources. They are the result of human activities. Natural resources may be renewable and non-renewable.

[12] Ibid

[13] EuroStat. (2021)

The 'labour force', i.e. the economically active population, is people who are willing and able to work, regardless of whether they have found a job or not.

The term 'capital' refers to things people use to create benefits in demand in the market. Tangible capital includes land, natural resources, buildings, animals and machinery. Examples of intangible capital are patents, copyrights and trademarks. Cash and cash equivalents are banknotes and liquid bonds in circulation in different countries. Capital is productive if it is used in business to generate income and profits, and it is non-productive if it is used in the public interest. Classical economic theory deals with capital only in physical objects, such as equipment, buildings and vehicles used in production. Some other economists have expanded the concept of capital and they observe investing in the skills and education of employees as building human capital.[14]

Entrepreneurship is the fourth factor that involves the visionaries and innovators behind the entire production process. Entrepreneurs combine all the factors of production described above to design, develop and produce the concept of their product or service.

The above listed production inputs are limited. By combining these limited resources, people have to make choices about what to produce, what factors of production to use, and how to distribute the goods produced. At the same time, production should be organised in such a way that GDP is constantly growing.[15]

GDP and GDP per capita are very good indicators to measure the material affluence of a country but they do not say anything about the distribution of this wealth in the country. Rapid economic growth does not mean that an increase in wealth will improve the overall standard of living of the population. GDP does not include unpaid services like child care or other domestic work, volunteer work, illegal black-market activities as well as some environmental costs. It does not provide information on whether the daily needs of the population are met, does not show anything on the promotion of health, education, living conditions, natural environment, etc. GDP does not measure the satisfaction of needs or well-being of the population. [16]

A process aimed at the economic well-being and quality of life of a nation, region, local community, or individual that is run by the public sector is called economic development. Whereas economic development is a policy intervention aiming to improve the well-being of people, economic growth is a phenomenon of market productivity and increases in GDP is described as "one aspect of the process of economic development". When economists primarily focus on the growth aspect and the economy at large, leaders of community economic development concern themselves with socioeconomic development as well. In general discourse about economic development it is generally believed that this means creating jobs, increasing the wealth of both the individual and society, improving the quality of human life, but besides the above-mentioned aspects, economic development leads to

[14] Ibid
[15] Kerem, 2004
[16] Dang (2015)

economic restructuring as well as social and cultural changes, which can be difficult for society without a state-supported socio-economic environment. [17]

In 1934, J. Schumpeter emphasised the importance of non-economic, cultural and social factors as influencers of entrepreneurship. In the case of economic development, economic growth is achieved mainly through indirect factors (such as economic freedom, increasing the value of human capital, i.e. the development of knowledge, social capital and its development, etc.). Schumpeter points out that though the driving force of economic development is the innovative activity of the undertaking, which stems from its private interest and leads to economic development, the importance of the public sector as the creator of a favourable business environment cannot be underestimated. [18]

In 1956, R. Solow explained that economic growth should not be based on the intensive use of natural resources but on an increase in capital, labour, and technological development. A change in capital and / or labour leads to a change in technology or productivity and ultimately to a change in the volume or quality of production. This is called a neoclassical model of growth. This model is a further development of the classical model, with an emphasis on the supply side of economic activity and it ignores almost all the Keynesian details of aggregate demand.[19]

P.M. Romer (1986) studied knowledge as a form of capital, concluding that the long-term development of technology results from the accumulation of knowledge by profit-maximising and prudent economic agents. [20] As claimed by the new growth theory, the economy grows due to the development of knowledge, rather than as a result of increasing labour and capital. If you increase classical production inputs but reduce investment in human capital, infrastructure and research and development, the output cannot grow. [21]

Knowledge has also been seen as a positive externality. All individuals are ready to invest in knowledge only as much as is needed for personal gain. To achieve optimal social well-being, the state has to make additional investments in the acquisition of knowledge and develop policies that would bring knowledge-based entrepreneurship to the state.[22]

R. A. Solo (1968) regarded economic development as the improvement of the economic well-being of a community in producing higher-value goods using the same resources as before. It means the increased capacity of society to provide its members with higher real incomes resulting from raised resource productivity and employment rates or in other words, an increase in material well-being of people through an improvement in their cultural and social quality. Well-being and cultural quality of

[17] Economic Development ... (2014)
[18] Schumpeter, J. (1934)
[19] Solow, R. M. (1956)
[20] Romer, P.M. (1986)
[21] Cornwall, Cornwall 1994, cited in Dang, Pheng (2015)
[22] Dang, Pheng (2015)

individuals are the result of average income, income distribution, consumption patterns and relationships between individuals.[23]

All authors mentioned above have noted that the public sector has an important role in economic development - they are a creator of a favourable economic and social environment for development. Economic development is linked to the following government policies[24]:

1. Policies that achieve certain economic goals (such as sustainable growth, low unemployment and inflation, etc.);
2. Policies designed to provide public services (e.g. access to education, construction of the road network, access to medical care, etc.);
3. Policies aimed at improving the business environment (including tax policy, access to education and its content, family policy, etc.).

'Limits to Growth' and decoupling

At the beginning of the 1970s, researchers at the Massachusetts Institute of Technology used a global development model to study how five key factors – population, agricultural production, natural resources, industrial production, and pollution – shape and constrain human existence. Past global developments were analysed and changes up to 2100 were forecast.

In the course of modelling, it was inferred that throughout the history of humankind, the usage of the above-mentioned resources has grown exponentially. On a planet Earth of limited size, the number of people, the area of cultivated land, and the amount of minerals to be mined cannot grow indefinitely. Known stocks of many major mineral resources will continue at the current rate of consumption growth for a few decades to a hundred years. Pollution is escalating at the same pace as production and consumption, thus affecting the possibility of a viable environment. [25]

Assuming that human society continues to grow exponentially in the 21st century, the change in eight parameters was calculated up to 2100. These eight parameters include population, industrial production per capita, food production per capita, level of pollution compared to 1970, number of births per 1000 inhabitants, number of deaths per 1000 inhabitants, number of services per inhabitant per year. This analysis demonstrated that the depletion of resources and the increase in pollution will replace the current development by regression. All eight parameters under consideration will reach their maximum value, some earlier, some later in the first half of the 21st century, and then begin to decline. The authors called this scenario the standard model of development.[26]

Forecasting the development of technology and analysing development scenarios based on future technologies, it became evident that technological development can postpone, but not avoid, critical

[23]Solo, R. A. (1968)
[24]Economic Development ... (2014)
[25] Meadows, D.H., Meadows, D.L., Randers, J., Behrens, W. W. III (1972)
[26] Ibid

moments of development. The study illustrates that the stable continuation of humanity is realisable, however, humanity must drastically change its current way of life.[27]

In 2004, the same authors published the book 'Limits to Growth – 30 Years Later', which inferred that for thirty years human development has largely followed the standard scenario. [28] Ahead of the 40th anniversary of the study report, one of its authors published the report '2052. A Global Development Forecast for the Next Forty Years'. The report presents important indicators of the functioning of society during the forty years since the publication of 'The Limits to Growth' and forecasts the behaviour of humanity over the next forty years. This book addresses, among other things, anthropogenic climate change and corresponding challenges. It has been pointed out that in the second half of the last century, humanity exceeded the limits of sustainable environmental use, and today the ecological footprint reaches approx. 1.4-1.5. This means that humanity exceeds the use of Earth's renewable resources by up to 1.5 times. [29]

Over the years, besides these three reports have been published a number of studies and analyses which shows that economic growth as it has been treated for centuries is unsustainable. The ecological sustainability crisis and its consequences – the climate crisis, biodiversity loss, and diminishing natural resources – cannot be resolved without addressing the linear economic model and overconsumption. The linear economic model (see figure 2) means that more and more natural resources are continually included in the economy. When natural resources have been used for some time, they are removed from the economy as waste and pollution.

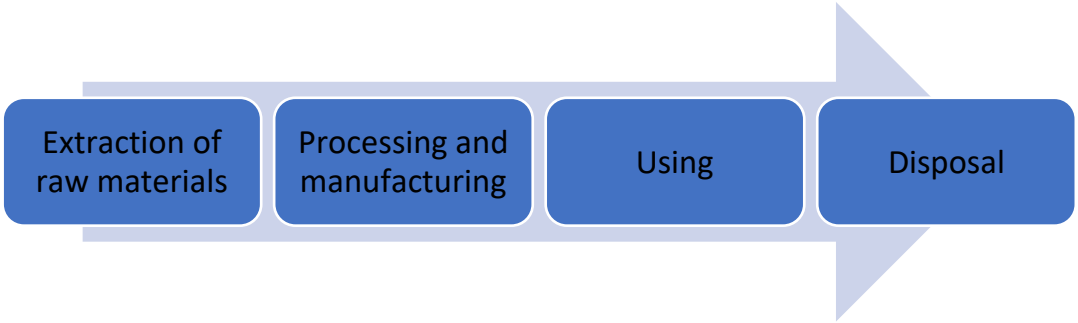

Figure 2. Linear economic model.

A linear economic model cannot guarantee the well-being of humankind and the environment and does not meet the long-term needs of modern society. The earth's natural resources are limited, which makes it important for the environment and economic development to find a sustainable way to use them.[30]

[27] Ibid
[28] Meadows, D., Randers, J., Meadows, D. (2004)
[29] Randers J. (2012)
[30] European Parliament (2021)

Globally, the use of natural resources has more than tripled in 50 years, and the OECD estimates that it will almost double from the current level by 2060 unless we change our production and consumption habits. [31]

In the context of the transformation of the linear economy, the most common ideas are decoupling economic growth from natural resources, and the circular economy. The term 'decoupling' refers to breaking the link between "use of natural resources" and "economic growth." Decoupling occurs when the growth rate of an environmental pressure is less than that of its economic driving force (e.g. GDP) over a given period. Decoupling can be either absolute or relative. Absolute decoupling is said to occur when the environmentally relevant variable is stable or decreasing while the economic driving force is growing and relative when the growth rate of the environmentally relevant variable is positive, but less than the growth rate of the economic variable.[32]

Direct practical action for decoupling is to implement the circulation of materials (see figure 3). The transition to a more resource-efficient circular economy offers a suitable solution, which in turn requires systemic changes in policy decisions as well as in the attitudes and behaviour of businesses, consumers and society. The aim of the circular economy is to decouple economic growth from the use of primary raw materials by creating a circular production and consumption system with the least possible losses. Resources need to be managed efficiently throughout their life cycle, from production and consumption to waste management and recovery, creating more value from existing resources while generating less waste. In addition to reducing the environmental impact, by effectively applying the principle of the circular economy, companies can reduce costs, increase their growth potential and promote their reputation. That is why it is important for the competitiveness and sustainable growth of a highly resource-efficient circular economy, focusing on existing materials and products: re-use, improvement, and recycling.[33]

[31] Pajunen (2021)
[32] Ruffing (2022)
[33] European Parliament (2021)

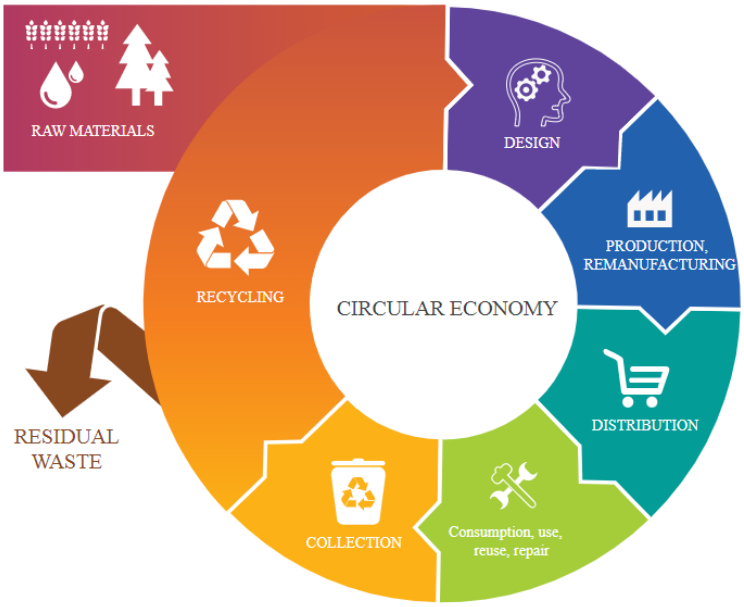

Figure 3. Circular economy [34]

The transition to a circular economy requires changes throughout the product value chain, from product design to new business models and consumption patterns. For new and existing products, the main focus is on life-cycle design, focusing on sustainable material selection, quality (long product life, room for improvement), supply chain optimization and reuse and reuse (universality, component separation). In addition to smart designs, eco-innovation and technological development play an important role in supporting the reorientation of economic development. For the circular economy to reach its full potential, systemic thinking and changes in the whole socio-economic system are needed to bring about real change in consumption, production, planning, politics, lifestyles, culture and values. [35]

The circular economy is a cross-sectoral principle, which is why cooperation between companies and international agreements are important, creating significant opportunities for the creation of new markets and partnerships. Successful cooperation between companies is well characterised by industrial symbiosis, the aim of which is to achieve a closed production cycle, where the waste, residual heat or other by-products of one company are used by another company. [36]

Major changes are also needed in the way products and services are consumed. The daily choices of millions of consumers have a significant impact on the environment. Raising awareness and creating demand for sustainable products will contribute to the development of a green economy.

[34] Ibid
[35] Ibid
[36] Ibid

The role of the state in the transition to a circular economy is to pursue the goals of development at all levels and to create favourable conditions for the implementation of the principles of the circular economy and to remove obstacles.

Sustainable development

In 1987, the UN Committee on the Environment and Development issued a report on the future of humanity. This report described the concept of sustainable development for the first time. Sustainable development is defined as balanced development that meets the needs and aspirations of the present generation without compromising the analogical interests of future generations. The concept, which drew worldwide attention, was presented at the 1992 Rio de Janeiro Conference on Environment and Development and 193 countries approved this idea of economic development.[37]

Sustainable development of society is a human-centred, or purposefully targeted development that ensures social justice and the improvement of people's quality of life in line with the nature of natural resources and the tolerability of ecosystems. On this basis, the concept of strong and weak sustainability has been proposed (see figure 4).

If problems are remedied based on technological replacement of the resources and services that nature provides then it is considered as weak sustainability. Weak sustainability is based on the idea that manufactured capital can take the place of natural capital. Weak sustainability is supported by the idea that as long as natural capital is manufactured into something with the equivalent capital value, it can be used without constraint. This view on sustainability does not take into consideration that some services cannot be replaced, e.g. what do we do when there is no more ozone layer?[38]

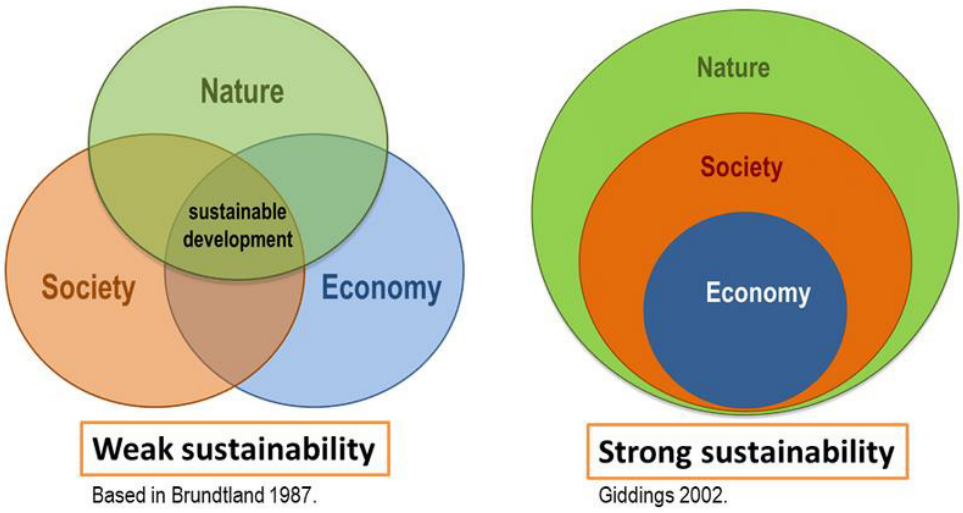

Figure 4. Weak and strong sustainability [39]

[37] The World Commission on Environment and Development (1987)
[38] Ecosystems United (2022)
[39] Ahuerma, I. M (2021)

Strong sustainability is an approach to sustainability that contends that existing natural capital cannot be duplicated or replaced. As such, it should be protected, maintained and enhanced in order to continue receiving the benefits of natural capital. Moreover, social elements need to be accounted for when aiming for sustainable development.

Strong sustainability is rooted in following principles[40]:

- The scale of human activities should be constrained by the actual carrying capacity of the planet.
- Technological development should focus on improving the efficiency of resource use.
- Renewable natural capital should be sustainably managed by harvesting at rates not higher than regeneration rates and keeping waste production to levels that do not exceed the renewable assimilative capacity of the environment.
- Non-renewable natural resources should not be exploited faster than the rate of creation for renewable substitutes.

The standard of living of Western civilization has risen exponentially in recent decades, but the model of a consumer society that has fostered it has exacerbated inequalities in other countries and communities and caused damage to nature around the world. In order to change the situation on September 25, 2015, the 193 countries of the UN's General Assembly adopted Agenda 2030 which consists of 17 Sustainable Development Goals (SDGs). For each goal 8 to 12 specific targets are proposed along with indicators used to measure progress toward reaching the targets. The year by which the targets are meant to be achieved is between 2020 and 2030 but for some of the targets, no end date is given.[41]

This comprehensive set of goals aims to end poverty, protect the planet, and ensure prosperity for all. The SDGs place in stark light some of the seemingly intractable challenges facing the world including education, health, poverty, climate change and the gender divide. The pictograms in figure 5 show the areas of sustainable development and goals to reach.

[40] Ibid

[41] Seventeen Goals Magazin (2021)

Figure 5. Areas and goals of sustainable development until 2030.[42]

The UN Sustainable Development Goals (SDGs) for 2030 are follows[43]:

1. Eliminate poverty everywhere in any form.
2. Eliminate hunger, achieve food adequacy and better nutrition, and support sustainable agriculture.
3. Ensure good health and well-being for all age groups.
4. Ensure inclusive and fair quality education and lifelong learning opportunities for all.
5. Achieve gender equality and increase the empowerment of women and girls.
6. Ensure drinking water, sanitation and sustainable management of water resources for all.
7. Ensure affordable, reliable, sustainable and state-of-the-art energy for all.
8. Support sustainable, inclusive and sustainable economic development and ensure decent work for all.
9. Build resilient infrastructure, support inclusive and sustainable industrialisation and innovation.
10. Reduce inequality both within and between countries.
11. Make cities and settlements inclusive, safe, resilient and sustainable.
12. Ensure sustainable consumption and production.
13. Urgently implement measures to combat climate change and its effects.
14. Protect and make the use of oceans, seas and marine living resources sustainable in order to achieve sustainable development.
15. Protect and restore terrestrial ecosystems and promote their sustainable use; manage forests sustainably, combat desertification, halt and reverse soil degradation and biodiversity loss.
16. Support peaceful and inclusive societies to achieve sustainable development; provide justice for all and create effective, responsible and inclusive institutions at all levels.
17. Strengthen the methods for implementing the action plan and revitalise the Global Partnership for Sustainable Development.

[42] Introduction to…. 2021

[43] Seventeen Goals Magazin (2021)

The overarching goal of the Global Agenda for Sustainable Development is to eradicate poverty everywhere and to ensure a dignified and good quality of life for all, while respecting the capabilities of the natural environment. The objectives of the action plan focus on improving the economic, social and environmental situation. The goals apply to all countries and require input from governments, the non-governmental sector and the economic sector.

No reasonable person will find any of the SDGs to be inherently objectionable. In our modern, interconnected and global society, we should care about redressing all manner of issues plaguing economic growth and not placing continual human progress at risk.[44]

Criticism of sustainable development idea and goals

Critics of Agenda 2030 have called it a 'bubble' with a beautiful vision that no country will take real steps towards, but its proponents have recognised that these are sketches showing the necessary direction, not a direct route to solving global problems *par excellence*. The stated objectives provide a structural background for a wide range of social initiatives and businesses with a social nerve. Besides, they offer a motivational slogan that forces countries to take responsibility for sustainable development and show results. It is a memorable frame that helps catch the attention of citizens.[45]

Lerch (2010)[46] and Hopkins[47] concluded that it is not possible to maintain the state of the environment in conditions of continuous economic growth. According to Lerch we should be preparing for change – society should be reorganised in a way where we are ready to survive the shocks of climate change and resource depletion. Hopkins sees a solution in community-based approaches: local food farming (also in cities); a community-owned energy network and alternative local money where possible.

'Planetary Project' sums up all criticism of the concept of sustainable development and its goals:[48]

- The concept of 'sustainable development' is incorrect, and the internal logic of this concept is contradictory.
- The term is too narrow and labels global problems only within the environmental context. Thus, it is believed that only environmental concerns cover the entire strategy of sustainable development.
- The lack of a coherent concept of sustainable development, together with several definitions of the concept, causes significant difficulties in implementation.

[44] Moyo (2016)

[45] Solnik, S. (2018)

[46] Perl, A., Miller, A., Ryerson, B., Sheehan, B., Schwartz, B., Martenson, C., Parker, C., Lerch, D., Fridley, D., Hughes, D., Orr, D., Allen, E., Flora, G., Brown, H., Kaufmann, J., Farley, J., Bomford, M., Shuman, M., Whybrow, P., Gilbert, R., Heinberg, R., Hopkins, R., Postel, S., Mills, S., Whipple, T., Karlenzig, W., Jackson, W., Rees, W., Barlow, Z. (2010)

[47] Transistion Network. (2021)

[48] Planetary Project. (2021)

- The selectivity of the concept of sustainable development, its original elitism and imperialist character will benefit only a certain part of humanity, not all people.
- The methods exploited in the concept of sustainable development are debatable. The extrapolated modelling used in the growth limits study cannot be definitive: it must be understood that predictions based on modelling will only materialise if all its assumptions materialise. The initial parameters of the model should be constantly updated based on the current situation.
- SDGs are understood in totally different ways. It stems from the cultural, social and political backgrounds of the participants applying the new model of civilization and from the different worldviews of the people. Undoubtedly, the greatest goal of the concept of sustainable development is to create a fair and balanced world. Nevertheless, it should be borne in mind that different countries, scientists and politicians interpret justice and balance differently. In itself, the readiness of humanity and individual countries for global integration, which requires a major transformation of their political and economic systems, is quite controversial.

Both opponents and proponents of the concept of sustainable development are convinced that the transition to sustainable development requires a dramatic transformation of the current civilization. At the heart of this transformation is the changing of all major human activities into sustainable ones. In particular, this means abandoning the hydrocarbon energy economy and switching to alternative energy sources. This technological development must also be socially acceptable. Still, the concept of sustainable development does not say anything about the sources of funding or the mechanisms for its implementation. Anyway, we do not have much time to save the world, so we should stop creating slogans and should take real action.

Glossary

Capital	Capital means all the man-made goods that are used in the further production of wealth.
Circular economy	A circular economy entails markets that give incentives to reusing products, rather than scrapping them and then extracting new resources. In such an economy, all forms of waste, such as clothes, scrap metal and obsolete electronics, are returned to the economy or used more efficiently.
Decoupling	'Decoupling' refers to breaking the link between "use of natural resources" and "economic growth." Decoupling occurs when the growth rate of an environmental pressure is less than that of its economic driving force (e.g. GDP) over a given period.
Economic development	Economic development generally means creating jobs, increasing the wealth of both the individual and society and improving people's quality of life.
Economic growth	Economic growth describes an increase in the quantity and quality of the economic goods and services that a society produces and consumes. Economic growth describes an increase in the quantity and quality of the economic goods and services that a society produces and consumes.
Entrepreneurship	Entrepreneurship is viewed as change, generally entailing risk beyond what is normally encountered in starting a business, which may include other values than simply economic ones.
Gross domestic product (GDP)	GDP is the total monetary or market value of all the finished goods and services produced within a country's borders in a specific time period.
Labor	Labor is the economically active population is people who are willing and able to work, whether they have found a job or not.
Land	Land as a factor of production connects land, natural resources, forests, water resources and natural conditions
Limits to Growth	The Limits to Growth is a 1972 report on the exponential economic and population growth with a finite supply of resources, studied by computer simulation.
Linear economy	A linear economy traditionally follows the "take-make-dispose" step-by-step plan. This means that raw materials are collected, then transformed into products that are used until they are finally discarded as waste. Value is created in this economic system by producing and selling as many products as possible.
Sustainable development	Sustainable development can be defined as development that meets the needs of the present without compromising the ability of future generations to meet their own needs.
Sustainable development goals (SDG)	SDGs are a collection of 17 interlinked global goals designed to be a "blueprint to achieve a better and more sustainable future for all". The SDGs were set up in 2015 by the United Nations General Assembly and are intended to be achieved by the year 2030.

Well-being	Well-being is a positive outcome that is meaningful for people and for many sectors of society, because it tells us that people perceive that their lives are going well. Good living conditions (e.g., housing, employment) are fundamental to well-being. Tracking these conditions is important for public policy.

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3. Training material

Methodology of activities

In order to better understand the theoretical part of the study material "Economic growth and sustainable development", to relate it to reality and already existing knowledge, it is recommended to perform the exercises described below in parallel with the reading of the theoretical part. The aim of active learning is to develop as an independent thinker and a self-directed learner.

The teacher's task in the active learning process is to create a favourable environment that allows each learner to achieve maximum development according to their abilities. There are no specific guidelines on how to achieve independent thinking, but there are certain conditions that encourage independent thinking. These are: time, a tolerant atmosphere, recognition of the diversity of ideas and opinions, active participation, risk-taking, respect and values. The task of the teacher is to create these conditions in the learning process.

Independent thinking takes **time**, as it is necessary to first find out what is already known about the new material; find words to express it and provoke discussion. Without discussion, it is not possible to get feedback that would lead to thought development and further reflection. The exercises below are given a minimum discussion time. The teacher can extend the discussion time as needed.

Not always and not all learners dare or want to express their thoughts. The teacher is often expected to have the "right answer", even if there is no "right answer". The task of the teacher is to create **a tolerant, supportive and creative atmosphere** for discussion related to the purpose of the task. This means that learners have the courage and desire to create, present and develop their ideas and concepts. **Active participation** is crucial in independent thinking. When learners understand that their thinking is recognized, they participate more actively. At the same time, it is the teacher's task to make it clear to learners that expressing their thoughts does not mean being allowed to be vulgar or inappropriate. The teacher can use the exercises below for active learning as well as create the exercises himself. If the teacher sees that there is no discussion in the group or that there is a discussion that is not related to the topic of the task, then he / her has to direct the group discussion with specific questions.

Learners often believe that discussions must lead to the "right answer". The teacher's task is to **create an atmosphere in the classroom that favours a plurality of opinions and ideas**, which is the basis for independent thinking. Free thinking can be risky, because the ideas that come up in a discussion can be intertwined in a strange or even contradictory way. The explanation by the teacher that this is natural is important here. Neither the teacher nor the fellow learners should make appraisal comments during the discussions. It hinders further discussion. When learners realise that their views are valued, that the teacher respects their opinions, they usually respond with greater responsibility and care.

If the learning **tasks are not accessible** for the learner or **do not provide sufficient challenge**, it will not lead to the learner's development. If, on the one hand, learning offers the learner a challenge to

test their abilities and, on the other hand, the confidence that learning is affordable, the preconditions for the learner's maximum development have been created. Consequently, the exercises described below should be used creatively - tailored to the learners' abilities.

In the exercises, there is written in which groups they could be performed. However, if the learning is carried out individually, all these exercises can be done alone.

Activity 1: Personal perceptions about the financial situation and well-being

Activity title	**Activity 1. Personal perceptions about the financial situation and well-being**
Overview	This activity will be carried out after a brief introduction to the topic, after the trainer has explained / reminded participants of the terms "personal financial situation" and "well-being". Discussion the following topics in groups: - How has your and your friends' economic situation changed over the last 5 years? - How has your well-being changed over the last 5 years? - Please try to explain these changes? - Please try to find sources / reasons of these changes
Objectives	Introduction to the topic
Materials	-
Time	15 minutes
Group size	2 students
Instructions for trainers	The trainer leads the general discussion. The precondition here is that the task of every national government should be to increase the well-being of its citizens. The most important indicator measuring the state of the country's economy is economic growth. Economic growth provides information to the government on how the economy is changing, but does not provide information on how the well-being of citizens is changing. Together, the following activities will enable learners to understand that their personal financial situation and well-being do not correlate with economic growth. Could it be concluded from this that the growth indicator does not provide the government with information on what the government should measure?
Recommendation for conducting e-learning	- The discussion can be conducted in groups, in separate rooms of the e-learning platform. - The results of the discussion can be presented in the public section of the e-learning platform.

Activity 2. Economic growth in your country during the last 5 years

Activity title	**Activity 2. Economic growth in your country during the last 5 years**
Overview	Activity should be carried out after learning about GDP. Carry out the Internet search and find what was the GDP (annual real growth) and GDP per capita in your country during last 5 year Discussion topics of groups: - Compare the growth of the country's economy and the trends of your personal financial situation and well-being over the last 5 years. What do you notice? - General discussion: -- Whether economic growth shows the state of the financial situation and well-being of citizens. -- What indicators would you propose to the state to measure the well-being of citizens?
Objectives	The learner knows what is measured and not measured by one of the most important statistical indicators - GDP.
Materials	Computer and web connection
Time	Minimum 20 minutes
Group size	2 students
Instructions for trainers	The trainer leads the general discussion.
Recommendation for conducting e-learning	- The discussion can be conducted in groups, in separate rooms of the e-learning platform. - The results of the discussion can be presented in the public section of the e-learning platform.

Activity 3: Discussion on the concept of "economic development"

Activity title	**Activity 3. Discussion on the concept of "economic development".**
Overview	The exercise is carried out after learning Chapter 1. Discussion topic: - How is the concept of economic development different from the concept of economic growth?
Objectives	The learner is able to explain the concepts of economic development.
Materials	-
Time	Minimum 10 minutes
Group size	3-5 students in group
Instructions for trainers	The trainer leads the concluding discussion
Recommendation for conducting e-learning	- The discussion can be conducted in groups, in separate rooms of the e-learning platform. - The results of the discussion can be presented in the public section of the e-learning platform.

Activity 4: The limits to growth – 30 + years later

Activity title	**Activity 4. The limits to growth – 30 + years later**
Overview	The activity should be carried out during the studying of Chapter 2, after reading the paragraphs on the report "Limits to Growth". Exercise content: - See the figure at webpage: https://thumbs-prod.si-cdn.com/RP0vwE02TqPadam4BYkYSOfPP2c=/fit-in/1072x0/https://public-media.si-cdn.com/filer/Futurism-Got-Corn-graph-1.jpg - Find answers to the following questions: ● How important do you consider the difference between the forecast in the book "Limits to Growth" and actual development in the following five factors: population, agricultural production, natural resources, industrial production and pollution. ● How do you assess the coincidence between the forecast made for the period 2000-2020 and the actual situation. Justify your opinion. - Concluding discussion in the auditorium.
Objectives	- The learner knows the problems related to economic growth. - The learner can find information in graphs.
Materials	Computer and web connection
Time	Minimum 15 minutes
Group size	2 students in group
Instructions for trainers	The trainer leads the concluding discussion
Recommendation for conducting e-learning	- The discussion can be conducted in groups, in separate rooms of the e-learning platform. - The results of the discussion can be presented in the public section of the e-learning platform.

Activity 5: Decoupling

Activity title	**Activity 5. Decoupling**
Overview	The activity should be carried out after reading the paragraphs where the idea of decoupling is introduced. Activity: Search the Internet for factual evidence that decoupling of economic growth and use of natural resources is indeed taking place.
Objectives	The learner understands the main idea of decoupling
Materials	Computer and web connection
Time	10 minutes
Group size	Individual work
Instructions for trainers	The trainer leads the concluding discussion
Recommendation for conducting e-learning	- The results of the discussion can be presented in a public rooms of the e-learning platform.

Activity 6: Sustainable development goals

Activity title	**Activity 6. Sustainable development goals**
Overview	The exercise is performed after reading Chapter 3. Discussion topic: - Each student does the quiz "Sustainable Development Goals" in an active learning environment. - Discussion of new knowledge learned during the quiz.
Objectives	The student has an overview of the goals of sustainable development until 2030.
Materials	Computer and web connection
Time	Minimum 20 minutes
Group size	-
Instructions for trainers	-
Recommendation for conducting e-learning	-

Activity 7: SDG and well-being

Activity title	**Activity 7. SDG and well-being**
Overview	The exercise is performed after passing Chapter 3. Discussion topic: - Look at the goals of sustainable development and discuss whether achieving these goals would improve well-being. - Do sustainable development indicators provide the government with better information on the well-being of its citizens?
Objectives	The learner understands the connection between sustainable development goals and well-being.
Materials	Computer and web connection
Time	Ca 25 minutes
Group size	3-4 students in group
Instructions for trainers	The trainer leads the discussion
Recommendation for conducting e-learning	- The discussion can be conducted in groups, in separate rooms of the e-learning platform. - The results of the discussion can be presented in the public section of the e-learning platform.

4. Interactive learning

Activity 1: Quiz

Right answer is green

1/ Which of the following definitions explains economic growth the best?
a/ Economic growth is the increase in the market value of the goods produced by an economy over time.
b/ Economic growth is the increase in the inflation-adjusted market value of the goods and services produced by an economy over time.
c/ Economic growth is the sum of market prices of the goods and services produced by an economy during the year.

2/ Which of the following indicator is used the most frequently to measure economic growth?
a/ Gross domestic product
b/ Average income
c/ Purchasing power of money

3/ Which list of the production factors that influence a country's economic growth is complete?
a/ Mineral resources, water resources, forest, labor
b/ Manufacturing companies, stores, suppliers, demanders
c/ Land, labor, capital, entrepreneurship

4/ In the early 1970s, researchers at the Massachusetts Institute of Technology concluded that ...
a/ … the number of people, the area of arable land, the amount of minerals extracted, and the economy as a whole, cannot grow indefinitely on a finite planet Earth
b/ … the number of people, the area of arable land, the amount of minerals extracted, and the economy as a whole, can grow indefinitely on a finite planet Earth
c/ … with the advance of economic growth, a history of global poverty reduction has begun

5/ The linear economic model means …
a/ … that more and more labor force is included in the economy, and they are withdrawing from the economy once they have retired
b/ … that more and more capital is included in the economy, and it does not generate enough interest
c/ … that more and more natural resources are included in the economy, and they are removed from the economy as waste and pollution very quickly

6/ Which of these statements is true?
a/ Sustainable development is goal-directed development that ensures the improvement of people's quality of life as a result of liberal economic development
b/ Sustainable development of society is a purposefully targeted development that ensures social justice and the improvement of people's quality of life in line with the nature of natural resources and the tolerability of ecosystems
c/ The goal of sustainable development is to protect nature and organize the use of ecosystems taking into account their carrying capacity

7/ In sustainable development policy decoupling is defined …

a/ … as economic growth without an increase in environmental costs
b/ … as the prevention of undesired energy transfer between electrical media
c/ … as the transition from close interactions between particles to their effective independence

8/ Agenda 2030 is a policy document for the implementation of the idea of sustainable development. How many Sustainable Development Goals are written in Agenda 2030?
a/ 15
b/ 17
c/ 35

9/ Which of the following points of view represents the basic position of the critique of sustainable development?
a/ It is possible to maintain the environment's state in conditions of continuous economic growth
b/ Economic growth must be continuous, the environment will regenerate itself
c/ It is impossible to maintain the environment's state in conditions of continuous economic growth

10/ Which the following is the overarching goal of Agenda 2030?
a/ To ensure the achievement of a good state of ecosystems
b/ To eradicate poverty everywhere and to ensure a dignified and good quality of life for all while respecting the capabilities of the natural environment.
c/ To ensure a dignified and good quality of life for all by increasing the supply of goods and services.

Activity 2: Mark all statements that are associated with sustainable development

- The overarching goal of the sustainable development is to eradicate poverty and to ensure a dignified and good quality of life for all, while respecting the capabilities of the natural environment.

- For implementation of the idea of sustainable development UN's General Assembly adopted sustainable development action plan, Agenda 2030 on September 25, 2015.

- The last two centuries have been the first in the history of mankind, when societies have achieved sustainable economic growth and the reduction of global poverty. It means that continued economic growth is a way to reduce poverty.

- Weak sustainability is based on the idea that produced capital can replace natural capital if the value of the produced capital is greater than the value of the natural capital used for it.

- Strong sustainability contends that existing natural capital cannot be duplicated or replaced therefore it needs to be protected, maintained and enhanced in order to continue receiving the benefits of natural capital.

- The standard of living of Western civilization has risen exponentially in recent decades, and the import of the consumer society model around the world has also raised the standard of living in other countries and communities.

Activity 3: Yes or no?

1/ Economic growth is the increase in the inflation-adjusted market value of the goods and services produced by an economy over time. YES

2/ The number of people, the area of arable land, the amount of minerals extracted, and the economy as a whole, can grow indefinitely on a finite planet Earth. NO

3/ The production factors that influence a country's economic growth are land, labor, capital, entrepreneurship. YES

4/ Average income is used the most frequently to measure economic growth. NO

5/ Sustainable development of society is a human-centred development that ensures social justice and the improvement of people's quality of life in line with the nature of natural resources and the tolerability of ecosystems. YES

6/ A linear economic model is sustainable economic model. NO

7/ Decoupling can be defined as reducing the amount of resources used to generate economic growth which leads to improvement of environmental quality. YES

8/ A circular economic model is sustainable economic model. YES

9/ The transition to sustainable development requires the transformation of all major human activities into sustainable ones and, consequently, requires a significant transformation of the current civilization. YES

10/ The objectives of the Agenda 2030 focus on improving the economic, social and environmental situation. YES

Activity 4: Fill in the blanks

1/ In the 1960s …….. began to doubt whether endless economic growth is possible at all. (Club of Rome)

2/ In the early 1970s, researchers at the Massachusetts Institute of Technology stated that the number of people, the area of arable land, the amount of minerals extracted and also the economy as a whole, …… grow indefinitely on a finite planet Earth. (cannot)

3/ Economic and social progress over the last century has been accompanied by …….. that is endangering the systems on which our survival depends. (environmental degradation)

4/ From the second half of the 1980s, the United Nations (UN) started to present the idea of harmonious economic, environmental, and social development or …….. (sustainable development)

5/ A sustainable economic model assumes that economic growth is …… from the use of natural resources. (decoupled)

6/ In 2015, the 193 countries adopted action plan for implementation principles of sustainable development, ……., that consists of 17 Sustainable Development Goals. (Agenda 2030)

7/ The overarching goal of the Agenda 2030 is to eradicate poverty everywhere and to ensure a dignified and good quality of life for all, while respecting the capabilities of the ……. (natural environment)

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FRESH-UP ECONOMICS

Public goods and social welfare

by Aija Kosk

Keywords: Well-being, public goods, common goods, free-rider problem, externality, social welfare, welfare state, liberal welfare state, social-democratic welfare state, conservative welfare state

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1. Overview

In general, countries are created by the people with the aim of increasing their well-being. In the European cultural space, well-being is based on good health; comfortable living conditions; personal liberty; safe working conditions; and guarantees in case of unemployment. These elements of well-being can be divided into economic well-being and general cultural well-being, which in turn are associated with fundamental societal values. Well-being can be achieved by satisfying people's needs and/or eliminating their unnecessary desires.

Based on economic principles, meeting peoples' needs requires the consumption of different types of goods and services. We are much less aware that well-being depends on the consumption of goods but it also depends on the quality of our social and natural environment. A sense of security is created by a state with an independent judiciary, a free media, internal and external security guaranteed by police and army, state support to education, science, transport, environmental protection and culture, and a functioning social security system. All the aforementioned goods and services are called 'public' or 'common goods'. In terms of a market economy, public and common goods are a market failure. According to Neoclassical economics, the solution to this problem would be to turn public and common goods into private goods. According to Keynesian economics, the government must intervene and organize the supply of public and common goods itself. How governments organize the provision of public and common goods depends on governmental policy.

Social welfare is a system aimed at securing various freedoms in society and towards creating better opportunities for economic development via human resource development. To achieve this aim, the state organizes the distribution of public and common goods. Social welfare includes also a social security system that supports people in case of sickness, accidents at work, incapacity for work, and unemployment. A country that takes responsibility for social welfare is called a welfare state.

How governments organize the delivery of public and common goods depends on the government's political approach. The specific goals the government chooses in order to increase the well-being of its citizens, and the means it uses to do so, depend on the socio-political views of the ruling party or coalition. Based on socio-political approaches, the Danish sociologist G. Esping-Andersen (1990) has developed three main clusters of the welfare state: liberal, social democratic and conservative. [1]

After acquiring this study material the learner has an overview of how well-being is defined and the consumer goods on which it depends; why the market cannot cope with the distribution of public and common goods; what the options for addressing these market failures are; and how welfare states are classified according to how they address the delivery of public and common goods. In conclusion, the learner is able to perceive how the government of their country organizes the provision of public and common goods and has improved their skill of making an informed choice in the next round of elections.

[1] Esping-Andersen, G., 1990

2. Background information

Introduction

The goal of all governments is or should be to increase the well-being of their citizens. Generally, well-being means just feeling well. Well-being can be achieved by satisfying the needs and / or eliminating unnecessary desires and dreams. In economic terms, 'meeting needs' implies facilitating the consumption of different types of goods. There are different opportunities for classifying or grouping goods. Here we divide the goods into types based on two characteristics: rivalry and excludability. On the basis of the existence or non-existence of these characteristics, the goods can be divided into four classes: private goods, club goods, common goods, and public goods. The market economy is relatively successful in providing private and club goods but fails in the provision of public and common goods. This situation is called market failure. In a market economy, governments deal with solutions to market failures. The organization of the distribution of public and common goods depends on the government's socio-economic policy. According to Esping-Andersen (1990), such an approach may be liberal, social-democratic, or corporate-conservative.

The main purpose of this study material is to provide an overview of how different types of welfare states deal with the provision of public and common goods and in doing so increase the well-being of citizens. To achieve this goal we will cover the following topics:

1. How to explain well-being?
2. How is classifying goods and services based on rivalry and excludability?
3. Problems with supply of common and public goods.
4. Social welfare and the welfare state.
5. Three types of social welfare states and their vision of the provision of public and common goods.
6. How to measure well-being and the success of social welfare policies.

Well-being

In every economic system, companies target maximizing their profit and households target maximizing their well-being.[2] According to the publication *Psychology Today*, well-being is the experience of health, happiness, and prosperity. It includes having good mental health, high life satisfaction, a sense of meaning or purpose, and an ability to manage stress. More generally, well-being is just feeling well. [3] In the European cultural space, well-being is based on the following values: good health; comfortable living conditions; personal liberty; safe working conditions; and guarantees in case of unemployment. These elements of well-being can be divided into economic (economic well-being) and general cultural

[2] Kerem, K., Randveer, M., 2007

[3] Psychology Today (05.05.2020)

well-being, which in turn are associated with fundamental societal values.[4][5][6] Well-being can be achieved by satisfying societal needs and/or eliminating peoples' unnecessary desires.

A simplified schematic overview of our needs is shown on Maslow's hierarchy of needs in Figure 1. Abraham H. Maslow (1908–1970) was an American psychologist who was best known for a theory of psychological health predicated on fulfilling innate human needs in priority, culminating in self-actualization.

Figure 1. Maslow's hierarchy of needs[7]

According to Maslow's hierarchy of needs, human well-being is based on physiological and safety needs being met. Physiological needs are needs we cannot live without (food, water, air, sleep, etc.), and safety needs include feeling safe (physical and financial safety, job security, health). These two groups of needs are also called basic needs. When basic needs are satisfied, a person strives for realizing their social needs. We all look for social connections with friends and family and want others to respect us. In doing so, we try to increase our self-esteem and self-confidence. Self-realization is the realization of one's full potential. This is the highest level of the hierarchy that we strive for.[8]

Unfortunately, needs and desires are often mistaken for synonyms and so are used interchangeably. In fact, a need refers to something that is needed for survival, and desires refer to the things and phenomena that people desire in life. A person's survival is not in danger if he is unable to fulfill his desires, especially given that desires are endless because we are never completely satisfied. It can be said that desires distort our self-esteem and ultimately even reduce our well-being.[9] At the same time, all people strive to fulfil their needs but also their desires to be happy.

In economic terms, people need to consume different types of goods and services in order to meet their basic and social needs. In the following chapters we explore on which bases the characteristics of goods are classified, and whether or not the market can handle the distribution of these goods.

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[4] Sutrop, M., 2016
[5] Stiglitz, J. E., Sen, A., Fitoussi, J.-P. 2009
[6] OECD Better Life Index (25.08.2020)
[7] Professional Academy, (08.05.2020)
[8] Ibid
[9] Purju, A., 2004

Private, club, common and public goods

These two characteristics are **rivalry** and **excludability**.[10]In economics, a good is said to be rival if its consumption by one consumer prevents simultaneous consumption by other consumers, or if consumption by one party reduces the ability of another party to consume it. A good is considered non-rival if, for any level of production, the cost of providing it to an additional individual is zero. If you buy a bottle of water and drink it, nobody else can drink it. If you buy a computer, nobody else can buy the same computer. The bottle of water and computer are rival goods. However, if you create a beautiful flowerbed in front of your house and you have no fence, people on the street enjoy looking at your flowerbed. The beautiful flowerbed is non-rival as it does not matter how many people look at it, they are not "using it up".

A good is called excludable if it is possible to prevent people who have not paid for it from having access to it. By comparison, a good is non-excludable if non-paying consumers cannot be prevented from accessing it. For example, you need a ticket to go into the cinema hence the cinema is excludable. Streets and street lighting are not excludable though because anybody walking down the street at night benefits from lighted streets. It is impossible to make users of lighted streets pay for walking on the street and ban those, who do not pay, to walk on lighted streets.

On the basis of the existence or non-existence of these two characteristics, the goods are divided into four types[11]:

1. Private goods
2. Public goods
3. Club goods
4. Common goods

Figure 2 shows the formation of these four groups of goods on the basis of rivalrous and excludability, together with examples. Most goods that people typically think about are both excludable and rival in consumption, in other words, the seller is able to prevent consumers from accessing the product. These goods are called **private goods**. Private goods are, for instance, mobile phones, clothes, cars, fridges, watches, consumer goods, and private services such as hairdressing and beauty services, etc. The distribution of private goods takes place on the market, as a result of supply and demand.

Club goods are excludable, which means that the consumer cannot use the product unless they directly pay for it. Club goods are non-rival, which means that the consumption by one person does not prevent others from consuming it. Club goods are, for example, Wi-Fi, Internet, satellite TV, private parks, private roads, etc (see Fig. 2). As a rule, club goods are available to club members and exclusion is based on the payment of a club membership fee.

Common goods are characterised by non-excludability and rivalry. Non-excludability means that it is practically impossible to prevent the consumption of these goods by those who have not paid for it. However, these goods are rivalrous - the more one person consumes, the less there is available to everyone else. For example, wild fishing is considered non-excludable as it is impossible to prevent

[10] Mnmeconomics (30.09.2020)

[11] BoyceWire. Behavioural economics (30.09.2020)

others from fishing there and it is rivalrous as the more one person fishes from a wild lake, the fewer there are available to others (see Fig. 2).

Public goods are characterised by non-excludability and non-rivalrous. This means that once a benefit has been made available to one consumer, each additional consumer does not reduce the ability of others to benefit from it, and it is virtually impossible to exclude non-payers. National defence is one representative example of a public good as it is not possible to selectively protect paying customers from military attacks, and one person consuming national defence (i.e., being protected) does not make it more difficult for others to consume it too (see Fig 2).

	Excludable	Non-Excludable
Rivalrous	**Private Goods** Food, clothes, cars and other consumer goods	**Common Goods** Fish, timber, coal
Non-Rivalrous	**Club Goods** Cinemas, private parks, satellite TV	**Public Goods** air, national defence

Figure 2. Four types of economic goods and services. (Source: https://boycewire.com/)

The best-known public and/or common goods and services are, for example, air, the ozone layer, oceans, the greenhouse effect, as well as state and local governance, creation of the judicial area and justice, national defence, ensuring public order, ensuring the country's international representation, and citizenship. Examples of goods and services that can be public, common or private goods are: roads and streets, traffic lights, museums, historic buildings, but also environmental protection, health services, education services, social protection network, culture, etc. However, it is possible to turn most goods and services classified as common goods into private or club goods.

In the next chapter, we will look at the problems associated with the supply and consumption of common and public goods.

Problems related to the consumption of common and public goods

A notable feature of public and common goods is that free markets produce less of them than is socially desirable. This is because public and common goods suffer from, what is called, the **free-rider problem**.

The free-rider problem is a type of market failure that occurs when those who benefit from goods or services do not pay or under-pay for them. At the same time, it is impossible to exclude non-payers from accessing or using these goods. Thus, the public and common goods may be under-produced, over-used or become degraded. Furthermore, if the marginal cost of serving one more customer is essentially zero, it is socially optimal to offer the product at a zero price. Therefore, producing public goods is not a business model, which is why private markets do not have an incentive to provide them. [12]

As public and common goods have no supply in the market sense, their price is not formed on the market. There is a demand for these goods in society, as a result of which the value of these goods can be assessed. The higher the value of these goods in society, the greater the demand and the greater the pressure on the consumption of these goods, which ultimately leads to the over-consumption of public and public goods, which G. Hardin (1968) explains as a "tragedy of common good".

"Tragedy of the commons" is an economic problem in which every individual has an incentive to consume a resource at the expense of other individuals. It results in overconsumption, underinvestment, and ultimate depletion of the resource. As the demand for the resource overwhelms the supply, every individual who consumes an additional unit directly harms others who can no longer consume. "Tragedy of the commons" occurs when individuals neglect the well-being of society in the pursuit of personal gain.[13]

Overconsumption of public goods leads to **pollution and pollution damage**. Pollution is the introduction of contaminants into the natural environment that cause adverse change or pollution damage. Pollution can take the form of chemical substances or energy, such as noise, heat or light. Many activities that are useful to people produce pollution: burning coal to create electricity pollutes the air; both industries and homes generate garbage and sewage that can pollute the soil and water; pesticides leach into groundwater, rivers and lakes and harm wildlife. Polluted air, soil, and water cause different pollution damages, for example, various human diseases, damage to buildings and structures, destruction of nature, etc. Pollution damage in monetary terms is called **external cost**. More specifically, an external cost is a cost that an individual, company or community incurs as a result of an economic transaction in which they are not directly related.[14] Therefore over-consumption of public and common goods that leads to external costs may result in reduction of the well-being of society.

Economists suggest two ways to address the free-rider problem and the problem of external cost:

- According to the Neoclassical approach, the government should organize the conversion of public and common goods into private goods.
- According to the Keynesian approach, the government should organize the distribution of public and common goods itself, using various "command-and-control" measures.

The decision as to how the government should intervene in the provision of public and common goods should be based on an analysis of whether the benefits of consuming those goods outweigh the costs

[12] ThoughtCo. Social Sciences (12.10.2020)
[13] Hardin, G. (05.05.2020)
[14] Economics Online. External costs. (12.05.2020)

to society of taxation. However, such an analysis is not always carried out, instead it is decided by those in political power. The following chapters describe different policy approaches to organizing the distribution of public and common goods.

Social welfare and welfare state

Welfare is a type of government support intended to ensure that members of a society can meet basic needs.[15] Often welfare is used as synonymous with **social security** but actually, social security includes a governmental support system only for sickness, accidents at work, incapacity for work, and unemployment. Welfare-related instruments can be both allowances and services. A country that takes responsibility for social welfare is called **a welfare state.**

Historically, the role of the state was limited to providing assistance to those whose needs could not be met by institutions like family, the market or voluntary service, e.g., the church. The state was not directly responsible for ensuring the social security and well-being of people. As a result of social changes that took place at the end of the 19th century and the beginning of the 20th century, the role of the state and its intervention in people's lives began to increase significantly.[16] The history of the modern welfare state goes back to the 1840s when Otto von Bismarck, the Chancellor of Germany, introduced old age pensions, accident insurance and medical care in some German states. These programs were introduced to reduce the emigration of workers to the United States, where wages were higher but welfare did not exist.[17] Over time, the needs of people expanded and besides social security, governments undertook the role of organizing new areas such as health, education and science, transport, environmental protection, agriculture, culture, etc. Governments expanded their activities to the social sphere and the concept of the welfare state emerged.

The welfare state is not designed for the poor, it is designed to protect people from poverty. The term "welfare state" is defined differently in the literature. Esping-Andersen (1999) argued that after World War II the welfare state included primarily state intervention to reduce the economic insecurity people experienced during their "inactive" years of life.[18] Pestieau (2006) focuses on defining the functions of the welfare state. In addition to mitigating social risks, the welfare state also provides social assistance and supports education. Thus, the welfare state does not deal only with "inactive" citizens but also for example low-income families with large numbers of children, etc.[19] According to Sandmo (1995), the welfare state can be viewed from two perspectives: (1) the welfare state refers to the part of the public sector that deals with redistribution through social security and the provision of social benefits that have a strong redistributive function, such as education and health; (2) it describes broadly a country's economic and social policies that prioritize the reduction of inequalities and the protection of the individual against social risks such as job loss or illness.[20]

[15] Encyclopedia Britannica (10.10.2020)
[16] Ware, A., Goodin, R. E., 1990
[17] Boundless Political Science (5.10.2020)
[18] Esping-Andersen, G., 1999
[19] Pestieau, P., 2006
[20] Sandmo, Agnar., 1995

The next chapter contains a short overview of different types of welfare states and how they define and organize the supply of public and common goods and services.

Three main types of welfare states

The general premise (at least in theory) is that all countries are designed to provide physical security, rights and freedoms for their people. Organizing the provision of public and common goods is an important task to achieve this goal. How countries do this depends on the government's views on social welfare

In 1990, the Danish sociologist G. Esping-Andersen developed a model for assigning welfare states to three main clusters: social democratic, liberal and corporative-conservative.[21] This classification is based on the two key factors: (1) commodification, i.e. the extent to which the provision of care services depends on the market; and (2) the extent of collective allocations. To create the index, the author used the indicators of old-age pensions, healthcare, and unemployment insurance policies. In addition to this index, various welfare indicators were used and countries' consistency with the results obtained was checked.[22]

According to this study Australia, Canada, Japan, Switzerland, and the United States are liberal welfare states; Austria, Belgium, France, Germany, and Italy are conservative welfare states; and Denmark, Finland, the Netherlands, Norway, and Sweden are social democratic welfare states. Ten years later R.E. Goodin, B. Headey, R. Muffels and H.-J. Dirven (1999) also divided welfare states into these classes and in general they replicated Esping-Andersen (1990) results.[23]

A **liberal welfare system** prioritizes economic growth. The system is characterized by modest universal transfers or social insurance plans. The social benefits tend to cover the needs of the low-income working class. Eligibility is usually stigmatized and the thresholds of support are designed so that people do not choose social assistance over work. The aim of this system is to create a situation where everyone who can do paid work would do so in order to guarantee their own well-being. In a liberal welfare state, both poverty and social stratification are high. The positive values of this system are equal opportunities, competition, and social rights.[24]

The **social-democratic welfare system** is highly equal in its purpose and conspicuously universal in its political style. The social democrats do not simply seek to eradicate poverty, but generally strive to promote social equality. This system is characterised by high social spending, decommodification of social rights, and social stratification. The state is also involved in caring for children, the elderly and the helpless. Thus, all residents of the country are connected to one universal insurance system, from which everyone receives earning-based support and, where everyone has the same rights regardless of status or gender. Such a system creates solidarity with the state among the citizens, because everyone depends on the state, they also feel obliged to pay taxes to maintain the system.

[21] Esping-Andersen, G., 1990
[22] Ibid
[23] Goodin, R. E.; Headey, B., Muffels, R., Dirven, H.-J., 1999
[24] Ibid

At the same time, high social costs can have negative consequences such as the deliberate desire to be unemployed and to receive benefits. A positive fact is that creating favourable conditions helps a person to adapt quickly to a changing situation. Knowing proper support is there in the event of an accident or job loss reduces individual risk sensitivity. The health insurance system is important for the development of health throughout the country. If a person is sick and the sickness benefit is decent, the citizen chooses the most reasonable option – he stays at home to heal himself.[25]

In a **corporative-conservative system** the market as a potential guarantor of well-being is marginalized, and the guarantee of social rights is not seen as a viable alternative for achieving material well-being. This system seeks to preserve social hierarchies and social statuses. As the state focuses on maintaining status differences, the redistributive effect of the state is not significant. The system is mostly influenced by the church and is committed to maintaining traditional family values. In this system, the family is the main provider of welfare services. The state's intervention consists primarily of distributing financial support to families, who must ensure the functioning of welfare services. Social security usually excludes unemployed women, but family benefits favour mothers. Kindergartens and other institutions providing care services are mostly underdeveloped.[26]

Irrespective of whether the attitude of the state towards social benefits is liberal, social democratic or conservative, it is the task of all countries to organize the distribution of public and common goods in order to maximize the well-being of their citizens. All governments are engaged in administering courts, providing a police force, and ensuring the continuity of ruling institutions. Also, nearly every nation in history has had a military, all modern states have carried out some environmental protection activities and support research. All governments spend on things like defence, research, clean air, and roads. At the same time, most governments are also concerned with social security. These are supports for sickness, accidents at work, incapacity for work, and unemployment. All services listed above are public or common in nature. [27] The differences between countries become apparent only in the choice of means to achieve the objectives.

How to measure welfare

In order to understand whether a country has fulfilled its main goal and increased the well-being of its people, it is necessary to measure the well-being of people. How to do it? In order to measure the effectiveness of social welfare systems in increasing the well-being of citizens, various indicators have been developed. The most known indicator is **Gross Domestic Product** (GDP). Unfortunately, this is not a good indicator for measuring the well-being of society. In order to get an overview of what is happening in society, social and environmental developments must be taken into account in addition to GDP, as intangible well-being is an important criterion for achieving people's general well-being and happiness. For example, an **Ecological Footprint** can be used to measure environmental developments, taking into account the impact of consumption and production patterns on the environment. More information on this indicator is available at www.footprintnetwork.org.

[25] Ibid
[26] Ibid
[27] Lehrer, E., 2018

Measuring human well-being and the performance of government social welfare activities is a key priority for the OECD. The latest OECD study, **"How's Life? 2020"** provides comparable statistics on how the lives of people living in the OECD and selected partner countries have changed. This welfare framework currently contains 11 related dimensions[28]:

- Material conditions that shape people's economic options (Income and Wealth, Housing, Work and Job Quality);
- Quality-of-life factors that encompass how well people are (and how well they feel they are), what they know and can do, and how healthy and safe their places of living are (Health, Knowledge and Skills, Environmental Quality, Subjective Well-being, Safety);
- How connected and engaged people are, and how and with whom they spend their time (Work-Life Balance, Social Connections, Civic Engagement).

The latest survey, conducted in 2018, shows that life has improved compared to 2010. People are living longer, safer, the OECD average homicide rate has fallen by a quarter, and people feel safer walking around. Employment rates and incomes have risen and people were more satisfied with their lives than in 2013. There has been a decline in well-being in the field of social interaction and also financial insecurity has increased. 7% of people say that life satisfaction is very low and a significant minority (13%) experience more negative than positive feelings on a normal day. More information from OECD homepage http://www.oecd.org/statistics/how-s-life-23089679.htm

The list of indicators for measuring the well-being and social welfare mentioned above is not exhaustive. A wide variety of well-being measurement methodologies can be found on the Internet.

Summary

The purpose of this study material was to provide an overview of how different types of social welfare states define what constitutes optimal provision of public and common goods, and solve the free-rider and external cost problem. To achieve the goal, the meaning of well-being was explained. The simplest definition of well-being is just feeling well. Well-being can be achieved by satisfying the needs and / or eliminating the unnecessary desires. American psychologist Abraham H. Maslow explained that human well-being is based on meeting people's physiological and safety needs. When basic needs are satisfied, a person strives for realizing their social needs. In economic terms, meeting needs requires the consumption of different types of goods.

Based on the features of rivalry and excludability, goods are divided as private, club, common, and public goods. The market economy is relatively successful in providing private and club goods, but fails in the provision of public and common goods. In terms of a market economy, public and common goods are a market failure, which means that the private sector does not provide these goods and services. The consumption of common and public goods is coupled with the free-rider problem, which leads to over-consumption of these goods and finally causes external costs to society.

To solve the above-listed market failures the government must intervene. Economists suggest two ways:

[28] OECD Better Policies for Better Life. How's Life? 2020 (14.08.2020)

- According to the Neoclassical approach, the government should organize the conversion of public and common goods into private goods.
- According to the Keynesian approach, the government should organize the distribution of public and common goods itself, using various "command-and-control" measures.

How governments organize the provision of public and common goods depends on the governmental policy approach to social welfare. A liberal welfare state prioritizes economic growth that enables most citizens to ensure their own well-being. A social-democratic welfare states seek to eradicate poverty, and strive to promote social equality. This system is characterised by high social spending. The country's population is concentrated in a universal insurance system, from which earning-based support and universal social services are distributed. In a conservative system, the market as a potential guarantor of well-being is marginalized, and social rights are not included as elements required for achieving well-being. The main idea is that the state intervention is minimal, with a focus on cash benefits that allow the welfare services to be provided by families.

Countries and associations of countries use a wide range of indicators to measure the results and effectiveness of their social policies. Examples of such indicators are GDP, the Ecological Footprint, and the OECD survey “How’s Life?” etc. The results are used by countries to shape their social policies in an effort to combine the provision of public and collective benefits in a way that increases the well-being of their citizens.

Glossary

Club goods	A club good is excludable, which means that the consumer cannot use the product unless they directly pay for it and it is non-rivalrous, which means that one person's consumption does not prevent another's consumption.
Common goods	Common goods are characterised by non-excludability and rivalry.
Excludability	A good is excludable if it is possible to prevent people who have not paid for it from having access to it.
External cost	An external cost is a cost incurred by an individual, company, or community as a result of an economic transaction that they are not directly involved in.
Free-rider problem	The free-rider problem is that market failure occurs when those who benefit from goods or services do not pay or under-pay for them. At the same time, it is impossible to exclude non-payers access to or use of these goods.
Market failure	Market failure is the economic situation defined by an inefficient distribution of goods and services in the free market.
Need	A need refers to something that is needed for survival.
Private good	A private good is a good that individuals compete for in order to obtain the good and service and if consuming the good by one person prevents someone else from consuming it.
Public good	A public good is a good that is both non-excludable and non-rivalrous. It means that individuals cannot be excluded from use, and use by one individual does not reduce availability to others, or the good can be used simultaneously by more than one person.
Rivalrous	A good is rivalrous if its consumption by one consumer prevents simultaneous consumption by other consumers, or if consumption by one party reduces the ability of another party to consume it.
Social security	Social security includes a governmental support system for sickness, accidents at work, incapacity for work, and unemployment.
Social welfare	Welfare is a system for securing various freedoms of the people and creating better opportunities for economic development through human resource development.

"Tragedy of the commons"	The tragedy of the commons is an economic problem in which every individual has an incentive to consume a resource at the expense of other individuals. It results in overconsumption, underinvestment, and ultimately, depletion of the resource.
Welfare	Welfare is a type of government support intended to ensure that members of a society can meet basic needs.
Welfare state	A welfare state is a state that is committed to providing basic economic security for its citizens by protecting them from market risks associated with old age, unemployment, accidents, and sickness.
Well-being	In the European cultural space, well-being is based on the following values: good health; comfortable living conditions; personal liberty; safe working conditions; and guarantees in case of unemployment. Well-being is just feeling well.

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3. Training material

Methodology of activities

In order to better understand the theoretical part of the study material “Public goods and social welfare”, to relate it to reality and already existing knowledge, it is recommended to perform the exercises described below in parallel with the reading of the theoretical part. The aim of active learning is to develop the ability of the learner to think independently and self-direct their learning.

The teacher's task in the active learning process is to create a favourable environment that allows each learner to achieve maximum development according to their abilities. There are no specific guidelines on how to achieve independent thinking, but there are certain conditions that encourage independent thinking. These are: time, a tolerant atmosphere, recognition of the diversity of ideas and opinions, active participation, risk-taking, respect and values. The task of the teacher is to create these conditions in the learning process.

Independent thinking takes **time**, as it is necessary to first find out what is already known about the new material; find words to express it and provoke discussion. Without discussion, it is not possible to get feedback that would lead to thought development and further reflection. The exercises below are given a minimum discussion time. The teacher can extend the discussion time as needed.

Not always and not all learners dare or want to express their thoughts. The teacher is often expected to have the "right answer", even if there is no "right answer". The task of the teacher is to create **a tolerant, supportive and creative atmosphere** for discussion related to the purpose of the task. This means that learners have the courage and desire to create, present and develop their ideas and concepts. **Active participation** is crucial in independent thinking. When learners understand that their thinking is recognized, they participate more actively. At the same time, it is the teacher's task to make it clear to learners that expressing their thoughts does not mean being allowed to be vulgar or inappropriate. The teacher can use the exercises below for active learning as well as create the exercises themselves. If the teacher sees that there is no discussion in the group or that there is a discussion that is not related to the topic of the task, then they should direct the group discussion with specific questions.

Learners often believe that discussions must lead to the "right answer". The teacher's task is to **create an atmosphere in the classroom that favours a plurality of opinions and ideas**, which is the basis for independent thinking. Free thinking can be risky, because the ideas that come up in a discussion can be intertwined in a strange or even contradictory way. The explanation by the teacher that this is natural is important here. Neither the teacher nor the fellow learners should make appraisal comments during the discussions. It hinders further discussion. When learners realize that their views are valued, that the teacher respects their opinions, they usually respond with greater responsibility and care.

If the learning **tasks are not affordable** for the learner or **do not provide sufficient challenge**, it will not lead to the learner's development. If, on the one hand, learning offers the learner a challenge to test their abilities and, on the other hand, the confidence that learning is affordable, the preconditions

for the learner's maximum development have been created. Consequently, the exercises described below should be used creatively - tailored to the learners' abilities.

In the exercises, it is shown in which groups they could be performed. However, if the learning is carried out individually, all these exercises can be done alone.

Activity 1. List of my needs

Activity title	**List of my needs**
Overview	The exercise is carried out after the introduction of the topic but before learning Chapter 1 of the theoretical part. Exercise content: - Each learner makes a list of their needs. This list could include at least 25 (or more) needs. Each need is written on a separate line. - Each student discusses their list of needs with at least two fellow students (the discussion takes place separately with each fellow student). During the discussions, learners are asked to add to their list. - Learner(s) may present their list to the group. During the presentation, fellow learners can add to their list of needs. Alternative: This exercise can be carried out so that all learners come to the board and write one or more needs. There may also be wishes and desires on that list. The teacher does not correct the list.
Objectives	The learner is able to notice needs.
Materials	Paper and pencil / board and marker
Time	Minimum 15 minutes
Group size	-
Instructions for trainers	The lists of needs likely include desires. They are not addressed initially. The distinction between needs and desires is dealt with in the following exercises.

Activity 2. Distinguishing between basic needs, social needs and desires

Activity title	**Distinguishing between basic needs, social needs and desires**
Overview	The exercise is carried out after learning Chapter 1 of the theoretical part. Exercise content: - Learners exchange the lists of needs made during Exercise 1. - The basic needs, social needs and wishes are indicated in colour. - The list will be returned to its original author and any additions will be discussed together. Alternative: Under the guidance of students, the teacher distinguishes between basic needs, social needs, and desires in a list written on the board.
Objectives	The learner is able to distinguish between basic needs, social needs and desires
Materials	Needs lists and coloured pencils / needs list on board and coloured markers
Time	Minimum 5 minutes
Group size	-
Instructions for trainers	If necessary, the teacher helps learners to differentiate between needs and desires.

Activity 3. Private goods, club goods, collective goods, public goods

Activity title	**Private goods, club goods, collective goods, public goods**
Overview	The exercise is carried out after learning Chapter 2 of the theoretical part. Exercise content: - Each learner reviews their own list of needs / desires and notes private, club, community and public benefits. This exercise can also be done in pairs. - If on the existing list there are no examples of some goods, the list will be updated in cooperation with a fellow student. The aim is to compile a list of needs / desires with different goods. Alternative: Under the guidance of the students, the teacher indicates private, club, community and public benefits in the list written on the board. If necessary, the list will be supplemented.
Objectives	The learner is able to notice different types of benefits in his / her list of needs / desires.
Materials	Needs and desires list and pen / needs and desires list on board and marker
Time	Minimum 10 minutes
Group size	-
Instructions for trainers	If necessary, the teacher helps learners to identify existing benefits and to complete the list of benefits.

Activity 4. Problems associated with the consumption of common and public goods

Activity title	**Problems associated with the consumption of common and public goods**
Overview	The exercise is carried out after learning Chapter 3 of the theoretical part. Exercise content: - The auditorium is divided into groups of 3-4 members. - Each group will receive larger paper for drawing and coloured markers. - The teacher gives each group one common or public good. These can be, for example, a river in a local area, a naturally beautiful place, a public park or square, and so on. - Based on the object given by the teacher and using the knowledge learned in Chapter 3, students compile a story about the problem of free-riders, overconsumption, pollution, pollution damage, and external costs. - The story is displayed as a picture, cartoon, scheme, etc. - An exhibition will be organized. The viewers explain the situations shown in the picture. If necessary, the authors of the picture will provide explanations.
Objectives	The learner is able to relate the problems associated with the consumption of common and public goods.
Materials	Larger paper and coloured markers
Time	Minimum 25 minutes
Group size	3 - 4 learners
Instructions for trainers	Before carrying out the study, the teacher finds the common or public benefits that actually exist in the area, which can be used, for example.

Activity 5. Compiling a list of social welfare services provided by my country

Activity title	**Compiling a list of social welfare services provided by my country**
Overview	The exercise is carried out before learning Chapter 5 of the theoretical part. Exercise content: - The auditorium is divided into groups of 2-3 members. - Groups of learners compile a list of social welfare services provided by their country. - The common and public goods and "our need which will be satisfied" is written next to the service name. - One group introduces their list. Other groups can help complete this list. In this way, an accurate list of social welfare services is formed. Alternative: - All learners come to the board and together they write a list of social welfare services with goods and needs. - Learners name social welfare services, together with goods and needs, and the teacher writes them on the board.
Objectives	The learner knows social welfare services and is able to relate them to benefits and needs.
Materials	Paper and pencil / board and marker
Time	Minimum 10 minutes
Group size	2-3 learners
Instructions for trainers	If necessary, the teacher will assist in compiling the list with guiding questions.

Activity 6. What socio-political system do I live in?

Activity title	**What socio-political system do I live in?**
Overview	The exercise is carried out after learning Chapter 5 of the theoretical part. Exercise content: - Looking at the list of social welfare services in Exercise 5 and using knowledge of politics of learners, discuss together in which socio-political system the learner lives: in a liberal, social-democratic or conservative one. - What would social policy be like in different systems?
Objectives	The learner is able to relate the provision of common and public goods to social policy.
Materials	List of social welfare services compiled in Exercise 5.
Time	Minimum 20 minutes
Group size	-
Instructions for trainers	The teacher prepares different government coalitions based on existing parties in the country and, if necessary, helps to enliven the discussion with guiding questions.

Activity 7. What recommendations would you share with your national government?

Activity title	**See OECD materials "How's Life? 2020". What recommendations would you share with your national government?**
Overview	The exercise is carried out after learning Chapter 6 of the theoretical part. Exercise content: - The auditorium is divided into groups of 2-3 members. - Learners review the OECD study "How's Life? 2020" video or slides and country-specific results for your country. - Based on these materials, the group will compile a list of recommendations that the state could make to increase the well-being of its population. - The moderator and secretary of the group work presentation are elected. The task of the moderator is to lead the discussion and the task of the secretary is to write a package of recommendations on the board. - Presentation of group work and discussion ensues, during which a package of recommendations is formulated.
Objectives	The learner knows the role of the state in providing common and public goods.
Materials	From the OECD website "How's Life? 2020 "general results in slide or video and country-specific results. http://www.oecd.org/statistics/how-s-life-23089679.htm
Time	Minimum 30 minutes
Group size	2 – 3 learners
Instructions for trainers	The teacher supports the learner's work as needed.

4. Interactive learning

Quiz

The Quiz on Public Goods and Social Welfare is an interactive study resource that supports the study on social welfare produced by the project "Fresh-up Economics Towards Economic Literacy in Europe".

The "Fresh-up Economics" project aims to integrate socio-economic issues into adult education by providing adult educators with information and teaching materials to increase their competence to promote learning on socio-economic issues.

Put your knowledge of public goods and social welfare to the test. The quiz contains 10 questions with multiple choice answers and 10 explanatory short stories.

The contents of the quiz are the sole responsibility of the Peipsi Center for Transboundary Cooperation and can in no way be taken to reflect the views of the program, the countries participating in the program or the European Union.

The #The FreshUpEconomics project has been funded with support from the European Commission. Its contents and material reflect the views only of the author, and the Commission cannot be held responsible for any use which may be made of the information contained therein. Project code: 2019-1-DE02-KA204-006534.

Questions

1. **Question**

In what order should needs and desires be met in order to increase human well-being?

Variants of answers

- Physiological needs, security needs and desires
- Wishes, physiological needs and the need for security
- Desires, security needs and physiological needs

Explanation

Well-being can be achieved by satisfying societal needs and / or eliminating peoples' unnecessary desires. According to Maslow's hierarchy of **needs**, human well-being is based on physiological (food, water, air, sleep, etc.) and safety needs (physical and financial safety, job security, health) being met. These two groups of needs are also called basic needs. When basic needs are satisfied, a person strives for realizing their social needs. We all look for social connections with friends and family and want others to respect us. In doing so, we try to increase our self-esteem and self-confidence. Self-realization is the realization of one's full potential. This is the highest level of the hierarchy that we strive for.
Needs and **desires** are often mistaken for synonyms and so are used interchangeably. In fact, a need refers to something that is needed for survival, and desires refer to the things and phenomena that people desire in life. A person's survival is not in danger if they are unable to fulfil their desires, especially given that desires are endless because we are never completely satisfied.

Maslow's hierarchy of needs.
https://www.professionalacademy.com/blogs-and-advice/marketing-theories-maslows-hierarchy-of-needs

2. Question

The goal of the state is to increase the social welfare of its citizens. If the state wants to achieve this goal, the distribution of what type of goods should it organize?

Variants of answers

- Private and club goods
- Public and common goods
- Common and private good

Explanation

Most goods that people typically think about are **private goods** (rival and excludable). Private goods are, for instance, mobile phones, clothes, cars, fridges, watches, consumer goods, and private services such as hairdressing and beauty services, etc. The distribution of private goods takes place on the market, as a result of supply and demand.

Club goods (excludable, non-rival) are, for example, Wi-Fi, Internet, satellite TV, private parks, private roads, etc.
Common good (non-excludable, rival) is, for example, wild fishing. If one person catches fish from a public lake, it is impossible to prevent others from fishing in the same place; the more one person catches, the lower the chances of others to catch fish.

Public good (non-excludable, non-rival) is, for example, national defence. It is not possible to protect only those people who have paid for national defence from military attacks. At the same time, the addition of one protected person does not weaken the protection of others.

Public and common goods are a market failure. This means that the market cannot distribute these goods and public intervention is needed. How governments organize the distribution of public and common goods depends on the government's policy approach to social welfare.

3. **Question**

Name the purpose of social welfare.

Variants of answers

- Provide support in case of illness, accident at work, incapacity for work and unemployment
- Ensure that basic needs are met in terms of public and common goods
- Ensure the provision of cultural, educational and social services

Explanation

Social welfare is a type of government support intended to ensure that members of a society can meet their basic needs. Often welfare is used as synonymous with **social security** but actually, social security includes a governmental support system only for sickness, accidents at work, incapacity for work, and unemployment. Welfare-related instruments can be both allowances and services. A country that takes responsibility for social welfare is called **a welfare state.**

4. **Question**

In order to increase social welfare, a liberal welfare state prioritizes economic growth that allows citizens to work and create their own well-being. Which of these countries is guided by liberal ideas?

Variants of answers

- Switzerland
- Netherlands
- France

Explanation

The aim of **a liberal system** is to create a situation where everyone who can be an entrepreneur or do paid work would do so and ensure their own well-being. Social benefits do exist, but in most cases, they only cover the needs of the low-income working class. In a liberal welfare state, both poverty and social stratification are high.

5. **Question**

A system that seeks to increase social welfare by eradicating poverty and promoting social equality is called:

Variants of answers

- Corporative-conservative welfare system
- Social-democratic welfare system
- Liberal welfare system

Explanation

The goal of a social democratic welfare system is to equalize society. In political terms, this system is strikingly universal in its approach to welfare. This system is characterized by high social spending,

decommodification of social rights, and social stratification. The state is also involved in caring for children, the elderly, and the helpless. Thus, all residents of the country are connected to one universal insurance system, from which everyone receives earning-based support and, where everyone has the same rights regardless of status or gender. Such a system creates solidarity with the state among the citizens because since everyone depends on the state to some extent, they also feel obliged to pay taxes to maintain the system.

6. Question

Which institution is the main provider of welfare services in the corporate-conservative system?

Variants of answers

- Family
- Church
- Government

Explanation

In a **corporate-conservative system**, the role of the market economy is not seen as a potential guarantor of prosperity, nor is the guarantee of social rights necessary to achieve prosperity. Maintaining differences in status dominates, rights are linked to class and status, and the redistributive effect of the state is not considered significant. The preservation of traditional family values and the influence of the church are considered important. Thus, the main provider of care is the family. State intervention consists in distributing financial support to families who have to ensure the functioning of welfare services. Social security excludes unemployed women, but mothers have family benefits. Kindergartens and other care facilities are generally underdeveloped. The role of private insurance benefits is only marginal.

7. Question

In a market economy, public and common goods are produced less than society wants. What is the reason for this?

Variants of answers

- Consumers are not ready to buy these benefits
- The 'free-riders' problem'
- Companies cannot produce these benefits

Explanation

The reason for the lower production of public and common goods is the fact that their consumption is accompanied by the so-called '**free-riders' problem'**. The 'free-riders' problem' is a type of market failure that occurs when those who benefit from goods or services do not pay or under-pay for them. At the same time, it is impossible to exclude non-payers from accessing or using these goods. Thus, the public and common goods may be under-produced, over-used or become degraded.
Furthermore, if the marginal cost of serving one more customer is essentially zero, it is socially optimal to offer the product at a zero price. Therefore, producing public goods is not a business model, which is why private markets do not have an incentive to provide them.

8. **Question**

How should the 'free riders' problem' be solved according to neoclassical economic theory?

Variants of answers

- Public and common goods should be turned into private goods
- The government should organize the distribution of public and common goods itself
- The market distributes public goods without government intervention

Explanation

Economists suggest two ways to address the free-rider problem and the problem of external cost:

- According to the Neoclassical approach, the government should organize the conversion of public and common goods into private goods.
- According to the Keynesian approach, the government should organize the distribution of public and common goods itself, using various 'command-and-control' measures.

The decision as to how the government should intervene in the provision of public and collective benefits should be based on an analysis of whether the benefits of consuming these goods outweighs the costs to society of taxation. However, such an analysis is not always carried out but is a matter of political decision.

9. **Question**

What is explained by the expression 'tragedy of the commons?

Variants of answers

- Overconsumption of public and common goods
- Overconsumption of private goods
- Overconsumption of club goods

Explanation

As public and common goods have no supply in the market sense, their price is not formed on the market. There is a demand for these goods in society, as a result of which the value of these goods can be assessed. The higher the value of these goods in society, the greater the demand and the greater the pressure on the consumption of these goods, which ultimately leads to the over-consumption of public and public goods. Such a situation was explained by G. Hardin (1968) as the '**tragedy of the commons'**. It is an economic problem where everyone has an incentive to consume a resource at the expense of other people. This results in over-consumption, under-investment and final depletion of the resource.

10. Question

Countries use the gross domestic product (GDP) to measure well-being. What does GDP measure?

Variants of answers

- The sum of the prices of economic benefits produced in one region during the year
- The sum of the prices of economic benefits produced by one nation during the year
- The sum of the prices of economic benefits produced in one country during the year

Explanation

Gross domestic product (GDP) is the sum of the prices of the total production of economic goods and services (hereinafter also economic goods) produced in one country during the year. Economic goods include for example bread, a car, house, a computer, fuel, but also various services such as beauty services, etc. For the country's population, GDP growth means better access for people to economic goods and services and the opportunity to improve their standard of living. Despite its widespread use, GDP is not a suitable indicator for measuring well-being.

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FRESH-UP ECONOMICS

Europe: Competition or Cooperation?

by Marcin Marczuk, PhD

Table of contents

1. Overview

In general cooperation can be understood as joint production (activity) or consumption by a group of people for their mutual benefit. It is the opposite of competition which is based on individual efforts to achieve a goal. There are different approaches regarding how to deal with the concepts of cooperation and competition in economics. International trade is a comprehensive solution to deal with it. International trade is about the purchasing, selling or exchanging of goods and services across national borders.

Trade is the all-time basis for forming economic relations. Key trade economic theory explains that trade offers welfare gains and that countries involved in international trade can gain substantially from cooperation. The free movement and exchange of goods was one of the primary reasons to establish the European Union. Currently the EU has progressed from a customs union to a single market and the euro area of nineteen countries. Also European integration has increased the European economy covering almost the whole continent with membership of twenty-seven countries. The notion of an internal market is built on the principle that market participants should operate with the greatest possible degree of economic freedom, unhindered by any (national) barriers to competition. Single Market establishes the EU as one economic entity with international trade agreements as the main external competence of the EU. The aim of EU competition policy is to safeguard the correct functioning of the single market. In essence, it ensures that enterprises have the possibility to compete on equal terms on the markets of all Member States.

Table 1. Evidence for economic results of competition and cooperation

	Competition	**Cooperation**
Intra-EU trade	What is the trade balance (export-import) for any country within Europe? Is the country gaining or losing economically? How has its trade changed during the last 3-5 years?	Exports and imports within EU: effects on employment and income
Extra-EU trade	EU exports to the world: effects on employment and income	How EU membership helps with trade development for any country? Is the country gaining or losing economically? How has its trade changed during the last 3-5 years?

Rising growth of exports in the world and a steady increase in trade as a share of the size of the world economy prove that trade has become ever important. The growth of international trade has been stimulated by the steady decline of trade barriers after World War II. There are arguments that support a free trade policy as well as arguments that support various types of protectionist policies. However, the Ricardian model of international trade introduces the principle of comparative advantage, which helps to understand reasons supporting international trade. This model explains for example how less productive nations can benefit from free trade with their more productive neighbors.

Exploration of the international trade flows helps to discover effects of economic cooperation and competition. Eurostat provides data and an interactive data visualization on trade in goods and trade effects on employment and income in the EU. There are different ways of conducting trade analysis. First, one should start from a general description and then go into details. Next, the current situation should be compared to the past to find out if trade growth promotes economic competition

and cooperation. Some suggestions on how to do trade analysis for competition and cooperation examinations in the EU are presented in Table 1.

This learning scenario is an opportunity for students to become aware of their countries trade characteristics. They can realize how people from different countries benefit from their country's export and how important it is to keep economic openness. Finally, students can discover how trade promotes economic cooperation and competition in the European economy.

2. Background information

Cooperation and competition

In general, cooperation can be understood as joint production (activity) or consumption by a group of people for their mutual benefit.[1] It is the opposite of competition which is based on individual efforts to achieve a goal. Some people perceive competition as morally suspect in comparison to virtuous cooperation. However as Timothy Taylor says: "..competition and cooperation are not polar opposites.(…) Competition refers to a situation in which people or organizations (such as firms) apply their efforts and talents toward a certain goal, and they receive results based substantially on their performance relative to each other. (…) Cooperation refers to a situation in which the participants seek out win-win outcomes from working together." If carried out in an unethical or illegal way, competition and cooperation are both unjustified, for example when criminals cooperate or sportspersons compete in an unfair way. Whereas when consumers seek the best deal and companies seek higher profits, only competition can provide optimal solutions.[2] And only through cooperation can market participants get the most out of exchange, as the modern market is a network of mutually beneficial interdependencies.[3] Therefore markets are a blend of competition and cooperation which are both beneficial for societal development.

There are different approaches as to how to deal with the concepts of cooperation and competition in economics. Depending on the point of reference, one can talk about cooperation and competition between citizens, companies, cities, regions, nations or states. At the national level, cooperation and competition concepts can be analyzed internally (within Europe), or externally (the relation between Europe and the rest of the world). As complicated as it may be, there is a solution to treat it in a comprehensive way; international trade analysis. International trade analysis helps to examine the processes of economic cooperation and competition between countries, as these are both aspects of economic exchange. International trade is about purchasing, selling or exchanging goods and services across national borders. An additional form of international trade is foreign direct investment (FDI), which means acquiring the ownership control of a company in another country.

Comparative advantage

Trade has always been the basis for forming economic relations. Key trade economic theory (Ricardian model of absolute and comparative advantage) explains that trade offers welfare gains and that countries involved in international trade can gain substantially from cooperation. According to this classical trade theory, countries can build their wealth through trade in the long term. Wealth could be acquired if the country runs a positive balance of trade, that is, if the country's exports are bigger than imports (the country sells more goods and services to foreigners than it purchases from foreigners). Modern trade theory focuses on gains from trade achieved through specialization in production, lower prices and market access. However the crucial factor is that through innovation and knowledge spillovers, trade enables productivity rise, which is a basic source of economic growth.

Rising growth of exports in the world and a steady increase in trade as a share of the world economy prove that trade has become ever important. The growth of international trade has been stimulated by the steady decline of trade barriers after World War II. The Ricardian model of

[1] Rutherford, D. (2007), Economics: The Key Concepts, New York: Routledge, p.34

[2] Taylor T., The Blurry Line Between Competition and Cooperation, Available at: https://www.econlib.org/library/Columns/y2015/Taylorcompetition.html

[3] Horwitz S., Economics as the Study of Peaceful Human Cooperation and Progress, Speech, Available at: https://www.econlib.org/economics-as-the-study-of-peaceful-human-cooperation-and-progress/

international trade introduces the principle of comparative advantage which helps to understand reasons supporting international trade. This model explains for example, how less productive nations can benefit from free trade with their more productive neighbors.[4]

Adam Smith in his book *The Wealth of Nations* (1776) stated that the real wealth of a country consists of the goods and services available to its citizens. Smith developed the theory of absolute advantage, which holds that different countries can produce some goods more efficiently than others, thus global efficiency can be increased through free trade. Smith reasoned that if trade were unrestricted, each country would specialize in those products that resulted in a competitive advantage for it, which would be either natural or acquired. A country then could use its specialized production excess to buy more imports than it could have otherwise produced.[5] In 1817, David Ricardo expanded Adam Smith's theory of absolute advantage to develop the theory of comparative advantage. He reasoned that there may still be global efficiency from trade if a country specializes in those products that it can produce more efficiently than other products without regard to absolute advantage.

The Ricardian model of trade was a real breakthrough. Up until then, world resources were considered to be limited and static. As a result, one country's economic gain was achieved at the expense of another. This situation is called a zero-sum game. However, David Ricardo proved that international trade is a positive-sum game (win-win situation). Any country can export the goods in which it has the greatest relative productivity and in exchange receive goods which domestically are more expensive to produce. Furthermore, exporting by an industry can increase its productivity as a result of learning-by-doing, economies of scale, or other factors.[6] Therefore comparative advantage becomes dynamic and may evolve because of the country's economic development. It means that countries' relative advantages are changing over time because of knowledge spillovers, technology transfers or factor accumulation.

Since then other trade theories have appeared, but the theory of comparative advantages is still valid as a simple explanation of a country's international trade performance.[7] A New Trade Theory included the assumptions of economies of scale, product differentiation and imperfect competition into a trade theory. In short, the increasing returns made from the large production of tradable goods make it easier to sell them abroad at competitive prices.[8] Gravity theory also adds a spatial context, in which geographical location influences the volume of trade, and distance factor limits the trade. Nevertheless, how much countries gain depends mainly on the nature of comparative advantage, which is related to sector-level productivity. Countries produce and export a wide variety of goods, which differ greatly by characteristics and by quality. That is why if any country is successful and achieves high export performance for some of these goods, it is most likely a result of its comparative advantage in their production.

Ricardian model of trade – example

The following example shows how the theory of comparative advantage works with a fictitious example of international trade. Suppose that Czechia and Poland currently produce beer and apples. Citizens consume their own domestic products. In Poland 1 hour of labour is needed to produce 1

[4] International Economics - Theory and Policy, p.53, Available at: https://open.umn.edu/opentextbooks/textbooks/international-economics-theory-and-policy

[5] Daniels J.D., Radebaugh L.H., (1994), International business Environments and Operations, 7th edition, Addison-Wesley Publishing Company, p.170-171

[6] Appleyard D., Field A., (2014), International Economics, 8th edition , McGraw-Hill/Irwin, p.58

[7] Fernandez-Nunez T., Marquez M.A., (2014), The dynamics of trade composition: Do trade-type interdependencies matter?, The Journal of International Trade & Economic Development, Taylor & Francis Journals, vol. 23(5), pages 710-734, p.3

[8] Rutherford D., (2007)… p.209

bottle of beer or 2 kg of apples. In Czechia 1 hour of labour is needed to produce 4 bottles of beer or 3 kg of apples. The table shows each nations efficiency in the production of beer and apples (labour productivity).

Table 1. Beer and apple productivity in Czechia and Poland.

	Beer	Apples
Czechia	4	3
Poland	1	2

Clearly the Czechia workers' productivity is higher than that of Polish workers, as during 1 hour they are able to produce more beer and more apples (Tab.1). It can be said that 1 bottle of beer is cheaper in Czechia, because it costs 0,25 of labour hour in comparison to Poland where 1 bottle of beer costs 1 labour hour. Similarly 1 kg of apples is cheaper in Czechia with the price of 0,33 labour hour than in Poland where the cost is 0,5 labour hour.

It is evident that Czechia has got an absolute advantage in production of beer and apples (Tab.2). Both of these products are just cheaper to produce in Czechia than in Poland (assuming equal cost of labour). In this situation the question arises whether Czechia should decide to produce both products domestically, or if it is still possible to achieve some gains from specialization and trade.

Table 2. Cost production (in labour hours) of one bottle of beer and one kilogram of apples in Czechia and Poland.

	Beer	Apples
Czechia	0,25	0,33
Poland	1	0,5

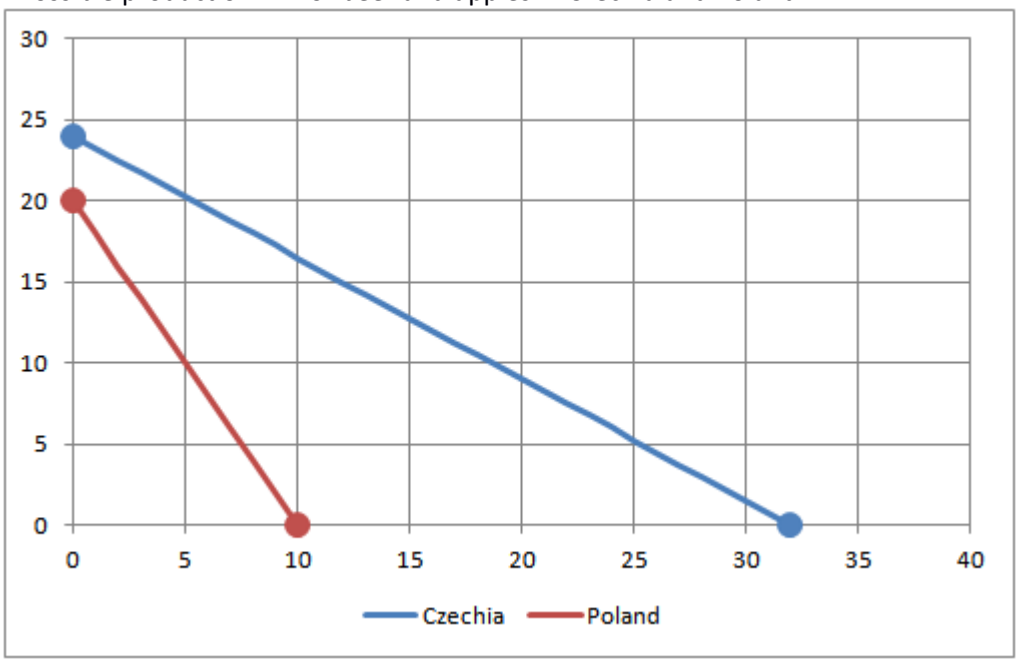
Table 3. Maximal production of beer or apples in Czechia and Poland under specialization.

	Productivity		Labour hours available	Maximal production	
	Beer	Apples		Beer	Apples
Czechia	4	3	8	32	24
Poland	1	2	10	10	20

Let's assume that Czechia has got 8 hours of labour and Poland has got 10 hours of labour available. With these resources Czechia and Poland can achieve different maximal production outcomes (Tab. 3).

The results of all possible production outcomes are shown on a graph (Fig.1). Although Czechia has less resources (8 labour hours) than Poland (10 labour hours), Czechia is able to produce more beer or apples than Poland. It is so, because Czechia has got higher productivity (absolute advantage).

Figure 1. Possible production mix of beer and apples in Czechia and Poland.



Let's say that initially both countries were producing a mixed outcome of beer and apples. Czechia was producing 20 bottles of beer and 9 kg of apples. Poland was producing 5 bottles of beer and 10 kg of apples. Total production was 25 bottles of beer and 19 kg of apples. (Tab.3) Now each country decides to specialize in production of only one product. Looking at the cost of production it is clear that in Czechia, beer is relatively cheaper to produce than apples. It is Czechia's comparative advantage. The situation is quite opposite in Poland, where production of apples is relatively cheaper than beer (Tab.2). Therefore it is Poland's comparative advantage. Therefore it seems obvious that Czechia chooses to produce beer and Poland chooses to produce apples.

Table 3. Initial mixed production of beer and apples in Czechia and Poland.

	Beer	Apples
Czechia	20	9
Poland	5	10
Total production	25	19

After specialization, total production of beer and apples rises (Tab.4). In total there are 32 bottles of beer in comparison to 25 before, and 20 kg of apples in comparison to 19kg before. The question is how to exchange goods between countries to fulfill their domestic demand. If Czechia wanted to have 20 bottles of beer and Poland wanted to have 10 kg of apples, the excess production can be traded. With this assumption an excess production of beer in Czechia (32 – 20 = 12) can be exchanged for apples. Similarly in Poland an excess production of apples (20 – 10 = 10) can be exchanged for beer. As a result, Czechia can export up to 12 bottles of beer to Poland and Poland can export up to 10 kg of apples (Tab. 5).

Table 4. Production of beer and apples in Czechia and Poland after specialization.

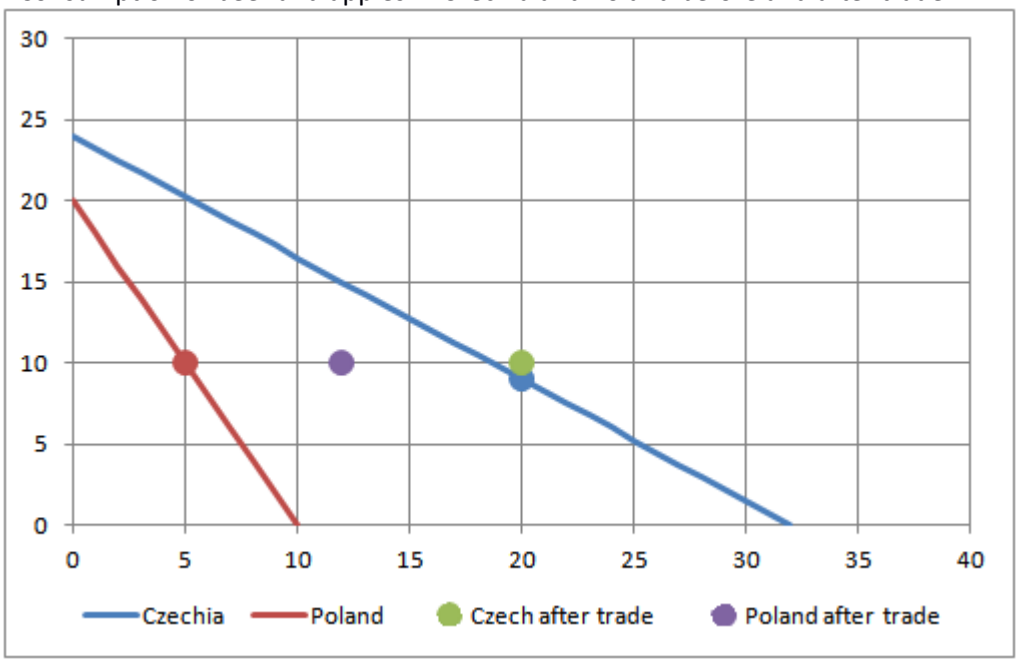
	Beer	Apples
Czechia	32	0
Poland	0	20
Total production	32	20

Finally, it is a matter of negotiations how many bottles of beer Czechia sends to Poland in exchange for 10 kg of apples. Czechia can decide to export 12 bottles of beer or less for 10 kg of apples from Poland. Nevertheless, with specialization and international trade both countries are in a better situation than before. The volume of consumption in Czechia and Poland is higher than was possible without exchange (Fig.2).

Table 5. Initial supply, export and supply after exchange.

	Initial supply		Export		Supply after exchange	
	Beer	Apples	Beer	Apples	Beer	Apples
Czechia	20	9	12	0	20	10
Poland	5	10	0	10	12	10
Total	25	19	12	10	32	20

Figure 2. Consumption of beer and apples in Czechia and Poland before and after trade.



European Single Market

The European Union (EU) is the world's most developed model of regional cooperation and integration. The free movement and exchange of goods was one of the primary reasons to establish the European Union. The EU has progressed from a customs union to a Single Market and the euro area of nineteen countries. European countries have proceeded gradually along the various steps required to create a regional community such as a free trade area, a customs union, a single market, a single currency, a common passport area, and a common foreign policy.[9] Currently the European integration process has grown the European economy to a point in which it covers almost the whole continent, with twenty-seven countries now members. Within this integrated market, several policies have been harmonized or transferred to the European level. Introduction of a common European competition policy enabled fair competition among the member states. Given this market situation,

[9] Cameron F., (2010), The European Union as a Model for Regional Integration, Council on Foreign Relations, cdn.cfr.org, p.2

companies within the European Union market can compete on the basis of their real comparative advantages rather than being protected by discriminating barriers to trade.[10]

In fact the EU has one of the strongest competition policy systems worldwide. The aim of the EU competition policy is to safeguard the correct functioning of the single market. In essence, it ensures that enterprises have the possibility to compete on equal terms on the markets of all Member States. European competition rules are established principally to protect competition, prevent distortions in the market and ensure fairness for market participants. The framework strives to ensure that governments and companies obey EU rules on fair competition, while providing sufficient space for innovation, unified internal market standards and the development of small businesses. EU competition rules also apply to agreements concluded outside the Union if they have effects within the internal market. The EU competition law applies to all the Member States as well as to other countries that form the European Economic Area: Iceland, Liechtenstein and Norway. The policy also applies to non-EU companies operating on the single market.[11]

Setting the EU's common trade policy and tariffs enables cooperation between nations. The Single Market of the EU is established as one economic entity and international trade agreements are the main external competence of the EU.[12] The EU helps its members to protect themselves against the dominant economic powers of their outside trading partners and continues to open up markets outside Europe in the midst of rising protectionism.[13] The EU's market access policies help to improve conditions for European companies to export worldwide and to make sure that their trading partners follow international trade rules. The EU enforces its rights under international trade rules alongside the EU's trade agreements with partner countries. The EU also uses trade defense instruments to stop imports of artificially cheap goods from flooding the EU market, and imposes additional import duties so that competition is fair. The Commission negotiates with trading partners to raise the standards of intellectual property in non-EU countries, protect the intellectual property of EU companies and to stop the trade in counterfeit and pirated goods and services.[14] The latest Trade Barriers Report provides examples of the EU supporting actions in 2019, for example the following:[15]

- Beef exporters from France, Ireland and the Netherlands regained access to China, producers from Ireland and Croatia recovered access to Japan, and Dutch pork producers can export also to Mexico.
- Polish producers of baby milk powder can export again to Egypt (check for detailed case description at the EC site).[16]
- Belgian pear producers regained access to the Mexican market.

[10] Van Hove J., (2010), Variety and quality in intra-European manufacturing trade: the impact of innovation and technological spillovers, Journal of Economic Policy Reform, Taylor & Francis Journals, Vol. 13, No. 1, 43–59, p. 45

[11] Szczepański M., (2019), EU competition policy Key to a fair single market, European Parliamentary Research Service, Available at: https://www.europarl.europa.eu/thinktank/en/document.html?reference=EPRS_IDA(2019)642209, p.1-2

[12] Congressional Research Service, (2019), The European Union: Questions and Answers, Available at: https://fas.org/sgp/crs/row/RS21372.pdf, p.2

[13] EC, Trade Barriers Report, Available at: https://trade.ec.europa.eu/doclib/press/index.cfm?id=2159

[14] EC, Enforcement and protection, Available at: https://ec.europa.eu/trade/policy/policy-making/enforcement-and-protection/

[15] EC, Trade Barriers Report …

[16] EC, Success story: Polish baby milk producer gains access to Egyptian market Available at: https://trade.ec.europa.eu/doclib/docs/2020/june/tradoc_158791.pdf

According to the French Council of Economic Analysis, European competition policy is rather successful in achieving its current goals: promoting investment, productivity and purchasing power.[17] An earlier study commissioned by the European Parliament has proved that antitrust policy, merger control, State aid control and liberalisation contributed significantly to economic growth in Europe. Effective competition was found to be a driver of an efficient internal market that delivers growth and jobs. Therefore the Commission firmly supports its long-standing view that competitiveness is improved through the exposure of businesses to merit-based competition, which needs to be open and take place on a level playing field. [18]

Free trade effects

There are arguments that support a free trade policy as well as arguments that support various types of protectionist policies. Cross-country evidence suggests however that more open economies have higher income levels and also grow faster. Therefore, openness is important for economic growth both in the short and long term. In the short term, net exports are a source of demand. In the long term, trade is a channel for knowledge transfer and for specialization according to comparative advantage, thereby improving resource allocation and supporting higher economic growth and welfare over time.[19]

One of the main EU goals is to improve Europe's economic performance. It can be achieved by increasing both European competitiveness and cooperation in international trade. The evidence of the EU trade policy results can be observed on the European job market as international trade is an important engine for job creation. According to the Eurostat:

- EU exports support 36 million jobs, up two thirds from 2000. Nearly 14 million of these workers are women. 1 in 7 jobs in the EU depends on exports.
- EU exports support a significant share of jobs in all countries across the EU.
- Exports create opportunities for everyone, both skilled and unskilled workers.
- These jobs are better paid on average.
- Thanks to the EU Single Market, one fifth of the export-supported jobs are located in a different Member State than the one exporting.[20]

Some people oppose the benefits of trade in spite of a large body of literature, which documents the link between growth and openness to trade.[21] It happens, because opening any economy creates both winners and losers. For example, after enlarging the EU with Eastern European countries, some Western European high-wage countries experienced an unemployment rise among the lower-qualified workers.[22] The "Polish plumber" even became an iconic example of cheap labour,

[17] Jean S., Perrot A., Philippon T., Competition and trade: Which policies for Europe?, Available at: https://www.cairn-int.info/article-E_NCAE_051_0001--competition-and-trade-whichpolicies.htm

[18] Szczepański M., (2019)… p.30-31

[19] Hoekman B., (2015), Trade and growth – end of an era? [in:] The Global Trade Slowdown: A New Normal? A VoxEU.org eBook, Centre for Economic Policy Research, CEPR Press, London, www.cepr.org, p.6

[20] EC, Trade means jobs, Available at: https://ec.europa.eu/trade/policy/in-focus/trade-and-jobs/

[21] Lind N., Ramondo N., (2019), The Economics of Innovation, Knowledge Diffusion, and Globalization, Oxford Research Encyclopedia of Economics and Finance, p.2

[22] Zeddies G., (2013), Skill Content of Intra-European Trade Flows, European Journal of Comparative Economics, Cattaneo University (LIUC), vol. 10(1), pages 81-107, p.99

who might contribute to lower social standards in Germany or even come and steal French jobs.[23] At the same time, Eastern European countries were afraid of becoming just a market extension for Western economies on the one hand and of being bought out by wealthier nations on the other. In fact in 2004, after joining the EU, Poland experienced an inflation rise caused by a higher demand for consumer goods from Western countries (Tab. 6).

One of the main arguments against free trade is that the gains and pains of trade are spread unevenly among citizens and between industries. For example, one of the reasons for Brexit was a poor assessment of the EU's trade policy among British citizens. The EU protects sectors of clothes and other labour-intensive goods which are produced in some Southern and Eastern EU countries. Britain advocated less protective trade policies for the benefit of the consumers but had been outvoted by other EU members.[24] Therefore unless there is a general belief that the gains and pains of trade are shared fairly, it is difficult to maintain a social consensus for liberal trade policy.[25]

Table 6. Consumer Price Index and Food and non-alcoholic beverages Price Index in Poland 2003 - 2006

Year	2003	2004	2005	2006
Consumer Price Index	0,8%	3,5%	2,1%	1,0%
Food and non-alcoholic beverages Price Index	-1,0%	6,3%	2,1%	0,6%

Source: Statistical Office of Poland GUS, www.stat.gov.pl

The other problem arises if trade partners do not cooperate in a fair manner. In 2013, the Transatlantic Trade and Investment Partnership (TTIP) negotiations between the EU and USA were launched and ended without conclusion at the end of 2016. Despite potentially benefiting millions of consumers by facilitating trade conditions through the removal of technical and non–tariff barriers and the harmonization of legislative regulations and standards, the TTIP had been long contested by lobbyists in the NGO sector. Although the TTIP was a proposed free trade agreement reducing the regulatory barriers to trade, the TTIP negotiations were criticized mainly for going far beyond standard trade settlements. The proposed TTIP agreement generated widespread public debate on its potential impact on citizens, consumers and businesses including the risk of contamination with genetically modified organisms, toxic chemicals exposure, and lower American standards for specific products or the lack of transparency regarding the talks.[26] Finally, after the United States had withdrawn from the Paris Agreement on climate change and past efforts had demonstrated difficulties in negotiating mutually acceptable commitments in areas identified as priorities by the Union, the negotiations were cancelled by the EU.[27]

[23] Czech Radio, (2005), Polish plumber and nurse feature in ads countering perception of cheap labour from East, 07/29/2005, Available at: https://english.radio.cz/polish-plumber-and-nurse-feature-ads-countering-perception-cheap-labour-east-8629252

[24] Baldwin R., Collier P., Venables A., (2017), Post-Brexit trade and development policy, Policy Insight No.88, CEPR, Available at: https://cepr.org/sites/default/files/policy_insights/PolicyInsight88.pdf p.2

[25] Baldwin R., Collier P., Venables A., (2017)…, p.6

[26] Ghidiu I.A., (2020), Contemporary patterns of transatlantic trade cooperation in a post-Brexit European Union (dis)order, CES Working Papers, Centre for European Studies, Alexandru Ioan Cuza University, vol. 11(4), pages 302-319, p.303

[27] Council of the European Union , (2019), Council decision of 15 April 2019, Available at: https://www.consilium.europa.eu/media/39180/st06052-en19.pdf

International trade analysis

Exploration of international trade flows helps to uncover effects of economic cooperation and competition. There are different ways of conducting trade analysis. To begin with, one can start from a general description, like a trade volume and main trade partners. The analysis can be conducted in absolute and relative terms (percentages). Then the analysis can be focused on bilateral trade among selected countries (for instance top trading partners).

It is important to describe both the current situation and refer it to the past. To analyze trends one should check data in a longer period of time (at least three years). To find out if trade promotes economic competition and cooperation one should assess trade balance (export minus import) for the last one or more years and calculate its cumulative sum.

Some suggestions regarding how to do trade analysis to examine competition and cooperation in the EU are presented in Table 7.

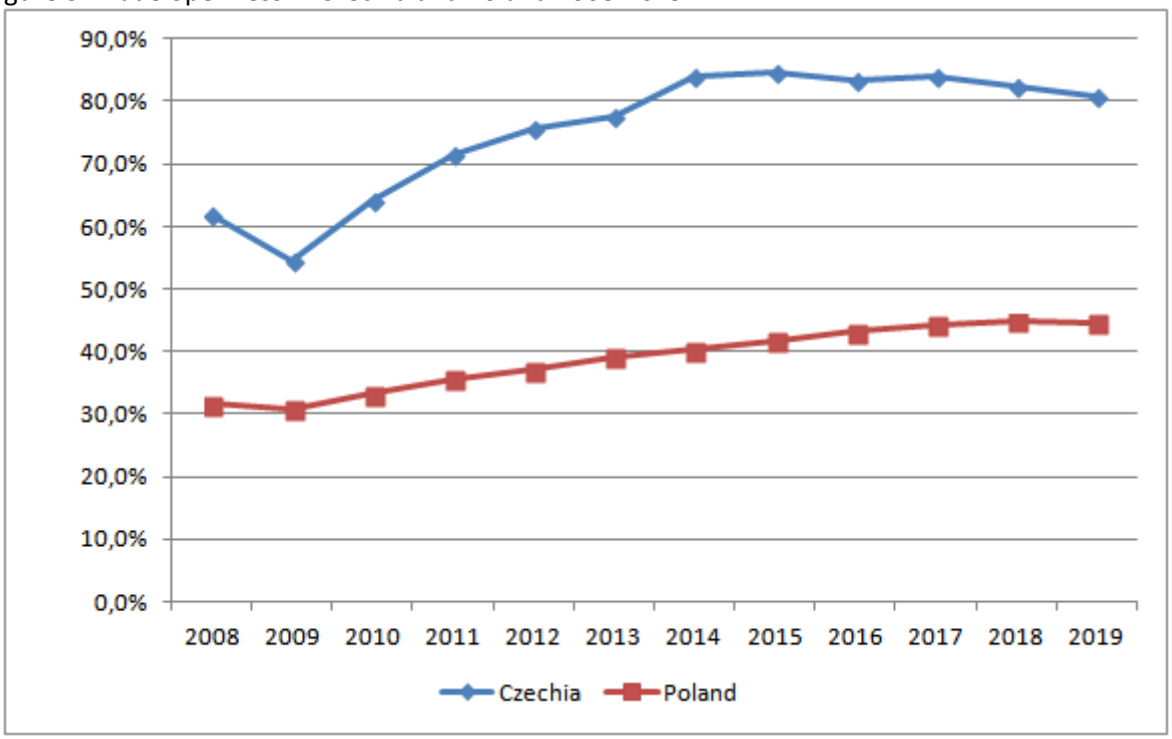
Table 7. Evidence for economic results of competition and cooperation

	Competition	**Cooperation**
Intra-EU trade	What is the trade balance (export-import) for any country within Europe? Is the country gaining or losing economically? How has its trade balance changed during the last 3-5 years?	Exports and imports within EU: effects on employment and income
Extra-EU trade	EU exports to the world: effects on employment and income	How EU membership helps with trade development for any country? Is the country gaining or losing economically? How has its trade / trade balance changed during the last 3-5 years?

To assess to what extent any country is engaged in international trade or in other words how open its economy is, one can use a ratio of export value (or sum of export and import) to GDP. The measure is simple and easy to calculate but it is not a perfect one. For example, it is not suitable for comparison between small and big economies, because the bigger the country's economy is, the smaller its trade as a percentage of GDP.

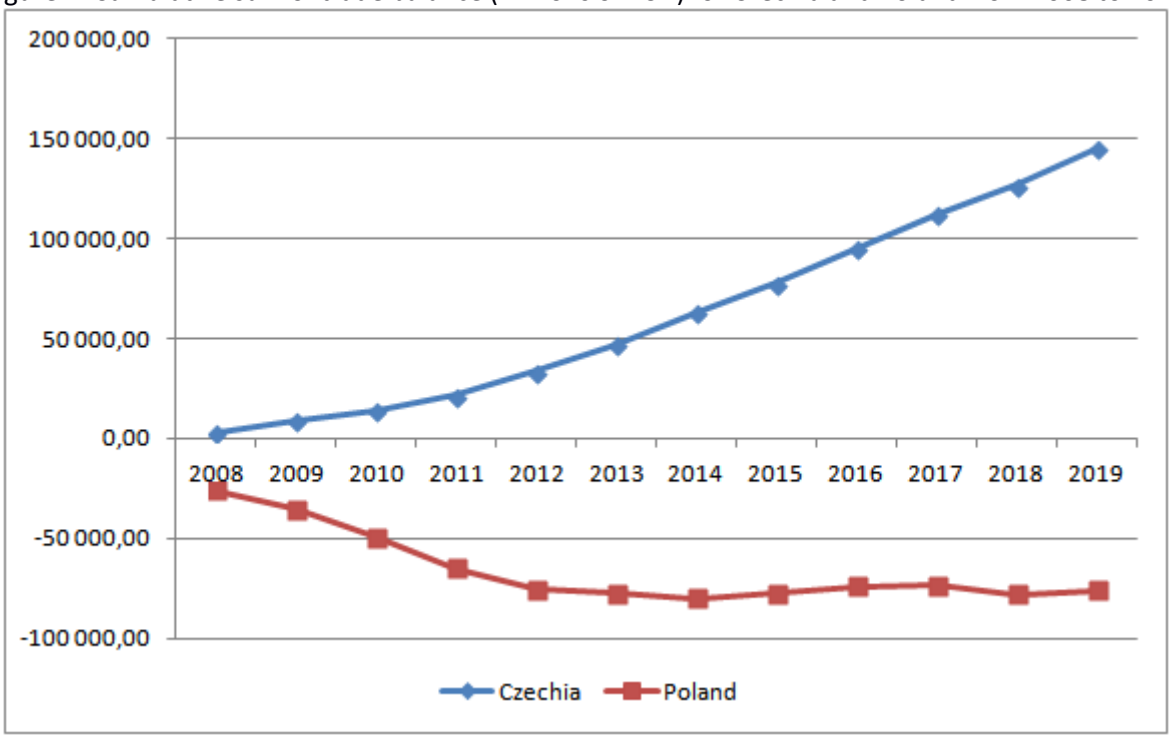
For example, overall trade effects can be shown using real data in the Czechia and Poland case. First, in terms of openness Czechia is more trade-oriented than Poland. In 2019 Czechia openness level (exports/GDP) was 80,7% in comparison to 44,6% in Poland (Fig.3). Then the overall trade effect is visible after calculating a cumulative sum of trade balance for Czechia and Poland from 2008 to 2019. While Poland struggles with its negative trade balance, international trade became a success factor for Czechia's economy, which reaps the gains of a positive trade balance in a systematic way (Fig.4).

Figure 3. Trade openness in Czechia and Poland 2008-2019



Source: Calculated with Eurostat data.

Figure 4. Cumulative sum of trade balance (millions of EUR) for Czechia and Poland from 2008 to 2019



Source: Calculated with Eurostat data

Additional exercise

Find out what is the level of openness (0-100%) and the share of exports for one or more top trading partners (0-100%) now and in the past (the longer the period, the more clear the results, so use at least a 3 or 5 years time period). Illustrate data for different EU countries with a chart (XY type): past and present. To download data for all EU countries check following resources:

- GDP from Gross domestic product at market prices, Available at: https://ec.europa.eu/eurostat/databrowser/view/tec00001/default/table?lang=en
- Trade balance, Exports, Imports from International trade by reporting country in total 2013-2019, Available at: https://ec.europa.eu/eurostat/databrowser/view/tet00002/default/table?lang=en

Compare and discuss the results. Can you identify any patterns of intra-EU trade flows? If so, can you explain it by referring to a country's characteristics like size, wealth, cultural similarities etc.?

Check the trade balance for the selected countries. How has it changed for the chosen period?

Advices for further studies

Possible extensions are as follows:

- Shifting a place of focus from general trade to goods and services and their types.
- Updating data to study the effects of current circumstances caused by Covid-19.
- Identifying trade patterns within the EU.

With the analysis of trade as a whole one can overlook some interesting features. Therefore it is advisable to look into details like trade of goods vs. trade of services or different manufacturing groups.

The recent Covid-19 epidemic has had a tremendously negative impact on the EU economy and trade. However, the analysis of the current situation is highly limited at present as publicly available data is delayed (usually for one year or more). Nevertheless, as access to economic data increases in coming months, 2020/2021 circumstances can be also included into the lesson scenario.

One can observe some trade patterns in the intra-EU trade. Looking for trade patterns with statistics can be an intellectually stimulating exercise. Here are some examples of the EU trade patterns:

- The large majority of Eastern European trade is with Western Europe. For Western Europe, however, Eastern Europe is still a minor trade partner.
- The EU dominates trade with Greece and Portugal despite their long EU membership.

Glossary

- Absolute and comparative advantage - Absolute and comparative advantage is the primary explanation for trade among countries. When a country has the best technology for producing a good, it has an absolute advantage in the production of that good. When a country produces some goods in the best way compared with how well it produces other goods then it has comparative advantage in producing those goods.
- Competition - Competition can be understood as individual activity which is aimed at an individual achievement.
- Cooperation - Cooperation can be understood as joint production (activity) or consumption by a group of people for their mutual benefit.
- European Union - The EU is a single market which is more than a customs union. The Single Market establishes the EU as one economic entity, with international trade agreements as the main external competence of the EU. Export - Goods leaving the statistical territory of a country.
- Import - Goods which add to the stock of material resources of a country by entering its economic territory.
- International Trade - International trade is about purchasing, selling or exchanging goods and services across national borders. An additional form of international trade is foreign direct investment (FDI), which means acquiring the ownership control of a company in another country.
- Openness – Economic openness shows to what extent any country is engaged in international trade or, in other words, how much its economy is open. This measure is based on a ratio of export value (or sum of export and import) to GDP.
- Ricardian model - The Ricardian model explains how a country's technology (productivity) affects its trade pattern. Ricardo showed that countries could benefit from international trade without having to use tariffs and that free trade between countries brings gains for all trading partners.
- Win-win situation - A win-win situation or result is one that is good for everyone who is involved. For instance, supporters of globalization assert that it is a win-win proposition for the rich and the poor.[28]

[28] win-win [in:] Cambridge Dictionary Online, Available at: https://dictionary.cambridge.org/pl/dictionary/english/win-win

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23. Zeddies G., (2013), Skill Content of Intra-European Trade Flows, European Journal of Comparative Economics, Cattaneo University (LIUC), vol. 10(1), pages 81-107

3. Training material

Activity: EU trade patterns analysis

Activity title	EU trade patterns analysis
Overview	The purpose of this lesson is to guide students into the economic perspective of international trade in the context of European cooperation and competition. The lesson is based on freely available resources provided by Eurostat. Students analyze the state of EU trade in various ways and changes that occur during their chosen period of time. It is a knowledge-based type of learning which is combined with analytical skills development. The learning scenario improves students' critical thinking skills, communication skills and use of ICT resources.
Objectives	The objective is to introduce concepts of European cooperation and competition in economics. This learning scenario should create an educational experience which reflects the complexity of the economy in the real world.
Materials	Computers with Internet access and preferably spreadsheet software (Ms Excel)
Time	1. Teachers presentation: 90 min 2. Students individual analysis: 60 min 3. Students presentation: 30 min 4. Discussion: 30 min 5. Final thoughts description: 30 min
Introductory requirements	The level of economic knowledge needed for this lesson depends on the planned depth of analysis. For an introductory level, an understanding of common economic concepts like GDP, export, and import is required.
Limitations	For the purpose of the workshop, simple analysis of trade is used to illustrate cooperation and competition issues. However, international trade is a matter of an advanced level of study in economics which requires a significant amount of time and effort. This analysis is limited in scope, both in theory and analysis. The analysis focuses only on the balance of trade (exports and imports) and does not include balance of payment investigation nor exchange-rate impact. Therefore the workshop should be treated only as an introduction to the subject.
Group size	10-15
Instructions for trainers	1. At the beginning, general trade theory and the EU's economic position in the world should be presented. 2. Students should individually analyze trade in their chosen countries using the Eurostat resources and present a description of their work. They are asked to examine exports, imports, 1-5 top trade partners and balance of trade.

	3. Students can also individually analyze trade patterns (changes in a longer period of time like 5-10 years or between selected countries). 4. After identifying and analyzing different trading patterns students should present their discoveries. Next they should discuss if presented results provide confirmation of economic cooperation and/or competition in the EU.
Debriefing and evaluation	After discussion students should write down their opinion on the subject (up to 500 words). They should answer what they have learned and if their opinion about benefits of international trade and its economic effects on cooperation and competition has changed after workshops.
Tips for trainers	Like many relevant subjects linked to economics and politics, the subject of economic cooperation and competition in the context of international trade may be controversial. Trainers should be aware that some people may have a strong opinion about the subject of economic cooperation and competition and/or emotionally engage in discussion.
More on http://economic-literacy.eu	

Background information

Workshops should be prepared mainly with reference to: Globalisation patterns in EU trade and investment. It is an online Eurostat publication presenting a summary of recent European Union (EU) statistics on economic aspects of globalisation, focusing on patterns of EU trade and investment. Statistics about trade (like how data are collected) are explained in the User guide on European statistics on international trade in goods.[29]

Eurostat resources for workshop activity:

- Globalisation patterns in trade and investment, Available at: https://ec.europa.eu/eurostat/statistics-explained/index.php/Globalisation_patterns_in_trade_and_investment_-_introduction
- General information about trade in EU, Available at: https://ec.europa.eu/trade/
- More EU trade websites, Available at: https://trade.ec.europa.eu/
- International trade in goods - a statistical picture, Available at: https://ec.europa.eu/eurostat/statistics-explained/index.php?title=International_trade_in_goods_-_a_statistical_picture

Eurostat provides an interactive data visualisation on trade in goods and on trade effects in the EU:

- Trade in 2019, Available at: https://ec.europa.eu/eurostat/news/themes-in-the-spotlight/trade-in-goods-2019
- Trade in 2018, Available at: https://ec.europa.eu/eurostat/news/themes-in-the-spotlight/trade-in-goods-2018
- Trade in 2017, Available at: https://ec.europa.eu/eurostat/news/themes-in-the-spotlight/trade-in-goods-2017

[29] User guide on European statistics on international trade in goods 2016 edition, Eurostat, Available at: http://ec.europa.eu/eurostat/

- Trade in 2016, Available at: https://ec.europa.eu/eurostat/news/themes-in-the-spotlight/trade-in-goods-2016
- Trade in 2015, Available at: https://ec.europa.eu/eurostat/news/themes-in-the-spotlight/trade-in-goods-2015
- Trade in 2014, Available at: https://ec.europa.eu/eurostat/news/themes-in-the-spotlight/trade-in-goods-2014
- Data for International trade by reporting country in total (Trade balance, Exports, Imports) 2013-2019, Available at: https://ec.europa.eu/eurostat/databrowser/view/tet00002/default/table?lang=en
- Gross domestic product at market prices, Available at: https://ec.europa.eu/eurostat/databrowser/view/tec00001/default/table?lang=en
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- Effects of EU Exports On Employment And Income, Available at: https://ec.europa.eu/jrc/en/research-topic/economic-environmental-and-social-effects-of-globalisation/effects-eu-exports-employment-income

Class organization outline

1. Teacher starts with an introduction based on the long version.
2. Each student makes a list of elements that characterize the trading position of a selected country.
3. After presentation of their findings students will discuss together the benefits and drawbacks of trade.
4. The lesson ends with a debate on economic cooperation and competition in the European Union.
5. By the end of the lesson, students should be able to describe the economic impact of trade in the EU. They should also be able to identify countries which benefit the most and the least from trade in the EU.
6. Students discover how economic cooperation and competition in the EU helps their national economies to grow in a globalized world.

4. Interactive learning

Quiz

1	Cooperation can be understood as joint production (activity) or consumption by a group of people for their …. benefit. **a) mutual** b) individual
2	Competition is based on … efforts to achieve a goal. a) common **b) individual**
3	Competition and cooperation … polar opposites. a) are **b) are not**
4	If acted in unethical or illegal way competition and cooperation are both… . **a) unjustified** b) justified
5	Markets are a blend of competition and cooperation which are both … for societal development. a) harmful **b) beneficial**
6	International trade is about purchasing, selling or exchanging of goods and services … national borders. **a) across** b) within
7	Countries involved in international trade can … substantially from cooperation. **a) gain** b) lose
8	Wealth could be acquired, if the country runs a … balance of trade, that is, if the country export is bigger than import. **a) positive** b) negative
9	Through innovation and knowledge spillovers trade … productivity rise. a) disables **b) enables**
10	The theory of absolute advantage holds that different countries can produce some goods more efficiently than others, thus global efficiency can be … through free trade. **a) increased** b) decreased

11	According to the theory of comparative advantage there may still be global efficiency from trade if a country specializes in those products that it can produce more efficiently than other products … regard to absolute advantage. a) with **b) without**
12	International trade is a positive-sum game (win-win situation), because any country can export the goods in which it has the … relative productivity and in exchange receive goods which domestically are … expensive to produce. a) smallest, less **b) greatest, more**
13	… by an industry can increase its productivity as a result of learning-by-doing, economies of scale, or other factors. **a) Exporting** b) Importing
14	The free movement and exchange of goods was one of the … reasons to establish the European Union. a) less important **b) primary**
15	Introduction of a common European competition policy enabled … competition among the member states. **a) a fair** a) an unfair
16	Companies within the European Union market can compete on the basis of their real comparative advantages … being protected by discriminating barriers to trade. **a) without** b) while
17	The aim of the EU competition policy is to safeguard the correct functioning of the … . a) national markets **b) single market**
18	Setting the EU's common trade policy and tariffs enables … between nations. **a) cooperation** b) competition
19	One of the main arguments … free trade is that, the gains and pains of trade are spread unevenly among citizens and between industries. a) for **b) against**
20	To assess to what extent any … is engaged in international trade or in other words how open its economy is, one can use a ratio of export value (or sum of export and import) to GDP. a) company **b) country**

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FRESH-UP ECONOMICS

Introduction into feminist economics

by AVITEUM's team

Table of contents

1. Overview

Introduction

What is feminist economics? What are its origins? How can feminist economics fill gaps in classical economic discourse? What are the main principles of feminist economics? And what are the main gender-based economic inequalities?

Answers to those questions are shortly outlined in this article which serves as an introduction to the topic of feminist economics. It guides the reader throughout the origins of feminist economics, clarifies main critiques of neoclassical paradigm, introduces principles of feminist economics and provides global data illustrating gender-based economic inequalities. A more detailed analysis of this topic is available in the background information.

Definition of feminist economics

Feminist economics can be regarded both as a **school of economic thought** as well as a **political action**. There are different definitions of the term "feminist economics". The below mentioned one offers a comprehensive explanation: "*Feminist economics analyses the **interrelationship between gender and the economy**. Thereby, feminist economics also takes the **unpaid, non-market intermediated part of the economy and society** into account and examines the driving forces behind common dichotomies such as economic–social, productive–reproductive, masculine–feminine, paid–unpaid or public–private. Moreover, feminist economics analyses patriarchy and capitalism as interrelated forms of dominance. Against this background, questions arise about the distribution and disposal of property, income, power, knowledge and the own body.*" [1]

Origins of feminist economics and important thought-leaders

The origins of feminist economics date back to mid-19th century, certain concerns about the situation of women can be found even in literature of 17th and 18th centuries. However, it gained on importance during the 1990s when the term "feminist economics" was first used.

The key material regarded as founding document of feminist economics was Marilyn's Waring book "If Women Counted" (1988). This book brought a fundamental critique of how economic growth is measured. Waring pointed out that women's unpaid work as well as value of nature have been omitted from variables considered to create the economic activity of nations (system of national accounts). Waring's findings triggered redefinition of gross domestic product by the United Nations.

A further important milestone was establishment of the International Association for Feminist Economics (IAFEE) in 1992, followed by the first volume of the journal Feminist Economics in 1995.

There are many scholars or "thought-leaders" who contributed to development of feminist economics such as the Danish economist Ester Boserup, American economists Marianne Ferber, Barbra

[1] Urban, Janina, Purckahuer, Andrea (2016). *Feminist Economics.* Available at: https://www.exploring-economics.org/en/orientation/feminist-economics/

Bergmann, Heidi Hartmann or Julie A. Nelson or Indian development economist Bina Agarwal. A list of further names of feminist economists can be found here: https://en.wikipedia.org/wiki/List_of_feminist_economists.

Over time, feminist economics developed its own theoretical base (concepts, analytical frameworks, methodologies) as well as initiatives for its practical application which became a source for political decisions. It gradually evolved in a clearly opposing school of thought to neoclassical economics.

Feminist economics has been also closely interlinked with political and social movements. It is not a single school of economic thought. It's very diverse and includes many different perspectives. Over the years three main perspectives developed: **liberal feminist economics, constructivist feminist economics, and critical feminist economics**.

Critiques: neoclassical vs. Feminist paradigms

Feminist economics criticises the neoclassical paradigm and its political correlates. The neoclassical paradigm is considered to be mainstream and is rooted in complex and technical discourses and methodologies. It prevails in academic as well as political institutions. On the other hand, the feminist paradigm is lacking in integrated theoretical base and common platforms to discuss and disseminate alternative views.

The neoclassical paradigm operates with a universal figure called **"homo economicus"** who is considered to be an active agent on the labour market who is self-sufficient, selfish and rational. Homo economicus is free from societal influence and has clearly defined preferences. It operates in an ideal market based on self-interest where prices are the only means of communication. Homo Economicus has unlimited desires and limited resources and is able to optimise his/her choices.

In contrast, the feminist paradigm sees people as **relational human beings** who are defined by many variables (e.g., gender, age, race, social class, religion, beliefs, values, migration status, family status etc.). They are influenced by the societies they live in. People's choices are influenced by many factors, and they have different opportunities resulting from unequal positions.

Further differences between the neoclassical and feminist paradigms are analysed in the long version of the article.

Principles of feminist economics

By pointing out the key differences between the neoclassical and feminist paradigm, we can observe substantial differences and also many aspects that have been traditionally neglected in economic theories. In 1998, Geoff Schneider and Jena Shackelford[2] proposed 10 principles of feminist economics as an antidote to the widely proclaimed principles of economics of the time, such as those of Gregory Mankiw. A professor of economics at Harvard, Mankiw brought a review of ten economic principles

[2] Schneider, Geoff; Shackelford, Jean. "Ten Principles of Feminist Economics: A Modestly Proposed Antidote". Dept. of Economics, Bucknell University. 2012
https://web.archive.org/web/20120630022557/http://www.facstaff.bucknell.edu/gschnedr/FemPrcpls.htm

in his book *Principles of Economics*[3]. By contrasting those principles, Schneider and Shackelford brought a feminist alternative which questioned the universally accepted principles. The complete list of principles is included in the long version of the article.

Gender-based economic inequalities in data

Many research studies discuss and bring attention to important subjects that highlight the gender-based economic inequalities. The critiques of traditional economics brought by feminist economists showed that many topics were neglected and not sufficiently regarded in economic discourse such as the care economy, unpaid work, gender pay gap, household bargaining, glass ceiling etc. The inequalities connected with all these topics have gender-based nature. Therefore, it's important to understand what the implications resulting from gender-based inequalities are. A comprehensive overview of data illustrating the main inequalities are brought by Esteban and Roser in their article published in 2018.[4]

According to Esteban's and Roser's research, the current data show following results:

1. *Men tend to earn more than women all over the world. The gender pay gap has decreased in the last couple of decades in most countries.*
2. *Women are often underrepresented in senior positions in firms.*
3. *Women are often overrepresented in low-paying jobs.*
4. *Women are less likely to own land and control productive assets.*
5. *Women have often limited control over household resources.*
6. *Gender-equal inheritance systems are not adopted in all countries.*
7. *On the whole gender inequalities have been shrinking substantially over the last century.*

Conclusion

To sum up, feminist economics covers a wide spectrum of areas which are being researched and contributes to a more holistic understanding of how men and women participate in the economy. Feminist economics brought new questions and variables into economic research and represents a strong contribution to diversification of economic discourse. It plays an important role in rethinking the way we understand economics and the driving forces behind it.

[3] Mankiw, N. Gregory (2020). *Principles of economics* (Ninth ed.). Boston, MA. ISBN 978-0-357-03831-4. OCLC 1109789332

[4] Ortiz-Ospina Esteban, Max Roser (2018). *Economic inequality by gender.* Available at: https://ourworldindata.org/economic-inequality-by-gender

2. Background information

Introduction

What is feminist economics? What are its origins? How can feminist economics fill gaps in classical economic discourse? What are the main principles of feminist economics? And what are the main gender-based economic inequalities?

Answers to those questions are outlined in this article which serves as an introduction to the topic of feminist economics. It guides the reader throughout the origins of feminist economics, clarifies main critiques of the neoclassical paradigm, introduces principles of feminist economics and provides global data illustrating gender-based economic inequalities.

Definition of feminist economics

Feminist economics can be regarded both as a **school of economic thought** as well as a **political action**. There are different definitions of the term "feminist economics". The below mentioned one offers a comprehensive explanation:

*"Feminist economics analyses the **interrelationship between gender and the economy**. Thereby, feminist economics also takes the **unpaid, non-market intermediated part of the economy and society** into account and examines the driving forces behind common dichotomies such as economic–social, productive–reproductive, masculine–feminine, paid–unpaid or public–private. Moreover, feminist economics analyses patriarchy and capitalism as interrelated forms of dominance. Against this background, questions arise about the distribution and disposal of property, income, power, knowledge and the own body."* [5]

Origins of feminist economics and important thought-leaders

The origins of feminist economics date back to mid-19th century, and certain concerns about the situation of women can be found even in literature of 17th and 18th centuries. However, it gained importance during the 1990s when the term "feminist economics" was first used.

The key material regarded as founding document of feminist economics was Marilyn Waring's book "If Women Counted" (1988). This book brought a fundamental critique of how economic growth is measured. Waring pointed out that women's unpaid work as well as value of nature have been omitted from variables considered to create the economic activity of nations (system of national accounts). Waring's findings triggered redefinition of gross domestic product by the United Nations.

A further important milestone was establishment of the International Association for Feminist Economics (IAFEE) in 1992, followed by the first volume of the journal Feminist Economics in 1995.

[5] Urban, Janina, Purckahuer, Andrea (2016). *Feminist Economics.* Available at: https://www.exploring-economics.org/en/orientation/feminist-economics/

There are many scholars or "thought-leaders" who contributed to development of feminist economics such as the Danish economist Ester Boserup, American economists Marianne Ferber, Barbra Bergmann, Heidi Hartmann or Julie A. Nelson or Indian development economist Bina Agarwal. A list of further names of feminist economists can be found here: https://en.wikipedia.org/wiki/List_of_feminist_economists. Below, we mention in brief the key theories of four female economists who brought important contributions to development of feminist economics. For further reading, please visit the hyperlinks.

Ester Boserup (1910-1999)	Ester studied connections between gender and economic development. She brought attention to the disproportionate division of work between men and women. Her work initiated discussion about better opportunities for women regarding work and education. She influenced the discourse related to gender and development practices with her work *Woman's Role in Economic Development* published in 1970.
Marianne Feber (1923-2013)	Marianne published several books that investigated the subjects of women and work, construction of gender and family. She pointed out that childcare and family responsibilities need to be readjusted not only in the family but also by the employers to support the increase of women entering the workforce. Her major publications include: *Women and Work, Paid and Unpaid* (1987) or *Work and Families: Policies for a Changing Workforce* (1991).
Barbara Bergmann (1927-2015)	Barbara made important contributions to feminist economics. She argued that labour markets do not have a pervasive discrimination character. Besides, she also criticised the traditional economic paradigms which she regarded as being based on unrealistic assumptions. Her work covered many topics, among them gender issues, childcare, social security or poverty.
Heidi Hartmann (1945 -)	Heidi is the founder of Institute for Women's Policy Research (IWPR) based in Washington. She specialises in research related to women, economics and public policy. Heidi calls for a fairer division of home care to improve work opportunities for women. She also pointed out that social security provides both advantages as well as disadvantages for women. Since women have less access to pensions and savings, in their elderly age they predominantly rely on social security which makes them more vulnerable.

Over time, feminist economics developed its own theoretical base (concepts, analytical frameworks, methodologies) as well as initiatives for its practical application which became a source for political decisions. It gradually evolved into a clearly opposing school of thought to neoclassical economics.

Feminist economics has been closely interlinked with **political and social movements**. Feminist economists have been advocating for women's right to vote, equal access to labour market, financial independence, participation in unions, sexual and physical self-determination and recognition of unpaid work. The **political demands**[6] of feminist economists include the reduction of working hours

[6] Exploring Economis. Avalilable at: https://www.exploring-economics.org/en/orientation/feminist-economics/

and a basic income or more radical concepts such as the four-in-one perspective developed by Frigga Haug, which requires distribution of available time to four equal spheres: wage, reproductive labour, volunteering and leisure. Feminist economics is also closely interlinked with ecological movements which point out the intercorrelation between the ecological crisis and the crisis of social reproduction.

Feminist economics is not a single school of economic thought. It's very diverse and includes many different perspectives. Over the years three main perspectives developed[7]:

- **Liberal feminist economics**
  This perspective strives for equal access to the labour market which is seen as a tool to reach gender equality. It focuses on analysis of wage differentials, barriers of equal access to the labour market for women and effects of political and economic instruments on women.
- **Constructivist feminist economics**
  Constructivist feminist economics analyses the question of the attribution of gender identities. Such identities have an impact on economic decisions, structures and processes. If women perform jobs perceived as "female" work, this perspective asks if such a decision does or does not reproduce stereotypes and gender inequalities.
- **Critical feminist economics**
  This perspective analyses the interdependency of capitalism and gender inequalities. It started from a critique of the Marxist labour theory of value which omits the unpaid reproductive labour carried out by women.

Critiques: neoclassical vs. Feminist paradigm

The feminist economics criticizes the neoclassical paradigm and its political correlates. Below we are summarising the key assumptions of both paradigms highlighting the key differences [8] [9] [10]

[7] -dtto-

[8] Agenjo-Calderón, A. & Gálvez-Muñoz, L. (2009). *Feminist Economics: Theoretical and Political Dimensions.* The American Journal of Economics and Sociology, Volume 78, Issue 1, 137-166.

[9] Satz, Debra (2017). *Feminist Perspectives on Reproduction and the Family*. The Stanford Encyclopedia of Philosophy, Edward N. Zalta (ed.). Available at: https://plato.stanford.edu/archives/sum2017/entries/feminism-family/

[10] Schneider, Geoff; Shackelford, Jean (2012). *Ten Principles of Feminist Economics: A Modestly Proposed Antidote.* Dept. of Economics, Bucknell University. Available at: https://web.archive.org/web/20120630022557/http://www.facstaff.bucknell.edu/gschnedr/FemPrcpls.htm

	Neoclassical paradigm	Feminist paradigm
Bases	The neoclassical paradigm is considered to be mainstream and is rooted in complex and technical discourses and methodologies. It prevails in academic as well as political institutions.	The feminist paradigm is lacking in integrated theoretical base and common platforms to discuss and disseminate alternative views.
Keywords	The key words are: free market, competition, individualism, rationality, individual interests, separation of ends and means, growth and progress as ultimate objectives and universal principles of social evolution	The key words are: gender, inclusion, equality, solidarity, social relationships, action and reproduction, unpaid domestic work and care-giving, human well-being as a measure of economic success, ethical dimensions
Actors 	**"Homo Economicus"** = a universal figure, an active agent on the labour market who is self-sufficient, selfish and rational. Homo economicus is free from societal influence and has clearly defined preferences. They operate in an ideal market based on self-interest where prices are the only means of communication. Homo Economicus has unlimited desires and limited resources and is able to optimise his/her choices.	**"Relational human beings"** = people are relational and they are defined by many variables (e.g., gender, age, race, social class, religion, beliefs, values, migration status, family status etc.). They are influenced by the societies they live in. People's choices are influenced by many factors, and they have different opportunities resulting from unequal positions.
Free trade	Neoclassical economists follow David Ricardo's theory of comparative advantage and consider trade as a tool helping everyone to have a better position through efficiency gains from specialisation and greater efficiency.	In contrast, feminist economists point out that specialisation might lead to increased vulnerability. An example is specialisation in the cultivation of a single cash crop for export in Africa which leads to vulnerability to price fluctuations, weather conditions or pests. Moreover, the earnings from cash crops are traditionally controlled by men.
Family	Family is an economic unit which searches for its self-interest outside the household, whereas it behaves altruistically inside to reduce possible conflicts. Family members specialise in activities where they have a comparative advantage: men in the labour market, women in unpaid domestic and care work. (*Based on Gary Becker´s model of "new family" in 1970s*)	Family is regarded as a social institution backed up by laws. Thus, the state is an important actor which intervenes in families. According to feminist economists the family has crucial role in development of future citizens. Domestic and care work are unequally distributed. The family constrains or enables women's freedoms.
Labour	Childcare and domestic work are regarded as non-market activities. Thus,	Childcare and domestic work are important phenomena which should be

	their value is not included into variables creating economic growth.	valued and incorporated into national accounts.
Power	Neoclassical approach sees sale of labour as a mutually beneficial exchange. As such, the notion of power is not an issue since both parties, an employer and an employee, are equal no matter their gender.	Feminist approach calls for attention to power inequities in employer-employee relations since men are often favoured and women tend to be disadvantaged in the workplace. Power and patriarchy are important terms to consider when analysing the functionality of economic institutions.
Inequities	Conventional neoclassical theories consider inequities on the labour market as a result of free choices made by women and men. Women and men have different preferences or abilities which result in different status and position.	Feminist economists see inequities such as gender pay gap, occupational segregation or glass ceiling as a consequence of discrimination, patriarchal beliefs, sexism or stereotyping.

Principles of feminist economics

By pointing out the key differences between the neoclassical and feminist paradigms, we can observe substantial differences and also many aspects that have been traditionally neglected in economic theories. In 1998, Geoff Schneider and Jena Shackelford[11] proposed 10 principles of feminist economics as an antidote to widely proclaimed principles of economics of the time, such as those of Gregory Mankiw. A professor of economics at Harvard, Mankiw brought a review of ten economic principles in his book *Principles of Economics*[12]. By contrasting those principles, Schneider and Shackelford brought a feminist alternative which questioned the universally accepted principles:

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Gregory Mankiw: Principles of Economics	**Geoff Schneider and Jena Shackelford: Ten Principles of Feminist Economics: A Modestly Proposed Antidote**
1. People face trade-offs. *2. The cost of something is what you give up to get it.* *3. Rational people think at the margin.* *4. People respond to incentives.* *5. Trade can make everyone better off.* *6. Markets are usually a good way to organise economic activity.* *7. Governments can sometimes improve market outcomes.* *8. A country's standard of living depends on its ability to produce goods and services.* *9. Prices rise when the government prints too much money.* *10. Society faces a short-run trade-off between inflation and unemployment.*	*1. There can be no such thing as a definitive list of the principles of feminist economics.* *2. Values enter into economic analysis at many different levels.* *3. The Household is a locus of economic activity.* *4. Non-market activities are important to the economy.* *5. Power relationships are important in an economy.* *6. A gendered perspective is central to the study of economics.* *7. Human beings are complex, and they are influenced by more than just material factors.* *8. People compete, cooperate and care.* *9. Government action can improve market outcomes.* *10. The scope of economics must be interdisciplinary.*

Gender-based economic inequalities in data

Many research studies discuss and bring attention to important subjects that highlight the gender-based economic inequalities. The critiques of traditional economics brought by feminist economists showed that many topics were neglected and not sufficiently regarded in economic discourse such as care economy, unpaid work, gender pay gap, household bargaining, glass ceiling etc. The inequalities connected with all these topics have gender-based nature. Therefore, it's important to understand what the implications of gender-based inequalities are. A comprehensive overview of data illustrating the main inequalities are brought by Esteban and Roser in their article published in 2018.[13]

According to Esteban's and Roser's research, the current data show following results:

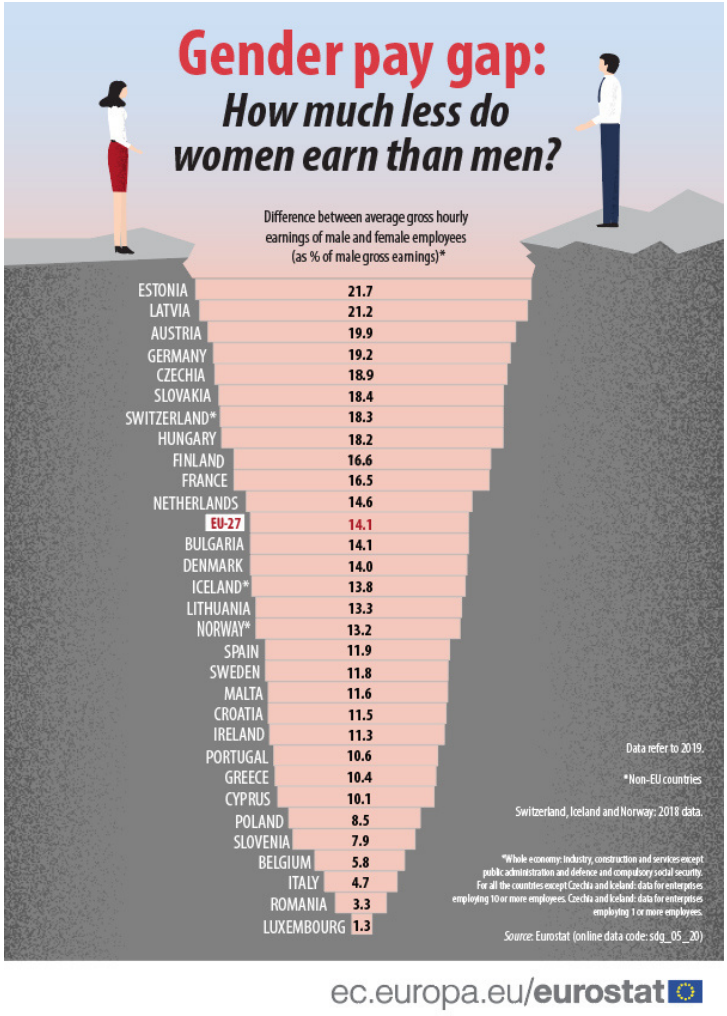
1. *Men tend to earn more than women all over the world. The gender pay gap has decreased in the last couple of decades in most countries.*

[13] Ortiz-Ospina Esteban, Max Roser (2018). *Economic inequality by gender.* Available at: https://ourworldindata.org/economic-inequality-by-gender

2. *Women are often underrepresented in senior positions in firms.*
3. *Women are often overrepresented in low-paying jobs.*
4. *Women are less likely to own land and control productive assets.*
5. *Women have often limited control over household resources.*
6. *Gender-equal inheritance systems are not adopted in all countries.*
7. *On the whole gender inequalities have been shrinking substantially over the last century.*

Below, we are summarising the key findings and data illustrating the above-mentioned results:

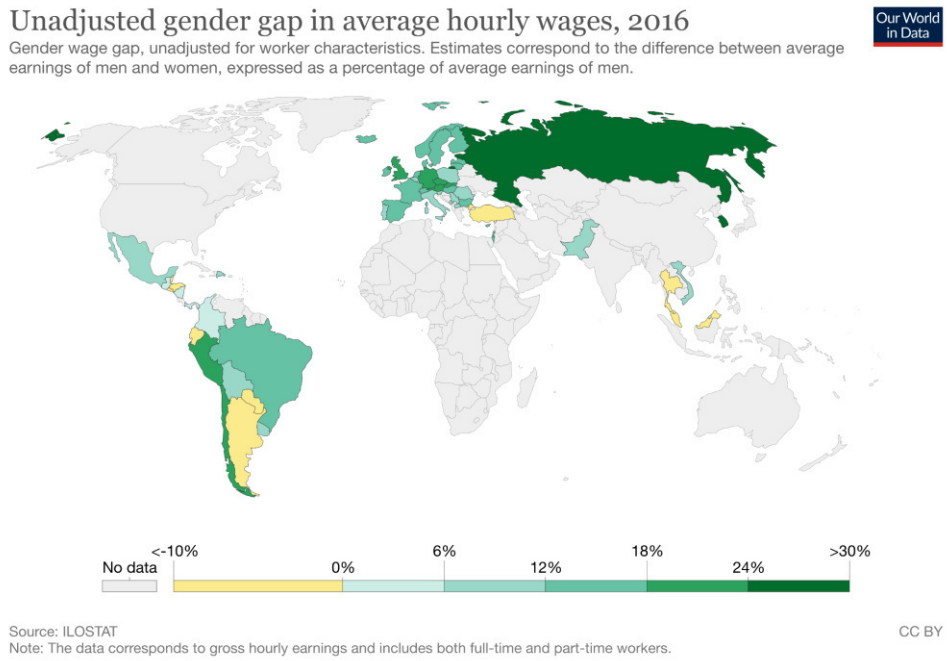
1. The gender pay gap has decreased in the last couple of decades in most countries.
The gender pay gap still persists, however it decreases year by year. When comparing the statistics over the past five years, the gender pay gap reduced across the European Union. The Eurostat data for 2019[14] show that the average gender pay gap in EU-27 amounts to 14.1% which shows the difference between average hourly earnings between men and women. The highest difference is in Estonia (21.7%), the lowest difference is in Luxemburg (1.3%).



Source: EUROSTAT. Available at: https://ec.europa.eu/eurostat/statistics-explained/images/4/43/GPG_2019_data.PNG

[14] EUROSTAT (2019). *Gender pay gap statistics.* Available at: https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Gender_pay_gap_statistics

When looking at the gender pay gap globally, the data of ILOSTAT (2016)[15] show that the highest gap was in South Korea, Estonia, Russia, Germany, Austria, Czechia, United Kingdom, Peru and Chile. A negative difference was in Thailand, Honduras, Belize, Malaysia, Turkey, Ecuador, Argentina or Paraguay.



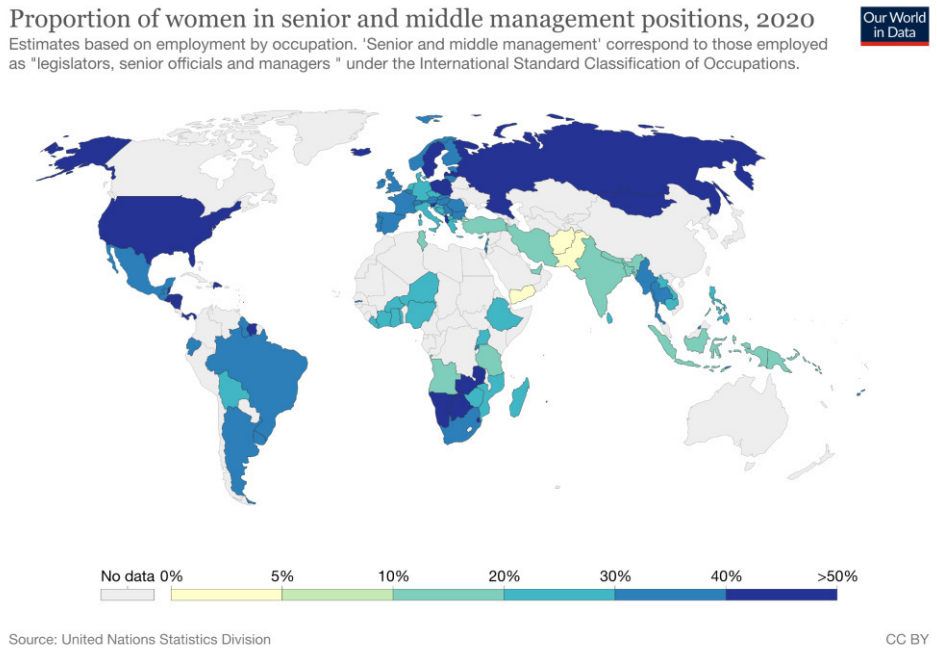
Source: ILOSTAT (2016). Available at: http://www.ilo.org/ilostat/faces/oracle/webcenter/portalapp/pagehierarchy/Page30.jspx

The gender pay gap also changes during life and it increases with age. The data show that it tends to increase when women have children.
The important question here is how to reduce the gender pay gap. There are many strategies which proved to be efficient to help closing the gender pay gap.

- Improving women's level of education has a positive impact on reducing the gender pay gap.
- Changes in public policy and management practices towards family-friendly labour market policies have a positive impact on reducing gender pay gap, e.g. maternity leave coverage or flexible working time arrangements help in women's retention in jobs.
- Early education and childcare help women to return earlier to work, reduces unpaid care work and reduces gender pay gap.
- Changes in social norms and culture stereotypes can positively impact equality in opportunities of men and women and help to reduce gender pay gap.

2. Women are often underrepresented in senior positions in firms.
Women are less likely to be found in management positions compared to men. High-profile jobs are still mainly represented by men. The map from the United Nations Statistics Division shows the proportion of women in senior and middle management positions by 2020. Globally, only about 19% of enterprises have a female manager.

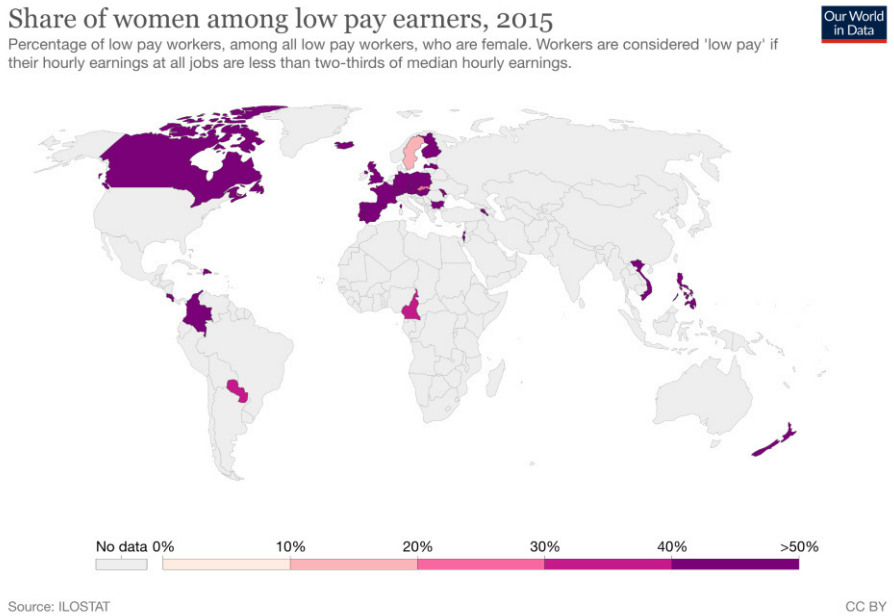
[15] ILOSTAT (2016). Available at: http://www.ilo.org/ilostat/faces/oracle/webcenter/portalapp/pagehierarchy/Page30.jspx



Source: United Nations Statistics Division (2000-2020). Available at: https://unstats.un.org/sdgs/indicators/database/

3. Women are often overrepresented in low-paying jobs.v

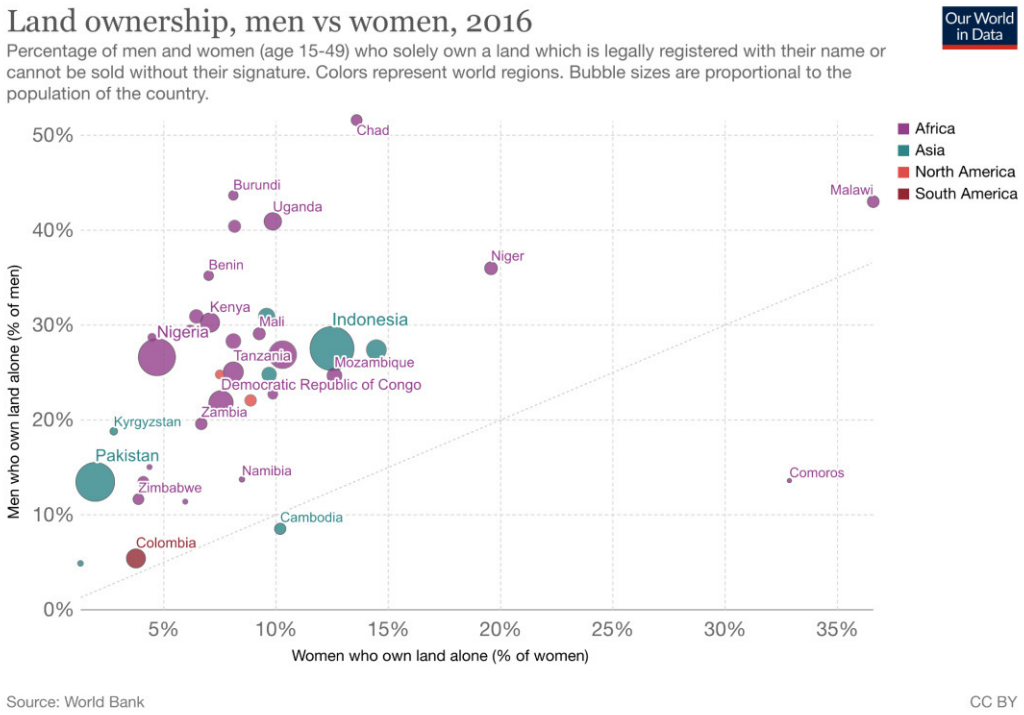
Women are not only underrepresented in management positions but they are also more likely to be employed in jobs with low wages. Low-pay workers refer to those who earn less than two-thirds of the median of the earning distribution.[16] Below in the ILOSTAT map you can compare the data for selected countries where the share above 50% means that there are more women than men in jobs with low wages.



Source: ILOSTAT (1995-2015): Available at: http://www.ilo.org/ilostat/

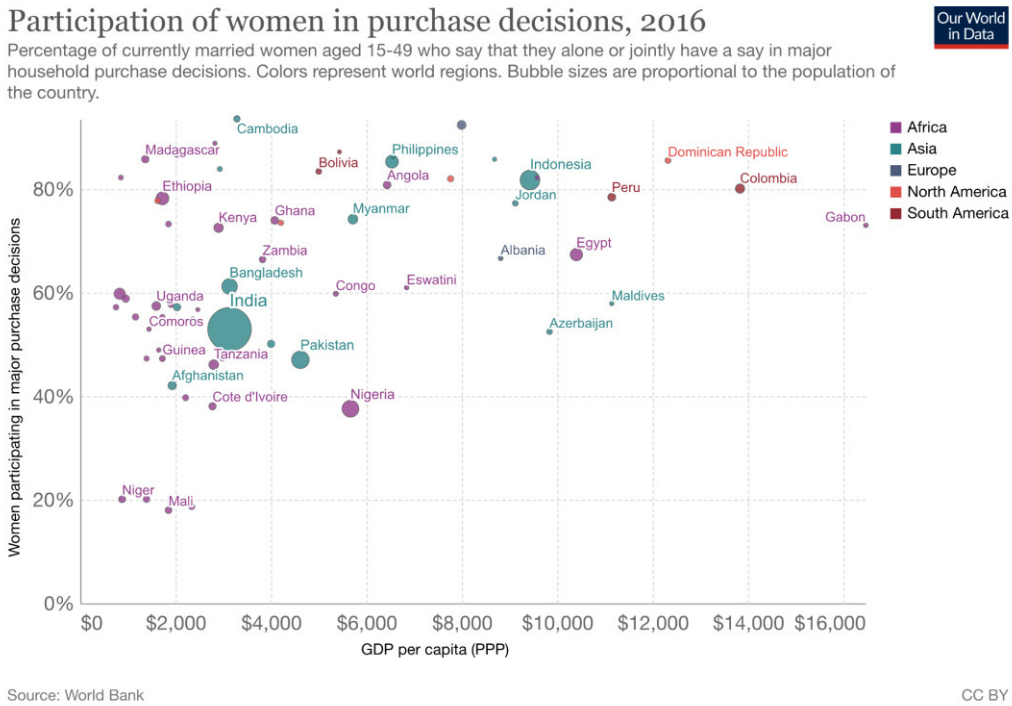
[16] Ortiz-Ospina Esteban, Max Roser (2018). *Economic inequality by gender.* Available at: https://ourworldindata.org/economic-inequality-by-gender

4. In many countries, women are less likely to own land and control productive assets.
Women have less control over important household assets such as land. In almost all low and middle-income countries men are more likely to own land than women. This fact negatively impacts women's rights e.g. in case of divorce or death of their husband. Moreover, in some countries women do not have equal rights to property compared to men. This fact is illustrated in the chart below from the World Bank Gender Statistics. It shows the percentage of men and women (age 15-49) who solely own land.



Source: World Bank Gender Statistics (2010-2016). Available at: https://data.worldbank.org/data-catalog/gender-statistics

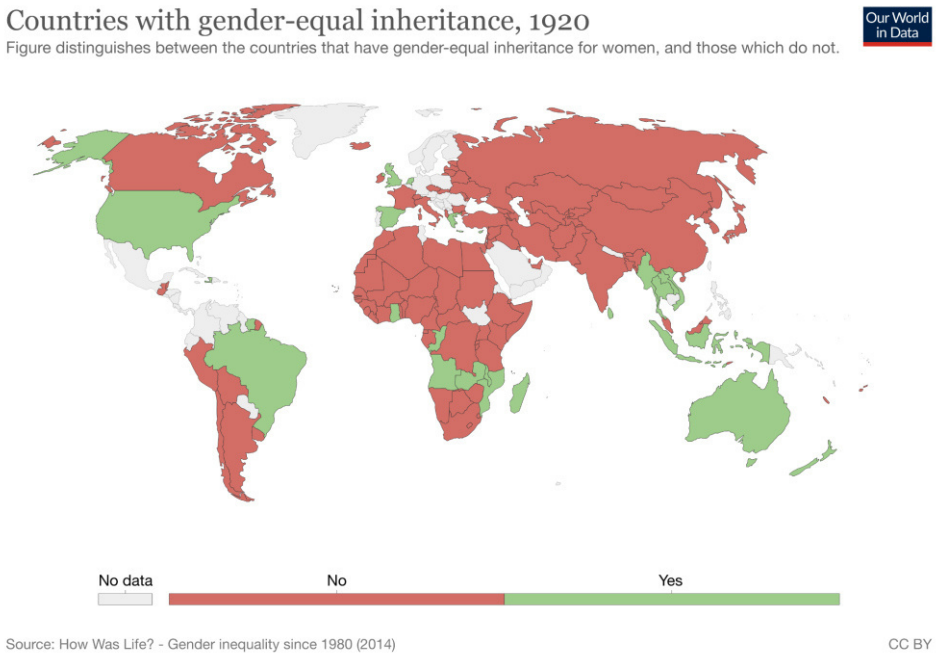
5. Women have often limited control over household resources.
The data show that women have often limited control over how their personal earned income is spent. Men are more often the main decision-makers. In Sub-Saharan Africa and Asia, the majority of women are not involved in household decisions related to spending of their earned income. The same applies for the overall influence of women over important household decisions such as major household purchases. This trend is notably seen in low-income households within low-income countries. The below listed chart shows the percentage of married women aged 15-49 who state that they alone or jointly with their husbands have a say in major household purchase decisions.

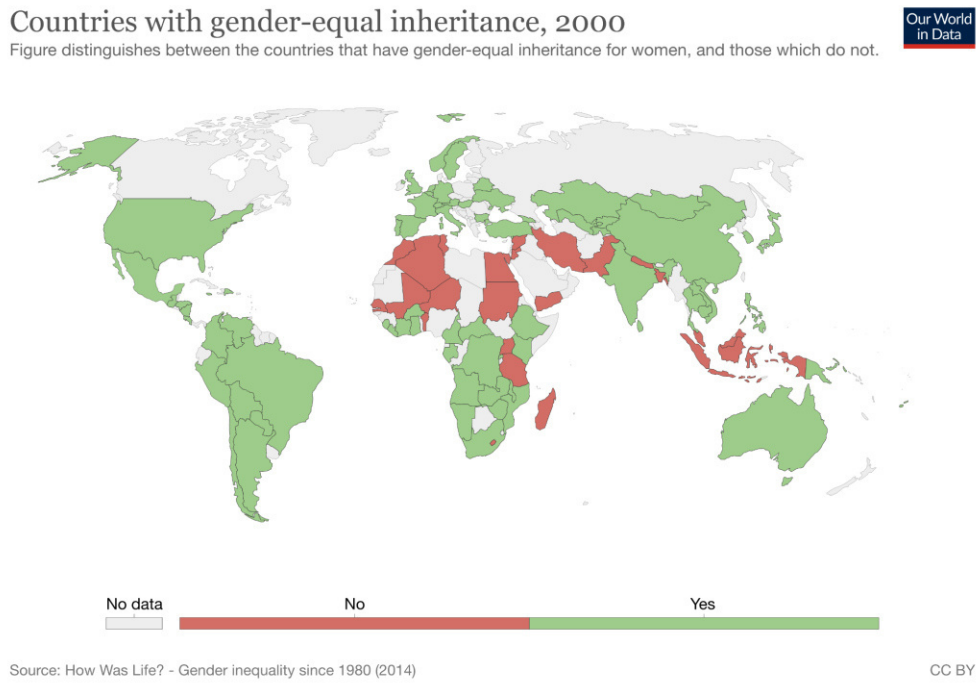


Source: World Bank Gender Statistics (1999 - 2016). Available at: https://data.worldbank.org/data-catalog/gender-statistics

6. Gender-equal inheritance systems are not adopted in all countries.

The gender-equal inheritance systems were rare until recently. Below you can see how the situation looked in 1920. Globally, in most countries women did not have equal rights when it came to inheritance. Today the situation is much better, however there are still countries in North Africa, Middle East or South East Asia which do not apply gender-equal inheritance systems.



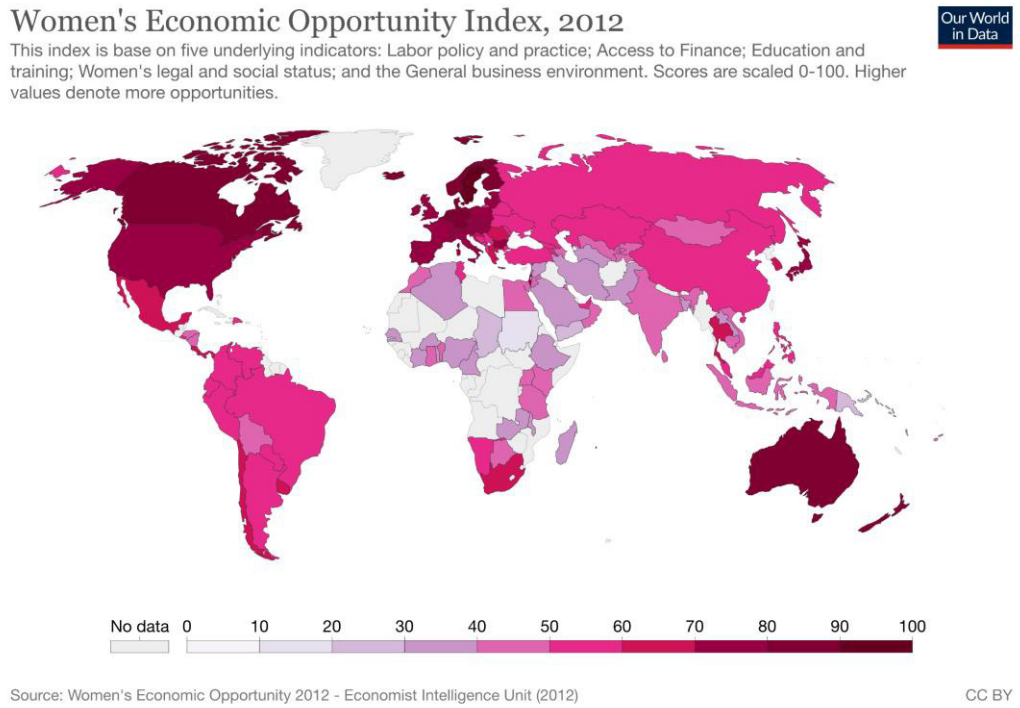


Source: How Was Life? Gender inequality since 1980 - Carmichael, Dili,and Rijpma. Available at: https://dspace.library.uu.nl/bitstream/handle/1874/306236/3014041ec016.pdf?sequence=1

Overall, gender inequalities have been shrinking substantially over the last century.
Tracking progress related to gender inequalities across multiple dimensions is facilitated by synthetic indicators that aggregate various dimensions. Such an indicator is the Women's Economic Opportunity Index (WEO) published by The Economist Intelligence Unit.

The WEO index defines women's economic opportunity as: *"a set of laws, regulations, practices, customs and attitudes that allow women to participate in the workforce under conditions roughly equal to those of men, whether as wage-earning employees or as owners of a business."*[17] The WEO index is composed of 29 indicators based on data from multiple resources including the UN and the OECD.
The below map from the Economist Intelligence Unit shows the WEO index globally. Higher scores mean better economic opportunities for women.

[17] Ortiz-Ospina Esteban, Max Roser (2018). *Economic inequality by gender.* Available at: https://ourworldindata.org/economic-inequality-by-gender



Source: Economist Intelligence Unit (2012)

Conclusion

To sum up, feminist economics covers a wide spectrum of areas which are being researched and contributes to a more holistic understanding of how men and women participate in the economy. Feminist economics brought new questions and variables into economic research and have made an undoubted contribution to diversification of the economic discourse. It plays an important role in rethinking the way we understand economics and the driving forces behind it.

Glossary

Feminist economics
Feminist economics analyses the interrelationship between gender and the economy. Thereby, feminist economics also takes the unpaid, non-market intermediated part of the economy and society into account and examines the driving forces behind common dichotomies such as economic–social, productive–reproductive, masculine–feminine, paid–unpaid or public–private. Moreover, feminist economics analyses patriarchy and capitalism as interrelated forms of dominance. Against this background, questions arise about the distribution and disposal of property, income, power, knowledge and the own body.

Gender pay gap
A difference between the average hourly earnings of men and women. The Eurostat data for 2019 show that the average gender pay gap in EU-27 amounts to 14.1% The highest difference is in Estonia (21.7%), the lowest difference is in Luxemburg (1.3%).

Homo economicus
Homo economicus a universal figure, an active agent on the labour market who is self-sufficient, selfish and rational. Homo economicus is free from societal influence and has clearly defined preferences. It operates in an ideal market based on self-interest where prices are the only means of communication. Homo Economicus has unlimited desires and limited resources and is able to optimise his/her choices.

Relational human being
According to feminist economists' people are relational and they are defined by many variables (e.g., gender, age, race, social class, religion, beliefs, values, migration status, family status etc.). They are influenced by the societies they live in. People's choices are influenced by many factors, they have different opportunities resulting from unequal positions.

System of National Accounts
The System of National Accounts is a metric according to which countries measure their economic output. The SNA does not include unpaid work as a variable. For that reason, the SNA is criticised by feminist economists, since basic and necessary labour is being ignored.

Unpaid work
Unpaid work covers care work, domestic work, subsistence work, unpaid market labour and voluntary work. There is no single definition of unpaid work, however in most cases unpaid work is seen as work which contributes to the reproduction of society.

Women's Economic Opportunity Index
A set of laws, regulations, practices, customs and attitudes that allow women to participate in the workforce under conditions roughly equal to those of men, whether as wage-earning employees or as owners of a business. The WEO index is composed of 29 indicators based on data from multiple resources including the UN and the OECD.

Resources

Urban, Janina, Purckahuer, Andrea (2016). *Feminist Economics.* Available at: https://www.exploring-economics.org/en/orientation/feminist-economics/

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Ferber, Marianne A.; Nelson, Julie A. (2003). *Beyond Economic Man, Ten Years Later.* Feminist Economics Today: Beyond Economic Man. Chicago: Univ. of Chicago Press. p. 7. ISBN 978-0-226-24206-4.

Exploring Economics. Available at: https://www.exploring-economics.org/en/orientation/feminist-economics/

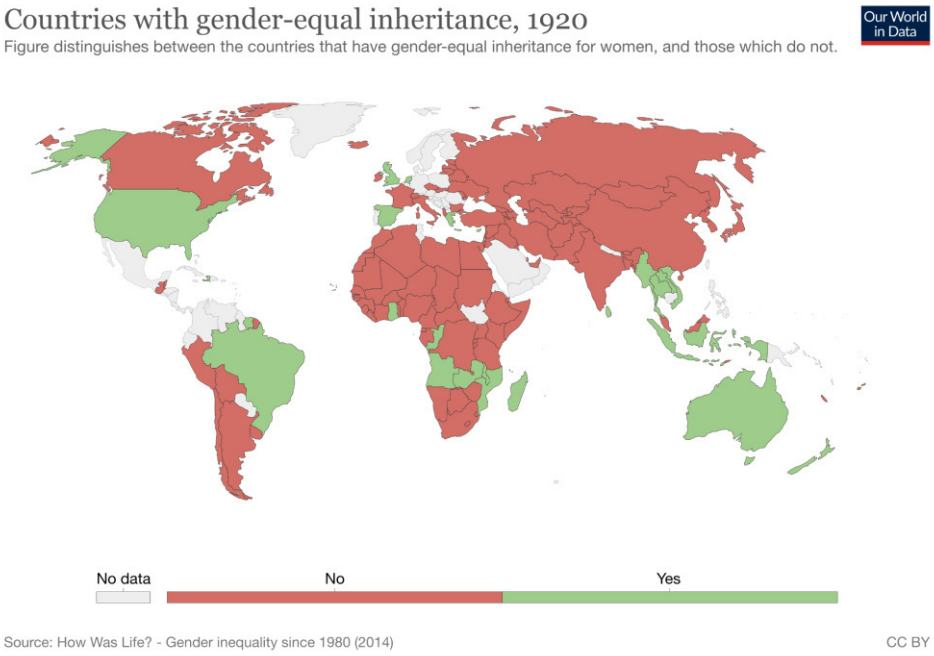
3. Training material

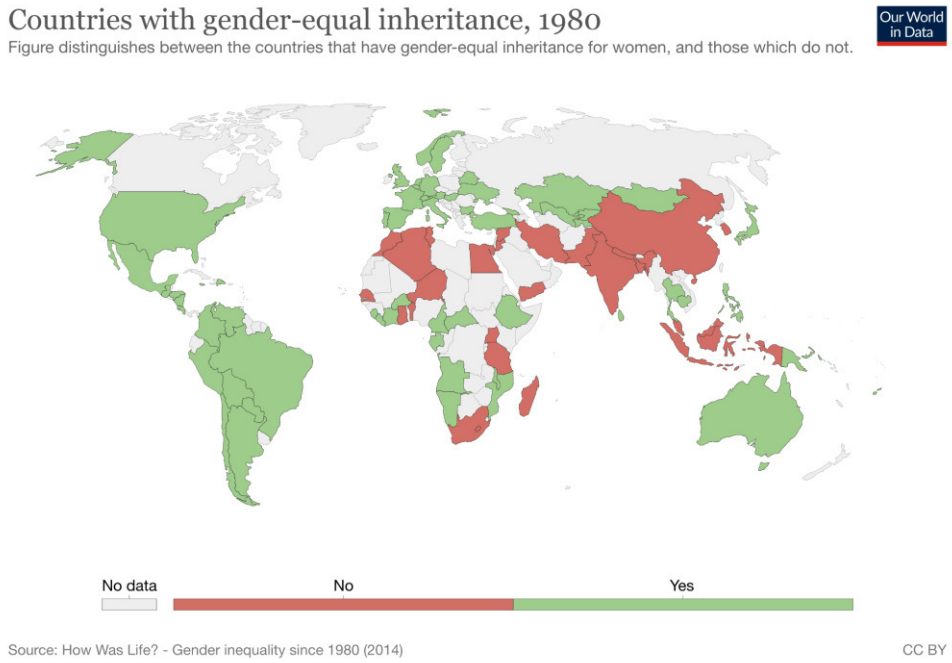
Activity 1: Equal inheritance rights for women

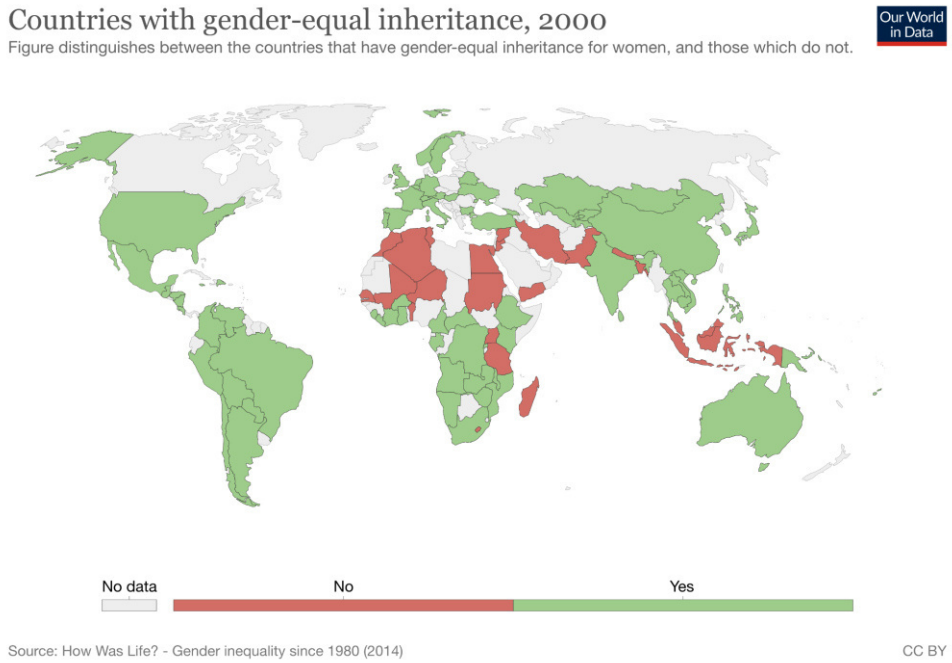
Activity title	**Equal inheritance rights for women**
Overview	The following exercise introduces the participants to one of the subject matters that illustrates gender-based inequalities. Thanks to the global data showing changes in inheritance systems in particular countries, the participants can broaden their knowledge on factors and aspects influencing the position of women in the economy relative to men.
Objectives	• to make participants aware of the underlying causes of inequalities related to inheritance systems • to enhance participants´ analytical and argumentation skills
Materials	• 3 maps • flipchart, markers, post-its • Internet
Time	In total 2 hrs 1/ Introduction to the topic, instructions, division of groups (15 min.) 2/ Group work (60 min.) 3/ Reflection (45 min.)
Group size	6-20 participants
Instructions for trainers	1. First introduce the participants to the topic and explain the overall idea of the exercise. 2. Divide participants into groups of 3-5 persons. 3. Let the participants read the instructions. 4. Follow the work of particular groups. 5. Let the participants reflect on the results of their work.
Instructions for participants	1. Read the introductory text: *"Inheritance systems are still not gender-equal all around the world. Until recently the gender-equal inheritance systems were rare. When you look at the map dated back to 1920, you can see that many countries globally did not have the same rights for inheritance for women and men. During the 20th century the situation considerably changed, however there are still countries in North Africa, Middle East or South East Asia which do not apply gender-equal inheritance systems.* *The unequal distribution of inherited wealth has a considerable effect on economic inequality. Since land is an important asset and source of livelihood, in many countries there are long developed rules on how the land is transferred*

from generation to generation. In many developing countries, women often face legal barriers that do not allow them to inherit property. In some countries, widows and daughters own the land only temporarily which might lead to conflicts caused by questioning the land ownership."

2. Discuss in groups the following questions and come up with substantiated arguments.
    a. *Look at the three maps below illustrating the changes in gender-equal inheritance in particular countries. Compare the situation in 1920, 1980 and 2000 in different countries and discuss the possible variables/factors which might have impacted the changes towards gender-equal inheritance system in particular geographical zones and countries.*
    b. *What consequences brings the unequal inheritance system for women, families, community, economics, politics and society in general?*
    c. *Imagine that you would be, as a high-level politician, responsible for introducing a gender-equal inheritance system in a country where women did not have equal inheritance rights so far. How would you proceed? What important aspects/factors/situations would you need to take into account to be successful?*







Debriefing and evaluation	Allow at least 45 min. for final debriefing and reflection. Firstly encourage the groups to share the results of their group work and discuss their arguments. After that you can also ask general questions evaluating the lessons learnt and the process. You can use the following questions: ● *What new knowledge and information did you learn during this exercise?* ● *What did you enjoy most?* ● *What was difficult for you?* ● *How are you going to use the knowledge gained?*

Tips for trainers	*Challenges that might occur:* The participants might have different levels of knowledge and skills regarding the topic. Therefore, it is advisable to assess it beforehand and make sure that the groups are divided accordingly (pair more experienced with less experienced participants).

More on:

Towards Economic Literacy: http://economic-literacy.eu

Ortiz-Ospina Esteban, Max Roser (2018). *Economic inequality by gender.* Available at: https://ourworldindata.org/economic-inequality-by-gender

Goyal, Aparajita (2012). Importance of Equal Inheritance Rights for Female Empowerment. World Bank BLogs. Available at: https://blogs.worldbank.org/developmenttalk/importance-of-equal-inheritance-rights-for-female-empowerment

Activity 2: How rigid are the norms and beliefs?

Activity title	**How rigid are the norms and beliefs?**
Overview	The following exercise shows participants how social norms and personal beliefs can evolve under different circumstances. It encourages the participants to discuss what factors/aspects/variables can influence social norms and personal beliefs. The exercise points out the influence of norms and beliefs on women's position in society and the economy. Moreover, it invites the participants to discuss strategies on how social norms and beliefs can be changed to support equal participation of men and women in the economy.
Objectives	• to make participants aware of the influence of social norms and personal beliefs on human behaviours and the participation of women in the economy • to enhance participants´ analytical and argumentation skills
Materials	• 2 figures • flipchart, markers, post-its • Internet
Time	In total 2 hrs 1/ Introduction to the topic, instructions, division of groups (15 min.) 2/ Group work (60 min.) 3/ Reflection (45 min.)
Group size	6-20 participants
Instructions for trainers	1. First introduce the participants into the topic and explain to them the overall idea of the exercise. 2. Divide participants into groups of 3-5 persons. 3. Let the participants read the instructions. 4. Follow the work of particular groups. 5. Let the participants reflect on the results of their work.

Instructions for participants

1. Read the introductory text:

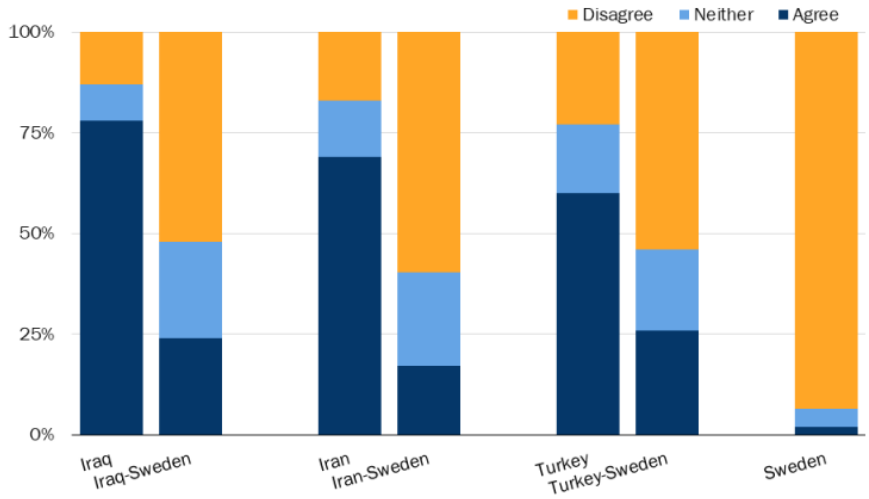
"Some economists argue that investments into women economic empowerment do not have any long-term effect because it is very difficult to change human behaviours based on rigid social norms and personal beliefs.

One research on migrant communities in Sweden (Institutet för Framtidsstudier, 2019) showed that social norms might not be that rigid. The research compared answers of migrant communities living in Sweden (Iranians, Iraqis and Turks) to dominant beliefs in their country of origin. The research used World Value Survey questions to analyze beliefs such as as gender equality, homosexuality, abortion or divorce. As an example you can see two figures showing the differences in answers of Swedes and respondents from migrant communities compared with prevailing beliefs in their countries of origin (Iran, Iraq, Turkey). The figures show interesting results."

3. Look at the following figures and discuss the questions:
   a. *The data show that people from migrant communities have different beliefs related to participation of women and men in the economy and society compared to people from their countries of origin. What might be the reasons that are causing the changes in their views and beliefs?*
   b. *Can you name some of the beliefs that lead to an unequal position of women? What are the causes of such beliefs and what is needed to change them?*
   c. *Imagine that you would be responsible for preparing the content of a soft-landing course for migrant people from Iran coming to your country. What topics would you include in the course?*

Figure 1: When jobs are scarce, men should have more right to a job than women

Percent who agree with the statement above

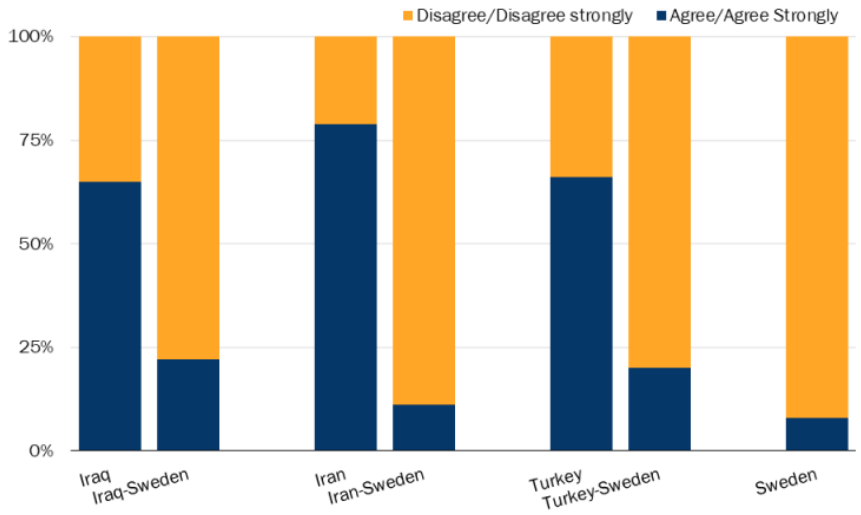


Source: Puranen, B. (2019). *Med migranternas röst: den subjektiva integrationen.* Stockholm, Sweden: Institutet för Framtidsstudier.

BROOKINGS

Figure 2: Men make better business executives than women do

Percent who agree with the statement above



Source: Puranen, B. (2019). *Med migranternas röst: den subjektiva integrationen.* Stockholm, Sweden: Institutet för Framtidsstudier.

BROOKINGS

Debriefing and evaluation	Allow at least 45 min. for final debriefing and reflection. Firstly encourage the groups to share the results of their group work and discuss their arguments. After that you can also ask general questions evaluating the lessons learnt and the process. You can use the following questions: ● *What new knowledge and information did you learn during this exercise?* ● *What did you enjoy most?* ● *What was difficult for you?* ● *How are you going to use the knowledge gained?*
Tips for trainers	*Challenges that might occur:* The participants might have different levels of knowledge and skills regarding the topic. Therefore, it is advisable to assess it beforehand and make sure that the groups are divided accordingly (pair more experienced with less experienced participants).
More on: Towards Economic Literacy: http://economic-literacy.eu Livani, Talajeh (2019). *Promoting women's economic empowerment: Mission impossible?* Brookings. Available at: https://www.brookings.edu/blog/future-development/2019/10/28/promoting-womens-economic-empowerment-mission-impossible/	

4. Interactive learning

Activity 1: Quiz

1/ Which of the following dichotomies are important subjects for feminist economists?
a/ growth - recession
b/ paid - unpaid
c/ market - value

2/ Which of these economists are regarded as feminist economists?
a/ Barbara Bergmann
b/ Milton Friedman
c/ Christine Lagarde

3/ Which of the following statements do not fit into the feminist paradigm?
a/ Domestic and care work is unequally distributed among men and women
b/ The state is an important actor which intervenes in families
c/ Family members specialise in activities where they have a comparative advantage

4/ What is the System of National Accounts?
a/ A universal accounting system used for regulating national interest rates
b/ A metric according to which countries measure their economic output
c/ A global institution measuring level of national growth

5/ Which countries have the highest gender pay gap?
a/ Poland, Bulgaria, Romania
b/ Cyprus, Spain, Greece
c/ Hungary, Slovakia, Latvia

6/ Which of these statements is true?
a/ Globally, only about 9% of enterprises have a female manager
b/ The gender pay gap can be impacted by offering early education for children
c/ The gender pay gap has increased in the last couple of decades in most countries

7/ Which of the following types of work is unpaid work?
a/ seasonal work
b/ domestic work
c/ precarious work

8/ What is the Women's Economic Opportunity Index?
a/ A famous research magazine specialising in feminist economics
b/ A set of different factors that allow women to participate in the workforce under conditions roughly equal to those of men
c/ A metric ranking the opportunities for women compared to men in developing countries

9/ What does the term “relational human being” mean?
a/ A human being who acts rationally according to trends in the labour market
b/ A human being who lives in communities which have their own laws and regulations
c/ A human being who is defined by many variables including race, beliefs or migration status

10/ Which of these principles can be associated with feminist economics?

a/ Rational people think at the margin

b/ Power relationships are important in an economy

c/ Trade can make everyone better off

Activity 2: Mark all statements that are <u>not</u> associated with feminist economics

Government action cannot improve market outcomes.
Non-market activities are important to the economy.
The scope of economics must be interdisciplinary.
Trade can help everyone to have a better life through specialisations.
Inequities in the labour market are the result of free choices made by men and women.
Occupational segregation and the glass ceiling are important phenomena.
Maternity leave negatively impacts economic growth.
The family constrains or enables women's freedoms.
Specialisation might lead to increased vulnerability.
Women are more suited to care work.

Activity 3: Yes, or no?

1/ The average gender pay gap in EU-27 has worsened over the past ten years. NO
2/ High-profile jobs are equally distributed between women and men in the EU. NO
3/ Gender-equal inheritance systems are introduced in the majority of countries globally. YES
4/ Men are the sole owners of productive assets in Sub-Saharan Africa. NO
5/ Homo Economicus has limited resources and is able to optimise his or her choices. YES
6/ Unpaid market labour is a natural consequence of women's choice to care for children. NO
7/ Women have often limited control over household resources in low-income households within high-income countries. NO
8/ Women more often end up in low-paying jobs compared to men. YES
9/ Prices drop when the government prints too much money. NO
10/ Feminist economics sees patriarchy and capitalism as interrelated forms of dominance. YES

Activity 4: Fill in the blanks

1/ When men and women have the same rights to property after their husband's or wife's death, it's called the gender-equal …….. system. (inheritance)
2/ The difference between average hourly earnings between men and women is called the gender pay …….. (gap)
3/ A figure representing an active agent of the market who is self-sufficient and rational is called ……. (homo economicus)
4/ Feminist economics gradually evolved in a clearly opposing school of thought to ……. economics. (neoclassical)
5/ Treating men and women differently based on their gender is called ……. (discrimination)
6/ The lowest gender pay gap in the EU is in …….. (Luxemburg)

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FRESH-UP ECONOMICS

WOMEN'S ECONOMIC EMPOWERMENT

by AVITEUM´s team

Table of contents

1. Overview

Why does women's economic empowerment matter (WEE)? How can we invest in and support women's economic empowerment? How can we boost women's entrepreneurship, itself a tool for the economic empowerment of women?

Answers to these questions are outlined in this article which serves as an introduction to the topic of women's economic empowerment. It summarises the context and provides an overview of the reasons why support dedicated to women to become independent and equally participative in the labour market is important. It also outlines some of the tools that could facilitate this increase in support. A more detailed analysis of this topic is available in the background information.

How do we define women's economic empowerment?

There are several definitions of the term 'women's economic empowerment' (WEE). Most of the definitions see WEE as a process that helps women to access resources and opportunities to increase their rights, control resources, increase their possibility to make independent decisions, and benefit from economic gains.

What are the limitations and barriers that women face due to their unequal position at the labour market?

Women face different limitations and barriers when accessing and participating in the labour market. Ample research has shown the following findings illustrating the unequal position of women in the labour market:

- *Women are less likely to participate in the labour market than men, they are over-represented in informal and vulnerable employment, and in some countries, they are legally discriminated against.*
- *Women are more likely to be unemployed than men.*
- *Women are paid less than men.*
- *Women are less likely to have access to social protection and financial services.*
- *Women are constrained from achieving the highest leadership positions.*
- *Women are disproportionately responsible for care work which is unpaid and remains unrecognized.*
- *Women are less likely to become entrepreneurs.*

What are the positive effects of women's economic empowerment?

When gathering support to promote women's economic empowerment, it is useful to prove its positive economic as well as societal impact. There are several studies and researches that acknowledge the contribution of women's economic empowerment to overall economic and social well-being.

Their findings show that women's economic empowerment:

- supports **equality** between men and women in terms of participation in the economy;
- helps to reduce the **gender pay gap** and the gap in employment between men and women;
- supports **adequate workplace conditions**;
- allows the social and economic potential of women to be fulfilled;
- indirectly, it influences the **quality of life of the woman's entire family**, **communities** as well as the **society**;
- sets a path for **poverty reduction**;
- gives **access to capital and financial services**;
- boosts **new businesses** and supports **local economies**, boosts **economic productivity** and increases **economic diversification**.

What are some of the tools to support women's economic empowerment?

There is a wide range of tools that are considered to be key prerequisites for enabling women's economic empowerment. However, there are huge differences globally in how they are implemented. In general, the following tools have proven to be effective in supporting WEE:

- *Enabling women to make independent decisions*;
- *Having open discussions about changes in social norms*;
- *Access to education and training*;
- *Access to income*;
- *Access to decent & flexible work opportunities*;
- *Access to child-care support*;
- *Providing incentives for men to take over a part of the care and family work*;
- *Having policies to promote workplace equality*;
- *Access to financial services*;
- *Providing support for women's entrepreneurship*.

Who are the agents of change and how they can become active?

Women and men play different roles in the diverse collection of societies and economies that exist. However, due to objective barriers, women face difficulties accessing the same labour market opportunities as men. Changing this situation is the goal of women's economic empowerment, specifically, women having equal participation and access to resources.

There are different agents who have different tools and possibilities to influence women's economic empowerment. Among them, there are women themselves, but also men, employers, trade unions or the state. Many economists admit that creating supportive conditions for women to enable them to become independent and active at the labour market contributes to overall economic growth and prosperity. For that reason, empowering women economically becomes a more and more important topic on the agendas of decision- and policy-makers. However, this requires not only a system change in policies and infrastructure, but also a change in our mindsets. Without involving men more in child and family care, a shift in the traditional family-paradigm cannot be achieved. Moreover, every tool for women's economic empowerment needs to be assessed individually in respect of the overall

country-specific situation and policies should be introduced while considering the whole societal context.

A more complex view of the relationship between gender and the economy is analysed in the article on **„Introduction to Feminist Economics“**. Hereby, if you are interested to know more about the key assumptions of the feminist paradigm and find out about the roots of gender inequality, we would like to invite you to read this article for another dose of inspiration.

2. Background information

Introduction

Why does women's economic empowerment matter (WEE)? How can we support and invest in women's economic empowerment? How can we boost women's entrepreneurship, seeing it as a tool for increasing the economic empowerment of women?

These and other questions are answered step by step in this article which gives an introduction to the topic, explains the context and rationale for women's economic empowerment, and delivers relevant figures illustrating the key claims. You will also find here a structured overview of tools and policies supporting women's economic empowerment. Moreover, you will get to know more about entrepreneurship as an efficient tool to support women and their empowerment.

How do we define women's economic empowerment?

There are several definitions of the term 'women's economic empowerment'. As an example, see three of them provided by different non-profit organisations:

"CARE defines women's economic empowerment as the process by which women increase their right to economic resources and power to make decisions that benefit themselves, their families and their communities." (1)

"The Bill & Melinda Gates Foundation defines women's economic empowerment as the transformative process that helps women and girls move from limited power, voice, and choice at home and in the economy to having the skills, resources, and opportunities needed to compete equitably in markets as well as the agency to control and benefit from economic gains." (2)

"OXFAM defines women's economic empowerment as a situation when women enjoy their rights to control and benefit from resources, assets, income and their own time, and when they have the ability to manage risk and improve their economic status and wellbeing." (3)

When reading those definitions, we can identify important intersections which define the key criteria on how to understand WEE: **power to make decisions**, **access to resources** and **economic benefit**.

What are the limitations and barriers that women face due to their unequal position at the labour market?

The question as to why to support and invest in women's economic empowerment can be easily answered when looking at the overall context and figures, both global as well as European.

Globally, women's participation in the labour market is lower than men´s. According to ILO statistics (4, p. 7) globally the gender gap in labour force participation was 26.5 % (75.0 % men opposed to 48.5 % women) in 2018. In Northern, Southern and Western Europe the gender gap in the labour market

participation was 11.9 % (63.4 % men opposed to 51.6 % women) and in Eastern Europe 15.2 % (67.0 % men opposed to 51.8 % women).

According to UN Women: Facts and Figures: Economic Empowerment (5) the situation in the world of work globally shows clearly that women suffer from disadvantaged positions in **the labour market**. Below, we are summarising the key facts and showing statistical data (with a focus on European context) illustrating the following statements:

- **Women are less likely to participate in the labour market than men, they are over-represented in part time jobs, informal and vulnerable employment and in some countries, they are legally discriminated against.**
  According to data collected by UN Women, the labour force participation rate for women aged 25-54 years is 63 % in comparison to 94 % for men. On a global view, over 2.7 billion women are legally restricted from having the same choice of jobs as men.
- **Women are more likely to be unemployed than men**
  Statistics from the International Labour Organisation (4) show that globally, the unemployment rate in 2018 amounted to 5.2 % for men and 6.0% for women. The projection shows a relatively stable trend until 2021. According to EUROSTAT (6) the unemployment rate in the EU was 6.6% for men and 7.1% for women in 2018.
- **Women are paid less than men**
  The so-called gender pay gap shows the relative difference in the average gross hourly earnings of women and men. According to EUROSTAT (7) the women in the EU earned on average 16% less per hour than men in 2017. There is a considerable difference between particular member states. The greatest gender pay gaps are in Estonia (25.6%), Czech Republic (21.1 %), and Germany (21.0%). The lowest gender pay gaps are in Romania (3.5%), Luxembourg (5.0%) and Italy (5.0%). The progress is very slow,decreasing by only 1 % over the last 7 years. According to Eurostat, French women earn on average 15.5 % less than men. E.g. in 2020, French women started to work „unpaid“ from November 4th until the end of the year due to salary inequalities.
- **Women are less likely to have access to social protection and financial services**
  Gender inequalities at the labour market result in lower access to social protection acquired through employment such as pensions, unemployment benefits or maternity protection. Lower wages result in lower access to financial capital.
- **Women are constrained from achieving the highest leadership positions**
  Women also face other barriers such as the so-called “glass ceiling” which is used as a metaphor for barriers to achieve high positions in hierarchy. Only 5% of Fortune 500 CEOs are women.
- **Women are disproportionately responsible for care work which is unpaid and remains unrecognized**
  Unpaid care work remains unrecognized, even though it is important for the functioning of the economy. According to UN Women (5), women tend to spend circa 2.5 times more time on unpaid care work than men. Besides, if women's unpaid work were assigned a monetary value, it would constitute between 10 - 39% of GDP.
- **Women are less likely to become entrepreneurs**
  In 40% of economies, women’s early-stage entrepreneurial activity (meaning being either a nascent entrepreneur, or owner of a business) amounts only to half or less than that of men’s (8).

What are the positive effects of women's economic empowerment?

When gathering support to promote women's economic empowerment, it is useful to prove its positive economic as well as societal impact. There exists ample research (see References) which acknowledges the contribution of women's economic empowerment to overall economic and social well-being.

Their findings show that women's economic empowerment:

- supports **equality** between men and women in terms of participation in the economy;
- helps to reduce the **gender pay gap** and the gap in employment between men and women;
- allows the social and economic potential of women to be fulfilled;
- makes **access to capital and financial services** affordable for women;
- boosts **new businesses** and supports **local economies**, boosts **economic productivity** and increases **economic diversification**;
- indirectly influences the **quality of life of the woman's entire family** (via an increase in household incomes, better healthcare, better nutrition, family planning, increased wellbeing, greater investment in children's education etc.), **communities** as well as the **society** (via taxes, contribution to social security and access to health insurance);
- sets a path for **poverty reduction**;
- supports **adequate workplace conditions** (via fair wages, safe working conditions, and the prevention of sexual and gender-based violence).

What tools exist to support women's economic empowerment?

There is a wide range of tools that are considered to be key prerequisites to enable women's economic empowerment. However, there is a huge difference globally in how they are implemented. In general, the following tools have proven to be efficient in supporting WEE:

- **Enable women to make independent decisions** (creating conditions free from legal restrictions based on gender, free from threats of violence etc.)
- **Have open discussions about changes to social norms** (discuss rigid social norms connected to gender, challenging prejudices and stereotypes such as "*women should take care of household and children whereas men provide for the families and work at the labour market*")
- **Access to education and training** (equal access for girls and young women to schools and universities, entrepreneurial education, financial and economic literacy, vocational education, upskilling and re-skilling, technological and digital training to keep pace with job changes etc.)
- **Access to income and decent & flexible work opportunities** (creating conditions for women to be able to integrate into the labour market)
- **Access to child-care support** (affordable child-care facilities, creating alternative forms of child-care, mutual community support etc.). For example, in Czech Republic, public care for pre-school children is provided, with fees covering mostly only the basic costs. Due to the lack of public infrastructure, child-care recognised and partly funded by the public sector can be provided also in alternative forms after meeting all criteria and requirements).
- **Inclusive value chains** (creating beneficial conditions for small businesses to help them to bring a product/service from its design and manufacturing to customers - e.g. prioritise and

promote small entrepreneurs and local economies, provide training on gender equality awareness at local or municipal level, educate consumers etc.).

- **Policies to promote workplace equality** (support for implementation of diversity and inclusion policies in the workplace. For example, the European Commission set up an EU platform of Diversity Charters as a place for NGOs, public bodies, private companies etc. to meet, discuss and exchange experience).
- **Access to financial services** (e.g., loans, access to bank accounts, low/no interest rates on loans).
- **Support for women entrepreneurship** (through education, networking, equal access to capital, business networks etc.).
- **Incentives for men to take over a part of the childcare and family care** (e.g. In Germany both parents together get Parent-Money for 14 month for each child, this time can be divided by choice between the parents. As it is mostly women who tend to avail of this opportunity, two of the 14 months must be taken by the other parent (most often the father), otherwise they expire.

Who are the possible agents of change and how they can become active?

There are different agents who have different tools and possibilities to influence women's economic empowerment:

1. **The women themselves**
   - by taking up opportunities of education and advanced training;
   - by asking for higher wages;
   - by organizing their family life in a way allowing work-life balance, involving fathers in the family care work;
   - by networking, supporting and promoting each other;
   - by founding their own businesses and becoming entrepreneurs.
2. **Husbands and fathers, male colleagues**
   - by taking over their fair share of the family care work;
   - by supporting women to have fair and equal pay.
3. **Employers**
   - by not discriminating women in their wage-policies;
   - by offering part-time jobs to men and women;
   - by offering flexible working conditions;
   - by providing childcare in the enterprises.
4. **Trade unions**
   - by advocating explicitly for low-income groups and part time workers;
   - by advocating for shorter weekly working time and a good work-life balance for all.
5. **The state**
   - by abolishing law that is discriminatory;
   - by introducing laws that favour and support women in areas where they are structurally disadvantaged;
   - by engaging actively in the change of gendered role models;
   - by introducing laws that force employers to not discriminate and favour family friendly policy in the enterprises;
   - by providing infrastructure such as childcare and care for the elderly;
   - by acting as employers with good working conditions for women.

Different economic schools as well as people with different political views will favour different approaches. The main differences are best illustrated by two following approaches:

Neoclassical and neoliberal approach

According to the neoclassical approach, liberalisation will result in greater gains to women, mainly in terms of reducing gender pay and employment gaps. The neoliberal approach sees gender equality and in particular women's empowerment as a tool to promote economic development and social justice. According to this perspective, women themselves should be the main agents of change, and equality should be exercised on an individual level. The state's role is to prevent women from legal discrimination and provide them with equal access to education while emphasising market liberalisation.

Feminist approach

The feminist approach puts women's economic empowerment at the centre and sees the current economic model as malfunctioning. Gender inequality is directly linked to economic inequality. For that reason, feminist economists call for a fundamental change in economic models that will bring equality for everyone. According to this view, it is necessary to start giving more attention to legal frameworks, labour rights, decent work, care economy and other areas supporting women's economic empowerment.

What are the key policy documents supporting women's economic empowerment?

Women's economic empowerment is an important topic with global reach. Many governments realise its potential for growing their national as well as local economies. Below you can find more information about international as well as European frameworks which define strategic objectives and actions to support women's economic empowerment.

International level

- **The 2030 Agenda for Sustainable Development (United Nations)**
  Economic empowerment of women is one of the tools to support the achievement of the Sustainable Development Goals. It relates especially to Goal 5 (Gender Equality) and Goal 8 (Decent Work and Economic Growth).
- **UN Secretary General's High Level Panel on Women's Economic Empowerment**, *Leave No One Behind: A Call to Action for Gender Equality and Women's Economic Empowerment* (2016)
  The report stresses the importance of shaping macro-economic policies and legal instruments to support inclusive growth and women's economic empowerment.

European level

- **Strategic Engagement for Gender Equality 2016-2019**
  Strategic document of the European Commission defining priorities and key actions to promote equality between men and women.
- **Council of Europe Gender Equality Strategy 2018-2023**
  Strategic document of the Council of Europe defining goals and strategic objectives regarding support for gender equality.

Women's entrepreneurship as a tool to promote women's economic empowerment

Starting one's own business might be one of the most powerful tools for women's economic empowerment. Despite this fact, women are less likely to become entrepreneurs than men. There is a long list of factors that build barriers or set limitations for women to start their own entrepreneurial activity such as those mentioned in the preceding text.

However, there are plenty of existing tools, initiatives and successful projects that can serve as inspiration to connect and inspire more women to become entrepreneurs and provide even more evidence-based figures to key decision-makers on how women entrepreneurship can potentially contribute to economic and social well-being.

What are some of the most interesting findings on global entrepreneurship of women?
Global Entrepreneurship Monitor analysed women's participation in entrepreneurial behaviors in 59 economies, and the findings are summarised in the 2018/2019 Women's Entrepreneurship Report (9).

- The total entrepreneurial activity (TEA) among the adult working-age population (18-64 y.o.) globally is 10.2% for women.
- The highest rates of TEA for women are in sub-Saharan Africa (21.8%) and Latin America (17.3.%) whereas the lowest rates are found in Europe (6%) and in the Middle East and North Africa (MENA) regions (9%). On the other hand, in the MENA regions there is the highest rate of women's entrepreneurial intentions (36.6.%).
- There are nine countries in which women report equal or higher entrepreneurial activity than men: Angola, Ecuador, Indonesia, Kazakhstan, Madagascar, Panama, Qatar, Thailand and Vietnam.
- Women in higher-income countries have less intentions to start a business than women in lower-income countries, with Europe reporting the lowest rates (8.5%).
- Business discontinuance rates are highest in low-income countries (~5%) with the highest rates reported in sub-Saharan Africa (10.1%) and lowest in Europe (1.4 %).
- The highest participation rate in entrepreneurial activity is among women aged 25-34 years and 35-44 years and increases with a higher level of education.
- Globally, 36.4% of women work as solo entrepreneurs without co-founders or employees. Only 2.5% of women entrepreneurs have more than 20 employees.
- Globally, 53.4% of women's entrepreneurial activity is in wholesale/retail trade and women mostly operate in government/health/education and social services. However, high-income countries report an opposite trend and women mostly operate in financial, professional and customer services.
- Women report lower self-confidence than men in their capabilities to start a business.

Critical discourse based on the necessity to reflect the overall context

On the other hand, it is necessary to mention that the support for entrepreneurship cannot be seen as a powerful tool for women economic empowerment without considering the whole societal context.

For example, in Germany in the early years of 2000, the government promoted individual entrepreneurship while reducing the guaranteed rights for employees. This resulted in less secure positions of employees and an increase in precarious working conditions. Therefore, every tool for women 's economic empowerment needs to be assessed individually in respect of the overall country-specific situation and the policies that have been introduced.

Advice for further study

If you want to know more about women's economic empowerment and stay up-to date with the current developments in this field, check out the following resources:

- **EUROPEAN COMMISSION**: https://ec.europa.eu/international-partnerships/topics/empowering-women-and-girls_en
- **UN WOMEN**: https://www.unwomen.org/en/what-we-do/economic-empowerment/facts-and-figures
- **OECD**: http://www.oecd.org/development/womens-economic-empowerment.htm
- **UNDP**: https://www.undp.org/content/undp/en/home/2030-agenda-for-sustainable-development/people/gender-equality/women-s-economic-empowerment.html
- **IMF**: https://www.imf.org
- **ECONOMIC INEQUALITIES BY GENDER:** https://ourworldindata.org/economic-inequality-by-gender#women-often-have-no-control-over-their-personal-earned-income

Conclusions and future prospects

Women and men play different roles in the diverse collection of societies and economies that exist. However, due to objective barriers, women face difficulties accessing the same labour market opportunities as men. Changing this situation is the goal of women's economic empowerment, specifically, women having equal participation and access to resources.

Many economists admit that creating supportive conditions for women to enable them to become independent and active in the labour market contributes to overall economic growth and prosperity. For that reason, empowering women economically becomes a more and more important topic on the agendas of decision- and policy-makers.

However, a true shift requires not only a system change in policies and infrastructure, but also a change in our mindsets. Without involving men more in childcare and family care, a shift of the traditional family-paradigm cannot be achieved. Moreover, without considering the overall historical, societal, economic and country-specific contexts of each community, we cannot introduce measures which will actually lead to long-lasting and efficient changes.

A more complex view of the relationship between gender and the economy is analysed in the article on „Feminist Economics“. If you are interested to know more about key assumptions of the feminist

paradigm and find out about the roots of gender inequality, we would like to invite you to read this article for another dose of inspiration.

Glossary

Discrimination
An act of making differences between people based on different factors such as gender, race, age, origin, colour, sexual orientation etc. Discrimination leads to unequal or prejudicial treatment of human beings.

Gender equality
A state of equal access to resources and opportunities regardless of gender. The gender equality index represents a composite indicator that is based on the EU policy framework and helps to measure and monitor progress of equality across the European Union. The current gender equality index for the EU amounts to 67.4 out of 100 (EIGE, 2019). The best results are seen in the domains of health (88.1 points) and money (80.4. points). On the contrary, the worst results are in the domain of power (51.9 points).

Gender pay gap
A difference between the average hourly earnings of men and women. According to data from the European Commission (2017), women earn more than 16% less than men in the European Union. The highest gender pay gaps are in Germany (20.8%), the Czech Republic (21.1%) and Estonia (25.6%). The lowest gender pay gaps are in Romania (3.5%), Luxembourg (5.0%), and Italy (5.0%).

Inclusive value chain
Creating beneficial conditions for small businesses to help them to bring a product or service from its design and manufacturing to customers. Possible ways to build more inclusive value chains are: to prioritise and promote small entrepreneurs and local economies, provide training on gender equality awareness at local or municipal level, educate consumers etc.

Unpaid work
Any work that produces goods or services but which is not directly remunerated. Unpaid work is represented for example by care work or housework. Unpaid work is not equally distributed among women and men. According to European Commission's data (2018) women take more time off from work to care for children or other family members (e.g., women spend 36 hours per week caring for adults, children and doing housework. Whereas men spend on average 21 hours per week doing unpaid work).

Vulnerable employment
A type of work that tends to be insecure and vulnerable to fluctuations in the economy. This refers to unpaid family workers and own-account workers.

Women's economic empowerment (WEE)
A process that supports women to gain power to make decisions, to get access to resources they need and to economically benefit from them.

Wellbeing
A state of experiencing health, happiness and prosperity. According to Carol Ryff the main factors which are most important for well-being are: self-acceptance, personal growth, purpose in life, environmental mastery, autonomy and positive relations with others. Feeling economically empowered contributes to reinforcement of those factors.

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3. Training material

Help Jane to become a successful entrepreneur!

Activity title	**Help Jane to become a successful entrepreneur!**
Overview	The following set of exercises offers a structured workshop scenario that you can implement within 4 hours. Since women's entrepreneurship might be one of the most powerful tools to support economic empowerment of women, we chose this topic as a central idea for the educative part. Firstly, the participants should become familiar with the content of the article since the exercises stem from the information contained therein. The workshop scenario leads participants step by step through development of an entrepreneurial idea. The participants get familiar with Jane and her family and throughout the workshop they help Jane to develop a business idea to gain practical skills which they might use for their own entrepreneurial activity or for a better understanding of entrepreneurship as a tool leading to women's economic empowerment.
Objectives	• to make participants aware of the barriers and limits that women face when becoming an entrepreneur and find strategies how to overcome them; • to empower the participants with new skills and knowledge facilitating development of a business idea • to enhance participants´ analytical and presentation skills
Materials	• Worksheets • Flipchart, markers, post-its • eventually computers with presentation software
Time	1/ Icebreaker (10 min.) 2/ Introduction to the workshop: objectives and expected results (10 min.) 3/ Meet Jane!: reading in groups (10 min.) 4/ Three steps to success • Come up with the business idea (30 min.) • Map the environment: micro and macro factors (30 min.) • Propose the value for your customer: your customer (30 min.), value proposition (30 min.) 5/ Pitch your business idea (60 min.) 6/ Reflection (30 min.)
Group size	6-20 participants
Instructions for trainers	1. First introduce the participants into the topic and explain them the overall idea of the workshop - helping Jane to become a successful entrepreneur. 2. Divide participants into groups of 3-5 persons. 3. Let the participants read the introduction and get familiar with Jane and her situation. 4. Follow the instructions written below by particular exercises.

Debriefing and evaluation	Allow at least 30 min. for final debriefing and reflection. Follow the instructions and questions written in the final part.
Tips for trainers	*Challenges that might occur:* The participants might have different level of knowledge and skills regarding the topic. Therefore, it is advisable to assess it beforehand and make sure that the groups are divided accordingly (pair more experienced with less experienced participants). *Remark:*
More on http://economic-literacy.eu	

ICEBREAKER

Time: 10 min.

Instructions: Let the participants say 3 things about them (two truths and one lie) and allow other participants to guess which one is a lie.

INTRODUCTION

Time: 10 min.

Instructions: Explain to the participants what the main objectives of the workshop are and what knowledge and skills they are expected to gain.

One of the most powerful tools to support women's economic empowerment is creating own business. As we already know, women are less likely to become an entrepreneur in comparison to men. There are a lot of challenges that women have to overcome to succeed as an entrepreneur. The crucial success factors are to:

- know the environment one lives in and define the key resources at disposal/needed;
- know who your customer is, what are his/her needs;
- create a value for your customer.

In this workshop you will accompany Jane who wants to start her own business. You will get to know her and her family better. Together you will decide on a solid business idea that might help her to ensure a steady income for her family.

MEET JANE!

Time: 10 min.

Instructions: Divide participants in groups and let them read the following text. You can prepare the text as a worksheet so all groups have it at hand.

- Jane is 32 years old mother of two children - Sarah (3 years) and Matthias (1 years). She has a university degree in teaching English. Before having kids she used to teach in a high school in the centre of Prague.
- Jane's husband Abdik comes from Saudi Arabia where his family is living, he is Muslim and works in a travel agency. Jane's parents are living in the countryside far from them and they do not have a close relationship with Jane since they didn't agree with the choice of her life partner.

- Jane lives with her husband Abdik in a small house with garden in the suburbs of Prague. There is only one kindergarten available, however the capacity is full. Since her first baby was born, Jane stopped working and takes care of the children and the household. However, she was always a curious person and she loved to learn new things. While she was on parental leave, she learnt how to build web pages and she also participated in an online marketing course. She knows that it wouldn't be possible to return to her former teaching job since the private child-care facilities are expensive and her former employer did not offer to work part-time or from home. For that reason, Jane is thinking to start her own business, however she is not sure what she could offer that the potential customers might want.
- Unfortunately, due to COVID-19 pandemic, Abdik lost his job and the family is currently without a steady income. Abdik is registered with the Employment office and gets 500 EUR per month. Jane still has parental leave financial contribution from state which amounts to 400 EUR per month. The monthly expenses of the family are around 800 EUR per month.

HELP JANE TO COME UP WITH A SOLID BUSINESS IDEA

- Jane decided that now is the right moment to take the risk and start her own business. She saved around 3.000 EUR that she planned to use for her business and disposes of a car. She knows how to teach languages and excels in English, she gained practical skills in marketing and web design. She is also interested in healthy lifestyle, upcycling and makes handmade jewellery. Moreover, she is a certified yoga instructor.

THREE STEPS TO SUCCESS

STEP 1 - COME UP WITH THE BUSINESS IDEA

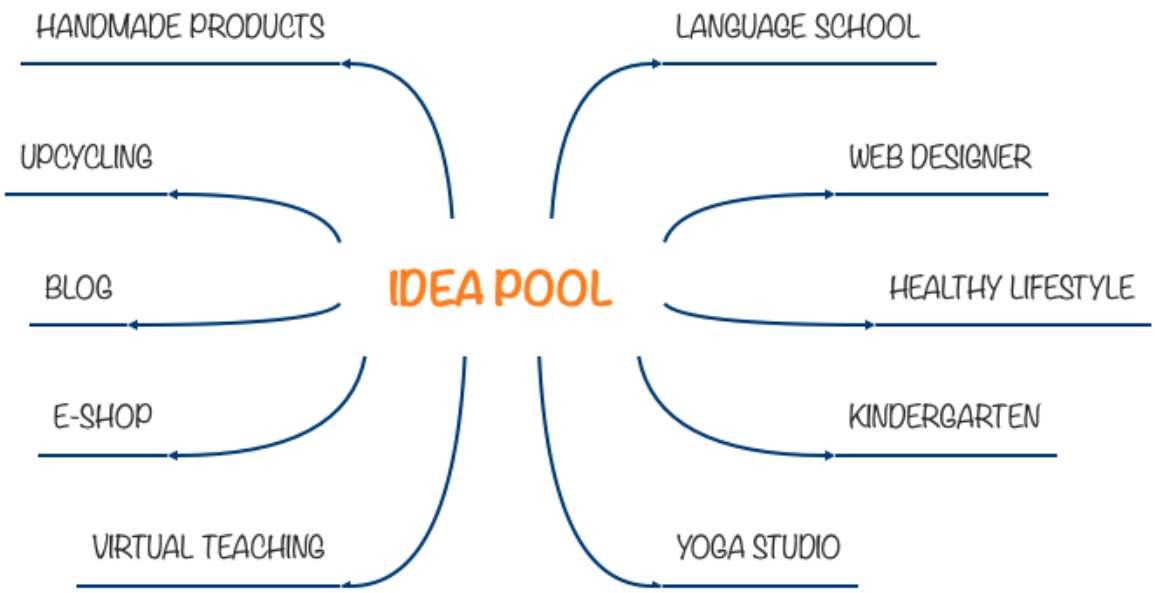
Now you know a lot of information about Jane and her life situation. You already know what resources Jane disposes of (education, experience, finances, material resources such as house, car etc.) and what environment she lives in (Suburbs of Prague, the political and economic centre of the Czech Republic. The economy is currently struggling with consequences of COVID-19 pandemic).

BUSINESS IDEA POOL

Time: 30 min.

Instructions: Let participants to work in groups and define a business idea based on the information they know about Jane and her skills and resources.

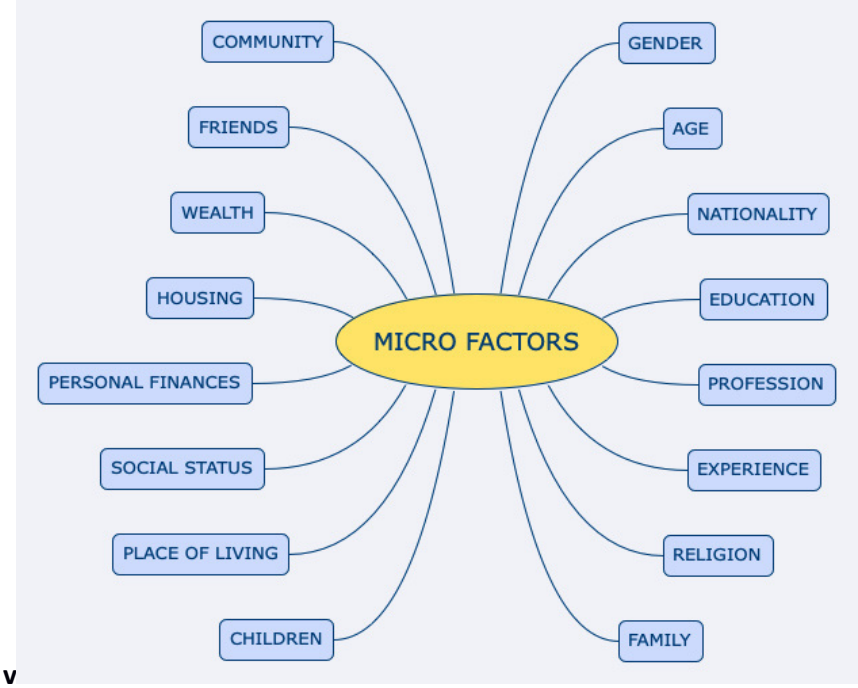
What business idea would you propose to Jane? Come up with your own ideas or choose from the idea pool.



Write down:
The business idea is:
……
……
……
……
……
The products/services are:
……
……
……
……
……
……

STEP 2 - MAP THE ENVIRONMENT

Time: 30 min.: 15 min. discussion in groups / 15 min. debriefing with follow-up questions
Instructions: Let the participants discuss in groups what the important factors are which might help or impede the success of the chosen business idea.
Now you know a lot of information about Jane and her life situation. Below you will find two mind maps with several micro and macro situational factors. Discuss if and how those factors might influence the success or failure of Jane's business.
Follow-up questions:
1/ Which factors do you consider as the most influential regarding potential success of the chosen business ide?
2/ What precautions/mitigation strategies would you suggest to prevent risks connected to those factors?



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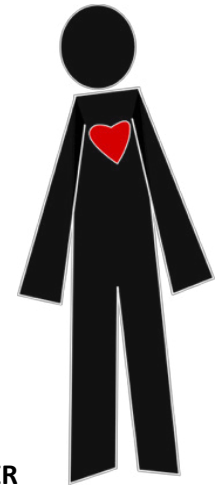
STEP 3 - PROPOSE THE VALUE FOR YOUR CUSTOMER

You have already mapped the environment and now you are better prepared to come up with a business idea that might have potential to succeed.



YOUR CUSTOMER

Time: 30 min

Instructions: Guide the participants through defining the customer and his/her profile.

Now you are clear about the business idea and what products or services you are going to offer. The next important step is to define your customer?

Task: Imagine your customer as a person with his/her own life, needs, interests, habits and wishes. Try to describe your typical customer as detailed as possible. Use the table below:

1/ Age: .....
2/ Gender: .....
3/ Education: .....
4/ Profession: .....
5/ Income: .....

6/ Family status: …….
7/ Interests & hobbies:
……
……
……
8/ Habits:
……
……
9/ Community:
……
……
10/ Problems and needs:
……
……
……
11/ Wishes, dreams, goals:
……
……
……

VALUE PROPOSITION
Time: 30 min
Instructions:
Now you know your customer better. You know how he/she lives, what his/her problems, needs and wishes are. To attract your customer, you have to create a value for him/her with the products or services you are offering.

Following questions will help you to define the value proposition:
1/ What problems/challenges does your customer face in everyday life? (at work, at home) What makes them feel bad, annoyed, feared or frustrated? What is your customer missing?
2/ What is your customer dreaming about? What would make him/her happy?
3/ What emotional needs does your customer want to satisfy? How does your customer want to feel?
4/ How does your customer want to be perceived by others? Is social status, good look or power important for him/her?
5/ What would make your customer's life or job easier?
6/ What savings would your customer appreciate in terms of time, effort, money etc.?
7/ What is important for your customer? (price, quality, availability, design, guarantee, low risk, special features etc.)

Define your value proposition:
OUR (products and services)
……
……
……
HELP (customer)
……
……
……

WHO WANTS TO (needs, problems, wishes)

……
……
……

BY (value proposition)

……
……
……

PITCH YOUR BUSINESS IDEA

Time: 60 min

Instructions: Explain to participants what a "pitch" is and guide them through preparation of their pitches in groups. Let them prepare a presentation in groups answering the key questions. You can allow participants to use a presentation software and prepare slides (max. 5). Preparation phase is supposed to last max. 30 min. + presentation 30 min. (max. 2 min. pitches)

Now you know what products and services you offer, who your customer is, what his/her needs are and what value you propose. It's time to present your business idea or as we say to "pitch". You will have maximum of 2 minutes to persuade us about the uniqueness of your business idea. Prepare your pitch in groups by finding answers to following questions:

1. *PROBLEM - What is the problem/challenge/need your are solving with your product or service?*
2. *SOLUTION - What solution do you propose to solve the problem/satisfy the need? What value do you propose for the customer?*
3. *MARKET - Who is your customer? Who do you target at?*
4. *UNIQUENESS - How do you differentiate yourself from your competition?*

REFLECT

Time: 30 min.

Instructions: Guide participants through the final reflection. You can draw a tree on the flip chart and put there empty post-its representing "apples of knowledge". Ask all participants to pluck couple of apples (post-its) and write down answers to following questions:

Case study reflection

- What next steps would you propose to Jane to make her business idea successful?
- How do you think that starting Jane´s own business will change her family life?

Personal gain reflection

- What new knowledge and skills did you learn in this workshop?
- What did you enjoy most?
- What was difficult for you?
- How are you going to use the gained knowledge?

4. Interactive learning

Activity 1: Quiz

1/ Which statement is true?
a/ Women are over-represented in positions of leadership.
b/ Women's economic empowerment (WEE) increases the gender pay gap.
c/ Access to child-care support impacts women's access to the labour market.

2/ Which of the following tools supports women's economic empowerment?
a/ Rigid working hours
b/ Access to financial services
c/ High interest rates

3/ Which of the below statements is incorrect?
a/ The state can positively contribute to WEE by abolishing laws that are discriminatory.
b/ Trade unions can positively contribute to WEE by advocating for high-income groups.
c/ Employers can positively contribute to WEE by offering teleworking to women.

4/ What are some of the key words associated with gender equality?
a/ wellbeing, sustainability, access
b/ unpaid work, limits, money
c/ productivity, rate, discrimination

5/ Which of the following factors contribute to wellbeing?
a/ loans & spending
b/ debts & investment
c/ health & prosperity

6/ What resources does one need to support a business idea?
a/ capital
b/ fluctuation in the economy
c/ drop in the equality index

7/ What are the micro-factors that create the business environment?
a/ school & social system
b/ education, experience & social status
c/ the environment & climate crisis

8/ Which of the following are the macro-factors that create the business environment?
a/ gender & age
b/ family & children
c/ demography & employment

9/ Which statement below is incorrect?
a/ The crucial factor determining the success of a business is whether value is delivered to the customer.
b/ Services are more innovative than products in inclusive value chains.
c/ A good pitch should describe the problem, solution, market and uniqueness of the business idea.

10/ Which of the following factors are the most useful when attempting to find out the customer's needs?

a/ growth & recession

b/ habits & income

c/ banking system

Activity 2: Mark all statements that are correct

Women's economic empowerment:

might have a positive impact on poverty reduction.
increases the inequalities between global economies.
helps to create more flexible working conditions.
positively contributes to reducing the gender pay gap.
contributes to a decrease in value proposition.
leaves care work unrecognised.
impacts social well-being.
closes discussion about how to change social norm.
reduces loans.
supports access to child-care.
boosts economic productivity.

Activity 3: Yes, or no?

1. Unpaid work is equally distributed among women and men. NO
2. Employers can support women's economic empowerment by providing childcare in the workplace. YES
3. Discrimination leads to natural selection of more productive citizens. NO
4. The gender pay gap is the difference between the average hourly earnings of men and women. YES
5. The gender equality index shows better performance of men at work. NO
6. Promoting small entrepreneurs and local economies supports inclusive value chains. YES
7. Trade unions cannot have any serious impact on women's economic empowerment. NO
8. Better access to financial services can boost women's entrepreneurship. YES
9. Inclusion policies are hindering economic growth. NO
10. Prejudices and stereotypes impact changes in social norms. YES

Activity 4: Fill in the blanks

1. The key criteria to define women's economic empowerment are: power to make ……, access to …… and economic …… (decisions, resources, benefit)
2. Women are paid ……. then men. (less)
3. Women's economic empowerment positively impacts a reduction of the gender …… gap. (pay)
4. Care work which is not directly remunerated is mostly performed by …… (women)
5. A state of experiencing health, happiness and prosperity is called …….. (wellbeing / well-being)
6. A short presentation of a business idea to a potential investor is called a ……. (pitch)
7. Treating people differently because of their origin or race is called …… (discrimination)
8. A type of work that tends to be insecure is called ……. employment. (vulnerable / precarious)

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FRESH-UP ECONOMICS

Migration: Economic and social effects in Europe

by Tomasz Wołowiec

Table of contents

1. Overview

Introduction

The growing phenomenon of migration constitutes one of the most important challenges facing Europe and particular member states of the European Union. It is connected with economics (mainly associated with globalisation), cultural and social transformations, but also with spreading areas of poverty, international and ethnic conflicts. Migrations provide a "mirror" for the changes taking place all over the world, affecting the lives of individuals and whole nations. High intensity of migration movements that can be observed currently calls for the need to analyse these processes. In recent years many European countries have introduced significant changes to their migration policies. This stems from adjusting these policies to the evolving migration models and changing political circumstances. The changes have been mostly directed at tightening limitations concerning the search for qualified staff, investors and entrepreneurs. On one hand some more beneficial (simplified) solutions have been introduced in procedures governing family migration, however, in the long term, the changes have been directed at toughening restrictions.

The causes of economic migration

Emigration can be defined as a situation when a person leaves their permanent place of residence for some time or forever. It is the movement of people outside the borders of a given territory, temporary or permanent departure from the country. There are various causes of emigration. The first one is the desire to improve one's living conditions. Unable to find employment in their country or dissatisfied with the reality of a specific place, many people decide to emigrate for economic reasons. Some of them, unable to choose their career path in their homeland, try to find something abroad. A frequent form of economic **emigration** is one related to seasonal work. **Emigration** is also driven by the need to see new places. Curiosity about the world, various cultures, totally different opportunities for earning a living and building one's career – this is something that may appeal particularly to young people. The main cause of **economic emigration** is the desire to improve one's living standards. A higher salary and a better standard of living are important. However, we should also remember additional factors – the quality of education, better healthcare, totally new standards in social care. Other countries do not only offer a higher salary. They can also guarantee better conditions of life "after work".

Historically, it is recognised that relatively **favourable economic conditions and political stability** have been factors in attracting immigrants to European Union countries. Europe is a continent that many people around the world associate with "paradise" on earth. Many European countries are perceived as rich with institutions that provide legal and social protection. Such institutions include legal protection of employment, minimum wage, and various benefits that affect the standard of living, which attracts residents of less developed countries. Moreover, many European countries have signed the Geneva Convention, which imposes an obligation to provide shelter to people who flee their home country from war or persecution.

The scale of the phenomenon, its consequences and impact on various economic and social spheres make migration one of the most important problems. Various disciplines attempt to learn and understand the phenomenon of contemporary international migration.

Learning about the causes and conditions, as well as predicting their course and consequences is still a very topical issue. The changes that are occurring in the modern world, also cause changes in attitudes towards people who change their country of residence. In many countries, there is a high demand for labour and indicates a "lack of hands for work". This gap is filled by immigrants taking up jobs with conditions that are not acceptable for the local population.

In 1965, the Swiss writer Max Frisch wrote a very telling task: "***We wanted hands to work, and the people came***". The growing proportion of immigrants in many countries has made their problems more visible, and even though they are economically active people and contribute to the economic development of the host country, they are still viewed negatively by certain groups.

The main purpose of migration policy is not only to ensure the effective management of migration flows, but also to prevent illegal immigration, to prevent trafficking in human beings, to ensure fair treatment of people from third countries and to help people to better adapt to a new culture and society. Migration is affected by a combination of economic, environmental, political and social factors in the migrant's country of origin (push factors) or in the country of destination (pull factors).

Economic effects of migration

The economic effects of migration vary widely. Sending countries may experience both gains and losses in the short term but may stand to gain over the longer term. For receiving countries temporary worker programs help to address skills shortages but may decrease domestic wages and add to public welfare burden. The economic effects of migration for both sending and receiving countries may also vary depending on who is moving, specifically with respect to migrant workers' skill levels. For sending countries, the short-term economic benefit of emigration is found in remittances. Remittances are funds that emigrants earn abroad and send back to their home countries, mainly in order to support families left behind. According to the World Bank, remittances totaled $529 billion worldwide in 2012, with $401 billion of that money flowing into developing nations. Significantly, these figures only account for funds sent through formal channels, so the amount of remittances is likely much larger than these numbers suggest. The World Bank notes that remittances sent through informal channels could add at least 50 percent to the globally recorded flows (UNCTAD, 2011-2018). Migration is a feature of social and economic life across many countries, but the profile of migrant populations varies considerably. In part this is because of the variety of sources of migration. In much of Europe, for example, citizens enjoy extensive rights to free movement. In Australia, Canada and New Zealand, managed labour migration plays an important role. Other sources include family and humanitarian migration (1).

Migration and societies

Whatever its source, migration has important impacts on our societies, and these can be controversial. The economic impact of migration is no exception. Benefit or burden – what's the reality? To answer this question, it can be helpful to look at migration's impact in three areas – the labour market, the public purse and economic growth.
Labour markets:

- Migrants accounted for 47% of the increase in the workforce in the United States and 70% in Europe over the past ten years.
- Migrants fill important niches both in fast-growing and declining sectors of the economy.

● Like the native-born, young migrants are better educated than those nearing retirement.
● Migrants contribute significantly to labour-market flexibility, notably in Europe.

The public purse:
● Migrants contribute more in taxes and social contributions than they receive in benefits.
● Labour migrants have the most positive impact on the public purse. ● Employment is the single biggest determinant of migrants' net fiscal contribution.

Economic growth:
● Migration boosts the working-age population.
● Migrants arrive with skills and contribute to human capital development of receiving countries.
● Migrants also contribute to technological progress.

Conclusions

Understanding these impacts is important if our societies are to usefully debate the role of migration. Such debates, in turn, are essential to designing policies in areas like education and employment that maximise the benefits of migration, especially by improving migrants' employment situation. This policy mix will, of course, vary from country to country. But the fundamental question of how to maximise the benefits of migration, both for host countries and the migrants themselves, needs to be addressed by many OECD countries in coming decades, especially as rapid population ageing increases demand for migrants to make up shortfalls in the workforce (2).

2. Background information

Introduction

The growing phenomenon of migration constitutes one of the most important challenges facing Europe and particular member states of the European Union. It is connected with economics (mainly associated with globalisation), cultural and social transformations, but also with spreading areas of poverty, international and ethnic conflicts. Migrations provide a "mirror" for the changes taking place all over the world, affecting the lives of individuals and whole nations. High intensity of migration movements that can be observed currently calls for the need to analyse these processes. In recent years many European countries have introduced significant changes to their migration policies. This stems from adjusting these policies to the evolving migration models and changing political circumstances. The changes have been mostly directed at tightening limitations concerning the search for qualified staff, investors and entrepreneurs. On one hand some more beneficial (simplified) solutions have been introduced in procedures governing family migration, however, in the long term, the changes have been directed at toughening restrictions (3).

The problem – A challenge to economic systems of the European Union member states

Fewer and fewer children are born in Europe. In 2011-2018 as many as 11 countries had a declining number of births[1]. Population decreases in particular countries allow us to claim that such countries need a large inflow of population in production and pre-production age as quickly as possible. A wise pro-family policy, encouraging families to have more children, is a must and we can only hope that relevant programs will become permanent in order to avoid similar situations in the future. One must remember, however, that activities taken in the country may help, but the "hole" generated in the past years will not be eliminated even by a sudden growth in the number of births. It is necessary to have some inflow of population from outside because negative demographic trends are dangerous for the economy and its development. Unfortunately, the growth in the number of births will not be sufficient to solve the problem. Another solution is needed – each EU country urgently needs willingness to work and easy assimilation of immigrants. Here religious and cultural issues are vital for the efficiency of the assimilation process.

The International Organisation for Migration identifies four main drivers of migration:

- globalisation and integration processes,
- geopolitical trends,
- transnationalism,
- demographic trends.

International population migrations are motivated by economic and non-economic reasons. Among the economic motives is the desire to find a job, improve living conditions, get a higher salary for work, improve their qualifications, gain work experience, or learn a language. There are many non-economic reasons, they are conditioned by many factors, including political, religious or racial persecution, but also be the result of overpopulation of the society, high unemployment or poverty. The causes of migration processes are divided into general global factors that affect all migration processes, push factors and pull factors that encourage immigration. This division is associated with

various conditions, such as: historical, demographic, socio-political, economic, etc.

Table 1: Non-demographic reasons for migration

Types of factors	Push factors	Pull factors
Historical	-the existence of nationality clusters in a given country -existence of cultural, educational and religious institutions of a given group of immigrants	-existence of old centres of refugees (e.g. Poles in France) -existence of large centres of new immigration favours the arrival of immigrants representing the same nationalities and greatly facilitates their assimilation into new environments
Socio-political	-discrimination against national minorities; armed social conflicts -restriction of basic human rights -disillusionment and frustration with the formation of a new regime -danger of authoritarian dictatorship or civil war	-benevolent attitude of society, public opinion and political parties towards foreigners and ethnic minority -ability to absorb foreign cultures
Economic	-high level of unemployment -lack of employment opportunities in your profession -poor housing situation -poor supply of consumer goods in stores -extinction and high purchasing power of foreign currencies etc	-the degree of expansion of "welfare state" institutions -low unemployment rate -employment opportunities -demand for foreign labour -high rate of economic growth -investment determining demand for labour

Law	-liberal passport and foreign exchange purchase regulations	- no visa requirements -liberal immigration regulations, including those concerning family reunification -regulations defining the status and social rights of political refugees and migrant workers -ease in obtaining asylum and work permits

Source: Author's own analyses based on statistical data from the European Union countries.

The causes of economic migration

Emigration can be defined as a situation when a person leaves their permanent place of residence for some time or forever. It is the movement of people outside the borders of a given territory, temporary or permanent departure from the country. There are various causes of emigration. The first one is the desire to improve one's living conditions. Unable to find employment in their country or dissatisfied with the reality of a specific place, many people decide to emigrate for economic reasons. Some of them, unable to choose their career path in their homeland, try to find something abroad. A frequent form of economic **emigration** is one related to seasonal work. **Emigration** is also driven by the need to see new places. Curiosity about the world, various cultures, totally different opportunities for earning a living and building one's career – this is something that may appeal particularly to young people. The main cause of **economic emigration** is the desire to improve one's living standards. A higher salary and a better standard of living are important. However, we should also remember additional factors – the quality of education, better healthcare, totally new standards in social care. Other countries do not only offer a higher salary. They can also guarantee better conditions of life "after work".

The concept of international migration is associated with migrants, i.e. all those who live in a foreign country for more than a year, regardless of the reasons. International migration is associated with its various forms:

- emigration means that people leave their current country of residence (native) and move permanently or temporarily to another country,
- immigration is the influx, the arrival to a foreign country permanently or temporarily of people previously residing in another country, in order to settle there,
- re-emigration - return to the emigrants' homeland,
- repatriation is a special form of migration, it means the return to the homeland of people who were forcibly staying outside the borders or people who, as a result of changes in national borders, ceased to be part of a given country,
- refugeeism - forced emigration accompanied by unfavourable economic or political conditions, e.g., resulting from armed conflicts, wars, revolutions, etc.

Positive and negative effects of emigration

As every significant social phenomenon, this one brings about some consequences. We can observe both negative and positive **effects of migration.** They can be analysed from the point of view of a person emigrating and from the perspective of the country they leave. A positive effect of emigration is obviously the improvement in the situation of a migrating individual. This change does not only concern such an individual. Usually the situation of the whole family improves. There are also non-material positive consequences of migration. Migrants have an opportunity to experience some adventures or even to find their new place in the world. They improve their qualifications as well as social skills – they are able to adjust to the new community, the new culture, etc. **Negative effects of migration** on the migrating person include mainly separation from their family and friends. This situation sometimes leads to divorces. Parents who emigrate and leave their children with their grandparents no longer have influence on their offspring. They are often unable to be with their children during important events.

A country experiencing the outflow of workers also suffers from another negative side effect – the increasing deficit of specialists. This is visible in various situations – the lack of doctors and nurses in hospitals limits access to healthcare, which brings negative effects to society. At the same time, as workers with relevant qualifications leave the country, enterprises find it impossible to recruit well qualified staff, which is detrimental to the domestic economy.

First: "...Jaumotte, Koloskova and Saxena at the IMF and VoxEU argue that migration, no matter how controversial politically (see figure 1), makes sense economically. In the long term, both high and low-skilled workers who migrate bring benefits to their new home countries by increasing income per person and living standards. High-skilled migrants bring diverse talent and expertise, while low-skilled migrants fill essential occupations for which natives are in short supply and allow natives to be employed at higher-skilled jobs. Gains are broadly shared by the population, so it may be well-worth shouldering the short term costs to help integrate these new workers." [https://www.bruegel.org/2017/01/the-economic effects-of-migration/]

Second: "…A multi-author report by RAND looks at the cost of non-Schengen from a civil liberties and home affairs perspective. They estimate the cost of re-introducing internal border controls in the Schengen Area at around €0.1–19bn in one-off costs – depending on the extent of border crossing point reconstruction – and around €2–4bn in annual operating costs, corresponding to around 0.02–0.03 per cent of Schengen Area GDP. Portes and Forte look specifically at the economic impact of Brexit-induced reductions in migration. Their scenarios imply that net EU migration to the UK could fall by up to 91,000 on the central scenario, and up to 150,000 on a more extreme scenario. Using the existing empirical evidence on the impact of migration on growth and productivity in advanced economies, they estimate the possible impact of falls in EU migration on GDP and GDP per capita growth between now and 2020, compared to a counterfactual where EU migration remains constant. In their central scenario, the impact would be to reduce GDP by between about 0.63% to 1.19%, while GDP per capita would be reduced by between about 0.22% and 0.78%. In the more extreme scenario, the hit to GDP per capita would be up to 1.16%." [https://www.bruegel.org/2017/01/the-economic-effects-of-migration/]

Case study – Germany

Germany is undoubtedly a receiving country for migration[1]. Every fifth inhabitant of this country comes from immigrant communities. This is especially visible in the youngest generation, where foreigners or people with foreign roots account for nearly a third of children aged under ten. Migrants living in Germany do not form a homogenous community. They include "Gastarbeiters", who came to Germany on the basis of employment contracts, people who came to join their families, displaced people and "late displaced people", members of the European Union settling down in Germany due to freedom of labour movement, and recently there have been more and more people who apply for international protection. Germany at present is the second most important country accepting immigrants (preceded only by the USA). The number of foreigners living in Germany exceeds 8 million, which accounts for 10% of the population. The biggest group of foreigners are of Turkish origin (nearly 2.8 million). More than half of them were born in Germany and nearly half already have German citizenship. This still influences the Germans' impression of immigrants as people with lower qualifications, performing badly-paid jobs. The second largest nation of immigrants are Poles – who outnumber Italians, Romanians and Greeks. In the 1970s-1990s the biggest group of immigrants were late migrants, people with German roots who had lived in Eastern European countries and in the former Soviet Union. The growing German society accounts for the decreasing pool of working people. The inflow of mostly young people slows this trend down. The average age of foreigners and people of migrant background in Germany is lower than the average age of Germans who are not of migrant background. The Bertelsmann Foundation study shows that this is exactly why they positively contribute to the state budget and the social security system (4). **Their absence in the labour market would mean that a declining number of workers - who pay social insurance contributions and taxes - would have to finance the growing number of pensioners and to be burdened by public debt. Thanks to the large-scale immigration to Germany, including refugees, the number of working people will increase in the coming years.** The federal Statistical Office informs that only with the regular inflow of a large number of immigrants (approximately 200,000 a year) the number of people of working age in Germany could grow. Referring to some qualifications, regions and sectors, we can already witness the shortage of qualified staff. **This presently concerns 19 groups of professions, such as healthcare and nursing sector, mechatronics and electric and electronic sector jobs, construction and energy supply sectors and communication and logistics** (5).

Following a long period of sceptical attitudes to accepting immigrants in the German labour market, the introduction of the so-called "green card" in 2000 (facilitating admission of qualified employees, mainly from the IT sector), followed by the immigration act passed in 2005, offered new opportunities for specialists who wanted to emigrate to Germany. In 2011 the federal government passed the "Fachkräfte-Offensive" program (Offensive for Specialists) in order to attract qualified workers. It covers five fields of activities: **employment activation and security, helping workers to balance their professional and family life, education opportunities for everyone from the start, vocational education and training. The last point of the program comprises "integration and immigration of qualified workers**" (6). A wide information campaign accompanied the project. The "Make it in Germany" portal, run in many languages, is trying to attract qualified employees all over the world. Its offer includes a search engine for job vacancies and the map of the world with offers of German institutions on every continent (7).

[1] Situation from 1990 and concerns West Germany.

Migration in the European Union policy – Beneficiaries – Costs – Benefits

The main beneficiary of migration is its participant, however, the subject literature often reveals controversies over potential benefits and costs for the countries sending and receiving migrants. It is generally believed that benefits outweigh drawbacks. Traditional benefits of emigration for the country sending migrants can be seen in lower unemployment and improved external financing thanks to transfers of emigrants' wages. Costs and potential losses of the country generating emigration entail the risk of worsened demographic structure. Benefits are visible for the receiving countries, as, for instance, emigrants implement the pro-family policy in the European Union countries by taking jobs in the childcare sector and looking after the elderly, as well as in healthcare services. An unfavourable phenomenon can be seen in the fact that Polish emigrants often accept jobs well below their qualifications (which, at the same time, brings benefits to their foreign employer). The international experience tells us that the emigrant's level of education is negatively related to their willingness to transfer money to the sending country. Emigration may pose a threat to the country's development if it is large-scale and if it means that the most active, most talented and best educated people leave.

The population of working age in Europe has continually been falling, therefore economic migration from third countries will become one of the ways of filling the labour gap. According to forecasts, in several years the number of working people in Europe will have decreased by over 20 million, therefore more developed member states of the European Union may increase their demand for young and talented employees from other countries.

Education is the greatest benefit derived from emigration. People who move abroad gain the knowledge and experience that is unavailable in their countries, they also establish valuable contacts. This may translate into measurable benefits for their country. **Economic migration** may have both positive and negative effects on the Polish economy. These issues can be analysed from a macro- and micro-economic perspective. In macroeconomics, migration affects: the situation on the labour market, the transfer of earnings and the foreign trade. The micro scale concerns incomes of households and conducting economic activity. The emigration of qualified and well-educated people means the loss of human capital. We can list the following consequences of emigration of highly qualified people, affecting them and the country from which they emigrate:

1. Positive consequences: higher earnings, better living standards, financial security, accomplishment of one's professional aspirations, personal development, raising qualifications, professional ties between countries, transfer of knowledge and financial means, transfer of economic culture, modern society, influence on young people's motivation to gain higher education.
2. Negative consequences: employing people with high qualifications to perform jobs requiring lower qualifications, loss of specialists, hampering development, threat to some sectors of the economy, such as healthcare, loss of expenditure on education of emigrants, depreciation of human capital.

Immigration may bring various effects – positive and negative, both for the society and the economy. We can measure its influence on the economy using various macroeconomic indicators. One of these measures is GDP per capita, showing the volume of production generated, inter alia, by immigrants. The presence of immigrants increases the value of GDP as well as it increases the population of the receiving country, however, some scientists believe that this is not a good ratio, therefore they propose the GDP per capita ratio (8). The economic importance of immigration for the receiving country can also be considered in the micro- and macroeconomic perspective. In the former, it is

essential to conduct the analysis of benefits or losses caused by the inflow of immigrants and their distribution among all market participants, whereas the macro-economic approach calls for an analysis of GDP and salaries of all employed persons. Whether the economic effect for the country is positive or negative depends on the combination of professional and social skills of immigrants and members of the receiving society, and also on the willingness of economic entities to change in order to allow accommodation of immigrants.

Some economists believe that the inflow of people with high education will bring more benefits to the economy, since it will probably change the distribution of income for the benefit of inhabitants, whereas the inflow of people without education will bring about the opposite effects.

A positive effect of migration will be visible when the skills of migrants and local workers remain different. **In the long-term context we have a positive and a negative model of economic and social adjustment of migrants.** The positive model can be observed when migrants from countries with higher earnings move to countries with lower earnings. There they engage in the process of gaining additional skills which are vital in the receiving country. This involvement at the beginning brings lower incomes, which increase in time, but the ultimate growth of income is decreasing. **The negative model, on the other hand, refers to a situation when migrants come from countries with similar levels of earnings.** In this model immigrants initially have higher incomes compared to workers in the receiving country, but then their ultimate incomes decrease along with the length of their stay. Some economists believe that the long-term effect of immigration consists in higher employment and economic growth (GDP). This approach, however, is criticised as it ignores side effects and feedback in the economy. GDP growth, a larger number of people with high qualifications and strong motivation, or society differentiation, may all in the long run have both positive and negative effects for the productivity level.

Should European countries be concerned with the effects of immigration inflows? In order to answer this question, we examine the potential economic consequences of immigration for European economies by distinguishing between general migration, economic migrants and refugees. Labour migration represents only a fraction of all movements to Europe, and more came through other channels, including family, humanitarian and free-movement migration. But even though most migration is not directly driven by workforce needs, immigrants are playing a significant role in the most dynamic sectors of the economy. New immigrants represented 15% of entries into strongly growing occupations in Europe (OECD, 2018). These include notably health-care occupations and STEM occupations (Science, Technology, Engineering and Mathematics). Also, in Europe, immigrants represented about a quarter of entries into the most strongly declining occupations (24%) including craft and related trades workers as well as machine operators and assemblers.

Conclusions

The economic effects of migration vary widely. Sending countries may experience both gains and losses in the short term but may stand to gain over the longer term. For receiving countries temporary worker programs help to address skills shortages but may decrease domestic wages and add to public welfare burden. The economic effects of migration for both sending and receiving countries may also vary depending on who is moving, specifically with respect to migrant workers' skill levels. For sending countries, the short-term economic benefit of emigration is found in remittances. Remittances are funds that emigrants earn abroad and send back to their home countries, mainly in order to support families left behind. According to the World Bank, remittances totaled $529 billion worldwide in 2012, with $401 billion of that money flowing into developing nations (2013). Significantly, these figures only account for funds sent through formal channels, so the amount of remittances is likely much larger than these numbers suggest (9). The World Bank notes that remittances sent through informal channels could add at least 50 percent to the globally recorded flows (UNCTAD, 2011-2018).

Migration is a feature of social and economic life across many countries, but the profile of migrant populations varies considerably. In part this is because of the variety of sources of migration. In much of Europe, for example, citizens enjoy extensive rights to free movement. In Australia, Canada and New Zealand, managed labour migration plays an important role. Other sources include family and humanitarian migration.

Whatever its source, migration has important impacts on our societies, and these can be controversial. The economic impact of migration is no exception. Benefit or burden – what's the reality? To answer this question, it can be helpful to look at migration's impact in three areas – the labour market, the public purse and economic growth (9).

Impact on labour markets:

- Migrants accounted for 47% of the increase in the workforce in the United States and 70% in Europe over the past ten years;
- Migrants fill important niches both in fast-growing and declining sectors of the economy;
- Like the native-born, young migrants are better educated than those nearing retirement;
- Migrants contribute significantly to labour-market flexibility, notably in Europe.

Impact on public purse/budget:

- Migrants contribute more in taxes and social contributions than they receive in benefits;
- Labour migrants have the most positive impact on the public purse;
- Employment is the single biggest determinant of migrants' net fiscal contribution.

Impact on economic growth:

- Migration boosts the working-age population;
- Migrants arrive with skills and contribute to human capital development of receiving countries;
- Migrants also contribute to technological progress.

Understanding these impacts is important if our societies are to usefully debate the role of migration. Such debates, in turn, are essential to designing policies in areas like education and employment that maximise the benefits of migration, especially by improving migrants' employment situation. This policy mix will, of course, vary from country to country. But the fundamental question of how to maximise the benefits of migration, both for host countries and the migrants themselves, needs to be addressed by many OECD countries in coming decades, especially as rapid population ageing increases demand for migrants to make up shortfalls in the workforce.

What changes can be expected in the coming years? Which main fields of conflicts and potential social tensions should be better taken into consideration?

Europe is facing the most serious migration challenge since the end of the Second World War. Aspects of managing the various tasks are covered by numerous legal instruments. EU action consists in promoting and implementing immediate and long-term measures, but attention is also focused on the internal and external dimensions of migration policy and on the EU's external borders. The instruments implemented oscillate around:

- return and readmission of irregular migrants who have no right to enter or stay in the EU,
- combating the smuggling of migrants,
- protection of the EU external borders,
- creating legal entry opportunities for persons in need of international protection, - establishing an asylum policy based on a balance between solidarity and responsibility, ● addressing migration issues in cooperation with third countries,
- the possibility to allocate funds skilfully.

Despite the migration crisis that has lasted for four years, its impact on the labour market (both Polish and European) is the subject of very little research. It is difficult to determine why this is the case. Perhaps the inability to determine how many immigrants currently reside in the territory of Europe prevents reliable observations. Available sources draw attention to many factors that determine the impact of migration on the labour market in two ways - both positively and negatively. A distinction should be made already at the level of the country of origin of immigrants, which often determines attitudes towards life in the country where they settled.

Migration, regardless of the reasons behind it, presents families with both challenges and opportunities. On the one hand, it may result in loosening of family ties, breakdown of marriages or developmental problems in children. On the other hand, it may lead to involvement of the so-far neglected parent in childcare, improvement of living conditions in the family or improvement of children's educational opportunities.

The current big problem is financial debt in family conflicts. People leaving for work usually choose to maximise their savings or to maximise their income, but the author points out that people who earn more income, migrate by saving and gaining a good life for their family in Poland usually alienate themselves from their family back home. Which is really paradoxical.

There are also people who try every opportunity to earn and send money to the country, even drug smuggling. However, when such a person does not see any profit from his action, he usually falls into a state of alienation and stops any activity.

Glossary

MIGRATION - in the global context, movement of a person either across an international border (international migration), or within a state (internal migration) for more than one year irrespective of the causes, voluntary or involuntary, and the means, regular or irregular, used to migrate. In the EU context, the action by which a person either:

(i) establishes their usual residence in the territory of an EU Member State for a period that is, or is expected to be, of at least 12 months, having previously been usually resident in another EU Member State or a third country ; or

(ii) having previously been usually resident in the territory of an EU Member State, ceases to have their usual residence in that EU Member State for a period that is, or is expected to be, of at least 12 months.

EMIGRATION - is the act of leaving a resident country or place of residence with the intent to settle elsewhere (to permanently leave a country). Conversely, immigration describes the movement of people into one country from another (to permanently move to a country). Hence one might emigrate from one's native country to immigrate to another country. Both are acts of migration across national or other geographical boundaries.

RE-EMIGRATION - return to the emigrants' homeland.

REPATRIATION is a special form of migration, it means the return to the homeland of people who were forcibly staying outside the borders or people who, as a result of changes in national borders, ceased to be part of a given country.

REFUGEEISM - forced emigration accompanied by unfavourable economic or political conditions, e.g., resulting from armed conflicts, wars, revolutions, etc.

ECONOMIC IMPACT OF MIGRATION - the economic impact of migration flows through into every aspect of the economy. It has a profound positive impact not just on population growth, but also on labour participation and employment, on wages and incomes, on our national skills base and on net productivity.

SOCIAL IMPACT OF MIGRATION - the change in the social status from non-migrant to migrant causes change in norms and values, attitudes and behaviour, motivation and expectation, material and social status, social priority and change in the circle of interaction. All these changes have a negative effect on fertility level and family size.

ECONOMIC EMIGRATION - is someone who emigrates from one region to another, including crossing international borders, seeking an improved standard of living, because the conditions or job opportunities in the migrant's own region are insufficient. The United Nations uses the term migrant worker.

SOCIAL MIGRATION - moving somewhere for a better quality of life or to be closer to family or friends. Political migration - moving to escape political persecution or war. Environmental causes of migration include natural disasters such as flooding.

LABOUR MARKETS - or job markets function through the interaction of workers and employers. Labour economics looks at the suppliers of labour services (workers) and the demand for labour services (employers), and attempts to understand the resulting pattern of wages, employment, and income. These patterns exist because each individual in the market is presumed to make rational choices based on the information that they know regarding wage, desire to provide labour, and desire for leisure. Labour markets are normally geographically bounded, but the rise of the internet has brought about a 'planetary labour market' in some sectors.

POSITIVE EFFECTS OF EMIGRATION - increased economic output; potential entrepreneurs; increased demand and growth. A fear of immigration is that 'Immigrants take jobs from native-born; better skilled workforce; net benefit to government revenues; deal with an ageing population; more flexible labour market; solves a skills shortage; filling undesirable job vacancies; multi-cultural society.

NEGATIVE EFFECTS OF EMIGRATION - potential negative impact on real wages; real GDP per capita could fall; structural unemployment; pressure on public services; housing costs & disharmony from rapid immigration.

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3. Training material

Migration: Economic and Social Effects

Activity title	**MIGRATION: ECONOMIC AND SOCIAL EFFECTS**
Overview	The aim of the lesson is to make students aware of what contemporary immigration is, what causes it, what factors activate it and what economic and social effects it has on the host country. It also examines various cultural, sociological and religious factors which influence the way immigrants are treated in the host country, and which affect social relations and the effectiveness of immigrants' assimilation. It is a knowledge-based type of learning which is combined with analytical skills development. The learning scenario improves students' critical thinking skills and good communication skills.
Objectives	The objective is to explain the causes of immigration, taking into account its social and economic impact on both the host country and the country of departure
Materials	Websites containing interesting statistical data and a powerpoint presentation of the content
Time	1. Teachers presentation: 90 min 2. Students individual analysis: 60 min 3. Students presentation: 30 min 4. Discussion: 30 min 5. Final thoughts description: 30 min
Introductory requirements	The level of economic knowledge needed for this lesson depends on planned depth of analysis. For the introductory level, an understanding of typical economic and social concepts such as GDP, unemployment, labor market, socio-economic development, and integration is required.
Limitations	For the purpose of the workshop, a simple SWOT analysis was used to diagnose the strengths, weaknesses, opportunities and threats of immigration to the host country. This analysis aims to identify the causes of immigration, its role for the host country in terms of economic indicators and social integration issues.
Group size	10-15
Instructions for trainers	First of all, it is necessary to present the processes of migration as a natural factor of socio-economic change, which for years have been part of economic processes (examples of the USA, Australia or Kandy, Great Britain and Germany). Next: students should identify which economic and social factors cause rotation and in what directions it takes place Next: students should identify the positive and negative effects of immigration both for the host country and for the country losing its potential and human capital

Debriefing and evaluation	After the discussion, students should describe their opinions on the causes and effects of immigration, including the positive and negative effects of immigration. An important aspect of the description should be to propose something like a “migration policy” - how to manage the process of migration, how to get the best results for the host country from immigration, and how to minimize the negative effects of 'unwanted' immigration.
Tips for trainers	Like many other topics related to economics, demography or politics, the topic of migration processes and the role and importance of immigrants in the social and economic development of the host country can and does stir controversy (as exemplified by Brexit). Trainers should be aware that some people may have strong views on migration and immigrants, which may be caused by a populist interpretation of reality, and thus become emotionally involved in the discussion.

Background information

Resources for workshop activity:
http://www.globalization101.org/economic-effects-of-migration/
https://www.oecd.org/migration/international-migration-outlook-1999124x.htm
http://www.globalization101.org/economic-effects-of-migration/

Class organization outline:

1) The teacher begins with an introduction based on the long version of the article.
2) Each student makes a list of elements that characterise the causes and drawbacks of migration and immigration processes
3) After presenting their results, students jointly discuss the advantages and disadvantages of immigration, taking into account social and economic factors, as well as the host country and the country "exporting" its human capital
4) The lesson ends with a debate on modern immigration and an evaluation of the advantages and disadvantages of migration processes, using the example of the EU.

4. Interactive learning

Migration: Economic and social effects quiz

Migration is:

a. the migration of a population to change its place of residence at home or abroad; its size is greatly influenced by the state of the economy

b. a departure from one's home country to another country for various reasons and settling in a new place permanently or for a period of time. Emigration is a form of migration

c. a return to one's home country of a person who has left it through no fault of their own

Emigration can be defined as:

a. the migration of a population to change its place of residence either at home or abroad

b. departure from the home country to another country for various reasons and settlement there permanently or for a certain period of time

c. the return to the home country of persons who have found themselves outside its borders not of their own free will.

The reasons for migration of people to other destinations may be:

a. unemployment, low wages and education abroad, desire for education

b. a desire for adventure and learning something new and a career in international companies

c. all of the above reasons are correct

Emigration for economic reasons involves:

a. political oppression in the home country, disagreement with acceptance of the existing political regime, or inability to remain in the country due to oppositional views

b. searching for work necessary to survive or striving to improve living conditions

c. Escape from the need to work in the home country

The registered unemployment rate is measured by the ratio of:

a. the unemployed to the number of economically active people seeking work to the number of employed people

b. the registered unemployed to the total labour force

c. the number of people able to work to the labour force

The negative economic effects of unemployment include:

a. the existence of a difference between the amount of GDP that could be achieved at full employment (assuming the existence of frictional unemployment) and the amount of GDP that was actually achieved over a given period of time

b. increase in the level of production - labour resources are fully utilised

c. development of the shadow economy - employees pay taxes and social security contributions

Unemployment, especially long-term unemployment, also causes a number of social consequences. As perceived by the unemployed in an individual way, these manifest as:

a. the enjoyment of being an active member of the community

b. a loss of sense of social worth due to being unemployed

c. loss of previous social position; loss of contact with friends and reluctance to participate in community, political and cultural life

The social effects of unemployment generate such problems as:

a. social pathologies, such as: alcoholism, drug addiction, crime, and lowering of qualifications and loss of skills, resulting in the need for retraining

b. excessively high standard of living leading to psychosocial development of a person

c. the need to marry wealthy people with a high standard of income

The occurrence of psychological effects of unemployment depends on many individual factors, including gender, age of the unemployed person, length of unemployment, attitudes towards work, and family support. The following effects of unemployment are listed in this category:

a. emotional disturbance and depression in the unemployed

b. loss of self-esteem, feeling inferior to others, and lack of confidence in own abilities

c. all of the above answers are reasonable

Sometimes, in addition to negative effects, unemployment can also produce positive outcomes. This is usually the case with short-term unemployment. In that case, the following consequences can be said to occur:

a. careful work performance by employees who are afraid of losing their jobs; high labour productivity and high work discipline

b. a decrease in competition among workers in the labour market

c. unwillingness of employees to improve their professional qualifications and worse allocation of labour resources

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