



# RESPONSES TO THE GLOBAL CRISIS: charting a progressive path

handbook of ideas

**progressive governance**

Chile, 2009



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## introduction

# PROGRESSIVE POLITICS AFTER THE FINANCIAL CRISIS

Olaf Cramme and Elena Jurado<sup>1</sup>

The full implications of the current global financial crisis are hard to assess at the present juncture, whether in relation to our economies or with regard to wider political dynamics. However, three striking developments are already discernible. First, the crisis demonstrates the stark reality of global interdependence in the 21<sup>st</sup> century. The suggestion that global economic growth – particularly among emerging markets – had somehow been “decoupled” from the health of the American economy has been proven hollow. Instead, barely any nation has remained untouched by the crisis in the inadequately regulated global financial system.

Second, the crisis has exposed the fragility of globalisation. As sources of financing dry up, we are witnessing a dramatic fall in world trade, with drastic effects on big exporting nations such as China, Germany and Japan. No longer willing to accept large emerging market risk exposures, banks are pulling in their horns to domestic markets. Rescue packages aimed at European and US industries threaten to reverse decades of hard-won multilateral trade liberalisation. All over the world there is a perceptible increase in anti-immigrant feeling. Indeed, several observers are already talking about evidence of *de-globalisation*.

Third, the neo-liberal faith in *laissez-faire* as the dominant guiding principle for the organisation of markets has been shattered. The crisis has glaringly exposed the

<sup>1</sup> Special thanks to Annie Bruzzone, Alfredo Cabral, Simon Latham, Michael McTernan and Priya Shankar for their excellent assistance in editing this handbook.

limits of excessive market liberalisation: left to their own devices, markets cannot be guaranteed to serve the public interest. In a similar fashion to the radical ideological shifts which took place at the end of the 1970s, we are currently witnessing the demolition of the political foundations of neo-liberalism and the irrefutable ending of its intellectual hegemony in the western hemisphere.

These developments have huge implications. First and foremost, they present progressive governments and policymakers around the world with the task of re-building an international economic and financial order at a time when the tendency is to focus on state-level solutions. Importantly, this challenge concerns developing and developed countries alike. Globalisation must remain the key framework for thinking about progressive politics; otherwise we risk undermining the progress made so far, including the creation of unprecedented levels of wealth which helped lift millions out of poverty around the world.

At the same time, as faith in unregulated markets crumbles, progressives urgently need to fill an ideological vacuum which risks being taken over by populists. Yet the "end of neo-liberal hegemony" is interpreted differently by people in different societies, depending on their prior conceptions and experiences of markets. The result is vastly different views on the needed reforms, including the viability and effects of global stimulus plans, the benefits and scope of increased financial regulation, or the measures needed to correct global economic imbalances.

In short, the challenges ahead carry a great opportunity for progressives but also a risk. On the one hand, the strength of modern social-democratic politics has always been to recognise and come to terms with new realities. On the other hand, this "progressive moment" will require a fundamental overhaul of centre-left policies, recognising not only the urgency and severity of the current crisis, but also the complex relationship between the quest for social justice, the need for economic dynamism and sustainable development in the global age. If the centre-left fails to present a credible alternative which can actually serve the population at large, it will risk fading into political irrelevance and further aggravating the crisis.

The intellectual challenge we face therefore encompasses two dimensions: *Internationally*, the task will be to devise a more equitable and sustainable system

for international cooperation, regulation and intervention which addresses the diverse needs of industrialised, developing and the least developed nations, as well as the emergence of a global society exposed to common risks. *Domestically*, it is about rethinking a modern role for the nation state in shaping a more stable economy which combines economic dynamism and growth with a more equal distribution of wealth and life-chances. Meeting this challenge will require a critical but forward-looking debate on the issues and options available for reform.

The aim of this “handbook of ideas” is to advance this debate by bringing together short policy recommendations and proposals by leading international thinkers on how progressives should approach the major economic and political challenges thrown up by the global crisis. The handbook does not claim to be comprehensive: the contributions touch on challenges which governments of all stripes need to address, but which we think are of particular relevance for progressives, in some cases even presenting major dilemmas. We have divided the contributions into three sections for ease of access but, given the overlap and connections between the issues discussed, each contribution should be read in its own right.

The handbook begins with a first section dedicated to the challenge of **financial market governance**. With credit markets frozen and equity prices plummeting, by far the most urgent priority facing governments around the world is the task of rebuilding financial market activity. However, restoring the necessary investor confidence will not be easy. The credit crunch has left many feeling that financial markets have become too far removed from real production and value addition and must therefore be reigned back. Indeed, as governments continue to provide the liquidity needed for the financial system to survive, the wider public has protested about the injustice of “bailing out” those banks whose irresponsible behaviour created the crisis in the first place. How, in these circumstances, do we re-conceive the role of the financial system so that we can make sure it properly takes into account the “public interest” in its future activities?

This section also contains proposals that focus specifically on the weaknesses exposed by the current crisis in financial regulatory structures. The failure of national regulators to prevent the excesses of the banking industry has led many to call for strengthening the supervisory role of international financial institutions.

But it is not clear what can in practice be achieved, beyond better pooling of information and closer mutual dialogue. At the same time, pooling sovereignty in new international structures may raise difficult questions of accountability. How can progressive governments and policymakers resolve the overall dilemma of building legitimate and effective global economic governance structures?

Improving governance of financial markets is ultimately only one component, albeit a crucial one, for ***building a more equitable and sustainable international order***. This challenge is more relevant today than ever before but must be tackled in light of the transformed economic circumstances.

One of the key transformations we are witnessing is the risk of a new “economic protectionism”. The current economic and financial crisis has placed heavy burdens and demands on nation states to act and find their own solutions to unprecedented market failure. Immediate reactions have included the raising of tariffs, much wider resort to subsidies for domestic industries and bank bailouts. Public resentment of migrant workers is growing. The Doha Round appears blocked. While the measures adopted so far are not yet far-reaching, they are evocative of the protectionist wave that marked previous economic recessions. Section two of the handbook therefore begins with a series of proposals on how progressives should respond to the current crisis without undermining the gains made by trade liberalisation.

The onset of the global financial and economic crisis is likewise also creating a grave situation in developing countries. In recent years, most developing countries have focused their economic strategies on export-led growth and openness to foreign investments. However, as recession deepens in advanced industrial countries, export markets and capital flows are drying up. Economic growth through commodity-price booms as seen in oil-rich countries is also slowing, leaving a vacuum of strategies for developing countries. In addition, donor countries have started announcing cuts in aid spending, with harmful consequences for the least developed countries. In this context, is it possible to articulate a new progressive model of economic development and what form should this model take?

Finally, as the current political debates on emission allowances for hard-hit industries make clear, the global economic downturn is exacerbating tensions between

promoting green policies and protecting jobs and livelihoods. This raises difficult questions for progressives, who must ensure that the process of overcoming the climate change challenge does not create an additional burden for the least well off in both the developed and developing world. Section two, therefore, ends with a series of contributions on how the climate change challenge may be tackled without compromising on the principles of equity, solidarity and progress.

The third and final section of the handbook focuses on ***a modern role for the state in the new economic and social paradigm***. Having shaken the foundations of unquestioned belief in free markets, the global crisis has led to growing calls for the state to be a more prominent facilitator of growth, by spending on public works or by providing incentives for new “green” industries. Indeed, the crisis presents an opportune moment for the centre-left to re-define the role of the state in “industrial policy”. However, the risk will be that a badly considered interventionist framework will repeat the mistakes of the past, potentially descending into economic nationalism and hampering the most productive aspects of open market economies. Against this background, what steps should be taken to ensure that the state plays an efficient and effective role in promoting sustainable growth?

With levels of unemployment and distress rising, the need for modern social protection policies is greater than ever. Even the most ardent supporters of market-based solutions for social needs are starting to realise that the state will need to play a more active role, as, for instance, the US debate on healthcare illustrates. Indeed, over the last two decades, countries with active social investment strategies have demonstrated that it is possible to reconcile high-levels of social protection and a dynamic labour market. For this to happen, the state must act as protector, investor and moderniser in the right measures. It is not clear, however, how the state will be able to sustain a more active role in the face of rising public debt and budget deficits. In this context, what kind of welfare state and social policies should we strive for?

Expectations for what progressive politics can deliver are very high. So are the stakes of the challenges we are confronting. This “handbook of ideas” made up of 38 short contributions, each offering a handful of proposals, attempts to help progressives meet these expectations. Bearing in mind the competing claims on the attention of our readers, made up of academics *and* policymakers, we have asked each

contributor to limit their proposals to approximately 700 words, a task that is by no means easy given the complex issues at stake. While important nuances have undoubtedly been left out, the concision and directness of the resulting handbook should help focus attention on the most critical issues and stimulate debate.

We would like to thank the authors for engaging so positively with this initiative, which we hope will make an important contribution to this year's Progressive Governance Conference and beyond.

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*Olaf Cramme is the director of Policy Network and Elena Jurado is head of research at Policy Network*

## POLÍTICAS PROGRESISTAS TRAS LA CRISIS FINANCIERA

### Olaf Cramme y Elena Jurado

Es difícil evaluar en la presente coyuntura las consecuencias de la actual crisis financiera global, tanto en relación con nuestras economías, como en consideración a dinámicas políticas más amplias. Sin embargo, se pueden distinguir tres fenómenos a este respecto. En primer lugar, la crisis demuestra la cruda realidad de la interdependencia global en el siglo XXI. La idea de que el crecimiento económico –particularmente en los mercados emergentes – ha estado “desacoplado” de la economía americana se ha demostrado equivocada. La realidad es que ningún país ha quedado inmune de la crisis en un sistema financiero tan global y tan inadecuadamente regulado.

En segundo lugar, la crisis ha mostrado la fragilidad del proceso de globalización. La creciente escasez de crédito está precipitando un descenso dramático en el comercio internacional, con efectos importantes sobre la economía de los grandes países exportadores, principalmente China, Alemania y Japón. Con el deseo de evitar operaciones demasiado arriesgadas con los mercados emergentes, los bancos se limitan hoy a invertir en sus propias economías. Las políticas de rescate

de industrias europeas y norte-americanas amenazan al progreso alcanzado durante las últimas décadas en la liberalización del comercio internacional. En efecto, ya se está hablando del comienzo de un proceso de *des-globalización*.

En tercer lugar, la fe neo-liberal en el "laissez-faire" como principio y guía de la organización de los mercados se ha visto fuertemente sacudida. La crisis ha evidenciado los límites de la liberalización de los mercados. Los mercados por sí mismos no pueden asegurar el interés público. En modo similar a los radicales cambios ideológicos de finales de los años 70, actualmente estamos siendo testigos de la demolición de los cimientos políticos del neoliberalismo y del fin de su hegemonía intelectual en occidente.

Estos fenómenos tienen importantes implicaciones para el proyecto político progresista. Ante todo obligan a los gobiernos y a los políticos progresistas a reconstruir un orden financiero y económico internacional en un momento en el que la tendencia política es mirar hacia dentro y buscar solo soluciones nacionales. Es destacable que tanto los países en vías de desarrollo como los desarrollados se enfrentan a este mismo desafío. La globalización tiene que seguir siendo el marco fundamental para la política progresista pues de lo contrario podríamos ver amenazados los avances conseguidos hasta el presente, incluyendo la creación de índices de riqueza sin precedentes, que han permitido que millones de personas de todo el mundo puedan superar la pobreza.

Al mismo tiempo y enfrentados a un declive de la fe en el mercado sin regulación, los progresistas han de llenar el vacío ideológico con urgencia, pues si no es así existe el riesgo de serlo hecho por los políticos populistas. Pero distintas sociedades interpretan "el fin de la hegemonía neo-liberal" de manera distinta, dependiendo de las ideas y experiencias de mercado pre-existentes que tiene cada una de ellas. Esto tiene como resultado perspectivas muy distintas respecto a las reformas necesarias a hacer, incluyendo la viabilidad y el impacto de los planes de estímulo, los beneficios y los límites de un incremento de la regulación financiera internacional, y las políticas dirigidas a corregir los desequilibrios económicos internacionales.

En resumen, los desafíos a los que nos enfrentamos abren una gran oportunidad a las ideas progresistas, aunque a la vez plantean algunos riesgos. Por una parte, el punto

fuerte de las políticas socialdemócratas modernas siempre ha sido el reconocer las nuevas realidades que surgen en la sociedad y a la vez ajustarse a ellas. Por otra parte, el “momento progresista” actual requiere una revisión profunda de las ideas políticas de centro izquierda, como reconocimiento no solo de la urgencia y gravedad de la crisis, sino también de la compleja relación que hay entre la búsqueda de la justicia social, la necesidad de dinamismo económico y el desarrollo sostenible en una economía global. Si el centro izquierda no logra presentar una alternativa creíble que realmente sea útil para la mayoría de la población, correrá el riesgo de caer en la irrelevancia política, y a la vez agravar la crisis presente.

El desafío intelectual al que nos enfrentamos por lo tanto abarca dos dimensiones: *A nivel internacional*, la tarea será establecer un sistema de cooperación, de regulación y de intervención más equitativo y sostenible para atender a las diversas necesidades de los países industrializados, de aquellos que están en vías de desarrollo, y finalmente de los menos desarrollados, así como al desarrollo de una sociedad global expuesta a riesgos comunes. *A nivel doméstico*, la tarea consistirá en repensar el rol moderno que ha de tener el Estado en la consecución de una economía más estable que combine dinamismo económico y crecimiento con una mejor distribución de la riqueza y de las oportunidades. Enfrentar este desafío requerirá un debate crítico pero con visión de futuro sobre los temas y opciones disponibles para la reforma.

El objetivo de este “manual de ideas” es avanzar en el debate, brindando recomendaciones sucintas y propuestas de los principales intelectuales del mundo sobre cómo los progresistas pueden aproximarse a y solucionar los principales desafíos económicos y políticos que plantea la crisis global. El manual no tiene carácter exhaustivo: las contribuciones abordan los desafíos que los gobiernos de todo tipo han de enfrentar, pero que son particularmente relevantes para los gobiernos progresistas. En algunos casos se presentan incluso dilemas difíciles de resolver. Se han dividido las contribuciones en tres secciones para conseguir una comprensión más fácil, aunque dada la superposición y conexiones que existen entre los temas debatidos, cada contribución debería ser leída independientemente.

El manual comienza con una sección dedicada al desafío de **la gobernabilidad de los mercados financieros**. Con los mercados de crédito congelados y la caída de los precios de los valores bursátiles, la prioridad más urgente a la que se

enfrentan los gobiernos es reconstruir la actividad de los mercados financieros. Sin embargo, la restauración de la confianza necesaria por parte de los inversores no será fácil. La contracción del crédito ha dejado a muchos con una sensación fuerte de que los mercados financieros se han alejado excesivamente de la marcha de la economía real y del valor añadido. En efecto, mientras los gobiernos siguen proporcionando la liquidez necesaria para que el sistema financiero sobreviva, la opinión pública ha protestado por la injusticia de rescatar a los bancos que han tenido una conducta irresponsable en la generación de la crisis. ¿Cómo, en estas circunstancias, concebimos el rol del sistema financiero y cómo introducimos en él una mejor forma de tomar en cuenta los intereses públicos?

Esta sección también contiene propuestas que se concentran específicamente en las deficiencias mostradas por la crisis con respecto a la actividad regulatoria de los mercados financieros. El fracaso de los reguladores nacionales para evitar los excesos de la industria bancaria ha llevado a muchos a demandar el fortalecimiento del rol supervisor de las instituciones financieras internacionales. Sin embargo, no está claro qué se podrá conseguir en la práctica, más allá de un mejor intercambio de información y de un diálogo más cercano. Al mismo tiempo, compartir soberanía en una nueva estructura internacional puede traer como consecuencia complejas cuestiones a la hora de rendir cuentas. ¿Cómo pueden los gobiernos progresistas resolver el dilema de establecer una gobernabilidad legítima y a la vez efectiva de las estructuras económicas globales?

Mejorar la gobernabilidad de los mercados financieros es sólo un componente, aunque crucial, para **construir un orden internacional más equitativo y sostenible**. Este desafío es hoy más importante que nunca y debe ser abordado a la luz de las nuevas circunstancias económicas mundiales.

Uno de los cambios clave, del cual estamos siendo testigos, es el riesgo de caer en un 'proteccionismo económico'. La actual crisis económica y financiera ha representado una pesada carga sobre los Estados nacionales a la hora de actuar y encontrar sus propias soluciones al fracaso sin precedentes de los mercados. Las reacciones más inmediatas han incluido alzas en los aranceles, mayores subsidios a las industrias domésticas y rescates de los bancos. La intolerancia hacia los trabajadores inmigrantes está creciendo de forma preocupante. La Ronda de Doha

parece estar bloqueada. Aunque las medidas adoptadas hasta ahora aún no son de largo alcance, recuerdan las olas proteccionistas que se dieron en recesiones económicas anteriores. La segunda sección del manual, por tanto, comienza con una serie de propuestas sobre cómo los progresistas debieran responder a la actual crisis sin socavar los logros alcanzados por la liberalización comercial.

El inicio de la crisis financiera y económica global nos plantea asimismo complejas preguntas sobre el impacto de la crisis en los países en vías de desarrollo. En años recientes, la mayoría de estos países ha concentrado sus estrategias económicas en un crecimiento basado en las exportaciones y en la apertura a la inversión extranjera. Sin embargo, a medida que se profundiza la recesión en los países industrializados, los mercados de exportación y los flujos de capital disminuyen. El crecimiento económico, impulsado por el auge de los precios de las materias primas, -como se ha visto en los países productores de petróleo- también decae, dejando un vacío en las estrategias para el desarrollo. Además, los países donantes han empezado a anunciar recortes en las ayudas para el desarrollo. En este contexto nos preguntamos, ¿es posible articular un nuevo modelo progresista de desarrollo económico? ¿Qué forma debería adoptar este modelo?

Finalmente, el actual debate político sobre las emisiones nocivas permitidas a las industrias afectadas deja claro que la recesión económica global está exacerbando las tensiones entre la promoción de políticas ecológicas y la protección de los trabajos y los medios de subsistencia. Esta tensión plantea complejas preguntas para los progresistas que deben asegurar que el desafío de superar el cambio climático no crea una carga adicional para los menos favorecidos, tanto en los países desarrollados, como en los países en vías de desarrollo. La segunda sección termina, por lo tanto, con una serie de contribuciones sobre cómo el cambio climático puede ser abordado sin abandonar los principios de equidad, solidaridad y progreso.

La tercera y última sección del manual se concentra en el **rol del estado moderno ante el nuevo paradigma económico y social**. Sacudiendo las bases de la fe incuestionable en el libre mercado, la crisis global ha conducido a crecientes demandas para que el Estado sea un “facilitador” más activo del crecimiento, invirtiendo en obras públicas e incentivando nuevas industrias ecológicas. En efecto, la crisis presenta un momento oportuno para que el centro izquierda

redefina el rol del Estado en la "política industrial". Sin embargo, el riesgo es que un intervencionismo mal diseñado repita los errores del pasado, cayendo en nacionalismos económicos y perjudicando los aspectos más productivos de las economías de mercado. ¿Qué pasos deben ser dados para asegurar que el Estado juegue un eficiente y efectivo rol en la promoción de un crecimiento sostenible?

Con el aumento en los niveles de desempleo, las políticas modernas de protección social son más necesarias que nunca. Aún los más fervientes partidarios de las ayudas sociales basadas en el mercado entienden que el Estado va a tener que jugar un rol muy activo, como lo demuestra, por ejemplo, el debate sobre el sistema de salud en los Estados Unidos. En efecto, durante las últimas dos décadas, los países con estrategias activas de inversión social han demostrado que es posible reconciliar altos niveles de protección social y un dinámico mercado laboral. Para que esto suceda, el estado debe actuar como protector, inversor y modernizador en su justa medida. Sin embargo, no está claro, cómo va a ser capaz de sustentar un rol más activo en un contexto de crecientes niveles de deuda pública y déficit presupuestario. En este contexto nos preguntamos también, ¿por qué tipo de estado de bienestar y políticas sociales habrá que luchar?

Las expectativas de lo que las políticas progresistas puedan ofrecer son muy altas. También lo son los desafíos que están en juego. Este manual de ideas compuesto por 38 breves contribuciones, cada una con sus propuestas, pretende ayudar a los progresistas a cumplir con estas expectativas. Teniendo en cuenta las exigencias de tiempo de nuestros lectores que son académicos y políticos, hemos solicitado a cada autor un límite de aproximadamente 700 palabras en sus aportaciones, que es una tarea nada fácil dada la complejidad de las cuestiones en juego. Si bien han sido excluidos importantes matices, la precisión y el carácter directo del manual debieran ayudar a concentrar la atención en los temas más críticos y estimular el debate.

Nos gustaría agradecer a los autores su participación tan positiva en esta iniciativa, que esperamos aporte una importante contribución al presente Seminario de Gobernanza Progresista y para el futuro.

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*Olaf Cramme es el director de Policy Network y Elena Jurado es jefa de investigación de Policy Network*

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## section one

# FINANCIAL MARKET GOVERNANCE

### **A GRAND BARGAIN FOR GLOBAL CAPITAL**

Will Hutton

What has happened to the American and British financial systems – the heart of the global financial system – is nothing less than catastrophic. Shock waves that have radiated out from New York and London have impacted on every national banking system. The interconnected global interbank market, on which so many banking business models were constructed, has seized up. Central banks have had to step in everywhere to provide liquidity that the interbank markets do not. The resulting contraction of bank balance sheets is threatening not just a recession, but depression. China, the US and Japan have recently witnessed falls in exports in excess of 20 per cent as a result of violent “destocking” and the collapse of demand. What to do?

#### **1. Put banks at the heart of the solution**

Banks are the centre of the crisis; they must therefore be the centre of the policy response. Any national action is much more effective if it is reinforced internationally, especially if this brings the US along too. G20 states must simultaneously agree that each will: guarantee that banks, through public investment, will have sufficient tier one and two capital to sustain their current balance sheets, however deep the recession; find ways to sterilise the impact of historically bad lending on new lending, either by creating “bad” banks to hold toxic assets, or creating asset protection schemes on the British model; guarantee interbank lending through insurance schemes; and create new lending capacity

by launching new “good” banks. Actual responses will depend on local conditions, but each state must commit to this policy mix.

## **2. Give central banks a central role**

The money supply held by individuals, households and non bank corporations is falling worldwide. Central banks must commit, again in accordance with local circumstances and financial system structures, to inject cash directly into banking and other sectors. One way to do this is to buy government and commercial securities with central bank reserves. Internationally, central banks should adopt a coordinated reserve requirement regime to quantitatively ease and tighten the money supply over the economic cycle.

## **3. Use “shock and awe” to restore trust in the banking system**

The financial system has lost the trust of everyone. There has to be an international “shock and awe” regulatory response, coupled with the creation of a new international financial framework to restore trust and reduce volatility. In particular: hedge funds have to be regulated as banking institutions; terms for trading in derivatives have to be set by an international college of regulators to reduce their speculative component and licenses withdrawn from any bank who lends to any agent whose prices do not conform to international rules; every country, including tax havens, must commit to maximum transparency; no annual cash bonuses that exceed twenty per cent of base pay are to be paid in the financial system anywhere; every deposit taking institution in excess of 1 billion dollars, in any country, should be subject to regulation by a national regulator and a representative of the international college of regulators.

## **4. Scale-up the international institutional dimension**

Existing international institutions should also be renewed. This should include the creation of a 1 trillion dollar IMF to support countries through short term balance of payments difficulties. More votes should be given to G20 members, and the EU should represent all European countries. There should be a similar scaling up and renewed governance structure for the World Bank. Both institutions should be made formally accountable to the UN. The US, Japan and the EU must commit to keeping the dollar, yen and euro stable, and agree to IMF monitoring if any is putting that stability under threat. This surveillance and early warning regime should also operate internationally.

### **5. Correct supply and demand imbalances**

Surplus countries – Japan, China and Germany – must commit to big fiscal stimulatory policies in close consultation with the IMF. If they do not, they should risk accusations that they are manipulating their currencies, rigging trade and unfairly exporting unemployment. The rest of the world could then impose short term tariffs on their goods if they do not correct their policies. Additional votes for China in the IMF and World Bank must be conditional on a Chinese commitment to derestrict their currency and accept reserve currency status. Every other country must use whatever scope it has to reflate demand by up to 2 per cent of GDP, in line with the IMF's recommendations.

### **6. Finalise Doha**

The Doha round must be completed by 30 June 2009. Beyond these measures there is an urgent conversation to be had about the future of capitalism. The consensus of the last twenty five years was flawed. Capitalists and entrepreneurs do not create business models or make profits independently of the “burdensome” state. Rather businesses, and banks, are profoundly intertwined with government and society. We cannot therefore have a global bargain with capital which implies that losses are socialised and profits privatised. Everything – company law, the role of trade unions, the role of taxation and regulation, corporate governance, the conditions of company listings, disclosure, the structure of finance, the obligations of company ownership, directors' responsibilities, tax havens – must be re-examined in the light of this now obvious truth. A fairer more sustainable capitalism must emerge from this crisis.

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## **TAMING THE FINANCIAL CASINO**

John Kay

We cannot discuss how we emerge from the present crisis unless we understand how we entered the present crisis. This is a confusing discussion. Politicians, public officials and bankers give mixed signals as they compete to point fingers

in any direction but their own. The crisis was not an act of God, unpredictable to and unpredicted by ordinary mortals. The crisis was not caused by loose monetary policy in the US. Nor was the crisis the result of the American and European love affair with housing, or the proclivity of English-speaking consumers for excess credit. The crisis was caused by sub-prime mortgage lending in the US only in the same sense that the first world war was caused by Princip's assassination of the Archduke Franz Ferdinand at Sarajevo. There were many contributing factors in the outbreak of the credit crunch, and the key ones are outlined below.

### **1. Origins of the crisis: unsuccessful speculation**

Failed speculation by large banks in wholesale money markets was both necessary and sufficient for the crisis. Necessary, in that in the absence of this wholesale market activity events in the housing market, or other economic disruptions, could not have been amplified to a degree that would threaten the survival of major banks around the world. Sufficient, in the sense that given the scale of the poorly controlled inter-bank trading which has now become evident some trigger would, sooner or later, have led to events like those which have unfolded.

### **2. Casino-utility attachment**

We attached a casino – proprietary trading activity by banks – to a utility – the payment system, together with the deposits and lending that are essential to the day-to-day functioning of the non-financial economy. The losses of the casino have threatened to bring the utility to a halt. If we are to emerge with any confidence from the financial crisis, we need to put in place measures which will prevent these events happening again. The problem points directly to the solution – permanent separation of the utility and the casino.

### **3. Structural deregulation**

We are at the end of what we should regard as a failed experiment in structural deregulation. Until the 1970s both Britain and the US had largely specialised financial institutions: such specialism was the result of a mixture of convention and regulatory restriction. These restraints were successively relaxed, allowing the emergence of the large, diversified conglomerates we see today.

#### **4. Conflicts of interest**

The conflict between retail and investment banking is central to the current crisis. This conflict was the result of deposit insurance. The deposits of the retail bank, effectively underwritten by the taxpayer, could be used as collateral for the trading activities of the investment bank. Deposit insurance introduced the large and costly subsidy to investment banking which we are all now meeting through higher taxes. In addition to these conflicts between retail and investment banking, there were the conflicts of interest within investment banking itself. The modern investment bank gives financial advice to large corporations, offers asset management services, engages in market making, issues securities, and undertakes proprietary trading on its own behalf. The customers of every one of these activities have interests which conflict directly with the interests of the customers of every other.

#### **5. Management failure**

The claim made was that market forces bolstered by internal and external regulation through Chinese walls, would mitigate these conflicts, and allow conglomerates to reap the informational advantages of conglomeration without the associated disadvantages. This claim has proved false. Worse, the conflicts of customer and taxpayer interest were aggravated by clashes of organisational culture. At its most extreme, it is hard to imagine two more diverse business styles than the individualistic opportunistic aggression required in proprietary trading and the routine bureaucratic processing of millions of daily transactions needed for retail banking. In practice, these financial conglomerates, characterised by incompatible baronies and unfathomable complexity of interactions between products, were unmanageable and, effectively, unmanaged. That management failure is the central explanation of why we are where we are today.

#### **6. The way forward: restore narrow banking**

We need to restore narrow banking – to ensure that the casino cannot again jeopardise the utility. That means ring-fencing the payments system, the routine deposit taking and the lending to consumers and to small and medium sized businesses. There are several measures that might help towards this objective and a combination is probably appropriate. I suspect the outcome will now be best achieved by taking the failed banks into direct public ownership for a period.

Measures to re-establish narrow banking will necessarily involve the divestiture or closure of the investment banking activities of retail banks. Such restrictions will provide an opportunity to reintroduce measures of structural separation between fundamentally incompatible wholesale financial activities. The causes of the crisis, and the remedial measures now required, are embedded in the structure of the modern financial services industry. Addressing these structural issues, which will require high political courage, is a prerequisite of policies to prevent a similar crisis re-emerging a decade from now.

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## **REHABILITATING FINANCIAL MARKETS**

Refet Gürkaynak

In the current period of financial turmoil people are angry about past deeds of financial institutions and skeptical about their future usefulness. Yet, financial markets play a crucial role in our economies and they need to be rehabilitated to better serve their purpose. To start this process, progressive leaders should take the following steps:

### **1. Do not punish financial markets**

Financial markets provide a valuable service for which there are no good substitutes. Lenders and borrowers have to be matched and risk has to be distributed for a well functioning economy. A knee-jerk reaction to punish financial markets for their past sins will only cause further disintermediation. Policy actions should be geared towards rehabilitating and reforming financial systems rather than penalising them.

### **2. Decide on what to do with the shareholders of failing banks**

It is clear that banks need recapitalisation, but recapitalisation of the scale required cannot proceed until the question of what will happen to existing shareholders is clearly answered. This is a political question and must be answered by elected

leaders rather than implicitly being left to central banks. Nationalisation wipes out the existing shareholders, while buying toxic assets at above-market prices with no further stipulations provides them a gift – and there are a variety of options between these two extremes. The further the decision on this is delayed, the longer these institutions remain in a zombie state. This indecision and the resulting loss of intermediation is what turned the Japanese banking problems into a lost decade. The rest of the world should not repeat this mistake.

### **3. Carry on helping financial firms**

Many financial firms, which are still healthy at present, will face difficulties as the global recession deepens and nonperforming loans increase. These institutions will have to be helped so that a reasonably healthy financial system will be present to foster growth when the worldwide fiscal stimulus begins to bear fruit. It is important to prepare the public for these further injections of cash into financial firms and make it clear that this is one large, drawn out, financial system-wide bailout rather than the same firms being bailed out time after time. It is also vital to make it clear that the fiscal stimulus and the financial market cleanup are both necessary ingredients of a recovery and that one of these alone will not suffice.

### **4. Make organised markets more flexible**

Moving large Over-The-Counter (OTC) markets, such as the credit default swaps to organised markets – where clearing and netting, as well as measuring risk taking is much easier – is a reasonable and conceptually simple policy action. This, however, only addresses a single instrument or a few instruments at best. New instruments will continue to be introduced in the OTC market. Legal changes to make it easier to introduce contracts in organised markets and regulatory changes to make this attractive should be considered so that instruments gaining popularity in OTC markets will be moved to organised markets without ad hoc regulatory interventions in the future.

### **5. Tailor regulations to the specifics of each country**

Financial systems and real economies are intertwined in all countries. Different countries have different production chains, labour markets, real estate sale practices, etc., and therefore different financial sectors to cater for these. A

one-size-fits-all approach to financial regulation will not be suitable for these different financial sectors. Better information sharing across national regulators is necessary and there can be a common understanding to promote more transparency in Over-The-Counter trading, better disclosure of risks and the like. However, financial sector regulation in the end must be tailored for the specifics of each country.

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## **THREE PROGRESSIVE IDEAS FOR THE RECESSION**

Oscar Landerretche

Outlined below are three policy instruments that will aid progressives in responding to challenges presented by the global economic crisis:

### **1. The World Finance Organisation initiative**

It has become increasingly clear that the structure of current multilateral financial institutions is inadequate. The global financial order is chaotic and inadequately regulated. Progressives now face an important – if difficult – challenge. We have to strike a new balance between global financial freedom and global economic responsibility. The coordination of financial regulatory standards has stopped being a purely intellectual endeavour, and become the order of the day.

Hence, the need to establish a World Financial Organisation (WFO). As we have learnt through our experiences with the World Trade Organisation (WTO), this new institution must be built slowly on the basis of regulatory checks and balances. A gentle, persuasive form of politics should be employed to build strong and long lasting international and intersectoral coalitions. There must be no institutional “overshooting” that risks simulating a “global state”. Rather, a system of rules for bilateral negotiations should be established over time to eventually become a comprehensive system. Countries should sign Financial Flow Agreements (FFAs) that match regulatory standards and share information. The existence of a WTO-like global discussion forum and clearing house would be important in order

to regulate the flow of treaties across financial sectors and national boundaries. Furthermore, the new WFO should be charged with oversight of all new products that will inevitably appear on the market when rapid financial innovation returns in a couple of years.

## **2. The financial thrift tax relief initiative**

It is always easy to have a scapegoat to blame for a crisis. When the post war Keynesian construct broke down in the seventies it was “bureaucrats”, now it is “bankers”. However, the fact remains that the banks were providing a service to individuals and firms. It is true that “bankers” were in a privileged position to control the boom in leverage and ensure stability. It is true that they did not do so. But it is also true that, ultimately, ordinary individuals and firms also failed to act responsibly. The reasons for this include “externality” and coordination failure. “Externality” implies that everybody acts more irresponsibly than they should because they do not assume the full responsibility and costs for their actions.

This poses difficult choices for regulators. On the one hand, if individual leveraging and debt have social costs, they should surely be taxed. On the other, there are strong economic reasons to avoid transaction taxes, especially on financial transactions, since they are the source of funding for new business ideas and innovation.

Hence, the Financial Thrift Tax Relief (FTTR) proposal. The idea is to generate a positive income or profit tax benefit for businesses and individuals who actively show that they are not excessively leveraged. To reduce the distortions of this tax initiative, it would have to be voluntary, so that businesses or individuals who believe that they have an interesting opportunity and decide to leverage anyway, can do so, only without the FTTR, thus being subject to the rest of the tax code.

One could argue that the FTTR is less than progressive, since debt helps provide important opportunities for low and medium income households to finance new business initiatives and other projects, especially in high-growth emerging economies. On the other hand, one cannot ignore the fact that access to cheap

loans can make debt spiral out of control, as the current crisis has demonstrated. The answer to this critique is to ensure that the tax relief initiative is coupled with other important policy instruments, such as means tested subsidies and access to security funds, to help ensure that lower income households still have access to capital.

### **3. The “human wealth era” initiative**

Emerging economies benefited during the “financial growth” era by creating attractive conditions for foreign investment, resulting in enormous investment flows that spurred local growth. However, this growth paradigm also rested on the assumption that labour in emerging economies would have the following desirable characteristics: cheap, flexible, repetitive and submissive. This strategy was therefore entirely at odds with the progressive labour policies that have been championed in the advanced economies, especially “High Productivity Workplace” (HPW) theory. The HPW strategy fosters better labour-management relations in order to encourage workers’ commitment, engagement, proactivity and productivity. It is also more consistent with the “knowledge economy” workplace.

An HPW initiative must now be established for emerging economies. My proposal is to call it the Human Wealth Era (HWE) initiative, indicating the start of a new progressive era where workers (skilled, engaged and organised) will also be the beneficiaries of capital. The HWE initiative should be similar to the “Washington Consensus” in its style. It should summarise a series of general policy recommendations that are applicable in different forms, thus allowing for the political and economic heterogeneity of different countries. It should include a guideline that involves pacts for development policies, labour policies and education policies (specifically worker training). The general principle would be that government subsidies, as well as labour rules, should be utilised to incentivise HPW style commitments from businesses i.e. business plans will be supported if they promise the wealth and wellbeing of workers. Policies would then become partnerships between the state, the workers and the firms.

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## **STRIKING THE RIGHT BALANCE**

Howard Davies

It is difficult to overstate the gravity of the financial and economic crisis which the world now faces. The crisis is so serious that it clearly justifies fundamental re-thinking about the way in which national governments, and the international institutions to which they are allied, carry out their tasks of overseeing the global economy and, particularly, of regulating financial markets. The following issues should form part of this process of reflection:

### **1. Striking a better global/national balance**

The "system", which oversees international financial markets, is based on a delicate balance between supranational entities and national governments. So far nation states have not been prepared to cede authority over their financial systems to a global body, however governed. This position contrasts markedly with the arrangements for international trade, where the WTO is able to enforce trade agreements. Some have argued that repeated malfunctions in the international financial system point to the need for a global regulator, perhaps a world financial authority. Might there be a case for some kind of supranational authority with an enforcement arm, to ensure that countries meet internationally agreed standards on a continuing basis?

### **2. Re-engineering international regulation**

The "system" is also built on an old fashioned subdivision of financial markets into three sectors: banking, securities, and insurance, which no longer reflects the reality of international financial markets. The result of that three-legged arrangement, combined with the existence of a wide-range of international bodies with different and overlapping responsibilities, is a highly complicated network of institutions and committees which lack obvious logic and structure. The crisis has focused attention on the continuing uncertainty about the appropriate role for the IMF in particular. At present its role is limited to a general financial stability oversight function, together with some monitoring of compliance with international standards. Should the IMF become a financial regulator, or is the Financial Stability Forum, with its broader membership, including regulators in nation states themselves, a more appropriate body?

### **3. Improving regional cooperation**

There is a particularly difficult version of this question within the European Union. Although the single financial market has been in operation for over 15 years, and financial firms authorised in one country can operate across the European economic area, the crisis has revealed incompatibilities in the domestic regulation of banks which has caused serious problems elsewhere. Can Europe's problems be resolved without the creation of a single regulatory authority to sit alongside the European Central Bank? Without such a body is there not a risk that the single financial market process will go into reverse? Some argue that the EU should now establish a European Financial Institute, on the model of the European Monetary Institute which was the forerunner of the European Central Bank. Jacques Delors has proposed a European System of Financial Supervisors, without new powers. Will this be enough to prevent the break-up of the single financial market?

### **4. Balancing legitimacy and efficiency**

It is now widely accepted, certainly by the G20 Summit, that the legitimacy of the international regulatory bodies needs to be strengthened. In other words new members from the major developing countries must be included. But we know from experience that broader membership of international bodies can lead to inefficiency and stasis. How will that balance be struck in the future? Which emerging markets need to be brought in? Do G7 countries need to reduce or consolidate their own representation? Why, for example, can the EU not be represented by one voice?

### **5. Rethinking the future roles of markets and the state**

Has the crisis revealed fundamental flaws in the market mechanism? An alternative, though perhaps complementary, hypothesis is that the fundamental problem lies in the way in which states seek to regulate markets. For years it has been fashionable to downplay and even denigrate the role of the state in financial markets. Now it is once again understood that financial markets depend on the existence of what Paul Tucker of the Bank of England has described as a complex "social contract" between them and the state. But elements of this "social contract" need to be rethought. The normal ways in which central banks provide liquidity to the system have proved wanting and have been revised several times during the crisis. Deposit guarantee schemes have not been generous enough to prevent bank runs. Prudential regulation has failed adequately to constrain risk-taking.

## **6. Toughening up regulation?**

It is easy in the midst of a crisis created by exaggerated risk-taking in the financial sector to argue that regulation must be tightened for the future, e.g. requiring banks to hold higher reserves and more liquidity. Some important changes have already been made to what we might call the “regulatory frontier”. Specifically, the main US investment banks have become bank holding companies, able to take retail deposits and with privileged access to the Federal Reserve. It is likely that, as a consequence, those investment banks will be able to take fewer risks than before, and their leverage will be significantly reduced. Another set of institutions which have been broadly outside the regulatory net are credit rating agencies. There are new legislative proposals in the European Union to impose a European regulatory framework on those agencies. But tighter regulation is not costless. It comes with a high price tag for firms and consumers in the form of raised costs of borrowing. How do we determine where to set the balance in future between financial stability and risk taking?

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*Howard Davies is the director of the London School of Economics and Political Science*

## **SAVING GLOBALISATION.....AGAIN?**

**Ngairé Woods**

A decade ago, massive anti-globalisation protests spurred finance ministers from the G20 countries to declare that they would make globalisation more inclusive. Ten years later what looks inclusive are the harsh costs of the financial crisis with unemployment, foreclosures, and a sharp economic slowdown spreading across the world. The public are angry and afraid. Angry that their governments let global finance veer hopelessly out of control. Afraid that their governments are now impotent to deal with the consequences. Leaders will have to show that they are willing and able to take measures to mitigate the harshest effects of this financial crisis at home and abroad. Yet, this will not be easy. Outlined below are five core elements that need to form part of the response to the global crisis, but each carries dilemmas of its own:

### **1. A “new deal” – direct government involvement in the economy**

Governments have pledged to use monetary policy to stabilise financial systems and fiscal policy to stimulate demand in each economy. While politically crucial, this is uncharted territory for most governments. They will have to learn fast. Equally challenging is how governments will invest in “British jobs for British workers” or in “America’s main street” without introducing protectionism via the back-door. The new deal of the 1930s took place amidst powerful beggar-thy-neighbour protectionism. Today, no country wants to find the door slammed on its export markets. But at the same time, as they invest in their own flagging economies, governments are invariably subsidising their own companies and disadvantaging those of other countries. Beggar-thy-neighbour protectionism is not so easy to distinguish from much-needed social protection. And in global finance, capital controls look increasingly attractive to countries swept into a crisis that originated in regulatory systems far beyond their control or influence.

### **2. Regulation of global finance**

It is clear that a new more robust global regulation of finance is required, but the challenges here are significant. Previous crises have generated promises to regulate global finance. But the spectre of robust rules has evaporated as soon as public attention has turned away. Agreement from the US and the UK will be crucial but their large financial sectors have typically made them averse to regulation. And once the new rules are agreed they will need to be robustly monitored (such as by a much-reinforced IMF), and enforced at the global level (such as by a new purpose-created international tribunal). A new more substantial architecture is required if the rules are to have any force.

### **3. Financing for poor countries**

It must be ensured that developing countries are not left bereft. It may be necessary to push the IMF, the World Bank etc. to use their full capacity. “Sweating” these institutions is crucial. In previous recessions, the poorest countries have suffered a drastic reversal of aid – and they have the least capacity to adapt to such shifts. The counter-argument to “stretching” the World Bank and other institutions is that they must be protected from any over-extension. But, it bears noting that the risks of over-extension fall mainly on the wealthy countries whose quotas and guarantees underpin the finances of each institution.

#### **4. Create a global fund to fight the crisis**

The IMF has less reserves at hand than some medium-sized emerging economies. Global leaders should agree to create more money for the world's governments to use in fighting the crisis. Provision for this already exists in the IMF. By agreeing to a large new Special Drawing Right (SDR) allocation, leaders could both prove that they are prepared to act collectively, and make more resources available to governments. They could, by fiat, create say a trillion dollars worth of reserves that would be allocated across the membership of the IMF. The only obstacle to this is a political one – the US requires that an allocation of more than approximately 270 billion dollars needs Congressional approval. Key then is for Americans to lead in this part of the solution.

#### **5. Reform international institutions**

The reform of international institutions is long overdue. The IMF and World Bank are still configured to reflect a world in which the US was the world's largest creditor (it is now the world's largest debtor), and in which Europe and the US could jointly "run the global economy". They are now finding it difficult to engage the new engines of growth – China and other emerging powers – in global cooperation in the absence of genuinely global institutions. For developing countries, the IMF and World Bank do not seem like impartial rule-enforcers. Power in these institutions will need to be redistributed – fast – to make it possible for them to coordinate global actions. A start to the process could be made by: agreeing on a new process for reallocating voting power; ensuring that the heads of the organisations are internationally agreed and the staff represents the countries in which the organisation works; and establishing a strategic decision-making directorate (like a new G7) that represents the major regions of the world.

The coming months will stretch leaders every bit as much as the crisis is stretching their populations. Yet there is much they can do if they combine coordinated national actions with global collective action.

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## **FINANCIAL GOVERNANCE NETWORKS**

Katharina Pistor

The global financial crisis has exposed fundamental weaknesses in the existing governance regime for global financial markets. Although the crisis is far from over, it is not too early to conceptualise a new governance regime for global finance. The new global governance of financial markets should ensure that individual countries can protect themselves against the negative impact of volatile capital flows, while facilitating a gradual process of re-building a global financial market place that is rooted in effective governance regimes. For this to take place, leaders should:

### **1. Establish several Financial Governance Networks (FGNs)**

FGNs with different risk profiles should be established that reflect countries' risk preferences with regard to financial activities conducted on their territory and the ability of institutions in those countries to cope with volatile capital flows (i.e. a country's risk profile). Geography should not be the defining criteria for membership in a given FGN. The reason for this is that countries within the same geographic region may display very different risk profiles and/or risk preferences. Moreover, geography as the defining factor for governance precludes entry and exit. It also exposes countries to regional contagion effects. Instead, countries should be allowed to enter and exit; and FGNs should be allowed to admit and expel members depending on risk profiles and established standards.

### **2. Develop governance principles for regulation**

Each FGN should develop governance principles on capital controls, the regulation of financial services as well as instruments that reflect the risk profiles and risk preferences of its members. FGNs will screen their members regularly for compliance with the established standards. Existing international organisations can play an important role in coordinating the establishment of FGNs by developing a first set of minimum standards. They may also help individual countries to meet the risk criteria of their preferred FGN. However, the development of detailed standards and their adaptation over time should be in the hands of FGNs and their members. This will facilitate information sharing and learning among FGN members and reduce problems associated with standardising on a single, but potentially flawed, model.

### **3. Set up an FGN arbitration tribunal**

A tribunal should be established to resolve disputes between members and FGNs over entry and compliance with FGN criteria.

### **4. Institute a global risk monitoring board**

This board, staffed with independent experts should be tasked with monitoring systemic risk in global financial markets and the exposure of different FGNs to such risk. The board should report on a regular basis and publish its reports. The global monitoring board should make recommendations for adjusting insurance premia of FGNs in accordance with changing risk patterns. (See below).

### **5. Create a global insurance fund**

The purpose of the fund would be to cope with future crises. Each country will pay an annual premium based on the risk profile of the FGN it belongs to and weighted by the size of that country's economy. The requirement to insure against additional risk would mitigate against a race to the bottom as a result of regulatory competition among FGNs. The fund should be able to adjust risk premia based on the recommendations of the global risk monitoring board.

These measures would bring about a shift from centralised governance by international organisations, such as the Bank for International Settlements and the IMF, to multiple, decentralised, yet inter-linked, governance networks. Centralisation precludes inclusiveness in the formulation of governance standards. This is due to coordination problems among large numbers of countries and the tendency of more powerful players to dominate the process as well as outcomes.

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## **TRANSFORMATION THROUGH THE CRISIS**

Ricardo Lagos Escobar

The current global financial crisis may usher in changes as extensive as those brought about by the fall of the Berlin wall in the twentieth century. Indeed, what

we are currently experiencing is the dramatic fall of another wall - Wall street. The fall of the Berlin wall brought an end to a school of thought that viewed the state as the only player in economic life. The current crisis signals the downfall of another school, one based on the idea that a market economy can do away with the state altogether, regulating itself and tending "naturally" towards equilibrium. However, unilateral schools of thought that attempt to simplify the complexity of economic processes do not provide adequate answers. When considering the consequences of the financial crisis, the following should be kept in mind:

### **1. Making the financial system more accountable**

The current crisis does not imply the death of the market economy or of the process of globalisation except in its financial aspect. It should, however, mark the end of a financial system outside public control, lacking in norms, and with a weak and ill-balanced international architecture that has not stood the test of time. Instead of supporting production, the financial system sought to maximise short-term gains, embraced speculation as a virtue, and took greed as its guiding principle. As a result, it has destroyed confidence, plunging the world economy into a lengthy recession. We need to bring an end to this logic, and build more sustainable financial markets that are geared toward the public interest.

### **2. Renewing the public domain in world affairs**

The crisis provides an opportunity to establish an international consensus on a renewed public role in world affairs. Governments intervene when there is a crisis because, in the end, it is entrepreneurs and small and mid-sized businesses who find themselves without access to finance, workers who lose their jobs, emerging economies whose development is interrupted, and people who have only recently crossed the poverty line who are at risk of slipping back below it.

It is the outcome of this crisis – the "afterwards" – that will be decisive. We need to strike a new balance between the logic of the market and that of our citizens' public interest and between short-term and strategic priorities. We need a new international financial architecture to replace that of Bretton Woods; we need new and better vehicles for international governability; we need to incorporate more voices into world decisions.

Are tax havens an essential part of the world economy? Or are they a grave distortion of the system? Should private agents, with their interests, be allowed to rate other private players? Should executives of large financial companies be permitted to take decisions that seek to benefit from the savings of millions of people? Those are questions that must be addressed by rules to safeguard the general interest.

### **3. Ensuring social progress remains the priority**

The current crisis threatens to reverse the important progress achieved by Latin America in recent years. Between 2003 and 2008, our economies grew more quickly than during any other period in the past 40 years, a remarkable achievement accompanied by increased savings, prudent fiscal policies, and more solid social policies. We have seen the region's poverty rate drop from 44 per cent in 2002 to 35.1 per cent in 2007. Critical to this success story was the development of a new strategic outlook, which ensured that the economic gains were used to promote sustainable development, democratic consolidation and a greater voice for Latin America in the world.

Today, the strategic debate about Latin America's future has been diverted by the need to respond to a brutal shock. As governments take action to respond to the crisis, there is a risk of back-slipping, particularly as regards social progress. Losing ground in this area has long-term consequences and destroys social cohesion. Governments must guard against corporate interests and pressures and review budget priorities to allow for emergency measures in relation to housing, infrastructure or public policies targeting the most vulnerable sectors of the population.

### **4. Transforming the crisis into an opportunity**

The road ahead will be difficult. Leadership will be needed. Governments will need to be credible and implement short-term measures without losing sight of their core strategic challenges. However, if the correct steps are taken, we may be able to transform this crisis into an opportunity, and achieve progress in areas which we failed to tackle during the boom years.

Regional integration is one example. In difficult times, we can abandon rhetoric, agree on norms that reflect our common interests, and embark on mutually-

beneficial cross-border infrastructure initiatives that reduce inter-regional asymmetries. Only this way will we be able to strengthen our region's international voice and contribute to the creation of more inclusive global governance structures and thereby prevent a re-occurrence of the current crisis.

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*Ricardo Lagos Escobar was President of Chile from 2000-2006*

## **THE EQUIVALENCE PRINCIPLE**

David Held and Kevin Young

Although it is increasingly acknowledged that complex global processes, from the financial to the ecological, connect the fate of communities across the world, the problem-solving capacity of existing international institutions is in many areas not effective, accountable or fast enough to resolve global dilemmas. This international governance problem is at the heart of the current global economic crisis. To be sure, the existing system of international financial institutions has enjoyed a measure of success, limiting financial regulatory competition among states in some respects, providing emergency liquidity upon occasion, and strengthening multilateral institutional capacity to react when problems arise. However, the failures of the system are much more striking and underline the need for root-and-branch reforms of the international financial architecture. The following five areas should be given priority in this process of reform:

### **1. Strengthen international rules that monitor and regulate financial market activity**

The existing system of global financial governance has failed to keep pace with the rate of change in private financial market activity and has proved largely inadequate to predict, moderate, or contain financial instability. Global financial governance must increasingly deal with issues in both the international and domestic spheres, yet due to fragmentation and competition between states, it has been unable to address systemic problems appropriately even when they have been identified. What is more, global economic interconnectedness has meant that the costs of governance failures transcend national borders and are often

widely dispersed across extremely vulnerable segments of the world population. Effective global financial governance therefore requires a better balance between the two worlds of financial globalisation: private financial activity on the one hand, and public financial governance on the other.

## **2. Expand the institutional capacity of existing global financial institutions**

Reforms to the system of global financial governance in the years ahead will have to build on institutions already in existence to a significant extent. Indeed, the existing institutions of global financial governance each have significant resources and expertise which could be called upon to address the diverse demands of the G20 summit and beyond. Yet it must be said that the current overall system of global financial governance has failed in a momentous way. Even when systemic problems were identified, proportionate action was not taken. For example, in 2007 the Bank for International Settlements recognised several structural problems with the international financial system, but this recognition remained at the level of research and observation, rather than action.

## **3. Provide a clearer division of labour between existing international financial institutions**

The existing global governance system is predominantly composed of institutions that were developed in response to specific problems associated with the reemergence of global finance which arose over the last three decades, and have transformed themselves since then to broader purposes. Subsequently, while they can work together on occasion, there is no clear division of labour among the myriad of international institutions that seek to address such global problems: their functions often overlap, their mandates conflict, and their objectives often become blurred.

## **4. Ensure more inclusive financial governance institutions**

No global reform process can be fully effective if it does not arise from a process that is highly inclusive of developing and developed states. Most current institutions of financial governance have promulgated an exclusionary model of participation when it comes to dealing with problems that are quintessentially global. The IMF, the Basel Committee, and even the Financial Stability Forum, for example, are all institutions in many ways driven by the preferences of the G7 countries, yet the consequences of their decisions are not only suffered by member states, but

also by the rest of the world. Any reform agenda geared to balancing the two worlds of financial globalisation must therefore simultaneously tackle the divide between the rich countries of the world that have dominated the existing system of global financial governance, and their developing country counterparts that have shared the costs, but have had little hand in shaping it.

### **5. Enshrine the principle of equivalence within the reform process**

Fuller participation of stakeholders is more than a means to legitimacy. It can also help to underwrite effectiveness. In areas of global governance that seek to protect or promote the provision of a global public good – such as global financial stability and soundness – there are inherent problems when that public good is protected and managed by a minority of stakeholders. The principle of equivalence dictates that the span of a good's benefits and costs should be matched with the span of the jurisdiction in which decisions are taken about that good. Participatory reform within the existing institutions of financial governance could give a voice to states and non-state actors that have a greater interest in protection against systemic instability, rather than a stake in risk-taking through profitable financial instruments. In this way, instead of limiting participation according to wealth, participation could be guided by a concept of a global commons – not only a shared set of resources, but a shared community of fate, the very basis of contemporary globalisation.

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## **FIVE IDEAS FOR STRENGTHENING THE IMF**

Barry Eichengreen

Policy Network has asked us to present five key proposals for strengthening international financial institutions, which in my case means the International Monetary Fund, in no more than 700 words. That times out to 140 words a proposal. (I've now got 650 words left.)

### **1. Align the membership of the International Monetary and Financial Committee (IMFC) and the G20**

This would enable the IMFC to become a proper steering committee for the IMF. Currently, the G20 is also seen as providing direction for the institution and yet its membership, while overlapping, is different. The G20 also lacks legitimacy. Who appointed it? Why is Indonesia in and Thailand, a larger economy, out? Where is Iran, a larger economy than South Africa? The IMFC with its 24 members, many of which represent constituencies, possesses legitimacy that the G20 lacks. The G20, on the other hand, has the advantage that Europe is represented by the European Union, not simply by national governments. The solution is to align membership in the two entities by expanding the G20 to 24 and moving to a single EU seat in the IMF and to consolidate their work programmes. The IMFC, transformed into a proper governing council as provided for under the Articles of Agreement, would set priorities for the institution and provide firm oversight of its management, holding the latter accountable for their actions.

### **2. Abolish the executive board**

IMF management (the managing director and his deputies) should function like the board of an independent central bank, making operational decisions without micromanagement and political interference from governments. Independence should now be tolerable because management will follow the guidelines of and be accountable to a strengthened IMFC. The standard objection to this proposal – central banks only set interest rates and have a simple mandate to pursue price stability, whereas the range of financial issues with which the IMF is concerned is much broader and more complex – no longer holds water now that we see central banks engaging in a wide variety of financial interventions in response to the crisis.

### **3. Routinise the process of quota enlargement**

Quotas should increase every year with the growth of national incomes. In addition, the elasticity of quotas with respect to the growth of incomes should be greater than one. Thus, when a country's growth is 3 per cent, its quota might increase by 4.5 per cent. When its growth is only 2 per cent, its quota might increase by only 1.5 per cent. In this way quota increases would have

a countercyclical influence. They would dampen demand when growth was strong and support it when growth was weak.

#### **4. Introduce a price-based scarce currency clause**

The debate over exchange rate misalignment and manipulation has been contentious and unproductive. Economists cannot agree on what metric to use to determine whether a currency is undervalued. Politicians cannot agree on what action to take on that basis. An alternative would be to “tax” countries that run large and chronic balance-of-payments surpluses by requiring them to contribute more resources to the fund. For example, a country that had run a current account surplus in excess of 3 per cent a year for three years might be required to transfer one half of the current account surplus in excess of 3 per cent of GDP to the IMF. Thus, nothing would prevent countries from running large and persistent surpluses if they chose to do so, but they would face an additional cost that would encourage adjustment.

#### **5. Commercialise the IMF’s Special Drawing Rights**

Finally, the current crisis has pointed up the intrinsic instability of an international monetary system that relies on a national unit (the dollar) as the international currency. Global growth that increases the demand for the international currency encourages chronic deficits by the reserve centre country, heightening financial risks. An alternative would be to commercialise the Special Drawing Rights so that they become an attractive instrument for use not just as official reserves but in private international transactions as well.

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## section two

# BUILDING A MORE EQUITABLE AND SUSTAINABLE INTERNATIONAL ORDER

## **HAMMERING ECONOMIC PROTECTIONISM**

Simon J. Evenett

Avoiding a re-run of the 1930s is not inevitable. Actions not just words count in perilous times such as these. Only together can progressive leaders prevent the protectionism, mass unemployment and misery, and ultimately the threat to peace that the 1930s became. Leaders must take these five steps immediately:

### **1. Follow Keynes, not Smoot-Hawley**

Use intelligent Keynesianism to design fiscal stimulus packages that revive demand for goods and services. Generous treatment of the unemployed and displaced, who tend to spend proportionally more of their income than most, helps reconcile economic and social imperatives. Open economies were cushioned on the way down. After all, the more open an economy was before the crisis the more demand reductions were felt by foreign suppliers. Restricting imports now will invite retaliation and harm export industries that tend to pay higher salaries.

### **2. Put a global surveillance mechanism in place to hammer protectionist measures**

February 2009 was a bad month for cynics who think that politicians always

cave into protectionism. Visceral condemnation of proposed US “Buy American” legislation by the European Commission, China, Japan, and many of America’s trading partners resulted in President Obama rejecting these proposals and them being substantially watered down in the US Senate. In the internet age only the deluded believe they can practice protectionism in secret. Assemble a team of independent, balanced experts to track protectionism and issue early warnings.

### **3. Commit to a temporary, legally-binding standstill on trade restrictions at the WTO**

Current trade agreements are not perfect, and there are plenty of trade-distorting loopholes that can be exploited. For every major type of trade policy, including those relating to agriculture, manufacturing, government procurement, and dumping, progressive leaders should commit not to raise trade barriers for the duration of the global economic downturn. This temporary commitment must be legally-binding and codified at the WTO. These steps would put teeth into previous G20, G8, and Asia-Pacific Economic Cooperation declarations and build private sector confidence.

### **4. Don’t abandon developing countries during the economic crisis**

Government budgets may be under pressure but the temptation to renege on aid commitments should be resisted. Further destabilising poorer countries when their economies are already in crisis, all for the sake of saving amounts of money that pale in comparison to the average Wall street bailout, is short-sighted foreign and economic policy. It will encourage further migration to the west and harm diplomatic relations for years to come. The damage done to the Millennium Development Goals could be incalculable.

### **5. Lay the foundations for a worldwide export-led recovery**

Cutting red tape and supporting transport infrastructure improvements in developing and industrialised countries help clear the arteries of the world economy. Ports and airports are some of the worst bottlenecks for commerce, as anyone who has run a supply chain will tell you. Use the momentum of the crisis to overcome self-interested defenses of the status quo and to accelerate the completion of the WTO’s current negotiations on trade facilitation.

Surely any progressive leader can ascribe to this combination of intelligent Keynesianism, mutual support for poorer nations, and a commitment to open borders?

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## **TELLING THE TRUTH ABOUT TRADE**

Ricardo Lagos Weber <sup>1</sup>

At times of global crisis, governments are naturally inclined to implement policies to protect their citizens. No government can stand idle in the face of massive market failure. At the same, a line needs to be drawn to prevent these policy decisions from descending into protectionism. The risk of retaliation is high even when measures are consistent with international obligations but discriminate against foreign suppliers, subsidiaries or workers. It seems reasonable to legislate that subsidies be spent at home. But is it reasonable to grant such assistance on the condition that only nationals are hired (or national supplies used)? Or to legislate that if any adjustment is required by a company, then it must begin by closing plants abroad? Such difficult questions must be considered carefully, especially since recovery will require greater and improved international cooperation. Bearing this in mind, progressive leaders should:

### **1. Conclude the Doha development round**

The priority today is to conclude an agreement that will entrench the achievements already made. Several developing countries have unilaterally liberalised trade and investment regimes. Only a fraction of this has been captured by multilateral commitments (WTO). Thus, these economies have room to legally raise their tariffs up to "bound" levels, going back on twenty years of trade liberalisation. Today, their governments are vulnerable to pressures to use this policy space.

1 I would like to thank Alejandro Jara, deputy director general WTO, and Sebastian Herreros, senior trade official, MOFAT-Chile for their comments.

Concluding the Doha round would capture a huge chunk of this unilateral liberalisation in binding trade agreements. The technical work on agriculture and non-agricultural market access has been done. The divergences are not huge. Now is the time for political decisions. This would provide much needed stability to the multilateral trading system, and allow for moving on with the rest of the agenda at a later stage.

## **2. Restore trade financing**

Trade flows are being affected by falling world demand. The negative impact of a fall in trade is being felt most strongly by vulnerable developing economies. Therefore, if commercial banks are unable or unwilling (for risk-related reasons) to finance trade, state governments and development banks such as Asian Development Bank, Inter-American Development Bank, Charities Aid Foundation and the World Bank will need to step in to restore trade financing.

## **3. Use positive incentives to increase domestic demand**

Rather than raising tariffs, establishing barriers such as the "Buy American Act", granting export subsidies such as those restored for the dairy shipments by the EU, or bailing out ailing carmakers, governments should spend their money on positive incentives to increase domestic demand. These include measures such as public works, additional funding and/or tax rebates for small and medium enterprises, employment subsidies, unemployment insurance, and retraining schemes.

## **4. Set up a Trade Watch Initiative**

This mechanism, suggested by the Centre for Economic Policy Research (CEPR, UK), relies on a global network of independent institutions to provide real-time information on government measures that are likely to discriminate against foreign commerce (i.e. trade in goods and services, investment, overseas subsidiaries, foreign workers, access to finance and government bail-outs). The initiative would bring out monthly reports containing policy-relevant findings and alternatives to protectionist measures. It would rely on a combination of increased awareness and peer pressure to deter states from engaging in beggar-thy-neighbour policies.

## **5. Communicate that trade is not the cause of the crisis**

Responsible and progressive governments around the world need to demonstrate to their citizens that free trade did not cause the current crisis. The world of finance, which plays a crucial role in the world economy (among other things, by financing trade) should not be demonised. But we need to find an (understandable) way to tell the truth: that the abuse of financial deregulation in some developed countries gave rise to speculative and irresponsible behavior that ultimately contaminated the real economy. Most people do not have a clear idea of what led to the crisis. In these circumstances, it is easy to blame “globalisation” (i.e. free trade) and believe that those advocating populist and old-fashioned leftist politics have been proved right. Therefore, it is even more essential for progressives to be firm in defending the benefits of trade and openness.

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## **SLOWING THE PROTECTIONIST JUGGERNAUT**

Gary Hufbauer

At the G20 Summit, held in November 2008, leaders pledged to avoid protectionist policies. Before the ink was dry, India and Russia put up new barriers. Since the turn of the year, Britain has engaged in financial protectionism, France and Italy both proposed restrictive auto measures, and the US has enacted a “Buy American” rider on its stimulus package. At least 16 other countries have contemplated or passed new measures that throw sand in the wheels of the world economy. None of these actions may breach World Trade Organisation (WTO) or other international obligations, but all of them defy the spirit of the G20 proclamation. The juggernaut of protection is rolling, slowly for now. What can be done to keep the speed from picking up?

### **1. Create a “name and shame” bench**

A visionary private foundation should convene a high-standard and independent bench to act as a watchdog. The bench would be charged with grading new trade restrictions on an accelerated schedule. How would it work?

**Members**

The bench would consist of 12 eminent economists and lawyers from all over the world. It would be independent of any government and the WTO.

**Timeline**

The bench is suggested as a crisis measure; it is not meant to be permanent. Hopefully the economic slump will turn around in two years or sooner, and the protectionist juggernaut will come to a natural rest. Therefore, the bench should have a defined life of two years.

**Case selection**

The chair person of the bench, the president of the World Bank and the director-general of the WTO would all be empowered to assign cases for evaluation by the bench.

**Method**

The bench would convene electronically, in panels of three, with the help of junior assistants. Panels would evaluate measures against the standards of the WTO, any relevant Free Trade Agreement, the G20 pledge of November 2008, the G7 pledge of February 2009, and any subsequent G20 pledge.

**Reports**

Case reports would be issued within 30 days. Reports would describe the measure and determine whether it violates the relevant standards. The reports are meant only to "name and shame"; they are not meant to be used as evidence in subsequent WTO disputes or other judicial proceedings.

Speedy reports are more important than detailed legal analysis. The idea is to slow the protectionist juggernaut, through the force of informed opinion. Press citations of "protectionism" far exceed the extent of protective action. But smoke often precedes a blaze, and a relaxed attitude is wrong when the world economy is sinking and protectionist sentiment is soaring.

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## **A NEW WORLD DEVELOPMENT ARCHITECTURE**

José Antonio Ocampo

The major objective of progressive governance should be to reduce the massive inequalities that characterise the world today, while facilitating sustainable growth. This implies reducing the fairly generalised trends towards increasing inequalities within countries that have characterised the world in recent decades. It also means reducing the massive inequalities in per capita incomes among countries, which explain about 70 per cent of world income inequalities. The new development architecture should focus on this latter dimension of world inequalities and should include at least five elements, some of which serve broader objectives of global governance.

### **1. Create a global fund for development assistance**

The history of official development assistance is the history of the incapacity to fulfill the UN target of 0.7 per cent of the income of industrial countries. It would be better, therefore, to create a truly global fund managed by the UN and financed by an international tax on carbon emissions, financial transactions or any other source. The distribution of funds would focus on the achievement of globally agreed goals (such as the Millennium Development Goals or a broader subset of goals agreed in the UN summits and conferences), particularly in poor countries. It should be fairly automatic in the way it distributes its resources, in a similar way to how regional solidarity funds are assigned in the European Union.

### **2. Design truly development friendly world trading rules**

The new rules would include further liberalisation of goods and services of interest to developing countries (agricultural goods and labour-intensive manufactures and services) with no reciprocity. It would also include special preferences of a global character for the least developed countries and more “policy space” for all developing countries (see point 4 below). And it would detach intellectual property rights from the trading system, include exceptions for development purposes (as well as for health and environmental purposes) to whatever global property rights rules are kept, and create strong incentives for technology transfer.

### **3. Revamp the IMF**

The IMF should become more like a central bank of the world, in charge of macroeconomic policy coordination and issuance of a global reserve currency. The latter could be based on the existing Special Drawing Rights (SDRs) or evolve into a global reserve asset. The issuing of SDRs would be countercyclical, particularly to facilitate financing of developing countries in the face of external trade or capital account shocks. Such financing would be provided by the IMF and/or by multilateral development banks, financed by their own funds or by bonds of these institutions that could be purchased by the IMF with the issue of SDRs. A major objective of the IMF would also be to support developing countries in the counter-cyclical management of their capital accounts – that is, avoiding excessive capital inflows during booms and capital outflows during crises, including through the active use of capital account regulations – and, if necessary, debt reduction or restructuring.

### **4. Enshrine “policy space” in WTO and IMF rules and practices**

A major objective of international cooperation would be support for national development and social welfare objectives. This would include allowing countries to adopt the trade and industrial policies that they require to accelerate economic diversification, including those that are not possible under current WTO rules (subsidies, domestic contents requirements, exceptions to intellectual property rights), and facilitating tax and other policies aimed at promoting active social welfare policies. It would also actively support developing countries in their efforts to adopt countercyclical and growth-oriented macroeconomic policies.

### **5. Create a strong UN Social and Economic Council**

A strong UN Council should be in charge of global social and economic (and possibly environmental) policy coordination; identifying and filling gaps in global cooperation (such as the absence of an international debt court or antitrust authority); and increasing the accountability of specialised institutions in fulfilling global goals. This council would meet at heads of state level every year, and would thus constitute a truly representative version of the G20. All countries would be represented on a constituency rather than individual basis, determined

by an appropriate measure of the “weight” of countries in the world economy. This council would not replace, however, the governing bodies of specialised agencies in their specific fields of expertise.

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## **CREATING CAPABILITIES FOR DEVELOPMENT**

Martha C. Nussbaum

All over the world, people are struggling for a life that is fully human, a life worthy of human dignity. Countries and states are often focused on economic growth alone, but their people, meanwhile, are striving for something different: they want meaningful human lives. They need theoretical approaches that can be the ally of their struggles, not approaches that keep these struggles from view. As the late Mahbub Ul Haq wrote in 1990, “The real wealth of a nation is its people. And the purpose of development is to create an enabling environment for people to enjoy long, healthy, and creative lives. This simple but powerful truth is too often forgotten in the pursuit of material and financial wealth.” What theoretical approach could direct attention to the salient features of today’s world, promote an adequate analysis of it, and make pertinent recommendations for action? When answering this question we should bear the following issues in mind:

### **1. The limitations of the current dominant theoretical approaches**

The dominant theoretical approaches in development economics, used all over the world, are not allies of real people’s struggles. They do not have an adequate conception of the human goal, equating doing well with an increase in Gross National Product (GNP) per capita. Such a crude measure of development does not even tell us about distribution, giving high marks to states that pursue foreign investment in a way that fails to address the needs of the rural poor. Another shortcoming of development approaches based on economic growth is that, even when distribution is factored in, they fail to examine aspects

of the quality of a human life that are not very well correlated with growth. Research shows clearly that promoting growth does not automatically improve people's health, their education, their opportunities for political participation, or the opportunities of women to protect their bodily integrity from rape and domestic violence.

## **2. Asking the right questions**

If we want to discuss how people are doing in an insightful way, we need to determine what they are actually able to do and to be. How have their circumstances, familial, social, and political, affected their ability to enjoy good health? To protect their bodily integrity? To attain an adequate education? To work on terms of mutual respect and equality with other workers? To participate in politics? To achieve self respect and a sense of their own worth as a person and a citizen? Developing policies that are truly pertinent to real people means asking all of these questions, and others like them. It means crafting policies that do not simply raise the total or average GNP, but promote a wide range of human capabilities, opportunities that people have when, and only when, policy choices put them in a position to function effectively in a wide range of areas that are fundamental to a fully human life.

## **3. The “capabilities approach”**

Today there is a new theoretical paradigm in the development world. Known as the “human development” paradigm, and also as the “capability approach” or “capabilities approach,” it begins with a very simple question: what are people actually able to do and to be? This question, though simple, is also complex, since the quality of a human life involves multiple elements whose relationship to one another needs close study. This new paradigm has had increasing impact on international agencies discussing welfare, from the World Bank to the United Nations Development Programme (UNDP). Through the influence of the Human Development Reports published by the UNDP, it also now affects most contemporary nations, who have been inspired by the use of the capability framework in those reports to produce their own capability-based studies of the wellbeing of different regions and groups in their own societies. In addition, the Human Development and Capability Association, of which Amartya Sen and I are the two founding presidents, with membership drawn

from seventy countries, promotes high quality research across a broad range of topics where the human development and capability approaches have made and can make significant contributions.

#### **4. Moving towards implementation**

How can nations implement the human development approach? First, as many do already, they can produce an annual Human Development Report that looks in more detail than the UNDP report can at the distribution of capabilities in their own country, focusing on gaps between urban and rural, rich and poor, male and female. Second, if they are currently making or remaking a constitution, they can draw on the approach as a source for the articulation of fundamental entitlements. Third, administrative agencies dealing with environment, health and safety, labour, and other regulatory matters can use this approach to measure their achievements, rather than a crude version of cost-benefit analysis. Finally, by focusing particular attention on access to quality education, they can ensure that the capabilities of young citizens are cultivated from an early age.

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## **TOWARDS A PROGRESSIVE GLOBAL ORDER**

Ricardo Núñez Muñoz

The global economic crisis has brought into stark relief serious flaws at the core of the current international order. In recent decades, the international system has been heavily dominated by market driven growth, which has frequently come at the expense of more progressive objectives. Indeed, the weakness of international regulatory structures contributed significantly to the current global financial meltdown, and has undermined efforts to tackle climate change and energy insecurity. Now is the time to build a new international order, which strengthens nation states' ability to coordinate their actions at a global level in pursuit of the global good. This new order must take into account the differing perspectives and capacities of each actor in the global

north and south. But it must also overcome any potential contradictions through a true commitment to united action and progressive goals. The following proposals indicate a way forward:

### **1. Building a new international financial architecture**

It is now widely agreed that international financial bodies such as the World Bank, and especially the International Monetary Fund, were not prepared for, and did not have the capacity to prevent, the crisis that we are currently experiencing. These institutions should either be restructured, or should make way for a new of global financial order that goes beyond the remit of agreements reached at Bretton-Woods. These new institutions should be given the necessary resources to deal with the challenges posed by current levels of economic and financial globalisation.

Currently, such existing bodies continue to be unduly shaped by the preferences and interests of the most developed countries and of multinational corporations. They have not given sufficient attention to the development needs of Latin America and other emerging economies. The reform of international institutions will only be effective if it takes into account the needs of both developed and developing countries. In addition to reforming and democratising international financial bodies, it will be necessary to develop effective mechanisms for international policy coordination. If this does not take place, the process of globalisation will continue to fall short of our progressive goals.

### **2. Improving north-south cooperation on the environment**

The current financial and economic crisis has coincided with both an environmental crisis and a global energy crisis. These enormous challenges not only oblige us to rethink our lifestyles and our models of development, but also highlight anew the disparities between developed and developing countries. As yet, progressives have not been able to develop a common strategy to face these challenges.

There is a clear contradiction between those advanced economies that are moving towards a more sustainable future, and countries in the less developed

world who are “forced” to continue making do with highly polluting fuels. For example, in the southern hemisphere, coal is once again in use and there is no sign of a decline in petroleum usage. Indeed, firewood continues to be used by the most underprivileged communities, hindering efforts to conserve native forests.

The international community needs to develop a new north-south dialogue on the pathways to meeting a post-carbon economy, which promotes an economic and political agenda for environmental sustainability. This conversation is beginning to emerge in the business world, as industries prepare the ground for what Jeremy Rifkin has termed the “third industrial revolution”. The challenge facing progressives around the world, especially in Latin America, is to ensure that public policies aimed at helping the most disadvantaged in society are compatible with sustainable development.

### **3. Strengthening platforms for progressive cooperation**

Today, it is no longer enough to simply talk about international solidarity. The rapid process of globalisation has connected our economies, politics, societies and cultures in ways that make international solidarity a necessity. Alongside strengthening existing international institutions, progressives around the world should build and improve their own platforms for cooperation. By joining forces, progressives can ensure their influence is powerful enough to guide the international order in a more equitable and sustainable direction.

A united Latin America, for example, would create a stronger presence on the international stage, able to count itself among other global actors such as North America, the European Union, Japan and southeast Asia. Latin American countries cannot continue to pursue economic integration with the developed world individually, or to preserve intra-continental trade barriers. Apart from damaging our political, social and cultural relations, we will not be able to successfully confront the challenges of the global age, nor make contributions to the global good which correspond to our social democratic and progressive ideals.

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## **DEVELOPING COUNTRIES IN THE FACE OF THE STORM**

Glauco Arbix

In the 1980s, a debt crisis shook Latin America and Africa. Another one then hit Asia, Russia and again Latin America at the end of the 90s. Many countries had their trajectories momentarily interrupted, even though they were able to recover rapidly in tune with the global economy. In the current recession, it is developed countries that are in the eye of the storm. Nevertheless, the impact on emerging countries will also be strong. Both for those that grew rapidly and benefited from a global environment marked by liquidity, low interest rates, a weak dollar and the rise of commodity prices; as well as for the more fragile countries, who will be, once again, the big losers. The developing world cannot stand idle and hope that the crisis will leave them unscathed. In addressing these challenges, both developed and developing countries must prioritise the following steps:

### **1. Move beyond temporary and localised measures**

These are not propitious times for small measures. Latin American companies and public finances have already been affected by the crisis in a very real manner, either through the reduction of revenue or by changes to the influx of foreign capital. On top of this, the magnitude of the crisis is likely to increase, given that the drop in the price of commodities has only just started. For this reason, the announcement of measures for temporary or localised mitigation, although well intentioned, will inevitably increase the insecurity of economic actors and society as a whole.

### **2. Restore confidence in the market and private investment**

In a climate of growing uncertainty about capital flows, every effort to keep or recover investment is key. The deceleration of the economy has already frozen out a great number of private companies' projects and opened up a cycle of dismissals. Public investments are certainly part of the solution. Yet, fundamental to this is the rehabilitation of confidence in private investment and the market mechanism.

### **3. Seek effective intergovernmental coordination**

The global crisis calls for a coordinated international response. At the national level

the adoption of expansionist monetary policies, new credit incentives, interest rate cuts and fiscal stimulus are all welcome first steps. This must be built upon by developing rapid and coordinated responses at an intergovernmental level. Yet whilst many countries are moving in the right direction, others are slow to react. The crisis will punish such sluggishness; therefore swift action must be taken at the highest possible level. In Latin America, engagement is hesitant at both the national and international level. This reveals indecision between policymakers, and even underestimation of the scope of the crisis. Our autarkic legacy detracts us further from coming up with adequate responses. In this situation, it is helpful to remember that those who look at one single country run the risk of seeing none.

#### **4. Strengthen international supervision of financial markets**

In Latin America, it is already possible to create mechanisms to debate and coordinate anti-cyclical policies. This proposal can be extended to the G20 and involve institutions within the UN system; thus paving the way for the establishment of an organisation to monitor and control financial risk. This would be an important step towards creating a World Financial Organisation (as proposed by Barry Eichengreen), using the World Trade Organisation (WTO) as a model. This organisation would fix rules, standards and obligations for its members; it would be responsible for the supervision and regulation of financial markets; and it would provide a dispute settlement mechanism.

#### **5. Promote greater inclusiveness in International Financial Institutions**

For developing countries, it will be crucial to reform the existing rules of the international financial system. This reform must ensure greater inclusiveness so that new proceedings, rules, instruments, obligations and rights are not determined wholly by the interests of the strongest. Active participation in overcoming the current international "disorder" is the first big test of maturity for developing countries.

#### **6. Resist protectionist tendencies**

Developing countries will have to look beyond their borders and resist protectionist tendencies, which will be particularly strong in the more developed countries. In Latin America, pressures of this kind may lead to a return to mercantilism.

Mercosur must either assume its vocation as an economic bloc or give way to a new project; it cannot modernise with the continued presence of trade barriers between its member states. It also runs the risk of hampering the search for a new international integration strategy for the region. Protectionism hinders, and even stops, the flow of knowledge and innovation, a basic condition for the competitiveness of private companies and the economy at large.

## **7. Act now**

The earlier governments coordinate their efforts for the recovery of their economies, the sooner the recession will end and the quicker will be the return to the previous economic upward trend.

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## **LAYING THE FOUNDATIONS FOR FUTURE PROGRESS**

**Bernardo Kosacoff**

As the global economic crisis deepens, the world is becoming increasingly uncertain. Now is the time to construct a shared public-private vision for development and progress. The key challenge is how to build a solid institutional framework for a stable economy. As the current crisis demonstrates, volatility and economic cycles can be extremely damaging. And the maintenance of external, fiscal and financial equilibriums is crucial for economic stability. At the same time, it is important to promote the development of competitive advantages and greater social cohesion through the equality of opportunity. This can only be achieved through a solid macroeconomic framework. To build this framework, progressive leaders should take the following steps:

### **1. Institute financial regulation**

Financial liberalisation must be accompanied by appropriate regulation and prudent oversight, aimed at avoiding boom-and-bust cycles and the inadequate distribution of resources. Profits tend to increase confidence and financial agents are likely to make increasingly risky and less considered decisions and investments, which involve a greater proportion of debt to

capital. This leads to excessive levels of debt and inadequate resource allocation that prioritises consumption over investment in productive social capital. Ultimately, this results in scarce capitalisation of financial entities leading to bankruptcies of debtors and financial intermediaries. The construction of an international financial architecture, which regulates and guarantees financing for both developed and developing countries is a key way out of the current crisis.

## **2. Aim to diversify exports**

Patterns of specialisation determine the sustainability of an economy. While export growth can play an important role in development, it is not sustainable when this growth is based only on resources and raw materials. Adding value to raw materials and previously installed productive capital through processes of innovation is essential. This involves the generation of domestic technological capacity, constant training of human resources, encouraging entrepreneurial spirit, and a collective effort to build knowledge and productive capacity networks.

## **3. Ensure that TNCs contribute to the domestic economy**

Transnational corporations have a significant role to play in development, but their mere presence does not guarantee this role. Clear incentives and rules of the game are required. Regulation and incentives should promote greater inclusion in global value chains and the generation of domestic knowledge and production capacities. At the same time, economic integration processes must be strengthened. Coordination mechanisms that deal with the crisis and strengthen complementary production processes are required.

## **4. Strengthen policies for equitable and sustainable development**

The provision of public goods should guarantee equality of opportunity and help build sustainable development capacities. The path for reversing poverty and exclusion lies in moving forward on processes of structural change. This will generate greater wealth, which will be beneficial for all through progressive distribution policies. The strengthening of equitable and sustainable public policies, including transparency and social evaluation, is

indispensable for achieving equity, strengthening businesses and creating competitive markets. All public actions and strategies need to be evaluated on the basis of their contributions towards social cohesion, respect for rights, and care for the environment.

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## **LINKING ECOLOGICAL AND ECONOMIC SECURITY**

Barbara Harriss-White

Concerns that the pursuit of a low carbon global economy may lead to further deprivation in the developing world rest on a false assumption. 'Low carbon life styles' are already lived by the poor in the 'South'. It is rich countries, accounting for most of the pollution, which face an unprecedented challenge in adapting their ways of life to allow human societies to survive on the planet. In fact, attitudes in rich countries towards the impending ecological crisis have gradually changed. Major political and business interests have evolved from denial, to recognising 'affordable solutions', and now to an agenda of mitigation. But while it is obvious that global public action is needed, the governments of the ten major polluting countries have yet to act in a concerted way that is adequate to the problem.

They have been missing the point. The reason atmospheric CO<sub>2</sub> continues to rise is now due to the growth logic and path dependence of the global capitalist economy. Policies responding to the ecological crisis that help "green" the rich without further harming the poor must therefore stem from recognition that the capitalism that creates wealth, waste and pollution also creates poverty. "Green" responses to the poverty of the world's poorest inhabitants must focus on these poverty-creating processes and their links if solutions to both global poverty and climate change are to be effective. Outlined below are some poverty processes and suggestions for green political responses:

### **1. Natural resources**

Corporations and individual capitalists create poverty when seizing essential resources such as land and biomass, minerals and water. People displaced by development have to be adequately resettled. Start-up capital and credit unconnected to loans on dwellings should be provided for their businesses.

### **2. Self-employment and small-scale enterprise**

Preventing the expansion of small-scale production and self-employment perpetuates poverty. Countering the many processes involved requires recognising work-sites, and combating extortion in rents, interest rates and prices. To release the vitality of small-scale enterprise, energy and capital need taxing, while labour and recycling need incentivising. Efficiency in energy and resources needs to be the top development priority.

### **3. Labour rights**

The pressure to reduce costs intensifies the exploitation of workers, driving down wages and damaging work environments. To protect workers, the ILO's principles of Decent Work need to be upheld and income guarantees put in place. The collective and cooperative organisation of production should not be penalised.

### **4. Labour-friendly green innovation systems**

To respond to practices that cut costs through technological change, outsourcing, and labour displacement, a 'green innovation system' is overdue. Educational curricula should be radically transformed to promote green innovation and award it social and political kudos. International public buyouts of patents on renewable energy and on efficient technologies for energy, water and materials would help transfer technology to developing countries. A 'national service' in recycling and a 'war against all waste' would help transform the economy as well as public ethical consciousness.

### **5. Toxic products, the arms industry and dangerous conflict**

The production of toxic products which harm poor people disproportionately needs well-enforced regulation. The arms industry drives poverty and destruction when financing, equipping, and encouraging the outbreak of wars. Social resources need committing to the peaceful resolution of conflicts.

## **6. Crises and public goods and rights**

Economic and financial crises pauperise people through bankruptcies, lay-offs and the destruction of savings. The state needs to maintain ownership of, and assure the provision of, public goods and rights protecting people against poverty and insecurity. The material preconditions for the enjoyment of freedom involve food, water, clothing, housing, sanitation, drainage - and healthcare, education and employment. Global finance should be regulated to achieve these objectives. Their production is at the heart of economic development.

## **7. Growth, waste and pollution**

Waste is the by-product of economic development. Untreated waste is dangerous to those living nearby. Waste gases that are warming the planet are already harming those living at its ecological margins and least responsible for global warming. So the attack on poverty-creating waste also requires energy, transport and environmental protection infrastructure to be redeveloped using materials-efficient technologies, regulated in the public interest.

## **8. Politicise ecological security**

The physical cycles that are involved in climate change, and in responding to it, are incomparably longer than electoral-democratic cycles which dominate party-political policy making and their vista of practical action. Many technological solutions exist already, but policies for their development are characterised by instability, idiosyncrasy and slow implementation. Some way of handling ecological security independently of electoral politics, perhaps in the way military security is treated, must be developed democratically and made the object of a binding moral consensus.

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## **THE GREEN OPPORTUNITY**

John Podesta

In countries around the world, the global financial crisis is crippling economies and making it more difficult for people to provide for their families on a daily

basis. However, there is an opportunity presented by the financial crisis – an opportunity to transform the way we produce and use energy. The challenge of solving our mounting economic, energy, and global warming crises provides an extraordinary opportunity to reinvigorate the economy through investment in clean, sustainable, low-carbon energy sources. There are two dimensions to resolving these challenges, each of which is explored below:

### **1. Transforming energy infrastructure to spur growth in advanced economies**

In the US and other advanced economies, the transformation of our antiquated energy infrastructure can be the engine for innovation, economic growth, and job creation in the coming decades. This transformation can be structured to ensure that green economic growth is a tide that lifts all boats, both internationally and domestically – especially those in poverty and living in the most marginalised communities – and reinvests in strong urban and rural fabrics. This investment can offer pathways into the middle class, skills training, and help to rebuild career ladders by creating jobs with family supporting wages in the construction trades and in manufacturing within the industries of the future. Investing in renewable energy and energy efficiency creates, on average, nearly four times as many jobs per dollar invested as traditional fossil fuel-based generating technologies. The transformation of advanced economies to low-carbon production is necessary to meet the climate change challenge, but it is not sufficient. Ultimately, a strategy is needed to reduce greenhouse gas emissions and to rapidly green the economies of the rapidly developing world as well. The G20 can and must make this a priority issue. Countries around the world are making more than 2 trillion dollars in new investments in an effort to recover from the current global recession, and it is imperative that this spending move the entire international community toward a low carbon future.

### **2. Eradicating energy poverty through green policies in the developing world**

While reducing emissions, we must ensure that the energy needs of the poorest countries are also addressed. More than two billion people lack regular access to modern energy services, and 1.6 billion do not have electricity in their homes. This extreme “energy poverty” undermines their ability to meet basic human needs, and places an increased burden on families, particularly the women and children who must use their labour to compensate by, for example, walking for hours to

collect water and firewood. The lack of access to clean, reliable and affordable energy supplies increases health risks and early mortality because people have no choice but to turn to “dirty” fuels for cooking and heating. Meanwhile, energy poverty also impedes economic development by constraining production, trade, and the growth of viable local markets. The global focus on renewable energy sources and the development of new, low-carbon emitting technologies offers promise for a new energy future for the developing world. The potential exists to develop renewable energy strategies that could both meet energy demand and reduce carbon emissions. In so doing, the long unmet needs for energy in impoverished communities and countries could be addressed in ways that encourage development while helping to minimise climate change.

The world's poorest countries have a right to development in a carbon-constrained world, and, as the primary contributors to global warming pollution, the world's wealthiest nations have a moral responsibility to assist in this development. Without effective and reliable funding streams and international mechanisms that prioritise those in greatest need, the progress of the developed world could leave the developing world behind, replicating historical patterns of development that have excluded the world's poorest countries. The consequences would not only lead to increased poverty, but would also deepen the already dangerous gap between the world's haves and have-nots.

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## **BRIDGING THE GAPS IN CLIMATE CHANGE POLICY**

Anthony Giddens

Here are some core principles for climate change policy:

### **1. Don't wait around for Copenhagen**

Whatever agreements are reached in the negotiations that will take place in that city, they will have to be implemented mainly by states. Therefore all countries, but especially the industrial ones, since they have to be in the lead, must begin

implementing policy measures now – and they must be real ones, not simply the setting of targets at a comfortable period in the future. Policy must be holistic: it has to be integrated within national policy as a whole. For instance, a full tax audit has to be carried out when tax-based measures are introduced.

## **2. Utilise an investment-driven approach**

Policies based upon trying to scare people aren't going to work, since most citizens find it hard to relate to abstract threats lying somewhere in the future. After all, no weather event, no matter how extreme, can be unambiguously attributed to global warming. We need an investment-driven approach, motivated as much by energy security as by climate change worries, to get citizens on board. Policy must be large-scale and ambitious, and driven by business leaders as much as by politicians. The price of oil has plummeted, but will spike again as soon as there are signs of recovery – we all must prepare beforehand. For instance, aid given to the car industry must be rigorously coupled to restructuring plans and technological investment to reduce traffic emissions.

## **3. Look out for new business opportunities**

Not many jobs will be created directly through a switch to low-carbon technologies. One should beware of easy statements such as, "in country X, 100,000 new jobs will be generated through investment in wind-power". Most new technologies reduce the need for labour-power and there is no reason why low-carbon technologies should be any different; some people will lose their jobs in the older energy industries. We will continue to live in a post-industrial society. The new jobs which will be created as we move out of the age of oil, gas and coal will be lifestyle related, as people alter their tastes and habits. We should be thinking now about where these lifestyle changes are likely to occur and where the business opportunities will be.

## **4. Encourage bilateral agreements**

Copenhagen-style agreements may possibly be fruitful, but could flounder. Much will have to be done through bilateral agreements and the direct transfer of knowledge and technologies. The most important development that could happen is the US and China working closely together, since jointly they are responsible for such a high proportion of the world's emissions. If they don't, or can't work together there could be a highly worrying conflict over scarce energy

resources whenever recovery begins. Other countries, and the EU, should actively encourage US/Chinese bilateralism as far as energy is concerned.

## **5. Plan ahead**

Climate change will probably affect us whatever happens from now on. All countries must think very seriously about adaptation and plan ahead. As in other areas the developed world has a direct responsibility to help the developing countries in an extensive way. Planning ahead means more than only drawing up assessments of vulnerability, which most countries have done to some extent. We need large-scale anticipatory adaptation, wherever possible, that will overlap with measures that will at the same time act to contain emissions. For instance, insulating buildings to reduce heat loss can be combined with increasing their durability in the face of more extreme weather.

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## **AN EQUITABLE CLIMATE CHANGE FRAMEWORK**

Andrés Rivera

Climate change is one of the most pressing challenges of our times. Its effective resolution will require an overhaul of existing frameworks at the domestic, regional and global levels. The following ideas are a few of the many measures that will need to be adopted in order to tackle climate change without compromising equally important principles of equity and progress:

### **1. A new international agreement to tackle climate change**

A post 2012 Kyoto protocol is needed in order to effectively reduce and limit the global rate of greenhouse gas emissions. An agreement on the quotas each country is allowed must be reached. Every developed, emerging and least developed country – especially those considered newly industrialised – should have a strong commitment to this reduction. The new protocol should also promote bilateral and regional agreements on co-ordinated action, regulation and policies to preserve

natural habitats that are especially vulnerable to climate change; particularly where an international approach would be necessary (for example the Amazon basin, Patagonia, Antarctica, the highlands of central Andes).

## **2. A new energy matrix for every country**

Newer and better policies for increasing energy efficiency need to be adopted. A progressive transformation of the status quo could be enhanced by encouraging the use of non-conventional renewable energy technologies, thus also establishing greater energy autonomy. Several initiatives could be adopted in pursuit of this goal, including funding research into new technologies and alternative energy sources; providing economic incentives for the development of alternative energy projects; promoting volunteer agreements between government and industry on new regulations and the application of new technologies, with the aim of increasing energy efficiency and reducing emissions; introducing progressively more restrictive definitions of the Emissions Standards for Thermoelectric Plants; and finally implementing incentives for individuals to conserve energy.

## **3. A new deal for water resources**

One of the main consequences of climate change will be the reduced quality and availability of freshwater resources in many regions of the world. A new relationship between our societies and our freshwater supplies needs to be adopted. This must ensure more efficient usage and management of water; avoid the contamination of surface and subsurface water bodies; enforce global standards in the treatment of sewage waters from urban, industrial, mining and agricultural activities; and promote the cleaning of rivers, lakes and seas. Specific regulations are required to improve the preservation and management of glaciers, rivers, lakes and seas. Possible suggestions for improving the quality and quantity of water resources include: better management of riversides and seashores in order to reduce erosion and the negative effects of extreme weather and to protect vulnerable regions; reduction of water contamination by implementing educational campaigns, introducing monetary incentives for residual water treatment plants and developing natural parks in coastal and riverside areas; introduction of early years education in order to inform the public about the importance of water and to promote its conservation; investment in irrigation infrastructure to reduce water loss; increased forestation and reforestation measures in areas that have

been seriously eroded, are susceptible to droughts, or have vulnerable soils, ensuring the use of native species in these processes.

#### **4. Enhanced scientific research**

Strong encouragement of scientific research is needed to improve our understanding of climate change and its effects on our societies, economies and global eco-system. There is a need for capacity building amongst new generations of experts whose analyses will help to propose effective adaptation and mitigation policies. Currently, the dynamics of climate change are not well understood at the regional level. New regional measurement networks, integrated observation systems, modelling techniques, inventories and databases are all necessary in order to improve our current knowledge and forecasting capabilities. Better links and efforts towards joint action between the global scientific research community and local, national and regional leaders should be fostered in order to promote more informed decision making processes.

#### **5. A new domestic framework**

Governmental institutions in charge of monitoring environmental planning and energy industries must be modernised and improved. A more professional, stronger, effective and well prepared public sector is vital. But without a clear commitment from the private sector, local organisations and common citizens, any political agreement regarding climate change is likely to be ignored by the general public. New measures are therefore needed to ensure citizens play a more central role – and thus have a greater stake – in energy efficiency decision making and regulatory processes.

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## **CLEAN CHANGE IN A CRISIS**

Miranda A. Schreurs

There is no doubt that the current crisis represents major challenges for the world's policy makers. Yet, while the problems we face are dire, the crisis may

provide us with an opportunity to institute changes that will lead towards a more sustainable and equitable global economic structure. Existing structures have contributed not only to our current economic woes; they are also responsible for other serious global problems, including climate change. It is clear that these structures are not working. Crises can be the engines of visionary change, and that is what is needed now. Yet, how can this change be brought about, especially at a time of recession?

### **1. Address global warming**

Global warming can lead to the melting of glaciers – threatening fresh water sources; the rise of sea levels – putting coastal communities in danger; droughts – affecting the availability of food crops; and extreme weather events – risking the lives of the most vulnerable. Various cost benefit analyses point to the same conclusion – that the costs of inaction are likely to far outweigh the costs of taking action now. While, the benefits of tackling climate change are many. Doing so can bring about a modernisation of industry and infrastructures that will help economies to be more competitive in the future. It can lead to cost savings and create new jobs with the development of new environmental industries.

### **2. Enhance energy efficiency**

There is tremendous waste in how we use the energy we currently have. Energy is lost because existing electricity grid systems in many parts of the world are out of date. Building codes are too lax. Goods transport is inefficient. Electronic equipment has unnecessary stand-by functions. This waste is not only detrimental to the environment, it is the equivalent of throwing money out of the window. Energy efficiency improvements – through the installation of insulation, the replacement of incandescent light bulbs with fluorescent bulbs, requirements for better windows in new buildings, and the use of less-energy intensive equipment can save heating and cooling as well as electricity costs in residential homes and businesses. Similarly, savings that stem from more efficient use of material resources reduce costs to consumers and businesses while reducing the waste that is introduced into the system. The money saved in fuel and material costs can then be reinvested, and new jobs can be created for energy auditors and environmental managers.

### **3. Rethink transport policies**

The development of mass transit systems can relieve road congestion, improve air quality, and reduce the need to build new roads. Getting people to reduce the number of car trips made in a day – through use of public transport, car pooling, car sharing, and the building of bicycle lanes could go a long way toward reducing urban air pollution problems. And in the meantime, research and development into low-emission and most probably electric powered vehicles can be promoted, so that an eventual technology-shift will be achievable.

### **4. Invest in renewable energies**

Investment in renewable energies through the development of wind parks, solar facilities, and tidal power can bring power and jobs to rural communities. With a supportive policy system behind it, these more decentralised forms of energy can help meet growing energy demands while enhancing energy security and reducing the need for reliance on fossil fuels.

### **5. Institute policies to stimulate change**

Governments must play a role in stimulating change. The framework provided by regulatory policies that demand more efficient performance by industry; tax and other incentives to encourage investments in energy and resource efficiency improvements; and information to aid consumers in their product choices can go a long way in changing behaviour. With the right incentives, people and industry will participate. Local governments have achieved cost savings through incentive schemes that provide extra financing when money is saved in energy and material outlays. Companies have improved their bottom-line by cutting waste in their production processes. Feed-in tariffs have contributed to the take off of various renewable energies. What is required is political will and vision.

These are the first steps in taking the global community closer to a more sustainable and just world. The ideas are not new, but they are getting new attention. A growing number of world leaders are talking about the importance of a “green new deal” that will move the world toward a green technology revolution. What these ideas share in common is that current structures are

premised on out-dated industrial models that need to be phased out so that new, cleaner, and safer models can be developed. There is growing recognition that existing industries and infrastructures based on cheap and abundant fossil fuels are becoming less competitive and less desirable. Working to change these systems can go a long way in helping address climate change while revitalising the global economy.

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## **section three**

# **A MODERN ROLE FOR THE STATE IN THE NEW ECONOMIC AND SOCIAL PARADIGM**

## **THE STATE IN A SHIFTING ECONOMIC PARADIGM**

Marco Aurélio Garcia

Economic crises tend to expose deep-seated contradictions in society. This is particularly true when the crisis in question has global and systemic proportions, as in the current case. In times of crisis, it is not unusual to witness “some of the most perverse phenomena”, to borrow a phrase from an Italian intellectual from the previous century, as old paradigms are questioned and new ones have not yet necessarily taken their place. Indeed, during such paradigm shifts, one must not underestimate the persistence of old modes of thinking, particularly when alternatives are not yet fully developed. This short digression is useful when thinking about the comeback of the state as a fundamental factor in economic organisation in light of the current global economic crisis but also from a historical perspective:

### **1. Post-war reconstruction and the strategic state**

After 1945, at the end of the “second thirty year’s war”, to borrow the term coined by Arno Mayer, the state assumed a decisive role in lifting Europe out of its economic and social depression. The newly created “welfare state” – not only in countries under social-democratic control, but also where Christian Democrats prevailed – was not only responsible for setting up wide-ranging social protection

nets, especially for workers; it also guaranteed a strong presence for the state in strategic areas of economic life. The strengthened role of the state was not only the result of the weakness of Europe's business elites, crippled by the war; the state was also the only actor in a position to think strategically about how European societies could be redesigned to guarantee economic reconstruction and long-term sustainability.

The post-war years also saw the state assume an important role in economic development in countries on the global periphery, notwithstanding the different circumstances they faced. This was particularly true of states experiencing a process of late industrialisation such as Brazil. This is not to say that there was no resistance to this new paradigm during this time. In Brazil, this resistance was associated with liberal groups who advocated an essentially agricultural role for the country and deemed industrialisation to be a protectionist aberration fostered by an oversized state. Still, the period between 1945 and the 1970s was marked by the rise of a strategic state paradigm.

## **2. Globalisation and the weakened state**

The end of the "the glorious thirties" in the developed world, together with the resounding failure of the Soviet model, saw the emergence of a conservative counter-revolution, which rapidly extended to the global periphery as well. One of the key elements of the emerging paradigm was the discrediting of the role of the state in economic growth. It was felt that the market was the only efficient mechanism for addressing the big social and economic challenges of the time. This belief fed on numerous examples of public managerial inefficiency and ultimately on the liberal fundamentalism that re-emerged from the 1970s onwards. All of this was assumed to be an inextricable part of "globalisation", an all-purpose argument used by conservatives to justify the radical changes affecting capitalism.

While the new paradigm developed in the advanced economies, it acquired a more extreme interpretation for countries on the global periphery. Here, conservatives consigned the nation state to the pantheon of history and spoke about the creation of a new international economic order based on the globalisation of production, markets and finance. In this new order, national

borders were meaningless, as was political debate, for there was no alternative but to follow the dictates of the global marketplace. The weakening of national sovereignty inevitably led to a dilution of popular sovereignty as well. Voting would become largely irrelevant, given the lack of meaningful alternatives.

### **3. The global crisis and the return of the state**

There is no need to revisit the reasons for the fall of this conservative paradigm. The roar of the crash, still under way, does not allow us to hear all the signals that the present crisis is sending. In the midst of it all, one can nonetheless hear pathetic calls for state intervention to rescue banks, insurance companies and industry. These calls cannot be ignored. Even if the firms in question are still run by the adventurers who created the chaos in the first place, their downfall would bring about unemployment, repossessions, cancelled pensions, and the disintegration of our social protection systems. Resistance to change takes the form of an unwillingness to call things by their names. To avoid old taboos, the salvaging of the banking industry is not labelled "nationalisation".

Clearly the state is back. It emerges as the only reliable response to the economic irrationality of the free market system. Its former detractors now bow before it, but are unwilling to show contrition. In developing countries, such as Brazil, the state's failings were largely caused by the encroachment of private interests, which suggests a democratic deficit. Concern about the state's renewed role in managing the economy should not serve however as a cover for cringing conservatives to deny responsibility for creating the global disorder into which humanity has been thrown.

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## **THE NEW INTERVENTIONIST STATE**

**Gunnar Folke Schuppert**

Discussions on the role of the state have always involved a search for appropriate metaphors. "The taming of the Leviathan," "the state in retreat," and even worse,

the “slim state” – between fitness and anorexia – are but a handful of examples. The most popular metaphor at present seems to be “the return of the lost Leviathan.” But this metaphor is misleading. The state is not returning from foreign exile. Instead, the state is reinventing itself by rediscovering its genuine institutional capabilities, its monopolies over rule making and taxation, and the privilege of not going bankrupt.

This is not to say that the functions of states have not changed over the years. We have witnessed, for example, the interventionist state in the age of industrialisation; the planned welfare state as the answer to the so-called “soziale frage” (social question); the corporate state as an arrangement between the state and organised interests; the preventative state as a still growing danger to civil liberties; and – last but not least – the ensuring state, which combines private entrepreneurship and public responsibility for the “common good”. Now, it seems, we are observing the birth of a “new (not a “neo”!) interventionist state,” spawned as an answer to the recent financial and economic crises of yet unknown dimensions. What will this state look like and what challenges will it face?

### **1. A new type of interventionism**

The “new interventionist state” will neither involve a friendly nor an unfriendly takeover of market governance. The new state configuration should be understood as government not by the state but with the state. It will bring about a new type of interventionism, one which is targeted i.e. allowing intervention only in cases and areas of system-relevant importance; phase-specific i.e. sensitive to developments in the crisis to be managed; conditional i.e. establishing clear rules of the game and clear exit options; and intelligent i.e. involving new modes of governance, especially hybrid forms of governance by private and the public sector actors.

### **2. The challenge of generating economic growth**

Meeting this challenge will require a predominantly economic debate about the possible incentives for generating economic growth. In this debate, economic expertise is indispensable, especially with regards to the intended and – more difficult – unintended side-effects of certain economic and industrial policies.

### **3. The challenge of regulating markets**

The state cannot be a viable substitute for the governing capacity of the market, and it should not become a dominant market actor. Its appropriate role is to be the “market-maker of last resort.” The state is or should be responsible for “working markets” by providing a regulatory structure which functions simultaneously as an enabling and a constraining framework. We therefore return to the notion of the “ensuring state” as a dynamic concept: that is, in good-weather times, we would have a soft regulatory state but, in times of severe crises, the state would become an interventionist regulator.

### **4. The challenge of transnational regulation**

The main difficulty presented by global crises, such as the current financial crisis, is that the problems to be solved are transnational whereas existing regulatory powers are still based on the nation-state. This results in a regulatory vacuum or gap, which serves the interests of uncontrolled non-state actors. International and transnational regulatory structures and institutions are needed. The G7/G8 meetings are not sufficient. They are an informal type of get-together. There is no secretariat, there are no compliance monitoring systems, and no formal rules. The usefulness of the IMF also seems limited. It has not succeeded in stopping any of the financial crises of the past 40 years – it did not prevent the debt crisis in Latin America in the 1980s, nor the Asian crisis in the 1990s, nor the present global crisis. Instead, what is needed is a formal international organisation with a secretariat led by a secretary-general, which can act as an independent transnational watchdog.

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## **RESTRUCTURE NOW**

Robert B. Reich

The current worldwide economic downturn is a manifestation of deeper structural problems in our economies. As a result of increasing global competition

and technological advancements, the US and other post-industrial nations have seen declining median incomes and a widening gap between rich and poor. Therefore, consumer demand in the US and other post-industrial nations has been insufficient to keep these economies running at full capacity. Other structural problems, including climate change and the west's dependence on oil and foreign capital, are growing as well. If we are to put our economies on the path of sustainable growth, a comprehensive structural policy is needed that prioritises the following:

### **1. Continue the stimulus beyond the current business cycle**

Those who support the economic stimulus as a desperate measure to arrest the downward plunge in the business cycle might be called cyclists. Others, including me, see the stimulus as the first step toward addressing the economy's deep structural flaws. We are the structuralists. These two camps are united behind the current stimulus, but may not be for long. Cyclists blame the current crisis on a speculative bubble that threw the economy's self-regulating mechanisms out of whack. They say that we can avoid future downturns if the Federal Reserve Board pops bubbles earlier by raising interest rates when speculation heats up. For structuralists, however, the stimulus is but a first step towards a more sustainable economy.

### **2. Invest in collective goods**

Solving the economic crisis will require increasing public investments in collective goods – renewable energy sources that emit far less carbon dioxide; life-long education that allows people to lead more productive and more fulfilling lives while reducing inequality; better health care, including improved public health; and a system of public transportation fit for the twenty-first century. Without policies that put America and other nations on a more equitable and sustainable economic path, we'll face deeper and more prolonged recessions, followed by ever more anemic upturns.

### **3. Do not make reducing the size of the federal debt a priority**

For structuralists, the size of federal debts is irrelevant. Debt has to be considered in proportion to the economy as a whole. According to government projections, the US national debt will exceed half the nation's gross domestic product by

the end of this year – not including the stimulus package. That's certainly high, but not close to a record. The US debt was far more than 100 per cent of GDP at the end of the first world war. That mammoth debt, put Americans back to work, financed industrial production, underwrote a new generation of science and technology and created a wave of demand for consumer goods when the war ended. It got the economy on a new and faster track, allowing the US to pay down the debt and ushering the country into a new era of widely shared prosperity. Even a high ratio of debt to GDP isn't especially worrisome if much of that debt comes from public investments that put a nation on a path towards solid growth.

#### **4. Raise marginal taxes on the most affluent**

However, gains from public investment might not produce enough economic growth to reduce the relative size of future debt. Since the late 1970s, a greater and greater share of America's national income has gone to people at the top of the earnings ladder. As late as 1976, the richest 1 per cent of the country took home about 9 per cent of the total national income. By 2006, they were pocketing more than 20 per cent. But the rich don't spend as much of their income as the middle class and the poor do – after all, being rich means that you already have most of what you need. That is why concentration of income at the top can lead to a big shortfall in overall demand and send the economy into a tailspin. A comprehensive structural strategy must therefore consider the tax code's structure and whether marginal taxes should be raised on the most affluent.

#### **5. Take advantage of the economic downturn**

The severity of the current crisis gives President Obama and other leaders more leverage to introduce structural changes in the economy. Even fiscal conservatives concede that when consumers stop buying and businesses stop investing, the government must step in as the buyer and lender of last resort. This downturn is revealing the flaws underlying the US, European, Japanese, and other economies. Once the business cycle turns up, the public and its representatives may be less inclined to tackle the things that truly drag us down. This was the problem that Clinton faced when elected in 1996, on the wave of a cyclical upturn in the economy. The structural problems that he failed

to address – widening inequality, sagging median incomes, a broken health-care system, crumbling infrastructure and global warming – loom that much larger in the US now, making the current crisis all the worse. Now is the time for progressives to face up to these challenges.

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## **A PEOPLE FIRST STRATEGY**

James K. Galbraith

In 1930, John Maynard Keynes wrote, "The world has been slow to realise that we are living this year in the shadow of one of the greatest economic catastrophes of modern history." Today, as then, we are in the shadow of catastrophe. Today, as then, our thinking is slow. We need to come to grips with the crisis itself.

Two ingrained habits are leading to failure. The first is to assume that eventually economies will return to normal on their own. In London in January, US Federal Reserve chairman Bernanke said, "the global economy will recover." He did not say how he knows. The fact that for months the news has been consistently worse than expected shows that the forecasts are wrong. Their basic failure is that they do not take account of the massive pay-down of household debt, everywhere underway, as a result of the collapse of the banks.

The second bad habit is to believe that recovery runs through the banks rather than around them. This idea holds that credit is "blocked;" it must be made "to flow." The metaphor is fallacious. Credit cannot flow when there are no creditworthy borrowers, no profitable projects. Banks have failed, and the failure to recognise this is a recipe for wild speculations and control fraud, compounding taxpayer losses. Thus the following measures, though far from exclusive, are needed now:

**1. Make economic forecasts realistic**

Economic forecasts should be consistent and realistic, with their point of departure being the consequences of debt deflation. Fiscal expansion programmes should therefore be geared to the actual scale of the crisis, not limited by the arbitrary thought that it will be shallow and short.

**2. Audit banks more honestly**

Competent regulators should take charge of troubled banks, install new management, and obtain an honest audit. A review of US loan files will show that fraud and misrepresentation were pervasive, that the market for bad assets cannot be recreated. Therefore, the condition of many major banks (US and foreign) holding sub-prime securities in quantity cannot be repaired without a pass-through receivership, reorganisation and recapitalisation. In Europe, the same conclusion will be drawn from fair examination of foreign-currency linked residential loans in central Europe, whether the individual credits were fraudulent or not. Audits will force action and restore confidence in the remaining healthy banks – nothing else can.

**3. Introduce effective financial regulation**

Financial regulation going forward should abolish tax havens, eliminate shell corporations and other forms of regulation-evasion, and restrict the carry trades and foreign-currency-linked debt instruments that fatally infected Iceland and central Europe in recent years.

**4. Keep people in their homes**

As this is a housing crisis, a critical need is for measures to forestall evictions and keep people in their homes, limiting chronic oversupply and collapsing values. This means measures to stop foreclosures or to permit foreclosed homeowners to convert to rentals under public management, with options to repurchase their homes when conditions improve. Measures adopted in the US may be adapted to meet conditions in other affected countries.

**5. Increase public retirement benefits**

Finally, an overlooked arena is a major opportunity. The crisis is dealing a major blow to the elderly in every aspect of their private wealth. Home values, stock

market values, and interest income are all being hit hard. This is surely the moment to increase public retirement benefits. In the US and in developing countries, a strong increase in social security benefits is called for. The European Union should start a European Pension Union, leveling up pensions payments in the poorer member states until a common minimum standard for Europe as a whole has been reached. This would have good effects on employment, and help to ease the mortgage crisis.

Some of these issues are long term but the time to start work on them is now. We are not in a temporary economic lull, an ordinary recession, from which we will emerge to return to business-as-usual. We are at the beginning of a long, profound, painful and irreversible process of change. We need to start thinking and acting accordingly.

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## **RECALIBRATING INDUSTRIAL POLICY**

Roger Liddle<sup>1</sup>

A new industrial activism is pivotal to how progressives respond to the global financial crisis and tackle the long-term need to rebalance our domestic economies. Anglo-America faces this challenge most acutely because the drivers of growth had become too dependent on financial services, cheap supplies of overseas capital, excess consumer debt and house price bubbles. But countries with strong export surpluses for which US demand has collapsed, or that have over-relied on the natural resource boom, may face similar long-term challenges.

For Europe, the political challenge is to devise a new activism that strengthens domestic capabilities and drives new sources of renewed growth without

<sup>1</sup> I would like to thank Simon Latham, policy researcher at Policy Network, for his excellent assistance in producing this piece.

descending into economic nationalism and protectionism and sacrificing the benefits of European integration and globalisation. Reverting to protectionism is not an option. So as well as giving substance to this new activism, we have to define the lines it must not cross.

### **1. At stake is the political acceptability of globalisation**

Anti-globalisation feeling was rising before the outbreak of the global financial crisis. The French rejection of the European Constitutional Treaty in May 2005 was a warning sign, while the increased support for right and left-wing populist parties in national elections is now echoed by the mainstream poses of some European leaders. The classic response of the “progressive redistributionist” is to say “ok – let free markets do their work, but we need stronger social protection and more redistribution to make this politically acceptable”. In other words, a “global Europe” must be a “social Europe” as well. But we must now go further. In the US, the Democrats have struggled to define policies that make the dynamics of globalisation politically acceptable. They have proposed strengthened trade adjustment assistance and “wage insurance”. But as Gene Sperling has pointed out, workers and their trade unions see these policies as “funeral insurance”: easing the pain of losing a “good job” by helping people obtain less secure, lower paid jobs elsewhere, probably in services. The political challenge is to develop a new activism with “new jobs that will be good jobs as well”. It is about creating the policy frameworks, getting the conditions right and supporting the growth of businesses that will deliver these outcomes.

### **2. Intervention has to be market-based and business-friendly**

A new industrial activism will not attract support if it does not learn the lessons of past failures. Governments cannot “pick winners”. Yet what they should do is mobilise all government arms to take advantage of new economic opportunities during low-carbon transition, and the pharmaceutical and new technology developments in an ageing demographic in western societies. To achieve this, better use of intervention from taxation to spending and regulation is required. We need to coordinate better action by government agencies on the ground, while ensuring that interventions meet specific business needs.

### **3. Classic horizontal policies to improve economic performance need to be deepened through recession**

Progressives support investment in skills development, infrastructure, in research and innovation, and financial help for small and medium size enterprises. During a recession these horizontal policies become yet more important. Progressives must ensure that businesses retain access to a wide range of finance, through generous and accessible loan and credit guarantee schemes and prevent the withdrawal of venture capital from domestic markets, where necessary by setting up new public-backed financial institutions, such as the revival of post-war 3Is (investment in industry bank) in the UK. Progressives should incentivise the maintenance of employer investment in skills, with the offer of targeted subsidies, while ensuring that the skills training on offer relates to specific future business needs. Progressives must maintain public investment in research and increase financial support for closer-to-market innovation: funds should be allocated through independent agencies on the basis of commercial and scientific judgement.

### **4. The new activism has to be sectoral as well as horizontal**

Within a deepened horizontal framework progressives must ensure that interventions are tailored for specific sectors or to meet new market opportunities. This broader market-based approach towards specific sectors is necessary for domestic industries to fully exploit emerging opportunities: for example, a comprehensive approach to the low-carbon transition which involves questions of skills, innovation, as well as infrastructure and planning. It is difficult to envisage a successful energy policy for the future without some return to long term state planning facilitating the investment in new infrastructure necessary for a low-carbon transition to become firmly entrenched; planning and coordinating this investment requires constant dialogue between government and business. Policy interventions which correct market failures, and provide a stable regulatory environment sector by sector, will help set the conditions of business success and are key to the new and recalibrated industrial activism.

### **5. Beware the ideo of protectionism: it is but a few steps from the crisis-induced economic nationalism of the past few months**

The renewed impetus behind industrial activism must lead neither to

protectionism nor excessive economic nationalism. The new industrial activism is about enhancing the capabilities of domestically based firms, not discriminating in favour of nationally owned companies. For Europeans, the importance of a strong EU is paramount in this respect. Rules over state aid levels must be enforced, while the regulatory parameters of the single market must be zealously guarded and its principles of free and open competition buttressed. The EU must also do its utmost to persuade the US not to entrench the worrying resurgence in protectionist rhetoric in Congress, exemplified by the inclusion of a "Buy American" clause in the Obama stimulus package. Renewed protectionism would also sink the prospects of a global deal on climate change that will be a crucial component in our collective transition to low-carbon economies: protectionism is a strong disincentive for leading emitters, such as China and India, to partake in such an agreement. That is why a commitment to complete the Doha Trade Round would be of huge symbolic and practical importance.

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## **IN DEFENCE OF PUBLIC POLICIES**

Aldo Ferrer

The current global financial crisis has triggered a lively debate on the role of the state in the shape and development of market economies. The free-market paradigm that prevailed prior to the crisis has now been swept away, just as it was in the 1930s following the Great Depression. The path to economic recovery will only be established through public policies. When considering the precise responsibilities of the state in this context, it is important to remember that these will vary depending on the level of economic development of each country. The recent economic history of Argentina, in particular its recovery from the 2001-2 crisis, provides important lessons for other developing countries attempting to respond to the challenges of the current crisis:

### **1. Observe public policies in successful emerging economies**

States in highly industrialised countries bear three principle responsibilities:

first, to oversee the functioning markets; second, to sustain stability of demand, production and employment; and third, to ensure social protection i.e. the creation of so-called "welfare states". States located on the global periphery must fulfil these functions but many others too. Developing countries should therefore observe the experience in the most successful emerging economies (South Korea, Taiwan, China, India and post-war Japan) rather than focusing their attention on the most highly industrialised and technologically advanced economies of the world.

### **2. Strengthen capacity to generate and manage knowledge**

States bear additional responsibilities in developing countries above all as a result of the weakness of the capacity of their societies to generate and manage knowledge, understood as the ability to make use of worldwide scientific and technological innovations for the betterment of society and economic growth. This in turn is the result of various factors, including fragmented societies, weak political institutions, and a narrow industrial base. Until developing countries are able to strengthen their capacity to generate and manage knowledge, the terms of their incorporation into the global economy will continue to be unfavourable. This increases the responsibility of states in developing countries to play an active role in generating growth.

### **3. Avoid indiscriminate market deregulation**

From the mid-1970s until the end of the century, Argentina followed an economic development path inspired by the dominant neo-liberal paradigm. This period witnessed the indiscriminate opening of markets, deregulation, and widespread privatisation of public services. The appreciation of Argentina's currency weakened the competitiveness of its domestic production, resulting in massive unemployment, excessive indebtedness and the selling-off of the country's principal assets to affiliates of trans-national corporations. These were the worst 30 years of Argentina's economic history, culminating in the default and economic crisis of 2001-2.

### **4. Restore the role of the state**

Consequently, the bankruptcy of the neo-liberal economic model, which we are witnessing on a global scale today, was experienced by Argentina as early as 2001-2. The Argentinean state emerged out of this crisis, restoring its fiscal and

monetary policies; recovering its redistributive functions (through salaries, taxes, subsidies etc); establishing the regulatory framework for private economic activity, including by foreign companies; and strengthening its capacity to manage public services and take control of private sector activity, when the latter violates contractual responsibilities. Today, Argentina has a state that can carry out these functions; our current challenge is making this state work as transparently and efficiently as possible.

### **5. Institute public policies that balance stability and growth**

Argentina's experience reveals that it is the responsibility of the state in developing countries to ensure economic stability and growth. This will require three key sets of policy measures. First, ensure balanced macro-economic policies to mobilise domestic resources and savings and make sure that economies remain relatively protected from external shocks; second, support the competitiveness of tradable goods sectors of national economies, to guarantee stable flows of domestic investments complemented by foreign ones; and third, strengthen investment in education, technology and social justice. None of this, in reality, is new as – contrary to neo-liberal tenets – countries remain responsible for their own future. Indeed, each country experiences the type of globalisation (and the economic crises) it deserves, according to the quality of its public policies. Briefly, it is necessary to ensure a sustainable form of development which balances growth alongside a general expansion of education and social inclusion.

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## **INNOVATING OUT OF THE CRISIS**

Robert Atkinson

While the causes of the global financial crisis are many, at the core there is one: Washington's belief in the primacy of unfettered markets. This belief is not just some random notion that happens to be in vogue. Rather, it lies at the heart of

the prevailing doctrine of neo-classical economics: the primacy of stable markets driven by rational actors responding to price signals. Whatever the challenge faced, the answer from the neo-classicists is largely the same: the market will take care of it. If a role for government is acknowledged, it is a strictly delimited one, so as not to “distort” the workings of the “market.” The current crisis demonstrates the failure of this doctrine as an effective guide to policy.

The centre-left now has a once-in-a-generation opportunity to shift the debate about the role of the state and the market. But unless they embrace the correct economic doctrine, their efforts will fail both economically and politically. For if in rejecting the neo-classical free market economic doctrine, the centre-left replaces it with the big government, populist Keynesianism that reigned during the post-war era, it will have failed to respond adequately. Neither neo-classical nor Keynesian economics provides an adequate guide for action in an economy transformed by technology, globalisation, and entrepreneurship. If we are to get out of the current economic maelstrom and ensure long term, broad-based prosperity, the following steps must be taken:

### **1. Put innovation at the heart of a new economic framework**

The most important step the centre-left needs to take is to embrace a new economic framework. That framework – innovation economics – reformulates the traditional model of economic growth so that knowledge, technology, entrepreneurship, and innovation are positioned at the centre of the model rather than seen as independent forces that are largely unaffected by policy. It is based on two fundamental tenets: first that the central goal of economic policy should be to spur higher productivity and greater innovation; and second that markets relying on price signals alone and actions by independent firms will not be as effective as smart public-private partnerships. If centre-left policymakers understand and embrace this doctrine, the likelihood of the right policies emerging is significantly higher.

### **2. Realise the global potential of digital information technology**

In a world being transformed by digital information technologies, it is time to set a goal of “making the world alive with information.” The last decade has been about connecting computing devices. Now we can connect the world, and in so

doing empower all citizens. This means creating intelligent infrastructure systems, including a smart electricity grid, real-time environmental monitoring systems, smart public safety systems, patient-centred health IT systems, and digital innovations in a host of other areas.

### **3. Abandon mercantilism in favour of an economic doctrine based on innovation**

The global economy, which has evolved into a beggar-thy-neighbor system where national advantage is at odds with global advantage, is crying out for solutions. At the heart of this dysfunction lie a host of mercantilist policies, including tariff and non-tariff barriers, subsidies to promote exports, forced technology transfers, theft of intellectual property, restrictive procurement policies, and tax policies that subsidise exports.

All nations must be encouraged to abandon mercantilism in favor of an innovation-economics doctrine that focuses on raising productivity in all sectors, not just internationally traded ones. Global bodies like the WTO need to work more proactively against beggar-thy-neighbor mercantilist strategies. International organisations, like the World Bank and the IMF, and national development organisations, will have to stop promoting export-led growth as a key solution to development. They will also have to go further and use their assistance to actually incentivise a rejection of negative-sum mercantilist policies by rewarding countries whose policies are focused on spurring domestic productivity, not on protecting the status quo.

Progressives are defined by their belief in progress. If they can embrace an economic doctrine that puts progress first, works to spur a digital transformation and enacts a win-win system of globalisation, they will have put in place the foundations for a lasting prosperity for all peoples. The right may blithely accept a fundamentally flawed global economic system, and the left may seek to return it to the days of old. The centre-left now needs to chart a course to a fully-integrated global economic system that works for workers, nations and the globe.

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## **A TRANSFORMATIVE STRATEGY FOR THE STATE**

Marcio Pochmann

The global crisis has exposed the false promise of neoliberalism. The countries which advanced most rapidly down the path of marketisation and state deregulation are now amongst the most vulnerable in a world undergoing rapid change. It is therefore not surprising that today, in our efforts to respond to the global crisis, we are witnessing a "return" of the state, even if the latter, in its current configuration, still lacks the transformative strategy needed to address the challenges of the 21<sup>st</sup> century. Yet, a new overarching development model is within reach and the new state will be a crucial part of it. The rise of this new development model is now possible due to new post-industrial trends: life-long education, admission to the labour market after the age of 25, and work that is associated less with survival and more with social improvement and creativity. Three overarching "axes" must serve as the basis for this process of restructuring:

### **1. Forging a new relationship between state and market**

The market, overvalued by the neoliberal consensus, ended up weakening rather than enabling economic competition. The latter was increasingly suppressed by the growing power and activities of large transnational corporations which effectively monopolised the markets. If we are to recover from the current crisis and advance towards a dynamic economy based on innovation, we will need to address this process of weakening competition as a matter of priority. One key step should be the creation of trail-blazing institutions, strong enough to break established monopolies thereby establishing the conditions needed for healthy competition and cooperation between enterprises. This will need to be accompanied by greater regulation of large private firms.

### **2. Establish a new social contract**

The indiscriminate process of privatisation which we have seen in recent decades has resulted in a rapid deterioration in social relations. A new development path is needed which strengthens public ownership over key collective goods, thereby triggering the emergence of a more transparent, democratic and just relationship between state and society. However, to create and sustain this 21<sup>st</sup> century

development model, it will be necessary to expand public finances. It should be possible to collect this additional revenue by reforming our tax collection systems so that they are able to capture new, more intangible sources of wealth.

### **3. Introduce a new model of public administration**

How best to organise systems of administration to make them responsive to people's needs has always presented a difficult dilemma. In the past, the state was fully in charge of this through bureaucratic systems. These systems followed an organisational model based around sectoral divisions and proved to be increasingly inefficient. With increasing market liberalisation, this model changed to allow room for private actors in delivering public goods. This led to the recruitment of external workers and outsourcing of government functions to private companies. It also presented unprecedented opportunities for lobbying by private groups. This resulted in increased corruption and an environment in which short-term goals outweighed long-term commitments. The current economic crisis reflects the corrosion of the state. It is now evident that neither the privatisation of public administration nor excessive reliance on rigid bureaucracies works. Now is the time to introduce a new model of public administration, which enables holistic and integrated public policies that respond to the needs of the people.

Only such a sweeping reform of the state will succeed in creating the necessary post-crisis conditions to uphold the new model of environmental, economic and social development.

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## **THE THIRD INDUSTRIAL REVOLUTION**

**Jeremy Rifkin**

The global financial crisis has shaken the very foundations of our economic systems. It has demonstrated that our models of economic growth, based on high-consumption and heavy use of scarce resources, are no longer sustainable.

Now is the time to move towards new modes of production. The way out of the crisis is to kick-start the third industrial revolution, which will also lead to a more sustainable economy for the future.

This revolution will be achieved through creating systems for decentralised renewable energy-use. The same design principles and smart technologies that made the internet possible are starting to be used to reconfigure the world's power grids so that people can produce and share renewable energy, just like they now produce and share information. The four pillars of the third industrial revolution will be:

### **1. The first pillar: renewable energy**

Renewable forms of energy – solar, wind, hydro, geothermal, ocean waves, and biomass will be key in the new economics. Progressive leaders need to establish targets for renewable energy and set in motion the process of vastly enlarging the renewable energy proportion of the energy mix of their economies.

### **2. The second pillar: buildings as positive power plants**

While renewable energy is available and new technologies are allowing us to harness it more cheaply and efficiently, we need infrastructure to load it. Progressive leaders need to ensure that millions of buildings – homes, offices, and other buildings – are renovated or constructed to serve as both power plants and habitats. These buildings will collect and generate energy locally from the sun, wind, garbage, agricultural and forestry waste, ocean waves and tides, hydro and geothermal – enough energy to provide for their own power needs as well as surplus energy that can be shared.

### **3. The third pillar: hydrogen storage**

In order to maximise usage and minimise costs, it will be necessary to develop storage methods that facilitate the conversion of intermittent supplies of these energy sources into reliable assets. While batteries, differentiated water pumping mechanisms and other media provide limited storage capacity, hydrogen is the universal medium that can “store” all forms of renewable energy to ensure a stable supply. Leaders need to institute research and technology initiatives to speed the process of commercial introduction of hydrogen technology.

#### **4. The fourth pillar: smartgrids and plug-in vehicles**

Power grids need to be reconfigured, along the lines of the internet, allowing businesses and homeowners to produce their own energy and share it with each other. The new smart grids or intergrids will revolutionise the way electricity is produced and delivered. The electricity produced could also be used to power electric plug-in cars or fuel cell vehicles. The electric plug in vehicles, in turn, will also serve as portable power plants that can sell electricity back to the main grid.

Just as second generation information systems grid technologies allow businesses to connect thousands of desktop computers, creating far more distributed computing power than even the most powerful centralised computers that exist, millions of local producers of renewable energy, with access to intelligent utility networks, can potentially produce and share far more distributed power.

The shift to a third industrial revolution infrastructure will require a massive public-private financial commitment. Laying out the new infrastructure will cost hundreds of billions of dollars. This may seem difficult at a time of crisis, but is even more essential to get our economies back on track. Those that argue that we can not afford it need to explain how they expect to re-grow a debt-ridden global economy dependent on a failing energy regime.

The third industrial revolution will bring with it a new era of “distributed capitalism” in which millions of existing and new businesses and homeowners become energy players. In the process, we will create millions of green jobs and dramatically increase productivity, while also mitigating climate change.

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### **THE PROGRESSIVE WELFARE MIX**

Maurizio Ferrera

As the financial and economic crisis deepens, the need for effective safety nets and social protection systems is today greater than ever. Yet the question of how

the welfare state can meet the new challenges in a sustainable way, considering demographic trends and budgetary constraints, remains complex. The following key issues should be given priority attention:

### **1. Introduce/redesign the safety net for the most vulnerable**

The “litmus test” for the welfare state is its effectiveness in alleviating poverty and promoting social inclusion. A successful anti-poverty strategy must provide resources to those most in need but also opportunities for them to (re)gain individual autonomy. Thus the so-called safety net must incorporate incentives for social and occupational insertion (including in-work benefits) and for personal development through commitment and learning. *Activation through workfare and “learnfare” is progressive.*

### **2. Focus on childhood and youth**

The prime objective of the 20<sup>th</sup> century welfare state was to guarantee economic security during old age. The prime objective of the 21<sup>st</sup> century must be that of promoting fair life chances to the young. This means investing in early child education and care, in educational quality more generally, and also in child-centred family policies: the so-called “lego model”. Education must become an organic and central component of the welfare state. It is of paramount importance to combat as early as possible the effects of the “social lottery” on individual prospects and attainment, promoting effective equality of opportunity and fair chances of social mobility. *Child-centred social policy is progressive. Investing in human capital and skill formation is progressive.*

### **3. Put female employment upfront**

Promoting female employment is good for growth and makes families less vulnerable – economically and socially. It is also in line with women's aspirations and increased educational credentials. High rates of female employment do not hamper fertility: quite to the contrary there is now evidence that it tends to favour it. Labour markets must be reorganised around the principles of gender equality and, more generally, non discrimination. Social policies must encourage the formation and meet the needs of dual “earner-carer” families, in which both partners share work and family responsibilities. *“Womonomics” is progressive. Gender equality and non discrimination are progressive.*

#### **4. Recalibrate social insurance**

The traditional catalogue of social risks must be updated and recalibrated, in both functional and distributive terms. Old age must be thoroughly redefined through policies of flexible retirement and “active ageing”. Dependency must be recognised as a new risk that can be countered through collective arrangements. Public health systems must guarantee universal coverage for high quality care, but must also be able to select cost-effective treatments. Prevention must become a top priority; medical risks and inequalities in health conditions should be combated by encouraging healthy life styles and behaviours. New schemes of universal insurance should be developed with a view to a) offering targeted support for coping with the adverse contingencies of the entire life cycle, and b) organising the provision of an adequate mix of benefits in cash, services, and time entitlements that individuals can combine as they need and wish for the pursuit of their professional and personal ambitions. Access to social insurance (old and new) should be designed so as to avoid labour market segmentation and the emergence of insider/outsider gaps. *Pension reform is progressive. “soft paternalism” in health care is progressive. A life-cycle approach to social insurance is progressive.*

#### **5. State or market? It’s the mix, stupid!**

The notion of “state vs. market” has become a false dichotomy for developing social justice strategies. The real challenge is that of identifying efficient, effective and equitable mixes between public and private arrangements, and developing adequate institutional capacities (including financial sustainability) for delivering a “fair distribution” of resources and opportunities. Welfare has traditionally been about security, equality, redistribution, and inclusion. Today it is also about personal autonomy, responsibility, capacity-building, and the expansion and enrichment of individual options. *A progressive welfare state rests on a dynamic mix of normative objectives and pursues them through intelligent mixes of public and private instruments, with the ultimate view of improving people’s chances throughout their entire lives.*

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*Maurizio Ferrera is professor of political science at the University of Milan*

## **REFORMING WELFARE AROUND WORKERS**

Dean Baker

The global economic crisis will have consequences at all levels of society, yet it is the most vulnerable who will be least well-equipped to cope. Governments must be bold in reorienting their policy agendas for the benefit of these groups. The following measures should be an important part of any progressive welfare reform agenda:

### **1. Sustain full employment**

The first principle of progressive welfare reform must be to strive for genuine full employment. It will be impossible to sustain an acceptable level of social welfare benefits if a large portion of the population is unemployed. The burden on public budgets will be too large. Sustaining full employment will require aggressive use of fiscal and monetary policy. The latter will require that many central banks abandon their focus on inflation targeting. Low rates of inflation are desirable, but there must be a trade-off against the costs of higher unemployment. The single minded focus on sustaining low rates of inflation to the exclusion of other concerns is recipe for disaster.

### **2. Restrain the costs of health care**

Health care, which is especially expensive in the US, is a substantial burden to populations everywhere. Any adequate welfare package must therefore include access to quality health care, but it will be very difficult to fund health care for large segments of the population if costs grow unchecked. Governments should thus seek to eliminate or reduce the barriers which raise the cost of health care. Most importantly, this will mean tackling patent protection for prescription drugs. Prescription drugs account for the fastest growing area of health care costs in the US and many other countries. This growth is almost entirely due to patent monopolies. In the US, the gap between patent protected prices and monopoly prices is approaching 2 per cent of GDP. If drugs could be sold at their competitive market price, they would be relatively cheap in almost all cases. More efficient mechanisms for financing prescription drug research, medical supplies and medical devices will also radically reduce their cost. If governments can effectively restrain the cost of health care, then assuring access to the entire population will be an attainable goal.

### **3. Provide access to benefits for low-wage earners**

Welfare benefits should not be disincentives to work. Rather, programmes should be designed so that benefits can be taken as a subsidy for work that is eventually phased out as income rises. By allowing low-wage earners to draw welfare benefits, governments will both encourage work and reduce the risk of creating a permanent group of welfare recipients. Creating a class of dependent people who are distinct from the working population is degrading to those affected and is likely to undermine support for government welfare programs. The earned income tax credit in the US is an example of a policy that effectively allows low-wage earners to benefit from subsidies.

### **4. Maintain high minimum wages**

Labour market policies should be designed in ways that increase wages for those at the bottom end of the wage scale. One obvious vehicle for raising wages for less-skilled workers is the minimum wage. Governments should maintain high minimum wages. A target of half the median wage, for example, would be reasonable.

### **5. Promote high skilled immigration**

Immigration policy is also an important factor affecting the wages of less-skilled workers. Most wealthy countries have de facto immigration policies that place their least-skilled workers in direct competition with immigrants from the developing world, who are often willing to accept very low pay by wealthy countries' standards. In contrast, formal and informal barriers largely protect higher-skilled workers from competition with their counterparts in the developing world. The predicted and actual result of this one-sided protectionism is to lower the relative wages of less-educated workers in wealthy countries. As an alternative, immigration policy can be designed to reduce the relative wage of more skilled workers by promoting the immigration of highly skilled workers from the developing world, thus leading to benefits for the less-skilled workers as well. To ensure that developing countries also benefit from this policy, wealthy countries can make payments to the home countries of immigrant workers to offset the costs of their education and training.

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## **THE FUTURE OF SOCIAL PROTECTION**

Clarisa Hardy

The social progress made in recent years in Latin America appeared in conjunction with universal social policies and increased social spending directed towards the poorest sectors in areas such as education, health, social infrastructure and connectivity, as well as basic services (sanitation, drinking water and energy). The speed and intensity of the poverty reduction process, however, are not only functions of increases in social spending towards the poor, but of ensuring that this spending is effectively distributed, through different formulas known as “conditional transfer programmes”: monetary subsidies linked to nutritional, health, education and housing programmes.

With the reduction in poverty levels, attention must be paid to vulnerability as a new social phenomenon. For large sectors of the population who today are above the poverty line, the risk of impoverishment is always present due to circumstances beyond their control. These circumstances include: precarious or lost employment, changes to family structures under single-breadwinner households (usually women), dependency conditions such as infancy, old age, illness or accidents. The risks of impoverishment are exacerbated in times of crisis.

Given this scenario, targeting policies only towards poverty is not effective. Rather, social policies should be progressively universalised towards vulnerable sectors. Depending on the country, these might represent 50 to 70 per cent of the low-income population. This, in turn, requires raising social spending, not only as a percentage of overall public expenditures, but in absolute, per capita terms. The way forward is through:

### **1. A new fiscal pact in favour of equity**

In a region which has the highest levels of inequality in the world (not only through the general distribution gap between rich and poor, but also due to the growing gap between the richest 10 per cent and the rest of the population), and whose tax burden is very low, the current challenges cannot be met without a new fiscal pact in favour of equity. A broad political and social agreement is required to achieve a “pact for equity”, which explicitly accepts a progressive

and countercyclical fiscal policy: an agreement on how much and how to link increases in social spending to increases in growth, as well as keeping social spending steady during periods of recession.

## **2. Institutionalised systems of social protection**

We must go from emergency policies or special programmes to institutionalised systems of social protection that are not subject to the whim of governments of the day and that are funded according to a logic of guaranteed rights. New economic and social dynamics require that social protection be available throughout the different stages of a person's life cycle, making families the recipients of social protection, and not its providers (as is currently the case, disproportionately punishing women – for their domestic responsibilities – and limiting their possible entry into the workforce).

## **3. Place employment and labour policies at the centre**

The importance that income plays in families' conditions places employment and labour policies at the centre of the social protection system (as opposed to the current Latin American experience, where social protection initiatives replace employment and labour policies, leading to loss of sustainability over time). What is required is: a) guaranteed family income; b) incentives promoting formal employment for young people and women; c) legislation protecting maternity/paternity (based on tripartite funding); d) unemployment insurance associated with training (based on tripartite funding); e) strengthening and linking labour market intermediation and skills training to the education system.

## **4. Guarantee equality of opportunity**

A rhetorical equality of opportunity is not sufficient; it must be guaranteed. Key to ensuring this goal are guaranteed rights in education and health such as: a) early childhood protection (from conception to entry into the educational system, which as well as leveling the playing field, leads to an increase in falling birth rates); b) at least twelve years of compulsory education with guaranteed universal quality standards; c) increasing accessibility (grants and state-guaranteed loans) and guaranteeing the quality of postsecondary education, be it technical or university; d) guaranteed access to healthcare, suited to diverse demographic and epidemiological needs.

## **5. Strengthen pension systems**

It is essential to strengthen the support pillars in pension systems. These include: a) guaranteed minimum pensions for seniors outside the pension system or with minimal savings; b) child bonus programmes encouraging motherhood (state-funded contributions to pensions for working mothers); c) state-funded contributions to pensions for young workers, thereby encouraging hiring of youth.

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## **IN SEARCH OF A NEW WELFARE STATE**

Anton Hemerijck

As the financial crisis deepens and spills over into rising unemployment and social duress, the need for resilient employment and social policy is greater than ever. We need to seize the moment for a major change in the way we think about 21<sup>st</sup> century welfare provision. Now is the time to modernise social services, safeguard pensions, and narrow the gap between rich and poor, while simultaneously consolidating state revenue. There needs to be a re-orientation in social citizenship, beyond freedom from want towards freedom to act. This involves prioritising high levels of employment while enabling a good work-life balance and guaranteeing a rich social minimum for citizens to pursue fuller and more satisfying lives. There are seven social policy priorities at stake:

### **1. Flexicure labour markets for all**

In the face of demographic ageing and a declining work force, nobody can be left inactive (for long). Impending redundancies should be mitigated by temporary and short term unemployment benefits, combined with additional training measures. Any kind of job is better than no job at all, especially to forestall long-term unemployment. The boundaries between being “in” and “out” of work have been blurred by increases in atypical work, low-wages, and subsidised jobs.

Yet the challenge is how to mitigate the emergence of new forms of labour market segmentation. Relaxed hiring and firing legislation is best combined with generous social protection and active training and labour market policies. The ability to balance careers and family-life also depends on effective employment regulation that recognises part-time work as eligible for social insurance, while also offering possibilities for career mobility.

## **2. Increased female participation in the labour market**

Depressed female labour participation widens the gender gap and constrains economic growth. Moreover, fertility also hinges on effective gender equality. This implies generous parental leave, employment security, and, especially, high quality child care. Higher fertility and higher female earnings lead to improved skills for future generations. Ultimately, this increases long-term productivity and significantly mitigates the adverse effects of population ageing.

## **3. Child-centred social investment strategy**

As inequalities widen, parents' ability to invest in their children's success is also becoming more unequal. Childcare demands cannot be adequately met via commercial care markets. And the dangers of inadequate childcare are immense. Inaccessible childcare and continuing gender biases in labour market policies will lead to low fertility; low quality care is harmful to children, and low female employment increases child poverty. Increasing opportunities for women to be gainfully employed is a key step. But the concept of early childhood development needs to go beyond the idea that childcare is necessary to allow parents to reconcile work and family life. A comprehensive child investment strategy with a strong emphasis on early childhood development is imperative. A "child centered social investment strategy" is needed to ensure that children will be life-long learners and meaningful contributors to their societies.

## **4. Lifelong human capital investment push**

In the new, knowledge-based economies, there is an urgent need to invest in human capital throughout the life of the individual. Considering the looming demographic imbalances in Europe, we cannot afford large skill deficits and high school dropout rates. Social and employment policies that are aimed

at increasing skills and developing the quality of human resources act as “productive factors” in our economies.

### **5. Later and flexible retirement**

As life expectancy increases and health indices improve, it will be necessary to keep older workers in the market for longer. Sustainable pensions will be difficult to achieve unless we increase employment rates of older workers and raise the retirement age to at least 67 years. Delaying retirement is both efficient and equitable. It is efficient because it implies more revenue intake and less spending at the same time. It is also inter-generationally fair because retirees and workers both sacrifice in equal proportions. In the future, older workers will be much better positioned to adapt to new labour market conditions, with the aid of retraining, lifelong learning, and flexible retirement.

### **6. Migration and integration through participation**

Priority should be given to problems of participation and integration of migrant groups, whose rates of unemployment in the EU are, on average, twice that of nationals. In our ethnically and culturally diverse societies, the welfare state faces a major challenge in ensuring that immigrants and their children do not fall behind. Economic exclusion and physical concentration (ghettoisation) reinforces educational underperformance, excessive segregation and self-destructive spirals of marginalisation.

### **7. Minimum income support**

We cannot assume that the measures described above will remedy current and future welfare deficiencies. Hence, it is impossible to avoid some form of passive minimum income support. An unchecked rise in income inequality would worsen citizens’ life chances and opportunities. Widespread low-wage employment poses a scenario of overall insecurity for a large section of society. It is, therefore, necessary to have an even more tightly woven net below the welfare net for the truly needy to meet minimum standards of self-reliance.

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## **A SOCIAL CONTRACT FOR THE GLOBAL AGE**

Will Marshall

Fate – or, more precisely, his White House predecessor – has dealt President Barack Obama a stupendously lousy hand. On the economic front, he faces not one huge problem but three: the worst banking crisis since the Depression, what seems likely to be the longest recession since World War II, and an exploding public debt that threatens America's fiscal stability. This triple whammy will hit the poor and children (tomorrow's taxpayers) especially hard. For this reason, however, the crisis could accelerate Washington's lagging efforts to write a new social contract for the global age. For example, President Obama's 787 billion dollar economic stimulus plan includes billions to expand food stamps, extend unemployment benefits, aid troubled urban schools, and help the states pay health bills for poor families. It remains to be seen whether this spending spurt will be temporary or lead to a permanent strengthening of the social safety net. What else could the Obama administration do to lessen inequality and spur social mobility? Here are five ideas:

### **1. End childhood hunger in America by 2015**

Nearly 700,000 poor US children go hungry and more than 12 million suffer from what the government calls "food insecurity," meaning their families struggle to meet their daily nutritional needs. For a remarkably modest investment, roughly 5 billion dollars a year, Washington could end this disgrace by expanding food stamps, providing all children with a free school breakfast, and streamlining the welter of federal food programmes and bureaucracies.

### **2. Making work pay for men, too**

One of America's most successful anti-poverty programmes is a tax credit for low-wage workers, which President Clinton persuaded Congress to expand dramatically as part of his campaign to reduce welfare dependence. That credit aimed at making work more attractive than the dole for single mothers. Now it's time to extend this "work bonus" to low-income men, whose work rates have lagged well behind those of women.

### **3. Investing in early education**

A glaring source of inequality in America is the education achievement gap:

poor and minority students score significantly lower on reading and math tests than their middle class counterparts. Recognising that such kids come to school with big cognitive deficits, progressives are calling for national investment in early education for three- and four-year-olds. Their case is buttressed by a growing body of research showing that dollars spent to develop young children's mental and social capacities have a much larger economic payoff than later remedial programmes.

#### **4. Closing the graduation gap**

In America's inner city school districts, as many as 60 to 70 per cent of kids – mostly Latino and black – fail to graduate from high school. The problem isn't money, it's motivation, which takes more intensive concentration on at-risk students than our old, factory-style public schools can provide. One remedy is school autonomy – letting school leaders call the shots rather than rule-bound central bureaucrats. Another is to challenge outdated rules, like lifetime tenure for teachers, which prevent self-governed schools from hiring the best teachers available.

#### **5. Dismantling the fiscal doomsday machine**

The baby boom retirement has begun to hit America with the force of a demographic tsunami. With about 4 million boomers reaching retirement age each year, the cost of America's social insurance programmes, especially Medicare and social security, are spiralling. As formula-driven entitlements, they are growing automatically and, especially in the case of health care, at unsustainable rates. They already consume nearly half the federal budget, and if not revamped will inexorably squeeze out fiscal space for investments in education, health care, safety, the environment, clean energy, transportation and other public goods – everything, in short, that progressives ought to care about.

Many, however, have been loath to face an inconvenient truth: we must renegotiate the intergenerational contract embedded in America's big social insurance systems. Fortunately, President Obama has declared himself "ready to spend political capital" on entitlement reform. He recognises that it is the only way to balance the twin economic imperatives of stimulating the economy in

the short run, and assuring US fiscal stability in the long-term, which requires reducing public debt as the economy recovers.

This fiscal balancing act, in fact, could very well turn out to be the central drama of Obama's presidency.

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## **PROTECTING THE VULNERABLE IN THE WORLD'S MOST UNEQUAL REGION**

Bernardo Kliksberg

The World Bank has predicted that Latin America will grow at a rate of only 0.3 per cent in 2009, fifteen times less than the average rate of 4.7 per cent over the last five years. Such a drastic drop in the growth rate would have a severe impact on any economy, but in the world's most unequal region, the consequences are likely to be even worse. At least 4 million jobs will be lost. The decrease in remittances from abroad will seriously affect 20 million families who depend on them. The region was already behind on meeting its Millennium Development Goals, especially in terms of maternal mortality and school drop-out rates. Despite progress, social security coverage is low and unemployment insurance is extremely limited. To strengthen public policy in Latin America is not a choice; it is the only way to prevent a potentially explosive situation. Progressive leaders must take the following steps:

### **1. Prioritise protection of the weakest**

Over 35 per cent of the region's population lives in poverty. Poverty rates are much higher among indigenous populations (80 per cent), Afro-Americans and the elderly. Unlike the middle and wealthy classes, these groups do not have savings to protect them from the crisis. Without public policies to aid them, they are defenseless. Instituting such policies might be difficult, but it can be done. One example is the way Brazil was able to implement the largest social programme in its history, Bolsa Familia, which protects 12 million of the poorest households.

Conditional cash transfer programmes that currently apply to over 80 million people must be strengthened and expanded.

## **2. Promote youth education and employment**

One in every four young people are outside the educational system and the employment market. Youth unemployment is double the general rate. Vigorous policies to promote youth employment and education must be designed. Chile, among others, has had very good experiences of public-private partnerships in this area. Argentina, in recent years, has also implemented creative programmes to encourage secondary school completion, and aid in establishing small businesses and cooperatives.

## **3. Invest in health and education**

Investment is urgently needed in health and education services, which in the majority of our countries are inadequate. The crisis could be lethal, increasing the already high levels of infant mortality, maternal mortality and malnutrition. And the damage caused by this could be irreversible. Costa Rica, where health and education are constitutionally enshrined, has immediately allocated the required resources for further investment.

## **4. Utilise public spending to generate employment**

Public policy must focus on the internal market. What is necessary now is the extension of credit; support for small and medium sized businesses; and investment in infrastructure, transport and other areas with a direct impact on employment. Amongst other initiatives, the strong public works programmes being implemented in Argentina, Mexico and Ecuador, point in the right direction.

## **5. Review the fiscal system**

The current fiscal system, which is regressive and inefficient, must be reviewed. It is possible to make it more progressive, and reduce the current tax evasion rates of 50 per cent. This would result in greater revenue that could be utilised for the initiatives mentioned above. Other potential sources of income could come from introducing taxes on luxury goods and expenses, eradicating corruption, and reducing military spending, which increased by 91 per cent between 2003 and 2008.

## **6. Forge alliances**

Leaders will have to forge a widespread consensus for the policies described above and also for other responses to the crisis. They must build alliances with the private sector through the increasingly prevalent concept of corporate social responsibility. Engaging civil society by encouraging volunteer work will also be necessary in social initiatives.

Will it be feasible to implement the ideas described above? Latin America has some advantages, which will be useful for the process of implementation. It has survived the market fundamentalism of the 80s and 90s, which caused disastrous damage. Those experiences have led the great majority to reject market fundamentalism. On the other hand, there is an active process of democratisation. In the last three years, over 80 per cent voted for change. From these election results, it is clear that people favour economic models with a human face. Citizens not only support, but are demanding, policies that put people first.

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