

The case for a green economy that works for all

By Klaus Linsenmeier, Director of the Heinrich Böll Stiftung North America

According to an estimate of the U.S. Congressional Research Service, the global financial crisis destroyed 40% of the world's GDP. Since then, stock indices show a significant recovery of the lost wealth; however, analyses are likely to show that, on the whole, the response to the crisis (government stimulus packages and especially bank bail-outs of worldwide estimated \$14 trillion) redistributed wealth upward. In the U.S., unemployment has exceeded the 10% mark and one out of every nine people receives food stamps. In South and East Asia, the unemployment level has risen to approximately 60 million people. Investors and financial sector institutions were not the only ones hard-hit by the crisis. Indeed, the stimulus resources for Main Street were dwarfed by the bail-outs and guarantees for the culprits on Wall Street whose recklessness brought down the financial system. As a result, the ordinary citizens on Main Street – those in sectors of the real economy, such as manufacturing and services – are carrying the burden of the destructive forces unleashed by an inadequately designed and regulated financial market.

Economic theory, environment and politics

The crisis triggered a new chapter in an ongoing discussion about the governance of the world economy, including the shortcomings of the dominant economic theory that provides the underpinning of our modern political and economic systems. For many years, ecologists and development professionals, supported by some in academia, have debated whether the theory provided an adequate basis for public policy. In the late 1970s, when the Green Movement emerged in Europe, neo-classical economic theory was beginning to dominate theoretical and political discussion. The proponents of this school of thought, however, failed to integrate nature into their models and, instead, treated it as an externality, in spite of the evident destruction of the environment worldwide, and particularly, in modern industrialized societies. However, in the political realm, neo-classical economists gained ground by providing analysis, advice and forecasts to politicians, despite the limitations of theoretical models or empirical backing. Eventually, all the shortcomings of neo-classical theory were forgotten, so that former Prime Minister Margaret Thatcher could state: "There is no alternative" and former Chancellor Helmut Schmidt could lecture his social-democratic constituency: "There is no left or right, there is only a good or bad economic policy".

In essence, neo-classical theory is based in microeconomics and lacks a greater narrative. The macroeconomic theory originating with John Maynard Keynes and dominating the post-WWII era was undercut by the "stagflation" following the oil price shocks in the 1970s. That is, when oil prices soared and destabilized governments' accounts, the Keynesian response – to boost fiscal expenditures in order to jump start growth – failed.

This failure was especially problematic in the days of the Cold War, when the great narratives were competing with each other. At this time, Milton Friedman and other scholars at the Chicago School of Economics argued that free markets promote free societies and represent a significant contrast to the political repression and centralized, planned economy of the Soviet Union. This generation of scholars called for the abandonment of the legal and regulatory frameworks that were forged through decades of disputes and which provided the necessary basis for competitive, well-functioning markets. Before the advent of the Chicago School in the 1970s, debates had concentrated on the permissible level of state intervention in markets beyond the set regulatory framework. The need for state regulation of market as formulated e.g. by the Freiburger School as "ordoliberalism", was never questioned not even by the post-war Chicago School.

The market revolution

Friedman and others in the Chicago School abandoned this tenet of thought and thus revolutionized theory. Their new credo was that markets, themselves, can organize their own functions, rules and structures to efficiently manage the exchange of goods and services. State intervention to engender competitive and equitable outcomes was regarded as counter-productive. In other words, the market is always right; all government actions distort the optimal market solutions.

The credo, the economic basis for neo-liberalism, was born – namely, that governments are not the solution to the problem, governments, themselves, are the problem. This became the cornerstone of the policy of the “Reagan Revolution” in the 80s and the market-radical reforms of the Thatcher-era in Great Britain. From here, the way was paved to mobilize the international financial institutions to implement policies based on neoliberal beliefs – which eventually became known as the “Washington Consensus” – in developing countries.

Booming markets...

The consequences on globalization, markets, and societies were enormous. Governments abolished regulations which contributed to an ongoing process of market concentration. The dominant belief was that globalization requires big banks and corporations to compete in the global marketplace. In many developing countries, there was no need to deregulate the economy, since there were no regulations to begin with. Others were pushed by the IMF and the World Bank into the neoliberal direction, often with destructive results for these emerging economies. Throughout the three decades since 1980, hundreds of small and medium-sized banks failed or were taken over by banks based in industrialized countries. In the U.S., two pieces of legislation were enacted in 1999 and 2000 – the Gramm-Leach-Bliley Act and the Commodities Futures Modernization Act (CFMA) – which facilitated these take-overs and eliminated some federal and state regulation of important banking and securities transactions. Other regulations were retained, but never enforced.

These two laws resulted in tremendous growth in the financial services sector, and in the average size of financial institutions. Politicians of all stripes hoped that – after the end of the IT boom – the financial services sector would generate new growth in the national and global economy. Their hopes were realized as the financial sector dramatically increased its share of the national GDP. Employment boomed as financial institutions continued to grow. So did the global market. After enactment of the CFMA, the unregulated derivatives market boomed, growing from \$250 trillion in 2001 to nearly \$600 trillion in 2008. The volume of credit default swaps grew from \$1 trillion in 2001 to \$64 trillion in 2007. These figures can be compared to the world GDP of nearly \$66 trillion in 2007. This was the time when financial institutions were becoming “too big to fail”.

...destroying (not only) themselves

The U.S. Treasury Department did everything it could to sustain this boom. For instance, by keeping interest rates low, banks had the opportunity to refinance themselves almost at no cost.

The response to the crisis violated many of the accepted tenets of economic theory. For instance, the theory sets forth the indispensable ingredients for the proper functioning of markets, including: 1) Market operations, which are financed by equity investments and debt, need to be compensated by an adequate interest rate; 2) A critical number of economic actors require fair opportunities to compete in the marketplace; 3) Market transparency and information disclosure are essential to foster competitiveness; and 4) “Moral hazard” must be avoided. Avoidance of moral hazard requires that, while the winners take the profit, the losers must lose market share or fail altogether. Risk is a central element of any functioning market. These basic premises of classical economic thought have been eliminated over three decades.

The financial institutions, which are now deemed “too big to fail”, do not have to assume risk since they are backed by government guarantees. This tilts the playing field against small and medium-sized banks and enterprises which, in turn, exacerbates the concentration process. For instance, in just the first three quarters of 2009, about 120 U.S. banks defaulted. The game is almost cost-free for the financial institutions thanks to an almost 0% interest rate. The

concentration process in the U.S. remains dangerous. The EU competition commissioner's decision makes sense – namely, to “shrink fit” those banks that receive massive bail-outs but still dominate the market. This, however, can only be the beginning of reform.

Violation of the basic tenets of economics was only possible due to the enormous influence of the financial services lobby which, ironically, continues to work against the long-term interests of its own membership. So, former head of the U.S. Federal Reserve Alan Greenspan, stated on the occasion of a congressional hearing on October 23, 2008: “Those of us who have looked to the self interest of lending institutions to protect shareholders equity, myself included, are in a state of shocked disbelief”. This belated confession came only after years of Fed policy unleashed market forces in ways that contributed to the destruction of essential parts of a functioning capitalist market.

More than a financial crisis

The financial crisis exacerbates the already-severe crises in many national economies, the development process, and the natural environment. The challenges are enormous: the solution of the development and environmental crises demands a broader analysis and a different kind of public debate that reaches beyond the classical economic thinking. As the Chinese Ministry of Environment estimated some years ago, 6% of the Chinese GNP is needed just to remedy the environmental damages of the dominant economic model. These results of the conventional growth model do not augment welfare; they undermine the livelihood of future generations, not only in the Third World. This footprint of ecosystem damage and collapse has a ripple effect which goes beyond climate change, to food and water crises, deforestation, loss of biodiversity and habitat, etc.

Since the 1992 UN Conference on Environment and Development or “Earth Summit” in Rio de Janeiro, citizens have challenged the economic and environment paradigm. In the 1990s, a series of UN conferences tried to address inter-connected problems associated with an increasingly globalized economy and its impacts on human beings, communities, and the natural environment. The process culminated in the ambitious efforts of then UN Secretary General Kofi Annan to reform the world organization. All these efforts produced poor results because of conflicting interests of its member states. Urgently needed new forms of governance are not yet in sight.

The Plea for greater diversity of thought and theory

Though it seems that the worst of the financial crisis is over (at least for the time being), questions are being raised about whether those who deregulated the financial sector are the best ones to reregulate the system, let alone to lead the world toward an environmentally and socially sustainable path.

The roots of these questions relate not only to political pragmatism, but also the need to revisit the theoretical economic models. Ideally, pluralism and diversity should become increasingly characteristic of modern times, particularly since one dominant school of economic thinking cannot deliver the urgently needed results. The world has become too complex for a “one theoretical school fits all” kind of thinking. The crisis revealed that the monopoly on economic theory and practice has catastrophic consequences. Those who predicted the crisis and understood its roots could most likely propose reasonable measures to correct the root causes. What is needed is an open competition of ideas and theoretical discourse that does not discriminate against those who do or do not belong to the mainstream. As in other fields of science and society, more diversity and pluralism are needed in economic debates:

New thinking: In the academic world, prominent thinkers have contributed to work on the development crisis (Amartya Sen and others), the ecological crisis (Daly and others) or have given the discussion a complete new perspective (Ostrom and others), to name but a few. Their work is well respected, even by the Nobel Prize Committee in Stockholm, but their political impact remained limited.

New governance: It becomes quite clear that new forms of governance are needed on a local, national and global level. So far, little reform has taken place in either the UN or the Bretton Woods Institutions. The formation of the G20 can only be a starting point for integrating the

priorities of efficiency and equity, building institutional legitimacy, and mobilizing the power to effect change.

New industry/new markets: While Greens always have been uneasy with the existing growth model, they have failed so far to formulate a viable and thorough alternative. Greens offer promising visions of a Global Green New Deal and a carbon-free economy, yet the concepts and strategies need further elaboration. Industry and markets have important roles to play, although different than in the past.

New knowledge, debates and democracy: While multilateral negotiations in the areas of environment/climate, economy, and development frequently bog down or get stuck, popular discontent is growing. The public sees that governments find trillions of dollars to rescue financial institutions, but offer only a pittance to rescue jobs and homes and save a planet that really is too big to fail. If national and global discourse is to undergo the kind of profound and expeditious change needed to preserve the ecosphere, it must welcome diverse thought and theory. This must happen before public discontent and the urgent need for change come to an unholy alliance.

Klaus Linsenmeier is Executive Director of the Heinrich Boell Stiftung's North America office in Washington DC.