DILEMMAS IN GLOBALIZATION
Exploring Global Trends and Progressive Solutions

A collection of essays directed by Josep Borrell Fontelles

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Table of Contents
Click on the titles for direct access

Introduction............................................................................................................ p.1

i. Aid and Development for a New Globalization
Josep Borrell Fontelles................................................................................... p.5

ii. The European Union and Globalization - A progressive agenda for the future
Martin Schulz................................................................................................ p.12

iii. Global Greed Paves the Way for a Better Globalization
Poul Nyrop Rasmussen.................................................................................. p.21

iv. Building an Architecture for a Fair Globalization
Juan Somavia................................................................................................ p.26

v. Jobs, the Missing Link
Guy Ryder..................................................................................................... p.36

vi. Collective Bargaining in the Global Economy
Larry Cohen and John Logan......................................................................... p.44

Joan Benach, Carles Muntaner, Orielle Solar, Michael Quinlan, Haejoo Chung and Montse Vergara Duarte, Wilma Santana.............................................. p.54

viii. A Progressive Agenda: Labour and Social Protection
Conny Reuter................................................................................................ p.71

ix. Redistribution in the Age of Globalisation - In Search of a New Economic Imperative
Javier Ramos Diaz.......................................................................................... p.76

x. Trade, Part of the Solution to the Current Economic Crisis
Pascal Lamy.................................................................................................... p.84

xi. Africa and Europe Together?
Aminata Traoré............................................................................................... p.88

xii. The Development Agenda as a Global Social Contract
Nancy Birdsall................................................................................................ p.94
xiii. Ensuring a Better Deal for Women
   Jayati Ghosh........................................................................................................p.106

   Praveen Jha........................................................................................................p.114

xv. Gone with the Offshore Wind - Tax, Economy Justice and the Development Agenda
   Marta Ruiz Carnés..........................................................................................p.127

xvi. Community Banks - Microcredit (the Brazil experience)
   João Joaquim de Melo Neto Segundo..................................................................p.142

xvii. Tax Havens, Tax Evasion, Regulatory Avoidance and Uneven Globalization
   Christian Chavagneux, Richard Murphy and Ronen Palan..............................p.151

xviii. The Case for Europe as a Global Ruler Setter
   Pervenche Berès..........................................................................................p.164

xix. Financial Crisis and Real Economy
   Prabhat Patnaik..........................................................................................p.170

xx. Global Financial Crisis...to World Economic Crisis
   Francisco Rodríguez Ortiz..................................................................................p.179

xxi. Towards a Global and Ethical Approach for Environmental Challenges
   Cristina Narbona Ruiz....................................................................................p.191

xxii. Climate change, the EU and Markets for Emissions
   Navraj Ghaleigh............................................................................................p.198

xxiii. Participatory Budgeting: Understanding the new role of participatory institutions in contemporary politics (the case of Brazil)
   Leonardo Avritzer............................................................................................p.209

xxiv. Democracy and New Technologies: Democratic Innovation or Illusion?
   Fernando Mendez............................................................................................p.224

xxv. A Real New Deal: Progressive Global Governance and Democratization
   Zita Schellekens............................................................................................p.237

List of contributing Authors............................................................................p.245
Introduction

A Crisis of Inequality

Today we are not only living a financial crisis but a crisis in globalization. The crisis started in the financial system but has spread to every aspect of the economy, creating socio-economic disequilibrium. In order to save the financial system we have invested billions of dollars but the problem is not to save only the financial system by restoring credit, but to sort out the huge structural economic problems which are at the origin of the crisis. In my view, the growing inequality worldwide is at the heart of the problem. This is the most important dilemma we must face; to restore a system that recompenses the rich, or transform the system using a model of integration to eventually increase overall equality.

If national income had been distributed more fairly, with lower profits and higher salaries, the economy would have been more stable and more durable. If the wealth that was speculated had been distributed, in the form of lower prices and higher salaries, we would have been able to avoid, or at least minimize, the current crisis.

It was along these same lines that M. S. Eccles, President of the US Federal Reserve from 1934-1948, identified the causes of the crisis in 1929 and the great depression which followed. One could say the same of the present crisis; that it is due to the unsound distribution of income, to the growth of inequality in developed countries and to the supremacy of financial speculation over the real economy.

The crisis which we are suffering, global and systemic, is to a great extent the crisis of a model based on the growth of inequality. Too much profit and too many extravagant salaries for some and a mass capital which feeds the speculation of the stock market, each time leveraging more risk. Salaries which are too low and poverty among the middle class has driven credit consumption to the exploding point of debt; thus credit is no longer a socially extended and economically solvent request used for investment into new fields of real production.

All of the data reflects that since the beginning of the 80’s, there has been a slump in the distribution of income and an increase in profit margins. Those countries with the most developed social systems are the best positioned to withstand the crisis, whereas the USA, with a meager social security system and where the superior decil has exceeded the 27% to 55% of the income, is doing worse. We should not forget that this crisis is from the outset very much an American tale. At the beginning of the 70’s, the director of General Motors, a company of reference at that time, earned 88 times more than the average salary of his employees. The Director of the company of today’s reference, the distribution chain Wal-Mart, earns 1,300 times more than the average salary.

The emergence of exporter economies has created a wider working market with a global excess of labour, an increase in competition in the property market, a better profitability demand of capital under the threat of off-shoring, and a strong downward pressure on wages.
In this way, the compromise between the capital and labour constructed in the post-war period was broken. The evolution of real salaries was disconnected from the productivity generating a real-wage deflation. This transformation in the distribution of income implied a change in the macroeconomic growth adjustment. Consumption moved away from income, turning to credit which became the stimulus of demand. Companies, in order to increase value for their shareholders, substituted capital with debt each time they had not launched strong enough corporate transactions which would normally give a guarantee of the same value as when they bought them. In Spain, we know a lot about this. Some of our main business figures have generated fortunes and others have been left, or will be left with nothing.

The result has been a spectacular increase in private debt, both for families and companies, and a fall in the rate of savings. In Spain especially, non-financial companies and family debt in 2006 was at 188% of the gross domestic product, a rate only equivalent to that of the UK, but 50% higher than Germany and France. One must say to be fair that the American growth model, based on credit-financed consumption, and the speculative bubble in the real-estate sector, has had two good replicas in Europe, Spain and the UK. While we were all extremely pleased with the reduction of the deficit and public debt, the private sector was accumulating a mountain of financial debt with external savings.

The crisis which provoked a trend of increasing debt was promoted by the Central Bank, and especially the Federal Reserve, lowering interest rates and in turn further increasing debt. The financial innovation allowed the banks to transfer risk and as a result, value it with less severity, freeing up capital in order to extend more credit.

Now the excess of debt must be reduced and the recession is fed by the interaction between the fall of income and credit. Only the State can make the vital changes needed to maintain activity and bring about the new financial regulations necessary to avoid further excesses. This is where we are now.

However, this will not alone be sufficient to generate stable growth. If the debt is no longer able to bring about growth by way of credit consumption, it will be necessary to increase wages in line with productivity. This is a necessary requirement for the success of any recovery plan including recovery for the financial systems.

**What’s next: a tentative exploration on what should be done?**

It follows that growing inequality has become the cornerstone of the current crisis. This problem affects other socio-economic spheres such as economic migration, human-trafficking and informal economy that result in a steady deterioration of working conditions worldwide. This explains why in the emerging economies of the world, more GDP does not necessarily mean more or better jobs, nor a steady improved in social cohesion.

The "winners" in globalization are devoting only a very small share of their increased GDP to social security and cross-national differences in social expenditure are huge. The ever-growing informal economies in developing countries means less state investment in infrastructure and thus little progress in overall development. In fact, there is a steadily growing gap between the emerging middle-class and the poor. Given the capital accumulation over the past several decades, the developed economies of the world have done relatively little to contribute to development worldwide. Free trade has been one of the great achievements of the 20th century
but if we look further, we can see that despite some benefits, there have also been devastating effects from trade imbalances throughout the world.

The following publication is a collection of diverse and progressive voices (academics, politicians, NGO’s, and civil society leaders) who speak out for a new globalization. One in which not only the developed economies of the world, but also the least developed will benefit from trade, capital flows, innovation, and all the potential that globalization has to offer.

There will be much discussion about the Decent Work Agenda and how the current growth model has negatively impacted the labour market by experts and leaders in the field such as: Juan Somavia (President of the International Labour Organisation), Guy Ryder (President of the International Trade Union Confederation), Conny Reuter (Secretary General of SOLIDAR), and Larry Cohen et al (President of Communication Workers of American Union). We will also look at social policy and social cohesion in depth with Javier Ramos (policy advisor to the GPF); and Joan Benach (EMCONET) et al will discuss employment and health inequalities. This will help us to see the consequences that this liberal system has left on the welfare state and particularly on those most vulnerable.

During this crisis in globalization, among the most vulnerable in developing economies are women and immigrants; themes to be treated by Professor Jayati Ghosh and Professor Praven Jha, (both from JNU, New Delhi.) Greed and a deficient understanding of our inter-dependence are at the root of the lack of commitment among rich economies to contribute their share fare to developing nations. Nancy Birdsall (President of the Centre for Global Development) as well as I myself, will explain that it is not only a responsibility, but in the best interests of developed economies to invest in developing nations so that underdeveloped economies are not continually the losers in globalization. And Aminata Traoré (Forum pour l’autre Mali) will discuss Europe’s role in partnership with the developing countries in Africa. We will also explore the themes of tax havens with Marta Ruiz Carnés (Policy Advisor, EURODAD) and see why they are so detrimental to the development agenda. Finally we will look at progress that has been made on the development agenda, particularly in the area of micro-credit, to be discussed by João Joaquim Del Melo Neto Segundo (Director of Instituto Palmas, Brazil.)

Despite all the ‘glories’ of globalization, the current liberal policies have provoked an unprecedented world-wide financial crisis. Professor Rodriguez (Deusto University, Bilbao), and Professor Patnaik (JNU, New Delhi) will examine in depth the processes that have brought us to the brink! Pervenche Berès (Chairwomen of the committee on Economic and Monetary Affairs in the European Parliament) will examine the history behind the financial rules and regulations that have driven the global economy and make a case for Europe to take the lead in reforming the system.

We will examine the forces behind this liberalization such as unbridled capitalism, speculation, fiscal policies, and fiscal paradises. These ‘paradises’ are also having a profound effect on the global economy. They allow the rich to hoard their gains rather than reinvest in productivity, and deprive states (especially emerging economies) of much needed tax revenues to reinvest into infrastructures and local economies. Christian Chavagneux et al, (Deputy Editor of Economique Alternatives, Paris) will discuss the tax havens and their role in the breakdown of the economy. The liberalization of the financial markets has actually produced greater volatility in the economic cycles, instead of stimulating more investment into new
infrastructure and productivity which would stabilize the world economy over the long-term.

Trade liberalization has also transformed the global economy but has it increased capital accumulation and job creation, or just served to relocate investment and jobs? Pascal Lamy (Director General of the World Trade Organisation) will explain the sometimes hidden drawbacks to this liberalization and propose alternative ideas so that trade can become beneficial to all stakeholders.

Although we have reaped many benefits from industrialization, we have also reaped the tremendous global challenge of climate change. Emissions of greenhouse gases are producing ever-increasing global annual temperatures resulting in dramatic climate change. We are only beginning to understand the wide-ranging effects of climate change on food production, migration, ecology, manufacturing, and in a multitude of other domains.

The more we grasp the extent of these effects, the more we comprehend how these changes are they are not only destroying our planet, but are collectively devastating the global economy and prosperity. The extensive reach of this problem will be explored by advocates in the field like Mr. Navraj Ghaleigh, (Professor of Public Law and Environment, Edinburgh) and Ms. Cristina Narbona (Spanish Ambassador to the OCDE and former Spanish Minister of Environment). They will discuss how climate change implies growing risks for the global economy, and especially for the most vulnerable on our planet, but they will also present potential solutions and progress that can be made towards a greener globalization.

Though globalization has produced much capital accumulation, it is still in the hands of a few powerful economies, and controlled by even fewer states. Instead of increasing democracy world-wide, many of the current global processes have increased inequality, trade imbalances, and poverty, and thus hindered the growth of democracy. In the final chapters of this book, different experts will examine possible ways to democratize global processes, such as Professor Avritzer (Federal University of Minas Gerais, Brazil) who will discuss participatory budgeting, and Fernando Mendez (Director of the e-Democracy- Center in Zurich) who will explain the possibilities that e-democracy offers to a new model of globalization. Zita Schellekens (IUSY, PVDA) will discuss the role of youth in democratic processes and Mr. Martin Schulz (President of the Socialist Group in the European Parliament) will discuss why the EU must take the lead in pushing a progressive agenda to bring about a more democratic globalization.

Looking at the fore mentioned subjects, it is clearly evident that despite much growth, the liberal model of globalization benefits only a portion of people; however the burdens of growth are spread out among the most vulnerable economies and peoples of the world. In this book we propose to offer new insights and reflections on globalization that will transform our thinking and hopefully inspire many to combat the oppressive liberal policies of the past few decades. Together progressive voices worldwide can bring solutions and breathe new hope into global processes; in search of a new globalization.........

Josep Borrell Fontelles
Chairman of the Global Progressive Forum
Member of the European Parliament and Chairman of the Development Committee
As President of the Development Committee in the European Parliament, I have had the opportunity to observe first hand just how awful the world we live in has become. Current inequalities have widened the North-South gap, tensions have worsened in a more and more interdependent world, and climate change has become a real threat that can no longer be ignored.

The year 2008 witnessed the re-emergence of famine as a consequence of a boost in agricultural products that proved to be stronger and quicker than petroleum. Afterwards, a brutal slowdown in the worldwide economy started, leading to the present global crisis. Once again, the developing countries will be the most vulnerable as they suffer the consequences of the decrease in their exports, in their emigrants’ remittances and in international development aid.

One should start by analysing the evolution and the actual perspective of the Official Development Aid. After a protracted decline during the 1990s, funding for Official Development Assistance (ODA) has grown steadily over the last decade. The share of ODA directed to low-income countries has been above 60% since the 1970s, and reached about 67% over the 2001-2005 period. Sub-Saharan Africa’s share of total ODA has been growing for almost half a century, from a little more than 20% in the 1960s to over a third of total ODA today. The share of the social sectors in total sector allocable ODA to low-income countries has also grown, from 29% in the early 1990s to 52% in 2000-2004. However this increase of ODA is deceiving because much of it has been due to debt relief, and to a lesser extent to emergency assistance and administrative costs of donors.

Donors promised to increase funding by some $50 billion a year by 2010 compared with 2004, but OECD (Organization for Economic Cooperation and Development) studies of their budget allocations found a shortfall of some $30 billion and the Development Co-operation Report calls on donors to boost their forward spending plans. Actually aid is expected to decrease in 51 countries in between 2005 and 2010, mainly in Africa and Asia. Four of these 51 states are in situations of conflict or fragility, thus programmed decreases could radically impede their recovery.

The manner in which aid is given and spent is as critical as is the amount. Developing countries also have their own role to play in ODA. For instance, they could increase their revenues sharply by strengthening their tax systems ensuring that those who are able to pay do so, plugging the drains of tax evasion and avoidance, and battling corruption. When receiving countries have better means, both economically and in infrastructure, they can better prepare and coordinate forecast projects and thus greatly increase the effectiveness of any aid given.
**AID and MDGS (millennium development goals)**

The global poverty reduction impact of aid varies with its allocation across countries. This affects donors’ allocation criteria: should they go for maximum global poverty reduction or should they aim at reaching the MDGs in each country? Should aid compensate disadvantaged countries and try to create equal opportunities for all? These alternatives have a substantial impact in terms of foregone global poverty reduction.

Unless the sector targeting of aid becomes more focused on MDG needs, even much larger amounts of aid may not be enough. Various developing countries, particularly those in Sub-Saharan Africa, will in all likelihood miss not only the most prominent MDG of halving absolute poverty by the year 2015, but also the more specific targets, like those related to health and education. Rich Western nations are urged to stick with the UN Millennium Development Goals (MDGs) despite the turbulence in the global economy. A report released prior to the meeting of the UN MDGs in New York in September 2008, found that development aid needed to increase by $18 billion per year between 2008 and 2010 to meet the Official Development Assistance (ODA) pledge by developed countries towards fulfilling the goals.

The global financial crisis needs to be addressed independently of matters relating to aid towards MDG commitments. It is all too easy for rich countries that have been hard hit by the financial crisis, to shy away from earlier ODA commitments or justify the unfeasibility of increased ODA spending. However, what these countries often refuse to acknowledge is that while their country may be experiencing higher levels of unemployment or foreclosures, in many developing countries the crisis is translated into even wider-spread poverty and mass-starvation. Thus, during this time of economic upheaval it is vital that each individual country carry out their own responsibility to deliver on the goals.

1. **Financing for development**

As the rich world struggles to deal with its financial crisis, the commitment made at the Gleneagles G8 Summit in 2005 to deliver $130 billion in official development assistance by 2010 seems less and less likely to be met. Even before the crisis there were questions as to how these commitments would be implemented. In the last few years aid numbers have been inflated by large debt relief programs, which do not involve cash transfers, but merely write-offs of often worthless debt. But most debt has now been forgiven and the aid numbers are slipping again.

The question is how can the current level of ODA be optimized? What possibilities are there to improve financing for development? We need not only to mobilize more ODA, but also to make sure that this is spent wisely on those types of infrastructure, services and social protection that provide the maximum benefit for the world’s most vulnerable people. Consequently, we should focus much discussion on aid effectiveness, as we did in the Accra Conference in September 2008. All the more so, given that the outcome of Doha proved to be less then successful.

For sometime now the effectiveness debate has been narrowly focused on growth, the new obsession among some bilateral donors, but the time has come to move forward and focus on its impact on poverty. This is especially so for chronically poor people, many of whom get left behind by growth, even if aid does help to raise the recipient countries’ growth rate.
We also need to move the debate on innovative sources of finance into the fast lane. It has pattered along since Monterrey despite the best efforts of the Action Against Hunger and Poverty Initiative of Brazil, France, Chile and Spain that was launched at the UN in 2004. Since there are such vast and diverse proposals on innovative finance, the best way to accelerate progress would be to focus on the moment on just one or two of these proposals.

The nexus between finance and climate change is one obvious focal point. At the just-concluded UN MDG summit, the EU, Mexico, Norway, and Switzerland were among those states pushing on the climate change issue. In particular, carbon taxation has come to the forefront. According to a Swiss Government proposal, a $2 per ton levy on carbon dioxide would raise around $48 billion per year. This is a brilliant way to raise funds using the riches and waste of the developed world to finance desperately needed aid in the developing countries, while at the same time promoting cleaner air, and a better environment from which all global citizens can benefit.

**Aid effectiveness, fragmentation and emerging donors**

The global aid architecture has become increasingly complex, with the growing importance of non-DAC and other “emerging” donors as well as with a high degree of aid proliferation and ODA fragmentation. New donors bring with them more resources to help developing countries reach the Millennium Development Goals, but also new challenges for coordination and standardization, in particular as limited data is available regarding aid volumes and terms. The impact of the proliferation of aid channels can be seen from the perspective of both donors and recipients.

From the donors’ viewpoint, earmarking, in addition to complicating budgetary management, may lead to a misalignment between donors’ and recipient countries’ priorities. By constraining recipients’ flexibility in allocating resources, earmarking may contribute to under-funding of other investments which are more important for economic growth and poverty reduction, while funding certain projects that are much less cost-effective.

From the recipients’ viewpoint, the growing importance of sector/thematic international organizations and private donors further increases the complexity of the aid architecture. The problem is particularly pronounced in the health sector, where the effectiveness of increased ODA will rest on finding an appropriate balance between providing resources for disease and intervention-specific health programs, and for strengthening health systems.

The Paris Declaration signed in March 2005 following a 2nd High Level Forum, is a sign of progress, albeit uneven across countries and donors. This international agreement of over one hundred ministers, heads of agencies and other senior officials, committed their countries and organizations to increase efforts in harmonisation, alignment and management of aid for results, with a set of monitorable actions and indicators. The declaration lays down a practical, action-orientated roadmap to improve the quality of aid and its impact on development. The 56 partnership commitments are organized around the five key principles: ownership, alignment, harmonisation, managing for results, and mutual accountability.

Despite the proposals made, some international actors seem to see the Paris agenda as an end in itself, rather than one of a number of means to improve aid quality. Another problem is that the ODA is gradually being overtaken by other financial flows, particularly the sudden growth in philanthropic funds but also by new forms of private sector financing, foreign direct investment and remittance income.
There are now about 225 bilateral and 242 multilateral agencies funding over 35,000 activities each year. For 24 countries there are 15 or more donors that combined provide less than 10% of that country’s total aid.

The transaction costs, both for donors and recipients, are massive and could easily be reduced if donors’ efforts were more coherent, co-ordinated and focussed. The fragmentation of aid flows among official aid donors has been widely commented on. There are more than 60,000 publicly funded aid projects currently underway, of which more than 85% are smaller than $1 million. Thirty thousand new projects are started per year.

It is important to note that twenty years ago 22 members of the OECD/DAC accounted for 95% of total aid to developing countries. Today, aid to developing countries is delivered via more than 150 multilateral agencies, 33 bilateral members of the OECD/DAC, at least 10 non-DAC governments and a growing number of global Vertical Funds. Furthermore, the number of donors per country has multiplied threefold in two decades. Some developing countries have more than 700 active (sometimes very small) projects and receive more than 400 missions a year, each with its own specific requirements. With these statistics it is hard to deny that a solution to aid effectiveness is crucial!!

In September 2008, a 3rd High Level Forum in Accra was held. With over 1700 participants the Accra Forum was an unprecedented alliance of development partners, including developing and donor countries, emerging economies, UN and multilateral institutions, global funds and civil society organisations. One of the goals was to take stock of the Paris Declaration targets two years before the 2010 due date and to set priorities that would accelerate those goals. Among the topics discussed was the still high transaction costs associated with aid, in particular, inordinate numbers of donor missions and reports make it difficult for country authorities to focus on delivering better results.

The lack of predictability of aid flows also makes it difficult for countries to plan. A survey showed that in 2007, only 46% of aid flows were disbursed according to schedule. The outcome of the 2008 Forum is the Accra Agenda for Action (AAA). Built on solid evidence, it lays the foundations for a reinforced approach to achieving the MDGs by 2015. The bottom line is that governments must allocate the human, financial, technological and natural resources available to them in a way that will truly make a difference in people’s lives.

2. Financial crisis and developing countries
Following the financial crisis that broke out in the US and other Western economies in late 2008, there arises a serious concern about its impact on the developing countries. Almost daily the world media reports scenarios of gloom and doom, with many predicting a deep global recession not seen since the 1930’s.

Remember that during this financial crisis, developing countries are also experiencing drastic decreases in their tax and GDP revenue, but to compound their problem, they are also confronting large decreases in their revenue from foreign aid, on which they are dependent to fund their very infrastructure. This makes developing countries extremely vulnerable during such a crisis, as their infrastructure may partially or completely collapse leaving them unable to meet even the most basis needs of their populations. Therefore, the crisis accentuates the urgent need for Western economies to accelerate financial development in poorer countries regardless of financial and political difficulties. This can be done by strengthening
domestic financial systems and mobilizing domestic resources, as well as reforming
the international financial system.

Europe plays a key role in the development architecture. Not only should Europe maintain its development activities, but it should transform them into an engine for growth. By investing in the less-developed neighbouring regions, Europe could achieve several important objectives. It could narrow the gaps that threaten regional stability (fragile states), and gain the international influence that it has long deserved, while at the same time contributing to the search for an adequate economic response to face the current crisis.

The importance of allocating aid to fragile states
State fragility has serious repercussions for national and international security and prosperity. Many fragile states are ravaged by conflict and have become “failed” states. Some have only recently emerged from devastating civil wars and still remain fragile. The World Bank created the LICUS Initiative (Low Income Countries Under Stress) for countries where traditional aid approaches have failed, but continued foreign aid is desperately need. Among some of the most fragile states LICUS classes Afghanistan, Cambodia, Central African Republic, Comoros, Haiti, Liberia, Somalia, Sudan, and Tajikistan.

Fragile states have weak state policies and institutions, and have a high risk of conflict and political instability, many in the midst of civil conflicts. These states can fail in three ways: by causing negative spill-overs for citizens of neighbouring countries, by failing to provide basic security for their own citizens, and by failing to create and maintain an environment for the progressive and sustainable reduction of poverty. One can argue that in any of these three aspects of failure, fragile states can amass and impose costs which, if large enough, may justify international intervention.

Some authors calculate that the combined total cost of failed states (using the World Bank’s classification of LICUS) is around US$276 billion annually, which is more than twice what international aid flows would be if the OECD countries actually reach the UN target of giving 0.7% of their GDP in aid. This suggests that there are significant financial and political benefits in finding solutions for the dilemmas of fragile states. In addressing these dilemmas specific to fragile states, LICUS tries to build state capacity and accountability, while stressing the importance of peace, security and development linkages. Further priorities include donor harmonization, a need for a strong and flexible institutional response, and field presence so that there is monitoring for abuses as well as productivity.

3. Climate change and development
There are two key dimensions to the climate change challenge: mitigation and adaptation to its irreversible effects. If we do not act against climate change urgently, advancing development and reducing poverty will become much more difficult and could even face reversals.

Poor and vulnerable developing countries will continue to be hit the hardest as they do not have the means to adapt, and their lives depend very much on real basics like food and drinking water. In short, climate change will undo global efforts to eradicate poverty and hunger. We should be reminded that the least developed countries are not responsible for the climate change we are facing today, albeit they will suffer its worst effects. The question of "climate justice" must therefore be at the forefront of the human development agenda.
4. A new vision for a development agenda

It is time for a new vision of social justice, which extends beyond simple measures against poverty. Of course there must be recognition that delivering a ‘social minimum’ is a priority, whether in the form of humanitarian aid or social protection. But far beyond the minimum, we need to bring to the development agenda a vision that includes social policy and infrastructure for developing countries. These countries need to be empowered to begin to develop their own infrastructures that will be capable of sustaining their domestic social welfare system long-term.

It is clear that due to the different factors and new global challenges discussed earlier in this chapter, (climate change, the financial crisis, debt relief, etc.) the current levels of ODA are far from sufficient to meet the UN’s MDG’s. The effort to increase aid must continue on all fronts.

The impact of globalization has transformed the concept of growth in real terms. We have seen that growth does not necessarily translate into poverty reduction or development. On the contrary, today in emerging economies growth often means an increase in migration, pollution, and an increase in the informal economy, which in turn produces increased inequality and poverty. The approach that has been used for years in the development community needs to be re-evaluated. As a global community we must recognize these changes and begin to adapt our development and growth agenda accordingly so that growth is accompanied by the necessary elements to truly increase equality and reduce poverty in developing economies.

Globalization also means that there are more streams of development funding aid available from more countries and organizations then at any time in the past. However, it also means that governments must collaborate more effectively than they currently do, so that the multiplied aid flows are not slowed down or even lost in endless bureaucracy. So much time and money is wasted because of a lack of coordination both among donor countries, and among receiving countries and projects. And more importantly, the UN agencies and other development umbrella organizations must be reformed and find ways to simplify and multi-lateralize aid so that donor countries and organizations can more easily channel development funding to the needs at hand.

Improved harmonization means an increase in the effectiveness per dollar, and also has the potential to reduce the enormous costs associated with transferring funds to developing countries. When this begins to happen, (ie:similar projects that are in the same sector in the same country are coordinated) then the maximum amount of aid can reach the neediest areas and be the most effective. Only then can we truly start to see an acceleration of progress towards the MDG´s.

Part of the reforms needed among institutions include an increase and coordination of the controls and assessments of development projects. There should always be independent evaluations so that development partners are held mutually accountable. This is crucial so that precious aid is not wasted on fraud and abuses, but can reach the targeted sectors without delays. I believe that the EU is an essential pillar of the new development architecture and should play a crucial role in the process of assessment and accountability.

On the other hand, it is easy to appreciate some weariness of the European public opinion about the problems related to global development, which seem to be never-ending. The lack of confidence concerning aid effectiveness increases in view
of the depressing scene represented by the real-estate patrimony that some African Chiefs of State possess in former metropolis.

Furthermore, the current crisis sparks off defensive reactions against emigration, considered once as a part of the solution but nowadays as an important part of the problem. However, Europeans as well as the citizens of most developed countries should bear in mind and accept that not only is our future intimately tied to that of developing countries, but also that we will be unable to raise walls high enough to protect our isle of relative prosperity from an ocean of absolute misery.
ii. The European Union and Globalisation – A Progressive Agenda for the Future

By Martin Schulz

Europe can look back at an unprecedented success story. After centuries suffering under a precarious balance of power, devastating conflicts and the catastrophe of the two World Wars, a new era dawned with the foundation of the European Coal and Steel Community. The idea of creating peace, stability and prosperity through regional integration has become a reality. The absence of war, together with Europe's open borders, has made one of humankind's oldest dreams come true. With member countries transferring a very few sovereign rights from the nation state to a supra-national institution a spiral of integration was set into motion. From the Schuman Plan in 1950, to the 1957 Treaty of Rome that paved the way for the common market, to the Monetary Union, a breath-taking level of integration has been reached. Starting with six founding members, France, Germany, Italy, Belgium, the Netherlands and Luxemburg, over time the Union has grown to 27. Peace, freedom, democracy and prosperity were extended to Spain, Portugal and Greece at the end of their dictatorships. Eastern enlargement put an end to the artificial separation of the continent by the iron curtain, and has contributed substantially to the peaceful transformation of these countries, thereby contributing to the security and stability of Europe as a whole. A war between EU member countries is unthinkable today.

The common market is a daily reality for half a billion people. The Economic and Monetary Union has created prosperity, growth and employment. But the EU is also a political and social project. For decades the people of Europe supported the integration process. They wanted the EU because it brought peace to a war-torn continent and because the EU was a driving force for social progress. The people of Europe still want the EU, but they no longer support it without reservation. European citizens are formulating new demands and they are stipulating conditions for their support which must now be included in the political process. They want a social Europe that creates jobs. They want a Europe that protects them against the risks and challenges thrown up by globalisation. They want a Europe that tackles climate change and one that can manage the economic crisis. They want a Europe that makes life better.

If Europe wants to be an exciting project again, it needs to demonstrate its ability to solve problems that are important for its citizens. The legitimacy of the EU does not only come out of its past achievements - its raison d'être needs to grow from a future-oriented need. The EU must develop a new vision for the 21st century, a vision with a cohesive force to revitalise the integration process. It is time to go back to the drawing board and rethink the possibilities for future development and action. What can and must the EU contribute for coping with the global challenges of the 21st century?

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Globalisation has become the basis of life and politics in the 21st century. Interdependence between economies and societies is growing, distances are shrinking, and borders are increasingly becoming open for people, money and ideas. New communications technology has created a world more interconnected than ever before. Decreasing transport costs, new information technologies and new forms of organising production are resulting in a global fusion of markets for goods, capital and labour. The growing inter-dependence of the world has ambivalent effects. Globalisation generates both positive and negative dependencies, and it gives birth to winners and losers. Globalisation creates global change and risk, but also huge opportunities. It means that a growing number of people gain access to mobility, education and knowledge. If wisely managed, the productivity of the world economy could generate more and better jobs and eradicate poverty. Global wealth is increasing, but it is unevenly distributed. Many countries and people do not share in the benefits. While highly industrialised nations and emerging countries are the winners with globalisation, many developing countries are losers. 40% of the world's population lives in poverty. One billion people must survive on less than one dollar per day. Economic and social marginalisation, environmental pollution and increasing scarcity of resources are negative side-effects of globalisation.

Globalisation is without doubt controversial. Some claim that globalisation leads to more efficient economies and gains in prosperity for all. Others argue that growing interdependence diminishes the capacity of states to act and increases social inequality. The buzzword globalisation evokes the fear of "social dumping" and job loss, but also holds the promise of a better life for many. It is undisputable that the globalisation of the world can neither be stopped nor reversed. Whether globalisation turns out to be a blessing or a curse is largely a question of governance. The openness and integration of the global economy raises questions of social justice that need to be addressed urgently. The challenge for politics in the 21st century is to make globalisation fair, just and sustainable.

The European Union has a key role to play in coping with the challenges of globalisation. In many ways, the EU is the most appropriate answer to globalisation. Today's problems ignore national boundaries. Globalisation gives rise to transnational sets of problems, necessitating cross-border governance as no country can solve these problems by simply acting alone. The zero-sum game played by nation-states in the 19th century is no longer valid in an age where globalisation has changed the rules of the game. In many respects economic globalisation has outpaced political globalisation. Economic globalisation has made the world more integrated and interdependent and it has opened up many issue areas that need cooperative action and the setting of rules. Earlier threats and risks were local and the state could offer protection. Today's dangers are often global and more imminent. Policy issues traditionally falling into nation-state responsibilities can today only be addressed in cooperation with other states. Neither the hole in the ozone layer, nor marine pollution, nor international terrorism can be solved single-handed. Only recently, the world experienced forceful reminders of shared vulnerabilities and global responsibilities. The first global food crisis demonstrated the complexity and interconnectedness of today's world. The spring 2007 "Tortilla Revolt" in Mexico signalled a world-wide famine and a full-blown wave of protests. From Cameroon to Haiti, from Egypt to Bangladesh, soaring food prices have made corn and rice unaffordable for the poor, pushing them into taking to the barricades. The world is not facing a temporary bottleneck, but a global, fundamental food crisis. Its causes are multi-faceted and intertwined, making the crisis even more difficult to resolve. The
world population is growing, while the amount of arable land is shrinking. Because of changing eating habits more and more forests are being turned into pastures that yield fewer calories per acre than arable lands. Climate change is causing bad harvests and the loss of arable land, as a result of droughts, floods and erosion. Millions of people displaced by civil wars need food that they are unable to produce by themselves. Speculators are driving up the prices of food and fuels. By betting cynically on soaring prices they seek profit in the hunger of others.

The “silent Tsunami”, as the food crisis was christened by some observers, does not respect state boundaries, but hits all countries indiscriminately. The after-effects of the crises will be felt for a long time. UN Secretary-General Bang Ki-Moon has warned that the current crisis, if not handled properly, could result in a cascade of related crises, a multi-dimensional problem affecting trade, economic growth, social progress and political security. The fight against poverty is in danger of being thrown back years. The soaring food prices may at first sight seem to have local causes and local impact, but they are the result of multi-layered causes on the global level and have worldwide repercussions.

Thinking in a global dimension has become a prerequisite for finding solutions. Re-thinking governance and including new levels of governance expands the room for manoeuvre. Growing interdependence between societies and states does not only create new categories of problems, it offers the solution, too. Nation states simply might not be the best vehicles for mitigating global change. The EU is much better equipped for finding solutions and implementing concrete measures in cooperation with other major players. At a time when the world is struggling to cope with the financial crisis and climate change, Europeans need a strong and social Europe more than ever. Transferring a very few sovereign rights from the nation-state level to the European level boosts collective sovereignty - and increases the capacity of everyone to act. As the world’s largest economic bloc and trading partner, the EU is a global player by definition. When it comes to fighting climate change, setting up new rules and supervision for the global financial markets, re-launching the economy, reforming the United Nations, eradicating poverty and fostering multilateralism, the EU can and must deliver. A large majority of EU citizens support the development of a stronger external policy dimension. They have realised a simple truth, if Europe acts in unison and speaks with one voice all member states regain political power to shape the world. Europe faces the task of developing a true external dimension to match its internal peace project; a Europe with a global vision that gives a lead, but one that also lives up to its responsibilities. Managing globalisation to the benefit of everyone must be the cornerstone of a progressive agenda for the EU.

**Leading the economic recovery and tightening control of financial markets**

The worst credit crunch since the 1930s has plunged the global economy into a crisis that is hitting people hard. In times of economic recession, rising unemployment, high food and fuel costs, the EU faces a two-fold task- tightening the control of financial markets and leading the economic recovery by promoting jobs and growth.

Blind faith in the market has led the world into its deepest recession for 80 years. The spectacular failure of the financial markets brought Europe and the world to the brink of economic catastrophe. The financial sector was only one heartbeat away from meltdown, when governments around the globe issued rescue plans and economic packages and central banks coordinated their monetary policies. We now know that the market is sometimes the problem, and politics the solution.
When Wall Street went bust and threatened to drag the world’s financial markets down, the ideology of ‘turbo-capitalism’ filed for bankruptcy, too. The market, claimed the High Priests of deregulation, regulates itself and does so more efficiently without state intervention. The near-collapse of the financial system has exposed self-regulation by the financial industry as illusory. In the brave new world of the market-radicals everyone wins eventually, or so unapologetic profiteers have claimed for years, because money is supposed to “trickle down” and help make everyone better-off in the long term. The reality, however, looks a lot different. The income gap has grown ever wider, and real earnings are in decline. While the poor became poorer, the rich became richer. Economic progress has become an end in itself instead of serving people’s interests. Now the house has burned down and it needs rebuilding. The world would be ill-advised to follow the advice of some financial experts, who now warn of ‘over-regulation’. Embracing self-regulation of the financial players would be akin to enrolling the arsonists in the fire brigade. The tremendous market failure was not only caused by the greed of speculators, however. A self-destructive dynamic inherent in capitalism drives it towards destroying its own foundations. In order to function well a market needs a regulatory framework. Taming the unleashed market forces of turbo-capitalism places too great a demand on the capacity of individual states. The financial crisis has laid bare the fact that the globalised economy needs a global political response.

The November 15th G-20 Summit in Washington, on the international response to the global financial and economic crisis, acknowledged the need for a global response and the fact that the world is entering a multi-polar stage. The era of the G-7 meetings has clearly come to an end. The G-20 meeting was a first step towards a New World Economic Order. The growing importance of the emerging countries was finally recognised by including them in the decision-making process. For an effective response all the world’s major players needed to participate. As the mirror of an increasingly multi-polar world, the G-20 will be the forum in which future solutions to global problems will be found.

The summit’s action plan was a first step towards a new global financial architecture. In order to prevent any repeat of the crisis, the financial market requires new global rules that produce more transparency, clearer rules, better supervision and greater stability. Effective order in the financial markets is inconceivable without institutions that work. One recommendation therefore is to turn the International Monetary Fund into an early-warning system. The Socialist Group in the European Parliament has long led demands to put financial markets on firmer foundations. Regulation need to be extended to all financial players, including rigorous capital requirements and limits on excessive borrowing and bad loans to prevent excessive risk taking and debt. Top executive pay and bonuses must be limited and de-linked from short-term profits. At the current time, perverse incentives exist to realise profits regardless of long-term effects. Detrimental short-selling and ‘betting’ on food prices should be outlawed. Rating Agencies must be subjected to closer supervision and better regulations, consulting and assessment must be de-coupled. It is intolerable that up to now Rating Agencies have been evaluating financial products that they have produced themselves. Hedge Funds and Private Equity Funds must be monitored and regulated more effectively. The disclosure of asset and regulatory structures must become obligatory, excess debt financing limited, and requirements to inform investors about risks restrictions on investments need to be stricter. Tax havens have to be closed down and we must put an end to tax avoidance schemes to ensure that all actors in the market pay their fair share of taxes. Governments now
face the task not only of mending regulations, but reforming international economic institutions and fashioning a new global economic order in line with the principles of the social market economy. If European states speak with one voice and act in concert, they have the chance to mould the future global economic order according to European ideas.

European cooperation is the key to fighting the recession effectively, because no national economy is capable of dealing with the effects of the financial crisis on its own. The real scandal in this crisis is that as the recession is now hitting home, it is felt hardest by the most vulnerable people - the EU has the duty to protect them. Besides providing support for member states experiencing financial difficulties, Europe has a vital role to play in raising and channelling capital for example through Eurobonds. Alongside closer coordination in the Eurogroup, a European initiative on jobs and small and medium-sized enterprises is required. Europe is the world leader in eco-technology. A package of smart green investments could create 10 million new jobs by 2020, at the same time putting Europe back to work and meeting its climate and energy goals.

**A new social Europe**

Existing inequalities, economic globalisation and the recession together place new pressures on people. Increased competitive pressures on the social systems threaten to damage the social cohesion of European societies. The pressure on salaries goes hand in hand with blackmail by international companies threatening to relocate to low-wage countries. In face of the highly mobile global economy nation-states have lost their capacity to act alone and to adequately protect social rights and collective goods. While capital, riding on the wave of globalisation, has swept away borders and has become ‘Europeanised’ in the common market, the welfare state has remained trapped within national boundaries and is now threatened by a ‘race-to-the-bottom’. The old balance between capital and labour is now at risk in the internal market. Even though the EU does possess a social dimension, it is currently underdeveloped. For decades the EU success model was the combination of economic progress with social progress. Then the governing conservative-liberal majority in Europe decided to focus on the removal of trade barriers while neglecting the social dimension of Europe. Deregulators claimed that economic growth can only be achieved through pressing salary costs and lowering environmental and social standards. The opposite is true, economic growth cannot be an end in itself, it is worth nothing, if it does not benefit the people. After all, it is the knowledge and creativity of people that creates competitiveness.

Now it is time to correct the existing imbalance - it is time for a new social Europe that places people, and not the market, at its centre. The European Union must develop a veritable Social Union to complement the existing Economic and Monetary Union. A European Social Progress pact could propose goals and standards for national, social, health and education policy while respecting national social models. The recent European Court judgements -the Viking, Laval and Rueffert decisions- are worrying signals. The EU’s Posting of Workers Directive is clearly in need of review. The rights of workers to collective bargaining and collective agreements across borders must be strengthened, as well as workers’ rights to information and consultation. Participation in economic decision-making processes by employees at the European level is a key for the future. To achieve this goal, workers’ rights need to be anchored more firmly in the European Company Statute and in European Works Councils. Additionally, a social progress clause needs to be
included in every piece of European legislation, and a social and environmental impact assessments needs to be taken into account in developing European legislation. If Europe again shows its social face, it will surely regain the trust and the support of its citizens.

**Climate change**

The financial and economic crisis is threatening to eclipse the danger of climate change. Some conservatives argue that the fight against climate change needs to wait until the recession is over. The reverse is true: recession is the world’s most immediate challenge, but far the biggest challenge of coming years is climate change. The only hope of avoiding catastrophe is a rapid shift towards a low emissions, low energy economy.

A two degree change in temperature will be the tipping point. If, and only if, the rise in temperature by the end of the 21st century does not exceed two degrees, only then will humanity still be able to adapt to the effects of climate change. This is the conclusion of the fourth assessment report of the International Panel on Climate Change from 2007. If the international community does not act now, the consequences of unchecked global warming would be catastrophic: rising sea levels, water shortages caused by periods of drought, melting glaciers, and the desolation and desertification of land. Climate change would affect the lives of millions of people throughout the world, their food production, access to water and health. All countries will be affected by climate change, but some of the poorest people will suffer most. Hunger and thirst would drive more and more people from their homes. Ecological collapse could lead to social breakdown; extreme weather could lead to political crisis. The threat of violent conflicts, mass migration and regional destabilisation loom over increasingly scarce resources. Climate policy is security policy! Even the UN Security Council has come to understand that. Climate policy, however, is also economic policy. The Stern report, commissioned by the UK government, clearly shows that just one per cent of global GNP would be enough to cut CO2 emissions - the follow-up cost of unchecked climate change could range between 5% and 20% of global GNP. The costs of inaction easily outweigh the costs resulting from the fight against global warming. The bad news is that, if we do nothing, we are careering towards global disaster. The good news is that we can overcome the greatest challenge the world faces - if we act now.

Reversing climate change requires global cooperation and a real commitment by the international community to cut CO2 emissions by half by 2050 compared to 1990 levels. Highly industrialised nations carry a special responsibility in the fight against global warming, as they are still the main producers of CO2 emissions. The USA alone are responsible for one quarter of the world’s CO2 emissions, but to date they have not signed the Kyoto Protocol. While Barack Obama has promised a U-turn in climate policy, the booming Chinese economy has drawn level with the USA on CO2 emissions. The poorest of the poor are currently afflicted most by the first effects of climate change. Bangladesh is increasingly haunted by storms and flooding, if sea level rises further, one third of Bangladesh might be lost to the sea. Without doubt, highly developed countries are called upon to assist developing countries in complying with climate goals as well as in mitigating the effects of climate change. The EU must shoulder the responsibility of taking measures against climate change within its own borders as well as leading the world by example.

Transforming Europe into the world leader in the fight against climate change will require both developing new efficient technologies that reduce Europe’s
dependence on fossil energy, and also taking a lead in the negotiations for a global agreement on the post-Kyoto period after 2012. Europe has long advocated an active climate policy and binding emission targets. The EU has signed both the 1992 Rio de Janeiro UN Framework Convention on Climate Change and the 1997 Kyoto Protocol. In the run up to the Kyoto negotiations, the EU member states signed a Burden Sharing Agreement, the first ever fixing of climate policy targets that have an impact on energy and traffic policy. In 2007, EU leaders agreed to limit greenhouse gas emissions and increase the proportion of renewable energy. The “energy and climate package” better known as the "20-20-20" agreement showed the way forward by adopting ambitious goals. The EU has committed itself to increasing the percentage of renewable energy from 5% to 20% by 2020, and also to become 20% more energy efficient than it is today. In order to reach these goals, Europe has invested in research and development activities focusing on environmental technologies, new energy sources, and the implementation of research undertakings. The EU will also reduce CO2 emissions by 20% compared to levels in 1990, and it will take on extra responsibility by increasing the amount of emissions from 20% to 30% - if other countries join in the framework of a global treaty for the post-Kyoto period 2012. The EU accepts a shared distribution of responsibility, within its territory richer countries shoulder greater burdens than poorer countries. “Climate justice” must be the model for a global agreement, especially as it follows the UN principle of common but differentiated responsibility. So Europe should increase its assistance to developing countries to fight climate change as well as adapt to it. Massive technology transfers could ensure that developing countries are able to fight poverty and develop economically – without disastrous effects on the environment. The Copenhagen Conference in December 2009 will set the course for the fight against climate change for years to come. Europe must take the lead in setting global climate policy goals and getting all major players on board.

Climate policy is the Siamese twin of energy policy. It is difficult to resolve one without tackling the other. Energy consumption is growing and, with it, the dependence on oil and gas, largely imported from non-EU countries. By 2030, 70% of all energy consumed in Europe will have to be met with imports, one serious prognosis claims. Reducing energy dependence therefore must be a priority for Europe. Security of supply, diversification of supply routes and diversification of energy sources should be the three pillars of a coherent EU energy policy. Rising energy prices are not only a geo-strategic issue, but they are also a socio-political issue. Soaring electricity prices and heating costs quickly wipe out the budgets of low income households. Energy poverty has become a threatening prospect for many Europeans. The key to reversing global warming and cutting energy costs lies in finding environmentally friendly and energy-efficient solutions. Investing in research, development, and innovation, and adjusting from an industrial fossil fuel-based economy to a sustainable society is the road we must take.

Eradicating poverty
Over the past two decades most of the world enjoyed unheard levels of growth, prosperity and low inflation. The economies of 124 countries expanded by 4% or more in 2007. Still, 80% of world populations live in developing countries. And one in five people live in extreme poverty and have to cope with less than one dollar per day. As a result of the credit crunch, the ILO estimates that 150 million jobs will disappear this year throughout the developing world. Much needed capital is flooding out of developing countries in search of safe havens. With its annual 6 billion Euros,
the EU is the world’s biggest donor of development aid. In addition, it has signed agreements with the 49 poorest countries concerning duty-free access to the EU market for ‘Everything But Arms’ (EBA). Yet there is no hope of achieving the Millennium Development Goals, that the EU member states signed in 2000 which agreed to eight goals, ranging from halving extreme poverty to halting the spread of HIV/AIDS and providing universal primary education, if global finance and trade return to 'business as usual' after the crises. In the short-term, we must see to it that the IMF makes enough credit available for the developing and emerging countries. In the long-run, the underlying rules of global finance must be changed to ensure a more accountable, stable and fairer global financial governance. The Doha trade round of trade negotiations must be concluded swiftly and in a development-friendly way. Although the EU has reduced its production subsidies and export subsidies, the EU agriculture policy, widely perceived as protectionism, is a shame. It inflicts grave damage on the credibility of the EU as a player living up to its global responsibility. The Socialist Group supports the “20-20” initiative. 20% of EU development aid should be directed towards social aid, especially health and education programs. Eradicating extreme poverty continues to be one of the main challenges and requires the combined effort of everyone to form a more effective global partnership.

Nuclear disarmament
Two decades after the end of the Cold War, there are still 27,000 nuclear warheads, making the proliferation of nuclear weapons one of the biggest threats to international peace and security. There is even the danger of a new arms race, if nuclear weapons are developed outside the recognised nuclear-weapons states. Also, terrorists could gain access to nuclear devices. Existing monitoring and inspection mechanisms do not guarantee adequate security. Every nuclear facility that is not properly safeguarded brings with it a potential security loophole.

A radical shift away from Cold War deterrence thinking towards a new consensus on banning nuclear weapons and placing fissile material under multilateral control is needed. The Coal and Steel Community, the bedrock on which the EU was founded, was based on a simple calculation. Two strategic industries, coal and steel, were placed under collective supervision to generate trust between former enemies. A lack of trust between nuclear and non-nuclear weapons states is one of the biggest problems of the existing non-proliferation regime. Placing the nuclear production cycle under multilateral controls thus might make supervision more effective and build confidence. The task waiting at the upcoming review conference of the non-proliferation treaty in 2010 is to develop a constructive timetable and practical measures to reduce the number of nuclear weapons, tighten control over the peaceful use of nuclear energy and counteract the threat from nuclear terrorism. Multilateralism and international treaties bring greater security. A world without nuclear weapons is a safer world for all.

A project of regional integration that is as ambitious and successful as is the European Union exists nowhere else in the world. With 27 member states, half a billion inhabitants and a quarter of world’s GDP, the EU is a global player by definition. Being an economic superpower comes with a responsibility for peace and stability in the world. It is time to give the successful 'within-Europe' peace model a true external dimension. Democracy, dialogue and diplomacy, cooperation and consensus – these values are at the heart of the European model for peace and must guide its external relations.
The EU has an important contribution to make to solving global problems and boosting global governance. First, the European methods of integration are the best strategies for solving transnational problems in a globalised world. The most important ones are the pooling of sovereignty, the continuous development of common interests, solidarity, and governing beyond nation-states, the setting of legally binding rules for cooperation, economic interdependence and an effective multilateralism. Peace, security, democracy and prosperity are served most effectively and at the lowest cost by pooling sovereignty and by international cooperation. Secondly, the EU is perceived as a benevolent player in world affairs. A large majority of people would like the EU to play a more important and active role on the world stage. No other player receives higher approval rates. The EU is not only perceived as a genuine broker between conflicting interests, for example in the Middle East, but also as a problem-solver as in the case of climate change. Europe’s capacity to act globally is based not on military power, but on its economic, cultural and political attractiveness - as a soft power the EU possesses moral capital and enjoys trust.

In a world that is becoming increasingly multi-polar, the development of a cooperative global-governance architecture built on a fair and rule-based multilateralism is a necessity. Nevertheless it requires great political effort to bring it about, but no one is more likely to play a major role as the protagonist of multilateralism than the EU. At a time when the election of Barack Obama as the 44th US President raises hopes that the era of US unilaterlism will be closed for good, climate change and the financial crisis have demonstrated clearly that global cooperation is the key for solving global problems, a window of opportunity exists to strengthen and reform multilateralism. The EU now has the great opportunity to fashion the processes of globalisation. The EU must now translate its great potential into a capacity to act effectively.

At the beginning of the 21st century, the European Union faces new global challenges. Looking inward, it must strengthen its social dimension and conclude the reform process. Facing outward the EU must act in unison and speak with one voice. The EU must deliver when it comes to tightening control of the financial markets and re-launching the economy, the fight against climate change and the reform of international organisations, dealing with international terrorism, eradicating hunger and poverty in the world.

Sixty years after its foundation, the EU again stands at a cross-road. Eurosceptics claim that the EU is opening the gates to unrestrained market forces. Economic nationalists make people believe that the nation-state is an effective protecting power against the negative side-effects of globalisation. By conjuring up nostalgia for the lost idyll of the protectionist nation-state, politicians may win elections. But they severely hurt the interests and the well-being of future generations by suggesting that 19th century ideologies can provide answers for the challenges of the 21st century. The retreat of politics behind state borders is neither desirable nor practicable. Slowly giving up integration leads us down the blind alley of a fragmented and powerless Europe. Will the people of Europe accept the destruction of the best tool they hold in hands for coping with the global challenges in the 21st century? Or will we develop a new vision for Europe and provide the EU with a progressive agenda and the means to face up to the tasks ahead? In the 20th century, Europeans needed Europe to overcome the past; at the beginning of the 21st century we need a progressive Europe to manage globalisation for the benefit of everyone.
For years progressives have been making the case that the actual neoliberal globalisation is not a law of nature. There is a way for a better globalisation; for a better managed globalisation. We have made the speeches, worn the badges, gone to the events, and sometimes wondered if we were making any headway.

While many indicators of global well being are getting worse rather than better, progressives have been labelled ‘anti-globalisation’ by conservatives. It’s a lie! We are the keenest and most natural globalizers. We celebrate the breaking down of the walls that divide us. National, cultural and religious barriers are not for us. We believe passionately in respect for diversity, in the benefits of sharing ideas, of working together for common goals. Don’t believe the free market fundamentalists: we are for economic globalisation, not in order to spread inequality and exploitation but to bring decent work and an end to poverty. We know that the market is a good servant but a bad master.

We face the deepest economic crisis in 80 years. And it is in the midst of crisis that the value of democratic government, the value of progressive new policy, is tested. We must act together to safeguard jobs and prosperity! Get it right, and they can build not just an economic recovery but also a better, more stable economic governance, a healthier democracy and a more progressive society.

Now after years of frustration there exists a real opportunity to press home the case for a better globalisation. There is a willingness to rethink that we must seize. There is a unique chance to engage in a new and fresh dialogue on the sort of globalisation we should pursue. We must create momentum, otherwise our moment will pass and it will be our children or grandchildren who will make the breakthrough.

It is not poverty or AIDS or climate change that has created that momentum, as many might have predicted, but the failure of our banks. It is the greed of international financiers that has demonstrated beyond serious debate to all decision-makers that deregulated globalisation has not worked. The previously unheard of phrase “a new global financial architecture” is on the lips of all politicians, those on the right as well as on the left. It is time for us to move.

**Warning number one.**

We do want a new global financial architecture but beware it will take years to agree and there are those who make the case for it precisely because they believe it will never happen or who use it as a bad excuse not to do anything at the regional level, for example in the European Union. There are enough political leaders who realise it is needed, and who know it has to be done with fast-growing economies in the east and the south on board, to make it happen. But it is not enough on its own.

We also need the largest economies like the US, the EU and Japan to give momentum to global reform by bringing in their own financial regulation. There are internal battles going on, but my assessment is that we will see new regulation on both sides of the Atlantic, in the US and the EU. If the Democrats can win elections in

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Japan we may also see new financial regulation in the Far East. It calls for a new global politic, one of coordinated actions with complementary but different legislation in the biggest economies; moving in the same direction and converging in the years ahead. And the new G20-Summit must be enforced to be the dynamic decision centre for a new global regulation of financial markets.

We must unite all progressive forces to create new global regulation of financial markets. Regulation of the greediness, the permanent tendency of using excessive debt, the lack of transparency and responsibility, and the abuse of dominant positions. We must never again risk meeting a financial credit bubble and crisis of the present kind which is destroying millions of jobs, people's savings and good companies.

What sort of regulation are we talking about? I think progressives could unite around 9 pillars of reform for the global financial markets:

1. Legislation covering all financial players including investment banks, prime brokers, private equity, hedge funds and anyone else who has been exempt from the rules of transparency and disclosure that have applied to everyone else. As this ‘alternative’ sector accounts for a very sizeable chunk of all new debt, they clearly need to be brought inside the tent if new debt crises are to be avoided.

2. Transparency and disclosure of debts, amounts and sources of funds, identification of large shareholders, executive pay and bonuses for ALL investment products.

3. Compulsory ‘capital requirements’ for ALL financial players, like those that already apply to banks and insurance companies. It means that to reduce extreme risk taking and excessive debt, all financial players need to have and to keep a certain amount of capital. To end the systematic risks and herd-behaviour, the capital requirements must be anti-cyclical: stronger build-up in good times and move flexibility in bad times.

4. Rules to prevent excessive borrowing including excessive debt caused by ‘leveraged buy outs’ and to protect viable companies from too much capital being paid out to shareholders or to service debt.

5. Greediness must be effectively kept down. Limits on pay and remuneration and mechanisms to ensure that earnings reflect losses as well as profits.

6. New rules to prevent conflicts of interest.

7. Protecting workers interests such as ensuring that employees are informed and consulted during all takeovers including leveraged buy outs and by obliging pension funds to inform employees how their pensions are invested.

8. End off-shore tax havens. It has been calculated that tax revenues lost through companies and individuals registering in tax havens could completely pay for the Millennium Development Goals to be implemented!


This is what we must argue for. It has to come out of the closet where we keep obscure, technical demands and into the light of day. It is here we can begin to forge a better globalisation. It's time for action now. The G20 Summit in April must take action.
Many, but not all of these proposals are contained in a report I steered through the European Parliament last September which was adopted with the support of conservatives and liberals who, until the financial crisis struck, argued that the market was already more than adequately regulated. Like in all times of change, things are moving fast and the facts are on our side. I cannot forget that just a year ago the conservatives and liberals were against any form of regulation "of the free market".

**Warning number two.**
While we fight to put in place a new global financial architecture, we must be equally engaged in the fight against a global depression. A new global financial architecture built on the foundations of mass unemployment is hardly an enticing prospect. If unemployment means misery for millions in our European welfare states, and worse in the US, what will it mean for Chinese workers whose goods are not longer being bought in the west, or for African agricultural labours who are having extreme difficulty coping with the ever fiercer global economic competition.

The US and China are trying to make serious investments in stimulating economic growth. At the time of writing, European efforts look inadequate. As the crisis worsens I believe we will have to demand new measures. The right is reluctant; they argue that increasing public debt is no way to deal with a crisis caused by debt. We must argue that public finances will get better if people are working, but with millions unemployed public finances will get worse. Business as usual is not an option. Extraordinary measures are needed for very tough times ahead. The demand made by the PES at the end of 2008 that Europe should not allow employment levels to decrease, should remain our objective even as unemployment is predicted to increase dramatically. Already we see the dangers of social and political unrest, (at the time of writing), strikes in the UK and France, and riots in Greece and the Baltic States.

We progressives must take action in the format of a New Global Deal - a New Recovery Plan. Worldwide, it is the most vulnerable who bare the brunt of the financial crisis. The ILO has estimated that 150 million jobs will disappear next year throughout the developing world, as a result of the rich world’s credit crunch. Much needed capital is flooding out of less developed countries as the financial institutions search for save havens for their money.

Europe rightly prides itself on being by far the world’s biggest aid donor. Yet we have no hope of achieving the Millennium Development Goals until the underlying rules of the global finance and trade systems are re-established on a more stable and progressive basis.

The lessons from the financial meltdown are clear; coordinated European action succeeded where national effort has failed. In the real economy too, coordinated action at both a European and at a global level, will be far more powerful than purely national solutions. We join the call for a new Bretton Woods to create a new, more accountable, more stable and fairer global financial governance.

In the short term, the G20 recovery plan must ensure that the IMF, together with central banks and governments in the developed world and in the cash-rich SWF’s, makes enough credit available to developing emerging countries to fight off recession. And the Doha trade round must be brought swiftly to a successful and development-friendly conclusion.

Recession is the world's most immediate challenge, but by far the biggest challenge of the coming years is climate change. Our only hope of avoiding eco-
catastrophe is to shift rapidly towards low-emissions, low-energy economy, but until now the scale of investments needed has been daunting.

Europe is a world leader in rapidly growing sectors such as eco-technology, environmental goods and renewable power generation technology. European social democrats have set out an action programme to create 10 million new jobs by 2020 through green growth. But to achieve these goals and meet Europe’s climate change commitments will require massive investment. We call on Europe’s leaders to rise to this challenge, with a package of smart green investment that puts Europe back to work and brings us closer to meeting our climate and energy goals.

We must turn the rhetoric for investment in green growth into reality. There is broad consensus on the urgency for the battle against climate change, and broad understanding that replacing our dependency on imported fossil fuels with more locally produced renewable energies would also increase the security of our energy supplies. Now we must generate real determination to act decisively on the growing understanding that investing in renewable energies and actions to reduce energy waste has the potential to create millions of much needed jobs. There will be those who claim we cannot afford during a recession to finance the fight against climate change. But this is a false argument. The costs for people, societies and for the planet of not doing anything serious are vast and irreversible. We cannot afford not to act; furthermore we cannot afford to miss the opportunity to create millions of new jobs in doing so.

This leads also to the opportunity for a new and stronger global climate deal to replace the Kyoto Negotiations for a new deal open in Copenhagen later this year. With leadership from the EU and US we can hope for an ambitious deal that sets tougher limits on emissions, that puts in place new actions such as a global emissions trading system, and that encourages and helps developing countries to contribute to saving our climate.

We must not neglect decent work, basic workers rights and social and environmental standards when we talk about world trade. ‘Fair trade’ is a progressive idea that we strongly support. The economic recession should not be a reason for a race to the bottom; social rights and environmental protection should not be the victims of the current crisis. On the contrary, respect of ILO Core Labour Standards and respect of bio-diversity and environment must be integrated in a progressive strategy to re-launch the economy.

We must not forget the UN Millennium Development Goals, and the fight against AIDS and other infectious diseases, poverty, maternal mortality to lift millions of people out of poverty. We fear that 2015’s objectives will not be fulfilled. The EU and the US, together with other industrialised countries, must respect their commitments.

The current crisis demonstrates that the market alone can’t solve the problem. It also demonstrates that codes of conduct or self-regulation are not enough. What is necessary now is to strengthen the international institutions for better cooperation between states and state institutions. Only with better global governance will we be able to face the current crises: economic, financial, climate change, the food crisis, etc. New tools to promote general interest and public goods are necessary in the framework of the multilateral system.

The time is right politically and economically for a big shift towards managing globalisation in a better and fairer way. Politically right because the Reaganite/Thatcherite idea that government is bad, markets are good is dead. Politically right because President War Against Terror and President Tax Cuts for the
Rich has been replaced by President Hope. Belief in the ability to achieve change, captured in that brilliant slogan ‘Yes we can’, is essential if we are to tackle the challenges facing us. For many the election of Barack Obama is in itself proof that change is possible. Our joy at the election of an African-American President is combined with the knowledge that his politics are far more progressive than those of President Bush. He knows there is far more to global politics than the war against terror. He has witnessed, and participated in, the very personal struggles of those trying to create a future for themselves and their families in developing nations such as Kenya and Indonesia, as well as in the poorer suburbs of Chicago. Economically right because the questions being asked about unregulated global capitalism in the context of the financial and economic crisis need to be answered.

We have already shown that the crisis in the international financial markets and the deep recession we are in also creates the biggest opportunity for years to make a decisive change in the way globalisation is managed. We have argued that one of the keys to getting out of the recession is to invest in ‘green growth’. But most of all we must remember that the keys to managing globalisation better are two-fold. Combining the fight against global unemployment with the fight against climate change, and implementing new regulation for the international financial markets are the keys to opening the door to a better future.

The failure of the markets, worshipping, "greed is good" philosophy of the last 30 years, must finally lead to fundamental self-examination by both economists and politicians. Economists have to rediscover a wider vision of how their profession can contribute to building a better society. And politicians must learn to think long and hard before contracting out their responsibilities to the magic of the market. That's where our Progressive New Global Deal for this planet comes in.
In the midst of the worst financial and economic crisis since the Second World War, a global framework for managing globalization is urgently warranted. As forecasts get gloomier the media report daily on massive job losses, rising unemployment, underemployment and foreclosures, the insecurity of individuals, families and communities is increasing at great speed. Too many feel left out and left behind.

The crisis we are facing today is the consequence of the absence of fair rules governing globalization. We must not forget that before this financial crisis there was already a major socioeconomic crisis among large segments of the world’s population, in both developing and developed economies, with massive poverty, under-employment, growing inequality and difficult social conditions.

The benefits of globalization have not been widely or fairly shared and the backlash was emerging. For many, this was globalization without a moral compass; a model that was morally unacceptable and politically unsustainable. There was a growing sense that globalization had become unfair and unbalanced. No one seemed to be in charge. This became even more evident when the financial crisis erupted.

The imbalance is reflected, for example, in the decline in the share of wages in Gross Domestic Product almost everywhere. In many countries consumption had been stimulated by increasing personal debt. Now governments are desperately trying to stimulate consumption when in fact if higher productivity had been transferred into higher wages, demand would also be higher today.

Everything we know about past economic crises, from the Great Depression to the Asian financial crisis in 1997, indicates that the social impact will be deep and long lasting: job losses; declining incomes, wages and purchasing power; effects on social spending; houses lost; deferred new investment; a decline in international trade. In sum, progress already made in reducing poverty will now suffer a setback and the middle classes worldwide will be weakened.

The highest price will be paid by the weakest and most vulnerable segments of society. There is fear that the economic recession will turn into a social recession. Social tensions are indeed brewing and people ask why hitherto unimaginable sums of money suddenly appear to bail out banks when so little has been available to confront the problems of poverty, unemployment and the lack of access to social protection. What has happened to commitments ensuring minimum social justice and fairness in the rules of the game?

**Global Jobs Crisis**

Finance is at the origin of the present crisis, but at its root, this is a crisis of a certain model of globalization. The market was overvalued; regulation and government were undervalued and the dignity of work and protection of the environment were devalued. There were warnings that the injustice of globalization would endanger further integration of the world economy. Indeed, the recommendations of the World

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4 Mr. Juan Somavia, Director General International Labour Organization
Commission on the Social Dimension of Globalization (WCDSG) called for a more balanced globalization and better regulation of the global economy, including the financial system. The comprehensive recommendations of the Commission could serve as a useful blueprint for engaging in multilevel policy making that would ensure a better managed globalization aiming at full employment, decent work and social justice around the globe.

For years now the ILO, anchored in the real economy, has been calling for a new model of globalization centred on decent work creation and a balance between government, markets and society. Not financial speculation. The ILO message is realistic, not exaggerated; different policies can change the future course of events. We are now facing a global jobs crisis. Governments are aware of this and are taking action. However, more decisive and coordinated international efforts are needed, particularly regarding job creation and social protection. In November 2008, the ILO was one of the first international institutions to propose a global approach. The Officers of the ILO’s Governing Body (representing governments, employers and workers) highlighted six priority policy actions:

- ensuring the flow of credit and stimulating demand;
- extending social protection, training and retraining opportunities, and other employment policies, with particular focus on the vulnerable—young men and women, workers in insecure employment, and migrant workers;
- supporting productive sustainable enterprises, particularly small enterprises and cooperatives;
- employment-intensive investment and green jobs;
- ensuring that fundamental principles and rights at work are not undermined and that respect for decent labour standards is promoted;
- strong cooperation between the ILO and the multilateral system, and deepening social dialogue and tripartism;
- maintaining and expanding development aid and investment flow to vulnerable countries

With bold leadership, this crisis can and should be used as an opportunity to make the economy more socially and environmentally sustainable. The short-term responses to the crisis should therefore pave the way for a fairer and greener economic growth model, an inclusive globalization based on sustainable development and opportunities for all.

The present crisis sheds a new light on global imbalances. Imbalances between developing countries and the developed world, imbalances in the rapid growth of some of the emerging countries, imbalances in income distribution and poverty, imbalances in trade and payment between countries, imbalances in some accumulating unsustainable amounts of debts and others large amounts of reserves, nurturing also the striking imbalances in the financial sector.

The biggest danger is finding only stopgap solutions to the immediate crises. We forget that this will only take us to where we were before; and where we were before was a globalization that did not deliver for many people, a globalization that might have reduced extreme poverty for some, but was clearly increasing inequality. We need a new model of globalization with coherent policies to make sustainable development a reality in open economies and open societies, a model that advances human dignity, decent work, and respect for the environment as the pillars of a new global approach. This requires a fundamental global rethink. We do not yet have the
policy instruments and the institutions in place for a global response to a global crisis. We need to create them and we can.

*It is about the management of globalization not globalization per se*

As the WCSDG report states, the problems of globalization have not as much to do with globalization, but with “deficiencies in its governance” and this clearly puts the blame for suboptimal outcomes on the management and the managers of globalization.

The easy answer of the neo-liberal period was that the “markets will fix it” and that a hands-off approach of small government would be the best way to unleash the forces that would bring prosperity to all through a trickle-down wealth effect.

The ILO has always attached an important role to government, policies and governance believing that a visible hand was needed to turn globalization into a sort of “public good” bringing prosperity and decent jobs to as many as possible. But to achieve this “public good” all must have the chance to participate in globalization and increasingly access its fruits. The impact of markets and government action should be judged by effectiveness in relation to common goals, not on the basis of ideology. The ILO has persistently drawn attention to the injustice of the present model of globalization and advocated that it should not be managed in such a way as to yield a maximum profit for a few, but rather in the spirit of economic and human development, jobs, income and social justice for as many as possible. In fact empirical research has proven that countries being excluded from the benefits of globalization are indeed the poorest in the world.

We have claimed that a decreasing labour share is a source of concern, as are rising inequalities with peak incomes making remarkable gains but the lower tiers of the income distribution and the middle classes falling backwards. The high numbers of unemployed, the large share of working poor and vulnerable workers add to the many imbalances of a poorly managed globalization.

The WCSDG also claims that management starts at home, with national policies and a reinforced state being indeed at the core of the governance system, although one must acknowledge different national capacities in steering economies and societies around the world. But in the globalised economy, national responses, whilst fundamental, are not sufficient as can clearly be seen in the present crisis. Therefore, any progressive agenda for managing global processes must seek a balance between the levels of governance and allocate proper responsibilities to each of these levels.

It is clear that the multilateral level, as a provider of ideas, money and coordination, is an increasingly important player in the efforts to better manage globalization. Inter-regional levels, such as the European Union and intergovernmental groupings such as the G7/G8/G20 or G77 also have an important role to play. Ultimately one cannot lose sight of the G192, the process of finding solutions must be inclusive and the UN has a logical role to play.

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5 Public goods are in essence “non rivalled” and non excludable, meaning that consumption of the good by one individual does not reduce availability of the good for consumption by others; and that no one can be effectively excluded from using the good.


7 Globalization can pragmatically be seen as the cross border exchange of finance, goods and services and people. Of course information technology is important as it operates immediate diffusion of, for example, the crisis materializes through the stock markets but also spreads the uncertainty that comes with a crisis and influences people’s behaviour.
The length and depth of the crisis will also crucially be influenced by the extent and structure of the various stimuli packages adopted almost everywhere in the world, whose estimated effects have, for example, been integrated in the recent interim forecast of the European Commission.\(^8\)

Although some countries have the fiscal space to implement stimuli and/or bail out programmes, or are able to access resources otherwise, in many parts of the world stimuli appear to be unaffordable luxuries. In some countries of Central and Eastern Europe or the Commonwealth of Independent States where the IMF acts as lender as a last resort, stimulus programmes cannot be enacted because credit conditionality encourages budget austerity. This is one of the incoherencies in policies that needs to be discussed.

In most of the packages, renewable energy, energy efficient houses and other "green" items are present but the main share is taken by tax cuts and spending on "traditional" infrastructure like road and bridges.

It should be understood that social protection in addition to jobs and income, are key to economic stability and any discussion on the subject must take this into account. Policy coherence among all the players is imperative and evidently there is a coherence deficit concerning issues, actors, institutions and their cooperation with one another.

Renewal through Decent Work

It has been said that a crisis is a terrible thing to waste, and with effective leadership, this crisis provides societies with the chance for a long-awaited reform and renewal. Any progressive agenda must address the global and national imbalances including the big moral hazards that drive social unrest.

It is therefore imperative that the positive consequences of bail-outs and stimuli also reach the broader public and do not just recreate the "status quo ante", that is the financial instruments actors and behaviour that existed before the crisis. A continuation of unfair globalization would bring us back to the same problems, not to solutions. A reregulation is warranted, especially for, but not exclusively for the financial sector; and a reorientation of production towards "greener" products and towards a more sustainable growth path.

While we do not know at the present juncture how long and deep the recession will be and we continue to see increasingly alarming forecasts, we can also acknowledge some positive, albeit timid developments. The awareness of the need for quick and concerted action has increased as it has been evident that concerted action, for example in the European Union where an overwhelming part of trade is intra-EU, will increase the effects of a stimulus both for growth and jobs.

Inward looking responses, whilst understandable as emotional reactions to the crisis, need to be avoided. There must be effective ways of responding to populist reactions and promoting greater receptivity to the essence of globalization: global interdependence needs to be nurtured. Coherence and cooperation between countries and interregional groupings also serve the purpose of minimizing protectionist reflexes that put the international interdependence of economies in jeopardy.

In a few short years, Decent Work has advanced on a number of practical fronts. There has been overwhelming support through regional and international commitments culminating in the 2005 UN World Summit; Decent Work is now part of

\(^8\) They have been estimated at three quarters of a point in GDP growth for 2009 and between a third of a point and a half of a point in 2010.
the Millennium Development Goals and we are now working to implement Decent Work country programs around the globe.

This is all supplemented by further concrete action. During the last ten years, for example, there has been a 50 percent increase in ratifications of the eight core ILO conventions dealing with child labour, forced labour, discrimination, freedom of association and collective bargaining. We have seen rising donor support for our technical assistance programmes. Decent Work goals are being factored into national planning and budget cycles of some countries.

Social movements have helped carry the Decent Work Agenda forward. Indeed, a global movement for decent work is emerging. This is essential. We would not have a women’s movement, an environmental movement, or a human rights movement without civil society. And we will not achieve decent work for all, the fundamental demand of people today, without that same kind of organisation, mobilisation, leadership and action. This was certainly evident when the International Trade Union Confederation organised a World Day for Decent Work with events in over 100 countries on 7th October 2008.

The values of the organization have therefore been largely endorsed by the national and international community, but what remains as an ongoing mission is to transform values into policies and actions on a global scale that matches the scale of the crisis of globalization.

The contribution of the ILO to a progressive agenda for managing global processes:

Decent work sets the overall framework and is a long-term development goal, both on the national and global level. The ILO Declaration on Social Justice for a Fair Globalization (2008) expresses the “contemporary vision of the ILO’s mandate in the era of globalization” for establishing fairer globalization through the implementation of the Decent Work objectives; that is full employment, rights at work, social protection and social dialogue between the main stakeholders in the economy, and society as an important governance instrument. These four objectives are “inseparable, interrelated and mutually supportive” (ILO, 2008).

After all, safer jobs are more productive jobs. Child labour undermines long-term economic performance. Effective gender equality policies lead to more dynamic business growth. A more secure population means a workforce more able and willing to adjust to economic change. Decent incomes translate into solid consumption which, in turn, stimulates the demand that keeps investment going. It all works together. Effectively, managing the Decent Work Agenda constitutes an important foundation of the overall efforts for managing globalization.

Rights at work

In times of bust and boom alike, workers rights are at the core of the ILO’s efforts for helping countries and the multilateral system to manage globalization fairly. The Declaration on Social Justice for a Fair Globalization reiterates the role of this central plank of decent work and the relevance of the ILO’s 1998 Declaration on Fundamental Principles and Rights at Work, which is an obligatory, though not sufficient, part of the social platform for globalization that the ILO proposes.

The richness not only of the fundamental rights of workers, but also of the bulk of the ILO international labour standards and assorted recommendations in helping

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9 It was recognized as a global goal by the UN World Summit of 2005.
countries to install the basic rules for managing their labour markets and basic safety nets in the spirit of fairness, cannot be overstated. Additionally, the inbuilt flexibility that these instruments have should be underlined.

While introducing some legal minimum standards and accountability, conventions are not imposed on countries, but can only be adopted by democratic, participatory processes. They are the fruit of careful and conscious arbitrage involving member States at different levels of development with sound technical support covering different domains. Conventions make sense ethically, socially, economically and they are without doubt, a necessary part, and in the interest of the fair management of globalization.

**Employment at the Heart**

There cannot be rights at work without work. Placing employment at the heart of social and economic policies is essential. Indeed, while (self or dependent) employment is not the only means of providing income, it is undeniably the most important and if work is decent, productive and freely chosen it gives people a gratifying and dignified way of participating in the economy and society. Working is the main way of belonging to society and unemployment is not only about losing income, but also about losing social networks.

A strategic focus on the links between the macro and the micro economy, employment, a well functioning labour market, and a sound investment climate is key to developing a national employment strategy. Such a national strategy, coordinated with other strategies can be a crucial element of the management of globalization, both during times of growth and in times of recession.

The question of how best to stabilise and balance economic stability with social objectives remains. Stabilisation “at all costs” can prove to be economically inefficient and socially inequitable as shown by the experiences with structural adjustment programmes in many countries, and even recent crisis related IMF financial packages. Fiscal space for critical public expenditures such as education and public health should be preserved, as poverty reduction strategies now clearly concur. But also shorter term business cycle downturns may often warrant anti-cyclical policies.

Financial policies are another important area for economic growth. Money is the oil of the economic motor and growth anywhere requires that the money keeps flowing. It is imperative for finance to flow to productive investment.

The smart regulation of global capital is essential for the management of globalization, the stabilisation of economic cycles, the achievement of the MDGs, and the realisation of decent work. In this field there is a need to look closely into the quality of financial institutions and the oversight mechanisms such as the Financial Stability Forum, the Bretton Woods Institutions and the credit rating agencies. Incentive and sanction schemes must be reformed. While this demands the work of many agencies, the connection of the financial system with the real economy also requires the inclusion of actors in the real economy, to make the system more coherent.

Trade and FDI liberalisation can be an effective way of promoting competition in the national market and access to external markets, creating opportunities for business, increasing exports and imports, and promoting investment and job

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creation. However, the current crisis points to some of the problems inherent in the current trade liberalization and investment regimes; such as the volatility of foreign capital and the trend to prefer portfolio investments or mergers and acquisitions, to greenfield site investments, deemed to be superior in their employment creation capacity.

The current crisis provides a chance for a renewal in industrial policies such as directing FDI into the right channels, for example towards greener and more sustainable growth. Trade liberalisation requires consequent trade adjustment packages, comprising among other elements, effective active labour market policies for reallocating displaced workers in security.  

National employment strategies must be concerned with the employment content of growth, which has been declining globally. Countries placing employment at the centre of their development strategies, and wanting to use the employment route to poverty reduction, have to allow for balancing policies and incentives across relevant sectors (labour-intensive vs. capital-intensive; formal vs. informal) so that the growth is as job-rich as possible in a context of accelerating technological change and productivity.

**Sustainable Enterprises and Skills**

Sustainable Enterprise Development is a significant source of new employment. The creation of new enterprises and the expansion of existing enterprises, most often small and medium-sized enterprises in the private sector, but also cooperatives and similar for profit or non-profit organizations, is of course fundamental as such enterprises employ a good fraction of the global workforce. Enterprise creation, innovation and business growth are an important part of employment policies that can address one of the endemic problems of developing countries: the lack of formal jobs available.

Higher rates of enterprise creation are associated with higher levels of employment. Policies to promote entrepreneurship begin with the educational system, where young men and women are introduced to business and entrepreneurial culture so that they can consider self-employment as a career option. A central role for governments in promoting enterprise creation is to lower costs and minimize bureaucracy, facilitate access to markets and offer credit and management training so that businesses can provide productive employment. Investment fuels business growth and is fostered by macroeconomic stability, as well as by transparent, corruption-free government structures and clear property rights. The absence or inadequacy of institutions guaranteeing and enforcing such rights is a brake on the engine that drives employment growth.

Enterprises and their workers will also be helped by a public sector that provides effective service and infrastructure. This can also become an important source for employment as has been demonstrated in many countries. The present crisis hits big and small enterprises alike, but often the rule nowadays is, “too small to be saved”, even though SMEs are not at the source of present troubles. Restoring the credit flows to this productive segment of the economy is crucial.

Education, skills and employability are also a key component of employment strategies. For the individual, education, skills and competencies define one’s capacity to make use of job and income opportunities, and to adapt to the changes in the labour market and organisation at work brought about by technology and

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globalization. Investing in knowledge and portable vocational and “foundation” skills, is one of the most effective ways to enhance the employability of the poor so that they too might participate in growth and globalization.

For companies and organisations, the skills of managers, workers and firm-specific knowledge are key determinants of firm-level productivity. Workplace and organisational learning are essential in maintaining workers’ employability in knowledge economies and the firm’s capacity to absorb and master new technologies so that they can innovate and remain competitive.

For economies, a skilled and knowledgeable workforce improves the investment climate, is a major determinant of sectoral and economy-wide productivity and, therefore, of economic growth and job creation potential. Improving the efficiency of training policies and training institutions, and supporting equal access to education, training and decent work opportunities, create a more employable workforce, which supports growth and competitiveness in open economies. These policy choices require large investments in human capital. The present stimulus packages recognise this and training has become one of the areas that is increasingly funded, also in connection with reduced working hours, the rationale being that it is better to train those who are redundant than those who are idle. Here the crisis provides at least a chance to marginally build up competencies that can later be used when the upswing occurs.

The crisis shows that good labour market institutions and policies are tremendously important for the management of globalization and ensuring income and employment security to workers.12 While the crisis will create momentum for new regulations and policies, it is important to note that “flexi-curit”, which aims at providing labour market security by combining the employment security of an employment relationship13 with security “beyond” the firm, provided by the social protection system, remains important in “boom and bust”, with the security part being more important in “bust” times.

Firms and the public sector, which are embedded in adequate safety nets, geared towards labour market integration, can also better adjust their workforce under conditions of social responsibility than firms located in countries without safety nets. In any case, an important condition for the success of such solutions to solve labour market problems is that a social safety net, comprising active and passive labour market policies and an effective employment service, exists. Indeed, such a safety net should not be considered as a temporary crisis solution, but as a permanent institution whose function is to provide labour market security in more open and thus more volatile labour markets.

Designing and implementing effective flexibility-cum-security solutions, which combine employment security and social protection, imply that there must be negotiations between industry and the state. Effective tripartism can aid the acceptance of change, improve the design of regulations and policies, ensure financing and make such solutions sustainable even in times of political change.

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Social protection
Social protection is another pillar of decent work and a critical factor in the management of change, as it can enhance the dynamism of the economy and the mobility of labour. Social protection encompasses policies that insure a series of risks, such as health, old age, maternity etc., but also those that insure against labour market risks, such as income loss for those who lose jobs or who are unable to enter the labour market. Indeed, people who face loss of income by job loss and have no other protection for themselves and their families, join the ranks of the poor whenever a crisis hits. Social protection not only provides the basic means for social inclusion but also helps to stabilize the economy by providing income even during times of recessions.

In the developed world, transition countries and parts of the developing world, social protection faces the problem of an ageing workforce, which increases the financial strain on welfare systems. In other parts of the world, one has to deal with large cohorts of unemployed and underemployed youth that may need additional help in order to become integrated into the labour market. A general challenge is that less than 20% of the world’s population is properly covered by social protection, which limits, for example, the scope of labour market security along the flexibility and security nexus. This implies that in some policies there is a sequence: workers and their representatives are naturally reluctant to accept more flexibility in the labour markets if little else than the security of a job exists. Therefore the goal of creating a safety net should be a priority.

For both social and economic reasons, many developing countries need to put in place an affordable social protection system. Although this will entail some costs, these costs will be repaid by increased worker’s welfare, better worker’s health and all the secondary benefits which will be seen in productivity. While there are questions about the initial financing of such a system, recent research of the ILO’s social protection sector has shown that these obstacles are not insurmountable.

Social Dialogue
Finally, social dialogue is the vital fourth pillar of decent work and crucial for the management of globalization. The social partners, i.e. representatives of workers and employers and their dialogue, sometimes bipartite, sometimes tripartite together with the government, are the key actors of the real economy. Social dialogue facilitates the development of consensus and implementation of policy at the global, national, regional and local levels. Social partners can exert direct influence on the governance of labour markets by engaging in collective bargaining, through participation in boards of labour market institutions like the public employment service, the unemployment benefit system or training boards, and social and economic councils.

By promoting participation, representation and empowerment of individuals, the social partners, together with governments and parliaments and civil society can create the processes and institutions necessary to mobilise social actors, manage conflict, promote social inclusion, and ensure adhesion to and sustainability of the visions and programmes adopted. Concerted efforts to improve governance and social dialogue are thus an essential part of the growth, competitiveness and employment agendas of countries.
An important part of such governance processes at all levels (local, regional, national and global) is again policy coherence.14 While coherence does not mean that diverging interests become one, discussions, negotiations and mutual information sharing among stakeholders becomes an essential part of the development process.

**Architecture of Global Fairness**

The present crisis provides fertile ground for change. But it will not simply just happen. It will take leadership, imagination, and difficult policy choices. There is a small window of opportunity to lay the groundwork for a better management of globalization on many levels. The depth of the crisis and its clear causes in the poorly regulated financial sector was a wake-up call for many.

Unfettered deregulation, unbound markets, global trade and investment interdependence can quickly transform a regional crisis into a worldwide crisis. Global governance has shifted with the new American administration, the IFIs, the European Union and new world powers, such as China and India, all calling for better regulation of the financial system, a stronger role for the state and for more resolute actions. All this has already been suggested by the World Commission on the Social Dimension of Globalization in 2004, but only recently has such advice become mainstream.

Even if the exact contours of the agenda on new management of globalization are not yet clear, some of its substantive elements and procedures are becoming more apparent. While the re-regulation of financial markets is one, multilateralism and policy coherence are two others. Decent work, comprising employment, social protection, rights at work and the social dialogue, as an accepted global goal is a vital foundation.

What is the right international forum for debating and negotiating the new management agenda for a fair globalization in a coherent manner? Is it the G 192, the General Assembly of the UN? Is it ECOSOC, the Economic and Social Council of the UN, the principal UN body for coordination, policy review, policy dialogue and recommendations on economic and social issues that have already endorsed decent work as a global goal?

Or is it the G 20, which seems to take on growing importance as an arena uniting developed, emerging and developing countries on the subject of economic stabilisation? Which of these bodies will be relevant and open enough to include the social dimension? Which body will understand that the social dimension of globalization is also an economic dimension, and the two can longer be clearly separated? Or must there be a new form of global governance that shifts from an international community of governments to a global community of multiple actors including, but also going beyond governments: for a globalized economy, a global forum?

Out of these different alternatives must emerge the design; a body compact enough to be effective, representative enough to be legitimate and transparent enough to be accountable. I have no doubt this is possible.

The Decent Work Agenda is a critical contribution to the common multilateral efforts to design the plan for a global architecture that creates balance in our societies and economies; an architecture of global fairness.

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14 WCSDG op.cit.
v. Jobs: the missing link
By Guy Ryder

Introduction
The spectacular worsening of the financial crisis in late 2008 is now having a
high impact on the real economy. GDP is forecast to fall, growth will most likely be
negative and unemployment has already surged in the major industrialised
countries. The crisis, as global leaders now recognise all too well, is spreading to
emerging and developing economies. Already, several governments have had to
request emergency loans from the International Monetary Fund (IMF) as their
financial sectors have become paralysed, capital flowed out of the country,
currencies collapsed and economic growth came to a standstill. The global economy
is facing a very serious recession. How protracted and deep this proves to be
depends on how timely and well-focused government action is. This systemic crisis
comes on top of the unprecedented rise in food and commodity prices in 2007-2008
and the resulting food crisis in developing countries. It also occurs against the
background of accelerating climate change which, without rapid action, will affect the
poorest across the globe most severely, especially vulnerable groups including
women.

At the time of publication of this book in April 2009, G20 leaders are meeting in
London to discuss a new financial and global architecture and to set forth a plan on
how to cope with the ‘global recession’. The trade union movement is presenting
clear and long-term solutions to the global crisis to influence the discussions among
heads of state and government in London, with a view to shaping a new era of
globalisation that is environmentally sustainable, socially just and economically balanced. This article sets out three goals: first, to explore the global economic
crisis; second, to evaluate the regulatory deficit of the financial world and third, to
suggest a progressive agenda that links job creation both to economic recovery and
to meeting the challenges of climate change.

1. The Deficit of the Financial Markets
History has shown that crises of the present scale frequently lead to social and
political instability with unpredictable and often tragic results. Working families have
an enormous stake in the response to this crisis. Already, for more than two decades
social cohesion has been under stress as a result of growing inequalities in many, if
not most countries. Today, those who are losing homes, jobs and pensions as a
result of the financial crisis, for which they bear no responsibility, are being called on
as taxpayers to bail-out those who are responsible.

The current economic crisis began in the US as a conjunction of a housing
crisis, a credit market crisis and, increasingly, an employment crisis. Each of these
crises was serious enough in itself, but their interaction makes for a particularly
complex and dangerous dynamic in the real economy. Housing prices have
collapsed, foreclosures have surged and trillions of dollars have been drained from

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household net worth. Consumers are pulling back sharply as their wealth declines, slowing the economy and forcing employers to shed jobs and cut wages and benefits. The continuing decline of housing prices also aggravates the credit crisis as the value of mortgage-backed assets continues to undermine the balance sheets of under-capitalised financial institutions. Unless the decline in asset prices and employment is halted, the banking system will continue to haemorrhage. This vicious circle is now repeating itself in other industrialised countries and in emerging economies originally thought to be immune.

For two decades most governments, together with the International Financial Institutions (IFIs) have promoted the lightly regulated ‘new financial architecture’ that has characterised the global financial markets responsible for this crisis. Governments have now been forced to intervene to save the banking system; the quid pro quo must be the reintroduction of proper regulation to the financial system. An agenda for re-regulation must cover: the public accountability of central banks; counter-cyclical asset requirements and public supervision for banks; the regulation of hedge funds and private equity; the reform and control of executive compensation and corporate profit distributions; the reform of the credit rating industry; the ending of offshore tax havens; taxation of international financial transactions; proper consumer protection against predatory lending and aggressive banking sales policy; and active housing and community-based financial service public policies. The new system needs to reflect the requirements of all regulators: bank regulators, tax and competition authorities, and governance and consumer bodies in each country. There must be no more piecemeal approaches to reform.

While the entry of governments into the financial markets to nationalise banks, guarantee deposits, buy up bad debts and recapitalise the banking systems across the US and Europe is necessary, it would be unacceptable for governments to simply nationalise the losses of financial capital and let financial institutions privatise the profits. This most serious economic crisis since the Great Depression of the 1930s must mark an end to an ideology of unfettered financial markets, where self-regulation has been exposed as a fraud and greed has overridden rational judgement to the detriment of the real economy. A national and global regulatory architecture needs to be built so that financial markets return to their primary function: to ensure stable and cost-effective financing of productive investment in the real economy. Beyond this, governments and international institutions must establish a new economic order that is economically efficient and socially just – a task as ambitious as that confronted by the meeting in Bretton Woods in 1944.

To enable a new global process that is managed responsibly, a major recovery plan must be the first step towards global governance and secondly, we must ensure that a financial crisis on such a scale never happens again. A recovery plan to stabilise global capital markets, move economies rapidly out of recession, stave off the risks of a global depression and get back on the track of creating decent work is being proposed by the trade union movement. The challenges in the coming time are numerous and if we do not embrace bold decisions that enable coordinated interest rate cuts or bring forward carbon-neutral infrastructure investment programmes that can stimulate demand growth in the short term and raise productivity growth in the medium term, we are sure to fail. Now is the time to move forward with a “Green New Deal” to enable economic recovery and create decent, sustainable jobs through alternative energy development, energy saving and conservation.
The establishment of a new structure of economic governance for the global economy must go beyond financial markets or currency systems to tackle all the imbalances of growth and capital flows that contributed to the crisis. Just as the post-World War II economic settlements included the strengthening of the International Labour Organisation (ILO), in parallel with the creation of the United Nations, the new post-crisis settlement must address international economic governance and its imbalances. Governments must start work on the necessary structures. But, this debate should not be held between bankers and finance ministry officials behind closed doors. Trade unions must have a seat at the table to ensure that a new governance system tackles the crisis of distributive justice that has blighted the global economy. It must ensure more balanced growth in the global economy between regions, as well as within countries, between capital and labour, between high and low income earners, between rich and poor and between men and women.

2. Reregulating Global Financial Markets
A new process of regulation has to begin; the irresponsibility of promoting the causal factors that are responsible for this crisis - deregulation that favours excessive leverage of financial institutions including investment banks, hedge funds and private equity, and the ‘financial innovation’ of securitised credit risk transfers that exported bad debt under the guise of structured products – is now manifest for all to see. The business of structured finance created the illusion of low risk, low-cost capital. As the crisis revealed, risks were not spread but hidden. Coupled with ‘pro-cyclical’ banking accounting rules and rigid capital requirements, the credit crunch that followed the collapse of the structure finance industry created a self-perpetuating, asset depressing process in the banking sector.

The interventions made by central banks and governments in an attempt to restore confidence, stabilise credit markets and inject new capital are necessary to save the banking system. The banking solvency crisis follows a decade of excessive ‘shareholder value’ model of corporate governance and corporate short-termism. The money that was wasted in generous dividends, share buybacks and grotesquely large executive compensation packages in the past 2003-2006 ‘growth cycle’ is now badly needed as banks search for fresh money to recapitalise their balance sheets. While ordinary people across the planet risk losing their jobs and yet more small businesses face grim times, corporate bonuses in the US actually increased by 14 percent overall in 2008, as top executives in finance and industry, many from companies heading for bankruptcy, rewarded themselves for abject failure and pushed the global economy further to the brink of recession. As large parts of the financial system are being supported by the public taxpayer, trade unions insist that governments take equity stakes and act as activist investors in order to protect the public interest and ensure that taxpayers are eventually reimbursed. Wall Street’s US$ 18 billion bonuses last year could have provided two years’ education for the 75 million children around the world who have no school to go to. It would certainly save millions of jobs if put in the pockets of the working people who really create wealth.

International cooperation must go far beyond what is currently under consideration; it is not enough merely to review prudential rules for banks and ‘encourage’ more transparency. Foreign investments and capital flows should be submitted to proper domestic regulation, including observance of internationally recognised governance and transparency standards. The national and global
regulatory architecture needs to be restored so that financial markets return to their primary function: to ensure stable and cost-effective financing of the real economy.

**On the road to recovery: Effective and Coherent Global Economic and Financial Governance**

World leaders must authorise work to begin on a blueprint for reregulated financial markets to ensure that central banks are publicly accountable for their actions and have the necessary mandate to deter and detect speculative financial bubbles. We need active supervision, proper counter-cyclical asset requirements and accounting rules for banks and large financial conglomerates. The financial system has been permeated by different forms of off-balance sheet transaction and this must come to a halt.

Government leaders and central bankers must not repeat the calamities of the 1930s, with efforts to balance budgets, cut wages and ‘beggar thy neighbour’ exchange rate and currency policies. Instead the G20 leaders must put in place a coordinated recovery plan targeted at stimulating the real economy nationally and globally.

The recovery packages should also be designed to redress the underlying fundamental economic imbalances that have produced the current crises. These are notably the imbalance between the US and other parts of the global economy, the imbalance between finance and the real economy and the imbalance of bargaining power between workers and their employers. Those economies that have surpluses should redirect them to supporting domestic consumption and productive investment. Trade union rights should be fully respected and promoted so that workers can improve their living standards.

A new approach to fiscal responsibility must accompany a global New Deal. The worst error in the current circumstances would be to cut public sector budgets further. There must be a renewed commitment to the provision of publicly financed, quality public services. Rethinking the responsibilities of both the private and public sectors must include responsible resourcing of the public sector through fair taxation and a new commitment to efficiency and the ethical value of quality public services, in which the organisations representing public employees must be invited to play a key role.

**Financial Regulation for Stability and Growth**

Those who have been paying the highest price during the last twelve months, namely consumers and workers, must be protected against predatory lending and aggressive sales policies by banks. Ordinary people are losing their homes and their jobs due to the oligopolistic structure of the credit rating agency industry. It is essential that credit risk transfers, derivatives and futures are regulated and that non-financial sustainability rating is developed. By enhancing the social purpose of pension schemes to provide decent retirement in both pension funding and investment regulations, we can strengthen the social dimension of globalisation. Indeed, an international regime for taxing financial transactions should be established and the proceeds from which could help support financial institutions that bear social objectives, such as pension funds.

On the currently elusive financial market, a new set of clear ground rules is needed. It must become a priority to regulate private investment firms such as hedge funds and private equity, for example by setting up a “task force” that can combat regulatory arbitrage within large financial groups and between jurisdictions. By
adopting controls to limit speculative behaviour in commercial exchanges including commodities and energy markets, we can regulate the extent to which speculative trading is causing such massive price fluctuations as we witnessed on the agricultural commodities market in 2007-2008. Action must be taken to address the tax and regulatory measures that have allowed market makers to take excessive risks.

Further coordinated reductions in interest rates by central banks are needed in Europe and the US. Fiscal stabilisers such as unemployment benefit schemes must be strengthened and supplemented by direct job creation schemes, where necessary. Fiscal stimuli should target increases in aggregate demand of sufficient magnitude to revitalise the real economy: employment, wage and household disposable income growth. Tax and expenditure measures must be targeted at low and middle income families who are suffering most in the current situation and who, having higher consumption rates, will feed this back into consumption, production and hence employment most rapidly.

Corporate grand theft and short-termism should be curbed by strengthening governance and tax rules on executive compensation, board of directors’ responsibilities, risk management and distribution of corporate profits. Strong action is also required to stem the loss of revenues to tax havens. Tax payers cannot be expected to bail out failing financial institutions when the same institutions have used tax havens to avoid paying their fair share of tax. All governments need to take the necessary steps to protect their revenue base and to offset expected substantial reductions in corporate tax receipts. This will require strengthening the political support for the OECD’s work in this area.

**Sustainable Development Pathways for the World**

Governments in industrialised as well as developing countries must now begin to encourage and rebuild the institutions that help distribute income and wealth more fairly, as opposed to continuing to call for deregulation of labour markets and dismantling of workers’ protection. The crisis of distributive justice is more strongly apparent in non-OECD countries. Even before the food price crisis of 2007-2008 and the current financial crisis, the World Bank noted that in 46 developing countries out of 59 examined, inequality had increased over the previous decade. The worsening economic situation, on top of the explosion in food prices over the past year, will further accentuate income inequality and add to the deficit of decent work across the developing world.

While capital is leaving many developing countries that can ill afford the loss of investment, the problems are being compounded by the reduction of remittances by migrant workers, many of whom are also losing their jobs. In developing and emerging countries, governments should counter economic slowdown through monetary policy, by supporting job creation programmes and extending or creating social safety nets. The IFIs must not repeat the errors of the Asian financial crisis a decade ago by pressuring countries to increase interest rates, cutting back government spending and allowing widespread bank failures – the opposite of what industrialised countries are doing today. Instead developing countries should be encouraged to maintain levels of employment and offer government assistance to the most vulnerable sectors of the population.

If we are to find a way out of this ‘great recession’, investment in labour market programmes is necessary. To restore faith in the global governance system, recovery packages must encompass employment-intensive initiatives in addition to new financial regulatory measures. Without an extension of social safety nets to the
majority of developing-country workers, currently without protection and a coordinated effort to boost world economy by building up public services and infrastructure for sustainable growth, we will have no chance of achieving decent work and a fairer globalisation.

Working towards universal social protection must become a primary challenge for world leaders in 2009. The food price crisis of 2007-2008 illustrated the urgent need for sustainable and just investments, both in agriculture and in the labour market - investments that can serve citizens, workers, unemployed and vulnerable women and men. Investments in social security remain an effective tool in alleviating poverty, hunger and inequalities but those investments have not reached 80 percent of the world’s population, which is the percentage of people working and living without social security nets. It can become a reality, even in the least developed countries, and especially in countries highly vulnerable to climate change, to finance minimal social transfers to combat poverty. A social security package consisting of a modest pension, access to safe drinking water and child and health services can make the difference between succeeding or failing in eradicating extreme poverty by 2015.

Beyond infrastructure, this is also the time to invest in people – in their education and health, and in care for the very young and the aged. 18 million new teachers must be trained just to meet the goal of quality education for all primary age children by the year 2015. Millions more teachers and instructors are needed for vocational education and training for skills that underpin the real economy and for retraining of working people as economies restructure. Such long term and productivity enhancing investment in public infrastructure – schools, hospitals, clean water and sanitation as well as public transport and energy – will not only help national economies to avert or climb out of recession, but will lay the basis for millions to overcome poverty.

3. A New Agenda of Economic and Environmental Reform
As stated earlier in this article, now is the time to reshape the global financial and economic architecture through a new set of ‘Bretton Woods’ negotiations that go beyond the exchange rate regime created at Bretton Woods in 1944. None of the existing institutions has the scope or the credibility to put in place such a structure. Governments must start the work, but the debate must not be held between bankers and finance ministry officials, behind closed doors. Trade unions represent the working families across the globe, those who are the victims of the current crisis, and must be present at the table as well.

The institutional reforms must go beyond financial regulation and introduce economic management aimed at reducing the imbalances in the global economy. Emerging and developing country governments must be a central part of the new governance structure. At the IFIs, a more fair and democratic governance structure should be put at the forefront of reforms. In the case of the World Bank, whose mandate is focused on developing countries, there is a need for a deep and systematic reform which must result, at the very least, in parity of voting power between developing and industrialised countries. Both IFIs must also put an end to the economic policy conditionality that has characterised their interventions in developing countries over the past three decades. This has minimised rather than strengthened the application of fiduciary controls and respect for internationally agreed standards, including core labour standards. The deregulation, liberalisation and privatisation conditionalties of the IFIs, in addition to interfering with countries’
own policy choices, have frequently led to serious and damaging impacts. This approach must be changed. The normative standards of the ILO, and notably core labour standards and environmental standards, must underpin the new international governance system. Governments must start work on the necessary structures and, in line with the ILO Declaration on Social Justice for a Fair Globalisation adopted by the International Labour Conference in 2008, the ILO must be at the heart of the new architecture.

Trade has the potential to boost economic growth, recovery and development, but only under the right conditions. Restoring the public legitimacy of the world trading system and concluding the Doha Round requires simultaneous progress on the enforcement of the protection of fundamental workers’ rights through all international institutions, including the WTO, and on ensuring that developing countries are able to achieve economic recovery, employment and future industrial development.

The changes that are necessary must benefit the people and our planet. Wage stagnation and the lack of purchasing power for working families are both a result of damaging policies and themselves a major factor behind the fall in household savings and the emergence of unsustainable debt that led to the mortgage crisis in many countries. Financial deregulation allowed creditors to promote borrowing against home equity as a substitute for income. Financial bubbles in asset prices, stimulated by excessive leverage and lax rules, substituted for sustainable growth based on shared earnings. There is a need for a new growth regime that – as was the case during the post-war period until the early 1980s – ensures balanced real wage growth in line with productivity increases. Fair responsible and progressive taxation should neither facilitate the accrual of fortunes, nor provide incentives for the pursuit of speculation, but rather contribute to growth.

The dual challenges of recession and climate change require leadership and ambition. The trade union movement sees jobs as the missing link between economic recovery and green solutions but in order to overcome the crisis of globalisation, we will have to restructure a new global governance system based on social justice, market regulation and green growth. The crisis requires responses that are fully coordinated with initiatives to minimise climate change. Only through a globally coordinated effort can climate change be mitigated and emission reduction targets achieved. The world urgently needs to mobilise resources and technology to enable developing countries, in particular major emitters, to achieve greenhouse gas emission reduction. Clear targets on renewable energy, energy efficiency, clean coal technology and avoided deforestation must be agreed upon to provide access to decent livelihoods for the citizens of the world.

It is paramount that the efforts to fight climate change build on synergies between poverty reduction strategies, job creation and new technologies. A ‘just transition framework’ should be promoted to ensure fairness in the transition towards a low carbon economy. By addressing worker displacement, migrations, unemployment in climate-sensitive sectors, along with the effects of adaptation and mitigation, a step closer towards the social dimension of climate change can be taken. The just transition should be based on decent jobs and the greening of workplaces; it should be based on sustainable industrial development and an equitable share of the burden of responsibilities and gains. We have to save jobs, not create more unemployment, by upgrading labour skills and retooling industry to create millions of new “green jobs” that can not only contribute to a reduction of the
environmental impact of enterprises and economic sectors but also lay the groundwork for stimulating the world economy.

The opportunity should be taken to launch a “Green New Deal”, as called for by the United Nations Environment Programme (UNEP), the ILO, the ITUC and the International Organisation of Employers in the 2008 Green Jobs report. This is the time to aid economic recovery through environmentally responsible investment designed to create jobs in the short-term, including for youth and women, and to reduce greenhouse gas emissions in the medium term. Measures to promote energy saving through retrofitting buildings will be particularly employment intensive, thus supporting the hard-hit construction industry. Public investment in infrastructure, mass transportation, and alternative energy sources will stimulate green job creation.

**Conclusion**

The international trade union movement has repeatedly denounced the growing divergence between unregulated and unmanageable financial markets on the one hand, and the financing needs of the real economy to provide decent work on the other. According to the OECD, the international financial architecture should be judged upon its capacity to “maintain financial stability by ensuring solvency of market participants”, to “protect investors” against failures and fraud, and “to ensure efficient and effective financial markets”. In past months it has become clear that the system has failed to deliver on all three objectives.

The current economic crisis provides an opportunity to alter the failed policies that have brought about the current situation. We need to seize this chance and adapt and change an international system devised in the 20th century to meet the needs of the 21st century. By reforming the global system of governance, the rules of the game can be reversed to correct the imbalances in environment and finance that have brought us to our present situation.

As I said at the beginning of this article, the decisions and the choices we make in the year of 2009 will be pivotal. Without wide-ranging international cooperation among all parties involved, our prospects to restart the world economy at the same time as tackle climate change will have a greatly reduced chance of success. We need to successfully address the challenge of combining institutional reform at the same time as sustainable job creation that will lead to higher productivity and thus stimulate carbon-neutral economic growth. We all have a stake and a common responsibility in achieving this transformation successfully and in thus ensuring that the downward spiral is turned around as quickly as possible, and on a truly sustainable basis.
vi. Collective bargaining in the global economy
By Larry Cohen\textsuperscript{16} and John Logan\textsuperscript{17}

Introduction: collective bargaining is essential
In February 1938, the British economist John Maynard Keynes wrote to US President Franklin Roosevelt about the recession gripping the US economy. After discussing government employment as part of a stimulus package and financial reforms, Keynes stated: “I regard the growth of collective bargaining as essential”\textsuperscript{18} In fact, collective bargaining was already growing following the passage of America’s first statutory reform promoting collective bargaining, the 1935 National Labour Relations Act (NLRA), as nearly one million workers a year were gaining bargaining rights, and building unions that increased incomes and buying power.

Seventy years later, bargaining coverage has expanded globally, but in the US it has declined to about 8 percent in the private sector, back to its pre-NLRA level, after peaking at 35 percent in the 1950s. Yet Keynes’ argument concerning the need for bargaining is as true today as it was in the 1930s. Bargaining coverage is directly correlated to critical living standards (health care, income equality, pensions and paid time off) while the growth of union membership has been directly related to the election of progressive governments in Latin America, Europe and North America.

Despite the social and economic benefits accruing from it, almost without exception, global corporations oppose collective bargaining to the full extent permitted by national laws. Even when national laws provide for workplace participation and codetermination, as in most of Continental Europe, this does not affect the behaviour of multinational corporations (MNCs) based in those countries when they operate in the US and much of the global South. Firms like Deutsche Telekom and BMW cooperate with unions in Germany, while engaging in aggressive anti-union campaigns in the US and elsewhere. These same firms oppose government regulation and public spending, and contend that they need unlimited flexibility to maximise profits, irrespective of the harmful social and economic impact of their actions on the majority of the world’s workforce.

The consequences of management hostility to collective bargaining have been different in different countries. The level of collective bargaining coverage in a nation largely reflects organised labour’s political clout, which itself is the main factor in predicting union recognition rights and collective bargaining coverage. In nations with high bargaining coverage and greater union influence on national labour policy, opposition to collective bargaining and its social and economic outcomes (social security, greater income inequality, and higher living standards) is more muted.

In the midst of the biggest global recession since the 1930s, governments in wealthy nations have rushed to bail out the financial sector and its CEOs – the very actors who created much of the current crisis, while they have concurrently produced the greatest wealth gap in generations. But the same governments have ignored

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\textsuperscript{17} Mr. John Logan, Research Director at the Institute for Research on Labor and Employment, University of California at Berkeley
\textsuperscript{18} John Maynard Keynes, Private Letter to President Franklin D. Roosevelt, February 1, 1938.
millions of workers around the world who lack bargaining coverage because they work in the informal economy, because they face hostile employers, because they are classified as independent contractors lacking bargaining rights, or because their former employers have relocated to countries where they can avoid bargaining altogether.

This paper examines the global assault on collective bargaining and how to reverse it. The first section analyzes the systematic destruction of collective bargaining in the US and its consequences. Section two examines why, with the exception of Colombia, bargaining coverage is higher in every other democracy in the world than it is in the US. The final section explains why global unions and progressive lawmakers in other nations should support the Employee Free Choice Act – a landmark attempt to restore the freedom to choose a union and bargain collectively in the US.

Section 1: The second worst democracy in the world for collective bargaining
As a result of a sustained assault by hostile employers and right-wing governments, the US has experienced a precipitous decline in collective bargaining coverage, which now stands at about 13 percent of the non-agricultural workforce. Among countries recognised as democracies, only Colombia (not a nation with which the US normally invites comparisons) has a lower rate of bargaining coverage. The consequences of the erosion of collective bargaining are clear: among developed democracies, the US has the greatest levels of income inequality, economic insecurity, and annual working hours, while basic entitlements at work trail far behind those of other nations. The stagnation and fall in real wages for most US workers, itself partly a consequence of the decline in bargaining coverage, has contributed to the current economic crisis. The lessons the US experience holds for global unions and progressives are clear: if they seek to encourage collective bargaining, and avoid the consequences of its erosion borne by most US workers, they must push for the enactment of laws that ensure that workers who want bargaining can get it.

“Representation gap” higher in US than in any other developed democracy
Aggressive employer opposition and government hostility in the US has led to an enormous unfulfilled demand for recognition and bargaining. The “representation gap” (the gap between those who have bargaining and those who say they want it) is the highest among advanced Anglophone countries and probably the highest in the developed world. Approximately 50 percent of non-union workers say they want bargaining but cannot get it. Thus, if all of the workers who want bargaining rights were able to get them, collective bargaining coverage in 2005 would have been about 58 percent, instead of the actual figure of 13 percent. The principal obstacle to eliminating this enormous representation gap is employer aggression. Over 50 percent of US workers view employer opposition as a “major reason” for their inability to obtain recognition and bargaining at work (Freeman 2007).

What happens when bargaining is destroyed?
The destruction of collective bargaining has had a profound economic and social impact on the lives of US workers: income inequality, economic insecurity, and annual working hours have increased, while basic entitlements at work trail far behind those found in other developed nations. The US has among the highest overall, child, and elderly poverty rates of all OECD nations. In 2000, 21.9 percent of
US children were living in poverty, compared with 2.8 percent in Finland and 2.4 percent in Denmark. Americans work longer hours than their European and Japanese counterparts. In 2006, the average American worked 1,804 hours, compared with 1,436 hours in Germany, 1,564 hours in France, and 1,669 hours in the UK. Even Japan, which for years topped OECD tables for annual working hours, has an average of only 1,784 hours (Economic Policy Institute, 2006-2007).

The US is one of only a handful of nations that has no national provision for paid family leave. 170 countries offer some form of paid maternity leave; 98 of these countries provide at least 14 weeks paid maternity leave. Americans are entitled to up to 12 weeks unpaid leave under the 1993 Family and Medical Leave Act, but up to 40 percent of workers are excluded from its provisions because of the size of their workplace, and even among those workers who do qualify, approximately 78 percent cannot afford to take unpaid leave. The only other developed democracy without paid maternity leave, Australia, is currently considering the introduction of this benefit. Countries such as Sweden, Denmark, Finland, France and Belgium, which all have high levels of bargaining coverage, provide generous entitlements for paid family leave. The US is also an exception among OECD countries in having no statutory minimum vacation for workers. Most European countries, in contrast, have four or five weeks statutory paid vacation. Stronger union movements in Europe have adopted the causes of shorter hours, paid family and vacation leave, universal health care and state pension provision, while high levels of collective bargaining coverage have kept down income inequality (Economic Policy Institute 2008-2009). Unless the current decline in collective bargaining coverage is reversed, this lack of workplace entitlements and growing income inequality in the US will only get worse.

“Recapturing the middle-class society we’ve lost”
The dramatic decline in US collective bargaining coverage since the 1970s, and resulting decline in real wages for most workers, has contributed to the current economic crisis. As a result of employer and government assaults on bargaining, the link between rising productivity and rising wages that existed for most of the post-war decades has been broken and real earnings have stagnated in recent years. Substantial gains in productivity have not been matched by gains in wages and productivity: median household income actually declined during the economic expansion of 2002-2007. While the end of the housing and stock market bubbles have contributed to the current economic crisis, those bubbles mostly masked the underlying crisis (declining real wages) by allowing working families to borrow against unsustainable rises in the value of their homes.

But some Americans have done well in recent years. CEO pay has risen from approximately 25 times the rate of the average worker in 1973 to 250 times the rate in 2007 – many times higher than the CEO/average worker pay differential in Western Europe or Japan. The income of the top 1 percent grew an average of $1.3 million per household between 1979 and 2006. The wealthiest Americans have not enjoyed such a large share of the total national income since the 1920s. Thus, those who actions have been most responsible for precipitating the current financial crisis have benefited most from the lopsided economy. Restoring the freedom to bargain collectively through the Employee Free Choice Act would ensure that the economy works for the vast majority of working Americans, not just for those at the top of the labour market. Collective bargaining boosts the wages of US workers – especially those of women and minority workers – and those with bargaining coverage do significantly better than those without in employer-provided health and pension
benefits. Restoring worker freedoms will help create a recovery based on rising real wages (not on consumer debt, which makes working families vulnerable to foreclosure and bankruptcy) halt the erosion of employer-provided health and pension benefits, and promote growth in which the median income grows. In the words of Nobel Prize winning economist Paul Krugman, enacting the Employee Free Choice Act would be “a huge step toward recapturing the middle-class society we’ve lost” (Krugman 2009).

Section 2: How does the US compare to the rest of the world?
First: the usual suspects. Collective bargaining coverage in every nation in continental Europe is several times higher than it is in the US. While union density has fallen in several European countries, collective bargaining coverage has remained high and relatively stable. Union density in Western Europe ranges from below 10 percent in France to almost 80 percent in Sweden, but collective bargaining coverage is over 80 percent in all but Germany, where it is over 60 percent. Several factors have contributed to a more supportive environment for collective bargaining: centralised labour market regulation, union involvement in unemployment insurance in certain countries, and union-friendly legal frameworks.

In most of continental Europe, employer opposition to collective bargaining is not a major problem; thus, many countries do not have specific legislation addressing the issue. US-style systems of majority recognition do not exist in continental Europe. Statutory or constitutional provisions on freedom of association are interpreted in some countries as entailing bargaining rights, and national laws in certain countries contain a legal obligation to bargain. In Austria and Slovenia, for example, compulsory membership of employers’ organisations results in almost 100 percent collective bargaining coverage. Even in those continental European countries in which multi-employer bargaining is voluntary, there is often strong state sponsorship for bargaining without statutory backing. Under mandatory extension laws, which extend collective agreements to cover non-union workers in Germany, France and Holland, bargaining coverage has remained high, even as union density has declined (Traxler 2002). But it is not simply the “usual suspects” that have bargaining coverage greater than the US. Even in post-communist Central and Eastern Europe (where unions are weaker and often operate under unfavourable macroeconomic conditions, especially skyrocketing unemployment) coverage is, on average, significantly higher than in the US (European Foundation for the Improvement of Living and Working Conditions, 2006, 2007).

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Europe is, of course, no paradise for workers. European unions are facing many of the same challenges as their US counterparts: heightened international competition and relocations to countries with cheaper labour costs and fewer legal protections, increasing employer demands for decentralisation in bargaining and company-specific flexibility, the challenge of maintaining stable organisations among low-paid, dispersed and transient service sector workers, and more hostile national governments. But aggressive US-style anti-union campaigns are still extremely rare. Few European employers campaign against bargaining coverage and threaten workers’ careers or predict job losses through relocation or closure if workers choose to bargain collectively. Organising in Europe typically means internal recruitment, as workers are already covered by a collective agreement. In the US, organising involves both an adversarial campaign for bargaining rights at a specific employer and a union membership campaign. This difference contributes greatly to the higher bargaining coverage in Europe, and explains why BWW and Mercedes-Benz workers, among others, have bargaining in Germany but not in South Carolina or Alabama.

**Collective bargaining in new democracies**
Recent developments in certain new democracies provide greater grounds for optimism. Despite inhospitable environments (unfavourable macroeconomic conditions, widespread privatisations, and enormous informal sectors) collective bargaining coverage has risen in several new democracies over the past few decades. In South Africa, for example, bargaining coverage has risen from around 10 percent to over 40 percent since the 1980s. In Brazil, Argentina, Peru and Uruguay, left-of-centre governments have strengthened recognition and bargaining rights and coverage has risen. Bargaining coverage has also increased in Taiwan and Korea. Workers in these nations can gain bargaining coverage without having to endure employer-dominated representation elections and bargaining campaigns, as they must do in the US. While one should not minimise the obstacles faced by workers in these countries, their experience demonstrates that, even under adverse circumstances, bargaining decline is not inevitable, pressures associated with globalisation are not irresistible, and governmental policies do matter. Having trailed other OECD nations for years, US bargaining coverage has now also fallen below that found in several new democracies (Cook 2007, Holdt and Webster 2008, Kuruvilla 2002, Phelan, 2007).

**The worst democracy in the world for collective bargaining**
The US is not quite the worst democracy in the world when it comes to collective bargaining coverage. That dubious honour belongs to Colombia, the only nation in the world recognised as a democracy that has lower collective bargaining coverage than the US. The explanation for this is clear. Since the 1980s, right-wing paramilitaries and their allies have assassinated 2,600 Colombian unionists. This murder of trade unionists has been well documented, but less well-recognised, Colombian unions have been destroyed in the process (Gill 2005). Collective bargaining coverage has fallen to less than 1 percent of the country’s 18 million adult workers. Adding to routine acts of terror committed against trade unionists, Colombia has among the most reactionary labour laws of any so-called democratic nation. Only 2 million of the nation’s workers are classified as employees. The rest are “contractors” or work for “collectives” and are denied employee status and collective bargaining rights. The law classifies, for example, almost all Colombian journalists as
contractors who must sell advertising along with their stories and are often prime targets for right-wing death squads. The Global Union Federation, International Federation of Journalists, assists an organisation of Colombian journalists but none have employee status or collective bargaining rights.

Nor are journalists an exception. Colombian telecom workers are routinely fired for anti-union purposes. Management recently fired nearly 10,000 workers at the nation’s main telecom company, which is now operated by Telefonica, the world’s fourth largest telecom corporation. The Global Union Federation, UNI Telecom, has a global agreement with Telefonica, but this agreement, which has led to widespread bargaining elsewhere in South America, has achieved nothing in Colombia. Telefonica management used the firings to destroy the union and cut costs after taking over from a government-owned entity. As a result of these anti-union actions, no Colombian telecom workers currently have collective bargaining agreements.

In common with other unions, Colombia’s once powerful public sector unions have been targeted by right-wing paramilitaries and have had many leaders assassinated. Like telecom unions, they have experienced mass privatisations and discrimination against union supporters. In one case that provoked a global union campaign, management fired 51 municipal union leaders in the city of Cali. The workers are still waiting reinstatement, several years after the International Labour Organisation found that they had been illegally victimised for union activity.

These extreme anti-union actions have not occurred in a vacuum. US corporations, including many that are household names, have benefited from the destruction of collective bargaining and have frequently been accused of complicity in the violence against Colombian trade unionists (AFL-CIO 2008). Thus, when ranking the worst democracy in the world for collective bargaining coverage, Colombia beats the US. But the US is much closer to Colombia than it is to Europe.

**Global unions and the assault on collective bargaining**

Global unions have started to resist these attacks on collective bargaining (Bronfenbrenner 2007). Most global bargaining campaigns have focused on the behaviour of MNCs within a specific sector or industry because resources are concentrated in the sector-based Global Union Federations (GUF). The 11 largest GUFs comprise the Council of Global Unions, which held its inaugural meeting in Brussels in January 2007. National affiliates of global unions in several sectors (food, steel, mining, textiles, services, finance, and telecoms) have coordinated efforts to advance bargaining rights at specific MNCs. The International Union of Food Workers has coordinated action between its affiliates to reach a global agreement with Nestlé and other large food processors, while the International Metalworkers Federation has coordinated action between its affiliates at Ford and other auto companies for several decades (Croucher and Cotton 2009).

Telecommunications unions have cooperated globally for more than half a century, mostly recently through UNI Telecom, even as the nature of the industry has transformed from traditional telephone services to high speed Internet with converged data, voice and video. Telecom workers have been among the best-organised workers in developed democracies for decades. Even in the face of intense international competition and the introduction of new technologies, telecom bargaining coverage remains well over 75 percent in OECD nations and in much of Latin America (Traxler 2006). But telecom workers are facing serious threats. New actors have entered mobile communications, and have promoted deregulation or, in many cases, no regulation. Several traditional telecom companies have eschewed
cooperation, believing that union avoidance will result in higher profits, particularly in their new ventures and global operations. Vodafone, the world’s largest exclusively mobile company, resisted collective bargaining in its UK operations until early 2008, when engineers gained recognition over sustained management opposition. The largest telecom company in the US, AT&T, has practiced neutrality and recognised unions on the basis of majority membership for more than a decade. In contrast, Verizon, the nation’s second largest firm, has opposed recognition and bargaining in new ventures and acquisitions. Likewise, Comcast, the largest cable TV and Internet provider, has fought recognition and bargaining, and has engaged in illegal anti-union activity. Thus, the telecom sector provides examples of both international union cooperation and transnational opposition to bargaining rights (Cohen and Early 2000).

Section 3: Why global unions and progressives should support the Employee Free Choice Act

If US unions are unable to win labour law reform under the current Democratic Administration, they may not be in a position to do so again. When Congress last considered reform of the NLRA to strengthen recognition and bargaining rights in 1977-1978, collective bargaining coverage in the US was around 23 percent, almost double its current level. Large regions of the country and large sectors of the economy already have virtually union-free private sectors. Without reform it will become progressively more difficult for even the most vigorous unions to organise the unorganised. And simply because bargaining coverage has declined at around 0.5 percent per year for the past few decades, there is little reason to assume that it will continue to decline at this slow, steady pace. We may soon reach the point where US unions are so weak that decline becomes rapid and irreversible. This would be a disaster not only for American workers, but also for workers around the world, who would be increasingly likely to encounter the same anti-union practices and the same anti-union firms as their US counterparts. No longer concerned about the “threat” of unionisation at home, US MNCs would be emboldened to export their union avoidance practices to their overseas operations. And non-US MNCs who could be guaranteed union-free operations in America may well be emboldened to resist unions in Europe, Latin America and Asia. But if US unions gain the enactment of the Employee Free Choice Act and reverse the employer offensive, this would benefit not only American workers, but also those in other democratic nations. If unions are to organise and bargain with MNCs and private equity firms on a global level, they must first reverse the trend towards a union-free environment in the US.

Exporting the US model of union avoidance

- Union avoidance consultants arrive in the UK
  Among developed democracies, the US is alone in having a sophisticated industry worth hundreds of millions of dollars per year devoted entirely to helping management undermine collective bargaining. But several US union avoidance firms have recently sought overseas markets for their expertise (Logan 2006). When Britain introduced its new recognition law in 1999, one union avoidance firm wrote: “65 years’ US experience with union organisational experience provides valuable parallels from which UK employers can learn how to stay union-free. It is clear from US experience that worthy UK employers... will be able to
defeat union organising efforts.”\(^{19}\) Former Trades Union Congress General Secretary and current European Trade Union Confederation General Secretary John Monks criticised the firm for promoting a “dubious approach” to bargaining that was “far more suited to the aggressive nature of US industrial relations.” But other consultant firms soon followed in its path. One large US union avoidance firm, The Burke Group (TBG), has established an international division that operates in Canada, Mexico, South America, UK, Belgium, France and Germany, telling clients that it enjoys an international reputation for “eliminating union incursions.” In recent years, TBG has conducted several high-profile UK campaigns with devastating effect. When confronted by US union avoidance tactics, UK unions typically spend more time and resources on campaigns and are much less likely to win recognition. If this behaviour were to become the norm in the UK, as it has in the US, it would likely have disastrous consequences for British workers (Logan 2007).

- US MNCs and union avoidance in Ireland
The US model of union avoidance has also transformed collective bargaining in Ireland. Prior to the 1980s, most foreign MNCs followed the country’s dominant industrial relations model, accepting unions and collective bargaining. This situation started to change when US MNCs opened non-union plants in Ireland in the 1980s. Today, most US MNCs operating in Ireland pursue an aggressive union avoidance strategy. US-based firms are much less likely to recognise unions in new plants than are their Irish, UK or European counterparts, and have been at the vanguard of an aggressive union avoidance strategy among Ireland’s MNCs. One study of several hundred US MNCs concluded: “It would appear that the pattern of union avoidance which began in a small number of US subsidiaries in the 1980s has now become widely embedded in the MNC sector, to the extent that it greatly threatens union presence in this very significant area of the Irish private sector” (Gunnigle, Cummings, Morley 2007). Union density in Ireland has fallen from 62 percent in 1980 to 35 percent in 2004, and the growing importance of US MNCs has ensured that its collective bargaining system is “closer to Boston than to Berlin.”

- US employer associations oppose labour rights in China
American employer associations have sought to block or weaken legislation designed at strengthening workers’ rights in other nations. China, now the world’s third largest economy, has no genuine collective bargaining between corporations and independent unions, and US employer associations want to keep it that way. The American Chamber of Commerce in Shanghai and the US-China Business Council (USCBC) tried to block the adoption of China’s 2007 labour contract law, which provides minimal protections for some of the nation’s most vulnerable workers. Part of their campaign included thinly-veiled threats that US corporations would leave China if the law were to be enacted (US-China Business Council 2006). US employers want to maintain a cheap labour force in China with few legal protections, but have other concerns, too. China is increasingly important to the establishment of global labour standards and the suppression of labour rights there encourages a “race to the bottom” in wages and standards in the rest of the world. But the USCBC has expressed a willingness to accommodate unions in

\(^{19}\) Eversheds, “Trade Union Roadshow,” May 16 2000, Ironmongers’ Hall.
China, as its state-controlled unions are unlike their US counterparts, “where, when they come in, they’re automatically antagonistic.”

**Conclusion:** the assault on bargaining and the end of US exceptionalism?

The US currently has a labour law that is, fundamentally, a lie. To this day, the stated purpose of the National Labour Relations Act is to “encourage collective bargaining,” but the law has been interpreted and enforced in a way that makes it virtually impossible for workers to exercise their right to bargain collectively. As a result of aggressive employer opposition and weak protection for recognition and bargaining rights, the US has the highest unfulfilled demand for collective bargaining in the developed world. With the exception of Colombia, in no other democracy do employers routinely fight workers’ efforts to bargain collectively using every weapon at their disposal. The assault on bargaining, and the resulting decline in real wages for most workers, has contributed to the current economic crisis in the US.

But strengthening bargaining rights will not come easy. US employer associations have promised “Armageddon” in the fight against the Employee Free Choice Act and have set aside a war chest of $200-300 million for the purpose of defeating this progressive attempt to restore the freedom to choose a union and bargain collectively. In response to international support for reform, the far-right National Right to Work Foundation wrote: “AFL-CIO is touting the fact that Big Labour unions in 45 countries are pushing the US Congress…. Is this something they really want to brag about?”

While union density has declined significantly in some European countries and remained relatively stable in others, levels of collective bargaining coverage have remained high. But there is little reason for complacency. Fewer European employers are participating in industry-wide bargaining, and it is unlikely that this trend will be reversed anytime soon. Even in Scandinavia, which has long had the world’s highest rates of coverage, some employers are pushing for greater decentralisation of bargaining. Unions throughout Western Europe have also experienced a decline in their ability to influence national labour policy. Adding to the problem of labour movements in several nations, US-based employer groups, MNCs, and consultants are attempting to export the US model of union avoidance. The trend towards a union-free environment in the US makes it more likely that aggressive anti-union behaviour will spread in Europe and elsewhere. This fact alone provides good reason why global unions and progressives should support the Employee Free Choice Act.

Recent developments in collective bargaining coverage in certain new democracies give more grounds for optimism. However, in South Africa, Brazil, Argentina, Taiwan and elsewhere, collective bargaining coverage has increased significantly over the past couple of decades. Although still low by European standards, the trend in collective bargaining coverage in these countries has been upwards, not downwards, as is the case in several developed democracies. Governments in these countries have strengthened workers’ bargaining rights, while unions have linked their struggles to democratic movements for political reform and social justice. Much can be learned from their experience.

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vii. The Global Impact of Employment and Work on Health Inequalities: the need for a new policy agenda

By J. Benach, C. Muntaner, O. Solar, M. Quinlan, H. Chung, V. Santana, M. Vergara

1. Employment and work under neoliberalism

Work is the means through which most people provide for their daily sustenance. People work in or out of their homes, with or without labour contracts, and in either safe or hazardous working conditions. Although factors related to working conditions have received a great deal of attention, being recognised as a key social determinant of health and health inequalities, this has not often been the case for employment conditions. Labour markets and social policies determine employment conditions such as precarious or informal jobs, child labour or slavery, problems such as having highly insecure or low paying jobs, or working in hazardous conditions, which heavily influence individual and population health status and thus inequalities. These types of employment and working conditions have different implications for the health of populations and social inequalities in health across social classes, genders and racial/ethnic groups.

Key influences affecting changes to employment dimensions over the past thirty years include the growing influence of corporations and the abandonment of Keynesian economic policies and social compacts. In their place has emerged a dominant neo-liberal model whose fundamental mission has been to facilitate conditions for profitable accumulation, with the consequence of transferring assets, wealth and income towards the upper classes and from poor to rich countries. These policies, often built on the dismantling of the post WW II cross-class agreement of corporatist order, have not only increased social inequalities across countries and social groups, but have also favoured the ideology of microeconomic rationality as the validating criterion for all aspects of social life and thereby resulted in universalised market dependence in a society (Rupert, 1990; Navarro, 2007).

Neo-liberal policies and practices stem from the belief that competitive private markets deliver the best social outcomes including the following: (1) the reduction of
state interventions in economic activities; (2) corporatisation, commoditisation and privatisation of hitherto public assets; (3) reduction of public social expenditures; (4) deregulation of financial transactions and interest rates, and the removal of credit controls; (5) liberalization of trade with removal of barriers to commerce; (6) the commoditisation and privatisation of land and the expulsion of peasant populations; (7) colonial, neo-colonial, and imperial processes of appropriation of assets, including natural resources ultimately backed by political violence; (8) conversion of various forms of collective property rights into exclusive private property rights; (9) more control over organised labour and limiting the right to organize; and (10) deregulation of labour with more “flexibility” in the labour markets, downsizing and outsourcing/off-shoring (Harvey, 2003; 2006; Navarro, 2007).

Under neoliberalism, the ideology of individualised self-interest and choice are seen as pre-eminent, while the significance of economic power imbalances amongst individuals and the counter-balancing role of collective interests are minimised. In this way, neo-liberalism has promoted individual assumptions of risk (e.g., individual pension plans rather than state pensions) and is much less sympathetic to redistributive mechanisms and social protection laws circumscribing business and commercial law and policies (on competition and the like) and more sympathetic to business practices such as downsizing, off-shoring, franchising, labour leasing, and greater flexibility in work arrangements, including “freer” international flows of labour (such as business and specialist migration, short-term entrants). The increased use of supply chains/subcontracting networks (at the national and international level), often driven by powerful corporations, has also accelerated changes to labour market conditions in both wealthy and poor countries.

In wealthy countries, the outcomes of these changes include a reduced social safety net for the unemployed and poor, job losses in the public sector, growth in job insecurity and precarious employment, a weakening (in practice) of regulatory protections, and the historical re-emergence of an informal economy, including home-based work and child labour. Comparison between wealthy countries in 1880 and poor countries in 2008 reveals some striking parallels in terms of labour market conditions, the power of labour, health infrastructure, and social protection (Steinmo et al., 1992; Quinlan et al., 2001) (see Table 1). This impact is further complicated by increased female workforce participation and an ageing population in these countries. In poor countries, the reliance on neo-liberal economic policy has resulted in a model of economic development oriented toward productivity and supplying products to global markets in three ways. First, irrespective of their effects on local communities, the strategies employed include “race to the bottom” working conditions to attract overseas capital and the use of corporate-friendly, low regulatory special export zones. Some of the harmful by-products of these practices include decreased domestic food production, rural dislocation, and social instability (Labonté et al., 2005). In addition, cuts to the public sector have had significant implications on education and health expenditures. It has been argued that weakening the capacity of the state to redistribute income has undermined the low income/high health outcomes which a number of middle-low income countries managed to achieve in previous decades (Labonté, 2001). The formal sector has experienced downsizing, job insecurity, and outsourcing analogous to those in wealthy countries while the already substantial informal sector—exempt from most forms of social protection—

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30 This theory has not been followed in practice since many states have actually become more interventionists (e.g. in the US with large subsidies to the agricultural, military, aerospace, and biomedical sectors)
has grown in many instances. These are the three major setbacks to poor countries pursuing a neo-liberal economic framework.
Table 1. Work and the protection of workers’ health in wealthy and poor countries 1880-2008.

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<th>Wealthy countries</th>
<th>Poor countries</th>
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<tr>
<td><strong>Employment security and contingent work</strong></td>
<td>1880: No regulated job security and substantial contingent work</td>
<td>1970: Secure jobs norm (except women)/small contingent workforce</td>
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<tr>
<td><strong>Minimum labour standard laws (wages and hours)</strong></td>
<td>1880: No minimum wage or hours laws (except children)</td>
<td>1970: Universal minimum wage and hours laws</td>
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<td><strong>Extent of union membership and collective bargaining</strong></td>
<td>1880: Union density low (&lt;10%) and limited collective bargaining</td>
<td>1970: Union density 25–50% and extensive collective bargaining</td>
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<tr>
<td><strong>Extent of vulnerable groups of workers</strong></td>
<td>1880: Extensive exploited vulnerable groups (women, immigrants, home-workers, young and homeless, old)</td>
<td>1970: Still vulnerable groups (women, immigrants and home-workers) but more circumscribed</td>
</tr>
<tr>
<td><strong>Extent of occupational health and safety law</strong></td>
<td>1880: Limited OHS law (factories, mines) and poorly enforced</td>
<td>1970: Expansionary revision of OHS laws initiated</td>
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These impediments are further exacerbated by a series of exogenous factors, multiplying the scale of the problem. Elaborate supply chains obfuscate the ultimate producer of goods and services in ways that help perpetuate work arrangements that often bear a close parallel to the exploitation of vulnerable workers (i.e., women, children, and foreign-born workers) in wealthy countries over 100 years ago (Quinlan et al., 2001).

In an increasingly globalised, market-based economic system, the political, economic, financial and trade decisions of a handful of institutions and corporations affect the daily lives of millions of people worldwide. These decisions create labour standards, occupational health and safety regulations, and union protections, among many others. Large corporations are particularly relevant to this process thanks not only to their growing power and resources, but also to their pervasive influence on key economic decisions that have serious consequences in the production of health, disease, and death (Wiist, 2006). Of the world’s 150 largest economic entities including countries, 95 are corporations. The revenues of Wal-Mart, BP, Exxon Mobil, and Royal Dutch/Shell Group all rank above the GDP of countries such as Indonesia, Saudi Arabia, Norway or South Africa (World Bank, 2005). Multinational corporations manufacture many of the goods and services we consume and they contract or subcontract millions of jobs, many of which have a negative impact on their employees’ health. Furthermore, corporate interests—predominantly neo-liberal policy instruments such as the World Bank, the World Trade Organisation, and the International Monetary Fund—and the governments of some wealthy countries (providing aid) in general have not been sympathetic to the expansion or upgrading of social protection frameworks within poor countries. It cannot be presumed that most poor countries will follow the path of wealthy countries over the past century in terms of labour market intervention and social protection. While a scaled-back welfare state persists in wealthy countries (Taylor-Gooby, 2008), these policy interventions are diminishing with the waning influence of labour unions.

The organized labour movement that played a critical role in encouraging and establishing this social protection in the first place (in conjunction with the political crises and depressions of the 1890s and 1930s) has been in decline and/or been suppressed completely in some poor countries (Betcherman et al., 2001), further facilitating the changes of the neo-liberal regime. The international wave of resistance to neo-liberalism has led, however, to significant mass strikes and protests in many countries. An analysis of workers’ movements and struggle on a world scale, over the past century and within the totality of global capitalism, shows that workers in different places are linked by the global division of labour and the international state system. When capital organises a profitable strategy, it produces resistance, generating new strategies of accumulation, and hence new forms of resistance (Silver, 2003). Both corporations and governments often hinder the development of trade unions in an attempt to shape working conditions that widen profit margins, and in turn fund lobbying activities. They may also limit involvement in work organization and occupational health and safety matters (Hogstedt et al., 2007). The result is a workplace environment where individual concerns and actions are very often emphasized, rather than collective ones.

2. Labour market, employment conditions, and health inequalities
“Free market” globalisation and increased global competition promote a continuous race to the bottom in labour costs. Therefore, corporations and the governments they control push labour standards down to levels of increased economic exploitation and
even slavery-like practices. This is particularly true in middle and low income countries. In other words, global economic pressures toward efficiency encourage the development of employment relations that are extremely unhealthy. The globalisation of production processes and the generation of health inequalities are rather apparent in the last decades, even in the most technologically advanced industries. Over the past decades capitalist globalisation has expanded economic migration, transforming the lives of hundreds of millions of people around the globe. In many countries, economic migrants meet the demand for flexible labour. Often labour markets are unable to provide workers who are flexible, mobile and willing to accept precarious employment conditions with long working hours for low pay. Fleeing poverty, war, or unemployment, workers migrate away from their families and neighbourhoods to serve as part of the labour force in rich countries and send capital in the form of remittances back to impoverished communities around the world. Neoliberal economic policies are also trying to create a new international guest worker system, guiding the flow of migrants on a global basis to fulfil corporate labour needs. In wealthy countries, employment relations are often subject to the provisions of law or a contract of hire. In these societies, the government is often the largest single employer although most of the work force is employed in small and medium businesses in the private sector. In middle income and poor countries however, most employment agreements are not explicitly subject to any formal contract, and a high proportion of total employment is within the informal economy.

The ways in which any society approaches inequalities in health is a political issue. On the one hand inequalities may be accepted as the inevitable result of individual differences in genetic determinants, individual behaviours, or the market. On the other hand, they can be seen as a social product that needs to be remedied. Underpinning these different approaches to health inequalities are not only divergent views of what is scientifically or economically possible, but also differing political and ideological beliefs about what is desirable (Bambra et al., 2005).

Thus, the reduction of health inequalities, especially attempts carried out at the level of social policy, will largely depend on the distribution of power among key political actors and the role of the state. While political and social scientists debate the structure, function and power of the state, this discussion has yet to penetrate the public health arena despite the state’s crucial influence on all health activities. We follow here a theory of power resources that identifies labour organizations and political parties as the key determinants of differences in the impact of the welfare state across countries and over time (Korpi & Palme, 2003).

In spite of growing scientific evidence regarding the effects of employment conditions on health, almost no conceptual models has been proposed to explain these effects. In general, there is a great lack of research concerning the impact, pathways and mechanisms that connect employment conditions with health inequalities. There is however abundant literature about the effect of employment conditions on health, but it rarely focuses directly on the important role they play as a social determinant in shaping health inequalities.

3. Macro-sociological employment relations and health
To demonstrate the origins and consequences of different employment relations, and to trace the connection between employment relations and economic and political factors, working conditions, and health inequalities we have developed a theoretical model. Put simply, they are a way of visualising the many factors that contribute to inequalities in health. Our explanatory model (Figure 1) begins with power relations
as macro-social determinants of employment conditions (i.e., full-time “permanent’
jobs, unemployment, precarious employment, informal employment, child labour,
slave and bonded labour), employment inequalities by social class, gender, ethnicity,
race, migration, as well as other social outcomes such as social and health policies.
Employment relations in turn determine proximal working conditions which are
shaped by the need to maximize labour effort and profits on behalf of employers.
Such an explicit link between employment and working conditions (reducing labour
costs and maximizing labour effort) sets our model apart from conventional social
epidemiology (e.g., Marmot, 2004) and occupational health (e.g., Karasek & Theorell,
1990). Our model also includes social networks as a moderating force on the effects
of employment and working conditions on individual health.
Figure 1. Theoretical model linking employment relations with health inequalities.

- **Political Power in Market**
  - Unions, corporations, institutions

- **Labour Market**
  - Labour regulations, industrial relations

- **Welfare State**
  - Social policies

- **Political Power in Government**
  - Parties

- **Political Power in Society**
  - NGOs, community associations

- **Employment**
  - Full employment
  - Unemployment
  - "Standard" or precarious employment
  - Partially informal or fully informal
  - Slavery or child labour
  - Social class, gender, age, ethnicity, migration status

- **Working Conditions**
  - Exposures and risk factors: Injuries, physical & chemical hazards, ergonomics, psychosocial

- **Material deprivation and economic inequalities**

- **Health related behaviours**

- **Physiological path change**

- **Social & family networks**

- **Health Inequalities**

- **Health Systems**
Power relations (mostly in government and labour markets) can be characterized by indicators such as gender labour market inequality, proportion of precarious workers, or informal workers. Thus, country-level macro-sociological indicators of inequalities in employment relations offer a starting social level of analysis in population health. Causal pathways originating at the national level cannot be uncovered with intra-country individual-level data as macro-social factors are held constant within countries (Rose, 1992). Labour market indicators at the national level have been incorporated in just a small number of recent population health studies (Muntaner et al., 2002, Navarro et al., 2003, Navarro et al., 2006, Chung & Muntaner, 2006). Yet employment relations are defining features of welfare states (Esping-Andersen, 1990). In Europe, union strength indicators (e.g., union density and collective bargaining coverage) overlap with welfare state regime types and predict health at the national level (Navarro et al., 2006). Employment relations are also associated with welfare state redistribution policies (e.g., universal health care). Thus, a country’s employment relations determine proximal exposures that affect workers’ health via two social causal pathways: compensation and working conditions.

4. Employment, working conditions and workers’ health
The full account of how employment conditions negatively affect the health of workers needs to include a detailed exposition of generic as well as specific social, psychological and biological pathways. Although most pathways and mechanisms seem fairly general (e.g., unemployment can be a risk factor for depression, alcoholism and cardiovascular disease), there is also room for specific disorders tied to the negative effects of particular employment relations in specific populations (e.g., developmental disorders linked to child labour; post-traumatic stress disorders linked to soldiering, slavery or bonded labour).

In this section we seek to compile evidence from various sources which is compatible with our model. This also means that we may not have enough information to confirm every pathway included in our model. However, we should be able to find available evidence broadly compatible with pathways hypothesized by the model. We concentrate here on the relation between the employment conditions and health. These dimensions may share some common pathways (e.g. lack of autonomy at work leading to mental illness) but may also be characterized by specific pathways (e.g., child labour leading to low growth). At the proximal level the pathways between social stress and disease (in large part a direct or indirect consequence of employment relations) are well understood and common to a host of social determinants. Social epidemiology and its associated disciplines have provided only a partial picture of the pathways and mechanisms linking employment dimensions to health inequalities. Moreover, the large majority of studies have been conducted in wealthy countries, thus precluding the examination of pathways and mechanisms that might be more important to low and middle-income countries (e.g., informal labour, employment relations in extreme poverty and war, bonded labour and slavery).

In our theoretical framework, the exposure to different working conditions is one of the causal pathways by which employment relations generate health inequalities: most of hazardous conditions and exposures are concentrated in middle and low-income countries, especially those with higher labour market inequality; in workers with non-standard work arrangements; and unequally distributed according to social class, gender, race/ethnicity, migrant status and age. We briefly review evidence on the ways by which working conditions emerge as a pathway to health
inequalities focusing on the links between employment and working conditions, and then showing the relations between working conditions with psychosocial factors, behaviours and psychopathological changes. Because the psycho physiological pathways and mechanisms common to many social stressors have been studied extensively in the last decade (Sapolsky, 1993; Brunner, 1997; McEwen, 1998), we concentrate our efforts on social and psychosocial pathways, with a particular effort in highlighting their integration.

The relative political strength of forces in the market (corporations, institutions and unions), government (parties) and society (community and its forms of organisation) in a country are key determinants of the development of laws, regulations, and social protection, which influence working conditions. In the context of globalization, lack of barriers to move production from one country to another increases the power of companies and corporations, which can easily search for less regulated markets, with a global “domino effect” of labour markets deregulation. In order to open their markets, and in an attempt to shape working conditions that widen profit margins for corporations, governments collaborate with corporations in hindering the development of trade unions, and limiting their own involvement in public protection of work organization and occupational health and safety matters (Hogstedt et al., 2007). Stricter regulation of preventive measures in rich regions parallels an outsourcing of dangerous industries to poor countries, which derives in an “outsourcing” of occupational hazards, injuries and diseases.

Workers’ control and participation in decision-making processes within firms is a key “protective” factor not only for the promotion of democratic work environment but also of workers’ health. Through the participation, workers can analyse and implement effective policies to address their own occupational health concerns. Labour unions are the most effective institutional tool to ensure good health and safety at work in advanced capitalist countries (Johansson & Partanen, 2002). A growing body of research attests to the influence that representative participation has on occupational health. Evidence shows that when trade unions are stronger, information and standards on workplace hazards are improved, health and safety systems work better and workers’ actions are more effective. Available experiences, knowledge and evidence support the conclusion that safety reps are a powerful force for improving workers’ occupational health in the EU (Walters & Nichols, 2007; Menéndez et al., 2008). The power of labour plays a vital role in the implementation of social policies, labour market regulations and collective bargaining. The specific effect of collective bargaining on workplace health and safety means adapting general legal preventive provisions into specific terms for the concrete realities of individual sectors, companies, production units, work places and working conditions.

The so-called non-standard forms of employment (precarious, informal, bonded, and child labour) do all share a pathway to health inequalities: the engagement in worse working conditions compared to the general situation of the full-time permanently employed. The relation between precarious employment and working conditions has been studied using the concept of temporary employment. Compared to workers with permanent contracts, temporary workers are exposed to higher level of physical hazards, such as painful and tiring positions, intense noise, repetitive movements; psychosocial stressors, such as less job autonomy and control over time on the job; organizational issues such as less freedom to choose when to take personal leave (Letourneux, 1998; Parent-Thirion et al. 2007). Temporary workers also suffer from a higher risk of occupational injuries (Virtanen et al., 2005, Fabiano et al., 2008), higher psychological morbidity and other health outcomes.
(Artazcoz et al., 2005; Virtanen et al., 2005). Other less studied dimensions of precariousness at work, such as powerlessness or capacity to exercise legal rights are likely to imply the difficulty to negotiate and avoid hazardous working conditions (Amable, 2006; Benach & Muntaner, 2007; Menéndez et al., 2007).

Workers in the informal economy, or informally employed workers at formal firms, whose condition is typically not monitored by the state, are engaged in the most dangerous activities, with high risk for occupational injuries or diseases, and are in a situation vulnerable to firing and economic difficulties due to low wages (ILO, 2006a). Awkward postures and exposure to toxic chemicals, excessive noise, poor sanitation, high workload, pesticides, violence, and sexual assault (Iriart et al., 2006) are commonly observed in informal economy settings, along with scarce training and supervision and limited access to protective equipment. In addition to evidence on the impact of what are now pervasive work arrangements on health inequalities there is also now extensive research that imbalances in demand/control and effort/reward within workplaces have serious adverse effects on health (Marmot et al., 2006). This evidence is consistent with the broad thrust of this paper and indeed, strengthens our argument about the need to pursue quality in work. The relationship between self-employment and working conditions may depend on type of job and context, with differences, for instance, between independent contractors and small business owners (Prottas & Thompson, 2006); higher autonomy may be counterbalanced by higher pressure and longer work hours. A study on self-employed workers in North Carolina disclosed elevated occupational fatality death rates, especially in retail and transportation industries, poor work organization, poor hygiene, ergonomic hazards, hazardous hand tools, and chemical exposures, particularly to pesticides and solvents (Mirabelli et al., 2003).

Although by definition, forced labour is differentiated from poor working conditions or hazardous working environments, very often slaves are exposed to the worst hazards, pushed in these situations by the over-exploitative nature of the employer-worker relation (Fassa, 2003; WHO, 2002). Though the invisibility of forced labour makes it a difficult area to investigate, a greater effort should be made to document working conditions in these settings. Unaffordable working conditions are one of the worst faces of child labour. Exposure to hazards in the workplace may be especially harmful for children due to increased vulnerability to biological or toxic agents due to the immature immune system, lesser bone elasticity, strength, and capacity to support heavy workloads, inadequate dimensions of tools and equipments. Children working in agriculture may be exposed to chemical agents such as pesticides, heat and harsh weather, repetitive work, hazardous equipments (hoes, tractor, etc), excessive work hours, demanding physical work, noise, and biological agents such as dust (ILO, 2006b).

5. The recent global economic crisis

Although neoliberalism and the deregulation of the financial sector has been hardly criticised in public health (Muntaner et al., 2001; Benach & Muntaner, 2005) the speed and magnitude of class inequalities has been fuelled by 30 years of neoliberal policies. In 2008 the meltdown in the financial sector arising from speculative investment practices (itself symptomatic of much deeper structural problems) rapidly impacted on the economies of both rich and poor countries. While the exact extent and likely length of the economic recession is still to unfold, it is now being acknowledged as the greatest upheaval since the Great Depression of the 1930s and in our own view parallels with the Great Depression – such as significant levels of
unemployment and large scale human misery - will only grow stronger as events unfold. The economic crisis is relevant to the issues presented in this paper on a number of grounds.

First, and most obviously, the crisis is already contributing to a growth of employment arrangements that we identified as health-damaging in 2007 and 2008. Apart from the growth of unemployment the economic downturn will almost certainly lead to downsizing/restructuring as employers ‘respond’ to falling demand or seek to re-align cost pressures (Quinlan & Bohle, 2009). It is also likely that the flexible and insecure work arrangements – the growth of which marked the so-called prosperity phase prior to 2007 – will continue to grow along. Like in the Great Depression, intermittent employment (serial bouts of short term employment and unemployment) will become more common. Presenteeism/longer hours and other forms of work intensification as workers try to retain their jobs as well as more irregular hours will also continue to grow, perhaps at an accelerated rate (Quinlan & Bohle, 2009). The myriad of small subcontractors in elaborate supply chains throughout rich and poor countries are also likely to suffer (Quinlan & Bohle, 2008). It is also possible, indeed likely in our view, that work will shift even further to the informal sector and that practices like child and forced labour will become even more difficult to control. Thus the impact on unemployment and precarious employment of the so-called emergent economies is already severe (e.g., China and India).

Second, all these employment conditions are associated with serious adverse health outcomes – both for workers, their families, and their communities. Therefore any global growth in these conditions will entail an exacerbation of these problems.

Third, even leaving aside these health effects, these changes in employment conditions will lead to increased social inequality including lower wages. As is noted in this book, these changes too will have important effects on population health. Governments in rich countries responded to the economic crisis by, amongst other things, providing massive bail-out packages to large banks and financial institutions who became enmeshed in, and indebted by, speculative investment in highly ‘engineered’ but essentially valueless investment products like CDOs (Collateralized Debt Obligations). It is not clear how the massive bail-out packages will be funded but most likely ‘ordinary’ taxpayers will “foot the bill”, especially as large corporations have become so adept at minimizing their tax exposure through the use of tax havens, transfer pricing and the like – leaving the tax burden largely with workers. Indeed, at the end of 2008 and beginning of 2009 we are witnessing the expenditure of massive public funds to bail out banks and other institutions in the USA, UK and elsewhere. The very organs and advocates of big business who extolled the free market and shunned government intervention (apart from large but hidden industry subsidies and wealth transfers from the public sector such as those achieved through privatisation) now call for public support of private interests. In essence, the poor who suffered from the excesses of the past decade are now asked to ‘save’ those who engineered and benefited from these excesses.

Fourth, it is also likely that, as is already the case with the environmental crisis and climate change, there will be arguments made by the very same businesses and associated interest groups/lobbyists who led to this debacle that the health inequalities related to employment conditions and other social determinants of health cannot be addressed until the global economic crisis is resolved. In a similar vein, the same neoliberal interest groups (and neoliberal agencies like the World Trade Organisation) are now arguing that maintaining, indeed extending, ‘labour market flexibility’ – the euphemism for precarious employment – is essential to re-initiate
economic growth. Thus, contrary to any careful assessment of evidence a critical part of the problem is redefined as the solution.

Fifth, the contention that we cannot afford to deal with health inequalities in the present climate –while it will undoubtedly exert significant pressure on governments– represents not only a morally bankrupt position (why should those whose health has been compromised by flexible work arrangements so advocated by these same interests be now asked to carry the burden for that same interest groups’ own failings?) but also a misreading of the causes of the problem. As a recent ILO report (2008) highlights the growth associated with the latest phase of ‘globalisation’, including the use of flexible work arrangements and the like, has not contributed to a general narrower socioeconomic inequality – quite the reverse. Therefore waiting for better times to resolve these issues would be a bootless exercise in futility (even ignoring that the situation will actually deteriorate in the meantime).

Sixth, it fails to acknowledge the role that the pursuit of policies that increased socioeconomic inequality within both rich and poor countries contributed to this very economic crisis. In other words the preferred solution is actually the cause of the problem. From the mid 1970s the Keynesian accord in socioeconomic policy that had been applied in rich countries following the Second World War was progressively abandoned in favour of neo-liberal policies that argued that deregulated markets were the best mechanism for achieving prosperity and public welfare. Keynesianism, it was argued, had failed to address stagflation (simultaneous inflation and unemployment), though note that the “free market” economists remain remarkably silent now when their preferred solution has also delivered stagflation. The elements of neo-liberal policy are sufficiently well known not be repeated in detail here but included privatisation, outsourcing/competitive tendering for government services, de-collectivised/decentralised industrial relations, an attack on and neutering/refashioning of government regulation, and the advocacy of flexible work arrangements, balanced budgets (with profound effects on government service provision) and tax cuts for the rich and risk shifting from government to individuals (now required to invest for their own retirement and the like). As has been well documented this ideological philosophy had dominated decision making with governments and key agencies such as the WTO, IMF and WB. A point lost in the current debate around the economic crisis is that Keynesianism did not simply entail fiscal management – something that has now been re-embraced – but critical redistributive mechanisms (full employment, government services to protect the poor, progressive tax regimes and the like).

In sum, however, imperfectly Keynesianism sought to manipulate social inequality to some degree in order to address the profound economic instabilities that arose from an unregulated market system and from capitalism in general. The new regime, on the other hand concentrated wealth in the hands of a few while income levels for workers often stagnated, and in wealthy countries at least, high levels of personal debt were increasingly used to sustain consumption (a marked difference with the Great Depression that is likely to exacerbate the effects of the present crisis). Further, current efforts at fiscal stimulus largely ignore the need for redistributive mechanisms. Pumping money into banks who still won’t lend because they cannot trust other financial institutions (and why would they as more evidence of ever greater debt burdens unfolds?) or to the automobile and other industries to save jobs (but it wont because the burgeoning wealth inequality and income/job insecurity means consumption will continue to contract) will not resolve the problem. Indeed, the latter was tried and failed in the Great Depression.
Seventh, the lessons to be drawn from the last two paragraphs are important. Not only has the notion of self-correcting markets and limited government intervention conspicuously failed but inequality needs to be a central component to redressing the current crisis. Employment arrangements should be a critical redistributive mechanism not a source of further exploitation and harm to the health of workers. Thus fundamental change is required in thought and action. It is unfortunately doubtful that governments will recognise these realities until the level of “immiseration” associated with the current crisis is too manifold to ignore in the context of pressure from social movements.

6. A New Policy Agenda
Neoliberalism has so steeped itself into the decision-making of governments that most policy-makers can no longer grasp the proactive role that government (at national and international level) can play in terms of social and economic development. Rather, the role of government has been limited to boosting private markets and, in times of crisis, responding to the lobbying of powerful special interest groups while the pleas of unions and other groups representing the vulnerable are largely drowned out. This needs to change.

The broad framework for critical changes to secure a more sustainable and healthy workforce and society are clear. First, effective action needs to be taken to minimise if not eliminate work arrangements known to be harmful (precarious employment, informal work, slavery, child labour and forced labour) through devices like legislation, income transfers and empowering groups that represent the vulnerable. Integrated minimum labour standards and regulation (like supply chain regulation) to combat evasive tactics are necessary at both national and international level. Trade cannot be divorced from labour standards and arrangements to safeguard the latter need to be integral part of international commerce. Second, promoting ‘quality’ work needs to be a central policy objective of governments and multinational bodies like the EU. At an EU presidency conference held in Belgium in 2001 such an effort was made but was quickly stymied by neoliberal opponents. This effort needs to be revived and extended. Again, this process must include unions and community groups as key decision-making participants. Third, inequality of income and wealth need to be addressed at both the national and international level.

Far from being an economic impediment, initiatives in this directive can address the current economic, environmental and climatic challenges facing Europe and the world. Government investment in more effective and environmentally sustainable infrastructure including education/research, transport (freight and people), healthcare, energy (including the manufacturing of new technologies), food production and urban environments can be used to simultaneously create quality and healthier work while undertaking an essentially restructuring neoliberalism has clearly failed to deliver. Promoting this form of ‘development’ in poor countries and re-orientating trade will avoid the current dilemmas whereby scarce healthcare workers are plundered from Africa by rich countries, domestic food production is sacrificed for export goods, and ‘dirty’ forms of manufacturing are shifted to poor countries. The EU should be ready to take a leadership role.
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An Old Crisis
Progressive political forces are unanimous in their view that this crisis has not fallen from the sky, nor is it a new concept. What is different about this crisis is that it is like trying to stop a high-speed train in the countryside: many different experts want to contribute to putting the train back on track.

The dramatic consequences of the crisis on people’s lives are direct consequences of the failure to set up the right policies in the past, which consist of:

- Investing in people instead of investing in shareholder value
- Reshaping a real economy around sustainable jobs and growth
- Investing in public policies, social infrastructure and social services
- Guaranteeing the transparency of financial markets and procedures
- Protecting the public good and the general interest
- Basing policy making on good governance

These policies are not new, but under the sweet poison of so-called modernism, progressive forces often gave up these essentials when about to govern.

What are the main effects of the crisis?

Job losses - According to recent International Labour Organisation (ILO) forecasts, global unemployment could increase by some 50 million due to the economic downturn. Job losses will be even more relevant because of the precarious nature of the jobs created in the past. We have seen that even if it was very important to bring people back into the labour market and social protection schemes, the first to be fired are the last to be hired: that is to say, the temporary agency work forces, the part-time workers and others in precarious job situations. According to European Commission’s figures (Employment in Europe 2007), between 2000 and 2006 over half of the total employment generated was with part-time jobs. Nevertheless, according to the Organisation for Economic Co-operation and Development’s (OECD) Employment Outlook 2007, even in rich countries, poverty and low pay have persisted and will rise as an effect of the crisis: across 24 OECD countries, the incidence of low pay (i.e. the percentage of workers earning less than 2/3 of median earnings) has remained above 17%. In 2009, the proportion of people in vulnerable employment could rise to 45% of the total employed.

Wages - It is always however a crisis for workers’ wages. In its Global Wage Report\textsuperscript{32}, the ILO stressed that the global economic crisis is expected to lead to cuts

\textsuperscript{31} Secretary General SOLIDAR
in the wages of millions of workers worldwide in 2009, with a rise in the number of working poor living on less than USD2 per day.

Based on the latest International Monetary Fund (IMF) growth figures, the ILO forecasts that the global growth in real wages will at best reach 1.1 per cent in 2009, compared to 1.7 per cent in 2008, but overall wages are expected to decline in a large number of countries, including major economies. Overall, wage growth in industrialised countries is expected to fall, from 0.8% in 2008 to -0.5% in 2009. This was the defensive calculation but with a recession and the fall in industrial production, this will be even more dramatic.

At the same time, the report shows that these cuts in wages follow the trends of the last decade in which wages failed to advance together with economic growth: “while inflation was low and the global economy grew at a 4.0% annual rate between 2001 and 2007, growth in wages lagged behind, increasing by less than 2% in half of the world’s countries”.

**Wages inequalities** - Since 1995, inequality between the highest and lowest wages has increased often reaching socially unsustainable levels. Among developed countries, Germany, Poland and the United States are amongst the countries where the gap between top and bottom wages has increased most rapidly. In other regions, inequality has also increased sharply, particularly in Argentina, China and Thailand. Some of the countries which have succeeded in reducing wage inequality include France and Spain, as well as Brazil and Indonesia, though in the latter two countries inequality remains at high levels.

**Pay gap** - The pay gap between genders is still high and is closing at a very slow pace. Although about 80% of the countries for which data is available have seen an increase in the ratio of female to male average wages, the size of change is small and in some cases negligible. In the majority of countries, women’s wages represent on average between 70 to 90% of men’s wages, but it is not uncommon to find much lower ratios in other parts of the world, particularly in Asia.

The gap in income inequality is also widening at an accelerated pace between top executives and the average employee. For example, in the United States in 2007, the Chief Executive Officers (CEOs) of the 15 largest companies earned 520 times more than the average worker. This is up from 360 times more then in 2003. Similar patterns, though from lower levels of executive pay, have been registered in Australia, Germany, Hong Kong (China), the Netherlands and South Africa.

For that reason the crisis cannot be the new ‘discourse’ of those who have justified and put in place the wrong policies in the past, which have led to widening the gap between the wealthy and the most vulnerable: According to the United Nations (UN), the richest 10% of the world’s adult population receives 85% of global wealth; in contrast, the poorest 50% barely receives 1%. A Global Social Floor is indispensable to ensure a social dimension to globalization. (International Labour Organization, Can Low-Income Countries Afford Basic Social Security?, 2008)

The crisis MUST be the opportunity to shift the paradigm of our model of development towards a social, sustainable and just model. More than a recovery plan whose role is to reply to an immediate urgency, we need a new development model and a new global governance system.
Decent Work is the Answer to the Current Crisis

The recent call made by the Head of the German government and the Heads of five international organisations, including the OECD, ILO, IMF, WTO and the World Bank on the occasion of their meeting on 5 February 2009 in Berlin, reaffirms their will to improve cooperation to build a 'stronger, cleaner and fairer economy'. The same document recognises that the ILO's Decent Work Agenda is a key element to achieving the goal of a fairer economy as well as the importance for the international community to deliver on Millennium Development Goals and the fight against poverty.

The message is clear; we cannot use the crisis to step back from previous commitments. Rather, we have to reaffirm them and integrate them into a larger agenda, setting the policy frame allowing for the creation and fair redistribution of wealth.

Decent work is a way to answer the crisis and we should push for a Decent Work Agenda to be adopted by all countries around the world, promoted by the IMF and World Bank.

The EU should not miss this great opportunity to show its leadership and the quality of its strong social model. This model is no mere accident of history, but was, in former times of crisis, an investment in a fairer and more just society known as the welfare state.

We know where protectionism combined with nationalism will lead. This historical experience need not be carried out again.

Leaders have the responsibility to adopt fair responses to the current crisis by backing social protection and social dialogue. In a way, it is a moment of truth for the wider challenges, not just to provide larger answers on a larger scale.

Amongst others, the urgency is now to:

- Widen the coverage of unemployment benefits and insurance schemes, re-skilling redundant workers and protecting pensions from devastating declines in financial markets;
- Invest in and extend social protection and employment policies with a particular focus on the most vulnerable;
- Maintain and expand development aid and other investment flows to vulnerable countries;
- Public intervention through income support measures. A social investment approach based on the ILO Decent Work Agenda is necessary to counteract rising poverty.

The EU has to put into place measures to ensure solidarity between Member States:

- Protectionist reactions to the crisis can dangerously put at stake the internal market as well as the European Social Model and fundamental freedoms (such as the free circulation of workers);
- Political reactions to uncertainty and economic distress in the form of racial and religious hatred, discrimination against immigrants and ethnic minorities, victimisation of union representatives and protectionist economic policies that would aggravate the crisis.

In our understanding, developing and strengthening social protection systems is key to tackling the social and economic imbalances. Moreover, social protection and social assistance mitigate inequality.
For a low-income country, even a basic social protection package can make the difference between achieving and not achieving the first Millennium Development Goal of halving poverty by 2015.

The minimum or Global Social Floor comprises the following social guarantees:
- Access to essential health care benefits through pluralistic delivery mechanisms;
- Family and child benefits;
- Income support for the unemployed and the poor in the active age group;
- Education and life learning schemes;
- Sustainable pension schemes and disability grants.

The Global Social Floor, can generate growth (cash injections in local economies), and promote peace, stability and social cohesion (through the redistribution of wealth).

Its implementation is affordable even in low-income countries. According to ILO calculations, less than 2% of the global GDP would be necessary to provide this basic set of social guarantees to all of the world’s poor (ILO, 2006).

Building a Global Welfare State

We along with other progressive forces have to gain the opinion leadership of their political orientations if we want policies which are socially accountable.

It is therefore up to us:
- To show the validity and value of public policies in the short, mid-term and long run;
- To create a global coalition of those forces which are able to propose realistic alternatives for getting out of the crisis, and for setting a new paradigm: sustainable growth and development!

The coalition which has come together around the Decent Work – Decent Life agenda has shown both globally and at the European level, the capacity for mobilisation and outreach. It is up to progressive politicians, leaders and activists from unions and civil society to promote a new social deal.

Through our cooperation with the members and partners of the Global Network in Africa, Asia, Latin America, North America and in Europe, we are ready to invest in a large strategic mobilisation of citizens who do not only say that another world is possible, but will act on it.

The G20 Meeting (on 2 April 2009) should not only look at urgent measures on financial issues but also implement measures to promote decent work and social protection. The unions and civil society will mobilise in London calling for an economy based on a fair distribution of wealth, and decent work for all.

With the renewal of the European Institutions in 2009, starting from the EU elections in June, civil society, both environmental and social NGO networks, have prepared a manifesto for a policy change.

In this manifesto, we say that we need the Lisbon Treaty because:

- We want the full applicability of the Charter of Fundamental rights;
- We expect new or amended regulations concerning services of general interest (SGI);
- We are waiting for a potentially strengthened Open Method of Coordination (OMC) and institutionalised civil dialogue;
- We see it as an opportunity to strengthen the social and citizenship dimension of Europe.

On 7 October 2009, the International Trade Union Confederation (ITUC) will call for a big mobilisation around the World Day for Decent Work where the other partners of the alliance will again be present.

In the field of social policies and social services, we have to make sure that the general interest prevails and that the policies are considered as in the public good, worthy of investment and not market-driven.

For development policies, we need to show that the famous 0.7% of GDP that developed countries pledged to pay in development aid, is not a luxury but simply a modest reply to needs.

Good governance does not only mean transparent and fair rules, good governance also implies the strengthening of the role of civil dialogue!

SOLIDAR is a European network of 50 NGOs and labour movement organisations working towards all people living in dignity. Working in alliance with trade unions, SOLIDAR promotes equality, solidarity and social justice in the fields of social affairs, international cooperation and education in Europe and worldwide.
For more information visit www.solidar.org
ix. Redistribution in the Age of Globalization: in search of a new economic imperative
By Javier Ramos Díaz

Although it is certainly arduous to synthesize the essence of an epoch, it is widely held that the last thirty years constitute the apogee of neo-liberalism on a global scale. Its core proposals are the true reflections of a vision that recover the centrality of the market to the detriment of the economic role of the state, while putting forward new social values (individualism, self-regulation, security) that challenge previous conceptions highly embedded in the public sphere.

After the Second World War, the confluence of certain forms of industrial production (Taylorism-Fordism), public economic intervention (Keynesianism), social provision (Welfare States) and household structure (Male Breadwinner model) moulded the socio-economic order of the so called "Golden Age of Welfare Capitalism", although with notable international differences as a plethora of literature on "welfare state regimes" has stressed.

This confluence made easier a wide compromise which basically meant the acceptance of a primary framework of property ownership together with rights of employment and citizenship in predominantly industrial societies. A mutual concession that made possible the institutionalisation of conflicts stemming from the tensions that exist between the inequalities inherent in capitalist property ownership and the idea of equality embedded in the concept of mass citizenship. It is what Crouch (1999) defined as the "Mid-century Compromise".

Yet the oil crisis of the seventies altered the previous scenario and by extension the roots of the "Compromise". The decline in real rates of GDP and the on-going increase in public deficit and inflation, together with a slowdown in productivity and profits, and an increase in unemployment gave way to a period of economic uncertainty which transformed the socio-economic order.

The need to maintain profitability under more restrictive economic conditions led employers to focus on achieving real productivity gains, expanding their markets and engaging in organisational decentralisation. These aims were accompanied by wider and more intensive processes of deregulation and employment flexibility that profoundly altered the previous labour scenario (Castells 1996).

A new epoch of "flexible specialisation" emerged on the ground of more dynamic adjustments to economic challenges and uncertainties. A new managerial strategy, defined as the “flexible firm” came into sight, dividing the labour force into a multi-skilled and functionally flexible protected core, and a disposable periphery with fewer labour rights that resulted in a segmentation of the labour market (Atkinson, 1987)

In this context advocates of labour market deregulation boosted a widely held view that the contrast between the “dynamic-unequal” USA and the “fossilised-equal” Europe suggested the existence of a trade-off between employment and equality. Countries with high income inequality and more flexible employment conditions showed better labour market performance, resulting in higher employment figures,

33 Mr. Javier Ramon Díaz, Lecturer -e-democracy center, Zurich, Former Policy advisor for the Global Progressive Forum and the Socialist Group in the European Parliament
than those with high income equality and more rigid labour legislation. The persistence of rigidities in hiring and firing conditions, of a high tax wedge and of considerable varieties of “generous” welfare benefits, were presented as major obstacles to employment creation in developed economies since they raised the cost of production, hindered competition and limited future profits (for an overview see Krugman 1993, Siebert 1997). Reduction in unemployment rates should be achieved through more flexible strategies of labour market relations and less generous social assistance.

In the last decades these principals have inspired a great number of policies not only in developed economies but in developing ones as well. The question guiding this chapter is whether this new economic paradigm has or has not served to improve people’s living standards worldwide.

**Globalization and the New Economic Order**

Although the term "global" is not at all new, it is perhaps the most appropriate term to define our epoch. In the last thirty years the so called "globalization index" has increased worldwide, particularly in Asia. All regions have registered an increase of interrelations. Even Africa, which is still the least "globalized" region, has experienced a boost in the globalization index.

This process of globalization is not ideologically neutral, nor spontaneous, but highly inspired by the liberal conceptions embodied in the so-called "Washington Consensus". The implementation of policies under the principles of trade and financial liberalization, privatization of state enterprises, redirection of public spending from indiscriminate subsidies toward pro-growth policies, liberalization of inward foreign direct investment and fiscal policy discipline, are modelling the global economy.

For free-market advocates this is the best scenario to foster economic growth, employment and wealth. The implementation of policies inspired by the principles of liberalisation, privatisation and commodification is thought to be responsible for the expansion of the size of the market allowing both developed and developing economies to take advantage of the economies of scale, and of the higher efficiency in production and exchange. Capital liberalisation and free trade encourages exports, increases human and physical capital, and boosts the total productivity growth factor (Cline, 2004) so that the competitive playing field between industrial and emerging markets countries levels and the world gets flatter (Friedman, 2005).

Indeed there are signs that developing economies are catching-up. The share of world GDP and world exports coming from developing economies has significantly increased in the last twenty years (World Bank, 2007). This is having a positive effect on poverty reduction. The percentage of people earning less than 1$ has decreased significantly and to a lesser extent the share of workers below 2$ (ILO, 2007). Additionally we are now witnessing a second cycle of globalization in which some emerging economies show a powerful capacity to export not only low-added value products, but also high-value ones demanding a highly skilled workforce (MRA report, 2007).

Yet, there are also signs that shed serious doubts on this optimistic evaluation. To begin with, the apparent reduction of poverty might not be so straight forward. According to Wade (2007), the World Bank’s poverty headcounts have a large margin of error in all years. The often-cited comparison between 1980 and 1998: 1.4 billion in extreme poverty in 1980, 1.2 billion in 1998 is biased as the Bank introduced a new methodology in the late 1990s which makes the figures no longer comparable.
Additionally, China and India, the two most important countries for the overall trend, have purchasing power parity figures (PPP-adjusted income) that contain an even bigger component of guess work than for most other significant countries.

Other signs also contradict the positive image of globalization. Trade liberalization has brought about, not a global but a regional economic integration. East Asia, principally China and India, has profited in this new context the most, moving from the 4% of total world export in 1990 to 11% in 2004. Yet other world regions have hardly increased their export participation (Sub-Saharan Africa, South Asia, Middle East and North Africa, are all accounting for the same share of world merchandise exports as in 1990).

Furthermore, although international trade and capital flows have been growing faster than ever, global income growth has been slower and the world economy is allocating a smaller proportion of its income to fixed capital formation (Akyüz, 2006). Similarly, although financial liberalisation has increased private capital flows at record levels, investment into new infrastructure and productive capacity has stagnated and international capital movements have led to greater economic volatility (van der Hoeven & Lübker, 2006) (For details see several chapters in this book which are devoted to analyse the crisis of the financial market).

Inequality is certainly growing worldwide. The gap between world regions and within countries has widened since the eighties. The sharpest rise has occurred in Eastern Europe, which accounted for the lowest inequality level until the mid-nineties, but inequality has also continued to grow in regions that already had high inequality indexes (Latin America and Asia). China, which is often presented as the globalization winner, is a paradigmatic case of growing inequality. Gini coefficient for both rural and urban population has significantly increased (0.224 in 1985 to 0.449 in 2003; WIID, 2007). But inequality has increased between rich and poor countries as well. The ratio of GDP per capital in the richest country to GDP per capita in the poorest country rose from 42:1 in 1970 to 62:1 in 1990 and the ratio of GDP per capita in the 20 richest countries to the poorest 20 countries rose from 54:1 during 1960-62 to 121:1 during 2000-2002 (Milanovic, 2005; Nayyar, D. 2003).

Similarly, informal economy is growing worldwide (McKinsey GI, 2004). At the beginning of the 21st century it represented 41% of GDP in developing countries, 38% in transition countries and 18% in OECD countries. In China 16% of GDP stems from informal sectors, growing at annual rates of between 12.51% (ILO 2002) and 13.5% (World Bank 2002) per year. Other winners of globalization show high rates as well. India (23%), Argentina (26%), Korea (27.5%), Mexico (30.1%), Malaysia (31%), Pakistan (36%), Brazil (39.8%), Russia (46.1%) or Thailand (52.6% (Schneider, 2002).

Economic immigration from poorer to richer countries is at record levels (IOM,2008) and cross-border human trafficking (illegal immigration, prostitution) is increasing worldwide (Danailova-Trainor & Belser, 2006). Economic and political openness are related. If borders are more permeable for goods and services, they are also so for movement of people. Especially when i) fertility rates are falling to levels below replacement rates in most developed countries, whereas they remain high in developing economies, ii) some low-skilled jobs are not taken by local workers at low wages in developed economies, iii) better and cheaper communication and transportation that facilitate global movements and iv) new technologies that permit immigrants a fluent and easy communication with their countries of origin.
Due to this ever-increasing immigration, an estimated 190 million persons reside outside of their country of birth or nationality. The number of those living in foreign countries for more than one year (long-term immigrant) has been growing since the seventies. There were 84 million international long-term immigrants in 1975, an estimated 105 million in 1985, around 120 million in 1990, 150 million in 2000 and 195 million in 2006 (Martin, 2001; OIM, 2008).

Many countries are trying to regulate migration and decrease borders’ permeability through restrictive immigration laws. This is favoring the increase of professional smuggling and human trafficking, that not only bring migrants across borders but exploit and abuse them in receiving countries. According to recent investigations, about two thirds of global victims are trafficked intraregional within East Asia and Pacific (260,000-280,000) and Europe and Eurasia (170,000-210,000). The region of the Near East is a primary destination for victims from East Asia and the Pacific (12,500-16,000) (Danailova-Trainor & Belser, 2006).

If all this was not enough, after a century and a half of industrialization, emissions of greenhouse gases into the atmosphere are increasing average global annual temperatures, resulting in climate change with the subsequent negative effects on the global economy and prosperity. With respect to the year 1856, emissions are 30 times higher today, whereas atmospheric CO2 concentration has moved from 275 parts per million (ppm) in 1856 to 380 ppm in 2004.

By definition, climate change is a global issue, which does not fit into the logic of political borders, or other cultural and economic determinants. Yet, climate disasters are concentrated in poor countries. Some 262 million people were affected by climate disasters annually between 2000 to 2004, 98% of which were in the developing world. In the OECD countries 1 in 1500 people was affected by climate disaster whereas for developing countries the figure is 1 in 19 (UNDP 2008). Fight against climate change requires rich nations to cut emissions by at least 80%, with cuts of 30% by 2020. Emissions from developing countries would peak around 2020, with cuts of 20% by 2050. Between now and 2030, the average annual cost would amount to 1.6% of GDP. This stabilization target is stringent but affordable. The costs of inaction could reach 5–20% of world GDP (Stern Report).

To conclude, it is possible to state that the current model of globalization is bringing about a substantive integration of new economies and a reduction of 1$ poverty (although there are serious doubts about the intensity of this reduction) but this is at the expense of increasing the levels of inequality, informal economy, economic immigration, human trafficking and ecological risks.

The effects of Liberal Globalization in EU economy

This scenario is affecting developed economies as well. If growth does not translate into development in emerging economies, central economies face not only relocations of production but pressures to deregulate employment, control salaries and reduce social policy expenditure as a result of competition from third countries with lower labor costs, lax labor laws and fairly small social policies (the famous "employment-equality trade-off").

We cannot forget that cross-national differences in social expenditure are huge. Total social security expenditure as a percentage of GDP was 26.8% in the European Union, 16.6% in North America, 16.1% in Oceania, 8.8% in Latin America, 6.4% in Asia and 4.3% in Africa in 2000. The winners of globalization are devoting only a marginal part of their increasing GDP to social security. China, devoted only 3.6%, India 2.6%, Singapore 3.3%, Malaysia 2.9%, Thailand 1.9% and Indonesia and
Philippines 1.7%. Other winners such as Russia, Brazil or Argentina devoted around 10% of their GPD to social issues (ILO, 2000). The resulting reality is that around 80% of the world’s working population has little or no social security (ILO 2007).

This situation places "social dumping" and "off-shoring" at the forefront of economic controversies regarding the financing of the European welfare states. If wages are not adjusted downward in the EU, there will be a rise in unemployment as a result of inferior competitive rates and productive relocation. However, if wages are fully adjusted, then the result will be a rise in inequality. This apparent "employment-inequality" trade-off, which has been considered the origin of one of the most important challenges for developed economies (Esping-Andersen, 1996; Scharpf, 1999), has adopted a more complex dimension as some emerging economies are not only catching up in the low-skilled sector, but in avant-garde sectors as well.

The consequences are already evident: 20% of total employment in the services sector in Europe is likely to be relocated (Welsum & Vickery, 2005). Most relocation is to new member states (51.2%), but Asia, primarily China and India now accounts for 36.3% and the rest of the world receives 12.5% of European off-shoring. And we are only seeing the beginning of job losses as a result of these relocations, (7.9% of total jobs lost in Europe in 2005, which in turn accounted for 1.2% of total employment loss compared to 2004), it is a troubling factor especially when the new EU member states are also beginning to relocate part of their production to other economies with lower labour costs (MRA report, 2007).

But the effect of relocation is reflected not only in job losses, but in the pressures to deregulate employment that is not relocated. Temporary employment has grown throughout the EU, rising from 9% in 1987 to 14.7 in 2006. Temporary workers are increasing involuntarily (60.9% in 2006 compared to 50.5% in 1986). The duration of temporary employment contracts is decreasing, thereby increasing job insecurity of unprotected workers. While the number of temporary contracts of between 1 and 2 years has doubled between 1992 and 2006, temporary contracts of less than 1 month have risen by 293% over the same period, and those between 1 and 3 months have also risen 256%.

These alarming tendencies are important as differences in terms of legal protection and wages between permanent and temporary workers continue to rise. The risk of in-working poverty (being poor despite having a job) stood at 4% in 2006 among the permanent workers and 12% among temporary workers (Eurostat 2008). And the wage gap between the two groups is remarkable with a 43% difference between temporary and permanent workers.

The ILO estimates suggest that 20% of GDP and 15% of employment in developed countries fall within the informal economy, with a remarkable increasing tendency (the percentage of workers employed in the informal economy rose in Western Europe from 12% in 1980/1990, to 15% in 1990/2000 (ILO, 2002 & 2004). Moreover, we have witnessed a loss of the importance of wages in the national income at a European level. At the EU-27, wages represented 50.3% of GDP in 1995 and 49% in 2005. This trend has occurred in virtually all member states, although it is especially pronounced in the larger European economies (Eurostat 2008).

**What should be done? Some Tentative Reflexions**

The integration of economies that up until now were not involved in international trade is great news. Yet the economic consequences of this integration are not so positive. In reality the benefits of the economic growth associated with globalization are being enjoyed by just a small percentage of the people, but the burdens of
growth, principally inequality, deterioration of working conditions, informal economy and human trafficking, are spread out among an increasing part of the population.

The entry of developing economies, mainly China, India and Ex-Soviet Republics, into the globalized economy has brought about gigantic supply-side shocks. In 1985 there were about a billion and a half workers. By the year 2000 the global labour force had doubled to 3 billion (ILO 2007). This doubling, in the context of insecurity, labour precariousness and lack of social protection described above, is bringing about a formidable process of proletarisation which is breaking the nexus between economic growth and development. The fact that around 80% of the world’s working population has little or no social security despite the vigorous growth of many economies in the last decades (ILO 2007) constitutes the core of the problem.

This is seriously damaging the sustainability of this growth model. Competition among economies is likely to be distorted unless a progressive harmonization of social standards and working conditions is achieved at the global level. The prospect of future growth and wealth will certainly be difficult to achieve if trade liberalization is just a question of extending the size of the market, ignoring social confluence and labour harmonisation. Therefore, although it is certainly arduous to synthesise the contents of a new proposal, one of its fundamental pillars should be the emphasis on social cohesion at the global level.

In order to achieve this objective it is necessary to make a profound revision of the economic imperative ruling globalization. While trade liberalisation and macroeconomic stability may be necessary to sustain economic growth, they are certainly not sufficient to spread about well-being. Global institutions such as World Bank (2000) and ILO (2007) have acknowledged that neither trade, nor growth, automatically leads to poverty reduction, and by extension that the more efficient way to reduce poverty is tackling it directly.

Therefore, greater concern for employment creation and income distribution should be more explicitly taken into consideration if the economic system is to perform better. We need to push the global agenda to favour a progressive integration of all economies into the global market, while at the same time developing new solidarity instruments in the face of rising inequalities and worsening employment conditions.

In this respect it is indispensable to pay much more attention to the prospect of setting up a "Global Social Floor" and to spread out the "Decent Work Agenda". The first option is feasible if we link social expenditure to economic growth. In the last 25 years some emerging economies have grown at a yearly rate of 10%, but their social expenditures have remained stagnant. A new economic imperative is needed to bring about a more balanced equilibrium between growth and social expenditure.

The ILO has undertaken two studies, one in Africa (seven countries) and one in Asia (five countries) which provide a first estimation of the costs of the global social floor in low-income countries. In all of the 12 countries considered, the initial annual cost is projected to be in the range of 3.7 to 10.6% of GDP. More importantly, the implementation of the Global Social Floor is affordable even in low-income countries. According to ILO calculations, less than 2% of the global GDP would be necessary to provide this basic set of social guarantees to all of the world’s poor (ILO, 2008).

The gradual application of these global objectives would mean a more equitable distribution of the benefits of market integration. The current economic scenario encourages global companies to select relocation from one economy to another searching for soft laws on labour conditions and taxation, as well as the capacity to impose on governments the most favourable conditions for investment.
This translates into rising inequality and a steady worsening of employment conditions.

The Global Social Floor, once implemented, generates growth through cash injections in local economies, and it promotes internal demand that, at the same time, reinforces the upward economic cycle. This will favour stability and social cohesion if redistributive policies are implemented. Additionally, the improvement of economic opportunity is not only the best long-term solution to illegal migration, but will also enable the spread business worldwide.

More political impetus should be aimed at reducing inequality on a global scale, to favor fair trade and a progressive integration of all economies into the global market but under the preponderance of new economic imperatives: redistribution and social cohesion. A globalization of this type does not involve autarkical solutions to global challenges but a significant integration by other means. Trade integration is a fundamental prerequisite for sustainable economic growth, but it must be accompanied by a distribution of its benefits that strongly reduce inequality and impede a deterioration of working conditions. This combination of economic integration and redistribution may trigger positive effects on the most important limitations embedded in the current model of liberal globalization.

Europe must play a more active role in the design of another model of globalization that would encompass social policies as one of its pillars. Despite the fact that many European citizens are still enmeshed in the logic of their local reality, Europe is a vital global player. Not only because for 50 years we have been "globalizing" a continent with significant social, economic and cultural differences, but also because we are the region of the world where the most progress on equality across a range of social policies and labour guarantees has been achieved.

In this sense the role played by progressive forces in globalization must significantly change. The ideological capital of progressive forces needs to be increased after 30 years of weak responses and accommodation to the liberal socio-economic mainstream. No longer can progressives by their silence, reinforce the economic status quo; it is time to strongly transform it.

"Third way‖ alternatives have shown to be a mere adaptation to the liberal principles that govern globalization, unwilling to provide a reliable substitutive model. So much more work needs to be done to move from analysis to a credible alternative. Yet, the idea of associating growth and redistribution constitutes a promising starting point.
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**x. Trade is Part of the Solution to the Current Economic Crisis**

*By Pascal Lamy*[^34]

The economic crisis that is unfolding around us has generated a great deal of reflection on the international architecture that harnesses globalisation. For many years, critics of globalisation have taken aim at the so-called Washington-Consensus which advocates deregulation, minimal government interference in markets, privatization and, yes, open trade. Many in the international institutions have used the Washington Consensus as the benchmark when drawing up policy recommendations and those who have found fault with more market driven economic policies argue today that the Washington Consensus should be scrapped.

Much re-examination of this institutional infrastructure is not only healthy, it is essential. What is clear is that there are gaps in the regulatory structure of the international economy that need to be filled. It's clear as well that a response to the crisis we face today must be a global one because the problems we have encountered are global in nature. The financial meltdown is a clear illustration of this. Money moves around the planet at a touch of a keystroke and lax rules pervade the financial industry. And yet we do not have a global regulatory structure for finance; we do not have a comprehensive system of transparent financial rules and procedures; we do not have a system for addressing international financial disputes.

However, as we reassess international economic governance, we must take care that we do not throw the baby out with the bathwater. In composing a new architecture, we must learn from the lessons of history. One such lesson is that open trade works. It is the most efficient means of resource allocation and we know that those countries with open trading regimes generate more wealth than those which do not. We also know that inclusion in the global trading system helps poor countries grow and develop. Through active participation in the trading system, governments of developing countries have been able to lift some 400 million people out of abject poverty. China's accession to the WTO is a good example of this. Moreover, open trading relations between nations foster greater international harmony and cooperation.

Critics of the WTO and the trading system sometimes make the mistake of confusing trade opening with deregulation or privatization. They see a financial system which lacks adequate regulation and has spiralled out of control, fuelled by excess and ever riskier instruments. But this is not the case with trade. More than 60 years ago, the architects of the global international system recognized that isolationist policies in trade had contributed to worsening the Great Depression and had fuelled economic nationalism. During these 60 years – first with the GATT and then with the World Trade Organization – trade has been a multiplier of growth and an insurance policy against protectionism. Today, sophisticated global rules ensure that countries follow internationally-agreed procedures in their commercial

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transactions. When countries divert from the rules and disputes arise, we have an advanced and highly successful system of dispute resolution.

All of this permits trade opening to take place in an environment which is transparent, predictable and credible. Our rules-based system is global in nature but this does not mean that it is a "one-size-fits-all" prescription for opening trade. Developing countries are not expected to adhere to the same rules as more advanced countries. They have longer transition periods in which to apply WTO rules and greater flexibility in applying their commitments. Moreover, roughly a fifth of the WTO's budget is devoted to technical assistance programmes which are designed to provide developing-country officials with the training they need to better understand how the trading system can be of benefit to their countries.

The poorest countries are afforded the greatest flexibility of all. In fact, in the Doha Development Round negotiations which are currently underway, Least Developed Countries are not required to reduce any of their tariffs or subsidy outlays and are not expected to open their services markets. Yet, developed countries are expected to do the maximum in support of the LDCs, largely through the scrapping of all quotas and duties on at least 97% of LDC exports.

However, while trade is an engine for growth and development, it does not mean that trade is good for everyone, everywhere at all times. Just as factors like technological change have an impact on income distribution, there are losers from more open trade in industrial as well as developing countries. There are inevitable structural adjustments associated with it. Some sectors, firms or individuals gain from trade, while others have to adjust into alternative activities, if they can, in the face of new competitive realities. There are also countries that, frankly, cannot participate in the global economy. They lack the institutional, legal, technical and financial capacity to make trade work for them.

All this makes a powerful case for addressing the social tensions arising from inequality, be this through public provision of basic services, better education and training opportunities or fiscal reform. On the other hand, countries that miss out on international production opportunities risk being marginalized through globalisation. Firms' decisions on location are strongly influenced by the quality of the institutional framework, the costs of setting up a business and the quality of infrastructure. Not addressing these issues is likely to limit the participation of low-income countries in production networks, despite their advantage in terms of factor prices. Being left out is surely much worse than trying to manage change and localized losses against a background of generalized gains.

It is therefore clear that the politics of trade have to be properly managed if societal gains are to be realized. Increasing inequality will be associated with an increase in opposition to trade and, ultimately, with more restrictive trade policies. Greater inequality will lead to increased calls for protectionism.

Restoring the confidence of citizens in trade requires ensuring that the right accompanying domestic policies are in place, whether on health, pensions, taxation or education. In fact a double agenda is needed, coupling trade opening on the one hand, with the right domestic policies on the other. This is true for developed as much as for developing countries. the latter, however, maybe not having the necessary financial means. This is where development assistance comes into play.

The WTO is at the centre of an international effort to boost Aid for Trade. For many countries the opportunities offered by the multilateral trading system cannot translate into reality unless and until it is accompanied by efforts to boost their productive capacities, to address bottlenecks or to help manage the adjustment. Aid
for Trade is a good example of how the international community can work together in a coherent manner to address these shortcomings. At the WTO Ministerial Conference in Hong Kong in 2005, the WTO placed the Aid-for-Trade agenda as a necessary complement to the results of the Doha Round. Since then the WTO has been working with other international organizations such as the World Bank, regional developments banks, OECD, UNIDO, UNDP, UNCTAD and ITC, with bilateral donors and with beneficiary countries, to mainstream trade in development programmes as well as to ensure adequate funding is provided for these projects. Today, as the economic crisis bites into our economies, it is important not to forget the commitments made to assist developing countries improve their productive capacities.

We know that open trade makes sense economically and geopolitically. We know that the sophisticated system of multilateral rules provides a transparent framework. However, it is also true that the system needs to be made more equitable and relevant, particularly for developing countries, through the conclusion of the Doha Round.

In spite of all we have learnt about the advantages of such a system, the threat of protectionism is growing. The global economic crisis has produced fear and even panic in many quarters of our planet. Wherever I go these days I speak to political, business and union leaders and what they say to me can be summed up in the words “pessimism” and “fear.” Fear of massive job losses. Fear of a sharp decrease in trade which is stalling an important engine for growth, especially for many developing countries. Fear of lack of credit even for relatively safe operations, such as those to finance trade transactions, which is compounding the decline in trade flows.

The world growth projections today are at 0 per cent, with developed countries posting a negative growth of -2 per cent and developing countries a positive one of around 5 per cent. The positive growth comes from emerging countries which are highly dependent on trade. Global export volumes will contract by 2.8% in 2009, says the IMF. In emerging countries, which are heavily dependent on exports for their growth, this has set off alarm bells.

Trade has become another casualty of the recession provoked by the severe financial crisis which in turn was caused by lack of regulation, supervision and excess. In these times of serious economic crisis, our biggest challenge is to ensure trade is part of the solution and not part of the problem.

In this period of uncertainty and fear, calls for a stronger role for governments and regulators to intervene resonate well. However, for this to be successful, all actors have to agree on common targets and enemies and work together. Global cooperation within and across countries is therefore of the essence. At times of global economic crisis, enemy number one is isolationism. In 1930, the US Congress passed, and President Hoover signed, the Smoot and Hawley Act which sharply raised US tariffs on more than 20,000 products. Other countries retaliated, raising their tariffs on US goods. The Great Depression followed. Whether it is with tariffs or with new, more sophisticated versions of Smoot and Hawley, today we run the risk of sliding down a slippery slope of tit-for-tat measures.

To help WTO Members have a better and real-time idea of global trends in international trade and trade policy developments, we have set up a radar tracking trade and trade-related measures taken in the context of the current crisis. As of now, our radar picture shows that most WTO Members appear to have successfully kept domestic protectionist pressures under control. WTO Members have expressed their
concerns about rising protectionist pressures both in their export markets and from their domestic constituencies. They have also made many good suggestions on how we can improve the reports we provide them with on the application of trade measures. Our hope is that in providing a clear picture of these developments, world leaders can better appreciate the dangers and respond forcefully to such isolationist pressures. I have been heartened to see that a number of world leaders have acted against measures that would have, at the very least, annoyed their trading partners.

This is not to say that governments must remain inert as job losses mount and social unrest grows. Governments must act to alleviate the social pain which is mounting. Although job protection does not mean protectionism. Social protection means improved training, better health care, more flexibility in pension plans and a social safety net guarding against workers displaced by foreign competition being consigned to society’s sidelines. Protection, yes; isolationism, no. Governments must provide answers to the social unrest which is brewing behind the massive job losses. The stimulus packages governments are adopting must provide answers to those who are being left behind in this crisis.

This is also the time to shore up global trade rules, making them more equitable, transparent and relevant. For more than 60 years these rules, which the WTO oversees, have provided a strong foundation for economic growth and development. A conclusion of the Doha Development Round of global negotiations would strengthen these rules and help ensure that trade is part of the solution to the economic downturn. A Doha Round on its own will not lift us out of this deepening recession, but more open trade would provide an important economic stimulus in its own right. It will also send the political signal that at harsh and difficult times, governments are capable of working together to provide the kind of global answer which is so desperately needed.

This is why WTO Members should pick up from where they left off in 2008 and enter the negotiating arena with renewed commitment. I am encouraged to find support in this respect from many political leaders around the world and I count on them to show the way forward. We have accomplished around 80 per cent of our set targets in the Doha Round but with the necessary political guidance, the willingness to compromise and realistic expectations, I am convinced that we can conclude these negotiations rapidly.

Yes, we are living in a changing world but, more importantly, we are living in a changed world, one which requires a new approach and a new infrastructure to help us chart a new course for international economic cooperation. A renewed commitment to rules-based open trade must be part of this paradigm.
Europe and us
One of the features of a Europe comprising 27 members is to include colonial powers such as Great Britain, France and Belgium. After all, the former Belgian minister of Foreign Affairs and current European Commissioner for development, Louis Michel, declared about Africa “If France, Great Britain and Belgium adopt a common strategy, the others will follow.” 36 That’s often how our fate as Africans is sealed, without us knowing, and inevitably to our detriment.

Europe being a key component of the machinery, our position in this market globalisation has already been designated. Our continent has been the backyard of Europe, where it can and wants to continue to draw upon our natural resources and select among workers strictly according to its needs. The modernisation of agriculture, industrialisation and trade to fulfil on a long-term basis the legitimate needs of the people have often remained pious vows, as the contents are not the same whether it is the dominant or the downtrodden. One can say the same regarding democracy, governance and human rights which the powerful and mighty respect to a certain extent, but in their climes they often deny and trample these same values. African leadership which ensues from such an asymmetry in the power struggle is formatted and weakened during dialogue.

It is like this because Europe knows how to thank and reward leaders, whom it takes for granted, and make its mark, all the more so since it prides itself on being the first “donor” to the continent.

With the Cotonou Agreement, which is a turning point in the relations between the EU and the ACP countries, Africa jumped in the so-called free market with an invisible hand which supposedly outdoes sovereign States in terms of wealth creation and distribution. Disqualified on this basis, the postcolonial State had to disengage itself not only from the production, marketing and the banking system, but also from vital social sectors that people desperately need. That’s how the vast majority of Africans are now deprived of education, healthcare, drinkable water because they are not able to afford them.

Crises
Three decades of African economies’ restructuring under the guidance of the International Monetary Fund (IMF) and the World Bank have ruined our societies and our lives. And now the mainstream economic model, which accounts for all sorts of miseries, hardships and humiliations, has reached deadlock in the countries of “happy” and triumphant globalisation.

The US-triggered subprime mortgage crisis in August 2007 is often presented by the defenders of the system as the spark that ignited the financial planet, with

35 Forum pour l’autre Mali, UNDP
dramatic social and economic consequences. In actual fact, it is the straw that broke the camel’s back. Such a situation was foreseeable and unavoidable due to the expansionist and predatory logic that has fuelled globalised capitalism. New products should create business opportunities for some, which is to say the initiators but what about the others. In this case it’s people from underdeveloped countries that are becoming ever more impoverished day by day, despite the fact that their wealth contributes to fuel the engine of growth. The expansion and predatory exploitation destruction process is not specific to financial capitalism, whose recasting by moralising its actors is not enough to curb the crisis as it is.

It has been systemic and rampant, under other forms since the 80’s, where in Africa, Latin America and Asia the severe structural adjustment programmes (SAPs) of the Bretton Woods institutions were supposed to hold it back and restrain it. Instead they translated into painful, unpopular, and inappropriate reforms. The lack of African information and reflection continues to conceal the role of the groundswell of economic liberalism. The winners of globalisation are confronted with the worst crisis since 1930. In the United States, Europe and elsewhere, banks which greatly lack funds, scarcely lend anymore to companies or individuals. In these countries, a drop in production, factory closures, mass redundancies and lay-offs are rife.

Africa does not escape from the consequences of the abrupt and brutal evolution of the global environment. How is it going to cope and come through? Is it going to lose the “gain” of economic reforms, ask worried liberals from here and elsewhere. From my point of view, there are two essential questions. Will Africa also have to pay dearly for the failure of the system or, take advantage of the present situation to move away from the supervision of world powers and IFI’s? Will Europe, its powerful neighbour, finally make concessions by acknowledging the right of Africans to think for themselves, to choose not only their leaders but also their proper economic and monetary policies, true to their interests?

We must demonstrate audacity, insight and political courage because our continent can no longer afford to be seen as the anti-model, to be looked after and kept on the straight and narrow; on the global market that leads us into the abyss. The model is not in crisis in Africa. It has been a failure from the very start.

From the G8 to the G20

Attending the G20 could be a false challenge and a distraction for us. Those behind it have no intention of relinquishing the advantages, nor the margins of manoeuvre they have created for themselves thanks to reforms. This authority won’t do more than the G8 which may, during several summits, have granted a few seats to leaders from the South that were viewed as reputable, that is to say in full agreement with the market dogma and disciplined in the dismantling of their economies in aid of large Euro-American groups. To pledge 0.7% of their recovery and stimulus packages to save banks, as the British Prime Minister Gordon Brown considers doing, is a blend of diversion and corruption, as long as there are no serious discussions on where responsibilities lie for the ruin of African economies. Let’s remind the reader that it was under the G8 presidency and the European Union presidency that Great Britain organised the 2005 Gleneagles Summit (Scotland) which made a mountain out of a molehill.

Many Africans have fond memories of the impressive Blair Commission report, as well as Bob Geldolf’s ten giant concerts which strengthened and accredited the reality of poverty and deprivation in an Africa whose foreign debt should have been
alleviated. The aim was never to go beyond capitalism as a process of alienation and pauperization of the vast majority of Africans, and corruption of the elite. Debt relief for 18 poor countries, including 14 from Africa, and an increase in public aid appropriation for development of 50 billion dollars per year through 2010 lengthened the list of vain promises. The trick was to cancel and write off debts that the states are unable to reimburse without granting them the additional resources needed. In return for this false generosity, the beneficiary states are compelled to carry on with and deepen economic policies that impoverish, dehumanize and force entire sections of the population to emigrate.

**Risks**
The great vulnerability of Africa given the consequences of the world financial and economic crisis, has to do with the hypocrisy of “rich” nations as well as our own lack of vision, solidarity and political courage. Nevertheless, we will have to face up the following realities:

- The drop in demand for raw materials which our economies highly depend on, as the production falls in importing countries
- The reduction of the volume of money transfers and remittances from emigrant workers due to the lay-offs that will continue to increase
- The reduction of public aid for development, that of Europe having already dropped in 2007, where it accounted for only 0.38% of the GDP of the EU
- The flight and net outflow of investment, although apart from certain strategic sectors, investment was not pouring in before, despite many African states being subjected to the required reforms.

Most analysts do not comprehend the alarming political risks at stake. They regard the worsening of tendencies among African leaders and negotiators, as a reason to give even more choices and decisions to world powers which impose their conditions.

Within its borders, the recent exacerbation of the international environment will generate new tensions and far more corruption in the quest to capture diminishing resources. The auctioning off of wealth will continue if people are not more well-informed and organised in order to protect African heritage and public goods.

**Opportunities**
The collapse of the capitalist system could have, in the mindset of people from underdeveloped countries and in terms of North / South relations the same healthy impact as the participation of our countries had in the Second World War. We came through with a new look at the colonial system after realising it was not unshakeable, immutable and that settlers were not invincible.

With regard to the neoliberal order, we must also say once and for all, that it is a dead-end and the disastrous economic policies it mandates constitute nothing less than violence perpetrated against a people. The G20, as I previously mentioned, is not the place for discussion as its most powerful members have yet to prove that they are credible or sincere interlocutors.

More concretely, Africa needs to ask the fundamental question of political, monetary, economic and food sovereignty which also lay at the very heart and core of the struggles for national liberation. It was also on the agenda in the 80’s when after two decades of dependent and outward-looking development, postcolonial States came to the realisation that they were mistaken in terms of challenge and
strategy. It is in this context that in April 1980, heads of States and governments of the Organisation of African Unity (OAU) adopted the Lagos Plan of Action in the Nigerian capital. This document was the successful conclusion and culmination of a long process of dialogue during which African countries devised the Monrovia strategy for the economic development of Africa. In one fell swoop, the World Bank discarded and jettisoned the Lagos Plan of Action and replaced it by a neoliberal agenda implemented through structural adjustment plans.

With the orientation and control of the continent’s development no longer in the hands of its own leaders, our role becomes only to keep up the pace of reforms, that is to please Washington, Brussels, Geneva and other strategic places of decision-making, and consequently to betray our populations instead of feeling indebted and loyal to them.

Isn’t it surprising that, after having converted the democratic transitions of the 90’s into opportunities to liberalise African economies, the United States of America, Europe and their allies posed as defenders of the rights the African people and as judges of their leaders? Isn’t it a way of patronizing us by asking us to think and act locally by voting, instead of repositioning ourselves in the globalised world which at present works to the detriment of our interests?

**Citizenship**

It is urgent and of the utmost importance to contemplate political alternation in Africa in the light of what is at stake worldwide, e.g. trade, debt, environment and migratory flows. It is no longer a matter of going from one election to another, well or poorly organised, of entrusting our fate to the hands of leaders who are prepared to make concessions and compromise all their principles for the control of external resources, including the European Union’s aid. When they try to escape formal democracy by looking after the interests of their people, Europe tries to dissuade and deter them. The signing under pressure of the Economic Partnership Agreement (EPA) with the EU illustrates how the continent’s democratisation efforts are being sabotaged and undermined. It aims to abolish and do away with non-reciprocal trade preferences and replace them with a free trade agreement, in accordance with the rules of the WTO. ACP countries will have to gradually remove and dismantle their trade barriers to become more competitive by 2020.

Critical civil society and many well-informed African decision-makers know from experience that when it comes to ‘free trade’ rich countries are at liberty to cheat and grant themselves the right to distort and dissimulate in the competition game. One perfect example regards the farm subsidy policies in the United States and the European Union which have stifled and throttled the African cotton industry. The defenders of the free and competitive market, especially right-wing parties, do not disarm. They are determined to corner African States more to have them sign the EPAs that are even more unjustified since the model they derive from is ailing.

In September 2005, at the Economic Forum of Alpbach (Austria), I was asked by the organisers the following question: “Are Europe and Africa standing together at this time of globalisation?” It is a burning question given the financial and economic crisis which has shaken the world system. “I’ll believe it when I see it », I replied, making reference to the asymmetry in the power struggle between the regions and the right that Europe arrogates itself to interfere. To truly stand together means equality, justice and transparency in bilateral relations. The freedom of movement is one of the best guarantees.
Repressive migratory policies in Europe contradict its discourse on democracy, human rights and justice that are not only incumbent on African leaders. The responsibility of thinking masters and sponsors is engaged. The latter cannot provoke chaos through neoliberal policies going against the interests of the African people and then clear their conscience by asking humanitarian organisations to plug the gaps. Global governance and peace in Africa require the clarification of the intentions of Western and emerging powers, particularly China, in its quest for greedy acquisition of raw materials and farmland.

The profile of new migrants be it laid-off workers, young unemployed graduates, peasants, or fishermen, is highly edifying given the damage inflicted on Africans in the name of a global market which is both unfair and destructive. Our distress calls as victims of the market have fallen on deaf ears. Allocating 0.7% to "poor" countries from their recovery packages which bail out bankrupt banks, does not remedy the situation. The required funds to fight against the food and environmental crisis remain clearly insufficient and sometimes non-existent.

Europe could have been an ally as well as a privileged interlocutor in Africa by giving a different globalisation than the terrible model based solely on profit. The dilemma for Africa is that, once we are rid of the burden of odious debt, and equipped with industries that fulfil its needs, exporting of goods besides raw materials, it will still not be of interest to Europe or the other great winners of globalised capitalism, including China.

**Duty to assert truth and justice**

The way for the continent to extricate itself from the current stalemate lies in clarity, sincerity and insight. We must examine, deal with and eradicate the harm that befalls Africa. The responsibility for this work of clarification is incumbent upon us as Africans. We need to revisit and compare former strategies to free ourselves from the crisis, especially the Lagos Plan of Action which has been completely overlooked because it has been denigrated, while the New Partnership for Africa’s Development (NEPAD) has been acclaimed by the international community.

The authors of the Lagos Plan of Action were right in considering that the African crisis of the 80’s was a by-product of the world crisis. They were also right in concluding that the answer was closely linked to the improvement of the international environment and the withdrawal and pull-out from the global market for further regional integration and self-reliance.

The current situation has reinforced and vindicated their thesis. The international environment has kept deteriorating, except in the realm of business which is at the centre of most states’ concerns; reforms for capital and goods to move freely. That’s how at the beginning of the 21st century, 20% of the world controls 60% of the planet’s wealth. For an Africa confronted with endemic, massive and chronic hunger and starvation, HIV/AIDS and wars, it is not only a matter of coming through and surviving the current crisis, but also of confronting capitalism in its most deadly and destructive form. This prospect urgently requires the dynamism and activism of national, sub-regional and regional economies, based on the creation and distribution of wealth in accordance with our own needs and by protecting our own ecosystems.

It’s about rewriting our vision and our priorities, not by continuing with the Lagos Plan of Action as written then but by revising it so that it is relevant for today’s challenges. The new vision which will emerge will most certainly contrast with the New Partnership for Africa’s Development (NEPAD).
Favouring and prioritizing human beings

The only prospect that corresponds to Africa today, but also to Europe and the rest of the world is to once again focus our efforts and resources on human lives and ecosystems, which are both endangered by the cult of growth and competitiveness. Lessons can be learned from the last century’s and more recent years’ trials. Alternatives to chaos can be found in the values of culture and society that the people are able to promote if they are given the opportunity to learn, understand and involve themselves more in the process of decision-making. It’s about “weaving the new cord to the former one”, as goes an African saying, in order to reconstruct our crumbled and shaken beings, manhandled and distorted social bonds and endangered environment. This prospect starts with awareness and speaking out, by Africans in their national languages and at all levels regarding their daily lives, but also regarding global challenges: trade, climate change, debt, migratory flows…

The other Europe, the people’s Europe, is well aware of the asymmetrical nature of the power struggle between their continent and Africa, as well as our common fate. Prepared to fight along with African civil societies, the existence and the struggle of these committed Europeans allow me to conclude that in face of the crisis of capitalism, the people of Europe and Africa can stand together. With their inexhaustible inner richness, their determination to live in peace, as equals and standing together, they can save human lives and the planet from the often foolish and destructive logic of the market.
Reframing the traditional development agenda

We are in the midst of an extraordinary moment. On the one hand, in my country, there are enormously high expectations of a more pragmatic, active government calling on Americans’ shared interests in a better world beyond, as well as within our borders. On the other hand, we are all absorbing the grim new reality of a financial crisis born in America now escalating into a global economic disaster, threatening the well-being of people everywhere and, sadly, undoing the recent gains against the terrible poverty so many people suffer in emerging-market and low-income economies.

I believe those of us in the development community need to seize this moment and make of the current crisis an opportunity for a major change in the way we think about the development agenda. I want to suggest that we reframe the conventionally defined development agenda as, in large part, the construction by an activist international community of a global social contract. A 21st-century global social contract should be designed to maximize the benefits of global economic interdependence (or to use the popular term “globalization”) while minimizing the risks and costs not only for the world’s poor, but for the world’s indispensable middle class, both the large middle class in the rich world’s mature democratic economies and the incipient middle class within emerging markets and in a few low-income countries.

Defining development as construction of a global social contract suggests two challenges for development advocates. First, it suggests a definition of development as a global imperative in which all nations and peoples have a common interest rather than as a matter primarily of aid as charity passes from rich to poor nations. Indeed, if the current crisis increases awareness on the part of the world’s rich and powerful (people and nation-states) of their dependence on prosperity and security in emerging markets and other developing economies, that would be the silver lining in today’s cloud of gloom over the sinking global economy because it could motivate citizens and voters in the rich world to pay more serious attention to their own interest in progress in the developing world. Second, it suggests putting high priority on strengthening the institutions that manage and protect our common interests by fostering growth and sustainable development worldwide. In our global economy these institutions including the multilateral development banks, the World Bank, the United Nations agencies, the International Monetary Fund, the World Trade Organization, the Basel Committee, and many more constitute the global “polity” we

37 Founder and President, Center for Global Development, Washington D.C.
need to manage the investment, protection and other functions that a robust global
social contract implies.

The ongoing crisis: a more activist state; a hyper-connected global economy

Discussion of these points should be prefaced with two observations about the
current crisis that bear on the overall message.

First, the ongoing crisis will not lead to a fundamental rejection of markets but
to a redrawing of the line between the state and the market in the mature Western
economies. On the one hand, what Churchill said about democracy is also true of
market-driven economies: “terrible until you consider the alternatives.” On the other
hand, there is little doubt that American-style capitalism is under siege. The state is
resurgent, especially in the United States and the United Kingdom, where the era of
Reagan and Thatcher has run its course anyway and is now decidedly over. In all the
advanced economies, markets, particularly financial markets (the cowboy sector of
American capitalism, which has in turn spread to Europe as well), will be “fettered,”
that is, more regulated. In the next few years, the views of people like, Ha-Joon
Chang, will be far more influential than they have been as the balance of state and
market in what are mixed economies shifts, and a more activist state emerges in
Europe, Japan, and America38.

One likely change in the balance will come in the form of an expanded
domestic social contract by which citizens contract with each other through the state
to guarantee access to health, education, and other public goods and protect against
individual risks and the systemic risks that markets generate. This will be true
especially in the United States, leading to a kind of convergence with Europe in the
nature of the welfare state. Everywhere that democratic politics works reasonably
well; the domestic social contract will be strengthened, especially the protection for
the middle class. In the United States, where the median wage has not risen in
almost two decades and where “globalization” has become the scapegoat of a
stagnant median wage and failed health and other social insurance policies, it will
otherwise be politically impossible to retain even begrudging support for open trade
markets and minimal levels of legally sanctioned immigration.

The only question is whether a strengthened domestic social contract will take
the form of increased public spending on health, education, and public infrastructure
and a shift in the tax burden toward the rich in order to reduce taxes on the middle
class, or direct government subsidies to protect “middle class” jobs in domestic
industries, with attendant risks to the current global trade regime. I hope it will be the
former, but one way or another, implicitly or explicitly, governments in affluent
democracies will be emphasizing increased support for their middle class majorities.

The second observation is that the hyper-connectivity of the global market,
including the reality of the rich world’s interdependence with the poor world, has been
driven home. We have seen in the last couple of months a desperate effort at greater
international coordination of macroeconomic and financial-sector policies because a
failure of international coordination, as in the 1930s, means running the risk of a
recession turning into a long and deep global depression. There are calls to eschew
beggar-thy-neighbor policies, both on the financial side (as when guaranteeing
deposits in Ireland led to flight out of banks elsewhere) and in the real economy, to
avoid (under the umbrella of “social” efforts to protect jobs) new trade and industrial

38 Chang, Ha-Joon. “Globalization and the Role of the State.” Address to the Scientific Council for
protection programs (though by early December such programs were already being actively discussed in Russia, France, and the United States).

Perhaps most noteworthy, is that with the first-ever meeting last year of the heads of state of the G-20 (the G-7 plus 13 emerging markets including Brazil, Russia, India, China, Indonesia, South Africa, and others), we may have seen the beginning of the end of the increasingly irrelevant G-7 club of nations. The G-20 meeting took place near the end of a year in which almost all of the paltry growth in the United States was due to exports of which almost 40 percent went to developing countries. In contrast to the past, this time it is the United States and to some extent Western Europe that bear responsibility (among other things due to their regulatory failures) for today’s economic losses throughout the world. And for the first time the rich countries are dependent on growth and effective countercyclical policy in China, Brazil, the Middle East, and elsewhere to help keep their own economies afloat next year; they cannot manage any recovery, for themselves or for others, alone.

For today’s rich countries, there is potential tension between a more activist state, which at the national level is more likely to intervene in support of home industries and jobs, and the demands on coordination of interdependence. Let us hope that in 2009, in contrast to the 1930s, “activism” takes a different form and the world’s richest and most powerful sovereign states will be able to subsume short-term domestic political interests to the general global welfare if only because protecting global welfare is actually more consistent with their own overall long-term interests.

What do these two observations, a more activist sovereign state and a continuing interdependence among sovereigns, have to do with the idea of a global social contract? The following: to save the hyper-connected global economy from its excesses and to make it fair and politically sustainable, there is a need for some sort of “activist” polity at the global level analogous to the state at the domestic level. An activist global polity is needed to construct and manage a contract at the global level analogous to the social contract at the domestic level that exists in one form or another in most mature democratic societies. On the one hand a global social contract sounds worryingly utopian. On the other hand, it is simply about adapting to the reality of a global market-driven economy that implies a convergence of global political necessity with the longstanding development agenda.

In the remainder of this essay, I will discuss further the logic of a “global” social contract for rich nations, given their increasing interdependence with developing countries; describe the logic of a “social” contract, given the shortcomings and risks of market-based globalization; and then set out briefly four actions rich countries should put on their development agenda to build a durable and enforceable global contract.

A global social contract...t
Why global? Global interdependence
The rich world’s own security and material prosperity depend increasingly on shared growth and on stable and competent governments responding to their people’s demands and needs “out there” in poor countries. One straightforward reason why this is true is that the relative size of the rich world economies and populations is declining. Under reasonable assumptions about future growth rates, the combined economies of the BRICs (Brazil, Russia, India, and China) will soon be larger than those of the G-7; they are simply likely to grow faster in the next several decades than rich countries, as their much lower per-capita incomes continue to converge
slowly to those of the rich world. The middle class in those and other emerging markets is likely to be twice the size of the entire population of the United States within the next 20 years. Three of the world’s five largest companies by market capitalization are Chinese, and by some accounts four of the top ten richest people in the world are Indian nationals. As this century unfolds, it is in these fast-growing economies that rich-world producers will find new markets and rich, new investment opportunities, and from them will emerge the ideas, people, and innovations that will improve consumers’ lives everywhere.

At the same time, most developing countries, even geopolitically ascendant China and India, contend with widespread poverty and misery and the attendant social and political problems. In India, approximately 2 million children die before age five, and 21 million children of primary-school age do not attend school. Their new middle classes are weak and often disengaged politically except when their own parochial interests can be served. (Indeed, my own analysis of income distribution data for over 50 countries indicates that most developing countries have no more than 20 percent of their populations in what I would define as the middle class – living on at least $10 a day per person and below the income of the 95th percentile of the total population; what we think of as middle-class consumers in Egypt, India, Indonesia, and Peru are actually among the 5 percent of richest households in their countries, and thus not in the “middle” at all.)

A small middle class cannot provide the ballast that undergirds responsible and effective government as in the rich-world economies, where the large middle class supports the rule of law, respect for property rights and human rights, and access for all to education and economic opportunities. Growth without development in Pakistan and in Bolivia, Nigeria and other natural resource–based economies, and setbacks following a decade or more of growth in Côte d’Ivoire, Zimbabwe, and even Venezuela have been far more about local political failures than economic ones. Even those low-income economies with responsible leadership such as Ghana, Mali, and Morocco face daunting problems of management and capacity constraints that deeply undermine their well-intentioned efforts to reduce poverty.

Yet the global community, including all of you and me, relies on competent governments everywhere to play by certain rules in our global society. Incompetent and corrupt governments are weak links in the chain that provides global security and enables global prosperity. Deforestation and the resulting climate risks in the Congo and Indonesia; avian flu incubated in Vietnam; consumer safety breakdowns in food and toy manufacturing in China; terrorist groups in the Philippines and Pakistan; none of these risks cannot be contained within the borders of the poor countries where they begin.

From both the perspective of new opportunities out there, and of new cross-border risks, development matters. It is in the interests of rich countries to bind themselves in some contractual form to engagement with poor countries.

Why social? Three market shortcomings

Market reform and outward-oriented economic policies are not to be disdained. They are a good part of the explanation for the rapid growth and huge reductions in poverty of the last two decades and more in China, India, Bangladesh, and Vietnam, just as they were earlier in the East Asian Tigers. In China, it was liberalization of agriculture that started the process; in China and in India since the late 1980s a more business-friendly environment and openness to foreign investment have contributed. In Latin America and Africa, good macroeconomic policies in the last two decades,
helped along recently by the global commodity boom, have brought growth rates as high as 6%, and in the democracies of Africa 7-8%, finally bringing reductions not only in the rate of poverty but in the absolute numbers of people living in poverty in many countries.

But I am no globophile. Markets as a mechanism for organizing societies have fundamental shortcomings, and the effects of these are easily intensified in the case of global markets. Let me mention three.

First, markets leave people and countries without the right assets behind. First, markets reward productive assets. They tend to lock in pre-existing income and wealth inequality or, generate along with growth, increasing inequality.

For individual people, the right asset in today’s global economy is higher education (and the skills and flexibility that higher education signals and reinforces). Since the late 1980s, the salary premium to higher education has been rising virtually everywhere. Although the supply of graduates of higher education has been increasing almost everywhere in the world, the demand for their skills has increased even faster, fuelled by rapid technological change (consider the influence alone of the World Wide Web) and the nearly instant diffusion of new technologies in globally connected markets. The demand for highly skilled and talented people at the global level has set off intense competition among rich countries to institute immigration policies not just to permit but to encourage the entry of skilled workers thus contributing to the much higher emigration rates of skilled compared to unskilled people from developing countries. (New research suggests that the benefits of that emigration for sending countries probably exceed the costs; I mention it here as an indicator of the reality of a global market rewarding education, not necessarily as a problem in itself.)

For countries, the key asset appears to be stable and sound government institutions committed to the rule of law, human rights, and property rights. An example of the wrong “asset” for countries is a comparative advantage in production and export of primary commodities, whether agriculture or, especially for immature democracies with minimal accountability to citizens, oil or other non-renewable mineral resources. Countries that entered the 1980’s highly dependent on commodity exports such as Angola, Bolivia, Ghana, Malawi, Nicaragua, or Nigeria, that have failed to diversify into manufacturing, lost out on more than two decades of growth, in contrast to China, Malaysia, and (more recently) Vietnam. One plausible explanation is that entry into manufacturing (and now perhaps into IT services) encourages the accumulation of skills by increasing the returns to human capital, and the diffusion of innovations that fuel endogenous growth.

We entered the 1990’s with pre-existing inequalities within countries in education and a dramatic gap between the competence and stability of rich-country governments and that of the poorest countries. The differences in assets have helped ensure that income inequality has risen in the majority of developing countries enjoying at least some growth; and that between the initially richest and poorest countries the gap in average incomes has grown dramatically, essentially because the poorest countries have grown little if at all, while the richest have continued to move ahead.

A second shortcoming of markets, particularly financial markets, is volatility. In 2008, we saw how the tightening of fuel and food markets led to price spikes that were particularly painful for importing countries that had relied on global trade of these products. In the absence of any global arrangement or rules to make those markets more resilient and less volatile, it is not surprising to hear renewed calls for
energy independence in the United States and food security in the Philippines and Indonesia, despite the efficiency losses and other costs that shifting from openness to real autarchy in these markets would imply. But of the triple whammy in food, fuel, and finance that poor countries suffered this past year, it is the financial one that will be the most costly and the best remembered, particularly in the emerging-market economies that had opened their financial and capital markets.

Financial crises hurt all countries, but developing countries have tended to suffer much greater relative losses in the past, losses of 10 percent of GDP and more, compared to 2 to 3 percent in rich countries following banking crises. And within countries, the poor who lose jobs and income often sell assets or take their children out of school, implying permanently lower lifetime income. In Mexico many children who left school during the 1994-95 tequila crisis, never returned.

For the relatively poor the results are long-lasting in other ways as well. An example: the high public debt that follows government rescues of banks and other financial institutions, crowds out private investment and job creation and reduces the fiscal space for spending on infrastructure, education, and health programs that benefit the poor the most and help build a middle class. There is good evidence that the labor share of total income relative to capital, declines during crises and never fully recovers. Thus, volatility is complicit in contributing to income inequality.

A third shortcoming of markets is that they cannot and do not address "public" goods, i.e. products and services on which market actors cannot make a profit (or fully capture the benefits were they to invest or spend). Basic education is publicly financed almost everywhere in the world because basic education is a quasi-public good. Parents (and their children) can capture some of the benefits of going to school but not all the benefits that societies reap, when more people are schooled. By the same logic, most governments spend public resources to prevent contagious diseases. The classic case of a public good is control of pollution: the factory owner who implements pollution controls pays the cost of control (in the absence of a subsidy) but captures only a small part of the benefits to his community. At the global level, the classic counterpart case is the reduction of greenhouse gas emissions. Countries that commit resources to reduce emissions cannot capture all the benefits for themselves. Just as local pollution control requires that some government entity impose regulations or create offsetting incentives through taxes or subsidies, global-level control of greenhouse gas emissions is likely to require that an activist international community (including at the least the major polluter countries) impose controls or agree on incentives.

Climate change is another example of a global problem that hits the poorest people and countries the hardest. By an unfortunate twist of fate, tropical countries that contributed least to the accumulation of gases are likely to suffer the worst declines in agricultural productivity, in precisely the sector where the poor within countries are heavily concentrated. In the absence of corrective action at the global level, projected declines in agriculture in India are on the order of 30 percent in the next 70 years, and as much or worse in parts of Africa. Sea level rise in Bangladesh, drought and floods, and the expanding reach of malaria and other diseases in many tropical areas will also hit hardest the most vulnerable. And even for the same risks, poorer people and poor countries have fewer resources with which to protect themselves and adjust to changes and will therefore suffer much higher welfare costs if not higher absolute costs from the effects of climate change.

Other global public goods that the market naturally neglects (in these cases a pecuniary market failure) include agricultural research and development likely to
benefit people and places with low incomes and limited market power, and health research and development on malaria and other diseases that primarily afflict the poor. These are areas where in the last several decades large philanthropies like the Gates Foundation have stepped in to compensate for chronic underfunding by rich-country “donor” governments.

In short, in the absence of government intervention, markets alone are not a sufficient organizing principle for socially and politically stable societies. They tend to generate inequality, since alone they favor those who already have financial or human capital or other assets (such as political privileges or family connections). They fail to protect the poor and vulnerable during financial and other crises, and alone will not provide the pension, health and other social insurance needs that reduce insecurity among the middle class (and invite reasonable risk-taking and innovation); and they naturally fail to provide for key public goods (due to what economists refer to as missing markets or market failures).

**Building a global social contract: A development agenda**

The conventional development agenda begins (and too often ends) with an emphasis on the quantity of aid. Let me suggest a four-part agenda for building and sustaining a robust global social contract, which includes but goes well beyond aid.

First, as is the case within country borders, there should be a laser-like focus on avoiding harm to any members of the global community. An apt example is the imperative, from a development point of view, that rich countries during this global economic crisis do not yield to the protectionist pressures that were so calamitous in the 1930s for the then “world” economy. I am optimistic they will not as there is a further understanding today of the dependence on global trading opportunities.

Doing no harm also requires changing some current rich-country policies and programs. The Common Agricultural Policy, which ends up hurting developing country agricultural producers, is an obvious example in Europe, as are cotton, sugar, and other forms of agricultural protection in the United States. The subsidy and protection for corn-based bio-fuel in the United States is discouraging investment in bio-fuels in which developing countries have or could have a comparative advantage. The WTO-agreed intellectual property rights regime reflects a trade-off between access and innovation pushed by the United States and others in the 1990’s that is inappropriate for the world’s poorest countries where the premium has to be on access, particularly to new medicines. And then there is the tough issue of migration.

A colleague of mine at the Center for Global Development argues that emigration is development. Certainly for the unskilled, emigration from a poor country to a rich country is the single easiest and most effective escape from poverty. Nigerian, Haitian, and Honduran construction workers and taxi drivers with little education can instantly increase their incomes fivefold and more by simply moving from their home to a rich country. Immigration is a difficult domestic political issue in all countries, rich and poor, and it would be naïve to expect all countries to liberalize this market as they have liberalized trade and capital markets. But development advocates could be more assertive in calling for easing of current illiberal restrictions on the movement of people across borders, given the growing evidence of the benefits of such movements for both sending and receiving countries.

The idea of do no harm extends as well to enforcing anti-corruption rules on investors abroad and actively supporting the Extractive Industries Transparency Initiative, the Equator Principles, the Kimberly process, and other efforts to bind
private and public agents to good behavior in their dealings with developing countries. Cooperating on programs to document and fight illegitimate and illegal tax and capital flight also falls into this category.

Second, again as is the case within country borders, all governments should allocate more resources to global public goods by spending both at home and abroad. As happens within countries, there should be some redistribution through taxes and expenditures of the burden and benefits of such spending from rich to poor, in this case across countries, in the enlightened self-interest of the rich. A good example is investments in clean-energy technologies to minimize climate change, including spending within rich countries on energy research and development. Naturally there is concern that rich governments will divert resources from traditional aid programs to “global” programs; but, in fact, recent evidence suggests that the effects of climate change are already imposing high welfare costs on the world’s poor, so whatever trade-off there may be, is far less clear than heretofore assumed. Ideally, in the context of a climate change treaty, the much greater per-capita emissions of rich countries compared to poor will imply major compensatory financial transfers from the former to the latter to purchase emissions rights. Those transfers would not be aid, with its administrative and proto-paternalistic burdens on poor countries, but legally based transactions in which all parties honor contractual obligations. In any event, R&D on clean energy would ideally include a major focus on sun, wind, and bio-fuel technologies that would tap the comparative advantage of developing countries, many of which literally have more sun than rich countries, and would be compatible with the needs of low-income and rural populations.

Other global public goods include public investment in new and improved medicines and health delivery technologies, and in agriculture (for example to create a Green Revolution in Africa and elsewhere) oriented to the needs of people in developing countries, and public contractual commitments to finance successful development and deployment of such technologies by the private sector.

Whether called “aid” (or better not – Jean-Michel Severino who heads the Agence Francaise de Developpement with his co-author Olivier Ray suggests the term “global public finance” in a recent paper)39, rich countries should develop and agree on clear norms and agreed financing mechanisms (the European Union aviation tax is an apt example) for the allocation of resources to global public goods relevant for poor countries and poor peoples.

Third, donor countries should focus on the quality and at the least maintain the current quantity of traditional aid. In domestic social contracts, some transfers (publicly financed education) are meant to support future growth by maximizing society’s investment in human capital and to level the playing field in ensuring access to health and education; some transfers (public subsidies and provisions for old age and health insurance) provide social insurance across the board for all income groups; some transfers (welfare payments to the indigent and unemployable) are primarily humanitarian in the interests of social solidarity. It is not always easy or useful to draw clear lines around these three purposes. As with domestic transfers, so with foreign aid it is not always easy or useful to distinguish between aid for “growth” and aid in the interest of global solidarity. The Millennium Development Goals obviously address both growth and solidarity objectives; budget support provides for both; infrastructure investments and agriculture are usually viewed as mostly about long-term growth.

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The bottom line is that aid can be framed as the counterpart of domestic public spending on health, education, credit programs for small businesses and so on, which, as with domestic spending, has multiple purposes. It compensates for the shortcomings of markets discussed above, both in the political interest of retaining the benefits of an open, global economy for all and in response to the solidarity impulse in an increasingly interlinked world. The striking difference of course is in the amounts spent – on the global social contract by rich countries less than 1% percent of GDP, while on the domestic counterpart upwards of 20%.

The shadow of a “contract” exists at the global level in the form of the commitment of the traditional donor countries to spend at least 0.7 percent of their own GDP on aid – but of course (as amply demonstrated at the UN Doha Conference November, 2008 on financing for development) it is in fact only the shadow of a contract. In the face of political resistance to increasing aid in the next year, donor agencies would be smart to focus on getting better results for resources they already commit, and in ways that would create accountability of recipient governments to their own citizens, rather than to donors. At the Center for Global Development, we have suggested one practical innovation toward that end (we call it cash-on-delivery aid)\(^{40}\), and there are others worth trying and systematically evaluating. Donors could easily and instantly move on far greater transparency of their allocations and expenditures, and all could increase the proportion of their aid that goes through multilateral institutions as one way to minimize recipient governments’ transactions and administrative costs.

Fourth, and perhaps most fundamental, is the tougher issue of creating an effective global polity to manage a global social contract. The global economy has far outstripped the institutions and clubs of nations that make up the global polity. In effect the economics of globalization has run far ahead of the politics of globalization. At the international level we have only the faintest shadow of the equivalent of the activist state at the national level, to fetter or manage a global economy or to provide the protection against its ravages for vulnerable global citizens concentrated in developing countries. What we do have is a hodgepodge of official and quasi-official institutions in which various combinations of nations make up the membership (the UN and its 20-odd separate agencies, the IMF, the WTO, the multilateral banks, the Bank for International Settlements, the club-like groups of nations (G-7, G-20, G-77, G-24). But in contrast to the sovereign state, this international polity is relatively weak and ineffective. In contrast to the democratic legitimacy of most states, this polity lacks legitimacy. As a result, in contrast to the condition of the domestic social contract in the world’s mature Western economies, the global social contract for which this international polity is responsible is fragile indeed.

Yet the interdependence among nations illustrated by today’s financial and economic crisis highlights the need for a more “activist” international polity; not with the power of sovereign states but certainly with more resources and responsibilities than it has today. In the near term, an activist international polity is needed not only for the coordination of a timely global fiscal stimulus and agreement on regulation of global financial markets, but also to agree on some minimal levels of protection (without protectionist trade and other policies) against the downside for vulnerable global citizens everywhere. Beyond today’s crisis, ensuring that the global market

http://www.cgdev.org/section/initiatives/_active/codaid
works better for the poor and middle class, as well as the rich, in some imitation at the global level of the domestic social contract, seems critical to the political sustainability of market-based globalization.

So I would put high on the development agenda the need to move beyond ad-hoc bilateral arrangements between rich and poor countries in 2 ways. First is the strengthening of the international institutions where the solidarity norms and the global equivalent of taxes, subsidies and regulations for the global polity need to be embedded. In the case of the development agenda, these include most obviously the IMF, the multilateral banks, and the United Nations; but also the WTO, the Basel Committee and so on. Second, for the financial institutions, is the reform of their governance to make them more representative and therefore more credible and effective in developing countries; I as well as others have written extensively on this issue. It is not surprising that the global trade, intellectual property migration and other regimes reflect the greater market (and military) power of rich countries; and that on such difficult issues as immigration that the domestic political constraints within rich countries tend to trump the needs of world’s poor. That does not mean that for solidarity reasons, and to politically sustain a global market system with all its benefits, the development community should stand aside and accept the hand dealt. On the contrary, it means there is logic in constant vigilance or readiness as global citizens to swim against the tide of market and political power at the global level, just as we do as responsible citizens within each of our countries, in the interests of a better world for all.

In conclusion: Restating two points about the global social contract

A global market-based economy has tremendous potential benefits for improving lives by generating and allocating resources well, but only if it is complemented by a robust global social contract through which rich and poor nations bind each other to commitments in the interest of the common global good. In conclusion, I would like to restate two points about this global contract.

First, it provides a way for the development community to think differently about aid and to think beyond aid. Aid as part of a social contract across nations and peoples can be thought of not only in its traditional form of investment in people, infrastructure, and better government, likely to raise economic growth over the medium term, but also in the form of solidarity or redistributive transfers to protect and improve the welfare of unlucky fellow global citizens today. Furthermore, aid is only one mechanism by which rich and poor nations interact. Beyond aid are trade, migration, investment, climate change, and other policies of rich nations by which they directly or indirectly affect poor nations and which should be shaped to promote development and the common global interest.

Second, management of a robust global social contract requires a strong and effective global “polity” to provide opportunities for the unlucky, protect the vulnerable, and bind us all to agreed rules and commitments through and by which those opportunities and protections are guaranteed. Development advocates in this 21st-century setting of global hyper-connectivity ought to put considerable priority on strengthening the institutions that make up our current global polity. A key aspect of their strengthening is to make them more representative and legitimate. Without greater representation of developing countries; small and poor, large and geopolitically ascendant, we put at risk the political and social sustainability of the market-based global economy itself. It is in the end through these institutions that the habits and norms, as well as the rules of a global social contract, are most likely
to be shaped in a way that will put global markets and globalization to work for the majority of people everywhere.
Notes on sources

- On why there must be a global contract, see:

- For Ha-Joon Chang’s WRR speech:

- On why we must move beyond aid, see:

- On why there must be a social contract and for literature on inequality, see:

- On aid in different forms, see:

- On CGD’s aid innovation, see:

- On legitimacy and governance reform at the global development institutions, see:
Background
The financial crisis has drawn attention away from some important features of the preceding boom: it was both unequal and ecologically unsustainable. The economic boom drew rapaciously and fecklessly on natural resources. It was also deeply unequal. Contrary to general perception, most people in the developing world did not gain from that boom; instead, the poor effectively subsidised the rich. This was true internationally, as central banks of developing countries parked their growing foreign exchange reserves in the US, so that the South provided net finance to the North instead of using such resources for its own development. It was also true within countries, as profits soared but wage shares of national income declined sharply and agrarian distress persisted.

The speculative housing bubble in the US attracted savings from across the world, including from the poorest developing countries, so that for at least five years the South transferred financial resources to the North. Developing country governments opened up their markets to trade and finance, gave up on monetary policy and pursued fiscally “correct” policies that reduced public spending. So development projects remained incomplete and citizens were deprived of the most essential socio-economic rights.

Furthermore, despite the evident economic dynamism in some parts of the developing world, there was no net transfer of jobs from North to South. In fact, industrial employment in the South barely increased in the past decade – even in the “factory of the world” China. Instead, technological change in manufacturing and the new services meant that fewer workers could generate more output. So old jobs in the South were lost or became precarious and the majority of new jobs were fragile, insecure and low-paying, even in China and India. The agrarian crisis in the developing world hurt peasant livelihood and generated global food problems. Rising inequality meant that the much-hyped growth in emerging markets did not benefit most people.

So the recent growth was not inclusive. But unfortunately the slump will be only too inclusive, forcing those who did not gain earlier to pay for the sins of irresponsible and unregulated finance, through loss of livelihood and reduced living standards. This is particularly true in the case of women in the developing worlds, whose lives have already been materially altered by many rapid social and economic changes. This essay examines these issues with special reference to women in developing Asia.

It is commonplace to say that changes in the lives of women mirror broader changes in society, but possibly that statement has been more true globally over the past two decades than at any time in the previous century. There have been major
and rapid changes in the living and working conditions of women across the world, which have both reflected and been expressed in equally substantial changes in global economics and politics.

Global capitalism is known to be systemically unstable and recently deflation and chronic unemployment have emerged as important characteristics even in periods of apparently high aggregate growth. The persistence of fairly high rates of open or disguised unemployment even in areas or sectors of high growth is now recognised. Interestingly, even though there has been something of a global boom in commodity markets and in certain developing economies for the past decade, employment generation has not really picked up commensurately and agrarian crises continue to plague most developing countries. Meanwhile, economic territories continue to be contested in new imperialist patterns, which cover not only conflicts over stable resources such as oil and other primary commodities, some new areas, which were earlier not even considered part of the realm of material transactions. The newest and most rapidly growing markets are those in intellectual property, and certain services and utilities that were earlier assumed to be the monopoly of public provision, such as power, water and telecommunications. Debates over permitted carbon emissions also amount to struggles over resources. At the same time, technological changes have also furthered the process of global corporate dominance by enabling the vertical disintegration of production and the spatial integration of ownership and control.

These broader changes in the international economy have affected national and international labour markets. The most significant change is the increase in open unemployment rates across the world. By the beginning of the century, unemployment rates in most industrial countries were higher than they had been at any time since the Great Depression of the 1930s. But even more significantly, and in a break from the past, open unemployment was very high in developing countries. It has continued to grow thereafter, even though the general absence of social security provision or unemployment benefits in the developing world usually means that people undertake some activity, however low paying, and usually in the form of self employment. It is notable that open unemployment has been growing in the developing countries that are currently seen as the most dynamic in the world economy, such as China, East and Southeast Asian countries and India, and in many of these economies, it has combined with the persistently high rates of underemployment.

The decline in formal sector employment, especially in developing countries, has been associated with the proliferation of workers crowded into the informal sector, especially in the low-wage low-productivity occupations that are characteristic of "refuge sectors" in labour markets. While there are some high-value-added jobs increasingly to be found as "informal" self-employment (including, for example, software and some high-end IT-enabled services that allow home-based professional work) these are relatively small in number and certainly too few to make much of a dent in the overall trend, especially in countries where the vast bulk of the labour force is unskilled or relatively less skilled. In turn, this has meant that the cycle of poverty-low employment generation-poverty has been perpetuated and even accentuated because of the diminished willingness or ability of developing country governments to intervene positively in expanding employment generation.

The emergence of global production chains is also an important feature in recent years. These are not entirely new, and even the current chains can be dated from at least the 1980s. However, two major sets of changes have dramatically
increased the relocation possibilities in international production. Technological changes have allowed for different parts of the production process to be vertically split and locationally separated, as well as created different types of requirement for labour involving a few highly skilled professional workers and a vast bulk of semi-skilled workers for whom burnout over time is more widely prevalent than learning by doing. They have also enabled geographical relocation in service activities which were previously locationally rigid. Organisational changes have been associated with concentration of ownership and control as well as with greater dispersion and more layers of outsourcing and subcontracting of particular activities and parts of the production process. Therefore, we now have the emergence of international suppliers of goods and services who rely less on direct production within a specific location and more on subcontracting a greater part of their production and distribution activities. This has led to the emergence and market domination of “manufacturers without factories”, as multinational firms such as Nike and Adidas effectively rely on a complex system of outsourced and subcontracted production based on centrally determined design and quality control. More recent outsourcing in services ranging from publishing to back-office work also combines some amount of flexibility (which implies greater control over workers) with centralised control.

In addition, there is much greater use by international capital of the skilled labour to be found in some developing countries, with the internationalisation of service industries, including banking and finance. This has greatly enhanced labour mobility of a small section of more skilled and professional employees, even as other labour finds it much more difficult to move, and aggregate rates of labour migration are lower than they have been in the history of capitalism. This has contributed in no small measure to the enthusiasm for the process of global integration among such groups of skilled workers in developing countries. In fact, an important reason for the success of imperialist globalisation has been its ability to draw local elites and middle classes across the world into its own ranks, to offer part inclusion into a privileged international space within which the travails of the local working poor can be forgotten, even while their crucial role in generating productive surplus within the local economy is perpetuated.

Finally, a crucial feature of work processes across the globe has been the increase in unpaid labour within households – dominantly (but not exclusively) performed by women, as governments renege on basic social responsibilities for the provision of public goods and services, and more of the care economy is devolved onto the unpaid sector. The peculiar combination of increased unemployment and increased requirement of unpaid labour is thus an attribute of labour markets globally.

The Asian region
All these processes are particularly marked for developing countries in Asia. This is now the most “globally integrated” region in the world, with the highest average ratios of trade to GDP, the largest absolute inflows of foreign direct investment, substantial financial capital flows and even significant movements of labour. These have been associated with very rapid changes in forms of work and life, especially for women. Indeed, the effects on economies and societies in the region have been seismic in their speed and intensity, and particularly in gender relations. The rapid growth of aggregate incomes (and equally rapid and sudden declines in some economies) have been accompanied by major shifts in employment patterns and living standards,
as familiar trends are replaced by sharp social changes that are now accelerated and intensified.

There have been very rapid shifts in the labour market in the space of less than one generation, as Asian women have been first drawn into paid employment, especially in export sectors, and then ejected from it. The phase of disproportionately high use of women in export-oriented manufacturing in several rapidly growing Asian economies in the 1980s and early part of the 1990s was followed by a period of subsequent ejection of older women and some younger counterparts, into more fragile and insecure forms of employment, or self-employment or even back to unpaid housework (Ghosh 2004, 2009). Women have moved – voluntarily or forcibly – in search of work within and across countries and regions, more than ever before.

Their livelihoods in rural areas, dominantly in agriculture, have been affected by the agrarian crisis that is now widespread in most developing countries. Across societies in the region, massive increases in the availability of different consumer goods, due to trade liberalisation, have accompanied declines in access to basic public goods and services. At the same time, technological changes have made communication and the transmission of cultural forms more extensive and rapid than could have even been imagined in the past. All these have had very substantial and complex effects upon the position of women and their ability to control their own lives, and many of these are still inadequately understood.

The most significant change for women throughout the developing Asian region since the early 1980s was their substantial increase in labour force participation, which was then followed by a decline in the early years of this century. This was similar to a worldwide pattern of increasing work participation by women. But the Asian experience was somewhat different, in that (unlike, say, Latin America) this was part of – and even led - the general employment boom created by export-led economic expansion. (Chhachhi and Pittin 1996, Seguino 2000) This trend towards feminisation of employment in Asian countries resulted from employers' needs for cheaper and more "flexible" sources of labour, which meant more casualisation of labour, shift to part-time work or piece-rate contracts, and insistence on greater freedom of hiring and firing. All these aspects of what is now described as "labour market flexibility" became necessary once external competitiveness became the significant goal of domestic policy makers and defined the contours within which domestic and foreign employers in these economies operated.

Women workers were preferred by employers in export activities primarily because of the inferior conditions of work and pay that they were usually willing to accept (Lim 1994). They had lower reservation wages than their male counterparts, were more willing to accept longer hours and unpleasant and often unhealthy or hazardous factory conditions, typically did not unionise or engage in other forms of collective bargaining to improve conditions, and did not ask for permanent contracts. They were thus easier to hire and fire at will, or according to external demand conditions. Life cycle changes such as marriage and childbirth could be used as proximate causes to terminate their employment and engage a younger and fresher set of female workers. Greater flexibility was thus afforded to employers, to offer less secure contracts. Further, in certain of the newer "sunrise" industries of the late 20th century such as computer hardware and consumer electronics, the nature of the assembly line work - repetitive and detailed, with an emphasis on manual dexterity and fineness of elaboration - was felt to be especially suited to women. The high "burnout" associated with some of these activities meant that employers preferred to hire workers who could be periodically replaced, which was easier when
the employed group consisted of young, mostly unmarried, women who could move on to other phases of their life cycle.

The feminisation of such activities had both positive and negative effects for the women concerned. On the one hand, it definitely meant greater recognition and remuneration of women’s work, and typically improved their relative status and bargaining power within households, as well as their own self-worth, thereby leading to some empowerment. On the other hand, since most women are rarely if ever actually “unemployed” in their lives, as they are almost continuously involved in various forms of productive or reproductive activities (even if they are not recognised as “working” or paid for such work) paid employment for them may lead to an onerous double burden of work unless other social policies and institutions emerge to deal with the work traditionally assigned to (unpaid) women.

Given these circumstances, it has been fairly clear for some time now that the feminisation of work is not cause for unqualified celebration by those interested in improving women’s material status. It is now becoming evident that the feminisation of labour in export-oriented industries may have been even more dependent upon the relative inferiority of remuneration and working conditions, than was generally supposed. Especially because it turned out to be a rather short-lived phenomenon. Already by the mid 1990s – the height of the export boom - women’s share of manufacturing employment had peaked in most economies of the region, and in some countries it subsequently declined in absolute numbers (Ghosh 2008). Some of this reflected the fact that such export-oriented employment through relocative foreign investment simply moved to cheaper locations: from Malaysia to Indonesia and Vietnam; from Thailand to Cambodia and Myanmar and so on. But even in the newer locations, the recent problems of various export sectors such as the garments industry worldwide have meant that jobs (especially for women workers) were created and then lost within the space of a few years.

As women became an established part of the paid workforce and even the dominant part in certain sectors (as indeed they did become in the textiles, readymade garments and consumer electronics sectors of East Asia) it became more difficult to exercise the traditional type of gender discrimination at work. Besides an upward pressure on their wages, which caused gender wage gaps to come down to some extent, there were other pressures for legislation to improve their overall conditions of work. But these strategies designed to improve the conditions of women workers tended to reduce their relative attractiveness for those employers who had earlier relied precisely on the inferior conditions of women’s work and their greater flexibility in terms of hiring and firing to keep their costs low and enhance their export profitability. The rise in wages also had the same effect. As their relative effective remuneration improved (in terms of the total package of wages and work and contract conditions), their attractiveness to employers decreased.

Subsequently, manufacturing in Asia tended to occupy a much less significant position in the total employment of women, and also relied less on female employment at the margin. It is increasingly evident that export-oriented production does not always result in feminisation of the workforce, which is essentially dependent upon the relative inferiority of female wages and work conditions. If mechanisation and newer techniques require the use of more skilled labour, or if the gap between male and female wages in not sufficiently large, export activities do not need to rely more on women’s labour. In conditions in which both male and female workers have been forced by adverse conditions in the labour market to accept adverse low-paid and insecure work contracts, as occurred not only in post-crisis
East Asia but in other countries of the region, there has been less overt preference for young women workers than was previously observed.

The nature of such work has also changed in recent years. It was already based mostly on short-term contracts rather than permanent employment for women; now there is much greater reliance on them as workers in very small units or home-based production, at the bottom of a complex subcontracting chain. This became even more marked in the post-crisis adjustment phase. In South-east Asia, women have made up a significant proportion of the informal manufacturing industry workforce, in garment workshops, shoe factories and craft industries. Many women also carry out informal, temporary activities in farming or in the building industry. Home-based workers, working for themselves or on subcontracts, make products ranging from clothing and footwear to artificial flowers, carpets, electronics and telecommunications.

The increasing use of outsourcing is not confined to export firms. However, because of the flexibility offered by subcontracting, it is clearly of even greater advantage in the intensely competitive export sectors and therefore tends to be even more widely used there. Much of this cross-border outsourcing activity is based in Asia, although Latin America is emerging as an important location once again. Such subcontracted producers vary in size and manufacturing capacity, from medium-sized factories to pure middlemen collecting the output of home-based workers. The crucial role of women workers in such international production activity based in Asia is now increasingly recognised, whether as wage labour in small factories and workshops run by subcontracting firms, or as home workers dealing with middlemen in a complex production chain.

A substantial proportion of such subcontracting extends down to home-based work, which provides substantial opportunity for self-exploitation, especially when payment is on a piece-rate basis; also such work is typically left unprotected by labour laws and social welfare programmes. However, even such home-based work may be in crisis, as the textile and garment exports from developing countries face increasing difficulties in world markets and the pressure of competition forces exporters to seek further methods of cost-cutting. The extreme volatility of demand for labour that characterises factory-based export-oriented production has also become a feature of home-based work for export production.

But paid work defines only part of the labour conditions of women. Recent economic policies and processes have generated more unpaid work as well. Macroeconomic policies of national governments that have systematically reduced employment opportunities for both men and women and allowed agriculture in the South to become a precarious and unviable occupation, have also reduced the quality of and access to public goods and services and thrown open many parts of everyday life to equalising market processes. In general these economic policies have generally been in the interests of large corporate capital. The rich, and especially large corporations, have benefited from competitive offers of substantial and growing tax benefits, while the common people have been told that there is no money in the state treasury for basic public goods and services. Food security has been threatened in poor countries; other economic rights have been denied; social sectors such as health and education have been underfunded; and workers’ protection has been reduced. The increasing emphasis on markets has implied the commoditisation of many aspects of life that were earlier seen as either naturally provided by states and communities, or simply not subject to market transaction and property relations. For example, the inability or refusal of several governments to
provide safe drinking water has led to the explosive growth of a bottled water industry. A whole range of previously publicly provided services and utilities like power distribution and telecommunications have been privatised. Even the growing recognition accorded to intellectual property rights marks the entry of markets into ever-newer spheres.

All this affects women and girls most directly. When incomes from work in the family go down, women are forced to seek any form of employment that will keep the household going. When there is less access to food, women and girl children tend to eat less. When the health services are inadequate, women (especially mothers) not only suffer the most, but they also have to bear the responsibility of looking after the sick and the old. When schools lack basic facilities or charge higher fees, girl students find it difficult to attend and get relegated to household tasks. When cooking fuel and clean drinking water are hard to come by, women have to somehow provide them for the family. So such government policies have led to large increases in the unpaid labour of women, and thereby contributed to a worsening quality of life for them.

In addition, these economic changes have other adverse social consequences for women. The increasing emphasis on markets and profitability requires luring more consumers into the web of purchase through advertising and attempts to manipulate peoples’ tastes and choices. In this effort, advertising companies have notoriously used women as objects to purvey their products. The dual relationship with women, as objects to be used in selling goods, and as a huge potential market for goods, creates a peculiar process whereby women are encouraged and persuaded to participate actively in their own objectification. The huge media attention given to beauty contests, “successful” models, and the like, have all fed into the rapidly expanding beauty industry in developing Asia, which includes not only cosmetics and beauty aids, but slimming agents, beauty parlours, weight loss clinics, and so on. Many of these contribute to the most undesirable and retrograde attitudes to both women and their appearance, which can push women into newer forms of social oppression that may be no less demeaning than earlier explicitly patriarchal forms.

One important response by Asian women to these changes has been economic migration. Asia has become one of the most significant regions in the world both for the cross-border movement of capital and goods, and for the movement of people. The picture of women’s migration in Asia today is complex, reflecting the apparent advantages to women of higher incomes and recognition of work, but also the dangers and difficulties of migrating to new and unknown situations with the potential for various kinds of exploitation. The desperation that drives most of this economic migration, and the exploitative conditions that it can result in, should not be underestimated. But it is also true that the sheer knowledge of conditions and possibilities elsewhere can have an important liberating effect upon women, which creates a momentum for positive social change and gender empowerment over time.

**Looking ahead**

It is clear that globally we need a clear change in economic strategy. Obviously, finance must now be controlled and directed. But it is equally important to increase public expenditure: to revive demand in flagging economies, to manage the effects of climate change and bring in widespread use of green technologies, and importantly, to provide minimally acceptable standards of living for citizens of the developing world. We must promote redistributive taxation and other policies to reduce economic inequalities, both within and between countries.
Of course, crises tend to make things worse, not better. As economies slow down, more jobs will be lost and people, especially those in the developing world who did not really gain from the boom, will face deteriorating conditions of living. But the gloom and doom is not inevitable. Now that there is overwhelming evidence of the failure of the economic model on which the boom was based, we can think afresh about how to organise economic life, both nationally and globally.

Such new thinking has got to take into account the changed international context, in which the overwhelming dominance of the US is likely to be replaced by inter-imperialist rivalry and scramble for resources and markets, in which it will be harder for any individual country (or even the G-8) to impose conditions on others. Several points must be noted if we want real democratic change and not just more of the same.

First, obviously finance must be controlled and the “innovations” in financial markets that are actually no more than sleight-of-hand scams must be disallowed. Otherwise we will remain vulnerable to more financial crises and continue to face speculative swings in prices of important commodities like food and oil. And poor countries will continue to send to rich ones, the capital they desperately need for their own development.

Second, fiscal policy and public expenditure must be brought back to centre stage. Across the world, we need significantly increased public expenditure: to revive demand in flagging economies, to manage the effects of climate change and bring in widespread use of green technologies, to fulfil the promise of achieving minimally acceptable standards of living for everyone in the developing world.

Third, restructuring the world order will have to be based on conscious attempts to reduce income and wealth inequalities, both between countries and within countries. We have clearly crossed the limits of what is “acceptable” inequality. The effects are upon us every day: in growing socio-political conflicts; in the spread of enthusiasm for terrorism and violence among the dispossessed and the frustrated; in the growing insecurity of daily life anywhere.

Reducing inequalities is not going to be easy. It will require the North to reduce its consumption of scarce resources and carbon emissions, which means some reduction of average consumption generally. It will require the global elite, spread across both developed and developing worlds, to curb extravagant lifestyles. It will require wage shares of national income to rise from their current very low proportions, with corresponding declines in the shares of profits and interest. And it will require governments in powerful developed countries to recognise that they can no longer call the shots in all important international decisions.

Finally, in order to ensure a better deal for women in the future, it is necessary to address four critical areas:

- Ensuring more availability, and better terms and conditions for paid employment of women.
- Reducing the pressures for and alleviating the conditions of unpaid work.
- Increasing the access to basic needs and to essential health, nutrition, sanitation and education.
- Managing the implications of ecological damage for social reproduction for women’s lives, and laying the foundation for more sustainable growth strategies.
Introduction
This article documents and analyses the movement of labour, in particular during the recent years of the so-called globalization period, across countries in search of employment. It brings into sharp contrast the fundamental asymmetry between the treatment of labour mobility and capital flows, and the theoretical assumptions of mainstream orthodoxy. It argues that while the rhetoric of globalization has been premised on greater integration in terms of trade and factor flows, labour mobility is highly regulated through restrictive instruments.

Increasing inequality, reduced transportation costs and demographic imbalances in recent years have created pressure on migration, both on the demand and supply sides. However, the challenge of overcoming developmental obstacles and enhancing individual functioning through the instrumentality of migration requires that the issues of labour mobility be given favourable status vis-à-vis that of capital and finance.

This paper begins by exploring some contentious issues regarding globalization, and then provides an outline of labour mobility in a historical context. This is followed by a discussion of determinants and factors that influence the magnitude of migration at the national level and the benefits associated with it, and concludes by summarizing the main points emerging from the entire discussion.

Globalization: Some Contentious Issues
As is commonly acknowledged, globalization is a complex phenomenon and its most prominent dimension in the current phase has been the increasing integration of the global economy through trade, investment and finance flows. Theoretically, as well as practically, this integration involves a considerable erosion of a nation’s capacity and willingness to intervene in the economic sphere in several important respects. The underlying premise of such a process is that increased competitive pressure together with ‘market-friendly’ regulation is enough to generate socially optimal outcomes. Leaving aside the logic of this argument and without getting into any larger debates about the huge paradigm shift in macroeconomic policy regimes globally, we need to take note of the obvious arguments here in which the proponents of globalization have been quite selective in their championing of the ‘virtues of liberalization and globalization’, revealing the implicit bias of their analysis. This feature comes out starkly, for instance, when we contrast the characteristic responses of protagonists of globalization towards the flows of finance and labour.

While economists such as Dornbusch declared in no uncertain terms that: “The correct answer to the question of capital mobility is that it ought to be..."
unrestricted” (Quoted in [13]); the typical discussion in developed countries regarding immigration is the following: “Sure, our borders are long and porous, but that doesn’t excuse the United States from stating its objectives for immigration. What types of immigrants should this country admit? And how many immigrants does it want?” (Borjas, [5])

The tenor of the analysis in the above-quoted article is strongly unsympathetic to the cross-border movement of workers. In general, the presumed economic ground to oppose migration is that it would have substantial adverse distributional consequences in receiving countries.

In other words, the argument of detractors is that migration from developing countries would bring down wages and create unemployment in these countries. This argument has been advanced despite the fact that several statistical studies failed to find any negative correlation between migrant population and wage levels.

Berkeley economist David Card, in a series of papers [6,7], systematically examined data that flies in the face of critics’ claims that migration has an adverse implication on the labour market opportunities of native workers. Card [6], studied the impact of migration on the lower end of labourers in Miami, when in the context of an influx of migrants the labour force swelled by as much as 7%. Data showed that it did not result in a reduction in the wage rate of native labourers, nor their employment opportunities. Again, using the US census data of 2000, Card [7] finds that the relative wage of native dropouts (i.e. the wages of unskilled labour) was uncorrelated with the supply of less-educated workers. Since the argument that large migration must reduce wages is based on a partial equilibrium approach, which arguably operates through changes in supply of the labour force, this finding renders the entire argument empirically untenable. Card [7], after careful examination of data, concludes: "Although immigration has a strong effect on relative supplies of different skill groups, local labour market outcomes of low skilled natives are not much affected by these relative supply shocks."

A number of alternative hypotheses have been advanced to explain this phenomenon. However, in our view, it is the neglect of migrants’ impact on the total demand of goods and services that holds the key for understanding this apparently paradoxical result. Migrants are not only the source of labour in the countries of their destination, but also raise the level of aggregate demand through their consumption expenditure, implying negligible adverse consequences for domestic labour in terms of employment opportunities and wage rates.

We may also emphasise that critics’ concern about unemployment and sources thereof are completely misplaced. Indeed, the era of globalization witnessed an increase in the global open unemployment market, which in 2003 was estimated to be about 188 million. However, the main reason behind job loss during this era is not labour mobility, as alleged by the critics; rather it is the deceleration, and in extreme cases, even collapse of real economies following the ascendance of neo-liberal macroeconomic policy regime globally for almost three decades now, and the rise of finance capital as, arguably, the most significant entity in the contemporary global economy. In other words, holding migration responsible for unemployment in developed countries is hardly a tenable argument; it is not the case that on the aggregate employment front, developing countries have gained at the expense of the developed countries through migration or even a whole range of relatively recent labour practices such as ‘off-shoring’ or ‘body-shopping’ etc.; rather the transition to what several researchers describe aptly as a neo-liberal economic regime which has hurt the prospects of employment generation everywhere. In fact, the ILO, through
its several publications during the last couple of decades, has expressed serious concerns over the unemployment growth in the global economy. According to the ILO Global Employment Trends Report (GET), the global unemployment rate would rise to 6.1% in 2009, up from 5.7% in 2007, resulting in an increase in unemployment of 18 million workers in 2009. In the worst case scenario, however, the global unemployment rate may go over 7.1%, resulting in an increase in the global number of unemployed of more than 50 million.

Sure enough, countries that become particularly acute victims of finance capital are prone to major shocks in the real economy as well as on the employment front, as was powerfully evident during the 1990s, for instance in the change of the unemployment rate in Latin American and East Asian countries in pre and post crisis years. In the immediate years following the financial crisis unemployment rates grew from 6% to 7.3% in Brazil, from 5.3% to over 10% in Chile, from 14% to 17% in Columbia, and from 2% to 3.7% in South Korea, (ILO [1]). If further evidence is needed, the activities in the global economy during the last 18 months, in particular in the USA, Japan, and several OECD countries should leave no doubt; the mayhem created by finance capital is there for all to see. As per the ILO Global Employment Trends Report (GET), unemployment rates sharply increased by 7% in developed economies and reached 6.4% in the European Union, in 2008. The unemployment rate in Latin America and the Caribbean witnessed an increase of 1%, in East Asia 3%, in South East Asia and the Pacific 2%, and in Central and South Eastern Europe 3%, reaching respectively the levels of 7.3%, 3.8%, 5.7%, and 8.8%. Relatively insulated regions such as Northern Africa, the Middle East and Sub-Saharan Africa have managed to sustain their pre-crisis employment levels so far; however the impact of the global downturn unleashed by the financial turmoil will sooner or later impact employment prospects in those regions too. Given these facts, even several ardent advocates of ‘market fundamentalism’ are running for cover, as these countries are entering a period of one of the worst recessions since the Great Depression.

Therefore it is the dominance of the neo-liberal ideology promoted aggressively by finance capital that has encouraged the pursuit of deflationary macroeconomic policies, thus indirectly lowering employment growth. Neither labour mobility has increased nor have changes in labour practices as noted above taken place.

Patnaik [11], in his DD Kosambi lecture, points out at least three different mechanisms through which globalization, particularly financial globalization, creates conditions for a secular tendency towards income deflation and employment stagnation, and it may be worthwhile to recall his arguments here. To begin with, globalization, as mentioned earlier, is first and foremost a process of financial integration, resulting in massive cross-border financial flows. Given the potential of such flows to give rise to economic instability in a particular country, the issue of maintaining ‘investor’s confidence’ becomes a matter of paramount importance concerning macroeconomics. One particular recipe for maintaining such confidence is the reduction in the scale of government expenditure. As Patnaik suggests, apparent arguments for such reduction are based on fallacious reasoning of ‘sound finance’, which was rejected comprehensively quite sometime ago by Prof. Joan Robinson as ‘the humbug of finance’. This aversion to financial capital for government expenditure, mainly stemming from a steadfast ideological opposition to an interventionist state, is made concrete mostly by ‘Fiscal Responsibility’ legislations.
The legal limit on the relative capacity of the State to intervene in an economic sphere is further complemented by the process of competitive tax reduction by developing countries for attracting the flow of capital, reducing import duties because of trade liberalization, and reducing domestic indirect taxes. Failure to do so would amount to negative protection. The net result of all these changes is a reduction in one of the most important sources of demand: Government expenditure, thus resulting in income deflation and employment reduction.

Secondly, globalization contains an implicit tendency towards the destruction of domestic producers, particularly in developing countries. Inflows of short-term financial flows exert upward pressure on the exchange rate, which, in the absence of intervention, results in currency appreciation, lowering the export demands. Even when such pressures are absent, in-flow of imports and diversion of demand from high labour-intensive traditional goods towards imports or low employment intensive luxury goods have the effect of reducing employment in developing countries.

Thirdly, the source of income deflation, highlighted by Patnaik as directly emerging from the process of globalization, is the declining term-of-trade of petty producers, in particular peasants. With the monopolistic power to set prices, an autonomous shift in terms-of-trade is brought about through the resulting higher prices for manufactured goods. This shift in terms-of-trade is conceptually equivalent to a tax imposed on peasantry, with similar aggregate-demand-reducing macroeconomic consequences. Furthermore, even as the terms-of-trade are occasionally moving in favour of such products, the presence of large transnational corporations in the marketing of primary commodities ensures that the terms-of-trade obtained by actual producers nevertheless is largely unaffected by favourable developments.

The explanation of declining employment flexibility of growth in the neo-liberal economic order, manifested in the form of globalization, therefore lies in these reasons; not the ones adduced by opponents of migration. In conclusion, it is financial globalization, not increasing migration, which is responsible for current unemployment.

**A Historical Profile of World Migration**

Migration, in the modern sense of mobility of labour from the labour-abundant economies to labour-shortage economies goes back to the 15th Century (Nayyar [10]). Migration, in this period mainly consisted of slave labourers captured from the Western coasts of the African continent to the newly-discovered American continent to work on plantation farms and in households. The Atlantic slave trade was the trade of African people supplied to the colonies of the New World. Starting from the 16th century, it went unhindered until around about the 19th Century. West Africa and Central Africa were the source of this trade and destinations included new European colonies established in South and North America and the Caribbean islands. The continuous supply of slaves was ensured through coastal trading with Africans, and also by direct capture by European slave traders through raids and kidnappings. The current estimate of forceful migration of Africans in this period ranges between 10 and 12 million, excluding the considerable number of slaves who died during the course of migration under inhumane conditions.

Following the end of slavery in the British Empire in 1838, plantation owners turned to indentured labour to provide services on plantation farms. An indentured servant is a type of debt bondage worker. The labourer was contracted by of an employer for a set period of time, and received necessities, including food, drink,
clothing, lodging and transportation. These servants emigrated from a number of places, including China, Portugal and India. As a result, the ethnic composition of the Caribbean islands has changed considerably: Indo-Caribbeans form a majority in Guyana, and are present in considerable numbers in Trinidad and Tobago, Suriname, Jamaica, Grenada, Barbados, and other Caribbean islands. Nayyar [10] documents the case of indentured labour in the United States of America, where the source of migration happened to be Japan. The second phase of global migration, a very significant phenomenon during the second half of the 19th Century and even later, was therefore in the form of indentured labourers from India and China to the Caribbean nations, Southeast Asia and Southern Africa to work in mines and plantations, mainly after the abolition of slavery in the USA and Britain. Movement was quite substantial. Roughly 50 to 70 million people migrated, which was around 10% of the combined population of India and China (ibid.).

Along with the forced movements of people, there was a voluntary flow of migration from Europe to America, New Zealand, Canada, Australia and South American countries (ibid.), which emerged as attractive destinations for settlement due to several factors. Starting from 1870 and before the outbreak of First World War, roughly 50 to 70 million people, as per different estimates, left Europe. Nayyar [10] argues that, going by a conservative estimate, this amounted to one-eighth of their population; in some countries such as Britain, Italy, Spain and Portugal, it was as high as 40% of the total population. This process of migration was driven, on the one hand by the abundance of natural resources, in particular land in newly-settled territories, and on the other hand by increasing the displacement of labour due to the rapid decline of agricultural employment, without a compensating increase in manufacturing employment. Political ties between labour-exporting and importing countries together with close cultural links meant that this phase of migration was relatively smooth: political friction now characterizing migration issues were, by and large, absent.

World War I was followed by the enactment of immigration laws and erection of institutional barriers in the mobility of labour. Documentary requirements such as passports became mandatory.
Table 1: Migrant Population Profile (world)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Estimated number of international migrants at mid-year (Total)</td>
<td>75</td>
<td>81</td>
<td>154</td>
<td>176</td>
<td>190</td>
</tr>
<tr>
<td>Estimated number of refugees at mid-year</td>
<td>2</td>
<td>3.8</td>
<td>18</td>
<td>15</td>
<td>13</td>
</tr>
<tr>
<td>Estimated number of female migrants at mid-year</td>
<td>35</td>
<td>38</td>
<td>75</td>
<td>87</td>
<td>94</td>
</tr>
<tr>
<td>Estimated number of male migrants at mid-year</td>
<td>40</td>
<td>42</td>
<td>78</td>
<td>88</td>
<td>96</td>
</tr>
<tr>
<td>Population at mid-year</td>
<td>3023</td>
<td>3096</td>
<td>5279</td>
<td>6085</td>
<td>6464</td>
</tr>
<tr>
<td>International migrants as a percentage of the population</td>
<td>2.5</td>
<td>2.2</td>
<td>2.9</td>
<td>2.9</td>
<td>3.0</td>
</tr>
<tr>
<td>Female migrants as percentage of all international migrants</td>
<td>46.2</td>
<td>47.2</td>
<td>49.0</td>
<td>49.7</td>
<td>49.6</td>
</tr>
<tr>
<td>Refugees as a percentage of international migrants</td>
<td>2.9</td>
<td>4.8</td>
<td>11.9</td>
<td>8.9</td>
<td>7.1</td>
</tr>
</tbody>
</table>

Note: The number of international migrants generally represents the number of persons born in a country other than that in which they live.

Table 2: Growth Rate of Migrant Population (World)

<table>
<thead>
<tr>
<th>Period</th>
<th>Growth rate of migrant population</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970-1975</td>
<td>0.7</td>
</tr>
<tr>
<td>1975-1980</td>
<td>1.3</td>
</tr>
<tr>
<td>1980-1985</td>
<td>2.7</td>
</tr>
<tr>
<td>1985-1990</td>
<td>6.7</td>
</tr>
<tr>
<td>1990-1995</td>
<td>1.3</td>
</tr>
<tr>
<td>1995-2000</td>
<td>1.4</td>
</tr>
<tr>
<td>2000-2005</td>
<td>1.5</td>
</tr>
</tbody>
</table>

Unemployment during the Great Depression also reduced the political feasibility of labour imports, resulting in a low level of labour migration. Thus global migration, for a while, declined.

The period after World War II witnessed a revival of labour migration. This phase peaked in 1985 (see Table 1). After that there was a distinct moderation in the migration rate, as it came down from 2.7% in 1980-85 to below 1.5% in the subsequent years (see Table 2).

Starting from 1970, there was incremental tightening of immigration laws, resulting in low over-all rate of growth in migration. However, the period of globalization saw, on a large scale, the emigration of people with technical skills from developing countries to developed countries. New destinations such as oil-exporting OPEC members also emerged as a destination for low-skilled labourers. Temporary migration of low-skilled workers also took place in the form of guest workers in Western Europe and the import of seasonal Mexican labour by US. Nevertheless, the proportion of migrants to total population worldwide has remained roughly constant, at between 2.9% and 3% (see Table 1), precisely in the period when trade and investment flows took off in the years of globalization. This intriguing stagnation is best explained by the fact that unlike trade and finance, where openness was peddled by international organizations, labour migration has, by and large, been conspicuous by its absence in international negotiations.

Table 3: Estimated Migrant Population: Area-wise (2005)

<table>
<thead>
<tr>
<th>Area</th>
<th>Migrant Population (Million)</th>
<th>Migrant Population (% of Total Population)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Africa</td>
<td>17</td>
<td>1.9</td>
</tr>
<tr>
<td>Asia</td>
<td>53</td>
<td>1.4</td>
</tr>
<tr>
<td>Europe</td>
<td>64</td>
<td>8.8</td>
</tr>
<tr>
<td>Latin America &amp; Caribbean</td>
<td>6.6</td>
<td>1.2</td>
</tr>
<tr>
<td>Northern America</td>
<td>44</td>
<td>13.5</td>
</tr>
<tr>
<td>Oceania</td>
<td>5</td>
<td>15.2</td>
</tr>
<tr>
<td>Total</td>
<td>190</td>
<td>3</td>
</tr>
</tbody>
</table>


Apart from the magnitude of migration, the regional distribution pattern conforms to the broad developmental stage of the recipient countries. In Africa, migrant stock as a proportion of the population is higher than in Latin America and Asia, mainly due to the presence of displaced people and refugees. Northern America, particularly the United States, has emerged as a key destination for, more often than not, technically qualified professional migrants (see Table 3).

A common classification is to group international migrants into permanent migrants, (also known as emigrants) and temporary migrants (Nayyar [10]). Temporary migrants are further divided into those having professional qualifications and unskilled or semi-skilled. Apart from these usual categories, illegal migrants and

43 Period of 1985-90 is non-comparable, as creation of new nation-states out of erstwhile Soviet Union inflated migrant stock figures.
refugees also account for a significant share of the migrant population. Statistical information on a global level about these categories remains sparse (ibid.).

**Factors Determining Magnitude and Pattern of Migration**
Existing literature on migration identifies the determinants of the magnitude and patterns of migration under three broad categories: push-factors, pull-factors and obstacles to migration. Push and pull factors are those factors which respectively push people into migration or attract them.

Push and pull factors together account for the migrant’s often difficult decision to leave their native land. Although not exactly quantifiable, such decisions entail substantial emotional costs. It follows therefore, that for migrants to make such a decision, the perceived opportunities must be very high. Such opportunities include perceived differences in wage levels, probability of employment and difference in lifestyle. Globalization, by increasing the inequality across the nation-states has thus created pressures on migration.

The declining absorption of labour in the agriculture sector, and the lack of a corresponding increase in industrial employment constitute an important push factor, especially for semi-skilled workers in developing countries.

On the demand side, demographic imbalances have been playing the role of a catalyst: the median age of the population has been steadily increasing in developed countries. With a larger share of older people in their population, industrialized countries require labour from the developing world to sustain their lifestyle and productive activities.

Improvements in information and communication technologies, the advent of cheap mass transportation facilities and the consequential decline in the transaction cost of global migration in recent years, has led to the significant demand for the creation of migration. Given this demand, intermediary institutions supporting and facilitating global migration have also cropped up, thus making the process of migration slightly easy for migrants.

These factors imply that in the era of globalization, with an increasing integration in terms of trade and finance flows, there should be a strong tendency towards labour mobility. However, as previously mentioned, migration has proportionately remained constant at the level of around 3%. This paradoxical situation could be explained in terms of asymmetric ‘rules of the game’: that is, institutional arrangements underlying global migration.

**Existing Institutional Framework for Labour Mobility**
In sharp contrast to trade in goods, there is no multilateral forum, institution or framework for coordinating the migration-related policies, leaving the entire question to national jurisdiction. Mode-4 in GATS is one possible exception that deals with the cross border supply of services. However, such services deal with temporary and professional migrants, which constitute a tiny fraction of the cross-border movement of people and where developing countries do not mostly have a comparative advantage.

In the absence of such a framework, migration is dealt with by domestic laws and consular practices. Such laws explicitly stipulate various restrictions on the movement of labour, including numerical quotas. Additionally, the actual process of migration is directly affected by the consular practices, which serve as an extra barrier for migration. In contrast to “National Treatment” given to foreign investment, guest workers have to wait for a general amnesty and face “E-verify” programs.
These direct and indirect methods of restricting labour flows are responsible for an almost stagnant migration, even when integration in other ways is increasing. Thus as Nayyar [9] noted: "This asymmetry, particularly between the free movement of capital and the restricted movement of labour across countries, lies at the heart of inequality in the rules of the game for globalization in the twentieth century." Apart from its direct relevance on the fairness of the rules of globalization, absence of a regulatory mechanism on a global level is also responsible for increasing incidents of illegal trafficking of labour, particularly of children and women, by criminal syndicates. Such immigrants often end up as being acute victims of economic, racial and social exploitation. Obviously there are no institutions and mechanisms to address the injustices they are subjected to, as they are devoid of even basic recognition.

We may also note here that every once in a while, terrible tragedies relating to illegal migration are reported by the media, and obviously not all the incidents come to light. In March 2008, 15 illegal immigrants aboard a rickety boat were rescued by U.S. authorities off the San Diego coast after an apparent botched maritime smuggling attempt. 15 dehydrated and sunburnt passengers were taken off the 24-foot boat, named Seaulater, by authorities nearly a day and a half after leaving Rosarito Beach bound for Southern California. They were allegedly charged $4,000 each for the passage.

Other migrants also face similar life-threatening and dangerous circumstances in order to work in predominantly an informal sector, often on low wages. Interestingly, not only is there an outflow of labour from developing to developed countries, but also of finances; for instance the USA has seen an inflow estimated to be more than $100 billion per year. This asymmetric flow sustains the differences in living conditions, which further act as a catalyst for labour migration.

**Potential and Current Benefits of Migration**

Migration is a potential source of growth, employment creation, poverty alleviation, macroeconomic stability and welfare improvement, not only for developing countries, but for the world economy as a whole.

Given the demographic imbalances, where developed countries are increasingly facing structural constraints due to the ageing of the population, developing countries have a younger population; migration can result in distinct welfare gains, both for the nation as well as the world economy.

Problems associated with an ageing population such as high dependency ratio and declining labour force could be mitigated to a great extent by the transfer of a workforce. This conclusion is further buttressed by the presence of high open and disguised unemployment in developing countries, implying a low opportunity cost of labour transfers.
Table 4: Remittances Compared with Some Selected Sources of External Finance (in billions $)

<table>
<thead>
<tr>
<th>Source of finance</th>
<th>2000</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Remittances (Total)</td>
<td>131</td>
<td>262</td>
</tr>
<tr>
<td>Developing Countries</td>
<td>84</td>
<td>191</td>
</tr>
<tr>
<td>Industrial Countries</td>
<td>47</td>
<td>71</td>
</tr>
<tr>
<td>FDI (Total)</td>
<td>1524</td>
<td>1001</td>
</tr>
<tr>
<td>Developing Countries</td>
<td>271</td>
<td>628</td>
</tr>
<tr>
<td>Industrial Countries</td>
<td>1252</td>
<td>373</td>
</tr>
<tr>
<td>Portfolio Investment (Total)</td>
<td>1513</td>
<td>3273</td>
</tr>
<tr>
<td>Developing Countries</td>
<td>84</td>
<td>188</td>
</tr>
<tr>
<td>Industrial Countries</td>
<td>1414</td>
<td>3058</td>
</tr>
<tr>
<td>Loans (Total)</td>
<td>508</td>
<td>1239</td>
</tr>
<tr>
<td>Developing Countries</td>
<td>4</td>
<td>76</td>
</tr>
<tr>
<td>Industrial Countries</td>
<td>504</td>
<td>1165</td>
</tr>
</tbody>
</table>

Source: Singh [14]
Note: Figures may not add up due to rounding off.

The global positive impact of labour mobility is further reinforced by the special role it plays for home countries, mostly developing nations. Remittances sent by migrants can help support a sustained growth process in the source country, with enhanced consumption demands. It also typically leads to savings and investment on the household level, creating a virtuous circle of income generation, especially when migration is from poor and rural regions. Moreover, with the emerging shortage of labour in rural areas, it increases the bargaining power of remaining labourers, thus creating pressure for an increased wage revision and improved livelihood opportunities.

Experience of migration, acquisition of skills and exposure to new opportunities result in higher productivity for workers, even when migration is temporary and migrants have to return home. Remittances have also been found to be responsible for the success of micro-enterprises in recipient countries. Cumulatively these factors imply a strong positive impact of migration on human development and the reduction of poverty, so much so that it has come to be equated with a “New Development Mantra” by some analysts [8].
Table 5: Remittances, Poverty and Inequality in Selected Countries

<table>
<thead>
<tr>
<th>Country</th>
<th>Year</th>
<th>HCR</th>
<th>PGR</th>
<th>Gini Coeff.</th>
<th>Migration</th>
<th>Remittance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bangladesh</td>
<td>1996</td>
<td>29.07</td>
<td>1.6</td>
<td>0.336</td>
<td>0.09</td>
<td>10.78</td>
</tr>
<tr>
<td>Brazil</td>
<td>1997</td>
<td>5.1</td>
<td>0.5</td>
<td>0.517</td>
<td>0.11</td>
<td>8.08</td>
</tr>
<tr>
<td>Colombia</td>
<td>1996</td>
<td>10.99</td>
<td>1.21</td>
<td>0.571</td>
<td>1.06</td>
<td>16.16</td>
</tr>
<tr>
<td>Ghana</td>
<td>1999</td>
<td>44.81</td>
<td>8.71</td>
<td>0.327</td>
<td>0.32</td>
<td>1.44</td>
</tr>
<tr>
<td>India</td>
<td>1997</td>
<td>44.03</td>
<td>NA</td>
<td>0.378</td>
<td>0.12</td>
<td>11.10</td>
</tr>
<tr>
<td>Indonesia</td>
<td>1998</td>
<td>26.33</td>
<td>1.69</td>
<td>0.315</td>
<td>0.1</td>
<td>4.71</td>
</tr>
<tr>
<td>Mexico</td>
<td>1995</td>
<td>17.9</td>
<td>2.92</td>
<td>0.537</td>
<td>7.39</td>
<td>40.30</td>
</tr>
</tbody>
</table>

Source: Adams and Page [4]
Note: HCR: Head Count Ratio; PGR: Squared Poverty Gap Ratio; Migration % of population; Remittances per capita official (1995 $)

In recent years, the impact of migration on human development and poverty has been the subject of rich micro-level literature, which concludes that remittances have a significant positive implication on poverty alleviation [3]. Adams and Page [4] evaluated the impact of international migration and remittances on poverty in developing countries based on a data set that includes information on international migration, remittances, inequality, and poverty for 71 low-income and middle-income developing countries. These countries were selected because it was possible to find relevant migration, remittances, inequality, and poverty data for all of these countries since the year 1980.

In their study, Adams and Page [4] found that the level of remittances per capita has a negative and statistically significant impact on each of the three poverty measures: headcount, poverty gap, and squared poverty gap. Estimates for the poverty headcount measure suggests that, on average, a 10% increase in per capita official international remittances will lead to a 1.8% decline in the share of people living in poverty. Remittances will have a slightly larger impact on poverty reduction when poverty is measured by more sensitive poverty measures: poverty gap and squared poverty gap. A selective list of countries documented by Adams and Page [4] is produced in Table 5.

Moreover, at the macro level, remittances play an important role in bridging the foreign exchange gap, and complementing national savings. In particular, India has been an important beneficiary in this regard, being the largest remittance receiver in the world. As Table 4 suggests, migrants remitted close to $262 billion in developing countries. As the proportion of GDP, it was 1.4% of the GDP of low-income countries in 2001 (Ratha [12]). This flow is quite substantial; as unlike the other sources such as portfolio investment, it is not subject to sudden reversal and indeed acts as a buffer in such situations, reducing the negative implications associated with the vicissitudes of speculative finance capital. For example, remittances continued to grow steadily in 1998-2001, even as capital flows witnessed a sharp reversal, as a consequence of ASEAN crisis [12].

Besides being a large and relatively stable source of external finance to the developing countries, remittances are more equally distributed among developing countries, with even relatively poorer countries having access to this source of
financing for their current account deficits. Ratha [12] documents that the top 10 countries which received the highest remittances in 2001 accounted for 60% of total remittances; this is substantially lower than the share of the top 10 in total GDP, total exports and capital inflow which were respectively 68%, 72% and 74% in the same year. It follows therefore that remittances are relatively more equally distributed among developing countries than other sources of external finance, such as exports.

One potentially disadvantageous outcome of migration, in the context of developing countries, is the reality of “brain-drain”- the flow of highly educated professionals from developing countries to the developed world. Given the asymmetric distribution of costs and benefits, it amounts to an unrequited transfer of scarce resources from developing countries to a developed one; this anomalous situation needs to be corrected through appropriate policies.

To summarize, migration is an important catalyst for development, without entailing any significant trade-off, both on the macro and micro level.

Conclusion
The present era of globalization is marked by a persistent tension on account of two opposite factors. For one, technological changes and dynamics of globalization itself are creating demands for the transnational movement of people.

Technological changes, increasing inequality in terms of opportunities, and unemployment in developing countries are some of the factors giving rise to such demands. All the same, growing demand for migration continues to be constrained by restrictive domestic immigration laws and consular practices. Such policies are entirely dictated by the interests of labour-importing countries, paying scarcely any heed to the needs of labour-exporting countries. The absence of any multilateral framework for dealing with the issue of labour migration in an equitable manner is thus indicative of the deeper problems associated with globalization. It is high time that appropriate multi-lateral dialogues take place between countries of origin and destination, covering key issues and policy concerns.

The current state of affairs is unsatisfactory, not only from a broader and richer perspective of fairness, well-being and development, but also in the narrower, conceptual framework of efficiency and optimality.

On a policy level therefore, this analysis underscores the urgent need to create an international institutional framework for the contribution of migration to mutual development. The interests and rights of migrant workers deserve at least as much attention as the whole range of ‘rights’ extended to the interests of capital.
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The current global crisis is producing very serious consequences for developing countries. Many voices are asking whether the renewed political attention to financial regulation will address the huge illicit flows of resources that leave developing countries every year. Tax havens, the majority in Europe and in African, Caribbean and Pacific (ACP) countries play a major part in this and are putting up a fight not to lose their status as secrecy jurisdictions. However, putting tax havens under control is not only a matter of concern for developing countries, it has global implications. In 2009 the UK Prime Minister stated “We want the whole of the world to take action. (...) against regulatory and tax havens in parts of the world which have escaped the regulatory attention they need.” Mr. Brown has indeed good reasons for taking action on tax havens. After the Northern Rock bank nationalisation in 2008, the government was criticised for losing control of it. The reason was that most of the “healthy” liabilities of the bank were held offshore in Jersey, in a separate company leaving the most risky lending on the Rock bank’s own balance sheet. The Government would therefore not be able to access these mortgages to pay off the debt. A good example of how tax havens enable the privatisation of profits and socialisation of losses.

Developing countries suffer much further the consequences of the crisis. Increased vulnerability led by deregulation and liberalisation policies pushed for the last three decades; shortage of Official Development Assistance and reduction of available loans as a result of the credit crunch, are only some of the impacts that developing countries have been, and will be facing in the future. To these should be added the permanent leak of financial flows that fly every year to the North, as a result of an unfair and badly regulated financial system. While much of these reverse flows result from global imbalances of the financial system, such as the accumulation of dollar based reserves, a considerable amount are unrecorded tax haven channelled flows resulting from corruption, criminal activities and above all, tax flight from transnational companies. However, when it comes to the development agenda much of the attention keeps focusing on the some US$100 billion worth of aid flows and the insufficient and highly conditional debt relief initiatives. Illicit flows exceed by far the official inflows received in terms of aid, debt relief or private foreign direct investments all together.

The financial crisis is triggering a renewed interest in tackling tax havens and some political leaders are beginning to bang the drum for the reform of tax havens. At their 22nd February preparatory meeting held in Berlin ahead of the G20 summit, EU leaders agreed on the need to crack down on tax havens and establish sanctions. French President, Nicholas Sarkozy, stated “We want to put a stop to tax havens, (...) with a list of tax havens and a series of consequences.” Adding that

44 Ms. Marta Ruiz Carnés, Policy Advisor, EURODAD, Brussels
45 See article “Northern Rock nationalisation runs into £49bn Granite barrier”; In : www.timesonline.co.uk/tol/news/politics/article3406368.ece
“Europe wants to see an overhaul of the system,” and stressing that “A new system without sanctions would not have any meaning.” German Chancellor Angela Merkel pointed to the need to “eliminate blind spots (…) when it comes to financial-market products, market participants and instruments.” and added that “a list of uncooperative jurisdictions and a toolbox of sanctions must be devised as soon as possible”.

There is a broad consensus on addressing tax havens as a major problem but the question is whether these statements will be translated into equally strong measures or will just be followed by cosmetic changes. The fact that Europe hosts many tax havens will not make substantive changes an easy task for the most proactive European leaders. This article sheds light on the role played by tax havens, the weakest link of an unfair financial system that is being questioned these days and that seriously threatens development. It will also raise key recommendations for change.

**A broken system where the South finances the North**

Many European politicians and citizens believe that Europe finances developing countries fairly generously and the EU generally positions itself as the leading donor of Official Development Assistance. In fact the reverse is the case. The UN Department of Economic and Social Affairs estimated that for Sub-Saharan Africa and generally for the least developed countries, the net financial flow has become progressively smaller and even turned negative in the last few years. Figure 1 shows the volume of financial flows between Southern and Northern countries.

**Global imbalances**

For middle income countries, which receive more investment, an important part of their outflows are interest and debt repayments, as well as profit repatriation from foreign direct investments. For emerging economies in general, especially for China, a large share of the outflows results from the accumulation of U.S. treasury bonds. While this outflow is not a loss, it prevents them from using their reserves for domestic productive investments. This huge accumulation of reserves is the response to protect their currencies from speculative attacks, and to prevent previous financial crises led by capital account liberalisation, financial sector deregulation and speculative capital flight.

**Figure 1 Net financial flows between developed and developing countries 1995-2006**

Source: UN DESA: World Economic Situation and Prospects 2007

The IMF’s damaging advice

The International Monetary Fund (IMF) is responsible for overseeing the financial system. Since the 1980s it has instead spearheaded the liberalization and deregulation of global financial markets in most developing economies. This has made these economies more vulnerable to external shocks and to capital flight.

The removal of capital controls and financial sector deregulation, both promoted by the IMF, has removed countries’ immunity to this financial contagion. Furthermore, the following of IMF’s advice after the crisis, further depressed the economy and exacerbated its dramatic social consequences. Under IMF advice, Indonesia had to diminish its fiscal deficit by reducing health expenditure by 12% in 1999. Education expenditure was also cut by 41% in 1999. According to World Bank estimates, the Indonesia, Chile, Thailand and Uruguay crises cost more than 30% of their respective GDPs. As a result of the financial crisis, real wages in Indonesia fell by 41% and 2.5 million jobs were lost. In Korea, 2.1 million non agricultural workers lost their jobs and 1.4 million in Thailand.

In response to the current crisis, the IMF is back into action, linking its “traditional” structural adjustment conditions to the rescue packages. This raises serious concerns in the EU, where the IMF is active in new Member States. A recent ETUC paper reads “Europe not leaving new Member States at the mercy of IMF” and explains “growth dynamics in these countries will get short circuited, especially if the IMF returns and imposes its usual anti-growth/anti-social stabilization measures.”

This system shows that we are very far from achieving the world’s governments’ pledges at the UN Financing for Development conference in 2002 to “mitigate the impact of excessive volatility of short-term capital flows” and to strengthen “prudential regulations and supervision of all financial institutions, including highly leveraged institutions”. It is ironic that seven years ago, when negotiators agreed this text, the recommendations were aimed at decision makers in Asia and Latin America, not in Europe or North America where the crisis originated.

The follow-up Conference on Financing for Development held in Doha end 2008, simply reiterates that “macroeconomic policies (should) attach high priority to avoiding abrupt economic fluctuations”. On tax evasion, the text only mentions “effectively combating tax evasion” without even mentioning the need to tackle tax havens. The wording on progressive tax systems as a means to enhance domestic resource mobilisation was erased in the last minute term.

Cross border illicit flows or the hidden art of the iceberg

Illicit flows can be defined as “The deliberate and illicit disguised expatriation of money by those resident within the country of origin.”

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48 European Trade Unions Confederation. “Action for recovery. A European plan to re-launch the economy: investing in people, the environment and innovation”. See: www.etuc.org/a/5589
See also Eurodad’s article: www.eurodad.org/whatsnew/articles.aspx?id=3218
50 Definition used by Raymond Baker and other analysts, including the Tax Justice Network.
By their nature, illicit flows from developing countries are very hard to estimate since they escape national and international controls. Attempts to scope these flows show that they represent a huge amount of money flying out of Southern countries each year. Recent estimates released in 2008 are close to $1 trillion per year at an annual growth rate of 18%.\(^5\)

The Global Financial Integrity (GFI) breakdown cross border illicit flows into three main components:\(^6\)

1. Firstly, bribery and corruption, that represent around 5% of the global amount. The stolen wealth looted by corrupted political leaders, bribes paid to elites and looted in private bank accounts are among the main causes of these illicit flows.
2. Secondly, criminal illicit flows that include terrorist financing, smuggling, drugs money and other crime-related money, account for about 30% of the problem.
3. Finally commercial transactions encompassing trade false pricing and false invoicing with the aim of escaping taxes, account for 65% of the problem. The largest percentage of cross border illicit flows is therefore channelled through commercial activities, and operated through tax havens.

While much public attention has been given to the first 5%, including the programme Stolen Assets Recovery initiative (StAR) launched by the World Bank and the UNDOC\(^7\), tax related capital flight generated by transnational corporations and channelled through tax havens remains the biggest problem - both globally and in particular for developing countries.

Why taxes matter for development?

Low income countries (LIC) suffer from a chronic lack of domestic resources and dependence on external funding. This is conditional and unpredictable. The mobilisation of domestic resources was identified in 2002 as one of the key pillars of the UN’s Monterrey Consensus on Financing for Development. But very little progress has been achieved in this area. Establishing capital controls, and instituting an effective fiscal policy constitute key instruments for governments to raise regular and predictable resources.

After thirty years of policy liberalisation, tax administrations in most LIC are very weak and extremely dependent on indirect taxation, namely Value Added Tax (VAT) penalising the lower incomes. The average tax revenue in LIC was approximately 13% of their GDP in 2000, less than half of the average, 36% for OECD countries. Moreover, the ability to raise direct taxes amount to 2-6% of GDP in poor countries, compared to 12-18% in developed countries.\(^8\) Under these conditions, mobilisation of domestic resources through progressive taxation systems remains a huge challenge for poor countries. Tax evasion and avoidance from developing countries represents a significant multiple of global ODA every year. This leakage is facilitated by tax havens, providing the necessary infrastructure and services in total opacity.

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\(^6\) The World Bank has also used these estimates. See footnote 10.

\(^7\) See: [www.unodc.org/documents/corruption/StAR-Sept07-full.pdf](http://www.unodc.org/documents/corruption/StAR-Sept07-full.pdf)

Plugging these tax leaks will help redistribute wealth, restore government policy space and foster responsibility and accountability towards the population. For these reasons, the promotion of progressive tax systems, the strengthening of tax administrations and the fight against tax flight and tax havens need to be addressed as a priority within the area of development finance.

In its report “Death and taxes”, Christian Aid outlines the crucial role taxation plays in a democratic society and summarises it in 4 R’s: Representation: by paying taxes, people contribute to building a strong state but they also become agents in the process of development – holding governments to account. Direct taxation of incomes and profits is the major channel in this process. Revenue: governments need taxes to provide systems of health, education, social security (…) and investments in infrastructure. Redistribution: taxes should reduce poverty and inequality, and ensure that the benefits of development are felt by all. ‘Re-pricing’: taxes can be used to deal with related social problems, for example, taxing carbon emissions to tackle climate change or taxing tobacco to limit damage to health.

**Capital flight and debt in Africa**

Conservative estimates published by UNCTAD in 2007 show that Sub-Saharan African countries lose an annual average of $13 billion in capital flight. The total amount of capital flight between 1970 and 2004 from a 40 country sample, amount to US$420 billion in real terms. Capital flight represents 82% of the sample countries’ GDP and almost 300% of the debt stock for that period. The authors conclude that Sub-Saharan African countries are net creditors to the rest of the world and add, “If we could restore the stolen assets then there would be more than enough money to pay the debt”. They also explain that Africa has the highest ratio of privately held capital abroad in the form of capital flight. In 1990, about 40% of African private capital was held abroad. Trade mispricing is a further key conduit for illicit flows in Africa, as UNCTAD suggests: “capital flight from Sub Saharan Africa is fast approaching a trillion dollars, more than twice the size of its aggregate external liabilities.”

**What are tax havens?**

Tax havens have at least one or more of the following features:

Firstly, they provide low or zero taxes for non residents. Secondly, they provide high levels of secrecy to conceal the beneficiaries of companies, trusts, and bank accounts. Thirdly, they do not require any economic substance to the transactions booked in the jurisdiction. Finally, they provide preferential tax regimes for non residents to encourage profit and income shifting from other countries.

Despite the fact that tax havens account only for about 3% of global GDP, they play a key role in global finance and global economy. According to the IMF, tax havens represented, in 2004, at least 50% of global financial flows and were involved in more than one third of global Investment Portfolios. UNCTAD estimates that more than one third of TNC foreign direct investment go to tax havens and explains that

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This trend has been increasing since the 1990’s. The Tax Justice Network estimates that rich individuals deposit around US$ 11.5 trillion in tax havens, representing a net loss of worldwide government tax revenue of US$255 billion per year. As mentioned above, GFI estimate that illicit flows from Southern countries channelled through tax havens, amount to US$1 trillion per year and grows at an annual rate of 18%.

When it comes to identifying tax havens, one would easily first think of the white sandy beaches in the Caribbean. In reality, the city of London represents on its own around 40% of all the activities related to tax havens. London’s financial centre is the first to attract foreign banks. Around one third of global currency transactions transit through the UK, making some authors state that “London is with no doubt the largest tax haven in the world” 60. Many others are dependencies or overseas territories of European countries, such as: Anguilla, Bermuda, British Virgin Islands, Cayman Islands, Gibraltar, Guernsey, Isle of Man, Jersey, Montserrat, (all UK dependencies), Aruba and Netherlands Antilles (dependencies of the Netherlands) 61. Other European tax havens, Switzerland, Monaco, Andorra and Luxemburg for example, account for 30% of all offshore activities. Only the remaining 30% is covered by the Pacific and Caribbean sunny territories we initially think of.

According to the Tax Justice Network, the list of European tax havens is much longer than the one set up by official bodies. Some European tax havens other than Andorra, Monaco, Switzerland and Liechtenstein would be: Belgium, Cyprus, Germany (Frankfurt), Gibraltar, Hungary, Iceland, Ireland, Italy (Campione d’Italia & Trieste), Latvia, Luxembourh, Malta, The Netherlands, Portugal (Madeira), San Marino, Spain (Melilla) and UK (City of London). Europe is therefore a key player in the fight against tax havens and the interests at stake are huge.

**Who uses tax havens?**
Rich individuals wanting to escape regulation and taxes and criminal groups and corrupted individuals using tax havens for money laundering, are among the prominent users. In this article however, we will focus on commercial and financial actors, which account for the biggest share of the cross border illicit flow problem.

**Companies**
Foreign direct investment (FDI) has been a key driver for developing countries since the 1990’s, promoted by the international financial institutions (IFIs) as one of the key engines for development. But the results of FDI in terms of development are far from rosy. In order to attract FDI, countries have generally offered very favourable tax conditions which included tax exemption, tax holidays and other tax benefits, creating very unfavourable conditions for local investors to compete with.

One of the consequences of this unfair system is the development of so called round trip investments, channelled generally through tax havens. In order to benefit from more favourable tax conditions, a local investor will shift to an offshore territory, from where he will invest in his original country but as a foreign investor, thus benefiting from better tax conditions. For years, the British Virgin Islands have been the second biggest investor in China, while in reality it was Chinese investors operating from offshore 62. The same pattern has been followed in other regions. At the end of the day, small local investors are unable to compete with large ones,

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increasing the countries dependence on external investors, whose main goal is to maximise profits including by minimising taxes. Figure 2 illustrates this phenomenon, showing the number of companies registered in tax havens as compared to local population of those territories.

**Figure 2 Foreign investments and tax havens**

Number of companies registered in tax havens compared with local population in millions

Source: Step journal & lawtax.net, 2004

**How do companies avoid and escape taxes?**

One key mechanism used by transnational companies to escape taxes is the transfer of false pricing or false invoicing. This means setting the price of sales between different entities within a multinational. In principle, transfer pricing is a legitimate practice, as long as it respects the “arm’s length principle”, that means that the price falls within the open market average price of the same product or service traded between unrelated companies. Problems occur when transfer pricing becomes a tool to set artificially high or low prices in order to minimise taxes. The arm's length principle is largely bypassed, one of the reasons being that more than half of global trade occurs among subsidiaries of the same TNC. Much of these transactions involve very specific goods and services that may not have an open market price reference and that are simply set internally within the group. According to a survey of 476 TNCs nearly 80% acknowledge having transfer pricing at the heart of their fiscal strategy. This suggests that false invoicing and abusive transfer pricing practices are part of the TNCs’ parent company strategy in order to minimise taxes. The parent companies are generally based in Northern countries and have subsidiaries in tax havens, where they can shift untaxed profits.

TNC operations are taxed following the residence principle. They are taxed according to the territory where they are registered. TNCs set up subsidiary companies, where they will be taxed the least. For instance, Microsoft has placed its software intellectual property rights in its subsidiary firm in Ireland. By doing so, Microsoft paid $1billion taxes between 2001 and 2004; a rate of 12.5%, instead of the

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$2.8 billion at a 35% rate that would have been paid had the property rights remained in the US.\(^67\)

Another example is Ikea’s complex structure established through tax havens in order to minimise taxes. Italian magazine Altereconomia published in 2009 “The real fortune of Ikea (…), is not the idea of selling flat-pack furniture (…). Rather that of having built a very complicated company structure, a net created just to use the mechanisms of “tax planning” to pay as few taxes as possible without violating the law”.\(^68\)

Some striking examples of how companies false price imports and exports with the only aim of escaping taxes are flash bulbs sold at $US 321.90 each, pillow cases at $US 909.29 each and a ton of sand at $US 1993.67 when the average trade price was 66 cents, 62 cents and $11.20 respectively.\(^69\)

Transfer false pricing strategies become a real development concern as they deprive the poorest from their legitimate resources and divert them through corporate tax planning strategies. According to recent research led by Christian Aid, poor countries lose at least US$160 billion per year in tax losses as a direct consequence of transfer false pricing practices.\(^70\)

Other analysts estimate that capital flight from Africa to the US through trade false invoicing, amounted to more than US$20.5 billion between 2000 and 2005.\(^71\) In this period, capital outflows from Africa to the U.S. grew by more than 50%, both through low priced exports and high priced imports.

**Figure 3. Capital flight from Africa to the US as a result of transfer false pricing (2000-2005)**

<table>
<thead>
<tr>
<th>Country</th>
<th>2000-2005</th>
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<tbody>
<tr>
<td>Tunisia</td>
<td>$3,000</td>
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<tr>
<td>Equatorial Guinea</td>
<td>$2,000</td>
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<tr>
<td>Ghana</td>
<td>$1,500</td>
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<tr>
<td>Angola</td>
<td>$1,000</td>
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<tr>
<td>Kenya</td>
<td>$1,000</td>
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<tr>
<td>Morocco</td>
<td>$1,000</td>
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<tr>
<td>Nigeria</td>
<td>$800</td>
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<tr>
<td>Algeria</td>
<td>$800</td>
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<tr>
<td>Egypt</td>
<td>$800</td>
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<tr>
<td>South Africa</td>
<td>$800</td>
</tr>
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</table>


\(71\) The methodology used in this research is based on the Balance of Payments, which excludes some non recorded flows and gives, as a result more conservative estimates.
Bananas’ virtual trip through offshore land

A concrete example of how transnational corporations shift profits and avoid taxes is the banana industry. Three big corporations, Chiquita, Dole and Del Monte, control more that two thirds of the banana market. They all have their headquarters in the US, where the nominal tax rate is 35% but their profit shifting mechanisms allow them to pay only 8% tax rate. In order to minimise taxes, these companies have been bundling different costs, treasury operations, intellectual property rights, etc, into offshore subsidiaries, allowing them to shift profits towards no tax jurisdictions while reporting lower benefits or even losses and subsequent tax benefits in producer countries. In this case, the trip from the producer country to the consumer in the supermarket, where the banana is sold at 1 Euro price, goes through the following havens:

First, bananas are exported at 13 cents each from the producer country. Here, labour and other production costs account for 12 cents, which makes around 1% of taxable profit booked in the producer country.

Second, the company invoices 8 cents fee charge for the use of purchasing network, registered in the Cayman Islands.

Third, from the Cayman Islands another affiliate based in Luxembourg charges 8 cents for the use of company financial services.

Fourth, a subsidiary in Ireland charges 4 cents for the use of the brand.

Fifth, another affiliate in the Isle of Man charges 4 cents for insurance services.

Sixth, a subsidiary in Jersey charges 6 cents for management services.

Seventh, from Jersey the banana travels to another subsidiary in Bermuda, where it is charged 17 cents for the use of distribution network.

Eight, the banana eventually arrives to the consumer country where it is imported at 60 cents and invoiced to retailers at minimal margin or even at loss. The retailer then adds a margin of about 40 cents, selling them at 1 Euro. This makes a 1% of taxable profit, booked in the consumer country.72

Banks, insurance, hedge funds and other financial institutions: Most international banks have subsidiaries in a tax haven. This network has facilitated the transfer and circulation of stolen assets from corrupted leaders, for instance, Sani Abacha’s stolen assets circulated via Crédit Suisse, Crédit Agricole Indosuez, BNP and many others. Tax havens have also allowed the financial and banking industry to develop speculative and risky products and host speculative actors. About 80% of hedge funds are registered in The Cayman islands73. Furthermore, the whole shadow banking system that has been creating and spreading risky financial products, without any control, was enabled by secrecy provided in tax havens.

Accounting standards: setting and transfer false pricing.

It is not surprising to see that transfer pricing regulations are easily circumvented, given that rules are set by the same companies that use them. Ernst and Young, one of the biggest accountancy companies, is a prominent member of the International Accounting Standards Board (IASB), a private body in charge of setting international accounting rules applied by most countries, and therefore used by most transnational companies. As journalist Prem Sikka explains, transfer pricing is a big business for this company, which markets its services with the following statement “Transfer


pricing affects almost every aspect of a Multinational Enterprise (MNE) and can significantly impact its worldwide tax burden. Our professionals help MNEs address this burden (…). Our multidisciplinary team helps MNEs develop transfer pricing strategies, tax effective solutions and controversy management approaches that best fit their objectives”.74

This practice creates enormous distortions in global trade and strongly pushes tax competition, which in general is detrimental to wage levels, working conditions and environmental concerns. It also nourishes huge tax losses at the global level and especially for poor countries where these big companies operate.

**Failed attempts to combat capital flight and tax evasion**

The Organisation for Economic Cooperation and Development (OECD) is one of the key institutions to deal with tax havens. In April 1998, the OECD first published its report on “harmful fiscal competition” attacking fiscal practices aiming at attracting foreign capital. This led to the publication in 1999 of a list of 47 tax havens. A few months later, in June 2000, only 35 territories remained on the list since some tax havens declared their intention to take immediate measures. In 2001, the George W. Bush administration put strong pressure on OECD’s work to combat harmful tax practices. Tax analyst Richard Murphy explains that the OECD “saw no problem in denouncing what it described as harmful tax competition. Many states, led by Switzerland, Luxembourg and the Caribbean havens, argued that a tax regime is a sovereign prerogative (…: this argument gained a powerful ally once the first Bush administration came to power in 2001 and broke ranks within the OECD”75. US Finance Minister at that time, Paul O’Neil, stated that: “The US does not support any efforts aiming at dictating at any country what its tax rate or its tax system should be and we will not take part of any initiative aiming at harmonising tax systems”76. Following this trend, the OECD updated black list only accounted 7 countries out of the initial 47 and most of them have been progressively excluded on the basis of the good quality of their policies. The last updated list only names 3 remaining un-cooperative tax havens: Andorra, Liechtenstein and Monaco77.

The Financial Stability Forum (FSF) was created in 1999 in the aftermath of the Asian financial crises in order to promote financial stability and international cooperation in financial supervision and surveillance. The FSF works closely with the IMF and the OECD and drew up a list of 42 tax havens. In 2005, a new report published by the IMF with a list of 41 countries, expressed that good progress had been made except in two areas: lack of international cooperation and of information exchange as well as inadequate regulatory policy. On the basis of this conclusion, and despite the fact that these two elements are crucial for significant progress, the FSF declared, in 2005, that “the FSF’s 2000 list of 42 Offshore Financial Centres which helped the IMF to set priorities (…) has served its purpose and is no longer operative”.78

Another body active on illicit flows is the Financial Action Task Force (FATF) established by the G7 Summit in Paris in 1989 in order to combat money laundering. The FATF has focused on drugs money laundering and, since 2001, in the financing


77 See: [www.oecd.org/document/57/0,3343,en_2649_201185_30578809_1_1_1_1,00.html](http://www.oecd.org/document/57/0,3343,en_2649_201185_30578809_1_1_1_1,00.html)

of terrorism. It set up a list of non-cooperative countries and territories, or countries having rules that might facilitate money laundering, and established 40 recommendations to address the issue. It identified 29 dubious territories by the end of 1999 but, in 2000, the list shrank to 15 “non-cooperative countries”. According to the FATF only 2 territories were identified as having dirty money circulating: Nigeria and Myanmar, and since 2006, its list of non-cooperative territories is simply empty. According to some experts, this name and shame policy has paradoxically strengthened the legitimacy of the strongest tax havens. Some powerful conservative think tanks in the US support them like the “Coalition for Tax Competition” that qualifies the OECD as “A global fiscal cartel to the benefit of a small bunch of overtaxed nations”.

A renewed interest to combat tax havens
There is a renewed interest by world leaders, especially in Europe and in the US, to combat tax havens. The Liechtenstein scandal that burst in February 2008, exposing the issue of tax evasion in the EU through European tax havens such as Liechtenstein, opened the way to other European territories such as Luxembourg, Monaco and Andorra. But despite strong rhetoric statements from many EU member states that could be summarised in the Swedish Finance Minister Anders Borg’s words “Tax paradises in practice become tax parasites,” no concrete steps were taken. As Luxembourg’s Prime Minister gladly announced, when his country was pointed as suspect by the public opinion “I look forward to many years of fascinating and fundamental discussion”. A few months later, in the middle of the turmoil created by subprime crisis, he still proved to be loyal to his arguments by openly defending bank secrecy “I am of the opinion that the existence of banking secrecy is not at the origin of the financial crisis we are currently experiencing. The fact that we have banking secrecy in individual countries in Europe is not to be blamed for the fact that we are witnessing this financial crisis.”

But despite Mr. Junkers fixed position, the financial crisis and its expansion throughout the world, has definitely led to questioning the role of tax havens and secrecy jurisdictions. While Junker praised bank secrecy, his French counterpart Mr. François Fillon sang a completely different tune arguing that “black holes such as offshore financial centers should no longer exist” adding that their disappearance should be a step towards “the refunding of a new financial system”. Similarly, German Finance Minister Peer Steinbrueck openly pointed to Switzerland, saying it had failed to fully cooperate on taxation issues. "Switzerland should be on the blacklist and not the green list" he said. Indeed, tax havens host affiliates of most international banks that created off balance instruments, such as special purpose vehicles that generated the securitization of sub prime debts and other structured

79 See: www.fatf-gafi.org/document/42/0,3343.en_32250379_32236992_33916420_1_1_1_1_1,00.html
81 See: www.spiegel.de/international/business/0,1518,535768,00.html
84 See: www.24heures.ch/actu/monde/2008/10/14/fillon-veut-faire-disparaitre-paradis-fiscaux
toxic products. This renewed interest comes after more than two decades of decreasing efforts from the international community on this matter.

While Europeans are waking up on this issue, the political tide is already moving towards the other side of the Atlantic. While he was still a Senator, Mr. Obama introduced, in 2007, the “Stop Tax Haven Abuse Act”, arguing that “We need to crack down on individuals and businesses that abuse our tax laws so that those who work hard and play by the rules are not disadvantaged” 86. This act has not yet been approved, but opens a crucial space on the need to establish strict regulations to combat tax havens and tax evasion.

**Europe’s key role in curbing illicit flows**

There are several areas in which European governments can take the lead in order to foster transparency and improve stability at a global level.

Firstly, with the strengthening and expansion of the European savings tax directive (ESD) that is under review. By obliging automatic information exchange, the directive dramatically improves transparency of financial transactions. Nowadays, however, it only applies to individuals’ interest income, which represents a very small part of the actual problem. A much broader scope should be applied to this principle. This would include an expansion to all legal entities and to all sources of income, not only interest payments. Such an extension would address illicit flows from commercial and financial actors, currently circulating in secrecy, and draining huge amounts of resources from States. The expansion should also be enhanced at the geographical level, incorporating other non European territories, which, to some extent, has been the case 87.

Secondly, Europe has a key role to play on setting international accountancy standards. This can be done by dramatically improving transparency in the way multinationals present their accounts. The present system allows companies with subsidiaries abroad to present consolidated accounts without breaking them down on a geographical basis where profits have been made. This is currently one of the main obstacles to combating transfer false pricing and profit shifting to secrecy jurisdictions. The European Parliament recently called for a country by country reporting standard for the extractive industry sector 88. Country by country reporting should not be the exception but the rule applied to all economic and financial sectors, and Europe should firmly push in this direction.

Global financial governance requires a balanced representation of countries not only in financial institutions but also in the standards setting bodies such as the IASB 89. The EU Council has expressed concerns about IASB governance and legitimacy: “The current financial turmoil illustrates the importance of a robust and legitimate independent international accounting standard-setting process, which is responsive to the public interest and consistent with the objective of ensuring financial stability”. 90 This means not only a stronger representation from other regions of the world - including developing countries - but also the implementation of the

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87 The collaborating non-EU states are: Switzerland, Andorra, Monaco, Liechtenstein, San Marino and all overseas territories dependent on EU member states. The EU has also asked to initiate a negotiation process with Hong Kong, Singapore, Macao, Japan, Canada, Bahrain, Dubai and the Bahamas.


89 International Accounting Standard Board.

principles of neutrality, transparency and public interest in all international accounting standards.

Following the Liechtenstein scandal, the EU Council committed, in 2008, "to implement the principles of good governance in the tax area" and to "improve international cooperation in the tax area (...) and develop measures for the effective implementation of the above mentioned principles." These principles are "transparency, exchange of information and fair tax competition". The Council added "the need to include in relevant agreements to be concluded with third countries by the Community and its Member States (...) a specific provision on good governance in the tax area".

These principles have been ratified by the European Parliament’s report on tax fraud where it says that Europe should take the lead and make the elimination of tax havens at the worldwide level a priority, and "invites the Council and the Commission to use the leverage of EU trade power when negotiating trade and cooperation agreements with the governments of tax havens, in order to persuade them to eliminate tax provisions and practices that favour tax evasion and fraud".

The effectiveness of such a statement will very much depend on how broadly or narrowly we define tax havens. The OECD has proved to be too narrow when defining tax havens and needs now to dramatically strengthen its work against secrecy jurisdictions.

**Conclusion and recommendations**

The financial crisis is part of a broader and deeper systemic crisis and therefore, systemic changes will be needed. Combating tax havens is part of a broader set of reforms that many civil society organisations (CSO) are calling for. A large number of CSO are putting forward comprehensive reforms for a new financial system that respects a sustainable model of development. There are many proposals for a fundamental and democratic reform of the international financial architecture in order to guarantee stricter regulation, more transparency and better control of capital. These also include a in-depth democratic reform of the global governance system and fair distribution of global wealth through global taxes and progressive tax systems. The implementation of such measures would be a win-win game for both the North and the South, generating productive and sustainable development-oriented economic growth.

In order to enhance policy areas in developing countries and mobilise domestic resources in the long run and on a predictable basis, progressive tax systems should be implemented and promoted by international financial institutions and donors. This directly implies strong efforts to strengthen tax administrations globally but more particularly in the South. It will be unrealistic to effectively combat tax evasion and avoidance as long as tax administrations remain much weaker than perpetrators of these schemes. To put things in perspective, the accountancy firm Ernst &Young alone employs 900 professionals to sell transfer pricing schemes, while the US tax administration employs about 500 full time inspectors to pursue

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93 See: www.europarl.europa.eu/oeil/file.jsp?id=5597642
94 See the Declaration out of the World Social Forum 2009 “For a new economic and social model. Let’s put finance in its place” at : www.choike.org/gcrisis and see also : www.rethinkingfinance.org
these issues\textsuperscript{95}. In Kenya, where estimates of annual capital flight amounts to almost $US700 million\textsuperscript{96}, only three to five investigators are employed for the whole country.

It is crucial to combat the channels and facilitators of capital flight. Tax havens should be dismantled and their users sanctioned. In order to end bank secrecy, the principle of automatic exchange of information and public disclosure of information should be applied globally. Global taxes on financial transactions and penalties on operations incurred with non-cooperative territories should be implemented. These would not only penalise tax haven users, but would also free resources which could be redistributed to combat inequalities and foster sustainable development.

An international tax organisation, under the auspices of the UN to address tax competition and tax evasion, should be put in place. A first step in the right direction would be the upgrading of the existing UN Tax Committee into an intergovernmental body, in charge of addressing these issues. A first outcome towards the elaboration of a binding framework could be an international code of conduct on tax evasion.

It is fair to say, that many of the Southern small state tax havens that exclusively rely on offshore financial activities, would suffer dramatic consequences from a sudden end to offshore finance. This is why this process should be accompanied by a strong international financial effort to reorient these territories to real economic sectors leading their economies to a sustainable development pattern.

Finally, the IASB should be strongly reformed. Civil society organisations call for its reform into a specialist Commission of the United Nations Economic and Social Committee. The accounting standards rules should prevent excessive risk taking and abusive behaviours. Amongst others, they should seriously address transfer false pricing by establishing detailed country by country reporting standards for all companies operations, including costs, benefits, taxes, etc.

Given the global and systemic dimension of the problems we face today, global responses are needed. Many Heads of State are expressing the need to rebuild the financial system. To achieve this, strong measures to combat tax havens must be at the heart of the global agenda. Any regulatory or reform attempt will be useless if secrecy jurisdictions or tax havens continue facilitating a double standard whereby a minority are able to escape tax and regulation, to the detriment of the majority of citizens.

Some key references

Global Financial Integrity: Illicit flows from developing countries, November 2008. See: www.gfip.org/
“Capitalism has as its basis not only the idea that capital is private property, but also that it is concentrated in the hands of a minority. Due to their lack of capital, the vast majority of people who have to work in order to survive, are forced to sell their capacity to produce to those who own the means of production. Therefore, capitalists have at their disposal a large supply of manpower begging to be hired, usually outstripping the demand.

If these workers had enough credit, many of them would prefer to have their own business instead of working for somebody else. The larger the number of people that open their own business, the greater the possibility of success, since the injection of many small quantities of capital in the market boosts demand, allowing for new businesses to find buyers for their products. There is a need to enhance access to capital for micro and small entrepreneurs, of which there were more than 10 million in Brazil in 2003, in addition to the huge number of unemployed, the million families that are assentadas (people given new land to cultivate) under the agricultural reform and more than 11 million families dependant on the Bolsa Familia (Government program to supplement poor families’ income). In spite of the various measures for democratization of credit taken by the current government, with examples such as the six-fold increase in Pronaf (National Credit Program for Family Agriculture), the large majority of those in need are still not taken care of.”

The above text was written by Professor Paul Singer and appeared in the newspaper Folha de São Paulo on June 10th, 2007; however, it could very easily have been the preface for a real practice that has been taking place in Brazil since 1998: community banks.

“Community banks offer solidarity-based financial services, in a network of an associative and communitarian nature focused on generating jobs and income within the perspective of the reorganization of local economies, having as their foundation the principles of the Solidarity Economy. Its objective is to promote the development of low income territories by encouraging the creation of local production and consumer networks based on the support of the Solidarity Economy initiatives and its diverse fields, such as socio-productive entrepreneurial activities, service delivery, and support to commercialization (markets, shops and solidarity fairs).”

This definition was agreed on at the second meeting of the Network of Brazilian Community Banks, which took place from the 18th to the 21st of April 2007 at Iparana (CE), and it is meant to explain or clarify an initiative that is gaining more and more momentum within the national economy.

The Background
This topic becomes relevant the moment the world is faced with a crisis that has its origin in the international financial system. This crisis is now widely discussed in the
different media networks; however, half of the Brazilian population has been excluded from this discussion for quite some time.

The banking industry in Brazil is highly concentrated: the largest 10 banks own 80% of the total liquidity owned by the 105 banks with a commercial portfolio and a credit offer that represents 75% of the total amount. For instance, the two largest financial institutions, Banco do Brasil S/A and Ciaxa Economica Federal are responsible for 25% of the total credit offer.

Despite having grown in the past three years the credit offer is still disappointing in comparison to GDP, barely 27%, when compared to other countries such as Uruguay, Thailand and Chile where the indicator is significantly larger, 40%, 99% and 70% respectively.

Beyond the high concentration of their activities, banks are extremely selective in their credit offer and tend to favour transactions in neighbourhoods with stronger economic foundations. Furthermore, they finance part of the public debt, an activity which provides them with 40% of their profit on average. It is part of the nature of these financial institutions to concentrate their activities on short-term gains, instead of financing the mid- or long-term opportunities.

**Banco Palmas: the Beginning**

The first community bank in Brazil was Banco Palmas, which was inaugurated in January 1998 in a neighbourhood called Conjunto Palmeira, which is located on the outskirts of the city of Fortaleza. The idea came from the Associação dos Moradores do Conjunto Palmeira (Association of Residents of Conjunto Palmeira) which has around 30,000 residents. They developed an economic system which has an alternative micro-credit line (for producers and consumers), incentive tools for local consumption (credit card and social currency) and new ways of commercialization (fairs, solidarity shops/stores) promoting local job creation and income generation.

Banco Palmas has three main characteristics: management responsibilities are borne by the community; an integrated system of local development which promotes credit, production, commercialization and training; and the local currency (Palmas currency), which complements the official currency (real) and is accepted and recognized by local producers, merchants and consumers, creating an alternative and solidarity market between the families.

The Palmas currency is pegged to the real (R$) (1 Palma is worth 1R$), which allows productive entrepreneurial activities within the community, like commerce, industry and services, to exchange currency each time it is necessary to replenish stocks of products that are not produced in the neighbourhood. The Palmas currency is already accepted by 240 businesses, which offer discounts from 2% to 15% to encourage people to buy with the social currency.

In March 2008 the Ministry of Work and Employment (MTE) hired the Federal University of Ceará to make an evaluation of the impact and image of the bank in the Conjunto Palmeira neighbourhood. Some of the findings are worth highlighting:

- 98% of those interviewed consider that Banco Palmas has contributed positively to the development of Conjunto Palmeira.
- 90% believe that the bank has contributed to an improvement in their quality of life.
- 26% believe that their income has increased because of the actions of the bank.
- 22% found jobs thanks to Banco Palmas.
- 61% would give the bank a rating of at least 9 out of 10.
These figures are supported by the words of one of the world’s most respected individuals in the area of finance, who states “Banco Palmas is similar to Wir Bank from Switzerland, created in 1934 and it is more advanced than the Grameen Bank of Nobel Peace Prize winner Muhammad Yunnus, because it provides the poor with better help to get out of poverty” (interest rates are lower). This statement comes from Bernard Lietaer, former director of the Central Bank of Belgium and an expert on complementary currencies (from frequent flyer miles to social currencies). Just as it is with the Palmas currency, Wir Bank makes transactions with the Wir currency as well as with Swiss francs. Of course, the scale of transactions of Wir Bank is much higher since they involve 65,000 businesses and the value of such operations is 2 billion dollars a year. Author of the book “The Future of Money” (2001), Lietaer defends the view that social currencies promote certain exchanges that would not happen otherwise and help fight the liquidity problems that occur during recessions. He estimates that currently there are 5000 types of social currency. Furthermore, he firmly believes that “spreading banks such as Banco Palmas as a tool to reduce social tension, should be used as an important precedent for developed countries, such as Switzerland, to follow” (Jornal Folha de São Paulo 02/02/2009).

**Instituto Banco Palmas: Spreading the Idea**

In order to spread the social technology of the bank, in 2003 the inhabitants of Conjunto Palmeira decided to create the Instituto Banco Palmas. Two years afterwards the entity signed an agreement to enter into partnership with the Secretaria Nacional de Economia Solidária do MTE (National Secretariat of Solidarity Economy) and the Banco Popular do Brasil. The agreement allowed not only Banco Palmas but also the rest of the community banks to have access to credit and to act as banking correspondents of Banco Popular do Brasil.

Thanks to that support it was possible to arrive at the number of 37 community banks by the end of 2008, 25 of them in the state of Ceará, 4 in Espírito Santo, 3 in Piauí, 2 in Bahia and 1 in Mato Grosso do Sul, Paraíba e Maranhão. These banks are located in areas characterized by poverty, banking and financial exclusion, in quilombolas communities (where descendants of African slaves live), indigenous areas, communities of quebradeiras de coco (women whose job it is to cut open coconuts whose seed is used in industries to produce cosmetic products), and isolated districts in the semi-arid northeast and the urban periphery.

The inhabitants of the majority of these places travel in paus-de-arara (privately owned trucks used to transport people) for about 40km just to pay their electricity bill or to receive their pension. Credit is not even a possibility and thus there is even less possibility of any local development.

This was the case in São João do Arraial (PI), a region where quebradeiras de coco live and work. With 7,000 inhabitants, the city has an 81° HDI (Human Development Index), the lowest in Brazil, and 77% of its population lives on less than half the minimum salary, based on the data from the United Nations Development Programme (UNDP). The county’s economy is based on subsistence agriculture, mainly rice, corn, beans and yucca and raising animals such as pigs, cattle, goats and fowl. Moreover, the inhabitants work in the extraction of Babaçu, producing 200 tons of almonds and oil. In order to understand the true dimension of the local poverty it suffices to say that within the county 260,000 USD circulate per month, of which 110,000 USD come from the INSS (National Institute of Social Security), 110,000 USD from the City Hall, 30,000 USD from the government programme Bolsa
Familia and just 10,000 USD from local production, according to data provided by the local government of São João de Arraial.

Similarly to the example above, the inhabitants of this city had to cover around 30km of dirt road to the county of Esperantina if they needed any banking services. Besides paying the bills they also used these trips to buy whatever they needed, spending most of their income in their neighboring county. However, the story of São João de Arraial began to change at the start of 2007, when an NGO called CARE asked Instituto Banco Palmas for advice on how to open a community bank in the city. With the support of the City Hall and the leadership of COCAIS (Council of Community Organizations for Support and Social Inclusion), a seminar was held to present the proposal and…Bingo! The local residents were mobilized. Afterwards, some community leaders and experts from the City Hall went to Fortaleza for a series of training sessions at the Instituto Palmas.

As an infrastructure sponsored by the municipal authorities, on December 12th 2007 the Community Bank of Cocais was inaugurated. Today, it is possible to use it to pay bills, receive pension payments, and have access to credit and social currency for consumption in São João do Arraial. One of the municipal laws to support the Banco Cocais lays down that government workers of the municipality receive their salary from the community institution, giving the option that up to 25% of the payment can be in social currency. Thus, São João do Arraial began to redesign its own development.

The DNA of the community banks is the same everywhere: local economic flow of credits for production purposes (in Real R$) and credit for consumption in social currency, with ownership of the financial system in the hands of the community.

Nevertheless, every institution has its own name and currency and its own social organization which manages the project. A community bank is not a branch of a central bank, even though it follows a reference and common work methods defined by the Brazilian Network of Community Banks.

**The Structure**

In order to better understand the inner workings of a community bank, it is essential to describe its main structure.

A. Objective of a Community Bank

Promote the development of low income areas, through the encouragement and creation of local production and consumption networks, based on the support of the economic initiatives by the Solidarity Economy and its diverse scope such as: socio-productive enterprises, service provider, support for commercialization (markets, solidarity fairs) and consumer organizations.

B. Characteristics of the Community Bank:

- the community itself decides to create the bank, becoming its manager and proprietor;
- it always acts with two credit lines: one in Real currency (R$) and another one in circulating social currency;
- its credit lines stimulate the creation of local production and consumption networks, promoting the endogenous development of the area;
- it supports enterprises, as a commercialization strategy (solidarity shops, fairs, central office for commercialization etc.);
it acts in areas characterized by a high degree of exclusion and social inequality;
• it is aimed at a public characterized by a high degree of social vulnerability, in particular the beneficiaries of governmental programmes;
• it aims to establish its financial sustainability in the short term, obtaining subsidies justified by their social utility.

C. Financial Services offered by the Community Bank
• Local social currency
• Solidarity credit through the concession delegated by financial institutions such as Banco Popular do Brasil
• Credit for financing solidarity enterprises
• Credit for personal and family consumption without interest
• Popular Solidarity credit card
• Opening account and account statements
• Deposits
• Invoice reception (water, electricity, telephone etc.)
• Subsidies and pension payments
• Cash withdrawals with or without credit card

D. Functioning of the credit system in Community Banks
• The interest rates are lower than the market interest rates.
• The credit system is fair. In solidarity finances this means for instance, that those with fewer resources pay lower interest rates and those with more resources pay higher interest rates. The interest rates are progressive to ensure a proper distribution of income. In this system the fortunate subsidize the most vulnerable in economic terms.
• This solidarity dimension has to be understood by the residents and recipients of credit. A policy of lower interest rates is not enough if its application does not raise critical awareness and a sense of solidarity among the population. Only these values can have a mid- and long-term impact in the process of radical transformation of the structures of society.
• The community itself (members of the association of residents and the credit recipients) owns and manages the credit system. As a result, any income from the credit operations, return on resources, interest and fees have to remain within the community. When we say “remain” it means that the community is at the same time customer and owner of these resources. The self-management aspect is extremely important. Many credit systems that function in specific communities simply provide a credit operation, but the resources generated are directed towards the headquarters of the main bank. This means that the recipients of credit are merely clients and so end up contributing to increase the wealth of the financial institution at the expense of the community.
• The credit system serves as a supply source for the production chains, the local production and consumption networks, the production arrangements and other ways to foster the creation of solidarity cooperation networks. Credit can be made available to someone but soon they have to be encouraged to participate in one of the local networks of producers and consumers. In other words, it is essential that the recipient of credit (individual or group) is involved in some way with a local production or social network.
For the credit analysis other verification tools for the trustworthiness of the client are used than the traditional capitalist instruments. One of the tools often used is the "neighbour guarantee" or the "introduction" system which basically means the recipient needs to have a reference from a local organization (e.g. association, church, union). Trust, therefore, has to be put in the community which ultimately decides on the future or direction of the credit system.

E. The Circulating Social Currency and the Community Bank
The circulating social currency serves as a complement of the national currency (Real R$), created by the community bank. It is essential to cultivate the circulation of money and wealth within the community itself, strengthening local commerce and generating jobs and income.

These social currencies possess some characteristics that make them different. Let us see what these characteristics are:

a) The local currency is backed up by the national currency (Real R$). Basically, for each unit of social currency issued, there is a correspondent value in the national currency.

b) The currency is issued with security measures (paper money, watermark, barcode and serial number) in order to avoid falsification.

c) The currency circulates freely in local commerce; generally, those that use the social currency get a discount from businesses and producers to encourage the use of the currency in the municipality or neighborhood.

d) Any producer, shopkeeper or entrepreneur that is registered in the community bank will be allowed to exchange the social currency for the national currency (Real R$) if he or she needs to buy or make a payment outside of the municipality or neighborhood.

Through the partnership with Banco do Brasil, the Instituto Banco Palmas organizes and manages a credit fund, which transfers a start-up sum of 30,000 R$ for each new community bank that is created. Furthermore, Banco do Brasil has also made available the software that it uses to monitor the activities of each bank, in order to avoid mistakes by correcting possible distortions. In this way, out of the thirty-five community banks integrated in the Brazilian network, thirty use the same credit fund and are linked by a computer program.

From the legal point of view, each community bank functions as a Civil Society Organization of Public Interest (OSCIP) of Micro-credit. Instituto Banco Palmas acts as an umbrella organization; it manages the network which provides legal support to all the community banks, the majority of which are just local associations with no institutional structure.

As part of being an OSCIP, Instituto Banco Palmas can establish partnerships with the public sector and official banks, generating resources and technologies for the benefit of the community banks that are part of the network.

Starting up a new Community Bank
For a new community bank to be created three factors are necessary/essential:
1. Local mobilization and a community organization process, and a strong, motivated civil society institution to manage the bank.
2. Availability of premises and infrastructure provided by a local partner, usually municipal City Halls.
3. Organization of training sessions for the agents, credit managers and cashiers, in addition to the sensitization of the local economic actors to join the initiative

It is the responsibility of Insitituto Palmas to certify the creation of a new community bank and to communicate the creation of a new social currency to the Central Bank, even though other organizations that take part in the Brazilian Network of Community Banks also facilitate training and consulting services in other states.

**Next steps for Community Banks**

Despite the financial crisis the Brazilian Network of Community Banks continues to grow all over Brazil. With its decentralized model and broad social supervision, focused on the balance between local production and consumption, it has already had an impact on the lives of more than 200,000 people.

After so many successful initiatives a new set of goals has been defined for the future.

1. To create 1000 banks by the end of 2010 of which 300 should be in the north-east of Brazil.
2. To have at least one community bank in each state of Brazil by the end of 2009.
3. Develop a legal framework for community banks; a bill Nº 93/2007 supported by congresswoman Luiza Erundina.
4. To set up the Centro Palmas de Refêrencia, a place to train future employees of the bank.
5. To train 200 technicians in community banks by the end of 2009.
6. To obtain 10 million R$ to fund the community banks with low interest rates and long-term repayments
7. To help 2 million Brazilians benefit from proper financial services by the end of 2010.
8. To create the Latin-American Network of Community Banks.

The Instituto Palmas is aware that in order to accomplish these goals a broad process of training, mobilization and community organization throughout Brazil will be necessary. To find organized areas and properly trained and empowered community leaders are the biggest challenges faced by community banks. Despite the best efforts by different social movements, taking into consideration our vast territory, there are still very few organized communities in Brazil. Of these, only a few give economic issues priority. The vast majority of local organizations are focused on initiatives such as, inter alia, the regularização fundiária moradia (right to build and own a home), access to health services, education, and human rights.

The economic issue, focused on financial and banking exclusion, remains distant from social movements, almost a taboo. The economy is viewed as just for economists, a hard topic that is almost never found amongst the priorities of local organizations. However, an example for the popularization of this type of initiative is being practiced outside Brazil.
In March 2008, the Palmas Institute signed a Memorandum of Understanding for social and economic cooperation with the Ministry of Popular Power for the Communal Economy of the Venezuelan Government.

As part of this agreement, the Instituto Banco Palmas trained a team of 30 technicians of the Venezuelan government in the methodology of the community banks and they established a visit schedule for monitoring and training in Venezuela. At the same time, the government of Hugo Chavez passed the Law of the Communal Banks, which provides that for each organization of 200 families a Communal Council can be created to form a community establishment. This process has resulted in the foundation of 3,600 community banks in different states of Venezuela. Thus, a priority for the Brazilian Network of Community Banks is the creation of a legal framework of a similar nature in Brazil. An important step towards this goal is the already mentioned bill Nº 93/2007 by Congresswoman Luiza Erundiana, which is being discussed at the National Congress. The text provides for the creation of the National Segment of Popular and Solidarity Finances. Its approval will constitute a great leap forward in the democratization of the Brazilian financial system – or more importantly – for the financial and banking inclusion of more than half the Brazilian population that continues to have no access to commercial (public or private) banks.

A look at the current international state of affairs encourages us to reflect that this alternative way to understand the world of finance, starting at the local community, stands out as an alternative to the globalized exclusion and speculation so present in the current global financial system. We believe that the poor, when empowered, become the solution; they are capable of creating their own financial system, in harmony with the local culture, strengthening neighbourhood relationships and cooperation.

It is not our objective to create a movement for the elimination of the current financial system. On the contrary we aspire to start a global crusade for the broadening of financial and banking services. It has been proved that commercial banks (public or private) only reach a small part of the world’s population, leaving the poor outside of the financial system. Thus, our model becomes essential; it is more democratic, humane, and inclusive. After all, it is named community bank because the common-unity itself is the owner of the bank.
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In September 2007, only a month after the beginning of one of the most devastating financial crisis ever experienced, the British bank, Northern Rock, was on the brink of collapse. Northern Rock had expanded rapidly prior to its failure, funding its growth as an aggressive player in the international market for Collaterized Debt Obligations (CDOs) and emerging as the fifth-largest mortgage provider in the UK. Those bonds were, however, issued not by Northern Rock itself but by what became known as its shadow company, Granite Master Issuer plc and associates. What was intriguing about the arrangement was that Granite was owned not by Northern Rock but by a UK charitable trust established by Northern Rock. Much of the management of the resulting, supposedly independent, structure was located in Jersey, well known as a European tax haven.

In March 2008 came the collapse of Bear Stearns, a leading American investment bank. Bear Stearns had hemorrhaged funds through its hedge funds, many of them registered in the Cayman Islands and Dublin’s International Financial Centre - both well-known offshore finance centres.

This was not a coincidence. If you think of tax havens as sun-kissed exotic islands reminiscent of the Garden of Eden where a few billionaires, Mafiosi, and corrupt autocrats hide their ill-gotten gains, then think again. Tax havens are the underlying constant theme of the financial crisis of 2008-9. Lehman Brothers, the next to fall (its collapse triggered a month of financial panic throughout the world), was registered in Delaware, a state that has served as an internal tax haven in the United States since the late 19th century. The Lehman collapse was followed by the Madoff scandal, a supposed $US 50 billion Ponzi scheme orchestrated by the well-known Wall-Street financier, Bernard Madoff. It took little time to discover a link between Madoff’s scam and tax havens’. ‘Madoff Spotlight Turns to Role of Offshore Funds’, announced the New York Times (30 December 2008)

We do not suggest that tax havens caused the financial crisis of 2008-9, but we do believe that they were one of the most important actors precipitating the crisis. We argue that their regulation is key to any future plan to stabilize financial markets. We are not alone. The French, German and British governments, and the administration of President Barack Obama, are all keen to pressure these havens, for the sake of stability and, not unnaturally, for other, more traditional reasons as well. For tax havens are places where one can avoid or evade at least one of life’s
absolute certainties, taxes, and so they leave a gaping hole in most states’ finances. Tax havens also help those who use them escape other regulations, launder money, hide money from partners or spouses and secure secrecy for their commercial activities.

Individually tax havens may appear small and insignificant, but in combination they play an important role in the world economy in two respects. Firstly, they undermine the regulatory and taxation processes of the mainstream states by the provision of what may be described as ‘get out of regulation free’ cards to banks and other financial institutions, to international business, and to wealthy individuals. Secondly, in doing so they skew the distribution of costs and benefits of globalization in favour of a global elite and to the detriment of the vast majority of the population. In that sense tax havens are at the very heart of globalization, or at least the heart of the specific type of globalization that we have witnessed over the past three decades.

**Money, wealth and tax havens**

The names of offshore jurisdictions have appeared with monotonous regularity in every financial crisis or scandal that has erupted over the past 20 years, whether financial crises in East Asia, Russia and Argentina or the corporate fiascos associated with companies such as Long Term Capital Management, Parmalat, Refco, Enron, and more recently Northern Rock, Bear Stearns and Madoff’s Ponzi scheme.

The sense of fiasco perhaps reached its pinnacle when it was revealed in February 2008 that a dog named Günter joined 1,400 of his fellow German citizens (most of the conventional homo sapiens variety) and set up anonymous trusts managed by Liechtenstein's LGT bank to avoid German taxation (Dinmore and Williamson, 2008). But relatively unknown banks in very small havens were not alone in pursuing such activity: in June 2008, an employee of UBS, the premier Swiss bank, pleaded guilty to helping a Russian oligarch evade millions of dollars’ worth of taxes in the United States. In November 2008 a senior Swiss-based employee of the same bank was indicted on charges of tax evasion in the USA. The UBS employee estimated that $20 billion of assets were involved and the total fee income to UBS each year might have amounted to $200 million. He stated that UBS chose to ignore regulations with regard to the operation of offshore accounts for its U.S. clients and in the process facilitated tax evasion.

The evidence is clear that tax havens and the tax evasion that at least some of them facilitate are serious business. At some point quantitative growth accumulates to a qualitative change, and the impressive figures associated with tax havens suggest that they play an important if often overlooked role in the contemporary world. We hope that anyone who still believes that tax havens are a mere sideshow, the playground of the rich and famous, will think differently after they read this book.

The statistics are certainly impressive. In our estimate there are between 46 and 60 active tax havens in the world right now; they are home to an estimated two million international business companies (IBCs), a term used to describe a bewildering array of corporate entities, most of them extremely opaque, and thousands upon thousands (if not millions) of trusts, mutual funds, hedge funds, and captive insurance companies. About 50% of all international bank lending and 30% of the world’s stock of Foreign Direct Investment (FDI) are registered in these jurisdictions. Some very small islands are among the world’s largest financial centres: the Caymans, a small set of islands in the Caribbean and a British Overseas Territory, is the fifth-largest international financial centre in the world. That list
contains, in addition, the small British Crown jurisdictions of Jersey, Guernsey and the Isle of Man, as well as what we call intermediate havens, such as Switzerland, Luxembourg, Ireland and Singapore.

The global rich - the 'Richistanis' as Frank (2007) calls them - hold between them approximately US $12 trillion of their wealth in tax havens. It is as if the entire U.S. annual Gross National Product (GNP) were parked in tax havens. The hedge fund industry has discovered the delights of tax havens. According to some estimates the 'big four' Caribbean havens - the Caymans Islands, the British Virgin islands, Bermuda and the Bahamas - are home to 52% of the world’s hedge fund industry. But these figures are disputed. The Cayman Financial Services Authority claims that 35% of the world’s hedge fund industry is located in its territory alone (Cayman Islands Monetary Authority (CIMA) figures as reported in GAO 2008) and some cite an improbably high figure of 80%. This unresolved debate is disconcerting: it shows how little we really know about the hedge fund industry.

The statistics are staggering, but these are only numbers and numbers need interpretation. What these figures represent can be captured in one word: avoidance. They are the abstract expression of the collective efforts of the state, corporate and business elites of the world to avoid the very laws and regulations which they have collectively designed.

Such elites seek to avoid, first and foremost, taxation. They seek to avoid or reduce their share in the collective effort that pays for the ‘collective goods’ provided (or supposedly provided) by states, such as security, economic, political and social stability, health, education and infrastructure. However, elites also seek to avoid regulations. The regulations they seek to avoid are often the financial and business rules and norms that states introduced to maintain order and stability—without which the rich would not have become so rich in the first place. Tax havens allow people to manage many other, more esoteric social regulations, among them the avoidance of gambling and pornography laws.

Granted, not all taxes and regulations are necessary or socially beneficial. Not long ago, most advanced capitalist countries heavily regulated their broadcasting industries, allowing only state-sponsored broadcasting companies to operate. The growth of offshore radio stations such as Radio Luxembourg and Radio Caroline, both of which operated on the tax haven principle (Palan 2003), appears in retrospect to have been a beneficial development. Here, ‘offshore’ proved to be a modernizing force compelling governments to abandon intrusive regulations. Broadcasting, however, is uniquely accessible to all. In most cases - indeed, in all the cases discussed in this book - entry barriers to the range of benefits offered by tax havens are high, limiting their clientele to a small and extremely wealthy minority. As a result, unfortunately, tax havens benefit the rich and the powerful, while the costs are largely borne by the rest of society.

This is the crux of the matter and what makes tax havens a highly political issue. Tax havens are among the most significant, if persistently overlooked, structural factors that are determining the distribution of the benefits and costs of globalization among the world’s peoples. That they skew the benefits of globalization to favour a small minority of the world’s rich and powerful is a matter of the highest political importance.

We can find examples of people taking advantage of collective goods for private pleasure at every level of society, of course, from the poorest to the richest. The tax haven phenomenon, however, and the figures cited above are testament to this, and is a massive organized attempt by the richest and most powerful to take
advantage of collective goods on a scale rarely seen; and it is, perhaps for the first time, taking place globally. Tax havens are, therefore, at the heart of a particular type of globalization; globalization that is characterized by a growing gap between the very rich and everyone else. Such globalization is neither necessary nor inevitable. Rather it is a product of a complex set of factors, key among which has been lenient and forgiving attitudes toward tax havens that have characterized international politics (and most especially those in which the United States has been involved).

**What are tax havens?**

It is not easy to define tax havens. At this point we suggest that tax havens are places or countries (not all of them are sovereign states) that have sufficient autonomy to write their own tax, finance and other laws and regulations. They all take advantage of this autonomy to create legislation designed to assist non-resident persons or corporations to avoid the regulatory obligations imposed upon them in the places where those non-resident people undertake the substance of their economic transactions.

An additional characteristic that most tax havens share is an environment of secrecy that allows the user of structures created under local law to do so either completely anonymously, or largely so.

The third common characteristic is ease and affordability in gaining access to the entities incorporated in the territory.

**Evasion and avoidance**

Tax havens are used, as their name suggests, for tax avoidance and evasion purposes. However, these two terms are often confused and so some clarification is essential at this stage.

Individuals and companies just about anywhere in the world have the opportunity to undertake what might be described as ‘tax planning’ within the law of the territory in which they live or operate. For the vast majority of the world’s population, however, including most people in advanced industrialized countries with reasonable wages, the concept of ‘tax planning’ is largely meaningless: tax is normally deducted at source from earnings, and that is more or less that with regard to the settlement of tax liabilities.

For the wealthy minority of the world’s population and for most companies, tax planning is, in contrast, an important part of their business and personal lives. There is even a special term to describe the life experience of some: they are called PTs, the ‘permanent tourists’ or those who are for tax purposes the ‘permanently not there’ (Maurer 1998). This is an extreme, however, and in practice tax experts distinguish between three basic approaches to tax strategy.

The first is ‘Tax compliance’. This happens when a company or an individual seeks to comply with tax law in all the countries in which they operate, makes full disclosure of all relevant information on all their tax claims and seeks to pay the right amount of tax required by law (but no more) at the right time and in the right place where ‘right’ means that the economic substance of their transactions is consistent with the form in which they are declared. These people are considered tax compliant.

At the other end of the scale is tax evasion. Tax evasion is an illegal activity undertaken to reduce an individual or company’s tax bill. It occurs when a taxpayer fails to declare all or part of his or her income or makes a claim to offset an expense against taxable income that he or she did not incur or were not allowed to claim for tax purposes. Tax evasion is a criminal offence in most countries but a civil offence in
a minority of countries, such as Switzerland and Liechtenstein. The difference is significant. Countries cannot legally cooperate in civil matters and hence the Swiss authorities’ most common response to other countries’ requests for assistance in cases connected to tax evasion has been that eager and keen as they are to stamp out such unsavoury practices, sadly they are unable to cooperate because tax evasion is a civil matter in the Swiss Federation. Their hands are therefore tied, and Switzerland, is of course, a democracy.

This characteristic response has been highlighted in recent events. In 2008, when massive tax evasion through highly secretive Liechtenstein foundations was made public, a Liechtenstein spokesperson explained how surprised and disappointed they were to ‘learn’ that these secret foundations, set up under a law passed in 1926, could be abused by foreigners for tax evasion purposes. Liechtenstein, she said, was perhaps a tad naïve, believing that most people in the world would behave just like its own citizens and would cheerfully pay all taxes due - but naivety, she said, was not a crime. The implication was clear: Liechtenstein wished us to believe that it was taken for a ride by these nasty foreigners. Liechtenstein had been known for nearly a century as one of the world’s most secretive tax havens and was associated with a string of scandals. Few were deceived by the response.

Finally, there is tax avoidance. Tax avoidance is the grey area between tax compliance and tax evasion. This is the favourite area occupied by an army of accountants, lawyers, bankers and tax experts. Strictly speaking, a tax avoiding individual or a company seeks to ensure that one of three things happens. First, they might seek to pay less tax than might be required by a reasonable interpretation of a country’s law. Second, they might hope that tax is paid on profits declared in a country other than where they were really earned. Third, they might arrange to pay tax somewhat later than when the profits were earned.

Legally, there is a clear difference between evasion and avoidance. Tax professionals like to cite a series of court rulings, mainly from the major countries in the world, which appear to support the legality of tax avoidance. The reality, however, is more complicated. First, the tax rules of almost every country are complex, and much avoidance relies on the existence of doubt. Second, when transactions take place across international boundaries in a world that has no global tax rules, the opportunities to play off the taxation law of one state against that of another (a process that tax professionals call ‘arbitrage’) is often difficult to resist. The consequence is that the line differentiating tax evasion from avoidance is often too difficult to determine in general terms, and is way beyond the ability of most of those who participate in tax haven practice to either know or understand - a fact that the tax professional can easily exploit. For that reason, we talk of avoidance and evasion without significant differentiation, relying in doing so on the maxim of former UK Chancellor of the Exchequer Dennis Healey who famously described the difference between the two as being ‘the thickness of a prison wall’.

How much tax is evaded through tax havens? The most candid and accurate answer we can give is that nobody knows. But as States feel that they are losing more and more tax receipts, some figures have been coming out. Richard Murphy calculates that annual avoidance in the UK is about £97 billion – 16.6% of expected tax receipts or 6% of Gross Domestic Product (GDP). The IRS believes that the US tax gap is about $330 billion a year or 16% of federal revenue and 2% of GDP. Official figures in France indicate that the French state loses 40-50 billion euros a
year, roughly 3% of GDP. The European Union estimates the tax gap for the entire Union at 2-2.5 percent of GDP. The numbers at stake are very high.

**Tax havens and the professionals**
The debates on tax havens rarely acknowledge one crucial factor: the role played throughout the years by commercial firms of accountants, lawyers, bankers and tax experts that service them.

The biggest accounting firms, together with lawyers and bankers, tax experts and financial traders, plus their associated trust and corporate services companies, are to be found in most tax havens, but most prominently in the thirty or so largest jurisdictions. These professionals are crucial: as far as we can tell, they were present at each and every legislative innovation designed to avoid tax and regulation. They advised and coaxed the politicians to provide the legislation they needed to pursue their trade, and on occasions they drafted that legislation for the states in which they had located themselves. The professionals have also been present in each and every redrafting of the laws of offshore, while the professionals are the ones who actually set up the offshore facilities that such legislation enables; the professionals innovate new techniques of evasion and avoidance, which they sell to clients; the professionals lobby against changes in the laws against tax havens; the professionals are also there to argue that tax havens are an entirely legitimate form of business.

The professionals are therefore absolutely irreplaceable, for they ensure that the business of tax havens flourishes. Most tax havens are very small jurisdictions and do not have the manpower and skills to operate on a global scale. The State of Jersey provides a perfect example. Probably few if any members of the State of Jersey have any real understanding of how ‘the offshore finance community’ within Jersey works or what it is its denizens really do. They are simply a legislature for hire, doing what is asked of them. So, for example, Jersey’s obnoxious Trust Law of 2006 was passed without a vote since no one objected, or as far as we can tell even commented on it, in that Island’s State Assembly. But legislators did do exactly what was asked of them: they provided what the local financial services industry demanded. In so doing they implied their understanding of something very simple and straightforward: that in exchange for legislation the tax havens collect revenue from some activities that the offshore community brings into their jurisdiction without encountering any obvious costs. It seems to be a win-win situation serving the interests of all, and so why spend time on the boring details of trust laws?

These professionals make up the so-called Offshore Financial Centre (OFC) community. They are international, transient, and interested only in following the money. If for any reason the money leaves a tax haven, you can be fairly sure that the OFC community will follow it. The perfect example of this type of behaviour is found among the Big Four accountant firms, which are all, almost without exception, present in all the world’s significant tax havens, including the most abusive. The people who service these firms are rarely local, and, it is now becoming increasingly clear, they rarely integrate into the local community. They service a client base that is almost never local, unless it be the local lawyers who are servicing offshore clients, and their reason for being there has little to do with geography but everything to do with the money flows they are managing.

Precisely because these people are transient, they have little real regard for local regulation. They may pay lip service to it as part of their costs of operation, but they can also afford to ignore it, as they evidently did in the case of UBS in the United
States, some of the consequences of which we have already noted. Their belief is simple: if a problem of compliance were to arise, they could simply move on. As a result, compliance is not a real issue for them, and that is why, we suggest, it is obvious that despite the theoretical soundness of the local regulatory systems, actual compliance rates are so low.

Any effective regulation of the offshore world (a hot topic of debate for the past decade, and likely to be equally hot in the next), would require not just that tax havens be regulated, but that the professional operators be regulated as well - and not just with regard to what they do in such places, but with regard to what they facilitate. They will resist such moves, but this is a battle that must be won. Not only because tax havens are not really home to the vast amount of money that the figures suggest. They are very largely ‘recording havens’ or, to use the jargon, ‘booking centres’ that serve as legal domains for the registration of contractual relationships that take place elsewhere (although they collect license fees and other revenues in return). The staggering statistics belie the fact that at heart, tax havens are largely a fiction, one almighty fictional world that is aimed at one thing: at the avoidance of taxation and regulation in the world in which the transactions they record actually take place or have real impact. Their activity is entirely parasitic, feeding on both the world economy and the system of states. That is why tax havens are one of the most important political issues of our times.

**Regulatory responses to tax havens**

The astonishing statistics associated with tax havens tell us, therefore, that they have played a central role in skewing developments in the world economy in two ways. First that they have helped to undermine the international financial regulatory environment, as well as the taxation policies of all those countries and regions that participate in globalization, as well as those that do not. Second, that in doing so, they have served collectively as a vehicle for skewing the allocation of costs and benefits of globalization. The degree to which modern business, large and small, have become embedded in tax havens, while astounding, is rarely acknowledged. An international company or business with no links to a tax haven is a rare species nowadays. But the impact of tax havens is felt largely indirectly, revealed through the statistics that show a persistent growth in the gap between rich and poor since the 1980s all over the world. The role that tax havens are playing in undermining financial regulations has come to light only recently.

Yet, all this was known for a while. How could the leading industrial countries allow these small jurisdictions to rise and flourish? Well, they did and did not. On the one hand, countries such as the US, the UK, France and Germany sought from time to time to close certain loopholes, pressurizing this or that tax haven to change some of its rules and policies. There were also some feeble attempts, dating back to the interwar period to try and develop a coordinated international response to tax havens. But frankly, not much was accomplished. Worse, the very same countries, with the possible exception of France and Germany after WWII, were indeed major players, as we will see, in the development of the tax haven phenomenon.

For a number of reasons, however, the sentiment has begun to change towards the end of the 1990s. Since then a number of initiatives, led initially by the OECD ‘harmful tax competition’ campaign, began to gather steam. In 2006, however, Jason Sharman (2006) exposed these efforts largely as futile in an excellent detailed analysis. Yet, only three years later, it appears that tax havens are under greater threat today than ever.
While concern with tax havens has gone on a long time, the full impact of tax havens on the world economy took a long time to mature and may have dawned first on the leaders of the European Union. While the OECD campaign was largely in a doldrums, the EU has emerged as the effective leader in the global struggle against tax havens.

Since 1997 a Code of Conduct on Business Taxation is in place. The code does not have the status of a legal instrument, but it provides an informal approach to regulation which is proving surprisingly effective (Radaelli 2003). In adopting this code, member states work to eliminate several harmful tax competition practices and avoid new ones. Whereas the OECD campaign is limited to financial and other services, the EU Code looks at business activities in general, with greater emphasis on mobile activities. It thereby avoids charges of a bias against mobile capital lodged by Luxembourg and Switzerland. The code of conduct also overturned another traditional objection of tax havens. To avoid the charge of imperialism, the code does not elaborate a principle of “just taxation” and impose it on recalcitrant states. Instead, taking a line adopted by the OECD, the code accepts the principle of tax competition, allowing states freedom of choice in this matter. However, the EU insists that the tax regime’s rules be applied equally on all businesses in the jurisdiction, domestic and foreign. The Code targets the practice whereby non-residents are provided ‘a more favourable tax treatment than that which is generally available in the Member State concerned’.

The code confronts, therefore, jurisdictions that have created a niche for themselves in the global economy precisely by distinguishing resident and non-resident companies for tax purposes. Citing the code, for example, in 2006 the Commission forced Luxembourg to abandon its 1929 holding companies. Similarly, the adoption of new tax regimes by Jersey, Guernsey and the Isle of Man from 2008 onward (notably the 0% tax rate on business profits) may be taken to task for not respecting the code.

The EU is also pushing for the harmonization of company taxation across the continent. Multinational companies with subsidiaries in more than one European country pay taxes in countries where they operate, but they tend to shift profits to the lowest-tax country through complex systems of transfer pricing. The EU is proposing a European-wide tax base that would reduce the incentives to shift profits by applying a “formulary apportionment.” In this process group profits will be taxed just once in the EU and tax revenues distributed among countries according to an agreed criterion (e.g., amount of capital invested or sales turnover) as is already done between states in the United States and between provinces in Canada. The Commission gave itself until 2008 to come up with a directive for company taxation, but the Irish 2008 no vote in the referendum on the Lisbon Treaty, partially won on the claim that the EU supposedly threatens the Irish tax system, has delayed the directive.

Any state can serve effectively as a tax haven by sheltering savings from taxation. The EU put forward a clear set of proposals to deal with this sort of abuse as well. Since July 2005 all member states are required to exchange information with the relevant national authorities. Austria, Belgium and Luxembourg retained their bank secrecy rules but are required to impose a withholding tax on earnings from deposits starting at a rate of 15% from 2005 to 2008, rising to 20% from 2008 to 2010, and to 35% thereafter. The Liechtenstein affair in early 2008 reinforced France and Germany’s resolve to increase the scope of the European Savings directive and
European states are now engaged in negotiations to determine an extended directive.

Is the mantle of the driving political force against tax havens likely to pass to the USA with the Obama administration? The issue was certainly known to both the Clinton and the George W Bush administrations, and the Clinton administration was one of the drivers of the multilateral efforts against tax havens. But one of the first acts of the Bush administration was to withdraw support from multilateral efforts to combat harmful tax competition. President Obama, however, has already played an important role as a Senator in various initiatives to combat tax havens and some declarations he made by the end of 2008 seem to confirm his political will to clamp down on tax havens. Whether the US will emerge as an ally of some of the leading European states such as France and Germany in the fight against tax havens is still to be seen. But it will be amongst the most important political choices made by the Obama administration with regard to the regulation of international finance.

The next step in the battle against tax havens
It is very obvious that the world’s tax havens have a significant impact upon its economies and the distribution of income and resources both within those economies and between states. What then are the most crucial next steps in the battle against tax havens?

The answer, we argue, at this point is secrecy. Without the deliberate veil of secrecy that tax havens create, those using tax havens for the purpose of tax and regulatory avoidance would be readily identifiable, and as such would either desist from doing so of their own volition, either for fear of the effect on their reputation or from fear of prosecution, or they could actually be prevented from doing so by the states in which they really undertake their economic activities. Tackling secrecy, however, is likely to be insufficient by itself. There remain legacy issues arising from the existing international architecture which will have to be addressed as well. Our recommendations are clustered around these two themes.

Secrecy is created within tax havens under the pretence that as sovereign jurisdictions, it is their sovereign right to write their laws as they wish. The impact of these provisions, however, is felt outside tax havens. Those who wish to address secrecy have a choice: they can either try to break the secrecy that these jurisdictions create from within those places, or they can seek to break it in the places where it has impact, or finally they can try to work around the issue. Despite tremendous pressure from civil society groups, tax havens have been very reluctant until now to give up their secrecy provisions. We do not believe that they are likely to change their position on the matter in the short term, particularly when reform in the United Kingdom, Delaware, Nevada and other locations appears to be a necessary prerequisite of any action in the secrecy jurisdictions.

As a consequence the attempts to break this secrecy from outside these jurisdictions are at present receiving greater attention. One line of attack consists of a proposed extension of the EU Savings Tax Directive. This directive was a substantial step forward, as we saw, but it was limited in its impact because all privately owned trusts and companies were excluded from its scope. In December 2008 the EU published a proposed revision to the Directive. In what can only be described as a bold move, it has sought to link together the information that banks must hold on the beneficial ownership of the entities with which they contract and the obligation to either automatically exchange information with the country of residence of the beneficial owner of an account, or to withhold tax of up to 35% from payments made
as an alternative. This requirement will apply to all paying agents who operate within the EU, and any additional states that apply this directive. This proposal, in effect, means that the actual beneficial owners of those entities located in tax havens must be known and indentified. Offshore entities, such as International Business Companies, or offshore trusts, will be treated for tax purposes as being located in the countries where the beneficial owners are. Information will then be exchanged with the countries where the beneficial owners are, by-passing the jurisdictions where the entities are registered. The entities include both companies and trusts and all other similar structures.

This is an extraordinary breakthrough: it basically sweeps aside all the tax planning that is undertaken offshore and says that the entities in question are owned by and must be taxed in the countries in which they really reside. There are, of course, obstacles to progress: the Directive must be supported by all EU states and it is not clear that support does exist as yet, with particular opposition coming from Luxembourg, but the mere presence of this proposal gives a clear indication of the direction of travel in which the EU wishes to proceed.

Similar indication is available from the USA. The Stop Tax Haven Abuse Act is drafted legislation before the U.S. Senate, but has the advantage of having President Barack Obama's name on it from the time when he served in that body. The fundamental presumption of the pack is that the person who engages with a tax haven entity has control of it, enjoys the benefit of its income and has the duty to declare that income in the USA unless they can prove the contrary. Legislation with similar intent has been tabled in Germany in January 2009 as well, whilst Germany is also seeking to deny tax relief on payments made to tax haven entities, even if within commercial groups of companies. In both cases, this is a blunt legislation that has the effect of presuming the taxpayer guilty until proven innocent! No doubt, this approach is likely be the basis on which it is criticised.

Another approach to tackling secrecy has been proposed for multinational corporations. With minor exceptions, the vast majority of corporations have to prepare accounts in accordance with the requirements of the International Accounting Standards Board (IASB) or its US equivalent, the Federal Accounting Standards Board (FASB). Under the rules of both bodies, multinational corporations at present do have to submit consolidated accounts to their members. These eliminate all intra-group transactions from view, including transfer pricing. In addition, under the now common rules issued by the two bodies, almost no geographical reporting of the transactions of the entity is required. As a result it is almost impossible to establish where a multinational group of companies trades, where it makes its profit, where it locates its assets and where it pays its tax.

Civil society groups, led by the Publish What You Pay coalition and the Tax Justice Network have argued that these corporations should be required to account on a country by country basis, meaning that they would report their sales by location, both the party and intragroup, their costs on a similar basis, where they employ their staff and what they pay them on the country basis, and by country what profit they make, what tax they pay what assets they have located in that place. Their argument is that this reform would substantially reduce shareholder risk; that it would enhance the allocation of assets and reduce the cost of capital within groups of companies and so bring economic benefits, and that it would make these corporations accountable for the actions they undertake in all countries in which they trade. By arguing, however, that this disclosure should be made for all jurisdictions, without consideration of size or the volume of trade undertaken there, the disclosure would
also expose the use of secrecy jurisdictions by these groups, and for both third-party trading and poor intragroup transactions, with the latter having particular significance for transfer pricing issues, where it is thought that much of the tax abuse of developing countries is perpetrated.

This proposal, in common with those from the EU, USA and Germany, works round the secrecy provisions offered by tax havens. Hence, the consent of those locations is not required for the policy to work, or for the accounting of these corporations for their actions within them to be put on public record. The direction of policy is indicative of the state of frustration that has been reached: negotiating for the reduction of secrecy in the jurisdictions is not working. It is widely acknowledged that the Tax Information Exchange Agreements that should supposedly ensure information exchange between those who have signed them and the major state participating partners is not giving rise to any meaningful exchange (just four exchanges had taken place between Jersey and the USA between 2002 and 2008) and therefore measures have to be taken to attack secrecy which do not require these places consent.

That being said, considerable problems within the jurisdictions need to be addressed as well. There is an obvious and continuing problem with regard to the regulation of banking in these places. As has been shown by banking failures in Iceland, Ireland and the Isle of Man, the capacity of small governments to support the depositors of a bank that is failed is very limited. It exposes those who have acted in good faith to unnecessary risk, potentially burdens the population of these places with debts which they have not reasonably afforded, and ultimately transfers risk onto the rest of the banking system that suffers from the failure of counterparties to many of their transactions.

Whilst it is true that very few independent banks indeed are actually located in the smaller secrecy jurisdictions, there does remain considerable risk in the tax havens where the ratio of banking assets to local GDP can be astronomical. In excess of 500:1 in the case of the Cayman Islands, and at least 80:1 in the case of Jersey. This is particularly troublesome to the United Kingdom who has responsibility for both those jurisdictions. Until very recently, banks have vigorously fought previous attempts to exchange information for taxation purposes: the major UK banks did so in the case of the 2007 exercise by HM Revenue & Customs that revealed that more than 40,000 of their customers in the Crown Dependencies were evading tax. But as a consequence of the financial meltdown of 2007-9, many banks in many countries are now at least part state-owned. The attitudes by those banks towards information exchange may therefore change.

In the same vein, it has also been suggested that regulatory reform might require that the parent company directors of these banks be responsible for the activities of their tax haven subsidiaries. In addition, the major financial centres have to decide if they wish to bring the funds, notionally resident in tax havens inside a domain for regulatory purposes on the basis that the funds management is located within their territory. Their right to do so is obvious: as the liquidation of hedge funds managed by Bear Stearns in the Cayman Islands revealed, there was no local substance to the Cayman Islands management of these entities; all decisions were taken in New York. If that is true for liquidation purposes, it is equally true for regulatory purposes: it is up to the regulators to make this point, and to claim their right to regulate these entities which would then become substantially more transparent as a consequence. All these reforms follow the familiar theme, noted above, of imposing control from outside the tax havens.
Some of those jurisdictions will refuse to cooperate. It is apparent that many have reacted to previous attempts to regulate them by promoting yet more secrecy, providing ever more sophisticated and obscure financial entities. This trend may well continue in some locations, such as Panama, Dubai and Singapore which remain largely outside the political control of other states which have made clear their commitment as the basis of their financial services industry.

For these states, sanctions are needed to ensure their compliance with internationally agreed standards of conduct. The cost of financial failure has now been identified, and its imposition upon the ordinary taxpayer of the world will in due course be quantified. As a result it is likely that the political will to reduce risks will be substantial. Those small states that refuse to participate in that process are likely to be the subject of considerable pressure. Many will succumb relatively easily. For example, all those jurisdictions under the influence of the United Kingdom will almost certainly be brought within the regulatory environment as a result of EU action. Others, such as Bermuda and Switzerland are clearly in the US sights lines. As they are targeted, the pressure on the remaining secrecy jurisdictions will increase. Then, and only then, will sanctions be imposed because the chance of further additional capital flight to another location will be eliminated as the number of available territories is reduced at that time.

How far away is this? It is hard to tell. Few would have predicted the progress in the battle against secrecy abuse that has been seen in 2008, or the change in the political climate that it created. The progress of the initiatives that have resulted will depend, in no small part, upon the severity of the recession in which the world now finds itself. But if, as expected, the impact of that recession will be long-lasting then the progress of these initiatives will be rapid simply because the governments of the world will need all the resources they can muster to support the creation of a new financial architecture in which stable banking institutions can trade. As their experience of owning banks progresses they will realise that the use of the capital that they provide to support secrecy jurisdiction transactions is not in their best interests. Then we can expect change. It might come as a result, sooner than anyone might have predicted. There is nothing like self-interest to spur action.
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The economic crisis or the failure of the model of deregulation:
The crisis that has been unfolding since the summer of 2007, first on the US financial market before spreading globally, hitting our economies and causing major social consequences, has shown how deeply intertwined the global economy has become. It has made the case for global governance, including all-encompassing regulation and multilateral surveillance. It also re-opens the pending debate between supporters of self-regulation or business-friendly attitudes on the one side, and partisans of public intervention on the other side. Finally, the crisis triggers a reflection on how to organise the checks and balances of the global financial system.

These debates were biased for a long time, because the advocates of market regulation were accused of hindering financial innovation which is seen as a major source of investment for the economy, and of chasing away capital through over-regulation. The financial innovation of the last years has undoubtedly enabled a considerable development of financing mechanisms for the economy. But it has also brought about a financialisation of the economy that in a period of cheap money didn’t result in an optimal allocation of capital. Capital looked for high returns first before thinking about long term investments that are essential for our economy to adapt to the vast challenges posed by globalisation, demographic ageing and climate change.

Today this crisis brings back to the agenda simple but healthy principles that had been forgotten; especially that high profit often bears high risks. After the collapse of the Bretton Woods system, 30 years of financial liberalisation on the global scale and ten years of cheap money that was driven by politics and promoted by the international organisations, this system has reached its limits. It is the end of the Reagan-Thatcher decades that have brought us to this real first crisis at the heart of the system. It shows that markets can’t be trusted to settle things on their own; they need rules within which to evolve. That is why I am deeply convinced that we socialists are actually the best allies of well functioning markets. We should act as regulators and not mere facilitators of market mechanisms and we must always keep in mind the global picture and long term objectives. Liberals perceive self-regulation as better regulation, but in doing so they are mislead. Markets are neither perfect, nor tend towards equilibrium. They are blind. Instead they follow cycles, oscillating between booms and busts. Future regulatory and supervisory frameworks must build on this "changed economic paradigm" instead of continuing to ignore it!

But there is more to the current crisis than the extraordinary melt down of financial capitalism gone mad due to a lack of structures. The deadly spiral of the US housing bubble fed by an illusionary faith in ever increasing real-estate prices, and a criminal distribution of credit, is only the symptom of a more complex phenomenon. This phenomenon is a short-sighted abuse of the factors that are at the heart of globalisation: communication and transport innovations. These innovations have led

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102 Member of the European Parliament and Chairwoman of the Committee on Economic and Monetary Affairs
to joint ventures with Western companies where goods are produced at low prices and low environmental standards; they are then shipped back and sold on the domestic markets.

This massive movement of outsourcing has transformed China into a global manufacturing workshop. It puts wages under pressure, especially in the US, where the device to keep the economy, i.e. consumption, growing, was the development of credit and indebtedness. This has created dramatic global imbalances where the richest nation in the world, the US, lives on credit on the expense of one of the poorest nations in the world, namely China. As we can witness now, this situation was highly unsustainable.

Today the large stimulus packages launched by the new US administration are welcomed as a great relief by the rest of the world that relies greatly on American growth. It is true that in the short run, they will contribute to getting the economy started again and towards recovery, but one has to be aware that this kind of intervention, if it is not very carefully designed, will only reproduce the causes and mechanisms that have lead to the current crisis. We urgently need to find a sustainable exit strategy, because one thing is certain, a return to the status quo ante is not an option!

The lesson to be learned from this tectonic move we are experiencing today is that we need strong multilateral surveillance mechanisms, including monetary policies in all countries, if we are to avoid the development of such bubbles and global imbalances in future.

It is this clash between both mechanisms on the micro and the macroeconomic level that lead to the mess we are currently in. Our answer therefore cannot consist merely of stimulus packages to revive industries from the past, or in capital injections for banks in distress. It has to be more comprehensive and address the system as a whole.

Tomorrow’s model, which I call “the second age of globalisation”, will be marked by the return of inflation, whereas in the last ten years globalisation has on the contrary led to a decrease of inflation. This should lead to real adjustments, such as a radical change in US consumption patterns which challenges the distribution of wealth, the development of another growth model for China more focussed on its internal market, a rise in influence of the euro as a reserve currency and a return to regulation and supervision of the financial markets. But these developments won’t take place without public intervention to direct and to shape them. No supranational entity is better prepared to play a leading role in this new age of rule-setting than the European Union.

Thoughts about regulation:

Today, the tools of normalisation and regulation have become major issues in the global competition. They can be used as a protective and sometimes even protectionist weapon. But the quality of regulation can also become an asset serving the strategy of a financial centre. This is a major field of competition between the EU and the US, and at present, international discussions are organised around the regulation drafted by these two regions.

One might wonder why and how alternative models to regulation, such as codes of conduct or self-regulation developed at all. For me, the explanation lies firstly in the complexity of technological developments and innovations. At some point, the legislator no longer had the necessary level of expertise required to impose rules on new developments and therefore gave way to professionals who necessarily
had vested interests in the norms they produced. It is, to some extent, the credit rating agencies’ conflict of interest, between an advisory function and a rating activity, transposed at a more global level. By giving up on his normative role in order to promote industry friendly regulation by private actors, the legislator also abandoned his role of promoter of the general interest; this led to an effective privatisation of regulation and a complacency vis-à-vis the development of tax havens.

A second set of explanations regarding the emergence of alternative means of regulation is that the public authority was lagging behind the economic actors’ global development. This is strikingly true in the whole debate around supervision. We are faced with cross-border, multinational conglomerates that no longer fit into the traditional categories of national and sector regulation. Their activities don’t fall within the remit of one single entity with the power and the means to monitor them. This raises a double set of questions: how to regulate and supervise such actors so that the totality of their activities is covered, and to what extent does this imply transfers of sovereignty? Are governments ready to give up some sovereignty for the sake of efficient supervision and regulation and what do they ask in return for this transfer of sovereignty?

In the turbulent times we are going through, some governments pretend to take action by resorting to protectionist tools. But these are an illusion because the crisis is global and because for one country’s economy to start exporting again, its neighbour’s internal market must also be in recovery. In a situation where the public opinion remains focused on domestic debates and politicians see the remit of their actions and of their careers only in the national arena, this kind of reflex can easily be understood. But it doesn’t provide us with efficient and sustainable answers. It is up to us as socialists to take the risk of long term and global initiatives. After all, internationalism has always been one of our founding principles and therefore we should be the ones to gear our actions to this end, remembering at the same time that we can never give up the short-term issues on which people expect us to deliver.

In doing so, I believe that three aspects need to be taken into account in elaborating a new means of regulation:

The first element is that there ought to be a new balance between actors. All stake-holders have to be taken into account when rules are drafted. Rules can’t rely on the expertise of the industry itself, but must reflect the concerns of consumers, users, employees alike. Taking the interests of all stakeholders into account is the only guarantee that a long-term dimension of action will be considered and that we put an end to short-term visions and behaviours.

Secondly, there needs to be a global, supranational authority in charge of the implementation of global financial regulation. It can’t be that norms are negotiated in international forums and that afterwards only some of the participants apply them. This undermines the authority of the principles and standards that have been drafted. Upholding multi-speed regulations and regulatory loopholes creates an unlevel playing field and fragilizes the entire system.

Beyond the question of how to draw up regulations, it is crucial to ensure that they are implemented and respected.

The example of accounting standards:
The dilemmas and challenges posed by the attempts at global rule-setting are perfectly illustrated by the example of international accounting standards (IFRS). This topic is not known by the wider public because it wrongly seems to refer to a rather technical and complex topic. But in reality, accounting standards have the primary
task of promoting transparency in financial reporting and the development and effective functioning of capital markets, the guarantee of avoiding pro-cyclicality and insuring financial market stability as well as preventing systemic risk.

Around the 70’s, there was an awareness at the European level that companies active on the (not yet finalised) single market needed to present their accounts in a standard format. The difficulty of this task was two-fold: harmonising national practices and finding an answer to the lack of standards that would have the capacity to reflect the complexity of the operations that were involved. The existing national accounting standards were not able to address this issue. At the time, some argued in favour of taking over the British or even the American standards. But instead of copy-pasting them, Europe made a daring move and decided to overcome its internal diversity and contradictions by enabling the drafting of international accounting standards. This was very attractive at the time as it was already clear that the future horizon of activity would be global. To a certain extent, this can be seen as the precursor to globalisation. From the start the United States developed an interest in this strategy and took an active part in the setup of the institutional framework in charge of drafting those new standards, notably around the concept of fair value. Some of these institutions were even based in New York.

As financial reporting involves highly public decision-making powers that have a major impact on many other areas of financial and even tax law, democratic legitimacy must ensure that the interests of all those affected are suitably represented and balanced in a transparent procedure using fair rules.

On the European side however, the Commission appeared to lack the human resources and expertise to take the lead in this process and therefore left it up to sector professionals. This means that no public authority defined the European interest in the process to ensure that the concerns of all stakeholders were taken into consideration. Moreover, the budget of these private normative institutions was funded by the private sector, which even further deprives the public authorities of power, influence and control. This is the first example of self-regulation in global capitalism. Whereas in other areas the Commission did take the initiative of drafting the rules that the EU needed even at times exporting them to the rest of the world, here, in the specific case of accounting standards, this activity was outsourced to a private body. The EU decision to oblige publicly traded EU companies to use international accounting standards from 2005 onwards significantly changed the context for the IASCF/IASB, which became a quasi law-maker, at least for the EU, because on the other side of the Atlantic, the US authorities took the view that IFRS, even though actively co-drafted by them, are not compatible with their own norms, the US GAAP (Generally Agreed Accounting Principles) and therefore refused to apply them.

Two lessons can be drawn from this case study. The first one is a positive one, because it shows where the power of the EU lies today. Indeed, since the generalisation of IFRS, the industry has called for endorsement of the IFRS in the US.

The second lesson to be drawn is less positive and sheds light on how we can improve in future. The lack of involvement on the part of public authorities in this whole process of drafting international accounting standards explains the current debates about the governance and the accountability of the IASB (International Accounting Standards Board), their integration in the global framework of financial governance and how to organise the European representation in its realm. Progress is finally under way, as the European Commission, after many calls from the
European Parliament, is now proposing to partly fund the international institutions that draft these standards which would increase its oversight over these institutions and their work. But this is only a first step and the whole issue of international accounting standards should be discussed on a political level in the framework of the G20 negotiations that will, hopefully, deliver profound changes in the international financial architecture.

A further example can be found in the case of credit rating agencies. Rating agencies perform a public role. Their task is to enlighten the markets. The ongoing financial turmoil has highlighted several concerns about rating agencies that the European Parliament has already voiced:\textsuperscript{103} conflict of interest, governance, reliability of ratings and rating of complex financial products. Transparency and understanding of underlying risks, in particular of complex financial products, need to be considerably enhanced. These concerns have been known for a long time and to avoid an unwelcome intrusion from legislators, the industry agreed on the introduction of a voluntary code of conduct in December 2004 under the auspices of the International Organisation of Securities Commissions (IOSCO). But the crisis has proven this code of conduct to be as ineffective as past ones.

In the end, the European Commission, which had been rather reluctant to address the issues that the European Parliament pointed out five years ago, put a proposal on the table to address them:\textsuperscript{104} The 3 big credit rating agencies that benefit from a quasi monopoly in their field deploy a lot of lobbying efforts to minimise the effects of this legislation and argue that a global activity like theirs can't be regulated locally. I strongly reject this argument and hope that the EU will put enough pressure on the G20 to deliver concrete results in terms of the regulation of credit rating agencies. It will be even more legitimate to do so if it manages to reach an agreement over the Commission's proposal beforehand. All this will take political voluntarism, a willingness to take action and a sense of responsibility that are mandated by the dramatic nature of the crisis. Moreover, the argument put forward by the industry, namely that ratings once issued are global by nature, only reinforces my strong conviction that such global goods or services have to be regulated very carefully.

The last point I wish to mention regarding credit rating agencies is the following one: beyond the huge responsibility they bear in the organisation and the functioning of markets, they also exert an abnormal influence on public authorities when rating sovereign debt. How can it be that private institutions that are sharing a market through a quasi monopoly and whose methodology and conflict of interests are largely questioned can put governments under pressure and influence structural reforms by threatening to downgrade the rating of their debt?

One solution to this problem that is largely debated today on the EU level is the common issuance of debt, so-called euro-bonds. This would be an interesting solution that I call for, but it doesn’t solve the principle problem of private institutions exercising a lucrative activity that puts democratically elected governments under pressure.

In these times when anything is possible, we as progressives should be bold enough to say that this system can't be right and that it doesn't serve the general interest of the people. We should call for an overhaul of public debt ratings so that it

\textsuperscript{103} cp. Resolution on the role and methods of rating agencies, 10 Feb.2004 (2003/2081(INI))

\textsuperscript{104} cp. speech by Charlie McCreevy, 7 February 2008: "Crisis or no crisis - Lessons for financial markets and regulators"
is put in the hands of public authorities such as a national and/or the European Court of Auditors.

Because the market has set the wrong incentives, another area where socialists should take the lead and call for global or at least European regulation is in the area of remunerations. I believe that market discipline and financial institutions’ corporate governance and incentive models (compensation) need to be revamped. Their short-termism has been a strong fuel for the entire system. Financial institutions should disclose their remuneration policy, in particular the remuneration and compensation packages of directors. Furthermore, disclosure and transparency should be combined with a requirement for supervisors to look into the remuneration packages of financial institutions, and if necessary require the supervisors to act. In their assessment of risk management, prudent supervisors should take into account the influence of remuneration, bonus schemes and taxation to ensure that they contain balanced incentives and do not encourage extreme risk-taking. Today we are told that this is not possible because of competition concerns. I agree that setting such rules on company or even national levels would distort competition and push top-executives to look for better conditions in other companies or abroad. That’s why I’m convinced that for this purpose guidelines should be designed at the European level. Here again, this should serve as a baseline for negotiation at the global level.

It is my strong belief that the crisis we are witnessing can’t be solved by conventional tools. It is not a cyclical crisis, but a systemic one. A qualitative change is needed and I am convinced that we as socialists have the right grid of analysis and tools to offer. The principles guiding our actions are that public authorities need to take back the lead in global standard-setting, that Parliaments can ensure that the executive takes this role seriously, and that Europe can be a motor in this process.
The crisis that is currently afflicting the capitalist world economy is commonly seen as an aberration. This aberration, it is argued, became possible because of the lack of adequate regulatory mechanisms with regard to the financial sector. The crisis could have been avoided with impunity if only sufficient safeguards, such as supervision and regulation of the financial sector, had been put in place. It represents an avoidable "system failure".

My purpose here is to argue that the current financial crisis represents not a failure of the system but the system itself, that it is the result of the modus operandi of contemporary capitalism rather than being unrelated or extraneous to it. The view that such crises are part of the modus operandi of modern capitalism is not some idiosyncrasy on my part; on the contrary it was central to Keynes’ analysis. And accordingly, those who argue that the crisis constitutes an aberration or a system failure, even though many of them advocate Keynesian remedies to get out of it in the present circumstances, are being at best “contingent Keynesians”. There is nothing wrong with being a “contingent Keynesian”. This fact should be noted; as should the fact that Keynes’ deep insights into the capitalist system have not yet been fully utilized in order to comprehend the current crisis.

Having developed his short-period theory of employment, Keynes sought in The General Theory to insert it into a theory of the trade cycle, and in doing so he observed an important characteristic of the cycle. He wrote: “There is, however, another characteristic of what we call the Trade Cycle which our explanation must cover if it is to be adequate; namely, the phenomenon of the crisis- the substitution of a downward tendency in favour of an upward tendency is often sudden and violent, whereas there is, as a rule, no such sharp turning point when an upward tendency is substituted by a downward one” (1949, 314). He saw the crisis as being endemic to the system, not an aberration in its functioning; as one of its essential characteristics as opposed to a symptom of its failure. He attributed the crisis to a sudden collapse in the marginal efficiency of capital, which in turn was related to the phenomenon of speculation.

He defined “speculation” as distinct from “enterprise” as follows: “If I may appropriate the term speculation for the activity of forecasting the psychology of the market, and the term enterprise for the activity of forecasting the prospective yield of assets over their whole life, it is by no means always the case that speculation predominates over enterprise. As the organization of investment markets improves, the risk of the predominance of speculation does, however, increase” (1949, 158). Speculators in short are concerned, according to him, “not with what an investment is really worth to a man who buys it ‘for keeps’, but what the market will value it at, under the influence of mass psychology, three months or a year hence” (1949, 155).

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106All quotations from Keynes are taken from the 1949 edition of The General Theory of Employment, Interest and Money, Macmillan, London. The page numbers are given in brackets.
Now, monetarist writers, whose views have come to dominate the economics profession in the period of neo-liberalism, see speculation as price-stabilizing in asset markets, and hence as an altogether benign phenomenon. And, precisely because it is a benign phenomenon, it has little analytical significance for explaining booms and crises. Speculation according to Keynes however did not give rise to asset-market stabilization but to bouts of euphoria or “speculative excitement” as he called it. And he was right; speculation in real life is far from being asset-price-stabilizing.

This is obvious from two recent examples. Oil prices which rose to an incredible $140 per barrel in early 2008, had crashed to as low as $35 per barrel within less than a year. Likewise the stock markets in “Emerging Market Economies” have moved within the space of a few months in the most volatile manner. In India for example, the stock-exchange price index, the Sensex, which was escalating by almost a thousand points a week to reach 21000 just a few months ago, has now crashed to less than 9000. Neither the earlier escalation nor the current collapse can be explained by any non-speculative factors, i.e. by any hypothesis that holds speculation to be price-stabilizing. The same is true about the incredible rise and fall in oil prices.

Speculation generates bouts of euphoria or “speculative excitement” which have the effect of pushing up asset prices in a cumulative manner. An initial rise in some asset prices, no matter what the cause, gives rise to expectations of a further rise, and hence to an increase in the demand for the assets in question which actually contributes to raising their prices further; therefore, the process feeds upon itself and we have asset price “bubbles”. Such “bubbles” typically characterize financial assets, which have low carrying costs and hence are more prone to speculation; but they are not confined to financial assets alone (as the housing market “bubble” in the United States has demonstrated).

Such “bubbles” have an obvious impact on the real economy. The rise in asset prices fed by speculative euphoria improves, for the individuals who own these assets, the estimation of the position of their wealth, and hence causes an increase in their consumption expenditure, and as a consequence an increase in employment. Likewise such a rise in asset prices, where the assets in question are producible, causes an increase in investment expenditure on those assets, which leads to their larger production, and hence to more employment. In short, speculative euphoria in the asset markets leads to a situation where the boom of the real economy, stimulated by whatever had caused the initial rise in asset prices, becomes more pronounced/prolonged. Or, putting it differently, speculation acts as a “super multiplier” (to use a term coined by the English economist John Hicks) or “compound multiplier” (as Polish economist Oskar Lange put it) upon the real economy. Speculation itself does not engender the boom; but it contributes to a prolongation of the boom by the euphoria it generates.

However, if for some reason the asset price increase wanes or comes to a halt, speculators attempt to sell off the assets in question causing a crash in the asset prices. This causes a reduction in consumption expenditure (because of the wealth effect), a collapse in the inducement to invest (since the price of the capital asset falls below its cost of production); a collapse in the state of credit, as banks face insolvency; and even a possible collapse in the inclination of depositors for holding bank deposits, which was the case during the Great Depression. In short, there is no longer any confidence in holding claims upon others, and hence a corresponding increase in liquidity preference; i.e. there is a disinclination to hold any
asset other than pure cash. Not all crises display this severity; but to a greater or lesser extent these features mark any crisis.

Speculation therefore has the effect of making the boom more pronounced and/or prolonged; but it also has the effect of precipitating a crisis as distinct from a mere cyclical downturn. In the absence of speculation the boom in the real economy will be a much more truncated and tame affair. But precisely, because it is not a tame affair it is followed by a crisis.

Two conclusions can be drawn from the above analysis based on Keynes. First, since speculation is endemic to modern “free market” capitalism, where financial markets play a major role, speculation-engendered euphoria and the consequent pronounced booms, together with crises, in the sense that Keynes had defined them, are also endemic to modern capitalism. “Bubbles” constitute in other words the *modus operandi* of the system. Secondly, if “Bubbles” must be eliminated and speculation curbed, then it is not enough to put in place some regulatory mechanisms; *an alternative instrument for generating pronounced booms in the real economy has to be found*; otherwise, the economy would remain more or less perennially sunk in stagnation and mass unemployment.

The contrast between Keynes and Dennis Robertson, a well-known Cambridge economist who was a younger contemporary of his, on this question is instructive. Robertson had argued that to eliminate the trade cycle, and hence by implication the rigors of the crisis, monetary policy should aim at increasing the rate of interest to truncate the boom deliberately; that is, whenever employment rose above the average level of the past decade or so, monetary policy should deliberately aim at preventing such an increase; and likewise whenever employment threatened to fall below this average level, monetary policy should be used to counter such a fall. Robertson thought that full employment was an “impractical ideal”, but monetary policy of this sort, while stabilizing employment at some level less than full employment, might well do so at an average that was higher than what would actually be obtained on average if the trade cycle ran its full course. Keynes was sceptical about this last proposition, and indeed thought that the opposite was more likely. But, above all, he felt that such an outlook was “dangerously and unnecessarily defeatist. It recommends, or at least assumes, for permanent acceptance too much that is defective in our existing economic scheme” (1949, 327).

Instead, what he suggested was that government policy should aim to achieve full employment; his suggestion was that when “disillusion” came, and with it the “error of pessimism” that threatened a collapse of the boom, monetary policy should aim at lowering the rate of interest to keep the boom going. “Thus the remedy for the boom”, he wrote, “is not a higher rate of interest but a lower rate of interest! For that may enable the so-called boom to last. The right remedy for the trade cycle is not to be found in abolishing booms and keeping us permanently in a semi-slump; but in abolishing slumps and thus keeping us permanently in a quasi-boom” (1949, 322).

But, above all, taking the economy close to full employment and keeping it there was not a task exclusively of monetary policy; fiscal policy had to be used in addition, with the State playing a pro-active role in demand management. Keynes in short wanted the regime of “bubbles-led growth” such as characterized so-called “free market capitalism” in the era of finance to be replaced by a regime of State-led growth or fiscally-stimulated and fiscally-sustained growth

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107 In drawing this contrast I do not mean that the “bubbles” are not themselves fiscally-aided. The dotcom and the housing bubbles in the U.S. for instance were aided by significant tax concessions by the government. But there is a difference between fiscal aid for a “bubble” and fiscally-sustained
The fact that finance capital would oppose such State intervention in demand management, or what he called the “socialization of investment”, was anticipated by Keynes, hence his remark about the need for the “euthanasia of the rentier”. After all, when Lloyd George, who had been the British Prime Minister during the first world war, had put forward a proposal on Keynes’ advice in 1929 for public works financed by government borrowing to mitigate unemployment, which was already quite high by then in Britain, the British Treasury, under the influence of the financial interests represented by the City of London, had come out in opposition to it. This “Treasury View”, which upheld that any such borrowing-financed public works project would “crowd out” private investment, to use a contemporary phrase, had called forth, by way of intellectual rebuttal, an article by Keynes’ pupil Richard Kahn in the *Economic Journal* in 1931, which can be considered the first salvo of the “Keynesian Revolution”. Keynes was thus familiar with the opposition of the financial interests to his proposals.

Keynesian “demand management” managed to overcome this opposition and gain currency only in the post-war period, when there was a changed correlation of class forces all over the world, with finance capital in retreat and with working class movements, whether expressed through Communist or Social Democratic movements, in the ascendancy. This conjuncture however, even though it lasted for well over two decades, finally had to change. Finance capital, strengthened over time, even during the period of Keynesian demand management, by what Marx had called the process of “centralization of capital”, eventually acquired the nature of *international finance capital*, through a process of “globalization of finance”. As a consequence, the incompatibility between the caprices of finance capital and State intervention in demand management became insurmountable. With “globalization”, the caprices of such *international finance capital* necessarily had to triumph over whatever autonomous predilections the *nation-State* had, otherwise, there would have been capital flight from the economy in question; and this led to the demise of Keynesianism.

But let us leave aside for a moment this changing historical conjuncture. The important analytical point that emerges from Keynes’ writing is that in the absence of State intervention in demand management through the use of fiscal means, the process of growth under capitalism is bound up with the existence of “bubbles”. Bouts of speculative excitement followed by “disillusion” and “errors of pessimism” are the hallmark of capitalist dynamics. *Hence periods in capitalism which are not characterized by Keynesian demand management, which means both the pre-war years and the post-“Keynesian” years of neo-liberal policies under “globalization”, would necessarily be characterized by “bubbles-sustained growth”, in which case “crises” cannot be seen as constituting “aberrations” or “system failure” but must be seen as the system itself.*

Not to do so amounts to analyzing the neo-liberal epoch as if it were still characterized by pro-active Keynesian State intervention; it is to miss the distinction between the “Keynesian” and “neo-liberal” periods of post-war capitalism. In the Keynesian period, a financial crisis of the current sort would indeed have been an aberration; and it is not surprising that the first major financial crisis to hit the capitalist world occurred only in 1973 (i.e. after the “Keynesian” era had ended, with growth, which typically involves the erection of a regime that tries to restrict the formation of bubbles through regulatory measures.
the introduction *inter alia* of free financial inflows among major capitalist countries). But under the “neo-liberal” dispensation it is the rule, exactly as Keynes had argued.

It follows that in the United States in the recent past if “sub-prime” loans had not been given, or if financial “oversight” had led to brakes on lending, or if the rate of interest had not been lowered, then the boom would have come to an end much sooner than it did, and unemployment would have increased much earlier. True, the crisis would not have been as severe or sharp as it has turned out to be, but the price paid for a possibly less severe crisis would have been a less pronounced or sooner truncated boom. After all, Alan Greenspan was doing exactly what Keynes had suggested, namely to keep the boom going by lowering the interest rate, so that either the old “bubble” continued or some new “bubble” was generated that would take the place of the bursting old one. The fact that the “housing bubble” that was stimulated by the decline in the interest rate enforced by Greenspan kept the boom going even after the “dotcom bubble” had collapsed only vindicated Greenspan’s position.

Of course any prolongation of the boom in this manner brings with it the danger of a more severe crisis attending its collapse, but then the real panacea for it is not the truncation of the boom but its sustenance through other means, in particular fiscal means. In short, it is not enough to say that “sub-prime lending should have been avoided” or that “the interest rate should not have been steadily lowered” or that “financial regulation should have been tighter”. All these statements have to be accompanied by some alternative suggestions for prolonging the boom; and these would necessarily have to focus on fiscal effort, exactly the way that fiscal effort is being emphasized now as the way out of the crisis by the “contingent Keynesians”. To what extent, and under what other concomitant conditions, the U.S. would have been able to substitute fiscal effort for financial laxity as the means of sustaining the boom, especially in view of the “leakage” abroad of the impact of any fiscal stimulus because of its large import propensity, is a matter that need not concern us here. But the point is that, since financial laxity played a role in sustaining the boom, merely debunking it as the cause of the crisis is inadequate.

Putting it differently, since the so-called “system failure” could not have been avoided with impunity; it is misleading to call it a “system failure”. Rather it is the system itself which was at the root of the trouble. The “system” itself could of course have been replaced by an alternative “system”, State-led as opposed to “bubbles”-led growth. But that would have meant going back to the era of Keynesian demand management, which the advanced capitalist countries, pursuing neo-liberal policies,

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108 This should not be taken to mean that fiscally-sustained booms, which overcome the syndrome of bubbles and the bursting of bubbles, can for that reason last forever. They obviously cannot, but what constitutes the limit to such booms is a matter that need not detain us here. One possible limit is the emergence of supply constraints, especially when the possibility of obtaining primary commodities *gratis* from the colonies via what economic historians have called the “drain of surplus” through taxation is no longer available; such supply constraints can result in extremely high rates of inflation in the presence of speculation. The last section of this paper discusses such speculation-engendered inflation. To prevent such speculation a “Keynesian demand management regime” must ensure social control over the financial sector. In other words, “socialization of investment” requires as a necessary complement “social control over the financial sector”. Even if this is assured, a fiscally-sustained boom will still not last for ever because of class reasons, such as class conflict over distributive shares, and the undermining of the discipline that capital imposes on labour. See M.Kalecki, “Some Political Aspects of Full Employment” in *Selected Essays on the Dynamics of the capitalist Economy*, Cambridge, 1971; R.E.Rowthorn, “Conflict, Inflation and Money”, *Cambridge Journal of Economics*, 1970; and P.Pathaïk, *Accumulation and Stability Under Capitalism*, Clarendon Press, Oxford, 1997.
including the policy of “sound finance”\textsuperscript{109}, under pressure from international finance capital, had already abandoned.

To argue the “system failure” or “aberration” thesis presupposes that the “aberration” did not contribute anything positive to the real economy; that in its absence the system would have performed almost equally well. In short, it amounts to saying that the system itself can perform adequately without these “aberrations” and hence also avoid crises, but these “aberrations” gratuitously superimposed upon the system because of lack of “oversight” and lack of regulation, even while not contributing anything positive to the functioning of the system, contribute towards a “system failure” and a resulting crisis. It also suggests that Keynesian measures are needed only because of this “system failure”, since once the crisis has hit the system the normal monetary policy instruments cease to work; but in the absence of such “system failure” these normal monetary policy measures are quite adequate for the system.

Paul Krugman, currently a strong advocate of a Keynesian fiscal stimulus, is quite explicit on this. He argues for instance that the “Treasury View”, which held that a fiscal deficit “crowded out” private investment and which Kahn had criticized in his famous\textsuperscript{1931} article, “makes good sense” in normal times. His argument is not of the simpliste kind which holds that the interest rate equilibrates the demand for and supply of “savings”, or of “loanable funds” or some other flow variable, and that a fiscal deficit, by increasing the demand for such a flow variable, “crowds out” private investment. On the contrary he sees the interest rate as being determined by monetary policy. But he argues that even in the case of an accommodative monetary policy, i.e. even if the short-term rate of interest, which is fixed by the monetary authorities, is kept unchanged, the long-term interest rate will nonetheless rise in the event of larger government borrowing. This is because the long-term interest rate is determined by the expected average of short-term rates, and people expect the short-term rate to be jacked up in the wake of the fiscal deficit’s increasing the level of activity.

Since this is supposed to happen in “normal” circumstances, let us now focus exclusively on “normal” circumstances. In such circumstances, people will expect the short-term interest rate to be raised only if there is no full “crowding out”, i.e. only if the level of activity increases in the wake of the fiscal deficit. But in such a case the total magnitude of profits, and hence the rate of profit, will also increase which will push the marginal efficiency of capital schedule outwards. If this happens then despite people expecting the short-term interest rate to rise in the future, there will be no reason why there will be any crowding out at all. In other words, if we assume full “crowding out” then there is no reason why the interest rate should at all be expected to rise and hence for any crowding out to occur at all, which invalidates our assumption; on the other hand, if we assume partial “crowding out” then the rate of profit must increase which implies that even if the rate of interest is expected to increase there need be no crowding out at all. Thus whichever way we look at it, the argument is flawed, and reflects the discomfort of contemporary economists, even radical ones, with Keynesianism.

\textsuperscript{109} The U.S., being the leading capitalist power whose currency is still considered “as good as gold” by the world’s wealth-holders, is not obliged to follow policies of “sound finance”, since capital flight will scarcely occur from the U.S. Indeed the U.S. has often run up substantial fiscal deficits even when the other capitalist countries were being obliged to restrict their fiscal deficits. But even in the U.S. there is a perennial pressure for fiscal “prudence” in the contemporary period.
Krugman argues for a Keynesian fiscal stimulus in the current situation, because he contends that, the advanced capitalist economies are in a “liquidity trap” where there is no expectation of a rise in the interest rate in the foreseeable future, and hence no question of any “crowding out”. But since private spending is not sufficiently forthcoming, a fiscal stimulus is essential.

This illustrates what I call “contingent Keynesianism”, that in “normal” times we do not need Keynesian fiscal stimulus because the economy performs adequately without it. But only when an “aberration” occurs, of the sort we currently have, a Keynesian fiscal stimulus becomes necessary. But this distinction between “normal times” and periods of “crisis” resulting from “aberrations” is itself invalid. If in “normal” times fiscal stimuli are avoided because they supposedly “crowd out” private investment, then such “normal times” must be characterized by “bubbles-led growth”, as Keynes had suggested, in which case the “crisis” must be seen as being embedded in such “normal times”.

The “contingent Keynesian” argument restricts the application of Keynesianism to crisis periods alone (this is reminiscent of the Austrian economist Joseph Schumpeter’s concession to Keynesianism that it could be legitimately considered only as the economics of the “depression” period) when “sound finance” has to be abandoned because monetary policy ceases to work as the economy is caught in a “liquidity trap”.

A word on the concept of the “liquidity trap” may not be amiss here, since it is commonly misunderstood. The usual interpretation of the concept, namely that at a certain interest rate the demand for money becomes infinitely elastic because bond prices are so high that everyone becomes a “bear”, is meaningless: if people still hold bonds at this interest rate, the question arises: why do they do so? And if they do not hold any bonds, i.e. all bonds are held by banks; in this case the idea of an infinitely elastic demand for money loses all meaning. The “liquidity trap” cannot be reflective of a state of equilibrium in wealth-holding decision, as the liquidity preference schedule is. Any point on this schedule shows the demand for money at a certain interest rate on the presumption that this demand is the aggregation of individual demands if every individual reaches equilibrium with regard to the form in which he or she holds his wealth at this interest rate. But this cannot be said of the “liquidity trap”. The “liquidity trap” is not reflective of a situation where every individual is in equilibrium with regard to his or her form of wealth-holding at the corresponding interest rate. The “liquidity trap” therefore can never be considered a part of the liquidity preference schedule, as is usually depicted in textbook diagrams.

It can only be considered as a state of affairs arising in the context of a dynamic disequilibrium where, at the prevailing interest rate, people prefer holding money to holding bonds, but are content to hold their existing portfolios even if these are not optimal from their points of view. It is in other words a situation where the ex ante demand for money at the prevailing interest rate is higher than the ex post holding of money for all economic agents, including banks, but this fact does not alter the interest rate because agents are content to let this divergence persist.

This situation of “excessive” liquidity preference typically is supposed to be unrelated to the state of the marginal efficiency of capital schedule, and the “liquidity trap rate of interest” is simply supposed to generate, given the state of the marginal efficiency of capital schedule, an amount of private investment that is way below what full employment, or even an adequate level of employment, warrants. But this understanding is erroneous. Liquidity preference and the state of the marginal
efficiency of capital schedule are themselves not unrelated, the desire to hold money being simply the obverse of the collapse of the marginal efficiency of capital schedule.

This fact is missed by many writers who hold the existence of an independently given "liquidity trap" as the main reason why the self-equilibrating nature of the labour market may break down, i.e. why a crisis of persisting unemployment may arise. (Here we are talking about general perspectives and not specific explanations of the particular crisis of the present). The liquidity trap however, is not the cause of the crisis, in which case since the occurrence of such a weird phenomenon of excessive liquidity preference can be assumed to be rather rare, the crisis itself would be rather rare. It is on the contrary a result of the crisis, or more accurately a reflection of the crisis which as we saw earlier is endemic to the system and is marked by a collapse of the marginal efficiency of capital.

Much of the monetarist critique of Keynesianism is based upon this misinterpretation of the "liquidity trap" as being the cause of the crisis, the "fly in the ointment" that alone can prevent the smooth self-adjustment of markets including the labour market. As long as the liquidity preference schedule is downward sloping and the interest rate can be pushed down with an increase in money supply in wage units (i.e. relative to the money wage), a money wage cut will always raise employment exactly as orthodox theory predicts. Only in a liquidity trap, however, things will be different. And if a liquidity trap represents such an extreme case that it is more curious than anything else, then all is well with orthodox theory.

But this interpretation both of the "liquidity trap" and of Keynesianism is wrong. Once we see Keynes' theory in the context of a cyclical process where the cycles are associated with the building up and bursting of speculative bubbles, then clearly "excessive" liquidity preference, characteristic of the crisis, or the bursting of the bubble, becomes a real life phenomenon. And when there is this excessive liquidity preference, captured in the concept of the "liquidity trap" neither monetary policy, nor any money wage cut can eliminate unemployment. The self-equilibrating market disappears into thin air.

To be fair, the "contingent Keynesian" position perhaps sees the situation of "excessive" liquidity preference in this manner; but it attributes its emergence to aberrations rather than the very functioning of the market system in the context of speculation. But precisely because it is "contingent Keynesianism" its belief that the "normal" functioning of the market is smooth, weakens its own case vis-à-vis the orthodoxy. The fact that the idea of a coordinated fiscal stimulus by a group of advanced countries, which was an idea put forward by Keynes during the Great Depression (the same idea had been put forward by many others including several German Trade Unionists) and which was revived recently during the G-20 meeting, has been pushed into the background of late, is the result of pressure from international finance capital, and has therefore to do with material interests rather than with intellectual reasons. But the intellectual diffidence of "contingent Keynesianism", which concedes to orthodoxy theory that its analysis is valid in "normal times", certainly does not help its cause.

So far, I have discussed only one aspect of speculation as it affects growth under contemporary capitalism. Let me now move on to another aspect. The boom creates inflationary pressures in critical primary commodities like oil. In the case of agricultural primary commodities, any inflationary pressures can be kept in check through the imposition of an "income deflation" on third world economies from which many of these agricultural primary commodities originate, and where there is much
absorption of all such commodities\textsuperscript{110}. But in the case of oil, where the major producers are organized into a cartel, the question of imposing such income deflation simply does not arise. In the case of oil, and hence of such other commodities whose prices move in a manner complementary to oil, such as food-grains in the recent period because of the diversion of grains towards bio-fuels, the capitalist boom is associated with inflationary pressures which are aggravated by speculation. Even in the case of agricultural commodities, whose prices are not directly linked to the price of oil, speculation may still lead to substantial increases in their prices, notwithstanding the income deflation imposed on third world countries through the “neo-liberal” policies associated with globalization.

In short, if in the boom speculation operates on prices of assets, especially financial assets which keep the boom going, it also operates on the prices of commodities, which threaten the boom and which in any case bring great hardships, even during the boom, to the ultimate users of such commodities. (The benefits of such speculative price rises of commodities scarcely accrue to the direct producers of such commodities, who, in general, are peasants and petty producers). It follows, that even if the world economy gets out of the current crisis of recession, that fact will only reopen the prospects of commodity price inflation. The recession caused by speculation is bad enough; but the inflation caused by speculation that follows in the wake of the world economy moving out of the recession will be scarcely better.

Speculation in the area of international finance capital in short pushes capitalism into a crisis of a profound sort, where the “crisis” as Keynes saw it is embedded within an even deeper crisis, whose hallmark consists in the fact that overcoming the crisis of recession will almost immediately, or within a fairly short period, push the economy into commodity price inflation, especially oil price-inflation, which will have serious consequences for food-grain prices hence for mass hunger. The system’s space for operation shrinks drastically because of speculation in contemporary capitalism.

\textsuperscript{110}For an explanation of the concept of “income deflation” and an elaboration of this argument, see P.Patnaik, “The Accumulation Process in the Period of Globalization”, www.netrokideas.org
1. Introduction: from financial crisis to the risk of wage deflation

The 21st century started with favourable omens for developed capitalist countries. The organised labour movement was weakened and divided. Emerging economies were poised to take-off. The US was consolidating its financial, economic and military primacy. The European Union, lacking international political relevance, pursued its enlargement and culminated its path to integration with the introduction of a common currency, the Euro. Markets were in the midst of a strong drive for deregulation. Globalisation, increasingly driven by international finance, accorded the leading role to markets regulating themselves but only a secondary one to government intervention.

However, the financial factor, which had taken the lead in shaping up the new economic order, was to become the triggering factor for the biggest crisis to shake capitalism since the Thirties. Financial crises are nothing new, but they tend to be more frequent and severe since the economy has become increasingly virtual and finance took on a life of its own away from the real economy. The current process of accumulation is no longer reliant on modernising production processes and social institutions, such as was the case under the Ford system. The markets tend to behave anarchically in the grasp of international finance which has been moving away from the real economy as the value of the whole array of financial instruments exceeds by far that of the underlying real assets on which they are based.

Financial crises have become recurrent since the 90’s. For instance, the Asian Crisis was a dark foreboding of how deep financial crisis can grow in a global system which is so little regulated and as opaque as the present one.

As remarked by Stiglitz112, when short-term capital markets are liberalised prematurely, before the development of adequate supervisory bodies, they prompt banks to grant an exceedingly large amount of credit without due risk assessment, increasing the likelihood of financial crises and economic downturns. Financial crises have become inherent to the system. This situation should have paved the way for greater intervention by public authorities to help prevent and avert their spreading. Nowadays a financial crisis brought about by the excessive indebtedness or leveraging of credit institutions, companies and consumers, is coupled with a “classic” crisis which finds its roots in the necessary shedding of debt, the vanishing of the “wealth factor” linked to the plunge in the prices of movable and immovable assets, the retrenchment of investments, the deterioration of the labour market, tighter wage restrictions and morose consumption. These phenomena may only be partially offset by a drop in interest rates and bigger budget and fiscal stimuli. The

111 Mr. Francisco Rodriguez Ortiz, Professor of European Studies, Deusto University, Bilbao

real economy was bound to fall into the trap created by globalised finances and, with a fallback effect at play, the financial sector is now in turn stricken by the adverse effects of the economic downturn.

The current crisis shows another unique feature: not only is it global, having spread from the real estate to the credit sector and from there to all the economic sectors, but also because unlike the 1998 Asian crisis, its hard core is to be found in the leading capitalist countries, from where it radiates to the periphery. Contrary to the “decoupling” theory, emerging economies will be hard hit by an increasingly systemic crisis mirroring the cracks in the worldwide economic interdependency and the capital appreciation systems.

Global as the crisis may be, the macroeconomic actions undertaken by governments have been lacking in coordination, as shown by the various choices used to manage monetary policy. As for the Euro-zone, not only had it to contend with the adverse fallout from the international crisis, but it also had to absorb the results of a mismatched monetary policy devised for an altogether different reality, plus being hamstrung by the inconsistencies in the Growth and Stability Pact and having to comply with a competition policy which hampers the rebuilding and dynamization of the industrial fabric. Growth and stability are perceived\(^{113}\) to be paramount “public goods” for the achievement of full employment, economic and social cohesion, environmental protection, etc.

Mistakes in macroeconomic policy and financial markets' regulation have triggered inadequate moves in the real estate and financial markets, all the more so since the risks stemming from a liquidity glut in the world had been underestimated. At a later stage, the various options to get out of the crisis might help in coalescing the forces most hostile to the legacy of the “European social model”. In a context of mass unemployment, the alibi of improving competitiveness as the way out of this crisis may well engender a growing challenge to the social gains won by workers in the more developed countries.

As underlined by Aglietta\(^ {114}\), the new competition conditions shift the brunt of the necessary adjustments to the wage earners. These wage restrictions will be all the more acute in the short term and will be explained away as being a requisite for improving the bottom line of businesses, notwithstanding its negative effect on the spending capability of individuals. Our societies, plunged in a deep downturn, are less vocal about income redistribution and are showing a greater tolerance for inequality. And yet, underlying the present economic downturn and financial crisis, there lurk the abuses in the deregulation of labour markets, long taken to embody the very paragon of a rigid market. Developed countries seem to opt for a non-cooperative strategy of competitive wage deflation, although there is a danger that such restrictive wage policies end up fuelling the deflationary trends already underlying the new model of accumulation.

The current crisis challenges the very feasibility of a financial model which is becoming more and more speculative. Employment will shrink, while consumption and investments will dwindle. The credit crisis will buttress the retrenching effects. Housing demand will retract further, and there will be a sharp decline in both their prices and employment figures. All of this will rebound negatively on the financial sector itself.


2. Factors which have triggered the international economic and financial crisis

2.1. On Greenspan monetary policy and its economic effects
Between 2001 and June 2004 US economic growth was encouraged by the accommodating monetary policy applied by the Federal Reserve. The Federal Reserve deployed a defensive strategy focused around offsetting the impact from the drop in stock exchange earnings through a promotion of the real estate and bond markets. Monetary policy had to furnish the financial system an ample supply of liquidity, stimulate expenditure by individuals and bring down investment costs. The steep drop in interest rates, which became negative in real terms, led to an increase in real estate wealth, which allowed households to offset the drop in value of their financial assets from 2000 to 2002. This appreciation of real estate equity in conjunction with strong job creation encouraged individuals to raise more debt, and later use the rise in the value of their collateral to take on more credit. Financial institutions, too, became increasingly leveraged. The outlook of constant price increases in real estate equity prices heated the market, paving the way to the subprime situation. The strength of the whole structure was underpinned by the assumption that interest rates would not rise and the assets would keep on appreciating. The drop in interest rates led to indiscriminate granting of mortgages, which underwent securitisation, and to the issuing of corporate debt. In an environment with an oversupply of liquidity there was a swollen demand for assets endowed with a high credit rating. In addition to that, many countries were in the midst of budget consolidation processes and the amount of public debt was therefore bound to be scarce. To meet this growing financial demand would result in the creation of the most complex financial engineering. Debt types of various kinds were packaged and marketed. Many products were simply devoid of regulatory frameworks, and the maximisation of earnings led many institutions to take on an excessive amount of debt to be able to purchase those assets. Investment banks, not supervised by the Federal Reserve in their liquidity and solvency ratios, would drive their leverage ratios to unprecedented levels.

“Ivestment banks, being free of controls, can leverage at a much higher level than commercial banks, thus taking advantage of the high shadow price of financial regulation. In a market with negative interest rates and a two digit growth in real estate assets, the temptation to cobble together instruments which would make it possible to finance real estate credit, and to sell them to investors who were greedy to get high earnings, was huge.”

Should monetary policy change course and the real estate market crash, purchasers would default massively and the financial instruments of this market would skydive. Assets would turn illiquid and mistrust would spread through the interbank market. As the credit market shut down, financing problems in the housing market would be exacerbated, with a most deleterious effect in the creditworthiness of the financial market.

Even though the Federal Reserve tightened up monetary policy from June 2004, long rates did not absorb the rise in short rates (oversupply of world liquidity until 2007, credibility of the US financial system, demand for risk free certified long

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rates claims from loan and savings banks, etc.). This was in part due to the expectation that structural adjustments changes (increased competition in markets, technological breakthroughs and productivity gains, massive imports of manufactured products from low cost countries, wage restraint in the face of relocation threats, precariousness in the job market, salary levels no longer linked to inflation, etc.) would make it possible to curb long term inflation. So, it turned out that the new conditions shaping up accumulation made credit policy far more accommodating than what would otherwise have been the case if judged only from the Federal Reserve actions. Nevertheless, the matching of long and short rates continued to be a source of problems.

“The near match of long and short rates continues to pose serious problems. On the one hand, it weakens considerably the banks profit margin and their economic balance (they borrow short and lend long). On the other, it deprives monetary policy of any room for manoeuvre, making further increases extremely dangerous and nullifying its current effects on inflation.”

Financial globalisation and an international liquidity glut, due to the US overindebtedness, made monetary policy transmission channels less effective. As noted by Vladimir Borgy:

“however, the most persuasive explanation is a process by which the US excessive indebtedness has led to excessive world liquidity, keeping interest rates at an abnormally low level and fuelling rises in assets prices, in such a way that ultimately it degrades the implementation of US monetary policy”

Greenspan’s policy of cheap money and diversified risks would create a real estate bubble in the US which would spread to the world financial markets through the explosive emergence of financial products linked to real estate assets and a boom of the more speculative hedge funds.

2.2 On the companies' financial leverage

The low cost of financing and credit facilities have made it easier for companies to take on increasingly higher levels of debt. They have used debt on a massive scale to raise their profit margin and to distribute generous dividends. This has pushed up the stock quotations of companies which used their shares as collateral to raise new loans. In this way their financial leverage became extraordinarily high since the cost of the debt was below their profitability (ratio between operating results after tax and the sum of equity and debt). But should monetary policy change course, companies and investment funds holding debt at variable rates would be in dire straits. The debt burden would simply be too high in relation to the market value of their assets and the banks’ balance sheets would consequently be weakened. As remarked by Michel Aglietta, “creation of worth derives then from a rationale based on making imbalance a permanent goal”. Stock markets would turn upside down and companies would no longer be in a position to release the necessary financial flows to service their debt. Whereas earlier they were eager to pile debt upon themselves, now they wanted to get rid of it. They would then be facing a contradictory restriction in this adverse stage of the financial cycle: they would need to trim their investments and achieve high profit margins to boost equity and soften the blow of financial

116 Le Héron, Edwin: “Alan Greenspan, la stratégie de la confiance”, Alternatives Economiques
118 Aglietta, Michel ; Berrebi, Laurent: Désordres dans le capitalisme mondial, Odile Jacob, Paris 2007, page 41
leveraging. From there would follow greater pressures to tighten up the labour market and bring down wages to be able to reduce unit labour costs.

2.3 Subprime crisis and crisis of the financial system
The primary core of the crisis is to be found not so much in the growth of mortgage defaults as in the financial edifice built upon real estate mortgages. More worrying than the defaulting of subprime mortgages was the exponential growth of losses for those who, through misuse of financial leveraging, had invested on paper linked to the payment of such mortgages. The system was heading for a fall off the cliff if, with debt-financed leverage levels which could be 50 fold (assets being up to fifty times bigger than capital), the assumption that housing prices could not plunge turned out to be wrong. The model had not taken on board those risks inherent to the primary market (housing). The subprime crisis would have remained in the real estate market had it not been for the generalised securitisation of loans by the banks. Banks spread these complex products among international investors using them to refinance and grant further loans.

The financial crisis dries up the interbank and credit markets. Banks can no longer resell their real estate linked assets. The mark to market value of such assets does not stop shrinking. The banks are in the eye of the storm for several reasons: they have traded directly in the US mortgage market, they have bought claims and have granted loans to customers to finance transactions in the securitisation market. They are being walloped by the problems and bankruptcies of the funds they loaned to, and they sustain losses derived from the explicit or implicit liabilities they had entered into with them. The number of players swept up in the process, through securitisation and leverage, is very high, even without having traded directly on the US mortgage market. The losses have eaten into the banks' capital, and they have responded by cutting back on their credit lines. The “guarantee” which came with an AAA rating turned out to be a deadly trap. Should the banks fail in transferring those loans to institutional investors, they would remain as assets in their balance sheet. This would inhibit their credit capability, all the more so since their ability to grant loans was already curtailed because they had committed large amounts of equity to finance corporate transactions.

José Carlos Diez mentions a “financial decelerator”. The decline in housing prices weakens the ability of households to raise debt. Companies encounter more problems to raise fresh financing, and the situation is compounded by the financial institutions' liquidity problems, leading to a further credit crunch. Impact on employment is devastating. Families, facing a restricted ability to take on new debt, seeing how the wealth factor vanishes, and being more and more anxious and restless about jobs and wages, choose to balance their finances and throttle back their spending. The crisis takes hold of the real economy.

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119 The “investment structured carriers” were created by the banks outside their balance sheets to invest them in long-term assets without drawing them out of their statutory capital stocks. But as huge losses pile on the banks or they go into bankruptcy, their off-balance sheet commitments have bled their financial results and balance sheets because they were bound by contract to grant them hefty credits.

120 Díez, José Carlos: “El fin de la Edad Dorada de la economía mundial”, Política Exterior, n. 122, Madrid, April 2008
2.4 Liquidity and creditworthiness crisis and the role of central banks

The leading central banks were forced to take massive action to guarantee liquidity in the interbank market: they expanded their open market transactions downgrading the quality of the collateral, and extending payback schedules.

But, whereas the Federal Reserve, having become the leading force in managing the crisis, decided to step up to the hilt the bailing out of investment banks, the ECB, in the grasp of its inflation phobia and suffering from the effects of the so-called wage second round effects, has kept up far too long its steadfast line on the risks of an inflation spiral. The ECB Governor went on record when he addressed the European Parliament on January 23rd:

“In all circumstances, but even more particularly in demanding times of significant market corrections and turbulences, it is the responsibility of the Central Bank to solidly anchor inflation expectations to avoid additional volatility in already highly volatile markets.”

He showed his preference for upholding interest rates and massive injections of liquidity. Even more so, scared by the peak in the HICP, he would make the mistake of raising the intervention rate to 4.25 percent in July 2008, even though he eventually caved in to merciless reality in October 2008. Indeed, the main central banks in the world had to step up interest rates' cuts at the beginning of September 2008. Eventually, the Federal Reserve would set them at 1 percent, and the ECB, departing from its notorious monetary orthodox practice, had to trim them down to 2.5 percent. Yet, it kept on insisting how important it was in such turbulent times to uphold the principle of sustainability of public finance. Such an attitude was tantamount to sarcasm when public authorities were compelled to raise massive amounts of debt to bail out private financial institutions. And, of course, he stressed the urgency of greater efforts to make labour markets more flexible.

Recession is causing a steep decline in the price of raw materials, pushing the major economies of the world to the threshold of deflation, in itself a bigger risk. In view of this, central banks, and especially the Federal Reserve, have chosen to increase their money supply. Having learned the lessons from the Great Depression, they have bailed out the banks, participated in their recapitalisation and guaranteed deposits to avert a money supply crunch which would turn recession into depression. Only in this way might some measure of normality be brought back to the interbank and credit systems.

However, it is doubtful that easing the money supply can help in stimulating spending in a context of unemployment, strong wage restraint, readjustment of former excessive indebtedness and a credit crunch. Interest rates, for all the power they may wield, are hardly the magic wand to all the problems bedevilling today’s economy. Investment and expenditure will not pick up unless families, banks and companies have got rid of and written off the excesses they previously indulged in and cut down their debt, and until the situation in the labour and interbank markets is brought back to normal, consumption and investment will not bounce back. It is likely that cutting prime rates will not re-establish the interbank financing flows. If the interest rate cut is not passed on to consumers and businessmen and is used instead to improve banks’ balance sheets, the monetary policies will need to be shored up with a budget stimulus package. The central banks’ strategy for economic recovery is showing its shortcomings. As remarked by Keynes, “You can lead a horse to water but you cannot make it drink”.

184
3. **A systemic crisis and the search for a financial and economic New Deal**

This global crisis has shown the dangers of over-indebtedness, the instabilities created by distorting financial engineering from productive logic and the shortcomings in the regulation, supervision and risk evaluation. It represents the final outcome of the excesses incurred since the eighties by the liberalisation and deregulation of the markets.

Faced with the enormity of the crisis, the political and monetary authorities had to adopt a package of heterodox measures that would have been unthinkable just a few months earlier. First came the Paulson Plan, whose first draft entailed the creation of a federal agency to buy the credit institutions’ “toxic” assets so the polluted loans would disappear from the banks' balance sheets. It was rejected by Congress. Following the announcement of several plans by EU Member States, the chosen option was the direct buying of preferential shares to reinforce private banks' equity and boost credit flow to companies and consumers. As in Europe, the Federal Government would underwrite new rights' issues by banks. But the most heterodox move would fall on the Federal Reserve who, after having agreed to the direct buying of companies’ IOUs to palliate credit limitations, would not hesitate to engage a higher gear at the end of 2008: it did earmark 800 billion dollars for the financial markets and for loans to consumers and companies. It increased its monetary supply to buy mortgage assets tainted by toxic debts, a role previously assumed by the Treasury\(^\text{121}\).

This measure, primus inter pares in the heterodox measures, preceded as it was by taking direct control of the major U.S. investment banks in the United States and the mortgage or commercial banks in Europe, could only be understood within the scope of an economy sliding into deflation and the gradual running out of room for manoeuvre for managing monetary policy from the interest-rate side. While the Paulson Plan leaned ultimately on the taxpayer and led to a slow and uncertain recapitalisation, the Federal Reserve made use of what euphemistically is referred to as “quantitative expansion” of the monetary base. Financial assets would no longer be bought by issuing debt as in Spain, but through direct monetary expansion. It does not seem the ECB is willing to go that far.

In parallel, the U.S. and European authorities seemed willing to increase significantly their deficit and debt levels in order to buy assets of varying levels of toxicity and to activate, through fiscal measures and government expenditure, the components of aggregated demand.

As an example, the U.S. Treasury Secretary proposed to raise the indebtedness ceiling from 10.6 to 11.3 billion dollars. In the most favourable hypothesis, the indebtedness to GNP ratio, that was low at around 30 percent, would exceed 70 percent in 2009. The European deficits will be higher than 3 percent in 2009 and public indebtedness will again grow substantially. The economic crisis and the massive State aids it has induced have reopened the debate on the European goal of reaching zero deficits by 2010. The time has come for unqualified support for

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\(^{121}\) 100 billion dollars to buy the debt issued by government sponsored mortgage lenders Fanny Mae, Freddie Mac and the Federal Home Loan Banks. Another 500 billions to buy more dubious mortgage claims from Fannie Mae, Freddie Mac and Ginnie Mae. And an additional 200 billion dollars for a new credit tool guaranteed by securitising recent high quality (AAA) loans to consumers and small and medium sized companies. The Treasury would support this fund with 20 billion dollars from the initial Paulson’s rescue plan to shield the Federal Reserve from eventual losses.
the aggregate demand components, with special attention to household consumption. Growth is still the best antidote against chronic government deficits. Nothing would be more destructive for government finance than the world economies entering into depression. The budgetary effort, needed from all countries, should be headed by those with current account surpluses. These schemes for boosting aggregate demand would then have to be coordinated internationally to prevent them from benefiting those countries with a more conservative agenda. The government deficit of some would become the surplus of others.

From October 2008, governments were compelled to launch massive rescue plans of their financial systems. Banks needed recapitalisation after having their resources destroyed by the real estate and securitisation crisis, the depreciation of financial assets and the defaults on loans by consumers and companies. All this increased the need to expand their reserves.

Not being able to call on the market’s made firm Government action necessary. It took the form of purchasing preferential shares (surprisingly forsaking the right to vote in exchange for a dividend; once the government agrees to support the banks the logical consequence would be to take part in their management) - purchases of damaged and illiquid assets (estimating their value is difficult), providing government guarantees, exchange of mortgage claims for bonds which can be easily converted into cash etc. Leaving aside national variations, governments have introduced guarantees on interbank markets loans. The banks need to be sure they will recover their equity in the case of default by the borrower. But monetary policy is not enough to pull the economy out of recession. This is the reason for several budgetary action plans implemented since October 2008. The forthcoming U.S. administration will enlarge them. It has stated its intention to boost government expenditure.

The nature of liberal capitalism, in vogue since the eighties, will be substantially altered. With the crumbling of the economy breaking the gospel of the intrinsic efficiency of the markets, interventionism is seen as the lesser evil. It appears that government funds will have to be mobilised to bail out an increasing number of activities and sectors. But priority is being given to the financial system. Should it collapse it would ravage the world economy given the significance of the brokerage activities of banks. Out of this deep crisis, so close to a credit crunch, should emerge a new regulation of the world’s financial system, addressed to curtail and supervise the unlimited capacity of risk-taking enjoyed by financial institutions working outside any supervision. Thus, on 15 November 2008, the G20 put up the idea of tightening the regulation of the almost totally unhindered freedom enjoyed by the derivatives markets, though the U.S. did not want to bind them too tightly, to prevent charges of restricting market freedom.

The economic role of governments will have to be redefined. A new mix between government and market is needed. Even if many people, among them the EU Commissioner of Economic and Monetary Affairs, would increase the regulatory component of the financial system and reduce it for the non financial sectors to enhance their flexibility (the labour market?).

For the time being Europe is only coming up with fragmented initiatives from its Member States. While trying to come to Washington with a coordinated response strategy to the crisis, in fact the apparent agreement did not overcome national quirks. The European nations seem unable to present a concerted answer seemingly preferring the uncooperative and counterproductive Merkel’s "first one out" tactics. Nevertheless, faced with the scope of the crisis, the European authorities have been
forced to better coordinate their actions. The Eurogroup, with the participation of the UK, produced a plan in October 2008 focused on three central measures: to keep providing liquidity to the more damaged banks by buying their 'healthy' assets; recapitalise creditworthy institutions injecting equity into them by buying their shares; and to underwrite new debt to banks up to 31 December 2009 to facilitate loans to business and families. The authorities agreed to provide a guarantee for interbank transactions. It was thought that by ridding this market of lack of confidence among partners the main cause of tensions would disappear. The funds engaged by the EU Member States exceeded those of the Paulson Plan (Emergency Economic Stabilisation Act), which points to the intensity of the crisis in Europe. The intention was to give an EU character, actually a cosmetic touch, to what had only been a series of national initiatives that made the European institutions look like the great absentees in this unprecedented global crisis. The Member States have concocted national plans: for infrastructures and aid/loans to small and medium-sized companies (Germany) or to strategic companies (France); reducing VAT to 15 percent to boost consumption (United Kingdom); reducing social security costs (Germany); 400€ income tax rebates (Spain), but there is no common strategy. Up until now national governments have been responding on a case-by-case basis to the evolution of a crisis that is getting the better of them. While Sarkozy advocated common action with a longer reach than the mere flexible collaboration of the 27 national plans, the German Chancellor refused any initiative that would put more money in the EU coffers. As their main net contributor, Germany privileged national stimuli over common action.

The Commission's scheme, for which opening the 'government faucet" has a stronger positive impact on short-term demand than fiscal rebates", has three pillars: coordinating the national plans so they do not mutually interfere; increasing the resources of the European Investment Bank; and modifying the Structural and Cohesion Funds' regulations to speed up the payments to Member States. There is no agreement to encourage both consumption and investment by coordinating a tax (VAT) cut. The plan proposed a reduction in national company income tax to stimulate investment in a context of growing unemployment. I would put forward a selective tax cut (unlike the 400€ cut per taxpayer) so households can spend and save more.

In all, contributions to the EU budget included, Member States could commit common actions of up to 200 billion euros (1.5 percent of EU's GNP), the upper limit imposed by Germany that stated the EU "should not launch itself on a millionaire's race for who approves the biggest bail out plan". The amount is a modest one, lower than the 2 percent recommended by the IMF after the Washington summit, though higher than the EU budget itself.

The situation repeated itself; the Commission had not had a plan for the financial crisis and would not have one for the economic downturn. Each State would draw up and promote its specific plan.

This crisis has highlighted the need for firm government intervention and revealed the need for renewed international architecture of the financial and monetary systems in a globalised economy. Its global character calls for a regulation and supervision frame that is also global. This leads us to a redefinition of the IMF role, the great absentee. There is not an international lender of last resort acting as guarantor to lower the cost of indebtedness. The current IMF, with its limited resources, is designed to impose budget and fiscal discipline to developing countries and "solve" their problems in financing external debt. While Europe advocates
strengthening the Financial Stability Fund, set up to "promote international financial stability, improve the operation of financial markets and prevent financial perturbations having cross-border effects", as well as coordinating national regulations, the U.S. has veto power in this Fund and does not want to hear of a global supervisor. They will not go further than reinforcing the coordination mechanisms. The G20 has remained at the rhetorical level and been incapable of starting the reorganisation of world capitalism. It is indeed disappointing that hedge funds, having contributed so much to financial leveraging, are still outside government supervision. And there is not even a mention of fiscal paradises. Banning them and imposing boundaries on speculative financial products seem more efficient than dusting off the Tobin Tax. A residual tax on speculative capital operations, difficult as they are to define, appears today less interesting than laying down rules to regulate the derivatives market and to stimulate cash-based products.

The depth of the financial crisis and its contagion of the real economy have brought back to life the paradigms of the Keynesian countercyclical interventions. Governments, even those operating within the liberal dogma of market freedom, have had to step in to stabilise the economy. Jaime Requeijo, analysing the late 20th century "modern" crisis, wrote: "While it is possible Keynesianism is on the retreat in academic circles, it is still very much alive in economic policies and, much more so, in the devolution of the crisis management to governments"\textsuperscript{122}. Faced with the evidence that monetary policy alone cannot overcome the crisis and could even lead into the liquidity trap if the deflationary trends are confirmed, hopes are now pinned on budgetary policy, notwithstanding deficit and indebtedness risks.

\textbf{Conclusion: the master beams of anti-crisis actions}\n
We are facing a complex crisis and the solutions being suggested are out of step and lagging behind the pace set by this downturn. The authorities, lacking the necessary information, underestimated its depth and the effects on the real economy.

Central banks will need to keep on providing the liquidity required to prevent the financial sector meltdown, as well as directly injecting capital and discounting commercial paper. They will also need to provide the economy with mechanisms for ensuring the existence of payment and credit tools. It is the only way to arrest the multiplication of company bankruptcies. But capitalisation by the governments will need to go hand in hand with the direct management of the bailed out institutions. It cannot be limited to a mere cover up of the bad speculative practices of some.

Even if the continuous and aggressive interest rates cuts are reducing the leeway of monetary policy, central banks need to show the willingness to set them at zero if needed. Monetary policy is losing multiplier efficiency and could even fall into the "liquidity trap", with the subsequent deterioration of economic activity as soon as interest rates are bereft of leeway. The consequences would be more unemployment, new falls in consumption, new investments retrenchment, etc.

Added to this, consumers, who previously tended to over-indebtedness, have withdrawn their consumption of durable goods at a time when the wealth effect has turned negative and the job market expectations look gloomy. They seem more prone to save, depressing even more the demand for goods and services, although the fall in inflation is slightly reactivating households' disposable income. It is also likely that real interest rates will remain high to allow states to keep on financing

themselves, thus preventing monetary policy from boosting more consumption and investment.

A parallel requirement is to hike the banks' minimum capital requirements, to get rid of excessive financial leveraging and fine-tune the regulation and supervision of all financial entities by a central authority. "Without a swift recapitalisation bank deleveraging would continue and the amount of loans allowed to the real economy would keep falling"\textsuperscript{123}. As companies undergo more difficulties and need to reduce their debt they could feel tempted to cut salaries to be passed on to prices so as not to lose market share. The results would lead to a generalised deflation and a subsequent deterioration of real debt and of the stimulating effect of the budget.

Another consequence is the need for use of fiscal and budget stimulus policies to dynamize the various components of aggregate demand. But as the Japanese crisis showed, higher transfers to households might well stimulate their propensity to save at a time when prices decelerate very quickly. Then, government expenditure, beyond and without forgetting ordinary headings, should prioritise social, economic and technological infrastructures, the environment, and research, development and innovation expenses; in short, sectors that can have a positive long-term effect on workforce productivity. These are unavoidable measures to counter job destruction.

The government deficit will deteriorate due not only to the automatic stabilisers but also to the discretionary actions of governments, which need to act forcefully. They would need to increase government expenditure further than they seem ready to go: 7 percent the U.S. and 4 percent the EU in 2009. This poses in no uncertain terms the question of how to finance it, and even more so as liquidity is getting scarce. But it is a minor problem in an emergency situation like the current one. A "crowding-out" effect propelling debt rates' increase does not look likely in a context of moroseness of the private components of aggregate demand. Currently, the main economic and social problems are not those linked to the short-term sustainability of government finances, however important their long-term sustainability may be.

The European countries' economic and financial interdependencies are so high that none of them can aspire to overcome the paralysis without a deepening of the European integration process. Nevertheless, and here lies the major contradiction of the integration process, the room for manoeuvre of EU Member States has been curtailed while alongside it macroeconomic regulation at European level has not emerged.

As Fitoussi\textsuperscript{124} mentioned, if the EU, bereft of a unitarian political perspective, refuses to see itself as a "great" economic country, it should come as no surprise that European nations see themselves individually as a "small" country in a playing field that is no longer just Europe but the world. This renders impossible a common response to a systemic global crisis.


\textsuperscript{124} Fitoussi, Jean Paul; Le Cacheux, Jacques: \textit{L’état de l’Union européenne 2007}, Fayard/Presses de Sciences Po, Paris 2007.
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Towards a Global and Ethical Approach to Environmental Challenges

By Cristina Narbona Ruiz

The crisis: an opportunity to overhaul the economic model

The current crisis offers a unique occasion to review from a progressive approach the economic model and, in particular, the relationship between economy and ecology. In the past few months we have seen the emergence of the dire economic, social and environmental consequences of a system which privileges personal profit over the general interest, and greed and wastefulness over responsibility and prudence. Thus, an economic and cultural paradigm based on the myth of boundless abundance is sinking. The share of responsibility of those on the left who have tolerated or even justified the prevalence of the market over public regulation cannot be eluded.

This crisis must be tackled urgently, but by understanding its deep roots and not yielding to the temptation of tending only to the more serious symptoms. All the analyses point to the subordination of the real economy to a financial economy that generated astronomical profits for a tiny minority of the world population, and promoted excessive consumption and indebtedness; while concurrently social inequalities and the systematic destruction of the ecosystems escalated. The lack of regulation and insufficient public oversight favoured this process. Public authorities tolerated speculation and tax avoidance, which run alongside pollution and the exhaustion of natural resources. All in the name of a type of economic growth that in no way increased global well-being, but rather increasingly threatens it for future generations.

For too long, even among the political left, environmental demands have been considered incompatible with economic growth, and in turn with job creation and social progress. The reality is that the economy has never been ‘autonomous’ from ecology: all the economic processes are interdependent with ecological processes. The consequences of having ignored this reality have become tragically evident today. As evident, unfortunately, as the capacity of the dominant economic model to destroy employment and seriously compromise the delivery of basic public services. By no means did environmental demands trigger this crisis, nor were the demands for social justice the culprits of the financial catastrophe, but rather quite the other way around.

On the other hand, the experience of some European countries has shown throughout the years that higher and lasting levels of continued job creation and increasing well-being, alongside reinforced environmental and social requirements are possible; in contrast to other countries such as Spain, where unemployment rates remained stable in a period of fast economic growth which featured a combination of low skilled jobs, scant attention to the impact on ecosystems and the inefficient use of natural resources.

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Since the mid-20th century there has been increasing scientific knowledge on the risks of ecological deterioration of our planet created by our economic model. Since the 90s there has been mounting evidence that global warming is the fallout of the overuse of fossil fuels and massive deforestation, two of the 'conditions' for economic growth. Climatic change is already on the political agenda of most countries, but until now the effectiveness of the existing policies has been minimal.

Climate change is just one face of the ominous incidence of human activity on the ecological balances, with very serious consequences for the less favoured citizens, especially in the poorest countries, and even, according to Pentagon studies that were kept secret until very recently, with significant consequences for peace and international security.

Other environmental challenges are still far from the political decision making arena. One example is the loss of biodiversity. Among other effects it has brought the extinction of species essential for the production of foodstuffs. FAO data from 2007 shows that almost 80% of the fishing-grounds are already exhausted or on the brink of depletion due to overfishing. Pressure on biological resources also reduces the potential for remediying illnesses and entails higher vulnerability risks to the geographical propagation of pests. But there are hardly any binding commitments to protect biodiversity at the national and international levels.

Air, water and ground pollution create increasing threats to public health, particularly in the poorest countries and developing economies. One million people die yearly in China solely due to pollution-related causes. Scarcity of drinking water and inadequate treatment of sewage is the number one cause of disease in the world.

Climate change is fuelling the recrudescence of adverse meteorological phenomena that are felt more severely by the populations of less developed countries. From 1984 to 2004, natural disasters caused 900,000 victims in these countries, with 75,000 in the rich countries. The fourth Report of the Intergovernmental Panel of Climatic Change (IPCC), published in 2007, confirms that the ability to adjust and become resilient to climate change (and any other ecological risks) depends on the economic and social development level of the country.

Africa is the great paradox. Despite contributing only 4% to the world emissions of greenhouse gases, it suffers the worst consequences of climate change: longer lasting droughts, more frequent floods, growing desertification and biodiversity loss. The IPCC estimates that by 2020 more than 400 million Africans will be severely affected by global warming.

As stated in the Brundtland Report (1987), "As a system approaches ecological limits, inequalities sharpen". Climate change, as any other environmental impact of our economic model, is above all a huge ethical problem, since those who suffer more greatly from the decline of the ecosystems are not only those who are the least responsible for it, but also those who benefited the least from the global economic growth. This demands a much more committed answer from developed countries. They need to re-orientate their consumption patterns while contributing to the introduction of cleaner technologies in developing countries.

On top of its ethical dimension, environmental decline carries increasing economic costs. The OECD has estimated the economic cost of environmental 'inaction' since 2004. Its methodology was later adopted in the World Bank reports (since 2006) and the well-know Stern Review on the Economics of Climate Change for the UK Prime Minister (2007). The costs of "inaction", broadly understood as total absence, insufficiency or delays of the decisions for reducing environmental risks,
are much higher than those of adopting the right policies in time. The mentioned reports see the yearly cost of inaction reaching 20% of the world GDP by 2050. Its counterpart, should action be taken, is only 1%.

This means that, even in a strictly economic approach which overlooks the ethical dimension, it is preferable to face up to the environmental challenges sooner rather than later. This reasoning has been absent from the recent operation of the economy that promoted, or at least tolerated, the pursuit of short-term personal profits. Maybe falling prey to short-term electoral interests, once again public action has failed by not favouring long-lasting collective benefits.

Political reaction has been absent even when the short-term effects of the ecological crisis rocked the economy as seen with the spectacular increase of energy and food prices in 2008. There is a tendency to interpret these signals as cyclical and not as evidence of the gradual depletion of fossil fuels in the case of energy or the effects of climatic change and the quality loss of soils in the case of foodstuffs.

Strong political leadership is needed to go beyond the described economic paradigm. In fact, the biggest current political challenge is leading the transition towards a more equitable economy that duly respects the environment and reinforces democracy: an economy that produces longer lasting well-being for more persons; an economy based on a new approach to the concept of efficacy, beyond the one measured in monetary terms, focused on answering more social needs with less resources and generating less pollution; an economy that imitates the natural processes that guarantee the maintenance of life, diversification, closed loops, and symbiosis in the long-term.

Undoubtedly, this downturn has revealed how extremely grave mistakes have been made when developing business strategies free of environmental constraints, as in the case with the auto industry in the US, and has brought about a renewed interest in energy efficiency and renewable energies. Every public stimulus plan aimed at economic recovery incorporates “green policies” of varying scope and intensity.

Nevertheless, in many instances the positive impact of these action plans will be far smaller than the negative effects from all the other policies which have been adopted. What is sorely missing is a global approach that consistently integrates environmental constraints into each and every one of these measures. In this context it is worth mentioning the initiatives taken by the US for building up renewable energies and calling for better energy efficiency in all sectors of production.

In summary, the present crisis should be seen as a manifestation of the lack of economic, environmental and social sustainability of our present economic model. It should be understood that in a long term perspective the economy is fully dependent on ecology and J. Genereux wrote that the “economic laws” are “man made laws”, reflecting human priorities and institutions, whereas “natural laws”, be they from biology or chemistry, cannot be circumvented by human action without entailing results which may even become irreversible. Therefore, to get out of this crisis ecology must lay down conditions, such as social justice, goals, and economic rationale and show the way to proceed.

A specific way to act upon this approach is given by the advocates for the so called “economics of functionality”, which makes the case for a shift from an economic model focused around the sale of products to another based upon the

renting and selling of services. Such an approach would make it possible to move back from the symbolic value we attach to material goods, favouring instead their use value. In Europe many cities have wide experience in renting council-owned bicycles and now this is being extended to publicly owned vehicles along the same lines. The environmental results and the improved use of public spaces have been both fully encouraging and herald the extension of this approach to many other durable consumer goods.

Democracy and sustainability: the right to the environment
Overcoming the present downturn calls for a paradigm shift which begins with accountability and the recognition of the right to a dignified life for all the citizens of the planet, both those living today and those who will live in it tomorrow.

The environmental challenges are not marginal issues stemming from an “aesthetic” stance towards the natural environment, but rather indispensable conditions for the health, quality of life and progress of the human race. Each and every human being is equally entitled to breathing unpolluted air, to have access to enough drinking water and to enjoy our natural habitat. Those are rights inextricably linked to the most fundamental of all, the right to life.

As observed by J.P. Fitoussi and E. Laurent, “environmental equality is the true key to sustainable development, and this calls for us to step up our claims for more democracy. The food crisis, as the energy crisis, highlights the relationship between distribution of resources and distribution of rights, between ecology and democracy” 127.

It would however be impossible to implement a “full equality of rights” to natural resources without first introducing sustainability criteria. For example, the right to food must be understood as an entitlement to an adequate caloric diet to keep the subject in good health, but it is not tantamount to an unlimited right to an animal protein rich diet which is unsustainable from the public health point of view due to methane emissions and intensive usage of land and water. The same can be said about the right to use energy resources, which does not extend to energy waste as practiced by rich countries.

A specific instance of the need to distribute environmental rights according to fair principles is that of the future agreement on the fight against climate change. The EU, following the suggestion from Spain among others, champions the gradual convergence of CO2 per capita emissions in order to introduce an element of justice which would make possible the involvement of developing countries in such an agreement. Following this approach Eco-equity, composed of a group of researchers, has put forward a calculation method to distribute the effort required to mitigate climate change which takes into consideration the per capita emissions, emissions accumulated since 1990, per capita income and the relative poverty level in each country. According to this calculation, the commitments geared toward reducing greenhouse gases by 2020 would represent an amount equal to 1.5% of the US GNP, 1.1% of the EU GNP, 0.7% of the Chinese GNP and only 0.08% of the GNP of all the developing countries combined.

Amartya Sen 128 goes as far as saying that “a famine means that people are starving, which does not imply that there is no food to eat ... famines never happen in

a truly democratic country.” Furthermore, many studies\(^{129}\) prove that “democratic quality”, the set of mechanisms guaranteeing the exercise of rights, accountability and participation of the public, has a far greater effect on a country’s environmental quality than on its level of economic development.

**Measuring development and well-being**

If the time has come to argue for worldwide ecological emergency and social justice as effective priorities of political action, this requires above all a new interpretation of the notion of well-being more in tune with the new conception of the relationship between people and between human beings and nature.

Up to now the GDP has been the primary indicator of “economic success” and even of social advancement, even though it does not take into account at all basic components of wellbeing such as income and wealth distribution, environmental quality, gender equality and quality of public services.

Alternatives to GDP have been suggested since the beginning of the 1970’s\(^ {130}\), and a whole array of indicators have been developed, especially since the UN “Human Development Report” in 1990 and the subsequent work by the Nobel Laureate for Economics, Amartya Sen.

However, this analytical work has hardly spilled over into the realm of political debate, where GDP continues to hold sway even today as an indicator holding more relevance than that warranted by its content. Such a consideration is linked, once again, to the dominant values. GDP measures the amount of goods and services traded in the market, determined by prices, overlooking the social and environmental effects of the current production and consumption model. If one or other indicators do not substitute for GDP, or at least complement it when assessing the evolution of the economy and the effectiveness of public policies, the reason is due to an “ethical”\(^ {131}\) choice and not to technical problems in developing or making available other indicators. GDP is not an indicator of well-being at all\(^ {132}\); if it continues to be the main indicator in the political and economic debate it is because the main goal of the dominant economic model is not the continuing well-being of all its citizens.

Selecting the “best possible well-being indicator”, or specifically weighing up several indicators, is thus subordinate to the goals of public policies and to the citizens’ own perceptions of their quality of life.

The OECD takes an active role in this discussion and it promotes an international platform to improve the measurement of social progress. The results will be made public in the course of this year. In addition, the French Government has instituted a Committee to pursue the same goal, headed by J. Stiglitz, A. Senn and J.P. Fitoussi.

At any rate, most of the available indicators on well-being today incorporate variables measuring environmental quality, depletion of natural resources or ecosystem degradation. The value of human well-being as the quality of the whole life web to which we belong is then explicitly recognized. This calls for a different outlook on our world, identifying basic elements which are vital for happiness and whose

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significance had been relegated by the dominant cultural patterns of the “consumer’
society”.

**Conclusion**
Natural resources are limited, but our imagination and determination in building a
better world should know no bounds. The chief role of progressive forces has always
been to push for a transformation of society beyond the dominant particular interests
holding sway at any moment in history. Following on from the struggle for the rights
of workers, women and minorities, the struggle must urgently be pursued for the
rights of all citizens on this planet, those of today and of tomorrow, to dwell in an
environment that is able to guarantee them health, quality of life and durable
progress.
xxii. Climate Change, the EU and Markets for Emissions
By Navraj Ghaleigh

Introduction
The concept that anthropogenic climate change is the greatest of the 21st century’s challenges has been taken seriously by the EU. Keen to fill the vacuum left by the Bush Administration’s abstention from multilateral attempts to engage with the problem, the EU has positioned itself as a climate change leader to the USA’s laggard. The most striking evidence of this role may be found in the EU’s Emissions Trading Scheme - anyone with even a nodding familiarity of global carbon markets recognises the position of primacy held by the Scheme within them. With a trading volume of at least €28bn in 2007, the EU ETS represents approximately 70% of global traded volumes in carbon products and 62% of physical volumes. It is variously described as “the main driving force of the global carbon market”, “the main driver for emissions reductions, both at homes and in developing countries”, “the engine, perhaps even the laboratory, of the global carbon market”. The EU ETS’s trading volumes dwarf those of its rivals - the voluntary Chicago Climate Exchange, the New South Wales ETS, the New Zealand ETS and the fledgling Japanese scheme - none of which has a volume equal to even 1% of the EU ETS. Within its own territory the Scheme is a significant policy instrument, with 40% of the EU’s total GHG emissions within its regulatory ambit, representing approximately 11,000 of the EU’s largest emitting installations. For the period 2008-2012 alone it is estimated to generate emissions reductions of 3.3% (139 MtCO2 p.a.) from the base year of 1990 in the EU-15. Whilst the European Climate Change Programme (ECCP) extends to issues of fuel efficiency and quality, vehicular emissions, biofuels, renewables, and carbon capture and storage, it is no exaggeration to describe the EU ETS as the keystone in the architecture of the European response to global climate change.

This paper commences with a discussion of the science of climate change and the international legal framework that underpins responses to the problematic – a crucial if not always considered matter – including the United Nations Framework Convention on Climate Change (Part A). The Kyoto Protocol is rightly considered to

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134 See generally, Ghaleigh, N.S. in O’Connor (ed) Anti-Americanism: History, Causes, Themes (Vol 1, Oxford, 2007) 139
135 Established by Directive 2003/87/EC, hereinafter ‘EU ETS’ or ‘the Scheme’
137 Ibid
138 Roine et al, ibid
140 Ibid, 7.
form the basis of current commitments to emissions reductions. The discussion here however seeks to ground it in its economic context which in turn raised a set of challenges for the EU in the Kyoto negotiations (Part B). Part C introduces the EU’s principal legislative commitment in the wake of that process and consequent regulatory realignment – the EU Emissions Trading Scheme. The state of the art of climate change negotiations, mechanisms and processes is addressed in Part D which seeks to outline the major currents of intellectual debate, diplomatic progress and structural capacity in climate change processes.

**Part A: Climate Change Science and the Framework Convention**

It is ‘very likely’ that the major risk of global climate change comes from anthropogenic increases in greenhouse gases. The greenhouse effect is the result of certain gases (principally water vapour, carbon dioxide and to a lesser extent, methane) which envelop the earth, regulate the in- and out-flow of the sun’s energy and make the earth habitable. In its absence, the earth’s temperature would be about -18°C. Carbon dioxide, the most voluminous of the greenhouse gases, was present in the pre-industrial (1750) atmosphere at a concentration of 280 parts per million (ppm). Its rise to 379 ppm by 2005 is substantially a function of global industrialisation, which is in turn driven by fossil fuel combustion. In the same period, methane (which has a global warming potential approximately 70 times greater than CO2 by mass) has increased in concentration from 715 to 1774 ppm. Other human activities, such as deforestation also contribute to global climate change, as to do emissions of methane from agricultural sources and the loss of soil carbon due to excessive ploughing and intensive agriculture. The effects of global climate change are likely to be felt world-wide, but with differential impacts. Predicted rises in global temperatures would potentially have world-wide effects on sea levels, forests, agriculture, natural ecosystems, and population distribution. The ability to adapt to such changes is not unconnected to the economic wealth, technical capabilities and government structures of different societies.

Science has played a decisive role in the formation of the current regime of climate change. Indeed, the Intergovernmental Panel on Climate Change (IPCC), was established in 1988 by UNEP and WMO “anticipating the critical role that scientific consensus would play in building the political will to respond to climate change.” Established to review the scientific evidence and make recommendations, the IPCC’s reports are recognised as the definitive source of information on climate change. The most recent Assessment Reports of 2007 give the lie to suggestions that climate change is a natural, not anthropogenic, phenomenon, finding that the rise in global average temperature since the mid-20th century is “very likely” (that is, more than 90% certain) to result from the increase in human-induced greenhouse gas emissions. If left unchecked, such increases in emissions are “likely” (more than 66% certain) to result in an average temperature change of up to 6.4°C by 2099. In addition, the IPCC predicts an average sea level rise due to thermal expansion and melting of ice of up to 65 cm by the year 2100, with the probability of reduced precipitation in Africa, Southern Europe, Amazonia and central North America due to temperature increases.

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143 Ibid.
144 Ibid
145 Ibid
Legal responses to climate change have had, inter alia to address the fact that greenhouse gas production goes to the heart of energy, transport, agricultural and industrial policy in all developed states and increasingly in developing ones too. The objective of the Convention is not to reverse greenhouse gas emissions but to stabilize them at a level that would prevent dangerous anthropogenic interference with the climate system. The principles listed in Article 3 include reference to inter-generational equity, common but differentiated responsibility, the precautionary principle, and the right of all parties to sustainable development, as well as the need to promote ‘a supportive and open international economic system’. Policies and measures taken should be cost-effective in the sense that they will ensure ‘global benefits at the lowest possible cost’ – a consideration that looms large in the architecture of the Kyoto Protocol itself. As articulated in Article 4, the explicit assumption is that the developed states that have contributed most of the greenhouse gas emissions should also contribute most to tackling the problem, both by providing resources and by ‘taking the lead’ in adopting control measures.

Part B: The EU and Climate Change

Before examining the substance of the Kyoto Protocol, we should pause to consider the EU’s own methods of addressing environmental concerns. Prior to and continuing into the 1990s, the EU adopted a policy approach of “regulatory environmentalism”, premised on the assumption that reliance on free-market solutions would misallocate natural resources and produce inadequate incentives to prevent environmental degradation. There also existed a secondary and emerging strain in EU policy that, as early as 1993 in the form of the Community’s Fifth Environmental Action Programme, acknowledged the limitations of command-and-control regulation and the utility of market mechanisms to “internalise external environmental costs”. Also familiar is the influence that these American domestic policy successes had in the negotiations at Kyoto, the architecture of the Kyoto Protocol and in particular the flexibility mechanisms contained in its Articles 6, 12 and 17.

The key feature of the Kyoto Protocol is its establishment, for the first time, of quantitative restrictions on emissions from industrialised economies. These states listed in Annex B of the Protocol are limited in their emissions of the six greenhouse gases listed in Annex A. The quantified emission limitation and reduction commitments contained in Article 3(1) (that seeks to ensure that overall emissions from annex B states are reduced to at least 5% below 1990 levels within the period 2008 to 2012) is of course subject to Article 4(2)(a) of the Convention. Article 3(1) sets out different limits for each party, in deference to their particular circumstances, including ability to reduce emissions, access to clean technology, use of energy and so on. In most cases (including the EU, USA and Japan) a reduction of between 5% and 8% is specified, but New Zealand, Russia and Ukraine need only stabilise emissions, while Norway, Australia and Iceland are permitted to increase by amounts

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147 “A European Community programme of policy and action in relation to the environment and sustainable development”, Official Journal C 138 , 17/05/1993, p.5
139
140 The list of parties in Annex B Kyoto Protocol is substantially similar to that in Annex I of the UNFCCC.
ranging from 1% to 10%. All parties listed in annex I of the Convention must show 'demonstrable progress' in meeting their Kyoto Protocol commitments by 2005\textsuperscript{150}.

Whilst reductions of 5% or so may seem low, they are deceptive. Choice of 1990 as the main base year means that percentage reductions of up to 30% or more of present emissions will have to be made by those states whose greenhouse gas emissions have increased since 1990. The United States is in this category: in 2000 a cut of some 36% would have been needed to reduce its emissions to 1990 levels. In certain circumstances economies in transition, including Russia and Ukraine, may opt for a base year earlier than 1990\textsuperscript{151} in order to enable them to increase emissions because their economies have contracted so sharply since then. Developing states are not included in annex B so no emissions limits apply to them and they are not required to do more than meet their existing commitments under Article 4(1) of the Convention\textsuperscript{152}.

The possibility that some developed states might find it economically advantageous to meet their commitments jointly, and that developing states might also benefit from such assistance, was envisaged in Articles 4(2)(a) and 4(5) of the Convention and in a decision of the 1st COP, although the commitments of each party would not thereby be modified\textsuperscript{153}. Such ideas were more fully articulated in the Kyoto Protocol and in particular, in its three flexibility mechanisms – Clean Development Mechanism under Article 12, Joint Implementation under Article 6 and International Emissions Trading under Article 17. Before each of these is explored at greater length, it is necessary to consider their conceptual underpinnings.

**Economic Background**

The Kyoto Protocol’s use of market based instruments to generate emission reductions is commonly described as innovative or radical\textsuperscript{154}. Whilst this may be true in the context of international environmental regulation, its pedigree in both theory and practice is venerable. Those familiar with Law and Economics theory will recognise in techniques such as carbon trading the legacy of Pigovian and Coasian economics. The former identified the social benefits of compelling companies to pay for the costs of their own pollution\textsuperscript{155}, whilst the latter’s The Problem of Social Cost demonstrated how allocating property rights and allowing trade yields pareto efficient results\textsuperscript{156}. These insights laid the foundations for market mechanisms, such as emissions trading, as an alternative to traditional command-and-control methods, based on its claim to deliver environmental outcomes at the least cost.

The rationale of mechanisms such as emissions trading is as follows. A regulator sets a cap on aggregate emissions, distributes the right to emit to regulated facilities (with their emission allowances totalling less than the aggregate emissions) and permits the market to determine the emission price and degree of abatement at individual facilities. If the regulator allows regulated facilities to transfer their emission allowances, the distribution of emission reductions among facilities will be equal to

\textsuperscript{150} 1997 Protocol, Article 3 (2).

\textsuperscript{151} Ibid, Article 3 (5). Annex I parties may use 1995 as a base year for gases listed in Article 3(8).

\textsuperscript{152} Ibid, Article 10.


\textsuperscript{154} See Freestone and Streck (eds) Legal Aspects of Implementing the Kyoto Protocol, Ch 1.

the marginal cost of emission reductions among facilities. If the marginal cost of emission reductions varies among facilities, total costs can be lowered by reallocating greater effort to the facility that can lower emissions at a lower cost. Thus, when marginal cost is equal among facilities, total costs are lowest and the environmental target is reached.

Market mechanisms were first used as environmental tools in the USA in the 1990s in the form of Title IV of the Clean Air (Amendment) Act 1990. A response to SO2 generated acid rain, the Act allocated a fixed number of allowances to the electricity industry, with firms being required to surrender allowances for tons of SO2 emitted, with transfers being permitted and banking. The success of the scheme in terms of costs but also as a driver of abatement innovation exceeded expectations. As a consequence the tool of emissions trading gained favour domestically and most significantly at the multilateral level, where it formed a key negotiating strategy for the Clinton administration in negotiations leading Kyoto. Each of the three Kyoto ‘Flexibility Mechanisms’ seeks to draw on the logic of the Coasian privatisation of the commons and trading the resultant property rights with a view to achieving emission reductions in the most cost effective manner, in the optimal global location.

Part C. The EU Emissions Trading Scheme

It is notable that having ‘lost’ the battle of ideas over the optimal means by which to tackle climate change, the EU subsequently embraced the new settlement with gusto. The Kyoto Protocol committed the EU to an 8% GHG reduction by the end of 2012. Reductions were to be re-assigned to Member States pursuant to its own ‘Burden Sharing Agreement’, facilitated by one of the EU’s few negotiating successes at Kyoto, Article 4(1). Foremost amongst the jointly implemented responses of the EU is the Emission Trading Directive. The Directive followed Commission consultations, studies and finally a “Green Paper on Greenhouse Gas Emissions Trading within the European Union” which acknowledged the EU’s Kyoto obligations as well as the necessity that that process did not represent the outer limit of the EU’s relevant ambitions. Accordingly the proposal was for a scheme whose industry sector coverage was substantially repeated in the final Directive, though with a threshold of 50MW rated thermal input. In terms of quantum of allowances and distribution, the Green Paper saw a role for the Commission only for purposes of determining Member States’ internal allocations where the risk of national discrimination arose. The setting of total quantities of allowances was for the Member States themselves. The question of free allocation (by grandfathering or benchmarking) or auctioning was left open whilst the need to avoid discrimination against new entrants was given consideration.

157 ‘Marginal cost’ is the additional cost to achieve an additional unit of emissions at any facility.
160 See Council Decision of 25 April 2002 concerning the approval of the Kyoto Protocol and the joint fulfilment of commitments thereunder, Official Journal L 130, 15/05/2002
161 “Any Parties included in Annex I that have reached an agreement [may] fulfil their commitments under Article 3 jointly…” Italics added.
162 For an account of the Scheme’s details, see Robinson J et al, Climate Change Law: Emissions Trading in the EU and the UK (Cameron May, London, 2007), Part I
163 COM (2000) 87 Final
164 see Legal Form supra
In terms of the substance of the process, it is notable that the questions of industry sector coverage and thresholds attracted minimal contention. Furthermore, the task of setting total quantities of allowances to be allocated and the task of distributing those allowances which were envisaged as separate in the Green Paper, were combined into what were to become National Allocation Plans. This created the risk that the “level of ambition under the scheme risks being diluted as a result of industry lobbying over their allocations…rather than ensuring that negotiation over the distribution [between and within Member States] is a zero sum game with no impact on the environmental integrity of the scheme.”

Legal form
The EU ETS is in its basic structure a conventional cap-and-trade scheme. At its heart a fixed number of allowances are issued which are divided into a quantity of pollutant which is emitted over commitment periods or phases. The level of resultant emissions is thus equal to the established cap on emissions. Allowances are allocated to operators who are then obligated to monitor and report their emissions, and to surrender at the end each period an equal number of allowances to the units of pollution emitted. Penalties are attached to non-compliance. The scheme also provides for the buying and selling of allowances between parties, whether regulated entities with obligations under the Scheme or mere third parties.

To this generic schema, the EU ETS’s specific approaches to coverage and allowance should be noted. The Directive’s coverage of activities, detailed in its Annex I, excludes aviation, shipping and most contentiously the aluminium and chemical sectors while including energy, ferrous metals, minerals, and pulp and paper. The Commission’s Explanatory Memorandum to its original proposal justified the chemical exemption on the basis of its mere 1% contribution to the EU’s total CO2 emissions and the fact that the large number of installations (approximately 34,000) would create significant administrative complexity to the Scheme. The Memorandum remains silent on the exclusion of the aluminium sector. These choices have generated much subsequent controversy, not least before the ECJ.

Allowances, as we shall see, have been a source of at least equal controversy. Defined by Article 3(a) as one tonne CO2e, allowances are allocated and issued to installations by way of a two stage process. Stage one requires Member States to develop National Allocation Plans “stating the total quantity of allowances that it intends to allocate for that period and how it proposes to allocate them…based on objective and transparent criteria, including those listed in Annex III.” Such NAPs are subject to Commission approval, only after which may MSs definitively determine the total quantity of allowances and the allocation of the same

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166 Ibid, at 65
167 The economic rationale for such mechanisms is the claim that they minimise the marginal abatement cost of arriving at a particular level of pollution - the locus classicus for which is Dales, J.H. Pollution, Property and Prices (Toronto, 1968), drawing, inter alia, on the Nobel prize winning insights of Ronald Coase’s The Problem of Social Cost, 3 Journal of Law and Economics (1960)
170 “Allowance’ means an allowance to emit one tonne of carbon dioxide equivalent during a specified period, which shall be valid only for the purposes of meeting the requirements of this Directive and shall be transferable in accordance with the provisions of this Directive”
171 See Article 9(1)
amongst installations\(^\text{172}\). As with the question of sectoral scope, the details of such matters have greatly exercised the ECJ and are discussed below.

The EU ETS has been implemented in phases - 2005 to 2007 and 2008 to 2012 - which coordinate with the Kyoto Protocol compliance period. Subsequent phases are intended to run in consecutive 5 year periods. Phase I is commonly described as a learning-by-doing phase, allowing Member States to get acquainted with a novel system, to make progress towards their Kyoto Protocol commitments and towards meeting their particular CO2 goals pursuant to the Burden Sharing Agreement\(^\text{173}\). The Scheme may be extended to other greenhouse gases and installations in subsequent phases.

As is well known, the ‘trial period’ of Phase I was characterised by a price collapse in late April 2006 after the publication of the verified emissions data by Member State after Member State revealed that emissions were significantly below their allocations to installations. Pre-announcement OTC prices were slightly over €30/ton, by mid-May had fallen to approx. €15/ton and then to near zero from early 2007 until the end of Phase I. In a sense it is inaccurate to characterize this as a market failure – on the contrary, it might be argued, the market reacted precisely as it ought to have by adjusting when information that changes expectations was made available. Once aggregate emissions and the resulting demand for allowances were known, the fact of over-allocation had its predictable price consequences.\(^\text{174}\) Thereafter, Phase II contracts dominated the markets’ attention, with December 2008 EUAs ranging between €12-25 per tonne, remaining within the €20-24 band for the majority of the year. Upon the commencement of Phase II, such prices remained durable (at around €20-25 for most of 2007), revealing the price of emitting GHG in the EU but also sending a strong signal to FlexMechs project developers that emission reductions generated through projects which generate carbon credits would find a robust market in the EU ETS\(^\text{175}\).

A consequence of the Phase I price collapse was its impact on the design of Phase II. The Commission’s approach to the Phase II caps has been described as “unquestionably tough”,\(^\text{176}\) being much tighter than in Phase I in an overt attempt to create demand for emission reductions, whether generated within the EU or in non-Annex I countries. The Phase II cap for EU 27 is 2,098 Mt/yr, cutting Member States’ suggested allocations in NAPs by 245 Mt/yr (10.4%). The largest absolute cuts were in Poland (76Mt), Germany (29Mt), Bulgaria (25Mt) and the largest relative cuts in Baltic States (ave. 37%).\(^\text{177}\) These figures represent a cut of 130MtCO2 (6.0%) below 2005 verified emissions and 160MtCO2 (7.1%) below 2007 verified emissions.

Constraints on Member States’ ability to comply with the Scheme are eased somewhat by Phase II’s credit limits (the maximum CDM/JI volumes that can be purchased for compliance purposes) which vary according to Member States from 10% in most cases, up to 22% for Germany. Coupled with tightness of allocations, this creates the possibility for sizable offset/credit imports. Nonetheless it remains the case that the EU ETS is projected to reduce EU-15 emissions by 139MtCO2 p.a.

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\(^{172}\) Ibid Article 9(3)

\(^{173}\) Op cit n.?

\(^{174}\) It should be noted however that there is also a strong argument that over-allocation was accompanied by over-abatement – see AD Ellerman & BK Buchner, “Over-Allocation or Abatement” A Preliminary Analysis of the EU ETS Based on the 2005-06 Emissions Data” 41 Environmental Resource Economics (2008), 287-287, at 270.


\(^{176}\) Ibid.

\(^{177}\) See Point Carbon Carbon 2008 - Post-2012 Is Now ibid., p. 28, Table 1.
during 2008-12 (a 3.3% reduction from the 1990 baseline). The ongoing impact of such measures is demonstrated by the fact that whilst the 2006 emissions of only 4 of the EU 15 were lower than their Kyoto target (France, Germany, Sweden and the UK), that figure is expected to rise to 12 of 15 by 2010 (Denmark, Italy and Spain being the miscreants). Such is the strength of these projections that the operation of Phase II in much of 2008 saw relatively strong prices between €19-29/ton, although that price had halved since the onset of the global recession in February 2009.

**Part D. An Assessment of the State of the Art**

The Economics of Climate Change: The Stern Review, commissioned by the United Kingdom Treasury and a comprehensive treatment, describes anthropogenic climate change in terms of catastrophic market failure. Its main conclusion is that in order to avoid the worst effects of climate change, prompt investment totalling one percent of global gross domestic product per annum is necessary. Investment would be required for mitigation and adaptation, thereby encompassing inter alia low carbon energy technologies and carbon capture and storage. The failure to do so, argues Stern, could risk global GDP being up to twenty percent lower than it otherwise might be.

In this context, emission reductions required by the Kyoto Protocol seem overwhelmingly inadequate. Similarly, whatever the achievements of the Clean Development Mechanism, it is clear that it has so far failed to drive technological innovation at an appropriate rate, or facilitate technology transfer on a scale that meets the needs of the burgeoning new economies of India and China in particular. Indeed a brief analysis of global energy forecasts brings the scale and dynamics of the relative positions of industrialised and emerging economies into sharp relief.

Global demand for energy is forecast to increase by 66% by 2030, with fossil fuels accounting for 86% of the total. Whilst energy usage by OECD and non-OECD states was roughly equal in 2005, the latter’s share is set to increase to 59% in 2030, with India and China’s accounting for the majority of that extra demand. Global CO2 emissions are estimated to increase from 28.1 billion metric tons in 2005 to 42.3 billion tons in 2030 and the share of non-OECD economies rising from 51% in 2005 to 63.3% in 2030. If such figures appear to support the argument for uniform emission reductions, it is of course the case that the historic responsibility for global emissions lies mainly with developed, not developing economies, and has facilitated a level of welfare the latter are keen to emulate. Moreover, disparities exist in per capita CO2 totals. Indian and Chinese emissions stood at 3.7 and 1.0 metrics tons per capita in 2004 as compared with 9.5 and 19.7 metric tons per capita for Japan and the USA. Even after the forecast increases by 2030 to 7.1 and 1.8 metrics tons per capita for India and China (with the US and Europe remaining substantially the same) the gap persists.

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180 Energy Information Administration, *International Energy Outlook* (2008). Whilst the previous edition of this work recognised the “risk that emissions from developing states such as Brazil, China and India will overtake those of OECD states as they industrialise further [as] a real one”, that possibility has now become a fact, with China soon to become the world’s single largest GHG emitter.
The Negotiating Context

Before considering possible amendments to the existing regulatory architecture of climate change, we must ask how future agreements will be negotiated. Whilst the negotiations under the auspices of the Framework Convention are clearly central, it is important to note the existence of parallel processes.

The Kyoto Protocol commitment period expires in 2012. At the time of writing, many of the key issues necessary for a successor agreement were expected to be substantially settled at COP 14 in 2008, if not their details. Adoption of a new protocol was scheduled for COP 15 at Copenhagen in December 2009. Both will build upon the Bali Roadmap—a series of decisions taken at COP 13 in December 2007, which include the Bali Action Plan, purporting to chart the course for a new negotiating process, with the aim of completion by Copenhagen. It also includes the AWG-KP negotiations, the launch of the Adaptation Fund, and the Article 9 review of the Kyoto Protocol, as well as decisions on technology transfer and reducing emissions from deforestation. This is an ambitious agenda.

Running in parallel with the ‘Convention’ negotiations are two other processes. The Major Economies Meeting (MEM), initiated by President Bush in 2007, is avowedly “a new initiative to develop and contribute to a post-Kyoto framework on energy security and climate change….” that seeks to “contribute to existing national, bilateral, regional and international programs” and not undermine them. Not surprisingly it has been viewed with some suspicion, given President Bush’s less than firm commitment to action on climate change at home and abroad. Moreover, participation is limited to major actors (principally OECD nations, USA, China, India, Brazil, EU) rather than the more broadly based Convention processes. A similarly handpicked parallel process operates under the auspices of the G8. Commenced in 2005 under the British Presidency, the G8 has undertaken various actions to combat climate change, including a ‘dialogue’ with Brazil, Mexico, South Africa, China and India. As with the MEM, the G8+5 process is intended to complement the UN Framework Convention process and recognises it as the “only forum in which binding agreements on future frameworks can be negotiated.”

The 2008 G8+8 meetings in Hokkaido reaffirmed that future cooperation would be “rooted in the objective, provisions, and principles of the Convention” and in the Bali Roadmap. “Serious consideration” would be given to the “ambitious IPCC scenarios,” and the role of technology in addressing climate change. Most significantly, governments agreed on the “goal of achieving at least a 50% reduction in global emissions by 2050”. Compared with the emission reductions of the Kyoto Protocol, this would represent a significant change in the commitments leading economies are prepared to undertake. Whilst the Summit Leaders Declaration states

182 Decision 1/CP.13.
183 Ad Hoc Working Group on Further Commitments for Annex I Parties under the Kyoto Protocol. Article 3, para 9 of the Kyoto Protocol mandates the Conference of the Parties to initiate consideration of future commitments for Annex I Parties. It aims to complete its work and have its results adopted by the Conference of the Parties at the earliest possible time to ensure that there is no gap between the first and second commitment period of the Kyoto Protocol.
184 Formally known as the ‘Major Economies Process on Energy Security and Climate Change’ – see http://www.state.gov/g/oes/climate/mem/.
185 http://www.g8.gov.uk/.
186 Expanded to include Australia, Indonesia and South Korea.
187 See G8 Hokkaido Toyako Summit Leaders Declaration, 8 July 2008, paragraphs 22-35.
188 Ibid, paragraph 23 – note the absence of a specified base year or shared medium term reduction targets.
that, “this global challenge can only be met by a global response, in particular, by the contributions from all major economies, consistent with the principle of common but differentiated responsibilities and respective capabilities”, it is far from clear that emerging economies take the same view. The Declaration emerging from the larger meeting of the MEM states the need to “ensure the agreed outcome [of negotiations] maximizes the efforts of all nations [with] nationally appropriate mitigation actions, supported and enabled by technology, financing and capacity-building, with a view to achieving a deviation from business as usual emissions” This differently nuanced emphasis is characteristic of post-Kyoto negotiations.

On the relative negotiating positions of Annex I and non-Annex I parties – and hence the future articulation of the principle of common but differentiated responsibility – the most striking development of recent years has been the vast economic expansion of India and China. As we have seen, most of the commitments under the Convention and the Protocol apply only to developed state parties. Given recent patterns of industrialisation, is it appropriate, or sustainable, for non-Annex I parties to continue to be largely unconstrained by the climate change regime? Whilst the Convention and Protocol provide some incentives for developing states to tackle greenhouse gas emissions, through various provisions on technology transfer, the clean development mechanism, and 'additional' funding from developed states and the Global Environment Facility, they have trenchantly resisted the application of quantified emission limitation and reduction commitments.

The background to this position is twofold. First is the historic fact that industrialised economies have long benefited from massive GHG emissions, are substantially responsible for the current problems and should not as such deprive newly industrialising economies from similarly raising the standard of living of their own citizens. Secondly, the rejectionist position taken by the Bush administration vis-à-vis the Kyoto Protocol, and its general appearance as a climate change denier, has not persuaded emerging economies that they are obliged to undertake binding commitments. Moreover, pursuant to Article 4(7)’s '[t]he extent to which developing country Parties will effectively implement their commitments under the Convention will depend on the effective implementation by developed country parties of their commitments….'. Here we can see that the already limited obligations of developing states appear to be conditional on provision of benefits by developed states. Whilst a regime in which one group of states bears most of the burdens and another group reaps most of the benefits accurately reflects a sense of historical responsibility for the causes of climate change it is far from clear that this approach is optimally placed to solve the problem at hand. The question thus arises whether the articulation of the principle of common but differentiated responsibility found in the Kyoto Protocol is sustainable given the scientific urgency indicated by the 2007 IPCC Assessment Reports and the economic realities of Indian and Chinese industrialisation.

189 Ibid.
190 See Declaration of Leaders' Meeting of Major Economies on Energy Security and Climate Change, 9 July 2008, paragraphs 2 and 5.
191 Wording of this kind is found also in the Convention on Biological Diversity, Article 20(4), and see supra Ch 3, section 3(3). On co-operation within the UNFCCC and Kyoto Protocol regime, see Baettig et al, 30 Environmental Science and Policy (2008)
Post-Kyoto, Pre-Copenhagen

As noted above, the Bali Action Plan aims to chart the course for a new negotiating process, with the aim of completion by the Copenhagen Conference of the Parties in December 2009. The preamble to the Bali Action Plan speaks of the need for “deep cuts” in global GHG emissions and refers to the “urgency” of the task, with the work of the IPCC playing an important role. The report indicates that global emissions of greenhouse gases (GHGs) need to peak in the next 10–15 years and be reduced to very low levels, well below half of levels in 2000 by the middle of the twenty-first century in order to stabilize their concentrations in the atmosphere at the lowest levels assessed by the IPCC to date in its scenarios. This goes further than either the Kyoto Protocol or the UNFCCC in emphasizing the immediacy of the problem. The majority of countries, with EU leadership, wished to consider cuts of between 25%-40% for rich countries, by 2020, but agreement was blocked by the USA, Canada and Russia. The commitment to “Measurable, reportable and verifiable… mitigation commitments or actions including quantified emissions limitation” for all developed country parties is however important in ensuring that the USA, which is not a party to the Kyoto protocol, remains involved in mitigation efforts. Although it is moving in a positive direction, the Bali Action Plan frustrates hopes of establishing binding targets, which will be the focus of subsequent negotiations.

The Bali conference made significant progress on putting deforestation and forest degradation firmly on the agenda – issue areas long accepted to mark the most significant failings of the Kyoto Protocol. Decision 2/CP.13 required the SBSTA to undertake a program of work in relation to this, with a report to be made at COP 14. This builds on the groundwork done in the Marrakech Accords on defining and adopting methodologies. The same decision invites developing countries to “explore a range of actions, identify options and undertake efforts, including demonstration activities, to address the drivers of deforestation relevant to their national circumstances”. Developed country parties are “invited” to mobilise resources in support of this, although it is left open what incentives might be provided. Decision CMP3/6 established Good Practice Guidance for land use, land use change, and forestry activities.

The inclusion of Carbon Capture and Storage Technology in the CDM continues to be discussed by the SBSTA. Strengthening of the previous regime on technology sharing is necessary if the potential for cooperation is to be realised. Here the Experts Group on Technology Transfer (EGTT) established by the Marrakech Accords has an important role to play. Decision CP13/3 establishes a very comprehensive work programme including assessing the gaps and barriers to

192 Decision 5/CP.13.
194 Morgan, Post-Kyoto: The International Context for Progress on Climate Change, Memorandum to the House of Commons Environmental Audit Committee, at 1.5.
197 Ibid, at 3.
198 In addition, the World Bank has launched a Forest Carbon Partnership Facility to help demonstrate the feasibility of accurately accounting for REDD reductions. The two components are a $100 million “readiness” fund focusing on capacity building and a $200million carbon finance mechanism for pilot projects. The Bank has already raised roughly half of this money from nine industrialized countries and The Nature Conservancy.
technology transfer, developing a set of performance indicators to monitor and evaluate the effectiveness of the technology transfer framework and bringing forth a strategy paper on how to move forward. The issue of secure funding for the EGTT is also given continued precedence. Decision CP13/4 requests the GEF to develop a plan for scaling up funding for transfer of environmentally sound technologies. Decision CMP3/1 on the clean development mechanism reiterates many of the concerns relating to establishing baselines, approval of methodologies and monitoring that have plagued the CDM from its inception. No promises about the long-term future of the CDM were made. In relation to Joint Implementation, there was again little in the way of radical reform.

Post-Kyoto, the two-track framework of Annex 1/non Annex 1 countries is likely to include further commitments for developing countries. Article 1(b)(ii) of the Bali Action Plan calls for “nation ally appropriate” mitigation actions to be undertaken “in a measurable, reportable and verifiable manner.” This may be compared to the commitments in Article 10(b) of Kyoto Protocol to: Formulate, implement, publish and regularly update national and, where appropriate, regional programmes containing measures to mitigate climate change and measures to facilitate adequate adaptation to climate change.

It is clear that, whilst the Bali Action Plan remains informed by the principle of common but differentiated responsibility, developing countries are increasingly expected to play a full role in mitigation efforts. The language used, although short of binding commitments, indicates that concrete evidence of progress will be required. The strengthening of the Dialogue on Long Term Cooperative Action on Climate Change to form an Ad hoc Working Group is another step towards a more inclusive international framework. This is a positive step in relation to the long-term actions necessary by all countries to address climate change.

**Conclusions**

The foregoing seeks to place the EU’s responses to the climate change challenge in a global and intellectual context. Suffice to say despite its singular contribution to the process, by way of the EU ETS, the EU’s leadership position in the approach to the Copenhagen COP is not secured. This is so not least because of the US position which post-Bush is only slowly emerging, so it is difficult to predict their appetite for adopting a leadership role in the negotiations. The Obama administration is certain to be different from its predecessor’s but what shape that may take is uncertain.

Further uncertainty, and undermining of the EU ETS, arises from the global recession. In early 2009 it was certainly the case that it operated as a significant interruption to the process, and Parties appear reluctant to table serious offers whilst they try to take stock of the impact of the recession. Furthermore, the global downturn is causing both a significant downturn in carbon prices and price volatility – problematic both for the making of investment decisions and the impact on carbon abatement projects. As with Phase I of the EU ETS, the recession is undermining the capacity of markets to deliver meaningful carbon abatements.

199 Decision CP.13/1 at 2.
200 For the most recent EU response, see Communication (‘Towards a comprehensive CC agreement’) COM (2009) 39.
xxiii. Participatory Budgeting: Understanding the new role of participatory institutions in contemporary politics*

(the case of Brazil)

By Leonardo Avritzer

Since the middle of the twentieth century, legitimate government has been increasingly associated with the existence of electoral mechanisms through which the general population of citizens delegate power to political agents authorized to act on their behalf (Schumpeter, 1942; Sartori, 1962; Dahl, 1990; Bobbio, 1984). However, in the last 10 years, democratic theorists have begun to question this association in two ways. Firstly, the construction of a supra-national political organization in Europe created of multiple and superimposed forms of national and post-national representation. The overlapping of different levels of participation and the emergence of a post-national political institution brought into question the role of political parties, which did not exist at the supra-national levels as well as the form of dealing with post-national forms of political representation (Held, 2004; Habermas, 2003; Schmitter, 2000; 2003). In the place of political parties, new forms of civil society representation and political participation (Baquet and Sintomer, 2005) at the European level began to emerge (Risse, 2003), raising questions about how to coordinate various forms of representation and whether civil society organizations could be considered “functional equivalents” of political parties. The question on how political participation fits into the European political arrangement is still an open one.

A second debate that led to the re-evaluation of the role of participation occurred through a variety of experiments in the developing world (or in the South) promoting the participation of civil society organizations in public policy formulation and implementation. These new “hybrid” institutions (Avritzer and Pereira, 2005; Avritzer, 2009) are now very common in Latin America (Dagnino, Olvera, Panficci, 2005; Abers and Keck, 2006; Peruzzotti, 2006), and have also been created in Asia (Heller, 2006; Jun, 2009) and in Africa (Friedman, 2009). Of all these countries, Brazil seems to be one of the most advanced in terms of creating new hybrid forms of state civil society relations.

Political participation in democratic Brazil has been marked by two important phenomena: the expansion of civil society involvement in public policy making and the growth of new types of “participatory institutions”. Since the end of the authoritarian period (1964-1985), civil society actors have demanded greater presence in policy deliberations in health, social services, urban policy and other areas (Coelho, 2004; 2005; Cunha, 2004, Avritzer, 2006, Avritzer, 2007). Alongside increasing support for decentralization and “stakeholder governance” coming from the international policy community, this demand from civil society helped produce a

* Parts of the data used in this paper were originally written in co-authorship with Brian Wampler for the World Bank project “The Expansion of Participatory Budgeting in Brazil”.

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series of new deliberative arenas. The Participatory Budget experiments, initiated by the local administrations of Worker's Party - which involve local citizens in decisions about basic infrastructure - have been studied in depth (Santos, 1998; Avritzer, 2002a; Avritzer, 2002b; Faria, 2005; Wampler, 2008). The Participatory Budget has disseminated throughout Brazil and mobilized large numbers citizens – approximately 180,000 people in four major cities alone in 2004\textsuperscript{202}. Less well studied are hybrid institutions called “councils” which bring together civil society organizations and state actors and have a formal mandate to make health care, social assistance, environmental, urban and other policies at the municipal, river basin, state and national levels, also have a strong impact in Brazil. (Coelho, 2006, Aber and Keck, 2006; Tatagiba, 2002.). Participatory budgeting also expanded to Europe where, in 2008, there were more than 100 cities practicing participatory budgeting (Sintomer, 2008; Alegretti, 2006).

These new deliberative institutions have largely been understood as places of increased political participation in the sense that they increased the direct participation of citizens in the polity. However, it is also correct to point out that their main role has been to bring citizens into policy making arenas and to provide new forms of articulation between participation and representation. These new forms of participation also enhance the deliverance of public goods, making PB an efficient public policy. In this paper, I will first explain the main characteristics of PB in Brazil. Secondly, I will give details of PB expansion inside Brazil and make reference to its expansion in Europe and Africa. Finally, I will make a proposal for the implementation of participatory budgeting in different situations.

The emergence of participatory budgeting in Brazil

The social and political origins of participatory budgeting must be traced back to the tradition of mobilization in the city of Porto Alegre in the extreme South of Brazil during the post-war period. The origin of popular movements in Porto Alegre was marked by the formation of Fracab, Federation of Community Associations in Rio Grande do Sul, in the second half of the 1950s (Silva, 2001: 79). Porto Alegre neighbourhood associations in the 50s aimed to foster a “humanist, anti-paternalist” form of participation which departed from forms of political clientelism organizing associations in other larger cities of Brazil (Silva, 2001: 81). Porto Alegre also had a strong tradition of leftwing politics which can be traced back to the same period. Between 1947 and 1963, the PTB (Brazilian Labor Party) received the largest share of the votes in all the elections for City Council whereas in the rest of Brazil it was closer to 12% of the national vote. Thus, participatory budgeting has its origins in the presence of a more democratic and horizontal political practice in one region of the country during the 1946-1964 democratic period.

Brazil passed through 21 years of authoritarianism after the break of democracy in 1964. At the time of democratization (1985-1988), the main electoral contest at the local level, was between candidates of the left and the right in most Brazilian capitals apart from Porto Alegre. There, the contest was between the PDT, a center-left party which sought to retrieve the populist past, and the PT, which sought to renew the Brazilian left and proposed popular councils to govern cities (Keck, 1992; Aber, 1996). Neighbourhood associations and the PT, however, claimed that the forms of participation were too limited. It was in this context that UAMPA, the União de Associações de Moradores de Porto Alegre, launched the

\textsuperscript{202} This figure refers to 2004 and was obtained by totaling the participation in PBs in São Paulo (80,000), Porto Alegre (30,000), Belo Horizonte (30,000), and Recife (40,000).
idea of participation in the budget-making process (UAMPA, 1986). Porto Alegre was thus the only city in Brazil in which political competition in the aftermath of re-democratization occurred among sectors of the left and centered on the issue of local participation. It was in this context that Olívio Dutra was elected mayor of Porto Alegre in 1988, and introduced participatory budgeting as a means of deliberating on the distribution of public goods by his administration.

Participatory budgeting in its Porto Alegre version (1990-2005), introduced many new institutions, three of them with strong deliberative elements: the regional and the thematic assemblies, the Council of Participatory Budgeting (COP), and the determination of the rules for decision-making. The regional and thematic assemblies are places where participants can make claims, criticize the administrative actions of local authorities, and negotiate their priorities among themselves. In Porto Alegre there are 16 regional and five thematic assemblies. The format of the regions was a point of conflict between social movements and the administration. Social movements pressed hard to maintain the pattern of collective action in the city’s regions, arguing that the administrative design of districts would conflict with the mobilization of many community movements (Baierle, 1998). The city agreed to redesign the regions in a way that overlapped with existing forms of mobilization. Thus, the first element of the deliberative process was an attempt to combine the logics of collective action and administration starting the participatory process from the bottom.

Regional and thematic assemblies are places for discussion and deliberation. An analysis of the socio-economic characteristics of the participants shows the strong presence of poor city-dwellers in the regional assemblies: 30.22% of the participants earn no more than twice the minimum wage and 25.51% two to four times the minimum wage, indicating that participants in the PB come close to the socio-economic condition of the population at large. In each assembly, 45 minutes are open for contributions of the participants. Presence in the assemblies does not necessarily translate into equality at other levels, as is indicated by Table 1, which correlates income with active participation in Porto Alegre’s PB.

Table 1: Socio-economic condition of the participants and of the speakers in the Assemblies in POA

<table>
<thead>
<tr>
<th>Income (multiples of minimum wage)</th>
<th>Participants in the assemblies</th>
<th>Never spoken in assemblies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to 2</td>
<td>30.22%</td>
<td>47.30%</td>
</tr>
<tr>
<td>2 to 4</td>
<td>25.51%</td>
<td>37.90%</td>
</tr>
<tr>
<td>4 to 8</td>
<td>20.60%</td>
<td>37.20%</td>
</tr>
<tr>
<td>8 to 12</td>
<td>9.43%</td>
<td>27.10%</td>
</tr>
<tr>
<td>Others</td>
<td>14.24%</td>
<td>--</td>
</tr>
<tr>
<td>Total</td>
<td>100.00%</td>
<td>100%</td>
</tr>
</tbody>
</table>

203 There are many useful descriptions of the functioning of participatory budgeting which I will not repeat here. For a full description of the process see, Baierle, 1998; Santos, 1998; Abers, 2000; Avritzer, 2002c; Baiocchi, 2002.

204 Source:Cidade, 1999.
We can thus note several deliberative characteristics of the PB regional assemblies in Porto Alegre. In the first place they express the social diversity of the city, a characteristic that establishes a new social balance in deliberation about the distribution of public goods. In the second place, although there are still some inequalities in relation to gender or class participation, there is rough gender equity in the number of interventions. Women participate in PB meetings slightly more than men (51.4% of participants are women) and are also more willing to speak. However, we should also note that socio-economic condition sharply predetermines the inclination to speak. Among the participants who make up to twice the minimum wage, a majority of the participants, 47.30%, have never spoken in an assembly. The number of those who have never spoken stands in inverse proportion to income.

A second deliberative body of the PB is the COP, the Council of Participatory Budgeting. The COP is formed during the second round of regional assemblies, when the region elects councillors to the PB Council. This process leads to the formation of a council composed as follows: two councillors from each of the 16 regions (32), two from each of the five thematic assemblies (10), one from the UAMPA and one from the public service trade union (2). The PB Council has 44 members. Administrative members do not vote, although they participate regularly and wield considerable influence\(^{205}\). The PB Council is a deliberative body in which two types of negotiations take place: between community members on their priorities and between community members and the administration on the final format of the budget. Several decisions are made at this level, among them the substitution of previous assembly deliberations by other deliberations due to what is called a ‘technical veto,’ when the administration disallows the decisions of regional assemblies on technical grounds. The most common vetoes involve environmental, property, and financial issues. Common environmental vetoes in Porto Alegre include the channelling of local creeks, which the population demands but the administration regards as a cause of summer floods\(^{206}\). Property issues involve the misidentification of land as belonging to the city; when it turns out to be owned by state companies, the state, or the union, the cost of public works increases.

Financial issues, finally, which involve the cost of extending sewage or water pipelines. In all these cases, there is vigorous debate between the members of the PB Council and the administration, with mixed results. One of the important results of these debates is the requirement imposed by the administration that the technicians attend the regional and thematic assemblies and discuss their positions on these issues with the population. Again, it is important to note that the presence of the technicians in popular assemblies enhances their deliberative nature. PB council is also a key element of bottom-up design. It is an institution constituted at the end of open entry assemblies. In spite of the use of representation in its composition its members are strongly linked to the regional leaderships from the places in which they have been elected. The presence of PB councils is a key element of bottom-up design because it expresses the concentration of most of the decision-making process in the hands of civil society actors.

\(^{205}\) To my knowledge there is only one city in which the administrative members vote in the PB Council, the city of Santo Andre. Santo Andre changed the composition of its P.B. council in 2004 and cancelled voting prerogatives of the administrative personnel

\(^{206}\) Pavement has been the public good mostly demanded in Porto Alegre since the emergence of the PB. As of today, 6 million square meters of pavement have been laid. As a consequence of the increase in the amount of pavement in the city, the soil of the city became impermeable and summer flooding increased. This has led to a technical veto on new channeling of creeks.
The third deliberative element of the PB is the process of decision-making on rules for deliberation. Porto Alegre inaugurated a rule-making process that has been followed by other cities in Brazil. In this process, the city determines the initial rules for deliberation (regimento), and then the PB Council is able to change them at the beginning of the following year. These rules involve: the composition of the Council of PB (COP); the attributions of the COP; rules for the election of local delegates; conditions for losing a mandate; rules for argumentation in the COP; rules for the election of a coordination body within the COP; and, last but not least, rules by which the COP can change the rules for deliberation. Thus, the COP may be understood to be a body which sets up its own forms of regulation, from its composition to its rules for deliberation. It shares some of its prerogatives with other bodies, such as the CRC and the GAPLAN. However, the final budgetary deliberation takes place at the COP level and includes making rules for the COP’s future operation.

The most familiar theories about Porto Alegre’s PB argue that participation increased quickly due to its deliberative elements (Avritzer, 2002a; Baiocchi, 2003; Wampler and Avritzer, 2004; Santos, 2006). Despite low rates initially, participation in the new institution grew rapidly and it is worth exploring the details of the process. Regions with previous traditions of participation, like Parthenon or the East zone of the city, had relatively high levels of initial participation whereas regions without such traditions, such as Restinga and Navegantes, had lower levels. Here, we see again the importance of civil society organization for the emergence of the institutional innovation. Without the participation of neighborhood association members in the initial deliberations, the process could have collapsed. Learning and demonstration effects occurred as the neighborhoods singled out above received more benefits than the least organized regions, leading to the reorganization of the more populated neighborhoods (Abers, 2000; Wampler and Avritzer, 2004; Baiocchi, 2005). PB in Porto Alegre has enjoyed steady growth in participation, rising from 976 people in 1990 to 26,807 in 2000. This evolution tells us something important about the relationship between civil and political society in the consolidation of participatory arrangements. Civil society was responsible for the initial success of the arrangement by providing the participatory institution with actors capable of fulfilling the roles required of them: attending meetings, identifying neighborhood problems, and participating and deliberating in councils (Wampler and Avritzer, 2004). Political society and the state then generalized previously existing practices to the rest of the city: they extended forms of participation to other neighborhoods and ensured that this would be the only way of claiming public goods in the city. Together, the two actions led to the consolidation of participatory budgeting in the early nineties as a strongly deliberative institution.
## Table 2: Participation in Porto Alegre’s P.B. by selected regions

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Regions with strong</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>associative traditions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Leste</td>
<td>152</td>
<td>510</td>
<td>339</td>
<td>623</td>
<td>710</td>
</tr>
<tr>
<td>Lomba</td>
<td>64</td>
<td>569</td>
<td>575</td>
<td>973</td>
<td>638</td>
</tr>
<tr>
<td>Partenon</td>
<td>75</td>
<td>1096</td>
<td>661</td>
<td>809</td>
<td>805</td>
</tr>
<tr>
<td>Cruzeiro</td>
<td>181</td>
<td>297</td>
<td>494</td>
<td>649</td>
<td>604</td>
</tr>
<tr>
<td>Regions with weak</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>associative traditions</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Navegantes</td>
<td>15</td>
<td>165</td>
<td>135</td>
<td>495</td>
<td>624</td>
</tr>
<tr>
<td>Nordeste</td>
<td>33</td>
<td>276</td>
<td>350</td>
<td>682</td>
<td>906</td>
</tr>
<tr>
<td>Restinga</td>
<td>36</td>
<td>369</td>
<td>1096</td>
<td>763</td>
<td>1348</td>
</tr>
<tr>
<td>Centro-Sul</td>
<td>101</td>
<td>591</td>
<td>352</td>
<td>151</td>
<td>1461</td>
</tr>
</tbody>
</table>

Thus, it is possible to note the importance of Porto Alegre in the emergence of the participatory design. Porto Alegre’s politics is directly linked to the bottom-up design of participatory budgeting. Civil society and political societies in the city have influenced a radically participatory design that caught the attention of Brazilian political actors from the early nineties on. However, in spite of the influence of civil society in the original design and in spite of the consensus of Porto Alegre’s political society on the design, two issues are important to keep in mind: the first one is that PB expanded from Porto Alegre to other cities in Brazil from 1993 to 1997 mainly due to the initiative of the PT. From 1993 to 2000 the number of PB cases expanded to 120, among them 37 (49%) belonged to PT administrations; in spite of the fact that most of the expansion of PB from 1993 onwards was based on the bottom-up design of Porto Alegre, most of the new cases adapted the design in its bottom-up elements in order to make it more palatable to both the local PT and the rest of political society, in particular, City Hall. In the next section of this article I will deal with the expansion of participatory budgeting to other regions and cities in Brazil.

### The expansion of participatory budgeting in Brazil

Participatory budgeting emerged in Porto Alegre in 1990 and expanded to the rest of Brazil and, by the beginning of the 21st century, to many other counties in Africa, Europe, Latin America and Asia (Avritzer, 2002a; Wampler, 2003; Wampler and Avritzer, 2005; Sintomer, 2008). The expansion of participatory budgeting in Brazil is noteworthy for numeric, political, and regional reasons. Numerically, PB expanded from 13 cases in 1992 to 53 in 1996 to 120 in 2000 to 190 in 2004 and to 201 cases at the end of 2008. The significant expansion of PB over a twenty-year period means that PB has been adopted in municipalities that are significantly different from Porto Alegre, the municipality with the first PB program. The greater number of PB cases, combined with a careful tracking of PB over the past twenty years now provides us

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207 Source: Wampler and Avritzer, 2004
with an incredible opportunity to better understand how factors such as region, municipality size, and political party affect how PB programs function.

The adoption of PB evolved in regional terms as PB expanded out of its original base in the South and Southeast of Brazil to other regions, particularly, the Northeast region (see table 3 below). The expansion of PB poses important research and institutional design questions to policy makers: How does municipality size or region affect PB performance? Which are the important institutional design innovations and continuities? How does variation in the institutional design of internal processes affect PB performance? Finally, how does party governance affect PB performance? There has been a de-centering of PB as it is no longer closely tied to the Workers’ Party, which led us to investigate how PB has been adapted to meet local needs.

Table 3: Experiences of P.B. in Brazil

<table>
<thead>
<tr>
<th>Year</th>
<th>Total number</th>
<th>% PT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989-1992</td>
<td>13</td>
<td>92%</td>
</tr>
<tr>
<td>1993-1996</td>
<td>53</td>
<td>62%</td>
</tr>
<tr>
<td>1997-2000</td>
<td>120</td>
<td>43%</td>
</tr>
<tr>
<td>2000-2004</td>
<td>190</td>
<td>59%</td>
</tr>
<tr>
<td>2005-2008</td>
<td>201</td>
<td>65%</td>
</tr>
</tbody>
</table>
The map below shows the spatial distribution of PB experiences:

Figure 1: Distribution of 2005-2008 PB experiences

The main identified in PB are: (a) the institutional design of the participatory process that brings citizens into budgetary decision-making; (b) the administrative agency/department that is responsible for the program; and (c) the frequency with which the participatory budgeting process is held. In the following sections of this article, I will outline each one of them.

**Institutional Design**
Participatory budgeting emerged in Porto Alegre with a very specific design as I have demonstrated above. Assemblies would take place every year at the regional level (sub-municipal). Two processes, based on the results region-level deliberations and voting, ensured that policies were implemented according to the demands of the regional assemblies. A municipal-wide Participatory Budgeting Council would oversee the drafting of the budget and the implementation of the public works would be carried out by the planning department (GAPLAN). A detailed analysis of these institutions shows that they were designed to fit into Porto Alegre’s politics. Regional
assemblies were designed to fit in with the participatory logic of the city of Porto Alegre, which was very intense in the beginning of the 1990s. The structure of a council and an administrative agency were also important for the success of participatory budgeting. The PB Council was important to establish a process of debate on budgetary issues outside the government. The regional assemblies were not the place for in-depth discussion on the whole of budget due to the importance of technical issues and also due to the way citizens and CSOs were organized. Many important issues were discussed in the assemblies such as who will acquire housing or whether the city would need new large avenues, such as the third “perimetral”, the most expensive public work carried out in Porto Alegre during the 90’s.

In addition, GAPLAN (Planning Department) also played an important role in the success of participatory budgeting in Porto Alegre due to many coordination issues that emerged from the participatory process and needed to be tackled by the administration. An administrative body with direct links to the mayor helps to solve crucial problems in the implementation of PB. Since the organization of PB in Porto Alegre was based on the political needs of CSOs and government officials, it is important to see how variation in this feature would affect the PB process. Today in Brazil, the most successful cases of participation have adapted the Porto Alegre’s proposal of PB administrative organization. In a research carried out in 2008 we found that in 32, % of cases, the PB administration is transferred to the Planning Secretary. If we concentrate on cases of continuity of PB for at least eight years, this data increased to 38, 2% (Avritzer and Wampler, 2008). In our view, this demonstrates that adaptation of the PB administratite location is one key to its success.

Thus, the Brazilian experience shows many different options of institutional design for participatory budgeting Belo Horizonte placed PB in its Planning Department, as did the city of Recife but there are other alternatives such as its allocation to the secretariat of government or the creation of a participatory budgeting secretariat which the city of Uberlandia did in the late nineties. It is important to evaluate success in relation to where participatory budgeting is allocated when we consider the possibility of expansion of the experiences of participatory budgeting to other countries in Latin America and Africa.

It is also important to analyze, the cycle of the participatory process as we discuss reasons for variation. Porto Alegre’s participatory process has been on a yearly basis. However, the yearly process does not fit completely with the administrative dynamics. Very few public works can be delivered in one year, due to the manner in which the Brazilian public administration works. Bidding processes in Brazil are slow as is the administrative process of implementation of public works. Although participatory budgeting created a public pressure for more efficiency in both areas (Marquetti, 2003), the fact that it assumed an unrealistic view about the completion of demands did not help its success. The solution of the city of Porto Alegre was to try to finish most of the demands for public works before the electoral period (Santos, 2002). Therefore, variation in timing is an important consideration when we think about the expansion of participatory budgeting. A more realistic approach as to how long it takes to process demands and how not to make excessive demands that governments may not be willing to meet in the short term is important for the success of participatory budgeting. Thus, it is important to bear in mind the two main variations caused by PB expansion: institutional placement of PB in the administration and duration of the budget cycle. Both of them should be adapted during the process of expansion of participatory budgeting.
Cases of Participatory Budgeting 2005-2008: explaining long term trends

The number of cases of PB in Brazil during the 2005-2008 period is 201 (Avritzer and Wampler, 2008). This number is nearly the same between 2001 and 2004 (172 according to a previous research and 199 in our most recent data collection). The first important issue to analyze is the distribution of cases according to region and municipal size. Historically, Brazilian PB case experiences have been concentrated in the South and Southeast regions, as well as in municipalities with more than 100,000 residents. With regard to city size, the first observation is that 41% of the 2005-2008 experiences are located in cities with more than 100,000 residents and 40% of all PB cases are located in cities with a population between 100,000 and 500,000 people. Importantly, this means that a little fewer than 50% of the PB cases were functioning in either small or mid-sized municipalities.

A second clearly identified trend is a change in the regional profile where PB is being adopted. There has been a de-concentration from a strong presence in the South and Southeast regions of Brazil and a growing presence in the Northeast region. Table 4 hereunder shows the PB experiences in Brazilian regions during the 2001-2004 administrative periods and compares it with the incidence from 2004 to 2008. Furthermore, the growth in PB in the North doubled during 2005-2008, which is remarkable given the smaller number of municipalities in this region (verify # of municipalities per region). There was also a comparable level of growth in PB cases in the Center-West region, also with conditions of minimal growth.

Table 4: Percentage of PB experiences

<table>
<thead>
<tr>
<th>Regions of Brazil</th>
<th>Years</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>North</td>
<td>2,5%</td>
<td>5,5%</td>
<td>8,5%</td>
</tr>
<tr>
<td>Northeast</td>
<td>14,2%</td>
<td>22,6%</td>
<td>22,4%</td>
</tr>
<tr>
<td>South</td>
<td>39,2%</td>
<td>22,6%</td>
<td>21,9%</td>
</tr>
<tr>
<td>Southeast</td>
<td>41,7%</td>
<td>45,2%</td>
<td>41,3%</td>
</tr>
<tr>
<td>Center West</td>
<td>2,5%</td>
<td>4%</td>
<td>6,0%</td>
</tr>
</tbody>
</table>

Thus, it is possible to make the following argument on incidence of PB experiences in Brazil between 1997, 2004 and 2008. There is a de-concentration of experiences from the South and Southeast regions. The decrease is more important in the South whose number of experiences decreased by 10% from 32, 9% to 22, 9%. The number of experiences in the Southeast region remained more or less stable concentrating 40, 2% of the experiences. The most important increase has taken place in the Northeast region where the total of experiences went from 16,45 to 21,0%. The above data indicates a new equilibrium among PB experiences among Brazil’s regions.

208 Brazil has 5,592 cities. However most of these cities are very small. The number of cities with more than 100,000 inhabitants in 2008 was 224 (4%).
Continuation/Maintenance of PB programs

An interesting finding is the degree of continuity of PB between the 2001-2004 and 2005-2008 administrative periods. We differentiate between two kinds of continuity: the first is between two administrations (2001-2004, 2005-2008) and the second over three mayoral administrative periods (including the 1997-2000 periods). There are 116 cases of continuity during the 2001-2004 and the 2005-2008 mayoral periods. There are 40 cases of PB continuity between 1997 2008. What characteristics are associated with municipalities where PB endures?

The first important characteristic of the cases of PB continuity is that these cities have socio-economic living standards that are well above the Brazilian and the PB average. The Brazilian HDI is 0,699, and the average HDI for cities which have PB is 0,753. When it comes to continuity this average goes even higher reaching a gap in between 0,701 and 0,800 in 47,4% of the cases.

The population of the municipality and that of the municipality’s region are two other factors that have a significant effect. Continuity between 2001 and 2008 was stronger in the Southeast region with 40,9% of the cases. When it comes to the second higher incidence of continuity the Northeast and the Southern regions occupy the second place with 23,6% of the cases. Table 3 below summarizes the cases of continuity according to region and size of city:

Table 5: Continuity between 2001-2004 and 2005-2008 mayoral periods

<table>
<thead>
<tr>
<th>Regions of Brazil</th>
<th>%</th>
<th>Size of city</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>North</td>
<td>5,6</td>
<td>Up to 20,000</td>
<td>19,1</td>
</tr>
<tr>
<td>Northeast</td>
<td>30,3</td>
<td>From 20,001 to 50,000</td>
<td>21,3</td>
</tr>
<tr>
<td>Center West</td>
<td>5,6</td>
<td>From 50,001 to 100,000</td>
<td>14,6</td>
</tr>
<tr>
<td>South</td>
<td>15,7</td>
<td>Above 100,001</td>
<td>39,3</td>
</tr>
<tr>
<td>Southeast</td>
<td>42,7</td>
<td>Above 100,001 and 500,000</td>
<td>5,6</td>
</tr>
</tbody>
</table>

Two important patterns in the data on continuity can be ascertained: The first pattern already noted in Wampler’s and Avritzer’s (2005) work is the concentration of PB cases and the cases of continuity in cities with socio-economic indicators above the Brazilian average. There are two explanations: the first one regarding the election of administrations whose cities rank between in the HDI cannot be explained by PB itself. It is the strong electoral presence of the PT in these cities that may explain the implementation of PB there. The PT is elected in these cities and implements participatory budgeting there. However, the continuity issue has to be explained in a different way since administrative continuity in Brazil is not so strong and large cities are particularly competitive.209 Here the explanation of administrative success emerges as strong and PB is a large part of this argument. Large cities with high HDI have more likelihood of having PB for 8 or 12 years

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209 The rate of administrative continuity at the local level in Brazil is 39,4%, the number of reelected mayors in the year 2000. There is a regional variation in this number with a 48,2% rate of reelection in the Northeast and 34,1% in the Southeast.
showing that there is a combination of strong electoral insertion of the PB and the success of the administrations which have implemented it.

The second pattern has to do with the expansion of PB to the Northeast region. In previous researches made on a number of cases of PB since 1997, the Northeast region of Brazil always ranked low in terms of number of cases. In between 1997 and 2003, the Northeast region has had 14 cases of PB totaling 13.6% among the 103 cases (Ribeiro and Grazia, 2003). In the following administrative period between 2001 and 2004, the Northeast region had 30 out of 170 cases making up 16.4% of the total cases (Wampler and Avritzer, 2005). In the current administration, 2004-2008, the number of cases of PB in the Northeast region increased to 21%. Thus, we can see a change in the regional profile of PB with the number of cases decreasing in the Southern region and the number of cases increasing in the Northeast of Brazil. What kind of new institutions does PB involve and how does it work in the Northeast? Does it have an impact on the administrative performance in the region? What can be proposed in terms of PB expansion to other countries?

**Understanding the Potential of the Expansion of PB**

Participatory budgeting can be expanded outside its initial context. Data for Brazil clearly shows that participatory budgeting has expanded to all regions and has recently made important inroads in the northeast of the country, one of its poorest regions. However, in order for participatory budgeting to expand outside its original context, two conditions must be met (and they are valid outside Brazil as well).

The first one is an institutional adaptation. Porto Alegre, the city that generated PB produced specific institutions, including a direct link between the mayor’s office and PB which gave the latter a centrality in the public administration. The expansion of PB tends to change this institutional arrangement. In its expansion to other cities in Brazil, but also to European cities, PB transforms itself into one participatory policy in the administration. This changes its relation within the administration and it is better for PB in this situation to be located in Planning Secretariats. The data that we have for Brazil shows that this adaptation is not crucial for the success of PB that may still have democratizing and distributive effects in this situation.

The second important issue involved in the expansion of PB, particularly to poor regions, is the way it allocates cities to regions and increases access of the poor to public goods. This is the most important aspect of PB that is reproduced in most of the new experiences in Brazil: distribution of public goods in the poor regions based on lack of access to public goods. This is the aspect that makes PB distributive and whose results are very clear. This feature is also readapted in many experiences, some of them involving the distribution of public goods and others expanding PB to the discussion on how to re-organize social policies.

The last important point to be made is the adaptation of the budgeting cycle. PB was introduced in Porto Alegre as a yearly budget program. However, even in Porto Alegre this was one of its most vulnerable points, because as I have already stated, it is very difficult to implement budget decisions in Brazil in a one year time gap. One of the important adaptations of PB, that also seems to work well in other countries in the developing world, is the biannual budget cycle for PB. It has been adopted in important cities in Brazil such as Belo Horizonte and Montes Claros. This is also one of the adaptations that make sense at the international level.
To conclude, PB is an important instrument for the democratization of public policies in Brazil. It has been successfully expanded outside Porto Alegre. One of the reasons for its portability is its adaptability to different institutional formats. Experiences in Brazil and elsewhere show that once PB is adapted it can work well in different contexts.
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xxiv. Democracy and New Technologies: Democratic innovation or illusion?
By Fernando Mendez

The various contributors to this volume have been asked to consider the phenomenon of globalization and to critically evaluate its impact across a number of areas. One of the areas, which like globalization is equally difficult to pin down, is the topic of democracy. In this essay the nexus between democracy and a specific attribute of globalization, namely technological change will be explored. Fortunately, the editors have provided a small analytical window of opportunity for grappling with what would otherwise have been a herculean task. Instead of an academic-style paper on the topic, the editors have asked for a macroscopic overview of the salient themes and some indication (speculation) on possible longer term trajectories. Nonetheless, the fact that both globalization and democracy constitute examples of contested concepts par excellence suggests that some definitional precision will be in order. This is what I propose to tackle in the first section, and then proceed to delimit a narrower area that is focused on the purported impact of technological change on a variety of democratic processes. Against this backdrop I will then explore three possible medium term trajectories for ICT and democracy.

On globalization
Let us start, then, by saying a few words about globalization. The concept is used to refer to a complex array of overlapping processes at the macro-level that seem to be related to the increasing intensity and variety of interactions between individuals and social groups across space and time. In facilitating these myriad exchanges of an economic, cultural, political and social nature, the most recent manifestation of globalization has overcome a series of previous barriers in an unprecedented way. However, contrary to suggestions of automaticity, globalization is an overtly political phenomenon. Indeed, we need not be reminded of Polanyi's observation that liberal markets do not emerge in a political vacuum to realize globalization's political nature, or that the present process has been encouraged, if not subsidized, by a complex decision-making web of generally acquiescent political authorities. Politics matters, it could hardly be otherwise. More relevant to our analysis, however, is the fact that what appears to matter most is a particular form of politics practiced in a specific type of political regime, a democracy. In other words, at the forefront of the process we refer to as globalization are some of the world's oldest democracies. Admittedly, these archeo-democracies have been recently and enthusiastically joined by a variety of neo-democracies -the latter being a rather broad church which includes many regime types that more accurately warrant the label of hybrid-democracies. It appears that democracy and globalization seem to be interlinked in ways that make it extremely difficult to identify any clear direction of causality. At such a meta-level of abstraction the tensions, interactions, and feedback mechanisms between democracy and globalization make it difficult to discern possible pathways of cause...

210 Mr. Fernando Mendez, E-Democracy, University of Zurich, Switzerland
and effect. We could therefore try a move down the ladder of abstraction. One way to accomplish this is by focusing on a particular manifestation of globalization and trying to investigate its impact on democracy. This will be the approach adopted in this essay.

One relatively unambiguous manifestation of globalization is the role of technological change. The spectacular global proliferation of the Internet since the mid-1990s offers us an illustrative example of such a process of technological change. The Internet merely represents one of the latest innovations in information and communication technologies (ICT), though it is arguably one of globalization's most potent symbolic markers. As an example of technological change, the ICT variable can at least be broken down into analytically manageable chunks. Furthermore, a causal type relationship between ICT and democracy can be specified that, in principle, is empirically explorable. The thesis could be formulated in the following way: the rapid, apparently uncontrollable diffusion of ICT is impacting upon the way in which citizens, civil society and political authorities organise themselves, communicate and exchange information with each other, and take collective decisions. This is a relatively easy question to answer in the affirmative. In countries where there is access to ICT, say, above a certain minimal threshold, it is reasonable to assume that ICT is impacting on the way certain individuals, groups and political organisations interact and perhaps even ultimately on how they take collectively binding decisions. The interesting question, therefore, is not whether ICT is having an impact per se, but rather the intensity, direction and overall effect of the impact. For political scientists the pertinent research question is typically formulated in terms of whether ICT is having an effect on democratic performance. When this question is asked in relation to one or more democratic regimes, the methodological aim is to somehow attempt to isolate the ICT variable and ascertain whether the latter has had any effect on some democratic criterion, such as the quality or quantity of political participation. The range of applicable democratic criteria suggests that there are important ideational and normative considerations at play when addressing the purported impact of ICT on democracy. We will attempt to specify this connection more fully below.

On ICT and Democracy

Two questions are raised by the discussion thus far. First, what do we mean by ICT and, second, how might it affect democratic processes. The first question is relatively easy to answer since it has an obvious material manifestation. As the acronym suggests, ICT refers to a vast array of information and communication technologies that had been around for some time as largely separate fields, but which converged spectacularly in the 1960s to bring about various so-called revolutions, the IT revolution, the mobile phone revolution, and the Internet revolution -to name but a few. Thus, ICT is a broader concept than the Internet and it includes other channels such as mobile telecommunications or digital television. Much more sophisticated taxonomies of ICT could obviously be formulated, but this would not necessarily add much to our understanding since the material dimension of ICT is characterised by rapid change or, to put it more accurately, by an accelerating pace of technological obsolescence. In other words, even in the short term the physical properties of ICT are changing so dramatically that it makes little sense to try to anticipate medium-term, let alone longer term dynamics. From a quantitative standpoint, therefore, we can assume that the variety and scope, as well as the intensity and frequency, of ICT-enabled interactions is likely to increase and spread over time. In terms of our
line of inquiry, this suggests that fine distinctions or extended taxonomies of the material properties of ICT are less important than ICT's normative application in the political realm. This ideational dimension, which will be clarified below, has attributes that are more 'sticky' than those properties of a material nature.

The importance of ideational factors calls for a more carefully tuned analysis of the application of ICT to the democratic process. Such an approach is less concerned with statistics on the availability and deployment of this or that ICT technique in a given country and its possible correlation with a country's rank on some quality of democracy measure. Many social scientists engage in this type of inquiry by making use of the datasets readily available from international agencies specialized in compiling such statistics. The correlations that emerge from this type of study might demonstrate empirical regularities, for instance that authoritarian regimes have less internet hosts per capita of population than democratic regimes, or that archdeo-democracies tend to have higher ICT deployment than neo-democracies. Though valuable in themselves, such findings can only scratch the surface of the social phenomenon. Whilst it may be possible to agree on certain objective brute facts about the material dimension, i.e. the rate of broadband penetration, the number of internet service providers, the number of mobile phone subscribers etc., what is missing from this account is what philosophers call intentionality. In the social (and political) world, the physical brute facts are directed at something and it is this intentionality that largely distinguishes the social sciences from the natural sciences. Intentionality is thus a convenient way to bring the discussion back to what it is that ICT techniques are directed at. This raises the second, more complex question of how ICT may affect democratic process.

Once we have shifted from the relatively simple material properties of ICT to examine its directedness in relation to democratic processes, a host of tricky issues are raised mostly connected to the meaning of democracy. Scholars have argued endlessly over this question and we shall not rehearse it in any detail here. The most relevant point for our discussion on ICT and democracy is perhaps the rather heated debate during the 20th century on whether to concentrate on the form of democracy (i.e. its procedural features), or whether to focus on democracy's content (i.e. its substantive features). It is probably fair to say that the debate was resolved in favour of the former rather than the latter, though as we shall see below, the substantive features of democracy cannot be ignored. Scholars who focused on the form of democracy tried to ascertain what constitute the minimal features of a democracy while remaining agnostic as to specific institutional arrangements. Notable attempts at a minimalist or generic working definitions of democracy include those offered by Schumpeter, for whom democracy was a 'method' for arriving at political decisions, or Dahl's influential conception of democracy which is premised on the continued responsiveness of rulers to the preferences of the citizens, as well as more recent attempts, such as those of Schmitter and Karl, which have stressed the notion of accountability.

What tends to unite scholarship on the form of democracy is the following. First, a focus on the relationship between citizens and rulers and second, a minimalist understanding of the properties of a democratic regime that does not privilege any specific institutional arrangement or format. By adopting a minimalist understanding of democracy's operational procedures we can answer the 'directed at what question' in relation to ICT. If we understand democracy as a form of governance in which citizens hold rulers accountable for their actions or where rulers are more responsive to citizens' preferences, then we can delimit our empirical
inquiry on the impact of ICT to precisely this narrower dimension. This substantially reduces our analytical universe. On the plus side, the benefit of this property reduction is that it allows us to exclude a wide range of ICT-related phenomena that are mentioned in the literature and frequently conflated as being part of a democratic process but do not satisfy this condition. For instance, this understanding would exclude a range of ICT innovations in e-government or e-administration which are all about making government operate more efficiently rather than democratically. On the down side, we are still left with a vast array of ICT techniques that could potentially be used to make rulers more accountable and responsive to citizens. This suggests the need to refocus on questions of intentionality and, more specifically, on some of the underlying normative conceptions of democracy that underpin ICT experimentation. Why should this be so? Well, for the simple reasons that the material properties of ICT cannot be divorced from their social intentionality. It is this interaction between the material and the ideational that defines the social facts we are trying to investigate. What I will suggest is that ICT techniques deployed in the democratic realm can be grouped under three primary categories and that this should probably hold across different linguistic and cultural divides. This is because ICT techniques applied in the democratic realm, as defined by our minimalist understanding, are informed by particular conceptions of democracy. It could hardly be otherwise. At the risk of gross simplification, there are at least three ideal type conceptions of democracy whose primary focus is on strengthening specific mechanisms of (1) representation; (2) participation and (3) deliberation. We shall now investigate the connection between each of the three models of democracy and the development of specific ICT techniques.

**On three conceptions of democracy**

All conceptions of democracy are based on some ideal account of values, e.g. freedom, political equality, enlightened understanding, and these values inform prescriptions about specific institutions such as the functioning of elections, forms of direct participation like citizens' initiatives, or deliberative institutions such as citizens' juries. Each of the three conceptions analysed below occupies a large space in political theory and one could easily identify additional models. Furthermore, there can be a great deal of overlap between them. Nevertheless, as we shall see, the three highly stylized conceptions of democracy have rather important prescriptive implications for our inquiry into ICT-enabled democratic experimentation.

1. **ICT and representation:** ICT techniques are especially suited to improving the transparency of the political process. This is very important for the representative conception of democracy because of the delegated nature of modern forms of liberal democracy. Since universal participation in the contemporary national state is impractical for reasons of size and scope of policy-making, the classical variant of democracy had to be reinvented to incorporate mechanisms of representation. The key was to have citizens elect political representatives at regularly convoked elections and to be able to hold them accountable through sanctioning measures such as dismissal at subsequent elections. For some proponents of this minimal conception, such as Schumpeter, democracy was simply an efficient method for citizens to choose among a cartel of competing elites who would then get on with the job of governing. Through this act of delegation and ex-post sanctioning, the principal (citizens) would exert control over its agent (political representatives).
In such a political marketplace greater transparency is an important lubricant because it helps to reduce information asymmetries between agents and their principals, increases competition among elites, and may even ultimately lead to more electoral choice.

Within the representative conception, ICT offers the potential to improve political transparency and monitor representatives more closely. A rather primitive example (these days) is a basic government website, which could contain information on parliamentary sessions, pending bills, as well as delegates' salaries, their declared commercial interests, and so forth. More sophisticated versions might have webcast feeds of live parliamentary debates, committee meetings etc., and these could be coded and archived in ways that facilitate an easy retrieval of information. There is no need to be restricted to the websites of political authorities, political parties or representatives. In fact, the websites of politically active civil society organisations could become increasingly rich repositories of political information. Many such websites are presently searchable by electoral district or constituency and provide information on, say, a representatives' campaign donations and their subsequent voting behaviour. Sometimes they offer tools that reveal representatives/candidates or political party's position on salient issues and allow for these to be matched with citizens' own preferences. ICT tools are being developed to enable citizens to monitor their representatives' performance in novel ways, in real time or through pre-configured alert systems on salient issues that have been pre-selected by citizens. In short, the ability to collect and store political data, organise it and retrieve it seamlessly and instantaneously is unprecedented. However, the intriguing element that flows from a representation conception is that it is not vital for citizens to actually get actively involved. The business of monitoring can be simply left to intermediaries organisations such as the media and civil society. The lubricant of ICTs helps to achieve a more transparent and efficient political marketplace, with improved signalling mechanisms that foster greater competition among competing elites and improved electoral choice. Crucially, these ICT developments do not require much time or commitment from citizens since competitive elections still provide the central mechanism for dismissing representatives.

2. **ICT and participation:** The participatory conception of democracy is rather more demanding of the citizen than the previous model. In its ideal form it would resurrect many of the perceived positive elements of Athenian democracy, in terms of an assembly of directly participating citizen legislators, while avoiding some of its more unsavoury features such as its very restricted notion of who counts as a citizen. Although the modern variant of participatory democracy has many strands to it, there is an identifiable common thread. This is the notion of self government by a community of citizens directly engaged in the process of making the decisions by which their lives are regulated. Rather than the passive involvement of the representation model, participatory democracy is predicated on an active conception of citizenship. However, as noticed by Rousseau -one of participatory democracy's most famous proponents- the model is only suited to small-scale communities such as the city-states of Ancient Greece, Renaissance Italy, or his own birthplace in the Republic of Geneva, rather than the modern national state. It is precisely on this last point where some theorists see potential for ICT to overcome constraints such as size and scale. Like the New England town
meetings that inspire this model, the starting point for a participatory variant would be at the local level where citizens would interact directly with one another. These horizontally spread community assemblies could also be vertically integrated through regional and national systems that enable citizen legislators to actively discuss salient issues at all levels of political aggregation. Furthermore, since political participation is radically incomplete without an actual decision at the end, citizens would need a mechanism to make their preference count. This is where the mechanisms of direct democracy, such as the referendum and the citizen’s initiative, come into play.

In the participatory model the properties of ICT operate in at least two principal ways. First, they provide the logistic tools for distributing the flow of information within and across communities at all levels of public aggregation. This is no small achievement even in a medium-sized country let alone a continent-sized democratic polity such as the US or India. Second, ICT can be used to facilitate the decision-making process through a variety of electronic voting technologies permitting citizens to not only express their preferences on a range of issues but to do so in a convenient and effortless way. In this regard, one could list a host ICT tools that can be used, and are being developed, in order to facilitate citizens' direct participation such as e-voting, e-consultation, e-petition, e-budgeting, e-referendums, e-enabled citizens' initiatives, and so forth. One could make a number of further distinctions such as the degree to which the results of any ICT-enabled direct participatory mechanism are legally binding on authorities (e-consultation may not be, whereas an e-enabled referendum could be) and whether they are initiated top down or from a bottom up process. An e-enabled citizen's initiative or an e-petition is bottom up (i.e. proactive) whereas an e-consultation or e-budgeting is generally top down (i.e. reactive). Notwithstanding these distinctions, the cumulative impact of these ICT tools, if made available and used intensively, offer radical opportunities for reconfiguring current models of democracy by opening up new spaces for direct forms of citizen participation.

3. **ICT and deliberation:** The deliberative model is the most demanding on citizens. It sets a high standard for citizen deliberators who are expected to interact discursively with one another on the basis of reasoning that is rational and acceptable to all. The intellectual backdrop to much of the present deliberative discourse swirling in the air flows from two sources on either side of the Atlantic: the revival of political philosophy in the Anglo-Saxon world brought about by the American philosopher, John Rawls, and work on the transformation of the public sphere by his European contemporary, Jurgen Habermas. Building on the latter's conception, in an ideal deliberative setting where participants are exposed to a plurality of viewpoints; legitimate public policy making is about reasoned argumentation. Arguing or deliberating acquires some very special procedural characteristics in this conception. Put very simplistically, in tackling a given issue of public salience, citizen deliberators' first need to be capable of imagining themselves stripped of their possible communal associations, ethnic, class and professional ties, etc. This generates favourable conditions for a type of political argumentation that is more enlightened since it is constrained by the need to argue in terms of a universal common good rather than the particularistic interests of a specific group or constituency. In this more impartial speech setting, the 'force of the
better argument' is likely to prevail, as is its corollary, a more legitimate public policy. Whether one comes at this from a Rawlsian 'original position' or a Habermassian 'ideal public sphere', philosophically both tend to converge on some rationalist procedure for creating legitimate public policies.

How, then, does the deliberative conception relate to ICT? The simple answer is that ICT can help to create favourable conditions for deliberative interactions by opening up new, online spaces of opinion formation. The spectacular proliferation of social networking sites, such as Facebook or MySpace, is an example of the technological architecture that could be used to this effect. Much hope is placed, therefore, on electronically mediated forums or virtual communities that could be configured to maximise deliberative ideals. Deliberative dynamics could spontaneously emerge in civil society initiated online forums, or they might be facilitated by the recent proliferation of web blogs, though strictly speaking the latter would need to cross-link with alternative viewpoints to maximise the deliberative ideal. In a vibrant civil society, deliberative virtual spaces could start to emerge as a result of some Hayekian type of spontaneous order. Alternatively, deliberative spaces, say for the formulation of a public policy, could be deliberately engineered by enlightened political authorities and moderated by experts. Sponsored e-forums could be designed to maximise the plurality of viewpoints and might, in some near future, even be able to do so in ways that overcome certain linguistic barriers or a host of other functional barriers. Furthermore, ICT-enabled deliberative spaces could be opened in many institutions of representation, such as parliaments and political parties as well as regulatory agencies, courts and so on. In short, ICT can be deployed to reform current political practices in ways that create opportunities for fostering deliberative interactions, ultimately improving the quality of political participation.

Is there an evidence base?
So far, the discussion has been framed in the realm of possibility, but what is the actual evidence base for any claim of movement towards any of these models. The first point to note is that evidence of experimentation with a variety of the techniques mentioned above can probably be marshalled for most countries, including unlikely cases with either abysmally low ICT penetration rates or with authoritarian governments. To take some trivial top-down examples, e-voting technologies are the object of experimentation in a number of authoritarian regimes, many archdeo-democracies have trialled government sponsored e-forums, and some neo-democracies have amongst the most sophisticated and interactive government websites. In fact, countless isolated examples of ICT-enabled experimentation promoting one (or a combination) of the normative strategies of each model can be found. But one cannot infer a change in forms of political organisation from an isolated example, or from many examples for that matter. This applies with particular force to models 2 (participation) and 3 (deliberative). Presently, if there is any evidence of effective ICT deployment that can be the basis for an aggregate style generalisation, then it is mostly in relation to the techniques connected to model 1 (representation). Even the poorest nations on earth have government websites as do most of their parties where the latter exist in any meaningful way. On the other hand, we do not have evidence of transformation towards participatory or deliberative models of democracy. What we do have are examples of small scale experimentation using the techniques of models 2 and 3. Sometimes the experimentation is on a relatively large scale, i.e. at the national level, but mostly it
occurs at the local level. We know, for instance, that there has been experimentation with participatory technologies such as e-voting across archeo and neo-democracies, and even in authoritarian regimes. We also know that, at this initial stage at least, the uptake of these technologies in terms of becoming a permanent, generalised mode of participation has been spectacularly unimpressive. Only a neo-democracy, Estonia, has thus far rolled out a generalised and binding system of e-voting for an entire electorate. Admittedly, this tells us little of the numerous examples of more informal and less binding experiments with ICT. Again, we can point to cases of experimentation with ICT-enabled forms of direct and participatory democracy across archeo and neo-democracies, which are primarily conducted at lower levels of political aggregation. Some of these are potentially very innovative such as the Brazilian ICT-enabled participatory budgeting (e-budgeting) which appears to be spreading to some archeo-democracies. Experiments with top-down e-referendums, e-consultations, or bottom-up e-petitions and electronically facilitated citizens' initiatives are still very much in their infancy. We know of a few (usually overly cited) examples from archeo-democracies that are considered successful. I would speculate, however, that at the aggregate level the mortality rate for most of this ICT experimentation is rather high. The same would most likely be true of government initiated e-forums, though at the level of civil society, and across our regime types, the situation is likely to be highly varied.

In brief, I do not believe that at the present stage we can empirically sustain the thesis that ICT is transforming democracies in terms of movement towards any of the models. Even in the case of ICT techniques within the paradigm of model 1, we cannot say -at any meaningful aggregate level – that ICTs are making rulers more accountable or that the latter are, as a result, more responsive to citizens' preferences. We can probably confirm that model 1 type tools are the most frequently deployed. None of this means that significant changes are not taking place in the way citizens, civil society organisations and political authorities interact using ICT. Indeed they are. What it does mean, however, is that it is too early to draw anything apart from anecdotal conjectures as to concrete trends towards any normative model. We are simply intervening in a process that is in its infancy. Probably the best we can do in terms of proffering any medium term prognostication -with all the usual disclaimers that apply to such speculations – is to identify three basic scenarios based on diverging assumptions about the nature of change. This is done in the three conjectures below that diverge in terms of the purported effects of ICT on democracy. Those effects can be positive, negative or neutral.

- **The transformation thesis:** The bare bones of this thesis have already been sketched out at length in the previous section. According to a strong variant of this thesis, ICT techniques from all three models could be deployed across all levels of political aggregation. The net effect would be a transformation of political practices. This thesis can even draw on a rich and well documented historical record for support. All previous information and communication revolutions, given a sufficient time frame, appear to have been accompanied by some significant reconfiguration of political organisation, from the emergence of papyrus in ancient Egypt, to the printing press in Reformation Europe and, in the previous century, the revolution in broadcasting. There is no reason to expect modern ICT to be any different. In its strong version, the major transformation would be a movement towards some combination of participatory and deliberative models of democracy. This would be the
normative Holy Grail for some theorists with ICT playing a significant role in combining the models. The key condition would be some form of ICT-enabled deliberative setting that fosters exposure to a plurality of viewpoints and rational argumentation. Technically, such a deliberative setting could induce consensus without the need for any explicit preference revealing mechanism. However, it is hard to escape the conclusion that in the final instance some mechanism for aggregating social preferences, such as voting, would be necessary for the formulation of public policies. And it is precisely on this point where the participatory ICT techniques of direct democracy would come into play. On the basis of prior deliberative interactions, ICT voting technologies would then provide the mechanisms for translating reasoned arguments into public policies. There is a potential snag however. The transformation thesis requires a considerable degree of institutional change. Present rulers, i.e. those who actually benefit from the existing rules, would need to change current practices in order to implement forms of direct democracy in any meaningful way. Crucially, this cannot be achieved by technology operating on its own. It is possible, however, that an incremental process of informal experimentation may over time generate formal institutional change. Given sufficient time, informal and non-binding practices could become institutionally embedded and lead to a formal change in rules. In the transformation model, the basic trend line is one in which citizens’ preferences -whatever the pattern and sequence in which they are revealed, discussed, and transmitted– have a progressively greater impact on the direction of public policy.

• The Dystopian thesis: Like the transformation thesis the dystopian view is also predicated on some fundamental shift in forms of political organisation. However, unlike the transformation thesis the prognostication is an explicitly negative one. There are many potential strands to the dystopian thesis, which include a rich literary pedigree, such as Orwell's 1984 and Huxley's Brave New World, and an imaginative genre of cinematic science-fiction. Many of the latter depict a new global order governed by unscrupulous corporations who stifle human freedom and are resisted by anarchic hacker movements. We need not speculate about such scenarios or the emergence of new social actors. In line with the framework set out in this essay our analytical focus is much narrower. If our working definition of democracy is a system of governance in which rulers are more accountable and responsive to citizens, then the dystopian thesis is an anti-democratic hypothesis. ICT, according to this conception, could reverse the purported arrow of causality providing rulers with new and unprecedented mechanisms for controlling citizens. The facade of elections could well persist, but behind the scenes a sophisticated architecture of control is perfected, which regulates and penetrates an ever increasing sphere of human behaviour, and thereby erodes individual freedom and creativity. In this dystopian scenario, the impact of ICT on democracy would be tremendous.

Is there any evidence of anti-democratic surveillance tendencies? Well, actually there is. Whilst ICT has many potentially liberating and decentralising features it is also undoubtedly a technology of control. Indeed, the control and monitoring potential of ICT is the current bête noire for many civil rights groups. One could take as an example the yearly global surveys of Privacy International, a leading civil rights NGO,
according to which some of the classic archéo-democracies (mainly the US and the UK) are increasingly becoming surveillance societies on a par with some of the repressive/authoritarian regimes of North Korea, China and Malaysia. Admittedly, their analysis is mostly confined to the impact of ICT on privacy, though the latter is broadly understood to incorporate fundamental rights such as constitutional protections as well as capabilities for communications interception, visual surveillance, border surveillance, workplace monitoring etc. In short, there is evidence of the deployment of ICT in ways that enhance new forms of surveillance and control and which, in the post-9/11 context, is increasingly legitimated under the rubric of addressing a dangerous external threat. Should this trend persist and be amplified, the net effect would be to tilt control in favour of rulers rather than citizens. Hence, the anti-democratic nature of the dystopian hypothesis. It should be also be noted that one could apply a much weaker dystopian view to the ICT strategies of models 2 and 3. From this more sceptical viewpoint, the deployment of participatory ICT techniques would not foster direct democracy but, instead, lead to negatively loaded variants of push-button democracy or plebiscitary forms of democracy. Similarly, efforts to create ICT-enabled deliberative spaces are unlikely to generate Habermassian rational, enlightened deliberative interactions. Instead, through some law of group polarization, forums are more likely to consist of echo chambers that reinforce pre-existing prejudices rather than lead to deliberatively induced preference change.

- The Lampedusa thesis: This thesis draws on an insight from Di Lampedusa's classic novel -Il Gatopardo (The Leopard) - that deals with change and continuity during Italy's unification. Lampedusa uses the imagery of the 'leopard changing its spots in order to stay the same' as a metaphor for Sicilian life. Some centuries before him Machiavelli, a Florentine, made analogous observations about religious institutions. More recently, Robert Dahl, one of democracy's foremost scholars, is famous for articulating a similar view about democracy. He noticed that over the centuries democracy has had to change its practices in order to stay the same. Perhaps the same will be true of the present challenges and opportunities to democracy heralded by the proliferation and application of ICT to political practices. In other words, democratic practices are likely to be altered but democracy's underlying principles might stay the same. This is a comforting thought when juxtaposed against the dystopian thesis.

How likely is the Lampedusa hypothesis? In the short term at least, it is rather likely. We do not have any solid evidence for the claim that democracy at some notional aggregate level, or even amongst the supposedly more advanced archéo democracies – is moving towards participatory or deliberative democratic models. Of course, we do know that some archéo-democracies, like Switzerland, possess features of the participatory model at all levels of political authority, including sophisticated mechanisms of direct democracy from the citizens' initiative to the facultative referendum and which, incidentally, have been established without the need for ICT. Switzerland is an obvious outlier case among archéo-democracies however. In the final analysis, though there appears to be greater experimentation with mechanisms of direct democracy across archéo and neo democracies in the last two decades (especially at local level), this does not constitute evidence of an emerging participatory model. We do have evidence of changing practices though.
For instance in the way people consume political information, in the way interest organisations operate, in the way new social movements spring up, and in the way in which political parties organise themselves and mobilise support, to name but a few. We also have evidence of a general decline in party membership and party identification, and a general dissatisfaction with political parties. This may be telling of a broader crisis of representation or, to be more precise, a malaise with particular channels of representation, such as political parties. The same is generally true of political participation, which appears to have dipped in democracies across the world since the 1990s, as measured by turnout in elections. All of this suggests that there is ample room for improvement and ICT could play an important role. We have already suggested ICT’s role in improving the flow of information and the transparency of the political process. This could generate changes in forms of representation, for example, by tilting the balance towards a Maddisonian notion of representatives as ‘delegates’ responsive to the preferences of their constituents, rather than the Burkean notion of representatives as ‘trustees’ who once elected are left to decide on the most appropriate course of action. ICT could also help reconfigure channels of representation, for instance, by empowering new political intermediaries such as social movements or fringe parties, rather than traditional ‘mass’ political parties. Other changes over the medium term could include a widening of the voting franchise to the significant numbers of foreign residents, or what is perhaps more likely and the subject of increasing experimentation, the use of ICT to try to incorporate so-called denizens more fully within the political process. In short, one could envisage the deployment of more participatory measures (say at the local level) and more ICT-enabled grass-roots democracy within political parties and other institutions of representation, and this could even entail more deliberative experimentation across various level of political authority. However, all of these changing practices operate at the margins of models 2 and 3 and firmly within the paradigm of model 1. From the Lampedusian perspective, therefore, none of these changing practices necessarily entail a regime transformation from the current model of liberal representative democracy to participatory or deliberative democracy.

**Between scenarios and conclusions**

Presently, there is evidence to support each of the three conjectures noted above. The literature is infused with hypotheses that adopt one or more combinations of the basic scenarios outlined above. The social sciences do not provide much help in adjudicating between scenarios, especially in the medium term, and are obviously even less reliable on any purported long term dynamics. What the social sciences can provide us with, however, is something akin to a rear view mirror that can be used to give us an idea of the possible road ahead. When looking through this rear view mirror what we notice is that from an historical perspective, democratic institutions are inherently fragile social institutions. In fact, so fragile are our democratic institutions that we do not know if in the medium term to long term we shall live in democracies, but we do know - at least with a greater degree of probability – that we will live in societies dominated by technology.

Since we cannot adjudicate between the scenarios we might want to apply some conceptual tools in order to explore their underlying assumptions. One important distinction is between the transformation and the dystopian thesis on the one hand, and the Lampedusa scenario on the other. Both the transformation and the dystopian thesis share the implicit assumption that the quantitative increase in the availability ICT will produce a qualitative shift in forms of political organisation.
But, there is no a priori logical reason for warranting such a belief. This brings us back to the Lampedusa thesis which tends to be more neutral with regard to wholesale type qualitative transformations. ICT's effects could simply be ambivalent, in some cases reinforcing existing power structures or undermining them in others – all depending on the particular context. This brings us to another potentially important dimension: that of convergence. Both the transformation and the dystopian theses, taken to their logical conclusion, are convergence type theses. Over the longer term, countries would converge on a particular model. The Lampedusian perspective tends to be more agnostic on this front. As a result of ICT deployment, it is probable that the present normatively dominant Western archetypal model of democracy may reconfigure some of its channels of representation and may even introduce more participatory and deliberative experimentation at the margins. But this would not lead to regime transformation or regime convergence. For instance, some neo-democracies (e.g. former communist countries within the EU orbit) might converge on archetypal practices, including how ICT is deployed in the political realm. Others might remain neo-democracies or hybrid democracies (e.g. successor states to the former Soviet Union that are within the Russia orbit). The same would apply to authoritarian regimes - some might transform themselves, though most regimes would probably simply adapt to ICT and use it to their advantage as appears to be presently the case. My own view is that the transformation thesis is normatively the most appealing although some variant of the Lampedusa scenario is, on balance, probably the most likely outcome. Evidently, the dystopian thesis is to be avoided – a point which suggests the need for a greater public scrutiny of the disturbing implementation of dubious surveillance measures across many democratic regimes.

There is one transformation that has been conspicuously absent from the analysis and, at this stage, is simply mentioned en passant. It relates to the possible transformation of the nation state. It is one of the dominant themes in the globalization literature but has been beyond the scope of this paper. Instead, our analytical concern has been directed at the interactions between citizens and rulers broadly understood rather than potential reconfigurations of political boundaries. The logic of the analysis - the three models, as well as the three scenarios - could of course be extended to supranational and international forms of governance. I leave such speculations as further food for thought to the reader. By way of conclusion, I will instead turn to the question in the title of this essay. Is ICT likely to be a possible source of democratic innovation or will it instead be nothing more than a digital illusion? At the aggregate level we cannot say much apart from the obvious observation that it will depend heavily on the particular context. I would expect to see innovative and illusory elements in various combinations across the regime types we have mentioned. A convergence on some Western archetypal model of democracy seems to me unlikely. Instead, I would expect to see greater differentiation and alternative ways of applying ICT to democratic practices across the globe. Perhaps the greatest potential for democratic innovation is in some of the neo-democracies as opposed to some of the more sclerotic archetypal democracies. The former should certainly be given more attention by the research community interested in democratic innovation. One thing remains certain however. Whether ICT will have an innovative or illusory impact on democracy will be the result of specific human choices and a whole host of other broader social practices rather than technology.
Works cited
The next generation will be a key element to delivering real change.

‘The Future is Now’, a 1955 short film by Larry O’Reilly shows the audience an insight into the future. It offers a tour through some of the finest American laboratories and centres of technology. In the film young scientists show us automated kitchens, video telephones and solar powered batteries. Mind you, the film was made in 1955. Who now wants to claim that young peoples’ imagination is ‘just their imagination’? Much has changed in the last decades. We need to work with those changes and use them to our best interests. These changes are part of the solution.

I would like in this article to share my reflections on current events, solutions and future possibilities. As a representative of the Union for Socialist Youth (IUSY), I will choose an international perspective and will focus on the role of youth in getting progressive global governance and democratization back on top of the political agenda.

In the years to come, we are facing some of the toughest challenges in our lifetime: amongst these the so-called credit crunch, severe recession, climate change and volatile commodity prices. There is a need to create worldwide action plans that do not just offer quick fixes but concrete sustainable solutions. Though logical for some, real sustainable solutions will have to come from truly working together.

My plea is to not overlook the aspect of democratisation as a tool for binding people, plans and projects or the role of young people in this process. I strongly believe that only by working with democratic countries and institutions, can we tackle world-wide problems and formulate sustainable solutions. I would like to support my argument by discussing the characteristics of the current generation of youth, the so called ‘Millennials’, and relate it to the question of whether there is still a future for intergovernmental and supra-national institutions like the European Union and the United Nations and if so, what their focus should be. Also, the current possibilities offered to us by technological advances and opportunities should not be overlooked. Finally, I will reflect on the possible role that today’s youth could play in these processes.

Democratization

Many countries, especially the developing and least developed countries, are hampered in their growth and development due to factors such as bad governance and soaring corruption. If democracy is a vital ingredient to reaching sustainable growth and development, then we all have cause to worry. There is a strong correlation between the level of development and good governance especially in the so-called third world countries. Children in countries like Burma grow up having no...
role model nor even the slightest idea of what makes a democracy, how it works and how they can find the means to change the current political climate. This leads to the continuation of problems such as corruption and undemocratic processes, and hinders many positive changes, let alone possibilities. At the same time, this generation will be the next generation to lead these respective countries, and if nothing changes, they will make use of the same methods as their predecessors.

Developing countries, of which many are also developing democracies, tend to have a pyramid youth 'bulge-like' population - a predominantly young population. Gunnar Heinsohn (2003) argues that a population excess, particularly in a young adult male population, predictably leads to social unrest, war and terrorism, given that the "third and fourth sons", who are unable to find prestigious positions in their existing societies, rationalise their impetus to compete by religion or political ideology. More basically; people tend to fight even when there is nothing to fight over. Heinsohn claims that most historical periods of social unrest lacking external triggers such as rapid climatic changes or other catastrophic changes of the environment, and most genocides can be readily explained as a result of a 'built-up youth bulge', including European colonialism, 20th-century fascism, ongoing conflicts such as that in Darfur and, of course, terrorism. If we follow Heinsohn's theory, 'bulge-like' populations can present a serious threat to societies.

Faced with this daunting pessimism, there are reasons to be optimistic. Youth can play a positive and vital role in politics. Based solely on democratic principles, the ideas and voices of such an important part of the population should be taken seriously. Young people can play a significant role in the reformation and stabilization process that their countries are undergoing. Unfortunately, this is not always understood and often is not the case. There are many countries that are led by malfunctioning governments which do not allow fair and free elections or any other form of civil participation, whilst not having to be accountable for any of their wrongful or brutal actions.

Youngsters growing up in these countries do not just need to learn what a democratic system resembles but they also need to be able to expand and defend democracy. They need to be able to use it to achieve their goals and bring about real change.

There are several reasons to explain the importance of youth taking part in political processes. One of those is representation, where a just democracy makes its decision based upon the judgments of all groups within society, which is particularly important in countries with youth-bulge populations. These societies should, therefore, include the interests and opinions of the youth. This will only be the case if they become an active partner and actor in the political decision-making process, either through formal functions or through (political) activism. Furthermore, when compared to adult politics and politicians, youngsters are usually less sensitive to the threat of corruption, nepotism, and electoral focuses. They tend to have strong ideals focused on the future instead of only aiming for quick wins.

However, as long as young people do not have the means, tools and experience to get actively involved in the political process, we end up in a deadlock. Therefore, youngsters need to learn and practice on their civil society and political

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212 Gunnar Heinsohn (born 1943 in Gdynia, Poland) is a German university professor who has published more than 400 scholarly articles and books. He has focused his research on the history and theory of civilization. Since 1984, he has been a tenured professor at the University of Bremen, where he heads the Raphael-Lemkin-Institute for Comparative Genocide Research. The Nation Master Encyclopedia http://www.nationmaster.com/encyclopedia/Gunnar-Heinsohn
skills. Young people have to familiarise themselves with the forms of debate, presentation, organisation building, capacity building, recruiting and activating volunteers and so on. As political and non-governmental movements, we have to invest in those processes.

Participation in civil society and governmental framework phases out the need for violence to achieve change. Young people need to learn how to effectively work without the use of violence, especially in fragile states. An early participation thereby results in a more stable and structural democratic development.

Stimulating the youth to participate in these developing countries will not be an easy task. However, as soon as the youth starts to join hands and build alliances, it can be very successful. There are many positive examples such as in the former Communist countries in Eastern Europe and the Caucasus. Youth does make and, in the past, has made a difference.

That is why we must invest in youth. The idea is to work closely with young people and teach them how they can peacefully and democratically achieve results, even in a country that is far from democratic. We should involve all young people who will be at the heart of current and future political activities. Instead of working with guns and violence, they must learn how to work together with other groups in society in order to build a strong civil society.

IUSY is a mechanism which endeavours to do so by exchanging knowledge and best practices, but also through the means of training programs. Moreover, we have a two-year solidarity program in which we support a youth organisation to bring about change in the most difficult situations. However, we can use all the help we can get. Through the means of this article, I call upon all organisations to put the topic of democratisation and the role of youth high on the agenda and act upon it!

**Millennials & Internet**

I represent the so-called ‘Millennials’, also known as the Web 2.0 generation. From the end of the Second World War and up until now, the world has known three generations. The first are the ‘Baby boomers’, known for their strong sense of justice and equality. As a group, they were the healthiest and wealthiest generation of that time, and amongst the first to grow up genuinely expecting the world to improve with time.\(^{213}\) The ‘baby boomers’ are now middle-aged and entering their senior years. Many of today’s political leaders belong to this generation, but at the same time, a lot of ‘baby boomers’ are retiring and leaving the workforce. Their children are known as the Generation X and are quite different. They are known for a cynical and low key attitude when it comes to politics. Generation X values espouse community, relationships, altruism and entrepreneurship. They witnessed the end of the cold war and saw the fall of the Berlin wall. This generation saw the inception of the home computer and later the internet, as a tool for economic purposes. Generation Y, Millennials or Web 2.0, born between 1976 and 2000\(^{214}\), grew up with the internet and often perceive themselves as world citizens. This generation is considered individualistic, diverse, possessing a broad field of knowledge. It is said that Millennials are optimistic and politically interested\(^{215}\), which is perfectly characterised

\(^{213}\) Jones, Landon (1980), *Great Expectations: America and the Baby Boom Generation*, New York: Coward, McCann and Geoghegan

\(^{214}\) The definition differs, some say the Millennials generation is between 1982 and 2000.

\(^{215}\) Before generation Y was typed to be seeking for wealth and a disinterest in politics, however new research shows a high interest in politics. For the sake of the article, we use this definition, the future might prove otherwise.
by the ‘change-politics’ of the President of the United States, Barack Obama. Millennials believe change is possible which often clashes with the more ‘real-political’ and cynical attitude of Generation X.

When we look at the recent elections in the United States, research has proven that if the 18-29 age-groups would have been the only group of voters, the outcome would have been 455 constituencies for Obama and only 57 for McCain. 216 For the record: the actual outcome of the elections in November 2008 was 365 constituencies or votes for Obama and 173 for McCain. It was not just the message of change Obama used to gain popularity with young Americans; it was also his presence on and use of the internet. Obama has his own Facebook 217 site with over 5.412.601 friends and fans. A group of youngsters organised themselves as ‘students for Obama’ and within one year there were more than 700 branches all over the country actively campaigning for Obama. At one point the organisation became an important part of the Obama campaign.

The term "Web 2.0" describes the changing trends in the use of World Wide Web technology and web design that aim to enhance creativity, communications, secure information sharing, collaboration and functionality of the web. Nowadays there are many aspects of the internet and new media, such as social network sites (Facebook), Twitter, blogs and video channels (Youtube). The idea is that anyone can post anything on the internet and the information can travel all around the world. This has led to a greater democratisation of information.

One of the biggest drivers of globalisation is the internet. Moreover, the number of households owning a computer and internet connection are continually growing. There are around 1,574,313,184 internet users218 worldwide, which is around 23.5% of the world’s population. Despite ongoing poverty, illiteracy and hunger, the growth rate of Internet users in Africa is high. According to International World Statistics, the number of Internet users on the African continent increased by 1100% during 2000-2008.219 The penetration of internet usage is by far the highest in Oceania/Australia with 59.9%, followed by the European continent with 48.5%. Needless to say, youngsters are the most active internet users.

Internet based activities are also used to spread and distribute news, especially in countries where journalists are restricted in their activities, for example during wars or in repressive dictatorships. Internet-based communication has, therefore, started to play a bigger role. A good example can be found in Burma where journalists are not allowed into the country and general footage is filmed at random. A group of thirty Burmese anonymous video reporters is trying to change that by secretly shooting materials of the ongoing abuses and violent acts in the country. During the demonstrations in September 2007 and Hurricane Nargis in October 2008, journalists and most NGO workers who were present were simply thrown out of the country. Thanks to those very courageous Burmese video reporters, information was diffused via the internet and the world was able see

216 Research done by: the outcomes of the other 26 constituencies are still unknown
217 Facebook is a social utility (website) that connects people with friends and others who work, study and live around them. A Facebook member has its own profile page, like a small website. Friends can go to your page and leave a message, but you can also join causes and groups.
218 Statistics of December 2008 by Internet World Statistics. Every year there is approximately one percent growth in the number of Internet users.
footage of the real situation; a peaceful demonstration of Buddhist monks being brutalised by the military army.\textsuperscript{220}

Some politicians are already using these different forms of communication. For instance, the Dutch Minister for Foreign Affair, Maxime Verhagen, is an active Twitter\textsuperscript{221} user. Twenty times a day, he posts small items on his meetings and travels and is followed by about 5000 Twitter users.

We can, therefore, conclude that the internet is an ideal tool for democratization as a whole. It allows any individual to participate in politics and to set the political agenda. Internet also brakes down barriers between different countries, situations and citizens. Internet allows news to travel faster and gives everyone access to that news. It also adds to build a bridge between politics and citizens. Political parties, think tanks and intergovernmental institutions should use the possibilities the internet offers. It is an excellent way to include and inform people as well as a means to increase political participation of youth.

Even more importantly, internet can be a tool for the democratization process. News has never travelled faster or reached so many people world-wide.

\textbf{Global Governance}

Here I will be frank and straightforward. When it comes to global governance, we are currently doing a very bad job given situations such as those in Burma, Belarus, North Korea, the Middle East, Afghanistan or Darfur. We are not even close to finding solutions.

It is absolutely unacceptable that a Nobel Prize laureate, Aung San Suu Kyi has been living under house arrest for more than 13 years and she is not allowed to participate in the so-called ‘free elections’ planned to take place in 2010. There are many reasons for such situations. There seems to be a general lack of interest for these ‘forgotten nations’ and the countries that do care are often on their own. These issues can be addressed on an international level but rarely are there any concrete proposals. There is also no official body that focuses on the implementation or ‘follow-up’ on resolutions that have been adopted.

However, thanks to the internet and youth pressure groups the attention is often raised on exactly such issues. A good example of an excellent youth campaign on a forgotten nation is the Students Take Action for Darfur (STAND)\textsuperscript{222} in the United States. STAND, is the student-led division of the Genocide Intervention Network, and envisages a world in which the international community protects civilians from genocidal violence. Their mission is to empower individuals and communities with the tools to prevent and stop genocide.

To do so, STAND’s Leadership Team recruits, trains, organizes and mobilizes students around the world by providing materials, educational information, online resources, policy expertise, and a network of concerned and active peers. Every day, STAND chapters are initiated by students in schools around the world. As key actors in the fight to build political will for putting a stop to genocide, students in STAND chapters organise and educate their peers and communities, advocate to

\textsuperscript{220} The Movie ‘VJ Burma’ shows their footage and is highly recommended. The movie is also promoted by the Amnesty International program ‘Movies that Matter’.

\textsuperscript{221} Twitter is a social networking and micro-blogging service that allows its users to send and read other users’ updates (otherwise known as tweets), which are text-based posts of up to 140 characters in length. A user basically tells others what they are doing or thinking at that specific moment. Other followers (who read your tweets) can respond to your actions or thoughts.

\textsuperscript{222} http://www.standnow.org/
their elected officials for substantial legislative action, and fundraise for civilian protection.

It has been called the fastest-growing student movement in the world today. Since the first chapter was formed in 2004, STAND has grown into an international network of more than 850 chapters in schools around the globe. As an international network of students, STAND has endowments and pension funds of more than 25 states and 8 universities from business companies in Sudan has advocated for the successful passage of federal legislation, including the Sudan Accountability and Divestment Act (SADA) and the Genocide Accountability Act (GAA) and hundreds of millions of dollars in peacekeeping and relief funds in the United States; fundraised more than $650,000 for the Genocide Intervention Network’s Civilian Protection Programme in Darfur; organized large-scale demonstrations in more than 25 major cities around the world, including New York, London, Los Angeles, Paris, Philadelphia, Chicago, San Francisco, Fort Wayne, Los Angeles, Miami, Washington D.C., Austin, Atlanta, Boston, and Denver; established more than 850 chapters in more than 25 countries worldwide; sponsored and organized, over a two year period, 13 conferences on genocide attended by more than 2,300 students in total. Here again, the internet played a vital role in this successful ongoing project.

This example greatly emphasizes the will of youngsters today to fight for justice and to bring to the attention of the world the forgotten nations and conflicts. We really want change and we want to raise our voices for those people who are unable to do so.

But, what is the situation we are in right now? Do we really need to fight this hard to change the international global framework? What is the current global governance framework?

Human Rights; the United Nations Human Rights Council (UNHRC) established in March 2006. This inter-governmental body succeeded the United Nations Commission on Human Rights and acts a subsidiary body of the UN General Assembly. Its main task, and only official authority, is to make recommendations to the General Assembly on Human Rights violations. In return, the General Assembly’s only authority is to advise the UN Security Council. It is the UN Security Council that votes resolutions dealing with the Human Rights violations. Needless to say, most Human Rights resolutions are blocked as the Human Rights Council has 47 seats and members such as China and Russia. We can, therefore, conclude that the Human Rights Council has no real power. The General Assembly of the United Nations does, however, adopt some of the discarded resolutions. The United Nations now has the responsibility to protect but is unable to actually put this into practice, Darfur being a prime example. In terms of democracy within the UN framework, there are many legitimate complaints; on the composition of the Security Council, on the role of the developing countries and so on.

Likewise, other well known international institutions are far from democratic, especially when it comes to developing countries. The IMF and World Bank have a long-term western centralised programme, similar to the Washington Consensus, requesting demands from the poorer countries that they are unable to provide within their own countries. There is little room for discussion and those who either do not listen or are not keen on implementation are simply left to their own devices. Take decisions and reaching any agreements for the poor are long and tiresome processes, such as the Doha rounds for example.
This all sounds pretty discouraging. The great international institutions like the United Nations, the IMF and the World Bank are ineffective and unable to save and improve human lives! While nobody has all the answers to these great problems, we have to believe that it is not too late; we can and must continue to work to ensure change to improve this world and safeguard Human Rights. It is the young generation that has to push this agenda forward. But, they need to work together with political leaders and other important decision-makers! Together they can make history and change the global situation.

Role of the European Union in global governance
The European Union has an important and strong role to play within the international framework. Whilst international politics are very complicated and agreements cannot always been reached, there are still many issues that can be agreed upon, especially when it comes down to basic Human Rights. We have to combine our efforts and forces to combat dictatorships, genocide, environmental crisis, the food crisis more recently the credit and economical crisis.

You might be wondering why I am addressing such these issues in this publication: "Dilemmas in Globalization". Firstly, a democratic Europe can play a strong role on democratizing the global framework. Secondly, a democratic Europe can play an important role on the international scene. Where there are many global problems such as HIV and Climate Change, the question remains as to whether Europe alone can solve these serious problems. The answer is no, a more democratic Europe with one voice cannot take the sole responsibility to change the current situation. It also has to rely on other key actors such as the United States of America, China, Russia, etc. But, the EU can serve as a good example to be pursued by others. The EU can be the guide, and it could become the leader of the "new world"

There are themes on which Europe especially can make a difference. A united Europe can, and within a short time-frame, make a difference on topics such as democracy and Human Rights, international diplomacy and the financial market and world trade.

With the new Lisbon Treaty, which will hopefully soon be ratified by all Member States, there is a strong focus on a common international foreign agenda. With the Special High Representative of Foreign Affairs also becoming Vice-chair of the European Commission, this is a strong sign to the international community and definitely a step in the right direction.

However, one problem will remain, even with the acceptance of the Lisbon Treaty. The European Union has a very long decision-making process. This may entail the High Representative spending more time on the decision-making process behind closed doors rather than in the international arena. The democratisation of Europe can only contribute to global governance if it speeds up the decision-making process. Global players such as China, Russia and the United States move faster and are able to respond quickly to sudden crisis or situations. The European Union is in this respect at a disadvantage.

Secondly, the democratic reform of Europe will only work if it is in conjunction with the democratization within the UN. As long as all members of the Security Council have a veto, there is no sense for Europe to claim a seat. Only when a fair and democratic voting system is in place, can the European Union Member States consider voting within the Council of the UN. The European Union should speak with
To conclude, there are many positive sides to the new Lisbon Treaty and we should remain optimistic. There are, however, still issues to be tackled before a more democratic Europe can make a real difference in the world. We need democratic countries, nations and institutions to tackle the challenges presented in this book. Only by achieving democracy at all levels will solutions prove sustainable. It will clearly be a difficult and challenging process. We will, however, be able to tackle whatever crisis or threat we are faced with in the future, if we have a strong political leadership and competent institutions. In this process, we need to make maximum use of the internet to reach across continents and ensure stronger participation in the political process.
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