



## The New Growth Model and Economic Policy Platform

**Dragan Djuricin\***

Professor of Economics, University of Belgrade, Serbia;  
Former President, Serbian Association of Economists

### Abstract

*Structural crises of the past have had a significant impact on the world economy even before the COVID-19 pandemic emerged in 2020. The ongoing medical crisis exacerbates the double dip recession we have witnessed before. Challenges are consequential. By checking the pulse of the global economy, we see a high level of risk, fragile growth outlook, and increasing tensions between economic scholars and architects of the system over the evident polarization regarding rules concerning new economics. It is undeniable that the global economy has imbalances, like high financialization, income inequality, climate change and economic shutdown. So, it desperately needs a new platform for shaping a better future. Identification of inflection points in the line of reasoning will help reveal the compatibility of emerging conceptual platforms.*

### 1. Issues to be Addressed

Neoliberal capitalism, as the latest version of free-market capitalism, has driven severe social and health problems. It also continued environmental degradation caused by the former version of liberal capitalism. The system places the human economy and society at great risk.

There are many well-known and extensively discussed structural imbalances of neoliberal capitalism, including financialization, income inequality, and anthropogenic climate change. The economic systems operating in many countries produce unsustainable growth, many crises, and inflating and bursting bubbles.

Unregulated negative external effects incentivize companies to cause environmental and social harm. They create a situation in which companies maximize profits by degrading the environment. Government internalization (or monetization) of externalities is essential for creating impact investments that produce environmental and social benefits. Most of the problems addressed by the SDGs can be considered as ‘externalities.’ Under current systems, it is difficult to internalize these costs and problems, and thereby incentivize companies to resolve them.

Current economic systems largely ignore the rules and operating principles of nature. In our highly speculative society, financial risk-takers externalize costs and unintentionally cause many problems. Economic goals (growth) often are in conflict with ecological limits and implied goals (limited growth, balance).<sup>1</sup>

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To become sustainable, economic systems must abide by the objective, observable limits and laws of nature. Sustainable and inclusive economic systems should be based on the circular processes of nature. Macro and micro levels should be guided by the precautionary principle or reversibility principle (ability to reverse course if actions or technology are shown to be harmful). Structural imbalances and asymmetric shocks, like climate change and pandemics, cannot be managed exclusively by the ‘invisible hand’ of the market. A new growth model respects the ‘visible hand’ of the state and biosphere laws. New circular economic policies (structural and industrial) are needed. Impact investments and the broader economy emphasize the 3R principle (reduce, reuse, and recycle).

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The structural recession of 2008 illuminated weaknesses of current economic systems. COVID-19 has created further economic, health and other problems, including deflation in commercial markets and value destruction in capital markets. The economy remains on pause.

The pandemic has shown that neoliberal rule and end-to-end privatization are not solutions for network technologies, natural monopolies, industries with unregulated externalities, and social services. For example, in healthcare, market forces do not function well in an environment where all players are private (clinics, medical insurance, pharmaceuticals, medical equipment suppliers, research labs, etc.). Similar situations exist in education, science and related activities.

Economic systems with structural imbalances are unable to effectively react to asymmetric shocks like climate change and pandemics. New systems and strategies for implementing them are needed. People and technology must be mobilized toward implementing more sustainable and inclusive growth and economic systems. This paper discusses principles and rules for achieving this transition.

## **2. Solutions and Remedies**

COVID-19 has compelled governments to implement massive and targeted policies. They did whatever it took to protect citizens and healthcare systems. In the first quarter of 2020, G-20 countries spent about 7 trillion US dollars on relief and stimulus programs.

Today no one is talking about a V-shaped recovery. The essence of recovery should be how to avoid a double-dip recession, L-shaped stagnation, or freefall. Effective crisis management and turnaround strategies are needed. Due to structural imbalances faced in the past, care must be taken to ensure that relief and stimulus programs providing short-term solutions do not create long-lasting problems.

After completion of crisis management programs, the next step in recovery will be turnaround strategies. But implementing a new growth pattern that is sustainable and inclusive for people and nature is not possible without a paradigm change and new economic rules. Current systems, with their long-term ignorance of negative external effects, have produced extensive unmet needs and underutilized, or wrongly utilized, potentials.

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Nearly all economic scholars agree that advanced economies are at the end of a long cycle of neoliberal capitalism supremacy. New models of growth and economic policy platforms must more effectively address the structural imbalances of neoliberalism and asymmetric shocks like climate change and ‘black swan’ events. The UN Sustainable Development Goals provide economic targets and guidelines.<sup>2</sup> Under sustainable economic systems, businesses will focus on meeting the needs of all stakeholders, not just shareholders.

New systems must overcome the “virus of neoliberalism”, and its major principles of deregulation, liberalization and privatization. We must avoid inertia and a leadership vacuum, which Z. Bauman<sup>3</sup> eloquently called the “liquid modernity”.

Sustainable economics would not replace the main pillars of capitalism, such as private property and market mechanisms. Instead, transition would involve eliminating the negative external effects of the previous growth model, expanding impact investments, improving the relationship between capital and labour during the Fourth Industrial Revolution, and making capital available for beneficial start-ups and innovations. Conceptual breakthroughs in economics, for example as in Mazzucato et al.<sup>4</sup> and Stiglitz<sup>5</sup>, support this line of reasoning.

New systems will not be in some form of an authoritarian capitalism (state capitalism), but more progressive, less conservative and balanced models of stakeholder capitalism. This system is gaining increasing support for addressing social, climate and healthcare crises. The approach positions private and public companies as trustees of society.

Businesses in stakeholder capitalism are not acting philanthropically. They are focused on benefiting all stakeholders and the environment. Instead of short-termism, stakeholder capitalism helps to propel the economy forward, while acting in a more socially responsible way.

The landmark Paris Agreement signals the necessity of transitioning from a linear growth model to a circular one.<sup>6</sup> Despite high ambitions and ongoing negative consequences of climate change, almost nothing has been done over the past five years.

After successive crashes in capital markets, M. Friedman's<sup>7</sup> view that a company's purpose is "just creating value for its shareholders" is becoming discredited. Lack of universal mobility, inequality and market concentration creates major problems. The economy must be refocused on benefiting all of society over the long-term.

In the new platform, economic activities will be focused on intentional policies. Government spending will emphasize industrial policies: horizontal, vertical, environmental, and medical. Mitigation of the climate crisis depends on development of renewable carbon-neutral energy technologies. These technologies are disruptive by definition.<sup>8</sup>

The above concepts work in synergy. They have been discussed in more detailed papers that are focused on the growth model<sup>9</sup> and economic policy platform.<sup>10</sup>

### 3. Interdependencies

Mitigation of the current crisis is focused on protecting people and the healthcare system now, as well as helping the economy to rebound later. A good way to do this is to simultaneously focus on flattening the pandemic curve to prevent overwhelming the healthcare system, while implementing programs that increase economic output and avoid long-term decline.

A key aspect of the Fourth Industrial Revolution is the growing use of ICT. New technologies can accelerate achievement of the SDGs. With new technological opportunities, Industry 4.0 can drive sustainable and inclusive growth of all economies, developed and developing. Only a fraction of this huge potential is being utilized at scale.

A new economic policy platform has a long list of policy targets. These include inflation (low and stable), output gap (low and stable), and ensuring environmental and human health protection.

The coordination between industrial and core policies is crucial. Under a new economic system, we think about core policies in a structural way. For example, effectively addressing the climate crises protects society and generates new business opportunities. Climate related risk adaptation and mitigation are predicted to generate huge investment opportunities of up to \$26 trillion by 2030.<sup>11</sup>

Automatic stabilizers help to align industrial policies with core policies (monetary and fiscal). This is a very old idea, actually a very Keynesian idea of countercyclical measures related to intertemporal reallocation of fiscal burden. According to O. Blanchard,<sup>12</sup> with the increase in the number of state-owned sectors, automatic stabilizers will play a greater role. Pro-development measures, particularly industrial policies, mean more reliance on fiscal automatic stabilizers (carbon tax, universal profit tax, universal medical tax, universal income, etc.) to prevent excessive build-up of debt and contain inflationary consequences of fiscal stimulus. Also, there is significant progress in implementation of monetary automatic stabilizers (neutral interest rate, loan loss provision, FX rate, etc.).

#### 4. Obstacles and Difficulties

A turnaround regularly needs decisions that benefit humanity but are difficult to implement. It is necessary to avoid the main legacy of neoliberal capitalism—benefiting a small portion of society, while causing many environmental, social and economic problems. To achieve this, regulation is critical.

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The COVID-19 pandemic policies are likely to produce some of the same problems as past measures. To monetize debt (public and private), central banks granted unlimited expansion of the balance sheet through quantitative easing. Bank bailouts were undertaken with almost no accountability and unprecedented flexibility in the interpretation of regulatory rules. Tax stimulus shows a continuation of low tax policies.

#### 5. Best Practices and Successful Strategies

The amalgam of shareholder capitalism, market fundamentalism and supply side economics cannot be entirely blamed for the free-market economy’s inefficiencies. But, it has helped to clarify the problems of neoliberal capitalism. In free-market economies, there were many propositions that were taken for granted. For example, by giving away natural resources as ‘free goods’ and ignoring negative external effects of their use, economics allowed manufacturers to exploit nature without paying the full cost. Institutions like the Club of Rome used reason, scientific evidence and truth to develop and advocate economic policies that resolved these problems.<sup>13</sup>

An inspiring framework for new economic rules is based on the “managed capitalism” ideas of Raghuram Rajan.<sup>14</sup> Despite export growth, developing economies regularly entered a “middle income trap” due to growing indebtedness. A shift to sustainable growth required an increased state role in technology development and related industrial policies. This was the seed of the framework known as “heterodox”. Interest in new industrial policies grew after the Great Recession of 2008.<sup>15</sup>

#### 6. Potential Strategies to be Considered

A Heterodox policy platform in Finland functioned through two different strategies: “verticalization” in fields like science, research and development, education and health care along with “horizontalization” of innovative solutions through the marketplace. When

combinatorial innovations dominate the competitive dynamics, it is not possible to innovate in isolation. Infrastructure and coordination between key players (government, research labs, universities, special purpose financial institutions, businesses, etc.) are necessary, more than ever before.

In other areas, the situation is exactly the same. For example, lifelong learning needs coordination through horizontal industrial policies. The new dimension of competition is competition in the speed of learning. Learning is only part of the job (or learning-by-doing). It also includes unlearning and relearning (or learning-by-learning). There are three types of industrial policies: horizontal, vertical, and environmental. Horizontal (or industry-neutral) policies tackle research and development, education, healthcare, etc. Vertical policies are dedicated to tradable sectors (export expansion and/or import substitution). Environmental policies include global warming mitigation and medical security. Thanks to automatic stabilizers, all policies function based on the reversibility (or feedback loop) principle. The concept of automatic stabilizers helps to harmonize industrial policies with core policies (monetary and fiscal).

Export-driven growth based on high tech is not easy to implement after deindustrialization. A shortage of employees with digital skills is a substantial threat to any industrialization trajectory. According to J. Lorre,<sup>16</sup> 10 million global manufacturing jobs remain unfilled.

One of the key problems is financing of industrial policies. The global financial system is on the verge of fundamental reallocation of capital toward carbon-neutral technologies and medical security. To deal with the climate crisis, development of new asset classes, like “green bonds” and “green credits” is critical. Better quantification of the associated financial risks of climate change led central banks to stress-test commercial banks in relation to climate and medical risks.

Pensions, social security programs and long-life insurance are important, perpetual source of funds for the investment needed to achieve the SDGs. These funds require the backing of their long-term liability side. Long-term bonds with high yields are a perfect match to attract savings.

In today’s world, savings are limited. Environmental and social benefits related to the SDGs are regarded as “positive externalities” of investments. There are many variations of the “shadow prices” concept, such as pollutant gasses emission trading, green bonds, guaranties for green credits, and tax cuts (or increases) that could help to internalize these benefits. “Negative externalities” should also be regulated, for example with “carbon taxes”, universally defined at a global level.

Informed by mistakes of previous crises, current policies must have additional conditions. Relief and stimulus programs should require businesses to increase production, employ people, and reward value creation instead of value release and extraction. New policy measures particularly should encourage investment in sustainable growth, reduced carbon emissions and enhanced medical security.

Switching from private to public sector money creation is another large source of investment and stimulus funds. In theory, there is no limit to money and credit expansion. As a result, supplementary digital money and credit channels for new carbon-free industrialization could be used parallelly with existing channels. Money will be used to fund economic and social development, instead of it being printed to fund real estate and other bubbles.

## 7. Questions to be Answered

First, should we have dual economic policies—one for good times (neoclassical) and one for bad times (Keynesian)?

Second, a new performance measurement system is needed to achieve the SDGs. These metrics will facilitate implementation of inclusive and sustainable economics. At the macro-level, we must focus on social well-being indicators, instead of GDP. At the micro-level, in addition to financial metrics, ESG metrics are needed to drive business improvement. How should this new performance measurement system be defined and established?

Third, what are the financing and investment mechanisms needed to fund the transition to sustainable economies? How can these be established and expanded?

### Author Contact Information

Email: [dragan.djuricin@ses.org.rs](mailto:dragan.djuricin@ses.org.rs)

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