PART 01

global transformation and global outlook

introduction

Part 01 is written by staff of the New Economics Foundation (NEF), in particular by the Jubilee Research team (which majors on international finance and debt), with contributions from Joseph Stiglitz. While we share many common values and principles, we have distinct voices, and these are reflected in the various contributions. We review the transformation of the global economy over the last 30 years, laying out the groundwork for an analysis of how this seismic shift impacts on today's economy, and of the future outlook.

In Chapter 1, we analyze the key forces that have shaped globalization, and challenge the frequently expressed but superficial explanation of 'new technology' as the key driver. We draw on the work of Eric Helleiner, who has a comprehensive grasp of the background to the deregulation of capital markets.

In Chapter 2, we present original research and data on the *consequences* of globalization: the growth of a massive credit bubble and its counterpart—the huge growth of debt; the 'hoover' effect of transfers from poor to rich; the predominance of speculation over enterprise; the threat of deflation; and the way in which governments—rich and poor—have lost, or given up, control over their economies.

Chapters 3 and 4 outline both the economic and the environmental outlooks respectively, which we conclude are bleak. We note that it is ordinary wage-earning consumers that are propping up the 'engine' economies of the world, by spending and borrowing excessively. When the bubble bursts, they will be left with unpayable debts. We examine the global economy's dangerous addiction to fossil fuels, a dependency that drives conflict, climate change, volatile energy costs, and unresolved confrontation over how to share the global commons of the atmosphere.

CHAPTER 1

making sense of our world: 1970–2003

ann pettifor

turning the world upside down

> *We used to build our cities and towns around churches. Now banks are at their centres . . .*
>
> *John Densmore, drummer for the Doors, explaining why he could not accept $1.5 million from Apple Mac for the use in their commercials of: "When the Music's Over . . ."* (*Guardian* 12 August 2002).

In just over 30 years, our world has been turned upside down. When Jim Morrison and the Doors were making music and rocking audiences in San Francisco, a form of economic regulation—the Judaeo Christian principle of the Sabbath—prevailed; namely that one day of each week would be set aside for rest, for a short respite to the exploitation of land (in its broadest sense) and people. On each seventh day, moneylenders were expected to retreat from the temple.

In the Western world, and in many parts of the Third World, Sunday had, for more than 2000 years, been a strict form of regulation: a periodic correction to imbalances and injustice. With the onset of the deregulated, globalized economy, this form of regulation had to be banished, along with other forms of regulation. Sunday was 'liberalized'—to use the loaded language of economists—implying that people and the land were emancipated from a forced day of rest. Instead they were 'freed' to work, consume, and make money, for long hours, seven days a week.

Since 1970, as a result of this and many other forms of deregulation, the world of people like John Densmore has changed beyond recognition. Today, banks and other financial institutions are indeed at the centre of cities and towns, promoting credit cards to all and sundry. Moneylenders use electronic equipment ('holes in the wall') to do business around the clock and every day of the week. Their presence in communities across the world is indicative and symbolic of much broader changes wrought by the remarkable economic experiment known as 'globalization' or market liberalism over the period

1970–2003. These changes have transformed our world, and rendered it much more unstable than the period 1945–70.

The post-war era was a period of relative economic and social stability and rising material welfare in all parts of the world. These advances were distributed unequally between the North and the South, the East and the West; yet there is widespread intellectual agreement that over this period world living standards were rising. As Robert Wade and Alan Freeman demonstrate in Part 03, this progress has now stopped. Instead, our world has for some years now become more polarized and divergent, with the rich countries 'pulling away' not just from the poorer countries, but also from middle-income countries. Gita Sen notes in Chapter 13 that global markets have acted to extract and transfer assets from poor countries to rich countries—engaging in what Sen reminds us is a form of 'primitive accumulation'.

This polarization and divergence, is we argue, not accidental or 'natural'. It is not because human ingenuity, geography, new technology, and advancement are present in one part of the world, and lacking in others. Instead, it is a direct consequence of the remarkable economic experiment of market liberalism, which has, we contend, brought our world to a point of grave peril.

The danger is expressed in the growing divergence between rich and poor; in the high rate of corporate defaults; in the collapse of world commodity markets; in the crashing of Western stock markets; and the bursting of the dot.com and telecoms 'bubbles'. It is reflected in the increasing number of conflicts brought about by our addiction to fossil fuels. It finds expression in a world made insecure by rises in crime, random violence, opportunistic diseases, and the threat of nuclear weapons. A world ruptured by terrorism on the one hand, and the military aggression of the United States, backed by the United Kingdom, on the other; a world divided by the shattering of UN authority, the splintering of European alliances, and destabilized by the ungovernability of much of Africa and Latin America.

These destructive and frightening consequences are not very different from the consequences of a similar experiment in market liberalism, tried out in the 1920s and 1930s but abandoned between 1945 and 1970. The cheerleaders of the earlier experiment deployed many of the same arguments and defences used by orthodox economists today. Then, as now, they expressed supreme confidence in the success of the experiment. Then, as now, politicians were advised that economic cycles had come to an end; that the 'end of history' was nigh. A New Economy had been designed and engineered, which would bring continuous and uninterrupted benefits. Winston Churchill reflected on this optimism in his history of the period:

The year 1929 reached almost the end of its third quarter under the promise and appearance of increasing prosperity, particularly in the United States. Extraordinary optimism sustained an orgy of speculation. Books were written to prove that economic crisis was a phase, which expanding business organisation and science had at last mastered, We are apparently finished and done with economic cycles as we have known them, said the President of the New York Stock Exchange in September. But in October a sudden and violent tempest swept over Wall Street . . .

The whole wealth so swiftly gathered in the paper values of previous years vanished. The prosperity of millions of American homes had grown up a gigantic structure of inflated credit, now suddenly proved phantom. Apart from the nation-wide speculation in shares which even the most famous banks had encouraged by easy loans, a vast system of purchase by instalment of houses, furniture, cars and numberless kinds of household conveniences and indulgences had grown up. All now fell together. But yesterday, there had been the urgent question of parking the motor-cars in which thousands of artisans and craftsmen were beginning to travel to their daily work. Today the grievous pangs of falling wages and rising unemployment afflicted the whole community, engaged till this moment in the most active creation of all kinds of desirable articles . . .[1]

Substitute the phrase 'the urgent question of parking motor-cars' with 'the urgent question of parking SUVs (Sports Utility Vehicles)' and Churchill's picture reflects pretty much the state of Western economies today.

Like the globalization experiment of the period 1970–2000, the 1920s were a period of 'extraordinary optimism sustained by an orgy of speculation' before it came to a catastrophic end after 1929—fuelled by greed and by the kind of fraud and deception that has today become commonplace in Wall Street and other financial centres. It was a period when, just as today, economic policies made the finance sector dominant: Moneychangers occupied the high seats of the temple. Then, as in the 1990s, economies were afflicted by a credit bubble conjured up by moneylenders who duped 'practical men'—those who believed themselves to be quite exempt from any intellectual influences, but who were nevertheless, in the words of Keynes, 'the slaves of some defunct economist'.

In a remarkable inaugural speech, which has a contemporary resonance for those millions who have lost pension savings, dot.com, or stock market investments, President Roosevelt attacked the role the financial community played in bringing his country to its knees in the 1930s:

. . . the withered leaves of industrial enterprise lie on every side; farmers find no markets for their produce; the savings of many years in thousands of families are gone. More important, a host of unemployed citizens face the grim problem of existence, and an equally great number toil with little return.

Yet our distress comes from no failure of substance. We are stricken by no plague of locusts. Plenty is at our doorstep, but a generous use of it languishes in

the very sight of the supply. Primarily this is because the rulers of the exchange of mankind's goods have failed, through their own stubbornness and their own incompetence, have admitted their failure, and abdicated.

Practices of the unscrupulous money changers stand indicted in the court of public opinion, rejected by the hearts and minds of men.

True they have tried, but their efforts have been cast in the pattern of an outworn tradition. Faced by failure of credit they have proposed only the lending of more money. Stripped of the lure of profit by which to induce our people to follow their false leadership, they have resorted to exhortations, pleading tearfully for restored confidence. They know only the rules of a generation of self-seekers. They have no vision, and when there is no vision the people perish.

The money changers have fled from their high seats in the temple of our civilization. We may now restore that temple to the ancient truths. The measure of the restoration lies in the extent to which we apply social values more noble than mere monetary profit. Recognition of the falsity of material wealth as the standard of success goes hand in hand with the abandonment of the false belief that public office and high political position are to be valued only by the standards of pride of place and personal profit; and there must be an end to a conduct in banking and in business which too often has given to a sacred trust the likeness of callous and selfish wrongdoing.

Small wonder that confidence languishes, for it thrives only on honesty, on honor, on the sacredness of obligations, on faithful protection, on unselfish performance; without them it cannot live.[2]

the post-war revival of market liberalism

During the Second World War, and in the immediate post-war years, politicians and economists tried hard to restore stability and equity to the international financial system: to 'restore the temple to the ancient truths'. In Part 04, we outline their designs, which culminated in the decisions of the Bretton Woods conference in 1944, for a more stable and equitable international financial architecture. They had learnt from the disasters of the 1920s and 1930s that unrestrained capital flows led to financial instability and more and more 'Ponzi finance' schemes—financing old liabilities with new liabilities—and furthermore, that these unregulated capital flows were incompatible with, and hindered, free trade. Central to their plans for the new international financial architecture were controls over capital and the restoration of policy autonomy to governments and states.

Yet at almost the same time, neoliberal economists were preparing to revive the economic ideas that had so devastated capitalist economies in the 1930s.[3] As the horrors of financial catastrophe and world war began to recede from public memory, economists like F.A. Hayek approached the politicians of a country whose foreign traders and colonial empire had for long oriented the

economy towards openness and market liberalism: Britain. From 1970-2000, thanks to the extraordinary perseverance of Hayek and his colleagues in right-wing think tanks, academics, journalists, and most importantly politicians and governments (of both the left and right) were slowly re-educated in the virtues and powers of market liberalism.

But it was not the power of ideas only that persuaded politicians of the virtues of market liberalism; economic and political circumstances conspired to make the liberalization of capital flows attractive to US politicians in particular.

why our world was turned upside down

Many argue that the phenomenon known as 'globalization' came about largely because of advances in new technology and communications. For example, Walter Wriston, once Chief Executive Officer of Citibank, one of the world's largest banks, has argued that

> *. . . today we are witnessing a galloping new system of international finance (which) differs radically from its precursors in that it was not built by politicians, economists, central bankers or finance ministers, nor did high-level international conferences produce a master plan. It was built by technology . . . by men and women who interconnected the planet with telecommunications and computers.*[4]

Others, particularly anti-globalization activists, hold strongly to the view that globalization, (often broadened into 'corporate globalization') was, or is, promoted by big, aggressive corporations, keen to expand their markets and brutal in promoting self-interest.[5]

We contest this view of the driving force behind financial globalization—central to the whole globalization project. On the contrary, we argue, democratic governments and their elected leaders have been the real driving force behind financial liberalization. These leaders were motivated to embark on the 'globalization' project, as Eric Helleiner has cogently argued,[6] because of the costs of the Vietnam War, and the steady expansion of the US trade deficit in the 1960s and 1970s. This led to deliberate decisions by the US and UK governments to remove statutory controls over movements of capital.

The US trade deficit had to be financed, and the United States was determined to get the money without having to make any unpleasant 'structural adjustments' to the US economy and without giving up policy autonomy to foreign creditors. The City of London, backed by the UK Government, was only too happy to broker financing for the US deficit through the 'stateless'

Eurodollar market based in London—a market carefully created by elected representatives of two of the world's most powerful states.

As Helleiner has argued:

> *Ever since the first dollar crisis in late 1960, the (US) government had attempted to postpone adjustment measures by persuading foreign central banks to finance its external deficit through dollar holdings . . . Taking an approach that would prevail throughout the 1970s and 1980s, Washington policymakers fostered a more liberal international financial system as a way of preserving their policy autonomy in the face of growing external constraints.*

The emergence of the Eurodollar market began the process of dismantling capital controls in the 1960s. But as Helleiner notes, the other:

> *advanced industrial states remained wary of international capital movements for the reason discussed at Bretton Woods: Disequilibriating speculative capital movements could restrict their policy autonomy and disrupt both the Bretton Woods system of stable exchange rates and liberal trading relations.*

The removal of these capital controls, which gained terrific momentum as the US deficit ballooned, was pushed by the United States and the United Kingdom and has been central to the process of 'globalization'. Today, the US deficit can only be sustained by mobilizing a staggering $4 billion of foreign savings each working day of the year.

it was not always thus

Back in 1944, as part of the Bretton Woods Agreement, the United States had helped construct the post-war economic order with other Western governments. The new order, which the IMF and the UN were tasked to defend, set out to:

- prevent and limit the imbalances and disorder brought about by the capital liberalization of the 1920s and 1930s;
- restore policy autonomy to nation states (primarily by imposing controls on the movement of capital); while
- liberalizing trade, which included challenging the UK's protectionist policies for imperial preferences.

Two decades after the Bretton Woods Agreement, the Eurodollar market represented the first attempt at bypassing the exchange controls of nation states, and enabled the United States to mobilize additional finance from a foreign capital market. The existence of the Eurodollar market gradually led to the erosion of capital controls by all major Western governments and, finally, most

developing country governments. This in turn laid the ground for a massive expansion in the role of finance capital in the global economy, and, as a consequence, for greater trade liberalization.

how our world was turned upside down

In promoting market liberalism, advocates of these policies often called for what spin-doctors describe as 'reforms'—of the financial system, of labour markets, and of trade. The word 'reforms' suggests incremental changes but, on the contrary, they are often fundamental both to social and political relationships, and their impact has been revolutionary.

These radical 'reforms' were sold to the broader public on terms that suggested that, while they might benefit the rich, wealth would 'trickle down' to the poor. Instead, they have achieved the reverse, and, in the process, transformed the world economy for the worse. This is an outcome we analyze in greater detail in Chapter 2, and which we call the 'hoover effect' of globalization. As a result, rich societies enjoy levels of consumption 200 times greater than other societies.

The three 'reforms' or pillars that make up the architecture of globalization are:

- The removal of regulations and controls over capital, both national and international.
- The 'downsizing' of government or the state.
- Attempts by the G8 (through the WTO and other institutions) to create a single global market in goods and services.

Of these three 'reforms', we regard the first as the most important because it led to the second and third—marginalizing the state; removing policy autonomy from elected governments; and facilitating the creation of a single global market. Finally, capital deregulation has helped create the crisis of debt now threatening the stability both of the developing and developed world.

Neoliberal economists and commentators tend to have a blind spot for the role played by deregulated capital in today's globalized world. Instead, as we have noted above, responsibility for globalization is often laid at the door of impersonal and disembodied 'technology'.[7]

One of the reasons why it is easier to identify technology as responsible for globalization is that the rapid development of technology is highly visible to all and sundry whereas the massive expansion in financial flows is not. Nor do neoclassical economists acknowledge expanded financial flows (as we demonstrate in the next chapter). In the words of Michael Hudson a 'protective cloak

of invisibility has become a distinguishing feature of the economic analysis promoted by the financial sector'.[8]

> *The neo-classical synthesis became the economics of capitalism without capitalists, capital assets and financial markets.* Hyman P. Minsky[9]

globalization's key 'reforms'

deregulating money or capital

The first of the policy changes advocated by neoliberal economists and required of governments is that regulations are removed over capital, over lending and borrowing, and over the creation of different financial instruments (see Peter Warburton's essay in Chapter 17). However a priority for these economists was the removal by governments of institutional controls and regulations over capital moving across national boundaries. Most governments, with the exception of those with the highest officially recorded rates of economic growth in the recent past (India and China) have obliged. Once removed, there is a general assumption that capital controls can never be re-imposed. Given the earlier experience of capital liberalization, and the subsequent imposition of capital controls under the Bretton Woods Agreement of 1944, we are not so sure.

The deregulation of capital meant effectively that elected politicians and governments abandoned their responsibility for managing finance, for preventing crises, for managing their country's exchange rate, and for protecting the weak, the elderly, the unemployed, and the infirm.

Central to the deregulation of capital was the release of the savings of millions of workers and employees. In the early days of deregulation, as governments were lifting capital controls and deregulating money lending, ordinary people were persuaded (by their elected politicians) to detach themselves from state pension provision; and to give up their hard-earned savings to speculators, disguised as merchant bankers, insurance companies, and other financial institutions. As Toporowski has noted, 'financial laissez-faire . . . provided a seemingly endless inflow into capital markets of money by compulsory prescription to pension funds levied on the workforce and their employers'.[10] These funds were recklessly deployed by merchant banks and insurance companies and used to enrich a few, while ultimately bankrupting or diminishing the value of pension funds. Having unleashed this torrent of money, elected politicians turned a blind eye as the people's savings were gambled on stock markets. Governments and regulators were either indifferent or negligent, as stock markets collapsed after the turn of the century and billions of dollars of pension fund value was destroyed.

The kind of speculation indulged in by pension fund managers, investment and merchant banks is well known—especially to those who have already been duped. It is 'Ponzi finance'. As Toporowski noted with prescience in 2000, because of their success, 'pension funds have become the newest and possibly the most catastrophic example of "Ponzi finance"'.[11] Three years later, after the collapse of the stock market and the closure and devaluation of many pension funds, he has been proved right.

ponzi finance

The term Ponzi finance was invented by the American economist Hyman P. Minsky as part of his analysis of financial market inflation. It describes a form of finance in which new liabilities are used to finance existing liabilities. Ponzi schemes are named after Charles Ponzi, an Italian immigrant who duped thousands of Boston investors in the 1920s with a postage stamp speculation scheme. Ponzi thought he could take advantage of differences between US and foreign currencies used to buy and sell international mail coupons. Ponzi told investors that he could provide a 40 per cent return in just 90 days compared with 5 per cent for bank savings accounts. Ponzi was deluged with funds from investors, taking in $1million during one three-hour period—and this was in 1921. Though a few early investors were paid off to make the scheme look legitimate, an investigation found that Ponzi had only purchased about $30-worth of the international mail coupons.

Decades later, the Ponzi scheme continues to work on the 'rob-Peter-pay-Paul' principle, as money from new investors is used to pay off earlier investors until the whole scheme collapses.[12]

Minsky noted that Ponzi's scheme 'swept through the working classes and even affected respectable folk'. Because they prey on the poor and the ignorant, Ponzi schemes in banking are usually banned. However, this does not prevent them from occurring in countries where it is difficult to regulate them. Ponzi schemes have surfaced in Portugal and Eastern Europe.[13]

In the United Kingdom, private pensions were first proposed as an alternative to state earnings-related pensions in 1976. The banks and stock broking firms that promoted them (and the politicians that eagerly agreed because they saw an opportunity to divest themselves of responsibility for the care of the elderly and offered tax breaks to these firms) did not realize that, by the 1990s, pension schemes would effectively own stock markets—or at least most of the stocks and shares quoted on the world's stock markets. As a result, gains could be made as long as the market as a whole was rising but as the market fell, pension funds were caught, unable to withdraw without causing a bigger catastrophe, but needing to withdraw to protect the value of their own assets.

Virtually the only 'check' on the giant pensions Ponzi scheme is the fact that, inevitably, as the labour market becomes more 'flexible' and more people become unemployed or suffer falling wages, fewer savings can be compulsorily diverted to the capital markets in this way. In other words, government and regulatory institutions have failed to provide checks on the irresponsibility of the capital markets; instead, it is the declining economic activity caused by speculation that finally placed a limit on the speculators.

deregulation as freedom

The removal of regulation over capital is couched in terminology suggesting freedom: 'liberalization'. The use of this language enabled economists to depict changes, which ultimately empowered and enriched those with money while impoverishing those without, as a liberating experience.[14] It enabled them to argue that the state's regulatory framework was oppressive, and freedom from the state was an emancipation.

> *To contain the evils that market systems can inflict, capitalist economies developed sets of institutions and authorities, which can be characterized as the equivalent of circuit breakers.* Hyman P. Minsky[15]

The removal of controls and regulation—of 'circuit breakers'—from capital is the most revolutionary of the economic doctrines promoted by neoliberal economists. Viewed from any perspective, this transformed and disrupted the economic landscape between 1970–2003.

The reason is straightforward: Removing controls over capital freed up the owners of money to move their funds to any part of the world. Naturally, they moved it to where returns, profits, or capital gains were highest. This made them richer, but also more powerful. As these 'reforms' have taken root, so the finance sector has come to dominate the global economy as a whole. In 1970, 90 per cent of international transactions were accounted for by trade and only

10 per cent by capital flows. Today, despite a vast increase in global trade, that ratio has been reversed, with 90 per cent of transactions accounted for by financial flows not directly related to trade in goods and services.[16]

As part of its expansion and growing dominance, the finance sector has fuelled and expanded credit, as we demonstrate in the next chapter. This has helped to create a vast 'credit bubble' which has, in turn, financed a 'bubble' in assets: stocks, shares, property, and dot-com companies. The easy availability of credit encouraged consumers, corporations, and governments to run up huge debts. In a deflationary environment, these debts will be transformed into heavy millstones.

banks and the corporate sector

The freedom for the owners of money to seek capital gains wherever they were highest between 1970 and 2003 revolutionized, in turn, relationships between the owners of capital and the owners and managers of productive capacity; those who engage in the real economy—growing, engineering, and manufacturing. They now have to deal with the unpredictability of land (in the broadest sense), resistance of labour, and the volatility of profits. By contrast, the capital gains from lending, speculating, and betting—until financial crisis strikes—are much higher. While the dynamics of profits might be unstable, the dynamics of capital gains (in particular, interest or compound interest) follow a straight line—upwards.

Because the free flow of capital enabled the owners of capital (creditors and investors) to capture the highest returns in any part of the world, this placed enormous pressure on the corporate sector (less mobile than the finance sector) to provide higher rates of return, or capital gains, that were comparable to those made from lending, speculating, and betting in parts of the world where costs were lower. Shareholders and creditors bullied managers, demanding that companies prioritize their interests, and compete with financial gains made elsewhere. The interests of consumers, employees, suppliers, local communities or, indeed, the environment, were downgraded. As shareholders were free to move their funds out and transfer them elsewhere to other parts of the globe, they were empowered effectively to hold a gun to the heads of the companies they invested in.

There can be no excuse or justification for corporate weakness, fraud, and malfeasance, in the face of this pressure. Nevertheless the intense pressure of the finance sector led CEOs and then managers to manipulate their balance sheets; to inflate the real value of their companies; to relentlessly merge and acquire new companies; ruthlessly to force down costs; and to carelessly harm

the environment. If this did not prove sufficient, CEOs and their advisers did not hesitate to devise 'tricks, contrivances, and bogus transactions' to please and satisfy the finance sector.[17]

bankers and governments

Governments, in particular poor country governments, suffered similar pressures from the finance sector. Their creditors are often grouped together as 'global capital markets' and include bondholders, investors, official institutions like the IMF and the World Bank, but also rich country Treasuries. To satisfy these predatory lenders, and repay their ballooning debts, governments have had to re-orient their economies towards foreign creditors, and expand revenue-generating exports to raise money for debt repayments. While the United States is able to repay its debts in a currency that it prints itself, this option is not open to poor countries who have to repay in 'hard currency' (dollars, yen, euro, and sterling)—the only currencies that international creditors understand, or will accept. So the pressure has been on to expand exports, which generate hard currency; domestic priorities such as feeding its people and trying to keep them healthy have had to go by the board in many developing countries. It has also meant far too often, the continuous stripping of forests, the handing over of natural assets (minerals, oil), and the ruthless exploitation of the land.

When these efforts at raising revenues have proved insufficient, governments are forced to hand over state assets (the 'family silver') to repay creditors and investors. This transfer of assets from poor countries to their creditors was disguised as another favourite 'reform' of this period: privatization.

Above all, the power of international financial markets strips governments of policy autonomy—the power to decide, independently, on policies that serve the interests of their people and environment. Instead, governments are obliged to implement policies effectively dictated by foreign creditors/investors. By doing so, elected governments lose legitimacy with their populations, and democratic deficits are made worse.

minimizing the state

The second of the major upheavals proposed by neoliberal economists to governments was audacious—that governments should divest themselves of power, transferring control to unaccountable markets, including financial markets. Neoliberals are contemptuous of the state, dismissing it as 'rent-seeking', and have systematically tried to diminish the role of the state in the economy. Before 1970, governments on the whole allocated resources for the weak and

defenceless in society; for public transport and infrastructure; for cultural activities and communication. Now, these roles are increasingly 'privatized' or 'marketized'. Public spending has been cut to please the markets. In sum, politicians have transferred to 'the market' those powers previously exercised democratically by parliaments and governments. The allocation of resources for health, clean water, sanitation, education, pensions, scientific research, transport, broadcasting, sport, culture, mineral extraction, and marketing are but a few of the government functions that, in many countries, are now carried out by 'the invisible hand of the market'.

And when the invisible market fails to allocate resources effectively—whether it is in employment, health care, public transport, or pensions—there is nobody to blame or hold to account. The weak, the unemployed, the isolated, the old, and the infirm are left in a democratic vacuum. NGOs and other extra-parliamentary organizations in the West have tried very hard to fill this vacuum; but there is unfortunately room for anti-democratic forces, authoritarian and extremist organizations of both a religious and political nature which thrive most when economic times are hard for ordinary people.

We used to aspire to 'government of the people, by the people, for the people'; but the period 1970–2003 saw the perversion of this ideal with 'government of the markets, by the markets, for the markets'. As Messner and Nuscheler note, 'the degeneration of political culture and the brutalization of social conflicts' are two of the characteristics of the last 20 years.[18]

We would go further and argue that the degeneration of political culture is a direct result of financial liberalization, which, in collaboration with elected politicians who chose to strip democratic institutions of political and economic power, has hollowed out the state.

a single global market

The third major change proposed to politicians and governments by economists (and facilitated by technological change) was bold, and we repeat, strikingly utopian: that governments should remove restraints on trade, and try and build a single global market for goods and services ranging from toothpicks to equities to music CDs to health services to pornography. We believe this to be utopian, because the social, political, and environmental pressures brought on by the increased competitiveness of a single global market 'racing to the bottom' would—and will—prove literally unbearable for humanity and will therefore be resisted.

WTO agreements now commit its governmental members not just to liberalize trade in goods, but also services, investment, and intellectual property.

Such a global market in goods and services, it is argued, is best freed from the constraints of public interest regulation and from tariffs imposed by elected governments. There is a need, the argument goes, to eliminate 'inefficiencies' in national and local markets, particularly in the 'inflexible' labour markets of highly-regulated welfare-state societies like those of Europe.

But free trade is imposing enormous and uncounted costs on the global economy, not least on the environment. As recently as 1995, trade accounted for 20–25 per cent of all carbon emission from energy use. By 2004, it is estimated that transport caused by international trade will have grown by 70 per cent. Such trends make a mockery of the reduction targets for carbon emissions set for industrialized countries.

conclusion

Global markets, above all, intensify 'international competitiveness', pitting groups, communities, and environments against each other in a futile 'race to the bottom'. Trade and investment liberalization, or 'beggar-your-neighbour' economics, as Colin Hines puts it, is harming the planet, and fostering international tensions.[19] And global markets transmit shocks more effectively. For example, the global market in travel has been hurt by the shock of a virulent, killer disease—SARS; and the shock of recession rolls from one country to another and then from one continent to another.[20] In this, perhaps, is the catalyst that will take us back to a world economic structure that has equity and social justice at its core. Once the developed world finds it cannot insulate itself from the damage it has done to its less privileged neighbours, thousands of miles away and bundled conveniently out of sight and mind, the time may have come when we can turn our world the right way up again.

references

[1] W. Churchill, *The Gathering Storm* (London: Mariner Books; Reissue edition 1986) p. 27.

[2] First Inaugural Address of Franklin D. Roosevelt, Saturday, 4 March 1933.

[3] R. Crockett, *Thinking the Unthinkable: Think-Tanks and the Economic Counter Revolution 1931–1983* (London: HarperCollins, 1994)

[4] W. Wriston, *Technology and Sovereignty* Foreign Affairs (1988) 67:63–75. Quoted in E. Helleiner, *States and the Reemergence of Global Finance* (Ithaca, NY: Cornell University Press, 1994).

[5] See, as examples of this thinking, D. Korten, *When Corporations Rule the World* (Connecticut: Kumarian Press: Berrett-Koehler, 1995) and N. Klein, No Logo (London: Flamingo, HarperCollins, 2000) in which she argues that; 'At the heart of this conver-

gence of anticorporate activism and research is the recognition that corporations are much more than the purveyors of the products we all want; they are also the most powerful political forces of our time. . . We have read how a handful of powerful CEOs are writing the new rules for the global economy, engineering what Canadian writer, John Ralston Saul has called "a *coup d'etat* in slow motion ". . . because corporations have become the ruling political bodies [our emphasis] of our era, setting the agenda of globalization. We must confront them, in other words, because that is where the power is.' p. 339–40.

[6] E. Helleiner, *The Reemergence of Global Finance*, (Ithaca, NY: Cornell University Press, 1994) p. 90–1.

[7] MF staff have written that 'at its most basic there is nothing mysterious about globalization. The term has come into common usage since the 1980s, reflecting technological advances that have made it easier and quicker to complete international transactions—both trade and financial flows.' From a paper on 'Globalisation: Threat or Opportunity?' published 12 April 2000.

[8] See M. Hudson, 'Savings, Compound Interest and Asset-Price Inflation' presented at Eastern Economics Association Annual Meeting, 22 February 2003.

[9] *Stabilizing an Unstable Economy* (New Haven: Yale University Press, 1986) p. 120.

[10] J. Toporowski, 'Pension funds and Ponzi finance' in Ends of Finance (London: Routledge, 2000).

[11] Ibid., p. 58.

[12] Taken from US Securities and Exchange Commission www.sec.gov/answers/ponzi.htm

[13] J. Toporowski, 'Pension funds and Ponzi finance' in *Ends of Finance* (London: Routledge, 2000).

[14] We have had appeals from a number of true liberals, not to use the language of neoliberalism, because of its distortion of liberal ideals. However we feel we have no choice but to use the language that is now widely used to describe the neoliberal agenda.

[15] H. P. Minsky, D. Delli Gatti, and M. Gallegati, 'Financial Institutions, Economic Policy and the Dynamic Behaviour of the Economy' Working Paper no. 126, Levy Institute, 1994. quoted in *Minsky's analysis of financial capitalism* by D. Papdimitriou and L. Randall Wray, Levy Institute, July 1999.

[16] R. P. Cronin, 'Asian Financial Crisis: An Analysis of US Foreign Policy Interests and Options', Foreign Affairs and National Defense Division 28 January 1998.

[17] 'As we go to press, AOL Time Warner Inc., executives are being sued by two institutional shareholders who accuse Chairman Steve Case and other top executives of using dishonest methods to inflate the company's share price.' MSNBC News 14 April 2003; available at www.msnbc.com.

[18] D. Messner and F. Nuscheler, 'World Politics—Structures and Trends' in P. Kennedy (ed) *Global Trends and Global Governance*, (London: Pluto Press, 2002).

[19] C. Hines, *Localization*: *A Global Manifesto* (London: Earthscan, 2000).

[20] 'A survey of the global economy' *The Economist* 28 September 2002, p. 31.

CHAPTER 2

globalization and its consequences

romilly greenhill

In all the debate about the remarkable experiment of finance-led globalization, taking up acres of print and hours of discussion, one blindingly clear point has not been made—that the past two decades of finance-led globalization have been bad for the poor and bad for the global economy. Let me summarize the main negative consequences:

1. The growth of a massive credit bubble and its counterpart—a huge growth of debt at household, corporate, and government levels, threatening a new 'debt crisis of the rich'.
2. A 'hoover' effect transfers *wealth* (assets minus debt) from poor people and poor countries to rich people and rich countries.
3. A dramatic divergence in the distribution of wealth both nationally and globally, which has been much greater than the divergence in *incomes*.
4. The predominance of speculation over enterprise, and of finance over the 'real' economy, leading to a dramatic decline in economic growth and rising unemployment.
5. A growing threat of global deflation, including collapsing commodity prices and falling real-wage growth, so that ordinary wage earners are being forced into debt just to keep the economy going.
6. An increase in economic instability, particularly in poor countries.
7. A loss of policy autonomy in both Northern and Southern economies, leading in particular to conflicts between free trade and the free movement of capital.

This is what the global economy *really* is and we present the data and analysis to prove it.

the credit bubble

The decades since 1970 have been characterized by a near-total abrogation by governments of any control over the growth of credit. Banks and other financial institutions have been able to 'create' credit at will, leading to a massive escalation in the total stock of financial assets. The total stock of these assets—which include bonds, shares, bank loans, and mortgages, as well as complex financial instruments such as derivatives and options—has mushroomed in relation to GDP and the 'real' economy of goods, services, and people.

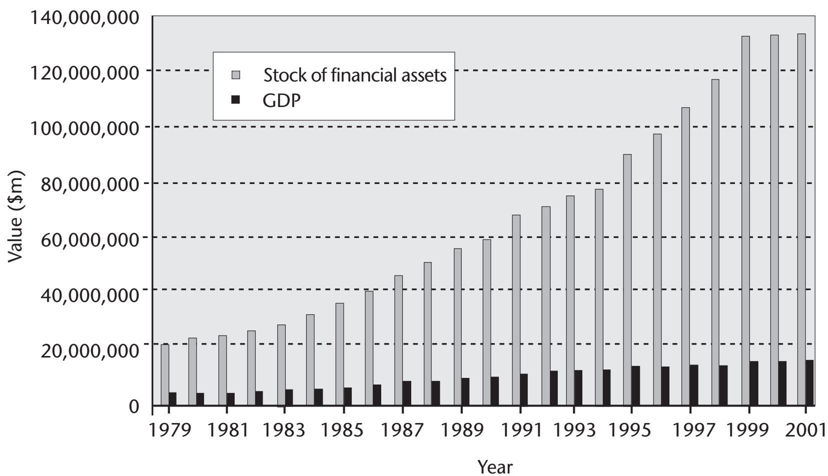

Figure 2.1 GDP and the stock of financial assets in G7 countries excluding UK and Japan

Source: US Federal Reserve: *Flow of Funds Accounts;* Statistics Canada*: National Balance Sheet Accounts by Sector;* Banque de France*: National Financial Accounts;* OECD*: National Financial Accounts;* Banca d'Italia*: Supplements to the Statistical Bulletin, Financial Accounts;* Deutsche Bundesbank*: Financial Accounts for Germany 1991 to 2001;* IMF*: International Financial Statistics*

In 1980, the total stock of financial assets in five of the major world economies was around $20 trillion—that is five times their combined GDP (see Figure 2.1). By 2000, this figure stood at almost $140 trillion, or *ten* times GDP. In some countries, the figures are even more dramatic—the financial stock in Japan rose from less than six times GDP to roughly *nine* times in just one decade, 1980 to 1990, a meteoric rise which may explain the country's equally rapid economic collapse.[1] In the United Kingdom, the total stock of financial assets stood at almost 15 times GDP[2] in 2000. Even taking into account the probability of some 'double counting'—an asset lent by a household to a bank

or financial intermediary, and then on-lent to a company is counted twice—this growth has been spectacular.

So who is holding these assets? There has been a huge growth in assets held by households, albeit only the rich ones. But mostly the explosive growth has been in the finance sector—banks, investment funds, pension funds, mutual funds, and other forms of 'financial intermediary' (see Figure 2.2). Over the past 20 years, this sector has changed from being just that—an intermediary between savers and borrowers—to being one of the dominant sectors within the global economy, in both economic and political terms.

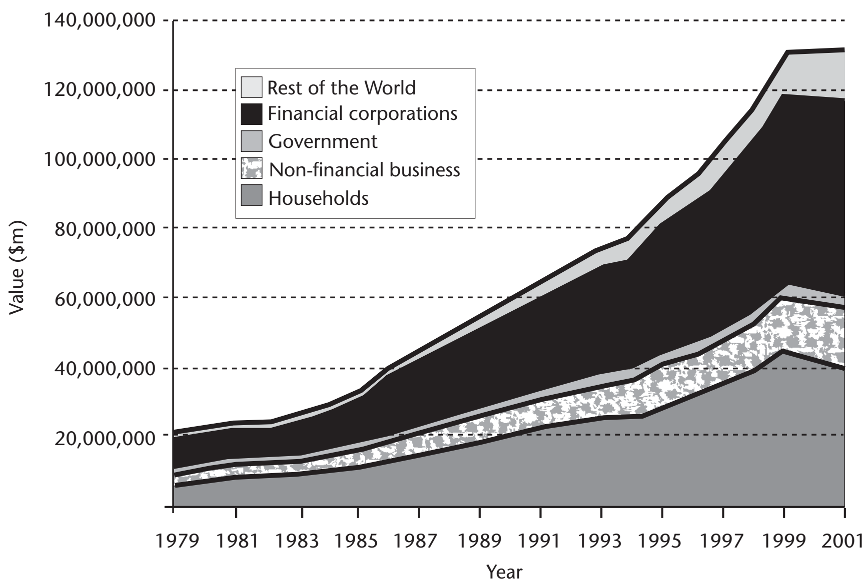

Figure 2.2 Trends in asset holdings by sector in G7 countries excluding UK and Japan, 1979–2001

Source: US Federal Reserve*: Flow of Funds Accounts;* Statistics Canada*: National Balance Sheet Accounts by Sector;* Banque de France*: National Financial Accounts;* OECD*: National Financial Accounts;* Banca d'Italia*: Supplements to the Statistical Bulletin, Financial Accounts;* Deutsche Bundesbank*: Financial Accounts for Germany 1991 to 2001;* IMF*: International Financial Statistics*

Does this matter? Does the dramatic growth in financial assets simply mean that we are all getting richer? And if the finance sector is getting more dominant, isn't that merely leading to greater risk-sharing and economic efficiency? The answer, quite simply, is no. The dramatic growth in the finance sector in relation to GDP has had a number of negative consequences. The huge growth in financial assets has become de-linked from any 'real' growth in the capital

stock and it has forced millions of people and companies into debt. For these two reasons, it is unsustainable and threatens global economic stability.

Figure 2.3 compares the total stock of financial assets in five major economies with the stock of 'real wealth', defined as physical capital, human capital, and research and development expenditures. In the late 1970s and early 1980s, the two were roughly the same. By 2000, financial assets were worth about three times the value of the real assets underlying them.[3] There was a total divorce from economic reality.

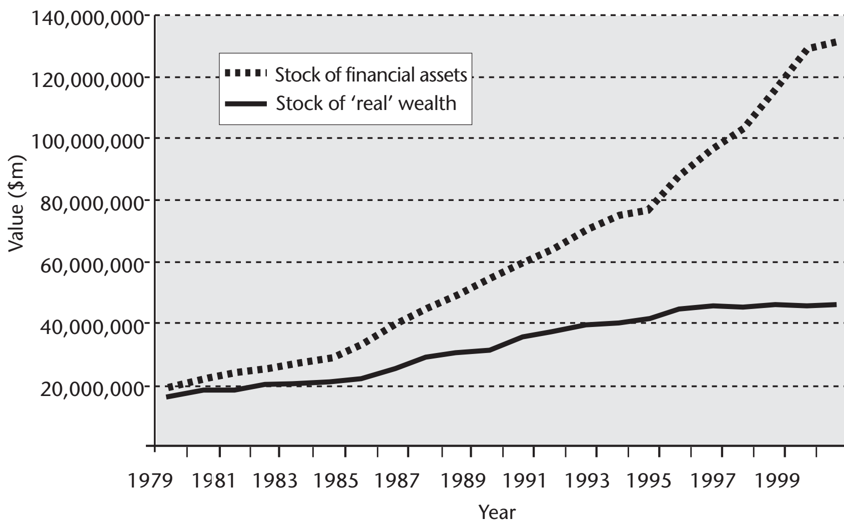

Figure 2.3 Stocks of 'real' wealth and financial assets in G7 countries excluding UK and Japan, 1979–2000

Source: The stock of financial assets is taken from Figure 2.1. The stock of 'real wealth' is calculated from data provided by the Centre for the Study of Living Standards*, 'Latest Estimates for the Index of Economic Well-Being for OECD Countries' August 2002*

But how can financial assets not represent anything 'real'? The explanation is simple. Money has gone into speculation against currency movements and on the price of existing assets; into hedge funds which gamble against movements of future asset prices; into vastly complicated derivatives, options, and so on—a big betting game, in other words. The stock of credit and of financial assets has grown exponentially but there has been no discernible impact on the real, tangible, earthy economic realities.

All this might be a harmless gain if it were not for the fact that for every lender, there has to be a borrower. In the 1970s, the loan pushers of the Western

banking system lent money to Third World governments, perceived at the time to be a source of ever-higher returns. Now, the financial sector is preying upon ordinary people on the high streets of London, New York, and Seoul.

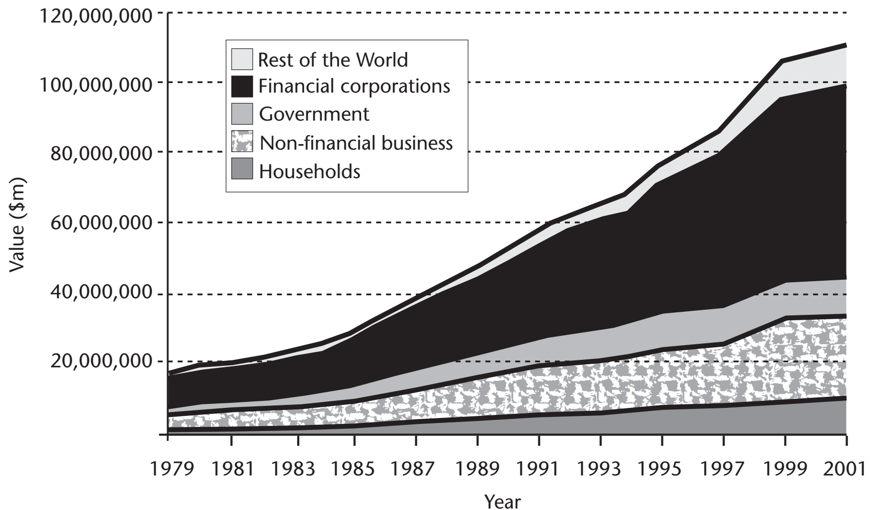

Figure 2.4 Trends in liabilities by sector in G7 countries excluding UK and Japan, 1979–2001

Source: US Federal Reserve*: Flow of Funds Accounts;* Statistics Canada*: National Balance Sheet Accounts by Sector;* Banque de France*: National Financial Accounts;* OECD*: National Financial Accounts;* Banca d'Italia*: Supplements to the Statistical Bulletin, Financial Accounts;* Deutsche Bundesbank*: Financial Accounts for Germany 1991 to 2001;* IMF*: International Financial Statistics*

The counterpart to growing financial assets is the increased liabilities of households, governments, and the corporate sector (see Figure 2.4). So we are now facing another kind of debt crisis. Unlike the Third World debt crisis, this one is taking place in the West, amongst the middle classes but also amongst the socially excluded underclass, preyed upon by predatory lenders. Lured by relentless pressure of the finance sector offering 'great deals', people are re-mortgaging their homes, running up credit card debts, overdrafts, student loans, hire purchase credit, and so on. In the United Kingdom, net credit card lending increased by 55 per cent between 2001 and 2002, net mortgage lending increased by 46 per cent, and personal loans and overdrafts by 13 per cent.[4] Debt is now financing about 10 per cent of all household spending. There is a similar story in the United States with personal sector liabilities now at 133 per

cent of national income, four times the value in 1946, while mortgage credit expanded by $222 billion each year between 1988 and 1997.[5] Unlike corporate borrowing, much of this debt is not being taken on to make investments that will generate future incomes, but to meet consumer needs.

predatory lending in britain

pat conaty

The credit underground in Britain is thriving in the 21st century. Recession, social exclusion, and the widening gap between rich and poor have pushed increasing numbers into a financial twilight zone where borrowing, even for necessities, carries an extravagant price tag. Estimates suggest that one in five adults are denied the loans and cheap interest rates most middle class Britons take for granted. For over eight million people, the only credit available is that offered by predatory lenders—a market worth over £16 billion per year and with interest and credit charges ranging from 35 per cent to 2000 per cent annually. In a NEF pocketbook *Profiting from Poverty* (which calls for radical reform of the lending system and shows how it could be done), we show how sophisticated marketing techniques involving some of the best-known names in business are being employed to sell expensive credit to those low and moderate-income households that can least afford it. For those on the receiving end, the results involve a downward spiral of debt, court judgments, loss of homes, and evictions. Unlike most other EU countries and many American states, Britain has no ceiling on interest rates or effective legal controls against usury.

Figure 2.5 gives us some indication of the extent of the credit bubble in the United States. From about 1985 onwards, the value of all financial assets often grew much faster than could be justified by new purchases. From 1995, asset values lost touch with reality altogether, and only came crashing down when the bubble started to burst in 1999.

The credit bubble is particularly worrying given that people have borrowed in order to invest in assets on the expectation that their value will rise by more than the rate of interest paid. In 1999, purchase of financial assets by the UK

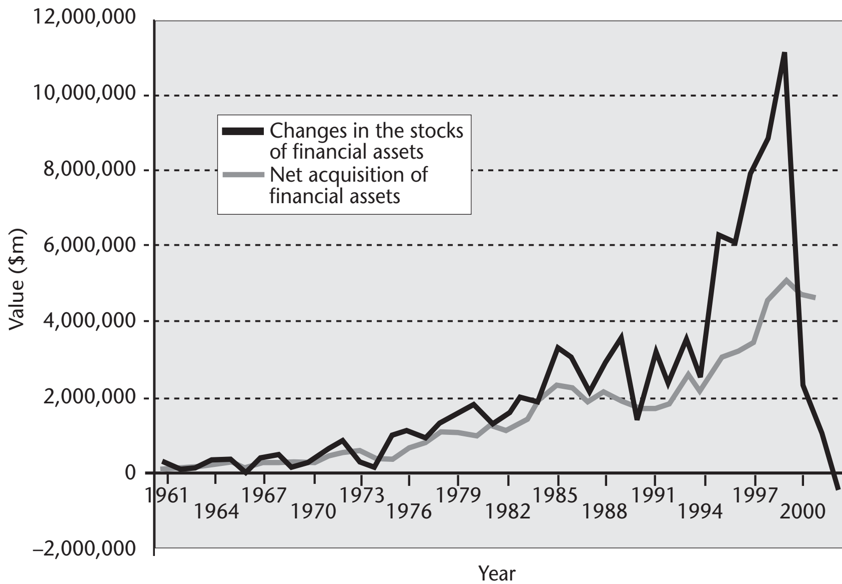

Figure 2.5 Changes in the stock of US financial assets against net acquisitions of financial assets, 1961–2001

Source: US Federal Reserve*: Flow of Funds Accounts*

Government, corporations, and households stood at £450 billion—around three times the value of gross national savings (see Figure 2.6).

The consumer debt phenomenon is not just an Anglo-Saxon or even a Northern Atlantic affair. There is now increasing pressure to get consumers into debt in other areas, particularly in Asia. As *The Economist* noted in its survey of consumer finance in February 2003, 'consumer finance is Asian banks' new thing'. Between 1999 and 2002, issuance of new credit cards in South Korea grew at an annual compound rate of 75 per cent. Aggregate household debt in South Korea has been growing at 25 per cent per year and now accounts for half of all bank lending. In Thailand, the credit card business has been growing by 15 per cent per year.[6] In January 2003, Citigroup, the world's biggest bank, won approval to take its first minority stake in a Chinese bank. The ability to promote credit cards and other consumer finance products in China was the chief attraction.

Moreover, as Peter Warburton explains in Chapter 17, corporations have also seen their debts spiraling out of control. Under pressure to massage their share price upwards, corporations have been borrowing by the billions, often to buy

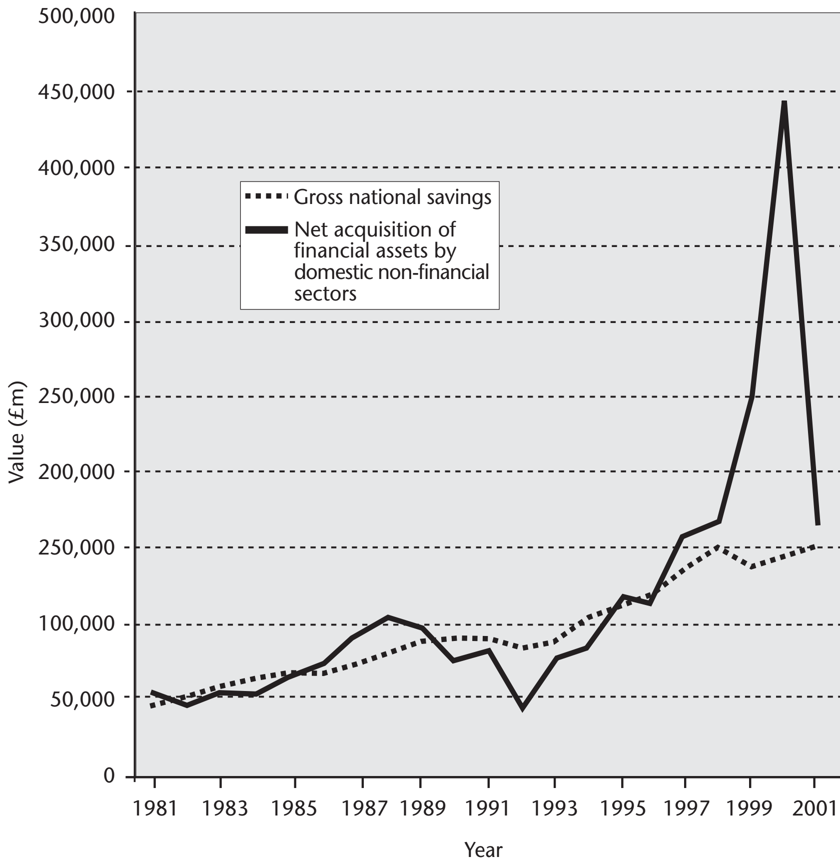

Figure 2.6 Gross national savings and net acquisition of financial assets by domestic non-financial sectors in the UK, 1981–2001

Source: UK Office of National Statistics*: UK Economic Accounts*

back their own stock. Much corporate debt has been hidden by accounting sleights of hand, a technique that has only come to light since the Enron scandal broke in 2001. So-called 'off balance-sheet' items include unfunded pension liabilities, stock options, property leases, derivative contracts, and joint ventures—liabilities which are now estimated to represent almost 40 per cent of long-term debt.[7] And, as with consumer indebtedness, the problem is not limited to the North American and European economies. In Asia, it has been estimated that the total stock of *non-performing loans*[8] is already at $2 trillion—quite apart from those loans which will, at least in theory, be paid back.[9]

And let us not forget that the crisis of sovereign indebtedness has not gone away, particularly in developing countries from Turkey and Indonesia to Uganda and Iraq. By 2001, total long-term public and publicly guaranteed debt (that is, excluding the foreign debts of private companies) owed by developing countries was almost $1.5 trillion—or one quarter of their total gross national income.[10] Many developing countries are paying sky-high interest rates on their government debt. Moreover, as the World Bank's latest edition of *Global Economic Prospects* has made clear, foreign capital flows to developing countries are still 'supply driven'—they flow according to the priorities of Western finance holders rather than locally generated needs.[11]

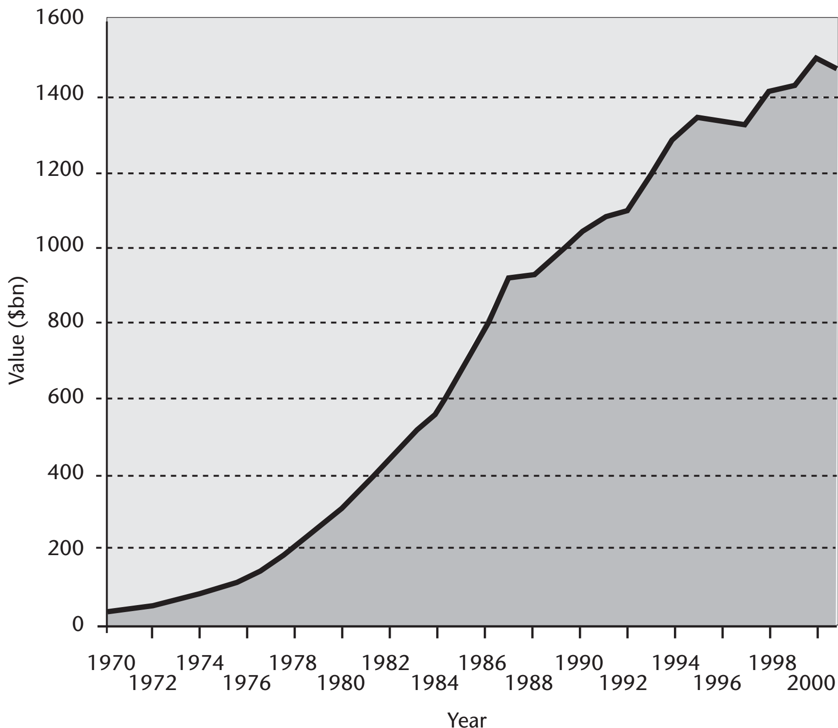

Figure 2.7 Total public and publicly guaranteed debt owed by developing countries

Source: World Bank*: Global Development Finance 2002*

This credit bubble, ultimately based on nothing more than expectations, cannot be maintained forever. There will be a crash. People will no longer be able to pay their debts, particularly if the values of the assets they hold against those debts start to fall as has already happened with equities, and will shortly spread to corporate debt and personal debt. The effect on people in both rich and poor countries will be profound.

pensions in crisis

The pension industry is in crisis. Globally, pension fund assets fall short of their liabilities by some $2500 billion.[12] This deficit is due to a combination of a collapsing stock market, plus company greed. When the going was good, many companies took pension holidays, failing to pay in what was needed to meet their overall liabilities while inflated share prices appeared to take up the slack. Now, employees are suffering the fall-out. In some cases, pension schemes have collapsed, wiping out a lifetime's worth of savings for the hapless employees who thought they were well protected. In other cases, companies are radically downgrading what they will be offering pension holders. At Maersk International Shipping Group, for example, employees may lose up to 60 per cent of their pension rights. Still, other companies are asking their employees to pay more. Sainsbury's, for example, is asking employees to increase contributions into its final salary scheme from 4.35 per cent to 7 per cent.[13]

The outlook for pensions is likely to get even worse, as the credit bubble collapses. Ordinary people, whose life savings have been handed over to risky and irresponsible pension funds, will see increasing levels of hardship in their old age.

national accounts and the finance sector

Economists and statisticians have developed ways of measuring the total output in any given economy. An economy's Gross Domestic Product (GDP) adds up everything produced. By definition, this is equal to total expenditure and total income. GDP figures, both in the aggregate and per person, are commonly used to assess economic performance across nations. Higher GDP growth is seen as a measure of success. Countries are also classified as 'developed' or 'developing' based on the level of GDP per person.

However, GDP measures are frequently criticized by 'alternative' economists for providing a distorted view of trends in economic welfare across time and across countries. Such economists rightly point out that GDP fails to account for the impacts of economic activity on the environment; that it counts clean up costs for environmental catastrophes, natural disasters, war, and conflict as 'goods' rather than 'bads'; that it neglects the work undertaken by women, and fails to take into account non-material aspects of well-being.

But GDP also excludes another important measure—trends in gross national wealth and indebtedness. GDP only measures annual flows. This means an economy such as the United States can become ever more indebted while still appearing to be the richest country in the world in GDP terms.

Our national accounts fail to fully understand capital, debt, and savings. 'Savings' are defined as any income that is not consumed. Debt repayments are therefore defined as savings! Similarly, people spending capital gains, for example mortgage equity withdrawal on their houses, is counted as running down savings. This is one of the reasons why economists fail to fully understand credit bubbles and the effect that these have on our economies and why they are unable to stop them occurring or deal with them when they do.

To be fair, national statistical offices are starting to produce 'national financial accounts' which track national wealth and indebtedness. But the data produced is often patchy, too short-term, and subject to large

revisions. While data on GDP, exports, and consumption can be downloaded from many a CD-ROM or website, financial accounts remain hidden in the depths of national statistics websites—if they are produced at all.

Maybe if we really want to compare the 'wealth of nations', in the seminal words of Adam Smith, we need to start taking 'wealth' a bit more seriously.

financial globalization and the 'hoover effect'

The huge growth in the finance sector and the abrogation of control by governments over the supply of credit have not happened by accident. Rather, they are the result of deliberate policy decisions of governments, particularly in the West. But if the resulting credit bubble is so dangerous, why have governments let it happen? Quite simply, financial globalization has taken place because it is in the interests of a small elite of politically and economically dominant people who have done extremely well out of it while ordinary people have found themselves increasingly indebted. It is indicative that the flow of resources from the poor South to the rich North has increased steadily.

stock options and their effect on wealth inequality

claus gruber

A stock option is a right to buy or sell a share for a defined price during a specified period of time. The movement of the underlying stock influences the value of this right. When the right is exercised, the owner gets the underlying stocks delivered into his account. The granting company is thus distributing wealth rather than income to the recipient.

Many companies are now granting stock options to employees as part of their compensation package. When they are exercised, these options are transferred into stocks and the company receives additional capital. But, given that the company has not changed in value at this very moment, the value due to other shareholders is diminished. In other words, the

company is creating wealth to new potential shareholders at the expense of existing shareholders. Great, isn't it!

In 1935, the legendary investor Benjamin Graham wrote a brief satire about the accounting shenanigans at US Steel, explaining this wonderful value-creating circle. In those times, stock options were already granted to executives, but only on a small scale.

Nowadays, almost everybody—especially in publicly-traded companies—is playing the stock-options game. The United States is the leading country and the one in which most statistics are available as well. Standard & Poor's has compiled a database out of the company reports over the last years. It states that, in 1999, all employees of S&P 1500 companies were granted an equivalent of $2508 in stock options. On the surface, this looks moderate; but split between CEOs and middle management, the size of the iceberg is apparent. While a middle manager in general received $2159, his CEO received $2,468,000. Between 1999 and 2001, the 25 CEOs with the highest total compensation together accumulated $5,634,187,000—that's more than $75 million annually each. But what might have been available to 'normal' employees? The statistics do not tell us (in most countries, because wealth is not, or only partly, subject to tax, virtually no statistics are available and academic research turns a blind eye on wealth-distorting effects) but it is indicative that the average annual earning of US full-time working employees in 2001 was $44,848, according to the US Census Bureau.

Stock options have other worrying implications. The exercising of stock options has allowed CEOs to see growing levels of compensation in 2001, away from the prying eyes of their Boards of Directors even at a time when corporate profits were falling by 35 per cent, stock prices had fallen by 13 per cent and unemployment had risen by 35 per cent.

Stock options also allow companies to manipulate their accounts. Although they account for part of employee compensation, they are not formally treated as costs. Efforts by the Independent Accounting Standards Board in the US to force companies to list stock options as expenses were dropped under pressure from CEOs, who often defended themselves from scrutiny by making large political contributions.

inequality

In a market economy, people should be rewarded for showing entrepreneurship and taking risks and that inevitably creates limited inequalities. However, inequalities increase exponentially in a system where money is made from money. The more money a person or a country has, the more money is made. Conversely, people and countries without a bed-rock of capital to start off with are getting priced out of the market, and are forced further into debt just in order to survive.

Inequalities between people and between nations have been exhaustively studied. However, most of the work done to date has focused on inequalities in annual *incomes,* while the distribution of personal wealth and indebtedness has been hidden from view. This is despite the fact that wealth influences both a person's subjective well-being—how secure they feel—and increasingly also their ability to make money over their lifetime. Conversely, as Gita Sen points out in Chapter 13, people and nations that are in debt lose 'their resources, their control over their means of livelihood, the security of their old age, their children's futures and their ability to make decisions on their own assessments of their needs and realities'.

Unfortunately, there is a real paucity of reliable global data on inequalities in wealth. Institutions such as the World Bank, the IMF, and the UN have let us down badly; they do not collect the required figures, arguing that it would be too difficult to provide an accurate assessment. But in our view, there may also be another motive; if the numbers were made available, the polarization in wealth would be too unpalatable for words.

Perhaps unsurprisingly, the private sector tends to track the rich. In a ghoulish alternative to publications such as the UN's *Human Development Report* or the World Bank's *World Development Indicators*, investment banks Merrill Lynch and Cap Gemini Ernst and Young have developed a *World Wealth Report.* The report notes that there are now 7.1 million 'High Net Worth Individuals' (HNWI) around the globe, with a total financial-asset wealth of $26.2 trillion. Although 2001—the latest year for which data is available—was not a good year for HNWIs, at least they 'managed to protect their wealth better than less-affluent groups'.[14] In Latin America, for example, HNWIs managed to see their wealth grow by 8 per cent in 2001, despite the appalling economic decline in the region in that year. This is highly suggestive of growing wealth inequality.

At a national level, we can track some of the trends in the distribution of wealth and indebtedness. In the United States, almost all of the increase in the stock of financial assets since 1983 has accrued to the top 10 per cent of the

population, while virtually all the increase in debt has accrued to the bottom 90 per cent (see Figures 2.8 and 2.9). The poorest 90 per cent now have debts equal to 75 per cent of their financial assets, while for the richest 10 per cent, debts amount to only 7 per cent of their assets. Of course, this leaves the poorest US households much more vulnerable to falls in asset values.

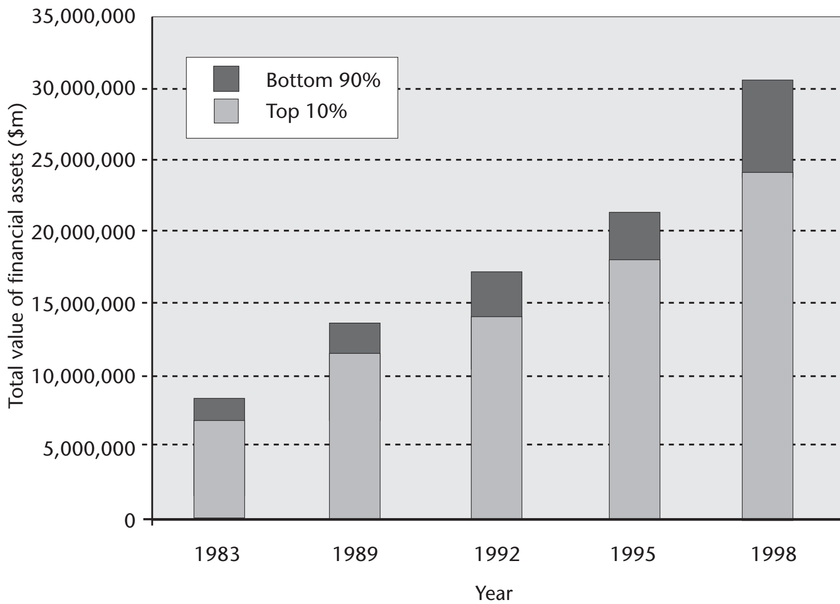

Figure 2.8 Growth of financial assets of top 10% versus bottom 90% of US households

Source: 'Recent Trends in Wealth Ownership 1983–1998' Working Paper No.300 by Edward N Wolff, Jerome Levy Economics Institute, April 2000

Growing inequality is evident in the United Kingdom too. Excluding household wealth, the bottom 50 per cent of the population now owns only 1 per cent of the wealth; in 1976, they had 12 per cent.[15] The richest 20 per cent of the UK population in income terms now has 41 per cent of the wealth but owes only 35 per cent of the total stock of debt. The poorest 20 per cent of the population has 7 per cent of the wealth but 11 per cent of the debt.[16]

The transfer of wealth from the poor to the rich is a global phenomenon; the 'hoover' effect is dramatic. Textbooks tell us that capital should flow from countries in which it is plentiful—the rich world—to those in which it is scarce—the poor world. But the opposite is happening. Even the World Bank,

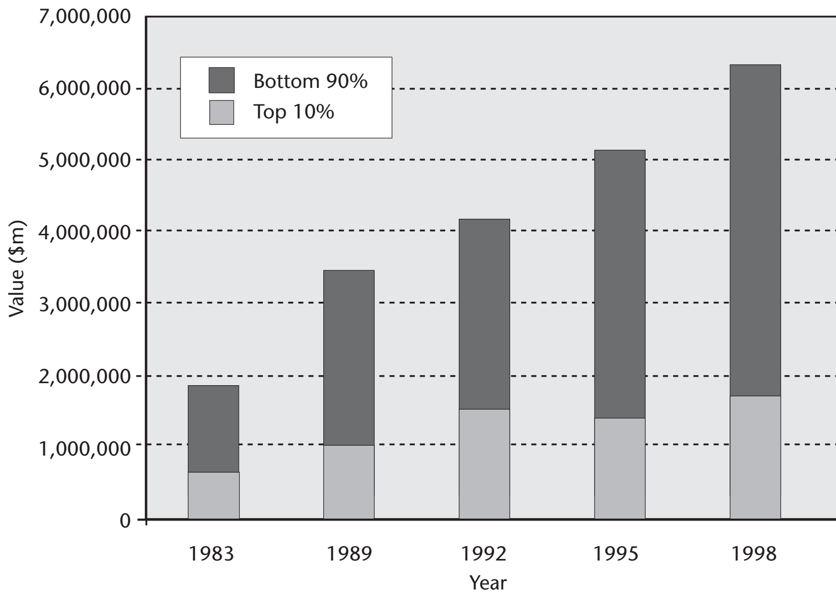

Figure 2.9 Distribution of debt amongst US households by household wealth class

Source: 'Recent Trends in Wealth Ownership 1983–1998' Working Paper No.300 by Edward N Wolff, Jerome Levy Economics Institute, April 2000

not known for its radical critique of globalization, has finally admitted that 'on a net basis, capital is no longer flowing from high-income countries to economies that need it to sustain their progress towards the Millennium Development Goals'.[17] What the Bank is saying, in essence, is that the poor are financing the rich.

A high proportion of these transfers from poor to rich are accounted for by interest payments and profit remittances. In 2001, developing countries paid a total of $122 billion in interest payments on their debt, and $55 billion in the form of profits sent back home by multinational corporations. In total, such countries were paying about 3 per cent of their GDP in such 'unproductive' payments. And this, of course, is in addition to the $260 billion loan principal they paid back to their creditors in rich countries.[18]

Such transfers also occur through the forced holdings of foreign currency reserves, usually US dollars. Countries have been radically increasing their foreign currency reserves as a result of the financial instability associated with globalization over the past decade. As Jane D'Arista points out in Chapter 24,

such transfers 'constitute an immense and expanding transfer of wealth out of these economies' to the United States. In 2002, the World Bank estimated these flows amounted to $110 billion[19] or more than double the total volume of aid.

Moreover, the officially recorded transfers from poor to rich do not include illegal and thus unrecorded capital flight from poor countries. The volume of such flows is notoriously difficult to quantify, but in 1994 was estimated at some $122.4 billion for all developing countries.[20] This capital flight is not accidental but has, at least in part, been promoted deliberately by Western banks and finance ministries because they need this capital to prop up their own economies.[21]

'Trickle down' is a discredited idea; let us think instead of globalization as a 'hoover' effect, sucking resources away from poor people in both poor and rich countries, and concentrating them in the pockets of the rich.

the 'real' economy is not performing

Advocates of finance-led globalization have often claimed that, while globalization may worsen income distribution, the poor are still better off because growth is higher than it would otherwise be—in other words, the poor get a smaller share of a larger global cake. The reality is quite different; the global economy has performed *much worse* during the last two decades of finance-led globalization than during the earlier era of capital controls and government intervention.

While we must beware of treating growth as the Holy Grail of economic policy-making because of its environmental costs, let us nevertheless look at growth on its own terms. Globalization has failed on growth. As Alan Freeman shows in Chapter 16, growth per person during the 1970s was almost 4 per cent per year; while during the 1980s it was only 0.7 per cent per year. Over the 1990s, output per person actually *fell* by 0.2 per cent on an annual basis. Developing countries have performed particularly badly, especially in Latin America and Sub-Saharan Africa. As IMF Managing Director, Horst Köhler admitted recently, in Latin America 'real per capita income levels today are basically back to their levels of 25 years ago'.[22]

Even in rich countries, the majority has not seen much benefit. The median wage in the United States is the same as it was 27 years ago, while unemployment rates across the OECD have been steadily increasing since the 1960s (see Figure 2.10). Even the so-called 'productivity miracle' has been largely illusory, with the 1.2 per cent annual growth rate experienced in the 1990s only slightly higher than the 1 per cent seen in the 1980s, and well below the 2.5 per cent growth rate seen between 1945 and 1973.[23]

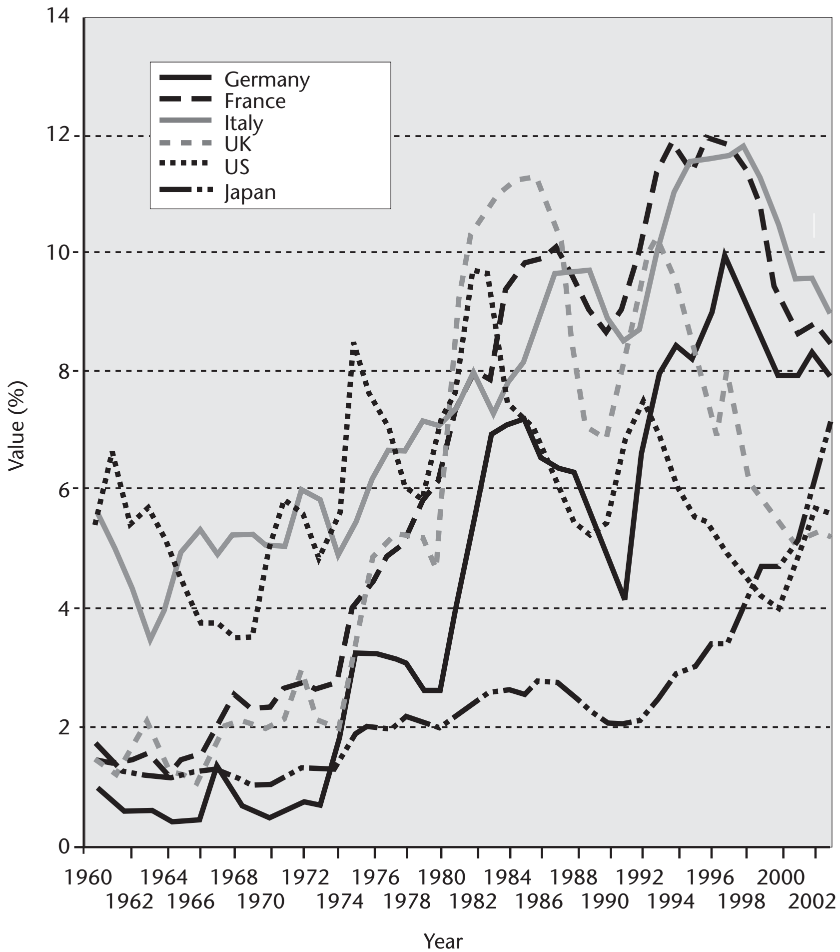

Figure 2.10 Unemployment rates in major economies, 1960–2003

Source: European Commission*: 'European Economy' No.4, 2002*

One of the causes of low growth has been falling investment. As a share of GDP, investment was lower in the 1990s than the 1980s in all G7 countries, except Germany. Moreover, despite the stock market boom of the late 1990s, investment rates fell between the first and second half of the decade in all G7 countries except the United States,[24] where, as Dean Baker argues, the figures were inflated by some 10 per cent because of an exaggerated way of calculating the quality of computers. [25]

Given the growth in global finance, which is supposed to channel resources more productively, why has investment fallen? According to Michael Hudson, one answer is that finance-led globalization has encouraged speculative investment in *existing* assets, including stocks, bonds, and property, rather than creating new assets. 'When markets are rising, the way to get rich most quickly is to borrow to the hilt to buy as much property [or stocks, bonds and so on] as possible.'[26] This has a parallel with foreign direct investment in developing countries, which so often has been used for the purchase of existing companies –often state-owned enterprises being privatized to meet the demands of the IMF—rather than increasing the productive stock.

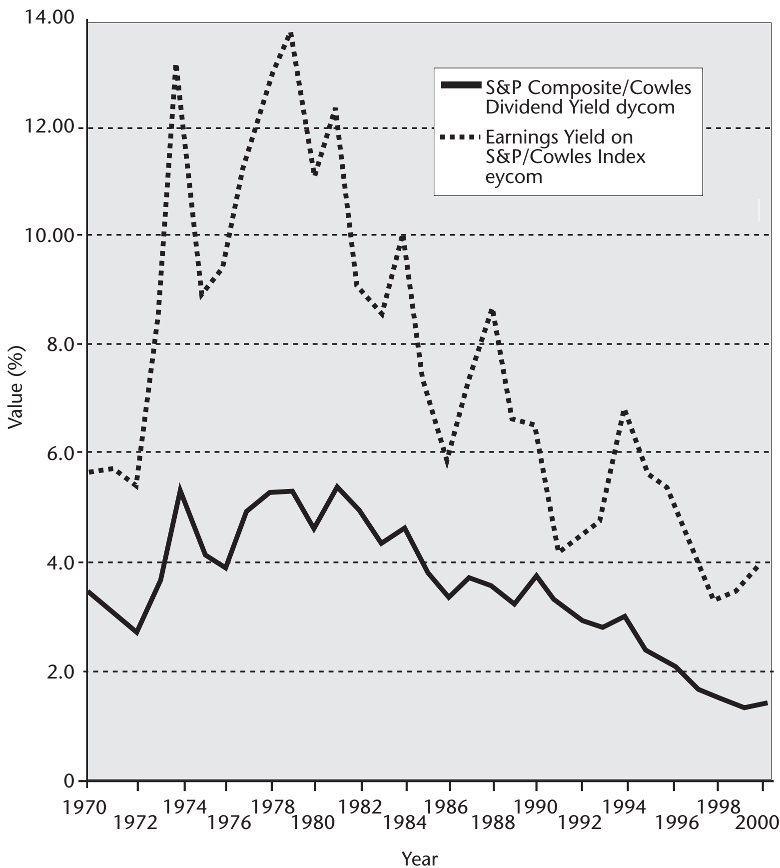

Figure 2.11 S&P earnings and the dividend yield, 1970–2000

Source: Wright (2001) Nonfinancial Stock Market Data

Moreover, companies have been reducing their levels of investment in order to increase dividend payouts to aggressive shareholders; dividends are now taking out a much larger share of profits than they were in the 1970s (see Figure 2.11).

the threat of global deflation

Since the 1970s, influential policy-makers and economists in both the North and South have been obsessed by inflation over all other economic priorities such as employment or tackling poverty. This monomania has even spread to Uganda where the government has rejected offers of new, grant-financed spending on areas such as agriculture and AIDS on the grounds that increasing government spending would be 'inflationary'. This inflationary obsession has, in fact, pushed us very close to deflation. Some countries are already suffering

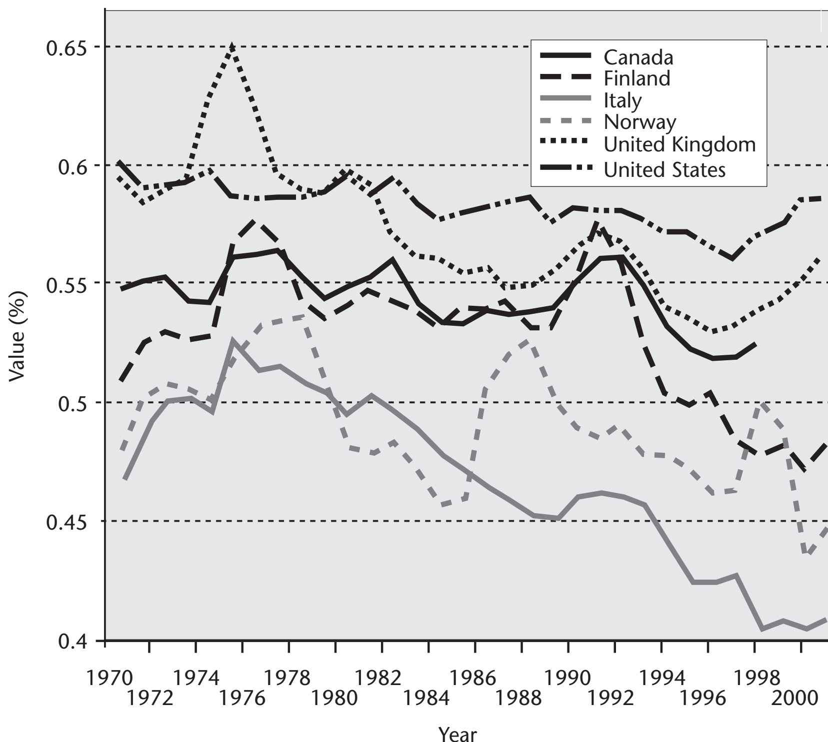

Figure 2.12 Compensation of employees as a percentage of GDP in selected OECD countries

Source: OECD

from it. Japan has been struggling with deflation for more than four years now, and a number of East Asian countries are seeing similar trends. Germany is on the brink of deflation, while inflation rates are at record lows in a number of OECD countries and have also fallen in other parts of the world under the influence of IMF-sponsored deflationary policies.

As we have noted in the Introduction to ***R****WEO*, a combination of consumer price deflation and asset price inflation is every wealth holder's dream. Under deflation, the costs of wages, commodities, and other inputs fall, while asset price inflation means that capital gains steadily rise and are not eroded in real terms. Lowering costs can make higher profits. Capital gains can be recycled into further capital purchases leading to yet more capital gains. In other words, money can be made from money—while those reliant for their income on current wages, and not from capital gains, receive a smaller and smaller share of national income.

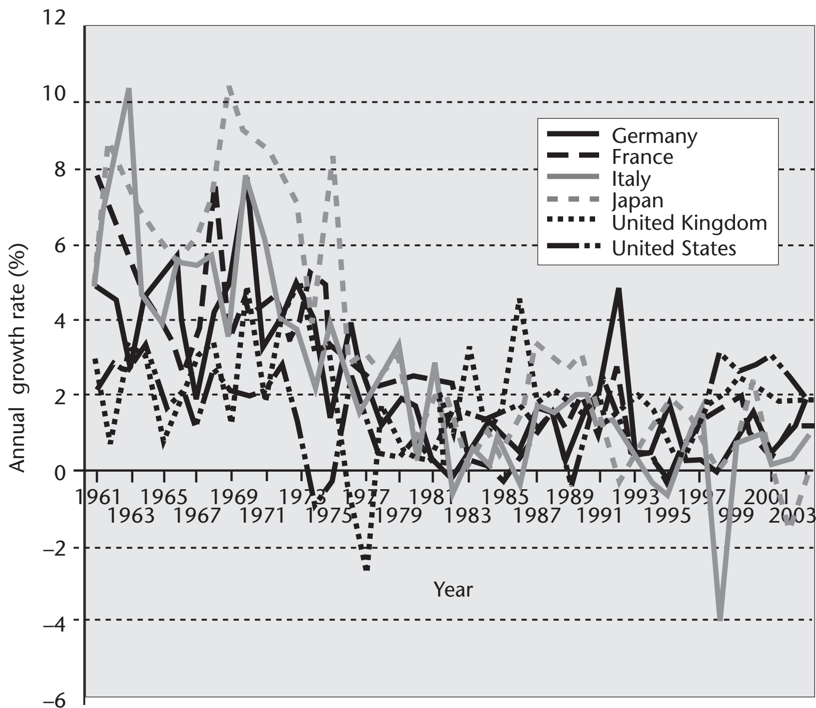

Figure 2.13 Growth in real wages in major western economies, 1961–2003

Source: European Commission*: European Economy, No 4. 2002*

The share of GDP going to employees in the form of wages and other compensation has fallen over the past three decades; despite high profile 'fat cat' pay deals (see Figures 2.12–2.14). In almost every country, the growth rate of real wages has been falling lower and lower. Similarly, commodity prices have been in steep decline—and by 2001 were at only 60 per cent of their 1980 levels.[27]

Central bankers and finance capitalists may soon get their come-uppance. Their obsession with inflation but laxity over asset prices has left us with chronic instability, the risk of financial crisis, and perilously close to outright deflation. What a stupid self-inflicted wound, particularly, as Joseph Stiglitz

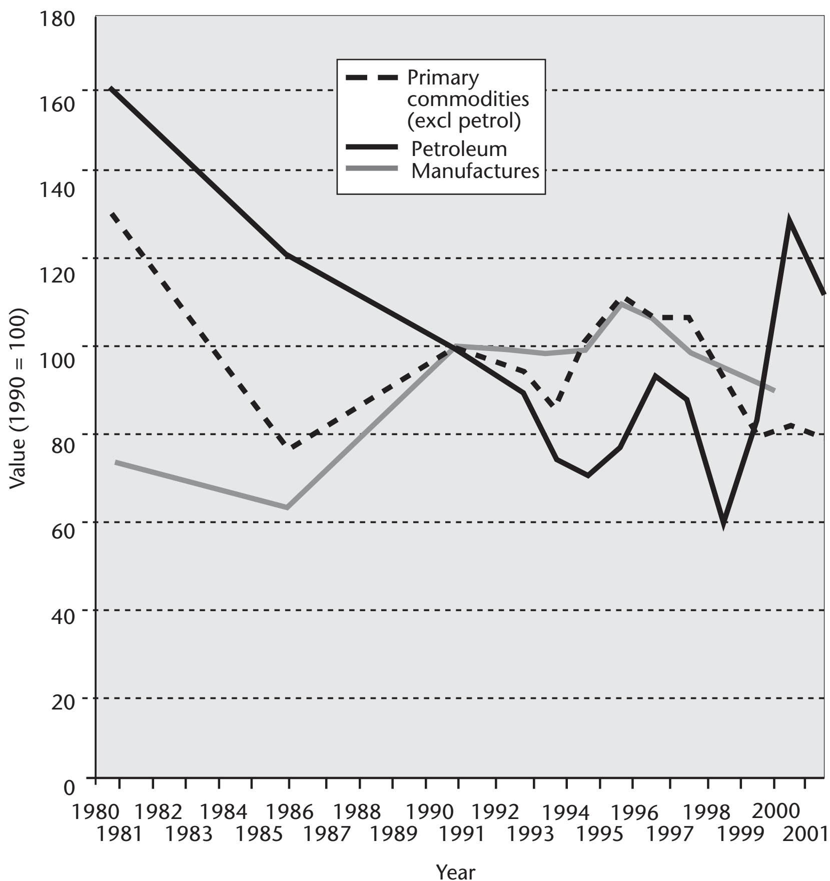

Figure 2.14 Trends in prices of manufactures and primary commodities, 1990 = 100

Source: UNCTAD *Handbook of Statistics 2002*, (Geneva: UNCTAD, 2002)

shows, given that low to moderate inflation does not have any significant adverse real consequences; being obsessive about driving down inflation ever further does.

inflation paranoia

joseph stiglitz

The oil price shocks of the 1970s set off a wave of inflation, and central bankers around the world took up the task of fighting inflation, no matter what the cost. They won the battle—today, in America, Europe, and Japan, as well as most developing countries, inflation has been tamed. We recognize that even the modest inflation numbers that we see may be a large overstatement of the true level of inflation. There are a host of biases, highlighted in the United States by the Commission headed by Michael Boskin, former Chairman of the Council of Economic Advisers under President George H. W. Bush. At the time, it was thought that inflation was overestimated by as much as 1 to 2 percentage points. Since then, methodological revisions in the United States have lowered the magnitude of the bias, but the problems remain in many other countries. Moreover, some countries, like Japan, face a problem of *deflation*.

Deflation—especially unanticipated deflation—is problematic because borrowers are forced to pay back more. In real terms, creditors benefit but debtors are hurt. The United States had a deflation problem at the end of the 19th century, which was accompanied by an economic downturn. The issue of deflation became the central issue of the electoral campaign of 1896, with the Democratic Presidential Candidate, William Jennings Bryant, running on the platform 'We should not be crucified on the cross of gold'. He wanted to reverse inflation by increasing the money supply, to be accomplished by switching from the gold standard to the bimetallic standard.

Economic research over the last decade has shown convincingly that the inflationary paranoia of earlier years was just that—largely paranoia. Low to moderate levels of inflation have no significant adverse real consequences; further reductions in inflation do not lead to faster economic growth, lower unemployment, and higher real wages. Indeed, pushing inflation too low

may have serious adverse effects, as George Akerlof (who shared the 2001 Nobel Prize) and his co-authors have shown. There is a trade-off between inflation and unemployment, and if lower inflation does not bring faster economic growth, then there can be a high cost to pushing the battle against inflation too far. For there is a real cost to those who otherwise would have been gainfully employed. Moreover, economic research has shown that this cost is long lived. Lower economic growth in one year—as a result of excessively contractionary policies—leads to lower economic growth in future years; some of the extra output would have been spent on productivity-increasing investments.

One of the reasons that deflation (or even low inflation) can be such a problem is that real interest rates, interest rates taking account of changing price levels, cannot be reduced by central banks to the levels required. In the Great Depression, when prices were falling 10 per cent per year, even zero nominal interest rates were translated into 10 per cent real interest rates—an extremely high number. Today, even in Japan, deflation is far more moderate. But even in the United States, there is growing recognition that the 'room to manoeuvre' has been reduced enormously. With nominal interest rates at 1.25 per cent, there is not much room to lower them further, and to stimulate the economy through monetary policy.

This puts more of the burden on fiscal policies, but here again, in the case of Europe, hands are tied because of the strict limits on the size of fiscal deficits imposed by the Stability Pact—again, largely because policy-makers have both eyes on inflation. The Clinton Administration managed to stop the Republican attempt to force a balanced budget through a constitutional amendment in the United States, but now the Republicans are taking full advantage, turning the huge fiscal surplus into mounting deficits reminiscent of the Reagan era. The deficits are being used not to stimulate the economy, but to finance large tax reductions for the very wealthy, with little effect on the real economy, either through output expansion in the short run or productivity enhancement in the long run. The centrepiece of the most recent proposal is a dividend tax cut, largely of benefit to the 'old economy' industries, like the railroad and aluminium from which Bush has drawn his Secretaries of Treasury, and not to the 'new economy' sectors, which pay out little in dividends.

The institutional frameworks—especially central banks—are fixated on the problem of inflation. Most central banks, including the European Central Bank, now have a mandate, which focuses exclusively on inflation; many have adopted inflation targeting. The problems are evident in Europe, which is facing mounting unemployment but has a central bank that does nothing about it because it does not view unemployment as its problem.

The threat of deflation is now so serious that even conservative economic institutions including the IMF, the Federal Reserve, and the Bank of England are starting to propose highly unorthodox policy measures for dealing with the crisis, such as simply printing more money. It is scary that some of these measures have been tried in Japan, but have failed to work. Could it be that we are now facing something even worse than deflation—debt-deflation?

Deflation is bad news for policy makers wanting to reflate the economy following a macroeconomic shock. Deflation is also bad news for debtors. Debt and deflation can interact in a downward spiral from which it is very difficult to escape.

deflation leads to debt….

Deflation is not just harmful in itself; it is also a major cause of indebtedness, particularly for households. If house prices rise by 25 per cent per year and real wages rise by only 2 per cent, people are forced to borrow heavily to secure a roof over their heads. Indeed, in a deflationary economic environment, consumers *must* get into debt just to keep the economy going. In general, people on lower incomes—wage earners—tend to consume a greater proportion of their incomes than the rich. When an increasing share of national income is going to wealthier households in the form of dividends and capital gains, consumption—and hence profits—is threatened. In the end, ordinary wage-earning consumers must get out there and spend, invariably on credit, just to keep a floor under demand.

…. and then to 'debt deflation'

Irving Fisher first coined the term 'debt-deflation' in 1932, at the height of the Great Depression. He observed that when prices are falling, the value of debts increases in real terms. As people try to save money to pay off their debts,

demand falls further, causing further deflation, and a further increase in the real value of debt. Once an economy enters a debt-deflationary spiral, governments can be powerless to pull it out again.

Record levels of debt in many of the world's major economies and looming deflation means that the risks now are real. And this time could be worse because finance-led globalization has emasculated governments' ability to act with the appropriate policy instruments. Consumers have been forced into debt by creditor-imposed deflationary economic policies; those same policies will prevent them from getting out again.

slicing and dicing risk

joseph stiglitz

At one time, it was hoped that the New Economy would end the business cycle. That clearly has not happened. Indeed, it is now recognized that much of the deregulation that was associated with the 1990s actually made the economy more unstable, and that the cutting back of welfare systems and the reduction of progressivity reduced some of the 'automatic' stabilizers. Other reforms, such as the switch from defined-benefit to defined-contribution systems, and the partial privatization of social security in some countries, exposed workers to increased risk, and at the same time increased economic volatility.

One of the often-lauded innovations of the past two decades has been in financial engineering, the ability of the economy to slice and dice risk, to shift it to those most able to bear it. But in spite of all of these innovations, developing countries are still forced to bear the risk of interest rate and exchange rate fluctuations, at enormous costs to themselves and the stability of the global economy. When investor sentiment shifts against emerging markets, the interest rates that they face may soar, and even well-managed countries may be pushed to the brink of bankruptcy. In 2002, Brazil managed its way through such a looming crisis. But the likelihood of another crisis emerging in some other country remains extremely high.

Meanwhile, the IMF, the international economic institution responsible for promoting economic stability, continues with its fixation on inflation.

Not only has it done nothing to address the fundamental real problems of risk, the policies it has pushed, especially capital market liberalization, have actually increased global economic instability; and meanwhile, when countries face an economic downturn, the contractionary policies it imposed on the countries exacerbates their economic downturn. While it finally admitted that it had pursued excessively contractionary fiscal policies in East Asia, it seems to have repeated the same mistake in Latin America. And while it finally admitted that capital market liberalization may yield little benefits in terms of economic growth, but exposes developing countries to the risk of increased instability, it is not year clear whether the policies which it pushes, and in some cases almost forces, upon developing countries have yet to change fully. This instability has a high toll, especially on the poor within these developing countries.

While the good news is that there is growing recognition that something is wrong with the global financial system, even the IMF has begun to question the efficacy of the big bail-out strategies that dominated its policies in earlier years. The bad news is that it has yet to turn its attention to the central issue: what reforms are most likely to make the real global economy more stable, and especially promote growth and reduce poverty in the developing world?

loss of policy autonomy and poor macroeconomic management

The sacrifice of political autonomy by governments all over the world as the markets were crowned king has seriously weakened the efficacy of macroeconomic policy to tackle the world's mounting economic problems.

Developing countries have long been in the grip of the 'market' in the form of IMF diktats to follow 'creditor-friendly' macroeconomic policies, including cutting budget deficits, trade liberalization, privatization, and deregulation. What is new is that developed countries are now getting a taste of the medicine that the IMF has long imposed on others. Developed countries have given up their ability to control the supply of credit and they have given away their capacity to manage their exchange rates and hence their external balances.

During the 1930s, governments sat by and watched—and squabbled—while the world economy slid into depression. Hemmed in by the Gold Standard, they were unable to make the exchange rate adjustments that were needed to reflate their economies. Today, we have a mix of exchange rate regimes, some fixed like the Eurozone, others pegged to the dollar from Latin America to East Asia, others floating more freely. However, in contrast to the 1930s, today our exchange rates are determined by financial flows as opposed to the balance of trade. Rather than countries importing and exporting on the basis of their economic needs, and then borrowing from abroad to make up the shortfall, countries are instead receiving supply-led inflows of foreign capital and allowing the current account to adjust to whatever exchange rate is set by the capital markets. This is what allows some countries, most notably the United States, to maintain a chronically over-valued exchange rate and hence to import half as much again as they export, sucking in resources from the rest of the world.

In today's world, countries may run external deficits, but only for as long as the markets allow them to do so. Once the market decides a current account deficit is unsustainable, money pulls out, and fast. In a self-fulfilling prophecy, the crisis predicted by these unelected and unaccountable creditors will come true. The result is that we can no longer rely on a smooth and gradual adjustment process to restore external equilibrium, but instead face a rolling series of financial crises which governments can do little about.

The one defence a government can erect is to build up foreign exchange reserves to use as ammunition against speculators when they attack. The world's foreign exchange reserves, usually held in the form of US Treasury bills, are huge: China has around $309 billion in reserves, Taiwan a further $169 billion, and South Korea $124 billion.[28] This is an enormous waste of resources. In effect, a dollar held in reserves is a dollar that could otherwise have been invested in health, education, or transport. Dean Baker and Karl Walentin of the Center for Economic and Policy Research in the United States have quantified the cumulative cost of these reserves on developing countries over the ten years. The numbers are staggering: 24 per cent of GDP in East Asia and the Pacific; 16 per cent in Latin America and the Caribbean; and 9 per cent in Sub-Saharan Africa.[29] Conversely, the United States has benefited enormously from a seemingly infinite supply of low-interest loans.

Because governments can no longer use exchange rate adjustment to restore the balance of trade, protectionism is on the rise. This is why, in the 1940s, Keynes lobbied hard for capital controls to be a central pillar of the Bretton Woods Agreement. He argued—and gained broad agreement amongst

policy-makers—that free movement of capital is simply not compatible with free trade.[30] We must now build a new consensus around this economic truth.

conclusion

The indictment of financial globalization can now be documented; the evidence is there. Growth is weaker, investment has fallen, inequality has risen, deflation looms, debt is becoming unsustainable; and governments' ability to tackle the serious problems we face has been fatally undermined.

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CHAPTER 3

real world economic outlook

romilly greenhill

In 0064—almost two thousand years ago—Nero famously sang to his lute and watched from the safety of a high tower while Rome burned. Today's Neros—the leaders of the G7, IMF officials, and economic forecasters—are not even shouting 'fire' as the world economy goes up in flames. They mutter strangled warnings about 'geopolitical uncertainties', 'financial imbalances', and 'structural weaknesses'. But, overall, they remain upbeat, saying, 'The global recovery is expected to continue during 2003.'[1] These words echo uncannily those of US President Hoover who, at the start of the worst depression of the 20th century in May 1930, said that he was convinced that US economic problems had 'passed the worst'.[2]

The reality is that the outlook for the global economy in 2003 is bleak. Financial globalization and the divergence of the superstructure of financial assets from the 'real' economy on which it is supposedly based, have led to one of the largest credit bubbles in history. Even recent stock market crashes have done little to dent the colossal stock of financial assets, now standing at almost ten times GDP in the G7 countries. At some point, the bubble must burst and that point is fast approaching.

As asset prices have ballooned, prices in the 'real' economy—wages and prices of goods and services—have sunk. Deflation may be good news for those looking to buy goods at lower prices, but it is bad news for debtors. The lethal combination of high levels of debt and falling prices was what characterized the Great Depression in 1929. There are now ominous signs of another debt-deflationary spiral.

the credit cycle collapse

Credit cycle collapses are not orderly or predictable but there are potential triggers—specifically to be found in the US economy—which suggest that the bubble will burst sooner rather than later.

As Dean Baker observes in Chapter 7, the US economy is currently running on three bubbles simultaneously: the dollar bubble, the asset price bubble, and

the housing bubble. 'Bubbles' exist when things—including stocks, shares, and houses—are priced at a higher rate than is justified by their fundamental value. Often, assets are purchased not because of the promise of a future stream of income but simply because their prices are expected to rise over time. Belief that assets will continue rising is therefore crucial; and that belief, or confidence, is fragile. Just as it can maintain a system, it can also break a system and break it with astonishing speed. As Thailand, Mexico, Russia, Brazil, Indonesia, South Korea, and Argentina know all too well, once investors start to believe that prices of stocks, shares, or houses will fall, they rush for the exits very quickly.

what will trigger the collapse?

In our view, the United States, the world's largest economy, may well be the first to fall. There could be a number of triggers, the first of which is interest rates. There is a relationship between interest rates and the level of a government's budget deficit. When governments run deficits, they borrow from ordinary people to finance their spending. Individuals are given Treasury bills and bonds, which the government promises to redeem at a specified future date. The government pays interest on the loan and, if it wishes to increase its deficit, it has to persuade individuals to lend it the money—and so has to offer a higher rate.

In the United States, proposals to cut taxes by something between $350 billion and $726 billion over the next decade mean that the government deficit is sure to rise. Note that the US Government's spending plans do not at present take into account future liabilities under social security and medicare;[3] nor do they include the costs of homeland security or future military interventions internationally. The Bush Administration justifies tax cuts on the grounds that the economy needs a boost and argues that they will be revenue-neutral with faster growth boosting tax receipts back again. In our view, the tax cuts will do little to boost the economy because they are targeted on the rich—almost 80 per cent of the total benefit going to the wealthiest 20 per cent of households[4]—who are much more likely to save than spend the money. Moreover, even the additional spending undertaken by the Bush Administration as a result of the Iraqi War will not provide much of a stimulus to the economy, being concentrated in a few areas of the United States.[5] So the main effect of the tax cuts will be to push up the US deficit and therefore interest rates. That will lead to widespread debt defaults, bankruptcies, unemployment, and hardship.

The second possible trigger for US collapse is the dollar. By 2002, the US dollar was over-valued by something like 20 per cent. That is good for imports, which are 20 per cent cheaper than otherwise, but damaging for exports because US goods are over-priced. The result is that the United States is currently importing half as much again as it exports, and borrowing from abroad to make up the difference.[6] As Wynne Godley points out in Chapter 19, the primary balance-of-payments deficit had hit 5 per cent of GDP by the fourth quarter of 2002.[7] The total external US debt already stands at more than $2.3 trillion, more than the total foreign debt of all developing countries combined![8]

As in the case of the asset price bubble, the dollar only remains over-valued because people expect it to remain so. Demand for dollars is high because international investors, lacking other outlets for their money, are pouring funds into the United States. Funds have also been sucked into the United States from developing countries in the form of profit remittances, debt-service payments, capital flight, and the forced holdings of dollar reserves. So, US consumers have been able to live well beyond their means.

So far, the rest of the world has been happy to keep the dollar over-valued because it has helped them to export into the huge US market. But current geopolitical tensions mean that this may be changing—there are now signs that many countries are unhappy with the free ride that the United States has been given. Some countries in the Middle East are starting to hold euros rather than dollars as their reserve currency, and the Indonesian government announced in April 2003 that it might start to use the euro in export-import transactions.[9] Several OPEC countries are also considering quoting the price for oil in euros rather than dollars, creating an incentive for even more countries to hold euros as their reserve currency.[10]

If the US dollar does fall from favour as a reserve currency, that would mean less demand for dollars and a weaker dollar; conversely, it would mean a stronger euro. That is not good news for Eurozone exports, and therefore manufacturing jobs, at a time when growth is anaemic and unemployment is already rising sharply. However, in the longer-term, the Eurozone would, with the euro as a reserve currency, have the benefit of the kind of low interest loans from poor countries that the United States has long enjoyed. The European Commission recently calculated that a 10 per cent appreciation in the euro/dollar exchange rate due to increased demand for euro assets would increase Eurozone growth by some 0.2 per cent relative to baseline projections.[11] And of course, such a shift would also be good for the euro's prestige, undermining the global position of the United States.

A major shift into the euro may or may not happen; but it remains the case that the US dollar cannot remain over-valued forever. The United States is already starting to haemorrhage, with income from interest and dividends paid out to foreigners with US asset holdings sharply increasing in 2002, even at a time of low US interest rates.[12] Once foreigners start to lose confidence in the dollar it will fall and the United States—like Thailand and Mexico—will be forced to raise interest rates in an attempt to stop the flow. A falling dollar and rising US interest rates would not only be bad for the United States but also for the rest of the world.

the collapse of US financial markets

Higher US interest rates will spell disaster for US households and corporations that have record levels of debt. Personal and corporate bankruptcies will start to rise, as people can no longer afford to service loans that were taken out when rates were low and bankruptcies will further undermine already-fragile confidence in a system based on nothing more than a confidence trick. The US housing market will be increasingly unstable, as more and more homeowners find they are unable to afford their mortgage repayments. Even the IMF—an organization not known for doom mongering—has raised concerns about the state of the US housing market, cautioning that 'the chances of a bust are notable'.[13] Crashing house values will bring substantial hardship for the majority of the US population, which has been relying on high house prices to shore up its net worth.

As Peter Warburton explains in Chapter 17, the next crash will come more in debt defaults and bankruptcies rather than in further equity-price falls. 'In truth, the tolerance limits in the world financial system are very fine. Once annual defaults rates approach 1 per cent (of the value of the loans) across the whole lending spectrum, banks' profitability is called into question. If default rates reach 2 per cent, then the probability of financial crises rises appreciably. By my calculations, the first landmark has already been surpassed.' As *The Economist* notes, US bankruptcies are getting bigger. 'Of the ten biggest bankruptcies since the modern version of Chapter 11 bankruptcy law was introduced to the United States in 1978, seven were in the Courts at the time of writing, in September 2002.'[14]

Sceptics may argue that the recent stock price falls have already brought asset prices back to earth but actually the decline in the total stock of financial assets has not been large. Although the value of corporate equities fell by some 40 per cent, or $8 trillion, between 1999 and the end of 2002, this has been more or

less offset by increasing credit market debt. Issuance of corporate and foreign bonds has surged by $1.6 trillion over the past three years while mortgages have increased by $2 trillion and US government securities have risen by $1.6 trillion. The credit superstructure is still very much in place.

the spread to other 'developed' countries

The US economy is the right place to look for the hardest crash because that is where the most extreme bubbles are located. But crashes will occur elsewhere in a knock-on reaction to the United States and an associated loss of confidence. Just as Malaysia and Indonesia found that they caught 'Asian flu' during the 1997 financial crisis when investors assumed that they *must* share the problems of nearby Thailand and South Korea, so there is a high chance of panic spreading from what appears to have been the world's best-performing economy.

The United Kingdom is vulnerable because it shares many of the US 'bubble' properties. There has not been a large fall in the total stock of UK financial assets despite recent falls in the stock market and UK consumer debt is also at record levels. The United Kingdom also has 'twin deficits'—a budget deficit forecast at £27 billion in 2003/04, and a widening current account deficit. The pound has already started to fall against the euro, and may fall further if there is a sharp decline in confidence, provoking a rise in interest rates both to stem the outflow of funds and also to prevent a build-up of inflation due to higher import costs.

Like the United States, too, the United Kingdom has a badly overheated housing market. Economist Andrew Oswald calculated in November 2002 that British house prices were at five times the average level of earnings, compared to a long-run average of about four times—and prices have risen even further since then. This in itself suggests that a correction will be necessary, and as Oswald points out, the decline in prices may 'overshoot' to below its long-run average as the market attempts to correct itself.[15] There are already signs that the UK housing market may be slowing, with house price rises at almost zero as at May 2003.[16] Once the housing boom cracks, consumer spending, which has been largely credit-financed, will slide, leading to lower demand, bankruptcies, and unemployment. The United Kingdom looks set to catch 'US flu'.

The Eurozone, which has had opprobrium heaped upon it because of low growth, rising unemployment, and difficulties of containing budget deficits within the limits of the Stability and Growth Pact, may, in one respect, be in a better position to insulate itself from financial crisis in the United States. The credit bubble is much more muted in continental Europe than in the Anglo-

Saxon economies. In Italy and Germany, the stock of financial assets is not that far out of line with the real economy, while consumer debt has not been rising at such record levels. In fact, although we do not have up-to-date figures, the losses on the stock markets in Italy and Germany over recent years may already be enough to bring financial markets back into line. Nobody expects the Eurozone to boom over the next few years—particularly when its major trading partners are stuck in recession—and Europe, as elsewhere is dangerously close to deflation. However, in the long-run, it may find itself in a better state of health than those economies currently boasting about their strong productivity growth and 'flexible' labour markets.

developing countries will be badly hit

Developing countries will be hard hit by any US financial crisis. As in the Great Depression in 1929, one of the 'transmission channels' from the United States to developing countries will be via lower demand for commodities and other major exports. This will further depress prices, which, as we have seen, are already at historic lows. As the past two decades demonstrate, adverse shifts in the 'terms of trade' (the price of developing country exports in relation to the price of their imports) have a very negative impact on output in poor countries.[17] Falling prices will hit poor people in developing countries particularly hard because they are so dependent on commodity exports.[18]

A falling US dollar will also increase competition from US exports in Third World country markets. Like Uganda, Thailand, Congo, or Mexico, the United States will find that it needs to start increasing exports to pay off external debt. Woe betide any country trying to compete with exports of the country with the largest economy on earth and the geopolitical power to match; unlike Uganda or the Congo, the United States will have the clout unilaterally to raise US tariff barriers to protect domestic industries.

The so-called 'emerging market' economies will be hard hit because new loans are likely to dry up. When a credit bubble bursts, funds that have appeared to be 'real' as a result of Ponzi-financed speculation will disappear as quickly as they came, leaving a reduced stock of capital flowing to developing countries. Poorer countries, most of which are dependent on aid rather than private finance, will also suffer. Aid flows are already in long-term decline, with recent commitments to additional resources unlikely to materialize once donor economies start to experience the kind of stress we are predicting. Even the aid budgets that remain intact are likely to be diverted towards the latest security hot spots, or countries of strategic interest to industrialized countries.

In the long run, this trend may be healthy for some developing countries, which have over-heated from the inflow and outflow of 'hot money' looking for high returns with little concern for the long-term effects on the host country. If this speculative money is no longer there in future, perhaps we will avoid the financial crises that so damaged Mexico, South Korea, Thailand, Malaysia, Indonesia, Argentina, Brazil, Uruguay, Russia, and Turkey. But in the short term, the reduction in flows will have a severe impact. Countries that rely upon a merry-go-round of new loans in order to repay old loans will find that the money no longer comes in while the debts continue to mount. As a result, the risks of financial crisis in heavily indebted emerging markets, many of which are already paying sky-high interest rates on their government debt, will increase sharply.

The outlook for developing-country debt could be even worse if US interest rates go up. Rates on developing-country debt are generally measured in terms of 'spreads' over the interest rates on US Treasury bonds so if US interest rates go up, all other things being equal, interest rates on emerging-market debt will also rise. This was one of the major factors behind the developing-country debt crisis of the 1980s, where the monetarist policies pursued by President Reagan pushed US interest rates to very high levels. Of course, all other things may not be equal; but it is likely that if there is a financial crisis in the United States, investors will seek a 'flight to quality'—they will want to put their money in as low-risk a place as possible. This means that they are likely to shy away from developing countries, which will put even further upward pressure on interest rates for these countries.

Add to this the fact that the collapse in the dollar will slash the value of the dollar reserves that developing countries have been so carefully squirreling away. Of course, the dollar value of debts will also fall, partly off-setting the loss of reserves but it will still leave countries more vulnerable to sharp falls in the value of their currencies as measured against the value of other world currencies.

Many of these trends will be accentuated by the impact of China's entry into the global economy. This is not directly related to the impact of the US/UK crash but it remains the case that China is tending to exacerbate global trends towards deflation, due to the impact of Chinese exports—which grew by as much as 22 per cent in 2002[19]—on global production. This is undermining the export potential of other parts of Asia, particularly in manufacturing. At the same time, China is also sucking in a steadily increasing proportion of the total flow of investment funds available to developing countries, becoming the world's leading destination for foreign direct investment in 2002.[20]

So, the outlook for the global economy is not rosy, and the chances of another bout of debt-deflation are high. What can governments do to respond to these worrying developments?

conclusion: what are the options open to governments?

In the Great Depression of the 1930s, governments *could* do little to reflate their economies and restore external balances. Moreover, the geopolitical tensions, which succeeded the First World War, and the failure of the United States to play an international leadership role, meant that governments *did* do little to get the global economy out of the abyss. Instead, they engaged in a pointless round of so-called 'tariff escalation' with each country trying to protect its own economy by imposing tariffs. All that was achieved was to reduce demand in other economies, further dragging the global economy down.[21]

What about governments today? To be sure, governments now have many more options in terms of 'policy instruments' that can be used to shore up falling prices and to prevent depression. In 1929, the Keynesian idea that governments should try to jump-start their economies by spending more or cutting taxes was still in its infancy. In those countries relatively free of excessive levels of government debt or stuck within the strictures of the Eurozone Stability and Growth Pact, increasing government spending remains an option. But, as the US experience has shown, they must take care to ensure that such fiscal stimuli serve to benefit the *whole* economy rather than certain narrow, privileged sectors.

In only a very limited number of countries, governments still have some scope to cut interest rates in order to provide a monetary stimulus. In the United States and the United Kingdom, however, we are likely to see interest rates go up; and many developing countries will fear that reducing interest rates will result in a substantial capital outflow. In Japan, short-term interest rates are already at zero.

Another option would be for governments to intervene by providing 'bail-outs'—that is, trying to prevent the financial collapse from happening in the first place. Bail-outs—of both companies and countries—are not a new idea. In 2002, the IMF made a $30 billion loan to Brazil, which helped to prevent investor panic over the new, potentially threatening left-wing government. In 1998, the US Federal Reserve organized a consortium of banks and finance houses to take over the failing Long Term Capital Management (LTCM) and to rescue the firm's portfolio.[22] But even the funds of powerful central banks such

as the US Federal Reserve, or international institutions such as the IMF, will be limited by the willingness of global taxpayers to stump up the cash. It is unlikely that these institutions would be able to provide a bail-out of the level needed to prevent a credit collapse on the scale we are predicting.

We cannot be complacent, therefore, about the ability of our policy-makers to protect us from economic collapse. As we have seen, governments have already given away much of their ability to manage their economies: to prevent credit bubbles; control deflation; manipulate their exchange rate and so on. Indeed, this has been one of the defining features of the process we know as 'globalization'. Governments may find that, once the going gets tough, they wish they had not been so eager to meet the demands of finance capital.

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CHAPTER 4

real world environmental outlook

andrew simms

The global economy is dangerously addicted to fossil fuels, driving conflict, climate change, volatile energy costs, and unresolved confrontation over how to share the global commons of the atmosphere.

For a short time towards the end of 2002 and early in 2003, Hans Blix was one of the world's most famous men. Leading the UN's weapons inspection in Iraq, he was a daily feature in the global media. After diplomatic twists and turns, revelations and condemnations for all the protagonists in the looming conflict, Blix saved his most surprising words until after the war began and his job became effectively redundant, 'To me the question of the environment is more ominous than that of peace and war . . . I'm more worried about global warming than I am of any major military conflict.'[1]

This book is called the ***Real*** *World* *Economic* *Outlook*. But the economy is a 'wholly owned subsidiary' of the environment. To understand anything real about the world economy, therefore, we have to understand the condition of its owner, the earth, and its biosphere. We also have to understand the most critical relationships between the economy and the environment. Here, even the most pathologically optimistic observer creates a bleak picture.

These are the conservative predictions of a famously anti-environmentalist professor of statistics, Bjorn Lomborg.[2] As a result of humankind's impact on the environment through our economic activity, species are becoming extinct at a rate '1,500 times higher than . . . natural background extinction'. Elsewhere '20 per cent of tropical forests' has disappeared. In countries like Nigeria and Madagascar, that figure is 'well over half', and Central America may have lost 50-70 per cent. Over one third of fish caught in the world's oceans is taken from 'stocks showing declining yields'. Erosion of agricultural land has left 38 per cent degraded. Many other observers think things are much, much worse.

Stripped bare, economics is about meeting our basic needs. Yet the continuing blind spot of mainstream economics to environmental impact—so called

'externalities'—and the obsession with crude growth, means that the dogma of orthodox economics is undermining its primary purpose.

From the range of available plant and animal species we draw genetic and chemical information to improve crops, develop new medicines and countless other products, and understand the ecosystems that the economy ultimately depends on. But a consensus has emerged that the economic exploitation of natural resources is driving a mass extinction event. This, in turn, will have enormous, unpredictable economic impacts. Forest loss, for example, exacerbates climate change and species' extinction, and undermines the possibility for sustainable livelihoods linked to forest management. The food chain especially is vulnerable to environmental degradation. Soil loss leads to farming failure and hunger.

oil—the weakest link

The greatest common threat is the global economy's enduring addiction to fossil fuels and its resulting symptom, global warming. And the UN weapons' inspector Hans Blix almost certainly understated the links between the war on Iraq, the United States' strategic desire to secure Middle Eastern oil supplies to feed the US economy's addiction to cheap fuel, and the current administration's official contrarian policy toward climate change.

It was fashionable over the last decade to point to an increasingly 'weightless economy'. The information age and the old, 'new economy' were supposed to reduce our dependence on raw materials. But where one of the most fundamental raw materials, carbon from fossil fuels, is concerned, the global economy just keeps getting heavier. A decade after the UN Framework Convention on Climate Change (UNFCCC) was signed, ranging from the United States to Australia, Canada, and across Europe, countries are, per person, pumping out more carbon dioxide than they were at the time of the Earth Summit. To put that into perspective, beginning from the stroke of New Year, as they sit down to their evening meal on January 2, a US family will have already used, per person, the equivalent in fossil fuels that a family in Tanzania will depend on for the whole year.

Even with technological advances in energy efficiency, and the creeping introduction of renewable energy, there is still an incredibly close correlation between crude measures of economic wealth and the consumption of fossil fuels. Rich people pump more greenhouse gasses into the atmosphere. That is why there is no more fundamental issue than the distribution of wealth in a carbon-constrained world economy. Unfortunately, until renewable energy

goes mainstream, access to economic opportunity and access to fossil fuels are, more or less, the same thing. This is a very big problem.

Estimates vary, but scientists suggest that to prevent dangerous climate change, 60–90 per cent cuts in greenhouse gas emissions will be necessary over the next century. Understandably, however, the majority world believes it has a right to become very much richer in the material things that the citizens of rich countries take for granted.

Without a radical change in how we manage the global commons of the atmosphere, that means one of three things. Either there has to be a massive reduction in rich country emissions, far beyond the scope of the current international agreement, the Kyoto Protocol, to give poor countries the environmental space to develop. Or, poor countries are to be simply denied the carbon-rich development path followed by industrialized countries. Or, finally, the engine of conventional development keeps running on carbon, as usual, and there is climate chaos. In this case radical or, perhaps, logical change, suddenly becomes an attractive option.

It's easy to forget how relatively new this predicament is. The global economy's oil addiction is little more than a century old. After early discoveries in Oil Creek, Titusville, Pennsylvania in the late 1850s, John D Rockefeller formed the Standard Oil Company of Ohio in 1870. No other event has bound the fate of economies as tightly to the fate of the environment. Anthony Sampson wrote his classic work on '*the great oil companies and the world they made*' in 1975.[3] If he were writing today with the benefit of hindsight and the knowledge of global warming, he might have said '*the great oil companies and the world they broke*'.

Almost all of humankind's fossil fuel emissions of carbon dioxide, the main global warming gas, have happened over the last century. Coal dominated first, followed by oil. The use of natural gas took off in the 1970s. All along there has been an almost exact correlation between greenhouse gas emissions and levels of economic activity—they rise and fall together. About 80 per cent of the world's total primary energy supply is accounted for by coal, oil, and gas.

The consequences for the climate are spelt out by an international scientific consensus in the reports of the Intergovernmental Panel on Climate Change (IPCC). According to the World Meteorological Organisation (WMO), 'Changes in climate are known to have occurred in the past. However, such changes were due to natural causes. Recent changes are largely attributable to human activities.'[4]

An increase in average global temperature of 0.6°C since detailed records began in the 1860s is linked to the rise in atmospheric greenhouse gas concen-

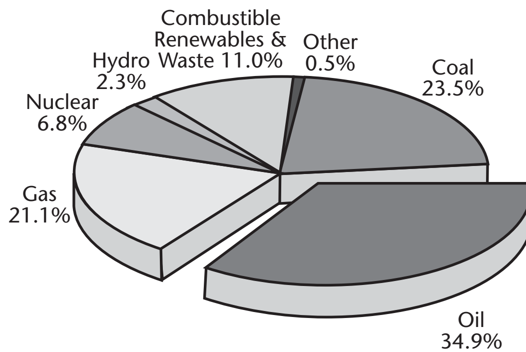

Figure 4.1 Global Energy Mix 2000
Source: International Energy Agency 2002

trations from about 280 parts per million by volume (ppmv) in 1750 to 370 ppmv at the end of 2001, an increase of over 32 per cent. Projecting forward against a huge range of scenarios, climate experts are unsure whether it will be possible to stabilize concentrations at any level ranging from 450 ppmv to 750 ppmv or beyond.

Yet even with current concentration levels, 1998 was the warmest year on record, with 2001 being the second. The 1990s was the warmest decade of the 20th century. Global average sea-level rise has been as much as ten times the average increase in the last 3000 years. Thinning sea ice and shrinking glaciers, droughts, floods, and storms are all driving natural disasters, the costs of which threaten to derail international efforts to reduce poverty in line with the Millennium Development Goals.[6] The scale of impacts is so great that it threatens the great reversal of human progress. With remarkable restraint, the Secretary General of the WMO said, 'The measures contemplated in mitigating climate change so far are inadequate to protect our future climate.'[7]

The problem is that global greenhouse gas emissions are set to keep rising for many years to come. There has been no move to agree a target for capping concentrations in the atmosphere at a level to prevent dangerous climate change. The International Energy Agency predicts that emissions will increase by 70 per cent by 2030.[8] This depends, however, on countless political, economic, and technological variables such as the will to switch to renewables, conservation measures, low-energy lifestyle choices, and rates of economic growth.

For many low-lying states such as the South Pacific islands, we already have dangerous climate change; any predictions of significantly rising emissions are nothing short of apocalyptic for their people as well as economies. Because of

delayed reactions in the atmosphere, we will not even feel the full effects of today's energy-intensive lifestyles for many years.

Projecting forward the rising economic costs from mostly climate-driven natural disasters, global insurance giant CGNU predicted that, under a business-as-usual scenario, the costs of natural disasters would actually overtake the value of world economic output by around 2065.[9]

Another insurance-based estimate from the UNEP Financial Initiative suggests additional costs of $300 billion annually to the global economy by 2050. This is almost certainly an underestimate as many costs escape these types of calculations. Yet a single year's worth of such costs is equal to the entire amount of poor country debt that the international debt relief campaign Jubilee 2000 was attempting to get written off. Already the extent of economic 'value at risk' from climate change could be as much as 15 per cent of the total market capitalization of major companies[10]—that's equivalent to wiping some $262 billion off the market capitalization of companies on the FTSE All Share Index.[11]

Following calculations based on the work of the UN Advisory Group on Greenhouse Gases, and emissions rising at current levels, we will have burned as much fossil fuels as it is safe to do so in just over 30 years. Beyond that, temperature rises linked to increasing greenhouse gas concentrations imply '*rapid, unpredictable, and non-linear responses that could lead to extensive ecosystem damage*'.[12]

Abrupt, or runaway, global warming is a serious environmental possibility and the danger is that it sets in motion a process of oddly called 'positive feedback' processes (they are not positive at all), which means that warming would become beyond our ability to control.[13] Even environmental sceptics like Bjorn Lomborg believe that much more effort needs to go into addressing genuine catastrophe scenarios.

where next?

Even without the prospect of managing climate change, what we do with fossil fuels in general, and oil in particular, is sufficiently explosive. We go to war in the Middle East to control it (there was an immediate cost of $74 billion to the United States alone, even as it struggles with massive trade deficits and merely very large budget deficits). When the oil price lurches up and down, economies overheat or plunge into recession.

In the middle of all of that, we now have to work out how to use less of it. And, because the atmosphere it affects is a global commons and because poor countries are going to use more of it, we have to work out how to share our

collective fossil-fuel inheritance more equally—both within our own generation, and between this and future ones.

Exactly how difficult this is can be demonstrated by how easily even senior civil servants can completely misunderstand the challenge. Take this graph from the UK Government's environment department DEFRA.[14] Put briefly, its projection for cutting emissions to 'stabilize' greenhouse gases at a certain level shows that, by around 2070, there will be no fossil fuels at all for countries outside the First World club—not a barrel of oil, heap of coal, or canister of gas to burn. Explaining that logic to India, China, Brazil, or Ethiopia will make for an interesting ministerial meeting.

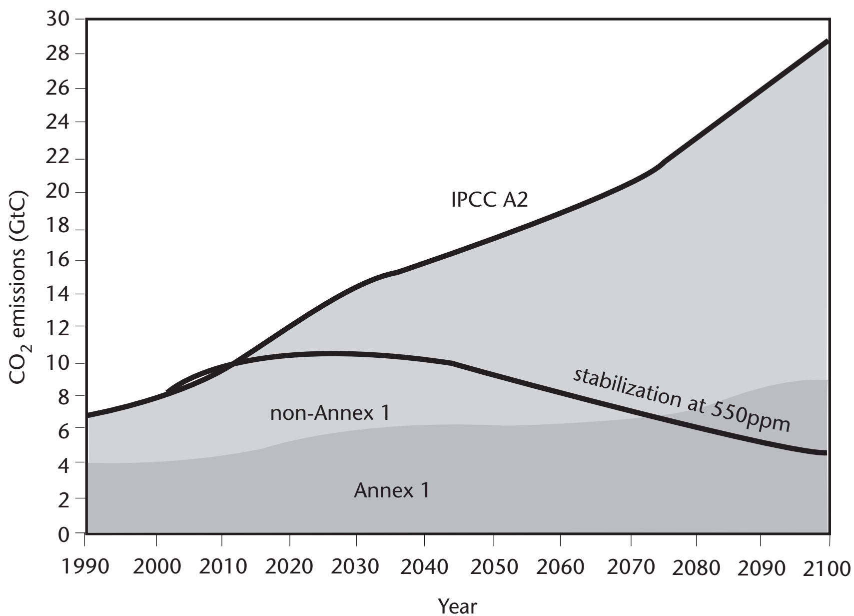

Figure 4.2 Projected global emissions under one business-as-usual scenario and a possible pathway to stabilization at 550ppm that leaves non-Annex 1 (less industrialized) countries no emissions entitlements

Source: DEFRA

This is politically explosive for another reason. Latest estimates show oil production in the high-consuming, advanced industrialized economies is set to tail-off dramatically over the next few decades. They will be left increasingly dependent on the Middle East, Russia, and other poorer producers for their oil. A gap between demand and supply is set to open up.[15] At one of two extremes

it will be filled in rich countries by either military aggression to secure supply, or greatly reduced domestic demand, within the context of a new constitutional settlement to share the oil and the environmental space it takes.

It is never likely that everyone in the world will use identical amounts of fossil fuels. However, any future settlement will have to be based on the principle that, in a carbon-constrained world, everyone should have equal entitlements to their share of the atmosphere's ability to safely absorb pollution. Under that agreement, those people and nations that take the economic benefits by polluting more than their fair share will have to somehow pay compensation to the 'under-polluters' by purchasing their spare entitlements. Otherwise they run up a huge ecological debt.[16] The process will have to involve capping total emissions, progressively reducing them, and sharing entitlements using a formula that will, over an agreed timeframe, mean they converge to be equal per person. If chaos is to be avoided, this process—given the name 'Contraction and Convergence' by the London-based Global Commons Institute—is unavoidable. In essence, the world has a limited carbon cake and the only way to begin negotiations on how to cut the cake is to start with the principle of equal access rights. What we do with them is another matter.

This has enormous, and from a development perspective, very positive consequences. Based on IPCC assumptions in 1995, to stabilize atmospheric greenhouse gas concentrations at 1990 levels implied a global, equal, per-capita entitlement of about 0.43 tons of carbon. Typical US per-capita carbon use in 1995 was 5.3 tons.[17] The UK Government estimates that the damage cost of carbon emissions (not including their much larger economic value) is in the range of $56 to $223 per t/C.

That means that, just to account for the damage cost of their unsustainable carbon use, each US citizen would have been liable to pay between $273 and $1086 each year for the privilege to pollute more than their fair share.[18] For the United States as a whole, that is a bill of between $73 billion and $290 billion—imagine the impact of that money being channeled into sustainable development and the Millennium Development Goals. And, this money would not be aid, but entitlement. Such calculations reveal that huge proportions of the G7 countries' economic output are built on the foundations of unsustainable per-capita carbon use.[19]

Action to combat global warming cannot be delayed because, over time, emissions grow, populations rise, and the sustainable size of a carbon cake slice will get smaller and smaller. There has to be a rapid, managed retreat from fossil fuel addiction because there is no other way to escape impending climate chaos.

Alberto di Fazio[20] has noted that, to make the planet fit for human life, carbon dioxide in the atmosphere was converted by natural processes into fossil fuel reserves over the course of 180 million years. According to di Fazio, humanity is converting fossil fuels back into the atmosphere 'a million times faster'. The correlation between the growing size of the global economy, which doubles roughly every 17 years, measured by 'world industrial product', and carbon dioxide emissions is, he says, 'astoundingly high . . . practically total correlation'.

Mainstream economists and policy-makers seem to assume that efficiency can grow indefinitely. This gives them the excuse to believe that carbon dioxide emissions can be cut without either renouncing fossil fuels or limiting conventional economic growth. However, even under the most impossibly optimistic scenario, bringing us close to the limits of the laws of thermodynamics, the best technology can do is not very much. Maximum efficiency gains in the best-case scenario would only postpone higher greenhouse gas levels by 24 years. A more realistic assessment of global best efforts, taking account of the difficulty of collective political action, is that the delay would be 'negligible'.

Trusting to efficiency will not allow 'any significant or appreciable control of the coming climate crisis', di Fazio concludes. From a strictly technical perspective, 'either we switch to non-fossil fuel sources of energy [which because of an implementation time-lag will take several decades to meet demand] or we limit the world industrial product, or both in some proportion'.[21]

conclusion

The magazine *Shares: the investors champion* ran a front page at the height of the Iraq War. It said, 'Oil, the burning issue: which stocks to buy.' They recommended buying one company's shares because it had '*got rid of interests in renewable energy . . . to focus on oil drilling*'.[22]

The global economy is run by a carbon aristocracy, holed-up in a handful of the richest countries, still wilfully oblivious of the real problem. But, presiding over extreme poverty and injustice like other aristocracies before them, they are fragile and ultimately unsupportable. At the time of writing, the oil-rich Middle East is riven with instability, recovering from one war and threatened with another. There is mutiny in Nigeria's offshore oil fields and violent protests in the oil producing areas on land. Other major producers like Venezuela are in turmoil. US economic hegemony is challenged by the rise of the euro against the dollar as a potential global reserve currency, possibly aided by a move to denominate more oil trades in euros.[23] With fabulous irony, the shares of oil giant BP are hit repeatedly when production is disrupted by

climate-driven extreme weather events in the Gulf of Mexico. And, all the time, the climate keeps warming.

We have to live within our environmental budget because we cannot survive without the life-supporting properties provided by the atmosphere—a bank of natural capital. The international community must agree to cap and reduce its carbon emissions, using a formula that equitably distributes entitlements to the carbon cake. Without that, the real world economic outlook is for an inextricably entwined economic and environmental crash, not a 'correction', as the complacent jargon has it, but a potentially irreversible collapse.

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