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World economy teeters on the brink

A SECOND RECESSION?

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Editor's Note

ONCE again the global economy appears to be mired in a deepening financial crisis which threatens to plunge the world into a second recession. Some two years after the 2007 global recession had ravaged the economic life and livelihoods of millions of people around the planet, the leaders of the United States and the European Union (EU) began to declare that they had successfully stemmed the economic downturn and thus averted the dreaded 'double dip'. But they might have spoken too soon. The resurgence of global economic instability and continuing turmoil in the financial markets have raised the spectre of yet another global recession.

The new tremors have been set off by the intensifying sovereign debt crisis in the eurozone countries, with Greece in the eye of this financial storm. When the Greek crisis first erupted in early 2010, a troika comprising the EU, the European Central Bank (ECB) and the International Monetary Fund (IMF) claimed in May of that year that they had put together a rescue package which would resolve the problem.

The truth is that, as in the case of the typical IMF-type rescue package, the cure has proved to be worse than the disease. In return for this financial life support, Greece has been required to undertake the most savage cuts in public spending and embark on a regime of privatisation of public enterprises and mass layoff of their employees. With each tranche of rescue monies, more austerity cuts have been demanded from the Greek people. The resulting asphyxiation of the Greek economy has only served to accelerate its downward spiral. As the economy and living standards collapse, the Greek people have understandably continued to put up the fiercest resistance.

The irrationality of this whole approach to tackling the crisis beggars belief. There is absolutely no way Greece can ever pay back the mountain of debt that is being piled on her. The only sensible course of action is to put in place an orderly debt default and workout programme. But for EU governments (especially France, whose banks are most exposed to such debt), the whole idea of such an orderly default has hitherto been anathema as this will involve a large 'haircut' – larger than the reduction of around 20% which creditor banks agreed in July. While they also fear the ripple effects of such a default on the debt due from other debtor countries such as Portugal, Ireland, Spain and even Italy, many financial experts are agreed that these effects can be contained in a properly worked out debt programme backed by adequate financial provision to meet such a contingency.

The fact that EU governments are avoiding uttering the dreaded D-word has not prevented financial market players from speculating on this prospect – not only on the likelihood of a Greek default but also on a default by the other heavily indebted states of the EU. This contagion from the Greek crisis has caused turmoil not only in stock markets (with bank shares taking big hits) but also in the bond markets, forcing heavily indebted governments to pay higher interest rates to raise their loans. A fresh wave of downgrades of the creditworthiness of some of these debtors by the international rating agencies has only heightened the climate of fear and speculation. As a result, interbank loans have been drying up and the threat of a credit crunch has become more real. The feverish market speculation has now reached a point where the spectre is being raised of a string of sovereign debt defaults beyond the financial capacity of the troika to withstand.

At the time of writing, there are reports from the IMF annual meeting in Washington of an ambitious new rescue plan in the offing. This is expected to involve a 50% writedown of Greece's debts and an increase in the eurozone bailout fund to 2 trillion euros. While an orderly debt workout programme is welcome news, the fact is that all the 17 eurozone nations must still agree on this plan. This is expected to take at least five to six weeks. Unfortunately, this leaves everything up in the air.

While Europe appears to be the epicentre of the current crisis, the fact remains that its real trigger was the 2007 financial crisis in the US. While the euro project was fatally flawed in some respects (it was a monetary union with no fiscal powers and characterised by the overarching dominance of the market), what opened up the faultlines in the eurozone was the crisis which began in Wall Street.

Unfortunately, that crisis has not gone away and US leaders and policy makers have shown the same sense of ineptitude, irresolution and subservience to powerful vested interests in tackling it as their counterparts across the Atlantic. Here too, continuing bad news of a slowdown in growth and a persistently high unemployment rate have been adding to the climate of uncertainty.

Hopes that China could play a major role in cushioning the shocks of a recession – as it did in 2008 – have also somewhat dimmed with the news that the Chinese economy is also experiencing a slowdown.

Other developing countries have also begun to feel the effects of these developments in the EU and the US. The ripples felt today from the West may soon develop into powerful shockwaves as the crisis deepens further. Rather than wait for things to grow worse, developing countries should start preparing for an economic downturn. In this regard, there should be more cooperation and consultation among them to mitigate such shocks. In a word, developing countries could use this crisis to give meaning and substance to what has largely become rhetoric – South-South cooperation.

Our cover story focuses on this threat of a second recession. After an overview of the looming crisis, we feature a number of articles which analyse the Greek and eurozone crisis. This is followed by articles that highlight the appropriate fiscal policy response and the critical need for some fundamental reforms, especially of the financial sector. We conclude with some analyses of the impact of the turmoil on the South.

– The Editors

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The eurozone crisis, centred presently in Greece *(picture shows Greek teachers protesting in Athens)*, **has erupted at a time when the US economy is clearly faltering, raising fears of a second global recession. 4**

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Defending the sea

Indigenous people in the Chilean coastal community of Mehuin are fighting against corruption, private property and corporate interests.

Eliab Viguera

Patricio Igor Melillanca/SAMUDRA Report

A Mapuche ceremony held on a beach in Mehuin. The indigenous Mapuche Lafkenche communities have made rational use of the region's resources and coastal marine areas for hundreds of years.

MEHUIN, a coastal fishing port and resort town in southern Chile, is located at the mouth of the Lingue River in the province of Valdivia in the Los Rios Region. The territory is shared between Chilean inhabitants and the Mapuche Lafkenche community. Local people partly live off fisheries activities of extraction and cultivation of molluscs, and harvesting seaweed. Subsistence agriculture, barter with other indigenous territories and communities, and tourism are the other main livelihood activities carried out by most of the Mapuche Lafkenche people.

A rich marine diversity thrives in the area as a result of the nutrients available in the large estuary of the Lingue River, whose huge tidal fluctuations ensure productivity. The area's resources are exploited not only by artisanal fishers and the Lafkenche communities, but also by the fleet of artisanal purse-seiners of the Los Rios Region and the vessels of the large industrial fishing fleet that violate the fishing zones and take valuable pelagic and demersal resources.

In recent years, the community of Mehuin has had to deal with differing interpretations of how property rights apply both to resources and to marine areas. On one side, we have the interpretation of big business and one segment of the artisanal fishermen who claim historical property rights over the exploitation of marine resources. On the other are the claims of the Mapuche Lafkenche to customary rights to the ownership, use and cohabitation with marine resources – that is, over everything that comprises the coastal marine territory. These two positions are based on arguments found in national laws such as the Fisheries Law, as used by the artisanal fishermen and big business, and the Lafkenche Law, as interpreted by the Mapuche Lafkenche communities.

Historical users

Although the artisanal fishermen may have been around for a long time, they were not the first users of the sea from a resource management perspective. The accounts sent to the authorities, which relate to the process of submitting requests from the indigenous communities for coastal marine areas, within the framework of the Lafkenche Law, show that the communities have been using the resources and coastal marine areas for hundreds of years. These indigenous coastal communities have made rational use of resources rooted in the relationship between coastal communities and nature, as well as links with other indigenous communities from the interior.

Hence it's not right to say that the artisanal fishermen are the first of the historical users of the sea. I am a fisherman, but I must tell the truth, I can't hide it: the communities, the indigenous people were the first, then came artisanal fishermen.

The Lafkenche Law 20.249 has included aspects of rights that apply to the coastal zone, the resources, and exchange between coastal and landlocked communities. The Law considers the establishment of the coastal space for indigenous communities who must also demonstrate that they have had use of the resources. They must first establish that fact, following which comes the next stage of the management plan. They must establish that they are not only the title holders, but also users who can access this space. The users may not only be the indigenous communities, but also the artisanal fishermen and others, such as communities from the interior, who come to the coast only at certain times to gather shellfish and seaweed or to fish from the shore.

The Law says that coastal marine spaces can be established in areas where no demarcated spaces have been legally established previously. In order to establish a coastal marine space for indigenous communities, they must send in a request with a geographical plan ('geo plan') certified by the competent authorities, who will review whether there is any other legal claimant to the area concerned.

Following this, the authority sends a proposal for the coastal space, which must be outside any other space that is already legally established, such as management areas or aquaculture or beach concessions that have already been legally established.

Various highly unreasonable interpretations have arisen, for example, that the Law deprives the artisanal fishing sector of the right to work. Such a view is divorced from the reality of the Law, whose spirit is strictly for the protection of natural resources.

In the Los Rios Region various threats have arisen from the different interests at play. First of all, artisanal fishing was so entrenched that the Lafkenche Law could not be applied, given that areas existed where the semi-industrial fleet catching sardines and anchoveta was operating. Besides, the Valdivia River is a vast area for salmon farming, where around 19 salmon concessions have been approved.

In the Mehuin zone there is another source of damage – a 35-km discharge pipe for industrial wastes from a cellulose plant. The Celulosa Aracuco Company (CELCO), which is part of the Angelini business group with investments in forestry, energy, mining and fisheries, does not wish to use the sea for tourism, but simply as a dumpsite for its wastes.

All this makes it difficult to establish a coastal marine space for the indigenous people of the Los Rios Region. The policy of the government is geared towards benefiting companies and large conglomerates. The organs of the state – the Marine Subsecretariat and the Fisheries Subsecretariat – are restricting the applicability of the Lafkenche Law. They have left out of the purview of the Law, rivers and lakes navigable by vessels of over 100 gross registered tonnage (GRT), including in the Lingue River. This contravenes the provisions of the Law, which stipulates coastal marine spaces as assets and maritime concessions for indigenous communities. The Lafkenche Law can be interpreted to mean that coastal marine spaces for indigenous communities will be determined by the area necessary to ensure the exercise of the customary use rights of indigenous people.

It is also possible to interpret the Law such that the meaning of customary rights is changed and there is a move towards private property rights. This is happening by means of transforming these spaces into concessions or areas that can be mortgaged. There are examples of this taking place in salmon farming, where the law has been changed to allow the owners of these aquatic concessions, which are national assets for public use, to mortgage them as guarantees against credit from the banks. This can be made to happen under this Law or under the Fisheries Law.

One segment of the artisanal fishing sector has sided with such destructive corporate behaviour, which seeks to modify the legal framework in place. The links between a fisheries association in Mehuin, the Ferepa Federation of BioBio, and CELCO are designed to transform the maritime zones into chemical waste dumps, in exchange for vast sums of money.

However, the leaders of the Sea Defence Front in Mehuin were very alert and knowledgeable about the law. They could check one of the syndicates that was operating in cahoots with CELCO, and succeeded in keeping the management area open.

Banks are also pushing for marine areas and fishery resources to be transformed into cash-generating, transferable assets. Once transferability comes into force, user rights to areas and resources will be undermined.

Government functionaries in the Araucania Region have proposed that the coastal strip be established as an 'AAA' (Area Apt for Aquaculture), with a view to privatising the sea in the shape of concessions which are transferable and can be mortgaged. Meanwhile, the genuine artisanal fishermen and the Mapuche Lafkenche communities have remained vigilant to ensure that the management areas continue to be used for the purpose for which they were established.

In the 1990s CELCO began to obtain the various permits for construction of the waste duct. The Navy turned a blind eye to this development, and refused to reply to queries on the studies being made, the vessels used, their crew and professional expertise. Despite our questions, the Environmental Impact Assessment was taken forward on the basis of false data. Worst of all, our community was brutally split by a company which, in connivance with the government and through threats of violence, turned our own comrades against us.

Human rights

We have brought all of this to the notice of the Inter-American Commission on Human Rights, pointing out that the passage of the waste duct, especially in and around Puringue, takes it through the middle of a Mapuche cemetery and through a place where Nguillatunes, the main ceremony of the Mapuche people, is celebrated. This is a clear transgression of the cultural and human rights of indigenous communities as enshrined in International Labour Organisation (ILO) Convention 169, which dates to 1989 and deals specifically with the human rights of indigenous peoples.

What is more, these communities and all those who defended the coastal maritime territory were never consulted about the CELCO project as is obligatory under Articles 6 and 7 of ILO Convention 169. Once we had exhausted all the possibilities of appealing to the Chilean state, we had no option but to approach the Inter-American Commission on Human Rights.

Despite over 15 years of vociferous opposition to the damaging project, and the appeal to the Commission, CELCO continues in its bid to install the waste duct, by also co-opting the artisanal fishermen of Mehuin. The company is also applying pressure on the organs of the state not to implement the Lafkenche Law that guarantees coastal marine areas for the indigenous people.

Yet, despite everything, the defence of the sea must be viewed from the perspective of those indigenous communities who live by the sea. Even as corporate interests seek to undermine the Law, we, as indigenous communities, continue to push forward, defending the sea. ◆

Eliab Viguera is the spokesman of the Mehuin Sea Defence Committee. Translated by Brian O'Riordan, this article is reproduced from SAMUDRA Report *(No. 59, July 2011), the journal of the International Collective in Support of Fishworkers.*

A looming global recession

All recent economic indicators point almost unambiguously to a new global recession, one which threatens to be more severe and prolonged than the 2007 crisis. While the epicentre of this developing crisis is located in the metropolitan countries, specifically the EU and the US, it will inevitably engulf the developing countries, says *CP Chandrasekhar*.

FOR a world locked in a crisis, August 2011 was a particularly bad month. Economic indicators relating to different locations in its more developed regions suggested that close to four years after the onset of the global recession in December 2007, the world economy that had not fully recovered was set to sink again.

Two developments – one in the financial realm and the other relating to the real economy – were particularly ominous. To start with, for the first time in history, a rating agency (Standard & Poor's) had downgraded US Treasury bonds from their hitherto unassailable AAA (or risk-free) status and even placed them on watch for further downgrade. Official analysts and some independent observers were quick to rubbish the assessment from S&P, an agency with a poor record of predicting fragility. The assessment was even shown to be based on wrong numbers. But the fact that the debt of the world's most powerful country that was home to its reserve currency was even considered to be of suspect quality was telling.

The other disconcerting development was the release of evidence that the strongest economy in the rich nation's club – Germany – was losing all momentum, registering a growth rate of just 0.1% in the second quarter. This came at a time when the news from elsewhere was depressing. Recovery from the recession was known to be sluggish in the US. Japan, which had been experiencing long-term stagnation, had been devastated by a wholly unexpected exogenous shock. And, France had announced that it had experienced virtually no growth in that quarter. The real-economy crisis had penetrated Europe's core, pointing to the possibility of a return to recession in the eurozone as a whole (with 0.2% growth).


Jobseekers in the US. The US is experiencing a sluggish recovery from the 2007-09 recession.

Even before the news from Europe had been officially declared, the nasty standoff involving the Republicans and Democrats over the debt ceiling in the US had obviously unnerved markets. The week ending 5 August was one of the worst since the onset of the financial crisis, with the FTSE 100 stock index falling by 10%. Confidence has hardly reversed since then, with investors wanting to flee from the markets but not knowing where to go other than into gold, prices of which had already soared. Over the week ending 14 August, the collective outflow from equity funds was $26.1 billion, while that from bond funds totalled $10.4 billion.

Slowdown

Underlying this panic were four factors of particular significance. The first was the evidence reported above that the still-feeble recovery from the crisis across the developed world was slowing. This was adversely affecting growth in the more buoyant export-dependent developed countries such as Germany and threatening growth in developing countries such as China. Even when growth was occurring in the emerging markets, offering a counter to developed-country stagnation, it was leading to inflation. This is necessitating an increase in interest rates and the contraction of government spending, with adverse implications for future growth. With the resulting threat of a global double dip, confidence was bound to wane, leading to volatility in the financial markets that had just been bailed out by governments and central banks from the collapse induced by the crisis.

The second problem, at least from the point of view of financial investors, was that this long-drawn effort to bail out a financial system that had speculated its way to crisis had resulted in a substantial increase in global debt. According to a calculation made by the McKinsey Global Institute, as a result of a combination of financial sector bailouts and stimulus spending, the total amount of debt incurred by governments across the world rose by a staggering $25 trillion to $41.1 trillion over the decade ending 2010. What seemed comforting was that on average it amounted to just 69% of the global GDP. But in individual countries, such as Greece and Italy, for example, debt-financed spending had indeed taken the net debt-to-GDP ratio to levels as high as 152% and 101% respectively.

In some instances when slowing growth reduced revenues, concerns about the ability of these countries to service debt emerged. As long as there was confidence that the stronger countries in the eurozone would back these economies with funding in the event of any financial difficulties, banks and financial investors ignored these concerns. But when it became clear that such backing had its limits, bond prices fell, interest rates rose and the willingness of financial agents to roll over past debt waned. That made it even more difficult for these countries to meet their commitments. This was when the threat of sovereign default in the developed world seemed real.

Consider, for example, the problem in Greece. The government had indeed accumulated excess debt to sustain growth and meet welfare expenditures. The private sector that had financed that debt has suddenly turned wary, and is willing to lend more, if at all, only at exorbitant interest rates. When the International Monetary Fund (IMF) and some European governments provided a modicum of support more than a year ago, it was in return for severe austerity measures that limited growth and reduced revenues, making sovereign default a real possibility. Not surprisingly, more than a year later, the Greek crisis has intensified.

What is alarming is that the problem in Greece or Portugal, in the eurozone periphery, is not staying there. Despite the fact that economic conditions or the debt problem is nowhere as serious in countries such as Italy and Spain, which happen to be the third and fourth largest economies in the zone, Europe, like Southeast Asia at the end of the 1990s, is overcome by ‘contagion’. The collapse of confidence and the fear of a sovereign default has touched these countries as well, resulting in a spike in the interest rates their governments have to pay for additional borrowing.


A container terminal in the German port of Hamburg. Countries like Germany which are dependent on exports to global markets are facing the danger of a slowdown in growth.

In fact the problem has now afflicted France as well, with President Nicolas Sarkozy having had to recall key ministers of his cabinet from holiday, to find ways of assuaging market fears that French debt would be downgraded because of a large deficit. The value of shares in French banks collapsed due to fears that the downgrade would adversely affect their balance sheets.

Backlash against public debt

This has led to the third of the difficulties confronting the global economy. This is that government bonds are now not an automatic safe haven to which investors can retreat without blinking. An ideological backlash against public debt had sent out (wrong) signals that made investors in sovereign bonds of countries with even reasonable public-debt-to-GDP ratios jittery. Consider, for example, government bonds issued by the US, which is home to the dollar, the world’s reserve currency that is still nearly as good as gold. Even for those infused with an unthinking dislike for government borrowing, US public debt is by no means too high relative to its GDP to warrant excessive concern. There are at least 10 advanced economies, from debt-strapped Greece to conservative Germany, that record a higher net debt-to-GDP ratio.

There is no real fear of US default. The standoff between the Republicans and the Democratic administration over a routine decision to raise the Congress-mandated ceiling on public debt stemmed from another source. It resulted from the Republican objective of extracting a cut in the fiscal deficit and ensuring that it was realised through spending cuts that hurt the poor and middle classes rather than tax increases that touched the rich. In the last-minute ‘deal’ that was struck, President Barack Obama was authorised to increase the debt limit by at least $2.1 trillion, on the conditions that there would be an immediate cut in spending so as to reduce the deficit by $1 trillion and that a bipartisan committee would identify ways of further cutting expenditures so as to realise an additional \$1.5 trillion reduction in the deficit. Despite this, Standard & Poor's decided to go in for an irresponsible downgrade supported with wrong calculations, only because it had decided that a \$4 trillion reduction in the US fiscal deficit was needed for debt sustainability. The Republicans had managed to extract 'only' the promise of a \$2.5 trillion reduction. S&P was not acting on its own. It was merely reflecting the opposition of finance capital to a proactive state financing expenditures with borrowing.

Bond market traders at work. An ideological backlash against public debt has made investors in sovereign bonds of even countries with reasonable public debt ratios jittery.

Spending cuts

Finally, because of the propaganda behind this blind fiscal conservatism, there is political opposition to increased public debt across the developed world, leading to a withdrawal of stimulus measures and a turn to expenditure reduction rather than expansion. The result was not just slower growth. It was also the erosion of an instrument that since the Great Depression was seen as the main remedy for recession: enhanced public expenditure. Governments voluntarily gave up their right to resort to fiscal means to reverse the deceleration in growth, even in countries that were not recording large fiscal deficits and faced no threat of a public debt crisis. This not only directly affected growth in individual countries and across the globe. It also meant that countries that were dependent on exports to global markets to sustain much of their dynamism, whether it be Germany in Europe or China in Asia, are facing the danger of a slowdown in growth. This is already visible in Germany, as noted above. It is likely to afflict China as well, especially if other countries choose to partially close their economic borders in response to the crisis.

Governments now respond only when finance (not the real economy) is under threat. As happened in 2008, they are intervening today because of the threat to the banking system, which is quite heavily exposed to public debt, especially in Europe. But since fiscal conservatism has gripped most developed-country governments and fiscal policy is not seen as an alternative, monetary policy or the infusion of liquidity into the system by having central banks purchase government bonds held by the banks has become the main tool to combat fragility. The European Central Bank that was adopting a conservative stance has gone shopping for government bonds including Greek paper to support the banks, while the US Federal Reserve has tied its hands by committing not to increase interest rates from their near zero per cent level in the foreseeable future. The latter would be fine if the global downturn keeps oil and commodity prices low. But if geopolitical and structural factors keep these prices, especially those of oil, buoyant, the loss of the interest rate lever may necessitate further fiscal contraction and even lower growth as happened after the second oil shock of the late 1970s.

In sum, while the reliance on monetary easing may stave off a banking crisis for some time, the evidence increasingly shows it is likely to do little to stall the downturn in growth and trigger a recovery. If the downturn persists, confidence is likely to erode, including confidence in government bonds.

Recession threat

There seem to be two messages coming out of the global economy right now. The first is that a second 'dip' or recession, potentially steeper than the first, is upon us and is likely to be of longer duration than the first. The danger this time around is greater because, for ideological and other reasons, the fiscal weapon that governments had deployed in the first recession is now being abjured by them. On the other hand, there is no evidence of the emergence of alternatives that can serve as effective substitutes.

The second message is that after a long time the crisis that capitalism faces is centred on its metropolitan core and not the less developed periphery. Mere talk of decoupling cannot prevent this crisis from spreading to the export-dependent economies in the successful periphery. The crisis, it appears, is bound to be global. Economically speaking, capitalism is under siege. Its strength is that politically the attack on it is largely spontaneous, sporadic and fragmented. Till that consolidates and gains political momentum, chaos and anarchy seem to be the promise. ◆

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The Greek and eurozone turmoil: A crisis with deep roots

The ongoing eurozone crisis is often projected in the media, somewhat superficially, as wholly the product of Greece's financial profligacy. There are, however, more fundamental reasons for this turmoil. The causes are to found, as the following analysis shows, in the skewed nature of the European Union and the 2007 economic downturn.

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THE sovereign debt crisis that broke out in Greece at the end of 2009 is fundamentally due to the precarious integration of peripheral countries in the eurozone. Its immediate causes, however, lie with the crisis of 2007-9. Speculative mortgage lending by US financial institutions, and trading of resultant derivative securities by international banks created a vast bubble in 2001-7, leading to crisis and recession. State provision of liquidity and capital in 2008-9 rescued the banks, while state expenditure prevented a worsening of the recession. The result in the eurozone was a sovereign debt crisis, exacerbated by the structural weaknesses of monetary union.

A protest against budget cuts in front of the parliament building in Athens. The sovereign debt crisis that broke out in Greece is fundamentally due to the precarious integration of peripheral countries in the eurozone.

The crisis of public debt thus represents Stage Two of an upheaval that started in 2007 and can be called a crisis of financialisation.[1] Mature economies have become 'financialised' during the last three decades, resulting in growing weight of finance relative to production. Large corporations have come to rely less on banks, while becoming more engaged in financial markets. Households have become heavily involved in the financial system in terms of assets (pension and insurance) and liabilities (mortgage and unsecured debt). Banks have been transformed, seeking profits through fees, commissions and own trading, while rebalancing their activities toward households rather than corporations. Financial profit has emerged as a large part of total profit.[2]

But financialisation has unfolded in different ways across mature countries, including in the European Union. Germany has avoided the explosion of household debt that recently took place in other mature countries and peripheral eurozone countries. The performance of the German economy has been mediocre for many years, while great pressure has been applied on German workers' pay and conditions. The main source of growth for Germany has been its current account surplus within the eurozone, resulting from pressure on pay and conditions rather than superior productivity growth. This surplus has been recycled through foreign direct investment and German bank lending to peripheral countries and beyond.

The implications for the eurozone have been severe. Financialisation in the periphery has proceeded within the framework of the monetary union and under the dominant shadow of Germany. Peripheral economies have acquired entrenched current account deficits. Growth has come from expansion of consumption financed by expanding household debt, or from investment bubbles characterised by real estate speculation. There has been a general rise of indebtedness, whether of households or corporations. Meanwhile, pressure has been applied to workers' pay and conditions across the periphery, but not as persistently as in Germany. The integration of peripheral countries in the eurozone has thus been precarious, leaving them vulnerable to the crisis of 2007-9 and eventually leading to the sovereign debt crisis.

Factory workers in Germany. Germany's main source of growth has been its current account surplus within the eurozone resulting from pressure on workers' pay and conditions.

Institutional bias and malfunction in the eurozone

The institutional mechanisms surrounding the euro have been an integral part of the crisis. To be more specific, European monetary union is supported by a host of treaties and multilateral agreements, including the Maastricht Treaty, the Stability and Growth Pact and the Lisbon Strategy. It is also supported by the European Central Bank (ECB), in charge of monetary policy across the eurozone. The combination of these institutions has produced a mix of monetary, fiscal, and labour market policies with powerful social implications.

A single monetary policy has been applied across the eurozone. The ECB has targeted inflation and focused exclusively on the domestic value of money. To attain this target the ECB has taken cognisance of conditions primarily in core countries rather than assigning equal weight to all. In practice this has meant low interest rates across the eurozone. Further, the ECB has operated deficiently since it has not been allowed to acquire and manage state debt. And nor has it actively opposed financial speculation against member states. Yet, the ECB has emerged as protector of financial interests and guarantor of financialisation in the eurozone.

Fiscal policy has been placed under the tight constraints of the Stability and Growth Pact, though considerable residual sovereignty has remained with member states. Fiscal discipline has been vital to the acceptability of the euro as international reserve, thus allowing the euro to act as world money. Since it lacks a unitary state and polity, the eurozone has not had an integrated tax system or fiscal transfers between areas. In practice, fiscal rules have been applied with some laxity in core countries and elsewhere. Peripheral countries have attempted to disguise budget deficits in a variety of ways. Nonetheless, fiscal stringency has prevailed during this period.

Given these constraints, national competitiveness within the eurozone has depended on the conditions of work and the performance of labour markets, and in this regard EU policy has been unambiguous. The European Employment Strategy has encouraged greater flexibility of employment as well as more part-time and temporary work. There has been considerable pressure on pay and conditions, a race to the bottom across the eurozone. The actual application of this policy across the eurozone has varied considerably, depending on welfare systems, trade union organisation, and social and political history.

It is apparent that the institutions of the eurozone are more than plain technical arrangements to support the euro as domestic common currency as well as world money. Rather, they have had profound social and political implications. They have protected the interests of financial capital by lowering inflation, fostering liberalisation, and ensuring rescue operations in times of crisis. They have also worsened the position of labour compared to capital. Not least, they have facilitated the domination of the eurozone by Germany at the expense of peripheral countries.

Peripheral countries in the shadow of Germany

Peripheral countries joined the euro at generally high rates of exchange presumably to control inflation, thus signing away some of their competitiveness at the outset. Since monetary policy has been set by the ECB and fiscal policy has been constrained by the Stability and Growth Pact, peripheral countries were encouraged to improve competitiveness primarily by applying pressure on their workers. But they have faced two major problems in this regard. First, real wages and welfare states are generally worse in the periphery than the core of the eurozone. The scope for gains in competitiveness through pressure on workers is correspondingly less. Second, Germany has been unrelenting in squeezing its own workers throughout this period. During the last two decades, the most powerful economy of the eurozone has produced the lowest increases in nominal labour costs, while its workers have systematically lost share of output. European monetary union has been an ordeal for German workers.

German competitiveness has thus risen further within the eurozone. The result has been a structural current account surplus for Germany, mirrored by current account deficits for peripheral countries. This surplus has been the only source of dynamism for the German economy throughout the 2000s. In terms of output, employment, productivity, investment, consumption, and so on, German performance has been mediocre. Thus, at the core of the eurozone lies an economy that delivers growth through current account surpluses deriving in large part from the arrangements of the euro. German surpluses, meanwhile, have been translated into capital exports – primarily bank lending and foreign direct investment – the main recipient of which has been the eurozone, including the periphery.

This is not to imply that workers in peripheral countries have avoided pressures on pay and conditions. Indeed, the share of labour in output has declined across the periphery. It is true that the remuneration of labour has increased in nominal and real terms in the periphery, but productivity has risen by more – and generally faster than in Germany. But conditions within the eurozone have not encouraged rapid and sustained productivity growth in peripheral countries, partly due to middling levels of technology, with the exception of Ireland. Peripheral countries have thus lost competitiveness as the nominal compensation of German workers has remained practically stagnant throughout the period.

Confronted with a sluggish but competitive Germany, peripheral countries have opted for growth strategies that reflected their own history, politics and social structure. Greece and Portugal sustained high levels of consumption, while Ireland and Spain had investment booms that involved real estate speculation. Across the periphery, household debt rose as interest rates fell. The financial system expanded its weight and presence across the economy. But in 2009-10 it became apparent that these strategies were incapable of producing long-term results.

The integration of peripheral countries in the eurozone has been precarious as well as rebounding in favour of Germany. The sovereign debt crisis has its roots in this underlying reality rather than in public profligacy in peripheral countries. When the crisis of 2007-9 hit the eurozone, the structural weaknesses of monetary union emerged violently, taking the form of a public debt crisis for Greece, and potentially for other peripheral countries.

The impact of the crisis of 2007-9 and the role of finance

The immediate causes of the crisis of 2007-9 lay in the US mortgage bubble which became global due to securitisation of subprime assets. European banks began to face liquidity problems after August 2007, and German banks in particular found that they were heavily exposed to problematic, subprime-related securities. During the first phase of the crisis, core eurozone banks continued to lend heavily to peripheral borrowers in the mistaken belief that they were a safe outlet. Net exposure rose substantially in 2008.

But reality had changed dramatically for banks as liquidity became increasingly scarce in 2008, particularly after the 'rescue' of Bear Stearns in early 2008 and the collapse of Lehman Brothers six months later. To rescue banks, the ECB engaged in extensive liquidity provision, accepting many and debatable types of paper as collateral for secure debt. ECB actions allowed banks to begin to adjust their balance sheet, engaging in deleveraging. By late 2008 banks were already reducing their lending, including to the periphery. Banks also stopped buying long-term securities, preferring to hold short-term instruments – backed by the ECB – with a view to improving liquidity. The result was credit shortage and accelerated recession across the eurozone, including the periphery.

These were the conditions under which states – both core and periphery of the eurozone but also the UK and other states – began to seek additional loanable funds in financial markets. A major cause of rising state borrowing was the decline of public revenue as recession lowered the tax intake. State expenditure also rose in several countries after 2007 as the rescuing of banks proved expensive, and to a lesser extent as states attempted to support aggregate demand. Accelerated public borrowing in 2009 was induced by the crisis, and hence by the earlier speculations of the financial system. In this respect, the Greek state was typical of several others, including the US and the UK.

In the conditions of financial markets in 2009, with the banks reluctant to lend, the rising supply of state paper put upward pressure on yields. Thus, speculators found an environment conducive to their activities. In the past, similar pressures in financial markets would have led to speculative attacks on currencies and collapsing exchange rates for the heavy borrowers. But this was obviously impossible within the eurozone, and hence speculative pressures appeared as falling prices of sovereign debt.

Speculators focused on Greek public debt on account of the country's large and entrenched current account deficit as well as because of the small size of the market in Greek public bonds. Credibility was also lost by the Greek government because of systematic fiddling of national statistics to reduce the size of budget deficits. But the broader significance of the Greek crisis was not due to the inherent importance of the country. Rather, Greece represented potentially the start of speculative attacks on other peripherals – and even on countries beyond the eurozone, such as the UK – that faced expanding public debt.

The Greek crisis, therefore, is symptomatic of a wider malaise. It is notable that the institutions of the eurozone, above all the central bank, have performed badly in this context. For the ECB private banks were obviously 'too big to fail' in 2007-9, meriting extraordinary provision of liquidity. But there was no similar sensitivity toward peripheral countries that found themselves in dire straits. It made little difference that the problems of public debt were largely caused by the crisis as well as by the very actions of the ECB in providing banks with liquidity.

To be sure, the ECB has been hamstrung by its statutes which prevent it from directly acquiring public debt. But this is yet more evidence of the ill-conceived and biased nature of European monetary union. A well-functioning central bank would not have simply sat and watched while speculators played destabilising games in financial markets. At the very least, it would have deployed some of its ingenuity, as the ECB generously did when private banks needed liquidity in 2007-9. And nor would it have decided what types of paper to accept as collateral on the basis of ratings provided by the discredited private organisations that were instrumental to the bubble of 2001-7.

Policy options for peripheral countries

The crisis is so severe that there are neither soft options nor easy compromises for peripheral countries. The choices are stark, similar to those of developing countries confronted with repeated crises during the last three decades.

The first alternative is to adopt austerity by cutting wages, reducing public spending and raising taxes, in the hope of reducing public borrowing requirements. Austerity would probably have to be accompanied by bridging loans, or guarantees by core countries to bring down commercial borrowing rates. It is likely that there would also be 'structural reform', including further labour market flexibility, tougher pension conditions, privatisation of remaining public enterprises, privatisation of education, and so on. The aim of such liberalisation would presumably be to raise the productivity of labour, thus improving competitiveness.

This is the preferred alternative of ruling elites across peripheral and core countries, since it shifts the burden of adjustment onto working people. But there are several imponderables. The first is the opposition of workers to austerity, leading to political unrest. Further, the eurozone lacks established mechanisms both to provide bridging loans and to enforce austerity on peripheral members. There is also strong political opposition within core countries to rescuing others within the eurozone. On the other hand, the option of forcing a peripheral country to seek recourse to the International Monetary Fund (IMF) would be damaging for the eurozone as a whole.[3]

Yet, despite apparent legal constraints, it is not beyond the EU to find ways of advancing bridging loans, at the same time enforcing austerity through political pressure. The real problem with this option is not the institutional machinery of the eurozone. It is, rather, that the policy is likely to lead to aggravated recession in peripheral countries, making it even more difficult to meet public borrowing targets. Poverty, inequality and social division will increase substantially. Even worse, it is unlikely that there will be long-term increases in productivity through a strategy of liberalisation. Productivity increases require investment and new technologies, neither of which will be provided spontaneously by liberalised markets.

Peripheral countries would probably find themselves lodged in an unequal competitive struggle against Germany, whose workers would continue to be severely squeezed. Attempting to remain within the eurozone by adopting austerity and liberalisation would lead to sustained falls in real wages in the vain hope of reversing current account deficits against Germany. The eurozone as a whole, meanwhile, would continue to be faced with a weaker world economy due to the crisis of 2007-9. It is a grim prospect for working people in the periphery, and far from a bed of roses for German workers.

The second alternative is to reform the eurozone. There is almost universal agreement that unitary monetary policy and fragmented fiscal policy have been a dysfunctional mix. There is also widespread criticism of the ECB for the way it has provided abundant liquidity to banks, while keeping aloof of borrowing states, even to the extent of ignoring speculative attacks.

A range of reforms that would not challenge the fundamentals of the Maastricht Treaty, the Stability and Growth Pact, and the Lisbon agenda might well be possible. The aim would be to produce smoother interaction of monetary and fiscal forces, while maintaining the underlying conservatism of the eurozone. There is very little in such reforms that would be attractive to working people, or that would indeed deal with the structural imbalances within the eurozone.

Hence there have been calls for more radical reforms, including abolition of the Stability and Growth Pact and altering the statutes of the ECB to allow it regularly to lend to member states. The aim of such reform would be to retain monetary union, while creating a 'good euro' that would be beneficial to working people. The 'good euro' strategy would involve significantly expanding the European budget to deliver fiscal transfers from rich to poor countries. There would be an active European investment strategy to support new areas of economic activity. There would also be a minimum wage policy, reducing differentials in competitiveness, and lowering inequality across the eurozone.

The 'good euro' strategy, appealing as it sounds, would face two major problems. The first is that the eurozone lacks a unitary state, and there is no prospect of acquiring one in the near future, certainly not with the required progressive disposition. The current machinery of the eurozone is entirely unsuited to this task. The strategy would face a continuous conflict between, on the one hand, its ambitious pan-European aims and, on the other, the absence of state mechanisms that could begin to turn these aims into reality.

More complexly, the 'good euro' strategy would clash with the putative role of the euro as world money. If fiscal discipline was relaxed among member states, there would be a risk that the value of the euro would collapse in international markets. Were that to happen, at the very least, the international operations of European banks would become extremely difficult. The international role of the euro, which has been vital to the project from the beginning, would come under heavy pressure. Thus, it is not clear that the 'good euro' strategy is compatible with monetary union. In this light, a 'good euro' might end up as 'no euro'. Those who advocate this strategy ought to be aware of its likely implications, i.e., leading to the end of monetary union. Institutional, political and social demands have to be tailored accordingly.

The third alternative is to exit from the eurozone. Even here, however, there are choices. There is 'conservative exit', which is increasingly discussed in the Anglo-Saxon press, and would aim at devaluation. Some of the pressure of adjustment would be passed onto the international sphere, and exports would revive. But there would also be losses for those servicing debt abroad, including banks. Workers would face wage declines as the price of tradable goods would rise. Devaluation would probably be accompanied by austerity and liberalisation, compounding the pressure on workers.

Long-term improvements in productivity would, however, occur only if market forces began spontaneously to develop new capacity in the tradable goods sector. This is extremely difficult for peripheral eurozone countries, with middling technology and middling real wages. It is notable that the ruling elites of peripheral countries are aware of these difficulties, as well as of their own lack of capacity to deal with them. They have implicitly admitted that they possess neither the means nor the will to pursue an independent path. Consequently, conservative exit might lead to stagnation with repeated devaluations and decline in incomes.

There is, finally, 'progressive exit' from the eurozone, which would require a shift of economic and social power toward labour in peripheral countries. There would be devaluation accompanied by cessation of payments and restructuring of debt. To prevent collapse of the financial system there would have to be widespread nationalisation of banking, creating a system of public banks. Controls would also have to be imposed on the capital account to prevent outflows of capital. To protect output and employment, finally, it would then be necessary to expand public ownership over key areas of the economy, including public utilities, transport and energy.

On this basis, it would be possible to develop industrial policy that could combine public resources with public credit. There are broad areas of the national economy in peripheral countries that call for public investment, including infrastructure. Opportunities exist to develop new fields of activity in the 'green' economy. Investment growth would provide a basis on which to improve productivity, ever the Achilles heel of peripheral economies. Financialisation could then begin to be reversed by lessening the relative weight of finance.

A radical policy shift of this type would require transforming the state by establishing mechanisms of transparency and accountability. The tax and transfer payments of the state would then take a different shape. The tax base would be broadened by limiting tax evasion by the rich as well as by capital. Public provision for health and education would be gradually improved, as would redistribution policies to alleviate high inequality in peripheral countries.

A policy of progressive exit for peripheral countries would come with evident costs and risks. The broad political alliances necessary to support such a shift do not exist at present. This absence, incidentally, is not necessarily due to lack of popular support for radical change. More important is that no credible political force in Europe has had the boldness to oppose austerity hitherto. Beyond political difficulties, a major problem for progressive exit would be to avoid turning into national autarky. Peripheral countries are often small and need to maintain access to international trade and investment, particularly within Europe. They also need technology transfer.

International alliances and support would be necessary in order to sustain flows of trade, skills and investment. These would be far from easy to secure if the rest of the EU remained under the spell of monetary union. But note that progressive exit by the periphery would also offer fresh prospects to core eurozone countries, particularly to labour which has suffered throughout this period. If the eurozone unravelled generally, economic relations between core and periphery could be put on a more co-operative basis. ◆

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Endnotes

1 Financialisation has been extensively discussed by political economists. A useful, but not complete, survey can be found in van Treeck, T. 2009. 'The political economy debate on "financialization" – a macroeconomic perspective', *Review of International Political Economy*, 16:5, 907-944. The theoretical views underpinning this report can be found in Lapavitsas, C. 2009. 'Financialised Capitalism: Crisis and Financial Expropriation', *Historical Materialism*, 17:2, 114-148; and Dos Santos, P. 2009. 'On the Content of Banking in Contemporary Capitalism', *Historical Materialism*, 17:2, 180-213.

2 See, for example: Krippner, G. 2005. 'The Financialization of the American Economy', *Socio-Economic Review,* 3, 173-208; and Dumenil, G. & Levy, D. 2004. 'The Real and Financial Components of Profitability', *Review of Radical Political Economics*, 36, 82-110.

3 Editor's note: Since the time of writing, the IMF has become involved but as part of a troika with the EU and the ECB.

Fundamental flaws in the European project

The fatal defect in the eurozone project was that it was informed by a neoliberal view of leaving policy entirely to market forces, say *George Irvin* and *Alex Izurieta*.

EURO notes and coins were launched with great expectations in January 2001, the product of a decade of negotiations between the original participants, all 12 of whom were signatories of the Maastricht Treaty of 1993. For nearly a decade the experiment appeared to prosper. A common currency, combined with the 'borderless travel' agreed earlier between Schengen area signatories, appeared to turn Europe from a disparate group of neighbouring states into a seamless giant whose combined population and gross domestic product (GDP) placed it at par with the United States.

Today, in contrast, the euro is under attack from the financial markets, with Greece on the verge of default, Portuguese and Irish Eurobonds demoted to junk status and Italian and Belgian bonds under speculative attack, with Spain next in line. What is more, the real fear is that a default in one country will trigger a domino effect and bring down some of Europe's major banks. Although the Greek and Portuguese economies account for only a small percentage of Euro Area (EA) output, were default contagion to spread to Europe's larger countries, the entire euro edifice could be brought down. Why has this happened? Are we witnessing the combined effect of a string of economic accidents, or were there potentially fatal flaws in the EA's original design?

In essence, our argument is that the euro, aimed at removing nominal exchange rate fluctuations in a wide free-trade area, was informed by a neoliberal view of leaving policy entirely to market forces. In consequence, by way of its specific design, it removed three essential policy instruments at once from the domain of national policymaking – exchange rate management, monetary policy and fiscal policy – and it intrinsically weakened labour and welfare policy.

The original design of the euro project was inherently flawed.

While the loss of exchange rate flexibility for individual countries is part of the common currency construct, exchange rate management of the euro for the EA as a whole was made to fall outside the remit of the European Central Bank (ECB). Nor was the ECB allowed to act as 'banker' for the EA in a manner analogous to the Bank of England (BOE) or the US Federal Reserve since it cannot issue its own bonds or engage in open market operations. Issuing government debt – in the form of national Eurobonds – is left entirely to the individual member states who must sell them on the financial markets; until quite recently, the ECB could not even purchase national bonds.[1] Indeed, for the ECB even to hold these as collateral against its short-term liquidity operations, national bonds must be well-viewed by the main credit rating agencies (CRAs). In the words of Thomas Palley (2011), '...the euro's architecture makes the bond market master of national governments. Given the dominance of neoliberal thinking, this was an intended outcome of the euro's design.'

Misleading view

While national exchange rate and monetary policies ceased to exist and EA regional exchange rate and monetary policies were also impaired, the general view is that fiscal policy, at both national and regional levels, survived the euro construct. But such a view is also misleading. Although there is a European budget, there is no EA or European Treasury. And because the European budget amounts to only 1% of the region's GDP, and must be balanced annually by law, it cannot be used as a counter-cyclical instrument. Apart from its small 'structural fund', the budget cannot be used either to effect transfers between rich and poor of the union.[2]

Famously, the decision to exclude fiscal policy from the EU or EA remit was one of the 'great compromise' conditions insisted on by Germany during the Delors Committee negotiations culminating in the (1992) Maastricht Treaty.[3] Instead, national governments agreed to be bound by the twin rules – initially meant as qualifying conditions for euro-access but set in concrete in the Stability and Growth Pact (SGP) inserted into the 1997 Amsterdam Treaty – that government annual budget deficits must not exceed 3% and a national debt ceiling equivalent to no more than 60% of GDP must be observed. Admittedly, examples of violation of the national budget constraints can be cited for either large countries like Germany, France and Italy, in the early 2000s, or the smaller countries, most notably during and in the aftermath of the great recession of 2008. Yet, German and Dutch governments have sought to re-incorporate them in even tougher form in the Economic Stability Mechanism (ESM), the permanent bailout facility for the EA due to come on stream in 2013. The irony of these rules in their pre- and post-recession version is that, despite remarkable cases of fiscal discipline shown by countries such as Ireland and Spain prior to the 2008 recession, and despite a gigantic effort by all governments to rescue the financial system, all sovereign crises are now deemed the result of fiscal irresponsibility – that is to say, crises caused by breaking existing rules rather than by the rules themselves.

More crucially, debates about the SGP or, more recently, its folding into the future ESM, tend to overlook the underlying constraint imposed by a common currency arrangement without common or federal government. Fiscal policy becomes effectively dependent on the performance of the external sector and the financial behaviour of the private sector. As shown elsewhere (Izurieta 2001, 2003; Bell 2003; Godley and Lavoie 2007), a country tied by common currency that faces an external shock can only have two policy options: a contractionary spending adjustment which causes chronic levels of unemployment, or a fiscal stimulus to regain employment losses at the cost of triggering a financial crisis down the road. Beyond the analytics of fully consistent stock/flow analytical models as those cited, the reason is simple: unable to exercise exchange rate or monetary policy, a country in distress without recourse to federal transfers or a lender-of-last-resort is at the mercy of the private market to finance its debt, the accumulated costs of which add to ever-increasing deficits. The large and obviously unaffordable borrowing costs of Greece and other peripheral countries of the EA are a sad example of this predicament.


The euro now finds itself under attack from the financial markets.

Effect of structural rigidities

This analysis runs counter to the common belief that economies are self-adjusting mechanisms and therefore that, faced with an external shock, a one-off adjustment triggers a response sufficient to absorb the shock and bring the country back to a steady state. But in the real world, structural rigidities often prevail, and underlying conditions tend to pull economies in diverging directions rather than towards a textbook-familiar steady state equilibrium.

The proposition of divergent underlying conditions is nowhere more obvious than in the construct under which the EA was created, and is an essential part of the explanation why the euro project is flawed. In a number of contributions, Flassbeck (2007, 2005, 2000) points to the inadequacy of real exchange rate regimes driving unsustainable external positions of trading partners in the global economy. More specifically, referring to the EA, Flassbeck questions 'the long run viability of a monetary system with absolutely fixed nominal exchange rates but dramatically divergent real exchange rates' (2007: 43). After carefully dissecting the asymmetries created in the two Germanys after reunification, he singles out the tremendous pressure that German policymakers placed on trade unions to accept wage restraint in order for the country to 'regain international competitiveness' (the 'Bündnis für Arbeit' agreement of 1996).

The tendency towards wage repression that started in the mid-1990s was aided by the fact that other European trading partners used the D-mark as an anchor to facilitate their smooth entry into the euro. It was this that prevented the domestic currency appreciation warranted by the deceleration of unit labour costs in the main surplus country, Germany, prior to the introduction of the euro. Indeed, the inauguration of the euro institutionalised Germany's advantage and created the seeds of an explosive situation: diverging trading performances between Germany and other EA partners, with diverging tendencies to real depreciation in the former and real appreciation in the latter.

To many observers, an easy remedy would have been adopting a similar pace of wage disinflation throughout the EA. This is the main motive behind calls for 'labour market flexibility' that dominated the policy discourse in the EA in the years prior to the current crisis. But if it is difficult to overlook the socio-economic consequences of wages lagging well behind labour productivity in a single country, it seems even more incongruous to ignore the fact that wage repression for the entire region imparts a recessionary bias to all.

In the absence of nominal exchange rate adjustment at the national level (precluded by the common currency), trade imbalances cannot be solved by means of 'internal devaluation', i.e., wage repression at the periphery. Just as the China-US trade imbalance is best resolved by increasing aggregate demand in China and supporting development strategies elsewhere rather than by means of expenditure contraction in the US (the cost of which would be further recession), EA trade imbalances cannot be resolved by inducing recession. Nor can it be argued that all current account deficits within the EU could be offset by running surpluses with the rest of the world. First, such a situation would result in a real appreciation of the euro, thus eventually choking off the surpluses. Second, as Whyte (2010) has shown, the EA is simply too big for the rest of the world to be in deficit with all its members.

The headquarters of the European Central Bank in Frankfurt. The remit of the ECB does not include exchange rate management of the euro for the euro area as a whole.

Club-Med countries not a problem

It follows that highlighting fiscal irresponsibility in the Club-Med countries as the source of the crisis is beside the point. Such a simplistic argument is negated by the basic national accounting identity that says that the sum of public and private financial balances of a country must exactly equal the external balance. As long as net export performance is driven by loss of competitiveness resulting from wage repression elsewhere in a common currency area (and import requirements and transfers are somehow correlated with the growth of output), and as long as the private sector as a whole determines its own net financial balance (net acquisition of financial assets) for reasons of its own, then the net financial position of the public sector is determined down to the last penny.[4] In other words, if GDP tends to contract because of adverse trade performance and if private sector saving represents yet another leakage from the circular flow of income, a proactive fiscal deficit will be needed to maintain the pace of economic growth. A conservative budget merely adds to the contractionary tendencies while alleviating the trade imbalance.

Greece and Portugal, for example, may not be role models of budgetary efficiency, but with private sector investment and spending falling behind the pace of GDP growth, only sustained fiscal expansion could produce economic growth. Alternatively, recession-inducing fiscal discipline would not have improved matters either for these countries or for their partners in the region.

A contrasting case is that of Spain, which, unlike Greece, combined poor trade performance with a lax financial structure leading to an over-leveraged private sector, of which (as in the US and the UK) the housing boom was a symptom. The combination of 'twin deficits' of the external and the private sector meant that the public sector found itself running surpluses or very small deficits in the lead-up to the financial crisis.

Germany, meanwhile, running large trade surpluses on the back of a decade of flat wages, and with a private sector running savings surpluses of about the same size, would find itself not needing fiscal deficits. The adoption of the 'debt brake' law (balanced budget) by German policymakers is in effect a way of institutionalising a wage-repressed export-led growth model. But such a model cannot work for all EA countries.

Clearly, the tremendous shock caused by the great recession has triggered a downward shift in the external position of these countries, as well as the rapid accumulation of public sector debt as governments rushed into bailing out the financial system to avoid a financial meltdown. Under the prevailing structural rigidities described above, it is no surprise that external deficit countries, if left to the mercy of 'the markets', are now threatened by a severe and protracted recession.

Policy action required

Policy action is necessary if these trade imbalances are gradually to disappear. Crucially, labour productivity must increase faster in the deficit countries than in the surplus countries, an aim difficult to achieve unless proactive fiscal policy and infrastructure investment trigger a modernising wave of 'crowding in' private investment. This means that Europe must redistribute investment resources from rich to poor regions. In addition, if higher labour productivity growth is to be achieved in the periphery, a 'common wages policy' (not to be confused with a common wage) must be adopted which better aligns wage and productivity growth and sustains aggregate demand. This will not be achieved with wage disparities exercising a deflationary impact on the union. In the absence of national exchange rate realignment, adjustment must take place through a regional wage bargaining process.

Three conclusions follow from the above analysis. First, a common currency system will fail unless sustained by an active central bank, a common fiscal policy and common labour policy. The EA system will either break down under the pressure of social unrest or because of a debt explosion and ensuing sovereign debt crisis.

Second, wage repression at the centre is an essential component of the euro crisis. Germany's net export success exactly mirrors 'failure' in the peripheral countries, and deflationary pressure in the periphery is a major problem for the system as a whole.

Finally, a reasonably egalitarian income distribution reached through a common labour policy – where the distribution of productivity gains is agreed upon – must be an essential feature of stable long-run prosperity. The 'wage flexibility' framework peddled by Brussels is dysfunctional.[5]

Without effective supranational fiscal and labour authorities and a fully functional central bank, the EA cannot resolve these problems – even if the contradictions are internally suppressed or else transferred to the rest of the world via the real exchange rate. ◆

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Notes

1 During the recent credit crisis, the ECB has purchased national Eurobonds, but its holdings are tiny compared to (say) US holdings of its own (say) Treasury bonds.

2 The notion of a union budget which could be used counter-cyclically was originally raised by MacDougall D and Commission of the European Communities (1977); more recently it has been revived by Goodhart (2007).

3 For critiques, see Irvin (2007), Bell (2003), Buiter, Corsetti and Roubini (1993), and Godley (1992).

4 See Godley and Izurieta (2004) for the conceptual framework, as well as Galbraith (2009) for its validation in the macroeconomic analysis of the US economy.

5 Although income distribution appears to be more egalitarian in the EU than the US when looking at individual member states, the same is not true of income distribution with Europe taken as a whole – as Galbraith (2009) has rightly noted.

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China is not a cash cow for resolving eurozone crisis

While media reports are emphasising the role China could play in helping to resolve the eurozone debt crisis, *Steffen Dyck* warns that expectations pinned on China might be far from realistic.

THE eurozone is China's most important trading partner. The region takes up around 20% of China's total exports, which is slightly higher than the US share in Chinese exports. From this angle, China has a vital interest in a stable eurozone, as exports and export-related investment account for a substantial share of GDP (Gross Domestic Product) growth and – what is probably even more important – employment.

Estimates show that Chinese export growth could drop by 6-7 percentage points (pp) and real GDP growth by 1 pp in case GDP growth in the US and EU slowed by 1 pp.

Furthermore, China has already invested in euro assets. According to various estimates, around 20-25 per cent of China's total foreign currency reserves or 480-600 billion euros are held in euro assets, presumably predominantly in highly rated sovereign instruments like German government bonds.

In addition, investors from China including Hong Kong bought 6% of the 5 billion euro initial issuance of the EFSF (European Financial Stability Facility) benchmark bond in January 2011. China has a stock of 7 billion euros in foreign direct investments in the eurozone, which comprises 3% of its total outward FDI stock as of 2010. Last but not least, the euro is part of China's envisaged tripolar world order – that is, co-existence of the US dollar, euro, and Chinese yuan as three leading global currencies.

The eurozone as a whole needs around 17.5% of estimated GDP for refinancing in 2012, equivalent to 1.7 trillion euros. (Refinancing requirements are calculated as the estimated government budget deficit in 2012 plus outstanding T-bills plus government bonds and loans.)

The largest share is of France with around 25% of the total, followed by Italy with a share of almost 23%. Spain, Greece, Portugal and Ireland together make up another 20% or 340 billion euros. Together, the five GIIPS countries (Greece, Ireland, Italy, Portugal and Spain) will probably need 730 billion euros in refinancing in 2012. In comparison, Germany needs 325 billion euros or 19% of estimated GDP in 2012.

China not awash with cash

Many news reports paint a picture of China as being awash with cash due to its large foreign exchange reserves. However, these reserves are for the most part invested in long-term sovereign debt instruments, with around 60-65% in dollar instruments, 20-25% in euro assets and the remainder split between other currencies. Presumably only a very small fraction is held in highly liquid short-term paper.

Theoretically, even longer-dated instruments could be liquidated, but given the large amounts necessary in the case of the GIIPS countries, this would send ripple effects through the UST (US Treasury) market – except that Beijing decided to sell German government bonds and other core-EMU (Economic and Monetary Union) government bonds instead. Therefore, a more realistic scenario would be a slight acceleration of foreign exchange reserve diversification by investing an increasing share of additional or new reserves in euro assets.

Let us assume that total reserve accumulation in 2012 amounts to $650 billion (500 billion euros), which is the Deutsche Bank forecast. Even if the euro share were to rise to 30-35%, this would only mean $195-228 billion (150-175 billion euros) in financing available from China – or 20-24% of the GIIPS countries' total refinancing requirements.

The analysis above shows that even if China were willing to buy more troubled eurozone countries' sovereign debt, this would not be sufficient to resolve the GIIPS debt crisis. Moreover, we doubt that China is willing to take on substantial additional risks. Even China Investment Corporation (CIC), China's sovereign wealth fund with a global portfolio of $135 billion, would be hesitant to load on GIIPS bonds as its 'underlying investment objective is to seek long-term, sustainable, and high financial returns […] within acceptable risk tolerance.'

Even if China were willing to buy more eurozone sovereign debt, this would not be sufficient to resolve the debt crisis.

On top of that, Chinese public opinion towards increased investment is unlikely to be supportive as the general perception is that the troubled eurozone member countries have lived beyond their means and are now turning to the savings of a country that is still confronted with domestic development needs of its own. – *IDN-InDepthNews* ◆

Steffen Dyck is a Deutsche Bank research analyst. A version of this article appeared on 16 September 2011 on www.dbresearch.com under the headline 'China – Not really a white knight for the eurozone'.

The game is up: The age of liberal finance is over

Ann Pettifor contends that the response to the regime of unregulated finance that has caused the eurozone crisis should go beyond focusing on bankers' bonuses and the failure of the rich to pay taxes. A coherent alternative programme should include such critical elements as the provision of liquidity to stimulate economic growth, an orderly debt workout, capital controls and the adoption of full-employment goals and policies.

THE game is up. The 2007-9 private banking crisis that started with the unpayable debts of the US sub-prime sector was never over. The crisis has now moved on to include the unpayable debts of sovereigns owed to private European bankers. It is increasingly clear that there is declining political and institutional support for further private bank bailouts. The dramatic resignation on 9 September of Jürgen Stark, architect of Europe's equivalent of the Gold Standard – the Stability and Growth Pact – marks an important step in the resistance to bailouts by the European Central Bank (ECB); in the inevitable collapse of the Maastricht Treaty, and, with it, the utopian vision of the neoliberal euro.

A mass protest in Dublin in 2010 against the EU-IMF Irish bailout. There is declining political and institutional support in Europe for further private bank bailouts.

And so the age of liberalised, deregulated finance appears to be over – at least in Europe. That is the conclusion of investors in both Wall Street and the City of London and explains the collapse of confidence in banks and the volatility of stock markets as investors rush for the exits, transferring speculative gains into the safety of government bonds.

The Stability and Growth Pact was and is repeatedly flouted by Greece and other eurozone countries – even by Germany under Gerhard Schröder. The ECB, led by Jean-Claude Trichet, is also obliged to flout its terms, by effectively adopting a fiscal role – buying up the bonds of deficit countries – and thereby causing the resignation of not just Mr Stark, but also Germany's Axel Weber.

This resistance represents a Polanyian counter-movement – however weak – which defies orthodox economists, central bankers and Haute Finance. Across the eurozone, Europeans resist further private sector bailouts and refuse to march like lemmings to their own destruction across cliffs of unemployment, deflation and social unrest.

Financial straitjacket

The eurozone and its economic framework was designed as a financial 'straitjacket' to undermine the sovereignty of Europe's elected governments, to transfer power over financial and therefore economic policy to unaccountable central bankers; powers then enforced by 'the invisible hand' – 'the markets' – international speculators on foreign exchange and financial markets. It was also, its protagonists argued, designed to ensure peace across Europe.

But so utopian is the vision of liberalised, unaccountable finance, that it has achieved the very reverse: the divergence, not convergence, of European economies, sovereign insolvency, bank failures, rising unemployment, the degradation of public services, and, with it, the intensification of tensions and conflict across Europe.

Regrettably we have been here before. The very same policies – and liberal finance model – were tried in the 1930s, under the Gold Standard. By 1933 their failure was complete, challenged effectively by both Karl Polanyi and John Maynard Keynes. The latter took on the responsibility of outlining and implementing a 'Plan B' – one which endured until overturned by neoliberals in the late 1960s and early 1970s.

So as we witness the death throes of this second experiment in liberal finance, what is today's progressive alternative? What is the left's Plan B?

Alternative policy programme

The failure of the left to pose an alternative to liberal finance was striking before, during and after the 2007-9 financial crisis. In the wake of the greatest financial catastrophe of our lifetimes, the loudest complaints were aimed at bankers' bonuses, and at the failure of rich elites to pay taxes. Recently, the pro-austerity Institute for Fiscal Studies in the UK has tried to turn this into a debate about the maldistribution of wealth.

But while these are important issues, they do not touch on the structural injustice of a liberalised financial system that is capable of wrecking the global economy, denies economic sovereignty to democratic states, and that stratifies the polarisation of wealth between rich and poor. Nor does the debate on bonuses or the addition of taxes structurally alter the role of Haute Finance as 'stupid master' (to quote the British Labour Party's Employment manifesto of 1944) as opposed to 'servant' of the real economy.

So what should the left's macroeconomic Plan B look like? Clearly it will have to embrace both monetary and fiscal policy, with monetary policy more important in the long run, but fiscal expansion needed immediately to deal with the collapse of employment and private sector activity.

The first element of any plan must be the careful and coordinated sequencing of both quantitative easing and fiscal expansion. This will involve the financing of a programme of public works expenditures designed not just for socially and ecologically essential projects, but also to stimulate private economic activity. Central banks are eager to supply liquidity to private bankers when they wreck both their own institutions and threaten the global economy; they should now act to supply liquidity to governments that need to stimulate economic recovery, and finance the transformation of the economy away from fossil fuels.

A progressive macroeconomic alternative to liberal finance would involve, among others, the financing of public works programmes.

Next, it will be essential to manage in an orderly fashion the massive write-off or 'restructuring' of unpayable debts – to replace the current disorder of random deleveraging by sovereigns, corporations, households and individuals. Many of these debts are phantom debts, and cannot ever be repaid. That reality must be faced. It is time for another debt Jubilee.

The third element should be the introduction by sovereign states of capital controls over the mobility of finance across borders, to strengthen democratic, accountable policy-making. In the words of Brazil's President Rousseff, governments must protect their 'internal markets'. The form these controls take will depend on local conditions and circumstances, and should be agreed by elected representatives of democratic states, with central bankers acting in the interests of domestic economies, not the proverbial 'gnomes of Zurich'. Fourteen countries already impose capital controls, including China and Iceland, but each week new reports appear. The most recent is Indonesia, which will require companies to repatriate about $33bn of foreign currency earned each year on exports (*Financial Times*, 9 September 2011).

Fourth, central bankers, while regulating the creation of credit by private bankers to ensure loans are repayable, should also seek to bring down interest rates across the spectrum of lending: for safe and risky loans, short- and long-term loans. Adam Posen's recent proposal for a public bank that would make cheap loans available to small and medium-sized enterprises should be given serious consideration. In other words, the rule should be 'tight but cheap' money.

Fifth, governments and central banks should be mandated to promote a) full employment and b) sustainable, localised economic activity, supporting the domestic economy – not a globalised financial elite. For just as employment makes things affordable for individuals and households, so full employment will make things – including the transformation of the economy away from fossil fuels – affordable for government.

'Look after employment,' as Keynes argued, 'and the budget will look after itself.'

Add to the above, terms and conditions for banks bailed out by taxpayers and a reformed taxation system, and you have a coherent and plausible Plan B. Correct me if I am wrong, but so far it seems the most comprehensive one on the table. ◆

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Behind the bankers' mask

In the context of another financial crisis, debt audits could offer a way to counter the power of big finance.

Nick Dearden

THE first wave of the banking crisis is over. Banks successfully passed their losses onto the public and their profits are once again 'healthy'. They are now looking to governments to repeat the same trick for them. Greece, Ireland and Portugal are suffering 'structural adjustment' policies so that public money keeps flowing to the institutions whose behaviour created the global economic crisis.

Ecuador was the first country to hold an official debt audit. Picture shows Ecuadoran President Rafael Correa ***(second from left)*** at the debt audit commission's inaugural ceremony in 2007.

Across Europe, and particularly in Greece, people are fighting back – but not simply over the question of 'who picks up the tab'. They are engaged in a struggle for democracy in its true sense, for an economic system based on a radically different set of values. And they are using models developed by social movements in Southern countries to begin the necessary process of education and empowerment.

Answering tyranny with knowledge

One idea that has fuelled the imagination of activists in Greece and Ireland is for a 'debt audit', to throw open their countries' finances to public examination and analysis. A launch conference was attended by hundreds of people in Athens in May and has united a good portion of the notoriously fractured Greek left. The call has subsequently been taken up by activists in Ireland, with further interest in Spain, Portugal and even the UK.

Sofia Sakorafa is a dissident Greek MP, a former member of the Greek government who quit her party after refusing to sign up to the first 'bailout' package in 2010. She believes 'the answer to tyranny, oppression, violence and abuse is knowledge' – that public understanding of how the crisis came about, what Greeks are paying and to whom, will help to convince people of the moral bankruptcy of the current financial system and re-ignite a sense of ownership over their economy.

Sakorafa is clear that this is a battle for different values: 'Beyond speculating market games, there are more valuable concepts. There are people, there is history, there is culture, there is decency.' The crisis will not be solved by the odd piece of legislation but by a transformation of how individuals and communities relate to power.

The history of the debt audit

The idea of debt audits arose from Southern campaigners with decades of experience in fighting against the capture of their societies by Northern financial interests. After all, the problems of Europe today are a repetition of an old story. Controlling the financial system at national and international levels was a key concern of John Maynard Keynes after he observed the impact of the 'rule of the banks' in the Great Depression in the 1930s. Keynes believed in policies that would encourage the 'euthanasia of the rentier' through government intervention and control of finance.

As that system of control broke down in the 1970s, the world economy has experienced crisis upon crisis, from the Latin American debt crisis of the 1980s to the currency collapse in Indonesia and Thailand in 1997 and Argentina's economic crisis in the early 2000s. For the financial institutions based in the North, debt has provided a means of extending the control of the financial sector. People have responded to each instance of crisis by fighting back – usually not with specific policy proposals for a softer form of financial control, but by calls for repudiation of their country's debts and kicking out those international institutions imposing austerity.

On one level the argument for a debt audit is simply a call for transparency. If these debts are 'ours' then the least we can expect is to know what we are paying. But their impact goes much deeper. In the words of Irish activist Andy Storey, an audit can 'remove the mask of financial power which pulls the strings over our economy and therefore our society'. It is particularly important in a country that has been through dictatorial rule, in unveiling how international lenders propped up the illegitimate regime. But even in European societies, it digs deep into the connections between power and finance, unveiling how and in whose interests an economy works.

Most debt audits have been done on a shoestring budget, using what information can be gleaned from freedom of information and other research. The Brazilian Citizen Debt Audit was the first such initiative in 2001. In 2006, President Rafael Correa made Ecuador the first country to hold an official audit, declaring 'my only debt is to the people'. Despite the presidential backing, the audit was a mammoth task which encountered constant resistance from civil servants unwilling to disclose the secrets of former regimes.

In 2008, the audit commission reported that debt had done 'incalculable damage' to Ecuador's society. It uncovered numerous illegal, useless and extortionate loans that had bled the country of resources. Correa essentially defaulted on the most dubious of this debt – a set of bonds. Even *The Economist* called Correa 'incorruptible' when public spending rose as a consequence.

Activists, however, wanted him to go much further in repudiating debts. This is one of the problems of state sponsorship of such mobilisation processes, which has also led to disappointment among activists in Argentina and Brazil as promises have not translated into broader economic transformation. Smaller official audits have been initiated, but not carried through, in Argentina and the Philippines, with more promised in Nepal and Bolivia.

Meanwhile, activists in Zimbabwe are working on an audit to show the role that lending from the IMF and World Bank, as well as Northern governments, played in the creation of crisis in that country. Once Zimbabwe is judged to have transited Mugabe's regime, the country faces a barrage of new IMF loans with accompanying control of the economy. The debt audit is a first step to challenging this control.

Some look on debt audits as 'reformist' – surely the truly radical answer is for a country to simply stop paying its debts? Actually it's not so simple. A default is not automatically progressive – look at those of Mugabe in Zimbabwe or al-Bashir in Sudan. Repudiation and default might be the best option, politically and economically, but it is not without pain. A country's population will need to proactively take on the hardships and isolation it is likely to experience. A thorough understanding is an essential prerequisite.

Freedom from Debt Coalition/Bobby Diciembre

Members being inducted into the Independent Citizens' Debt Audit Commission of the Philippines in March 2008. The idea of debt audits arose from Southern campaigners with decades of experience fighting against the capture of their societies by Northern financial interests.

People can't be led to support a default in the mistaken belief that 'everything will return to normal'. Things may get worse. As 28-year-old Icelander Thorgerdun Ásgeirsdóttir said after he voted to turn down the British and Dutch terms for repaying his country's debt, 'I know this will probably hurt us internationally, but it is worth taking a stance.'

Such an understanding is also necessary if a default is to become a genuine first step towards wider change. Argentina pulled off one of the biggest defaults in history in 2001, after years of following faulty IMF advice. Economically it worked – the economy began recovering quickly. But many activists lament the failure of the Argentinian government to build on this by creating a different form of economic development. In spite of rapid growth, poverty remains at 30%, inequality is high and the majority continue to suffer from a debt-led form of 'development'.

Audits in Europe

Clearly debt in Europe has many differences from debt in the global South. Little European debt today was run up by dictatorial regimes, and the payment of that debt will not lead to the levels of hardship experienced by truly impoverished countries. But issues of wealth and power redistribution, of who controls our society and who foots the bill for that accumulation of power, are the same everywhere.

What does the Greek audit hope to uncover? Greek academic and activist Costas Lapavitsas has said he is not certain that the bulk of Greek public debt is legal, 'given especially that it has been contracted in direct contravention of EU treaties which state that public debt must not exceed 60% of GDP' – something the creditors were fully aware of. Some Greek debt was massaged by Goldman Sachs to hide the true extent of Greece's liabilities. According to Lapavitsas, the bailout package itself was not contracted in accordance with normal parliamentary oversight.

We in Europe are living in a society in which financial interests have captured our governments, control our economies and eat into every aspect of our lives. They have even captured our very notion of democracy – overruling the fact that true democracy cannot really exist in a society of vastly growing wealth differentials, where bankers pull all the strings. Struggles for political democracy cannot hope to succeed separate from struggles for economic democracy. Debt audits are means of seeing democracy in a more holistic way. Their adoption could help pave the way for a genuine break with the failed economic policies of the past. ◆

Nick Dearden is the director of Jubilee Debt Campaign in the UK. This article is reproduced from Red Pepper *(August/September 2011, www.redpepper.org.uk). Subscriptions to* Red Pepper*, at £20 for the first year, can be taken out via its website at www.redpepper.org.uk/subscribe/?new.*

Fiscal tightening could be self-defeating, warns UNCTAD

The shift towards fiscal tightening appears to be premature in many countries where demand has not yet recovered on a self-sustaining basis, and where government stimulus is still needed to avoid a prolonged stagnation, the United Nations Conference on Trade and Development (UNCTAD) has said.

Kanaga Raja

A European Trade Union Confederation demonstration against government austerity measures in Europe. Many European and other developed economies have embarked on fiscal tightening, concentrating on spending cuts.

IN its *Trade and Development Report 2011*, UNCTAD cautioned that premature fiscal tightening could be self-defeating if it weakens the recovery process, hampers improvement in public revenues and increases the fiscal costs related to the recession and bailouts. Hence, by hindering economic growth, such a policy would fail to achieve fiscal consolidation.

The current obsession with fiscal tightening in many countries, the report said, is misguided as it risks tackling the symptoms of the problem while leaving the basic causes unchanged. In virtually all countries, the fiscal deficit has been a consequence of the global financial crisis, and not a cause.

According to UNCTAD, between 2002 and 2007, fiscal balances had improved significantly in most developed and developing economies, as a result of growth in output, lower interest rates and, in some countries, the price boom in commodities.

The crisis caused a significant deterioration in public sector accounts, as automatic stabilisers and fiscal stimulus packages were put in place. In several developed countries, public bailouts of financial institutions accounted for a large portion of the deficit, reflecting a conversion from private into public debt.

As a result, notes UNCTAD, the median public-debt-to-GDP ratio in developed countries almost doubled, to more than 60% of GDP, between 2007 and the end of 2010. Economic growth in developing countries, as a group, suffered less impact from the financial crisis, partly thanks to active counter-cyclical fiscal policies: as a result, fiscal balances improved in 2010 and debt-to-GDP ratios remained in check.

According to the UNCTAD report, the global financial crisis has once again brought fiscal policies and, more generally, the role of the state to the forefront of the economic policy debate.

Public sector accounts have been dramatically affected by the global crisis. In addition to policy-driven fiscal stimulus packages, which typically involved a discretionary increase in public spending and/or tax cuts to counter the macroeconomic impact of the crisis in the financial sector, the crisis itself affected fiscal balances and public debt through several channels.

One reason for the increasing public deficits and debts was the operation of automatic stabilisers, in particular reduced tax revenues, which reflected the downturn in economic activity, and, in countries with well-developed social security systems, increasing social expenditure, especially higher unemployment allowances.

Clearly, therefore, the crisis was not the outcome of excessive public expenditure or public sector deficits; rather, it was the cause of the high fiscal deficits and/or high public-debt-to-GDP ratios in several countries.

Nevertheless, says the report, some governments have already changed their policy orientation from providing fiscal stimulus to fiscal tightening, while others are planning to do so, in an effort to maintain or regain the confidence of financial markets which is viewed as key to economic recovery. This policy reorientation comes at a time when private economic activity is still far from being restored to a self-sustained growth path.

Although it is universally recognised that the crisis was the result of financial market failure, little has been learned about placing too much confidence in the judgement of financial market actors, including rating agencies. Many of the financial institutions that had behaved irresponsibly were bailed out by governments in order to limit the damage to the wider economic system.

It is therefore surprising that, now that 'the worst appears to be over' for those institutions, a large body of public opinion and many policy-makers are once again putting their trust in those same institutions to judge what constitutes correct macroeconomic management and public finance.

'In any case, the shift towards fiscal tightening appears to be premature in many countries where private demand has not yet recovered on a self-sustaining basis, and where government stimulus is still needed to avoid a prolonged stagnation. Premature fiscal tightening could be self-defeating if it weakens the recovery process, hampers improvement in public revenues and increases the fiscal costs related to the recession and bailouts. Hence, by hindering economic growth, such a policy would fail to achieve fiscal consolidation.'

The report argues that the recent global financial and economic crisis was not due to profligate fiscal policies, and that the increase in public debt in a number of developed countries was the result of the Great Recession.

Primary deficits caused by discretionary fiscal policies were a much smaller contributory factor to higher debt ratios than the slower (or negative) GDP growth and the banking and currency crises. Therefore, any policy that seeks to reduce public debt should avoid curbing GDP growth; without growth, any fiscal consolidation is highly unlikely to succeed.

According to the report, a review of a number of systemically important countries (including developed and emerging market economies) shows that the evolution of government savings is not the main factor behind external imbalances.

Anti-IMF graffiti on the wall of a bank in Athens. IMF programmes in most European borrower countries misjudged the effects of the prescribed fiscal restraint.

In the United States, the current-account balance fell steadily, from equilibrium in 1991 to a deficit of 6% of GDP in 2006, in the build-up to the crisis. Government savings can hardly explain this trend: they first increased significantly between 1992 and 2000, as a result of strong growth of GDP and tax revenues as well as what was then called the 'peace dividend'; they subsequently fell due to slower growth and policy shifts that reduced taxes and increased military expenditure, but this shift had no noticeable impact on the current account.

The progressive decline of household savings would be a better explanation for the widening current-account deficit, but this alone could not have been sufficient. Rather, the trade and current-account deficits were more likely the result of a combination of rising consumption – by incurring ever-increasing private debt (which lowers household savings rates) – and the loss of industrial competitiveness.

However, the lower household savings were less of a contributory factor than the greater consumption of imported rather than domestically produced goods, which slowed down growth of domestic income, corporate profits and tax revenue for the state and federal governments.

Another major developed economy, Japan, has run a current-account surplus every year over the past three decades, with a rising trend from 1.5% of GDP in 1990 to 4.8% in 2007. During that period, government savings plunged by 8 percentage points of GDP, and household savings also fell by an equal amount. Thus, the country's current-account surplus was clearly not because the government or households decided to save more.

The report summarises that external imbalances in the countries reviewed were not caused by government dis-savings, firstly, because in several countries government savings were positive before the crisis, and secondly, because government (and corporate) savings behaved basically as endogenous variables.

The main factors contributing to their current-account deterioration were the loss of international competitiveness of their domestic firms and the decline in household savings, both of which were linked to massive capital inflows and financial deregulation that spurred credit-financed household expenditure and led to real appreciation of their currencies.

Between 2002 and 2007-08, fiscal balances improved significantly in many countries, although some governments continued to run relatively large deficits. On the eve of the crisis, fiscal accounts were balanced, on average, in East, South and South-East Asia, and Latin America; and in Africa, the transition economies and West Asia, governments were achieving sizeable surpluses. In developed economies, fiscal deficits had fallen, on average to less than 1.5% of GDP. However, the crisis caused fiscal accounts to turn into deficit in all the regions.

In general, says the report, the improvement of fiscal balances in the years preceding the crisis did not result from fiscal retrenchment and expenditure cuts; in most countries, government revenues and expenditures increased together, although at different rates.

With the exception of developed countries, where they remained flat as a percentage of GDP, government revenues expanded significantly in all regions from 2002-03 onwards. This was supported by broad-based acceleration of growth and increased earnings from commodity exports.

The declining share of interest payments in public expenditure has been a widespread trend. It resulted from the reduction of public debt ratios in most developing and emerging economies, as well as from lower real interest rates in most countries. In Africa, Latin America and East, South and South-East Asia, interest payments fell by 1 to 2 percentage points between the periods 1998-2000 and 2008-10. In the transition economies, there was a similar reduction between 2002 and 2008-10.

'Such expansionary adjustments of fiscal balances, with higher revenues and primary expenditure, implied a structural change in many developing and transition economies, and served to enlarge their policy space which they were able to use when hit by the financial crisis.'

In developed countries with well-established social security systems and a comparatively high share of direct taxes in fiscal revenues, changes in government revenues and expenditure are partly related to automatic stabilisers.

Between 2007 and 2010, spending on social security benefits increased by 3% of GDP in Japan and the United States, and by between 1.5% and 4.3% of GDP in most European countries, with the highest increases in those countries where unemployment rose the most, such as Greece and Spain.

Financial crises – such as those that struck many emerging market economies in the past – typically create fiscal costs through interest rate hikes, currency devaluation that increases the burden of public debt denominated in foreign currencies, and public-funded bailouts. This is in addition to the direct effects of slower growth or recession on current revenues and expenditures, and on discretionary fiscal stimulus measures.

In the context of the latest crisis, bailout operations have been taking place mainly in developed economies. Developing countries were generally able to avoid this kind of fiscal cost, because most of them did not experience banking crises, and therefore did not need to bail out any of their banks.

In contrast, says the report, fiscal accounts in several developed countries were severely affected by the financial crisis. In these countries, the authorities gave top priority to preventing the collapse of the financial system, making available the financial resources necessary to achieve this objective.

'The current obsession with fiscal tightening in many countries is misguided, as it risks tackling the symptoms of the problem while leaving the basic causes unchanged. In virtually all countries, the fiscal deficit has been a consequence of the global financial crisis, and not a cause,' the report stresses.

Today's fiscal deficits are an inevitable outcome of automatic stabilisers and measures aimed at countering the effects of the crisis, including policy-driven stimulus packages that involved increased government spending, lower tax rates and public-funded bailouts of financial institutions.

Empirical evidence from different countries and regions shows that the crisis was caused by underlying changes in national competitiveness and private sector imbalances, which were closely related to a malfunctioning financial sector in developed countries.

'These fundamental causes are not being addressed in the current focus on fiscal tightening in some countries.'

Worse still, the diversion of attention away from the underlying causes and towards so-called fiscal profligacy in other countries, which in turn could eventually lead to fiscal tightening, increases the risk of stalling, or even reversing, economic recovery.

The level of a country's fiscal deficit (or surplus) needs to be viewed from a more holistic and dynamic perspective, in the context of its impact on the sustainability of the country's financial position and on its economic stability and growth prospects. From this perspective, the composition of fiscal revenues and expenditures and many other variables that have an impact on a country's fiscal space are also important.

According to the report, after an initial wide consensus on the necessity of proactive macroeconomic policies to support demand, many policymakers have now shifted their focus from fiscal stimulus to fiscal tightening. The policy debate today is about what measures should be taken to achieve the widely agreed objectives of recovery from the crisis and an improvement in fiscal accounts, as well as the sequencing of those measures.

An argument frequently advanced in support of fiscal retrenchment is that there is no more fiscal space available for further fiscal stimulus, even if it is acknowledged that such policies were useful at the initial stages of the crisis. However, this argument overlooks the fact that fiscal space is not a static variable. It would be a mistake to consider this policy space as exogenously determined rather than a largely endogenous variable.

Despite the lack of solid conceptual foundations, most developed economies have embarked on fiscal tightening, concentrating on the expenditure side. Spending cuts on welfare, health care and pensions have been the most frequently used measure in OECD (Organisation for Economic Cooperation and Development) countries, occurring with up to 60% frequency.

IMF programmes

When the crisis erupted, a number of European and transition economies that were among the most seriously affected turned to the IMF for emergency financing. Although at the time the IMF approved of counter-cyclical fiscal policies, in most of these countries the programmes it supported entailed fiscal adjustment, as has been typical of its conditionality.

Hence, fiscal restraint was required without a previous injection of fiscal stimulus aimed at limiting the impact of a crisis that, in general, was not caused by fiscal deficits. Given the pressure on financial markets, no fiscal space was assigned to those countries by creditors. In order to obtain IMF support, countries are expected to adjust their current-account deficits by reducing domestic absorption (including fiscal retrenchment), which normally slows GDP growth.

'Misjudging the effects of fiscal tightening seems to be the rule rather than the exception in IMF-backed programmes,' says the report.

A detailed examination of fiscal adjustment in 133 IMF-supported programmes in 70 countries carried out by the IMF's Independent Evaluation Office (IEO) notes that there was 'a tendency to adopt fiscal targets based on over-optimistic assumptions about the pace of economic recovery leading inevitably to fiscal under performances' and 'over-optimistic assumptions about the pace of revival of private investment'.

That report observes that 'a more realistic assessment in certain circumstances could have justified the adoption of a more relaxed fiscal stance on contra-cyclical grounds'.

According to UNCTAD, in country after country where fiscal tightening was expected to both reduce the budget deficit and boost investment and economic growth, the opposite happened. Private sector demand and investment, in particular, responded much more sluggishly than the IMF had expected.

In addition, fiscal balances, on average, failed to improve during the first two years of the fiscal adjustment programmes, even though this was an explicit goal of those programmes.

The UNCTAD report also highlights the need for a dynamic definition of fiscal space, while showing that other factors, such as monetary policy and the international financial environment, might also be relevant for creating that space.

The crisis has created higher levels of public debt in many developed economies. However, it is not clear that these levels are unsustainable, and whether fiscal policy should become contractionary if economic recovery and low real interest rates are sufficient to maintain the debt-to-GDP ratio on a stable path.

To a large extent, central banks around the world control the rate of interest, and there is no justifiable reason for raising interest rates when global recovery is still fragile. If inflationary pressures not directly associated with excess demand develop, there are alternative policies that might be used to deal with the problem, such as an incomes policy.

The report summarises that monetary policy is an essential instrument, not just to promote the level of activity while maintaining stability, but also to create the necessary space for fiscal policy. There are good reasons to believe that monetary policy should continue to create fiscal space by maintaining low interest rates in a two-speed global recovery in which developed countries such as Japan, several European countries and the United States face a sluggish recovery, and developing countries remain steadfast on their catching-up path.

However, particularly when interest rates are low, or at the lower zero bound level, and demand for credit remains weak, as is normally the case after a financial crisis, fiscal policy should bear full responsibility for promoting output growth. In that respect, the way the public sector spends and collects revenue becomes an essential ingredient.

The report underscores that fiscal space depends not just on how fiscal policies are implemented, but also on how well those policies are supported by monetary policy and by the national and international financial environment.

This is in addition to considerations of the political viability of the policy changes. If fiscal space is an issue in the design of counter-cyclical macroeconomic policies, this should be taken into account not when it has allegedly reached its limit, but at the outset (i.e., when decisions are taken on fiscal stimulus measures), because demand and fiscal feedback effects differ widely depending on which specific expenditures or taxes are changed.

'An optimal combination of such changes would achieve a maximum expansionary effect, as there would be a minimum drain of demand in the income circulation process on savings and imports, and a maximum encouragement of additional private spending.'

As a result, there may be a debt paradox in the sense that the income effects of stimulus measures would lead to full compensation, or even overcompensation, of the initial deficit through additional tax incomes. Moreover, to the extent that it accelerates GDP growth, the debt-to-GDP ratio may fall.

In other words, as a result of multiplier and accelerator effects on income, which increase the tax revenue at constant tax rates, a deficit can finance and, under favourable conditions, even over-finance its own debt service, so that an expansionary fiscal policy may be more likely to reduce the deficit and the debt ratio than a restrictive one.

Although public debt crises often do not have a fiscal origin, some are indeed caused by unsustainable fiscal policies, while others are caused by irresponsible lending for purposes that do not increase the overall productivity but amount to zero-sum games over the medium term. However, even when a debt crisis has a fiscal origin, it may well be necessary to undertake expansionary fiscal policies to promote growth, which may lead to increasing public debt in the short run in order to forestall even worse consequences later.

Since banking crises are often followed by sudden increases in public debt, associated with policy decisions to rescue financial institutions in distress, policies aimed at reducing the risk of debt crises need to include measures to keep in check private sector debt, both domestic and external.

There are a number of useful instruments for limiting excessive risk-taking by the private sector, such as: tighter financial regulation, including guarantees that borrowers have income streams compatible with the accumulated debt; restrictions on certain types of predatory lending which misinform borrowers about payment conditions; caps on interest rates charged by certain types of credit lines; higher capital requirements for banks; and capital controls.

Although debt crises do not always have a fiscal origin, the standard response to a sudden jump in public debt is often fiscal retrenchment. 'This appears to be a misguided policy, because the appropriate response should relate to the nature of the crisis.'

If a crisis originates from the bursting of an asset bubble, the response should be financial reform, and even quite the opposite of fiscal retrenchment, namely, counter-cyclical policies to absorb private sector deleveraging so as to reduce the macroeconomic slump created by asset deflation.

If the crisis originates from excessive foreign currency lending and excessive real appreciation, the appropriate response at the national level might be to improve the debt structure and introduce policies aimed at avoiding misalignments of the real exchange rate as well as introducing controls on capital inflows.

Debt restructuring may be part of a strategy to resolve a debt crisis, not just for the borrowing country but also for creditors, since the possibilities for renewed economic growth and the ability to repay increase. If debt renegotiation frees up resources for growth-enhancing activities it may allow a country to better finance its own reduced debt service. However, sovereign default or debt restructuring are no panacea, and their risks have to be weighed carefully against the risk of contagion, which is a major hazard in the European monetary union.

Fiscal expansion

The report goes on to suggest that the best strategy for reducing public debt is to promote growth-enhancing fiscal policies. Moreover, it would seem from the evidence that fiscal expansion tends to be more effective if spending takes precedence over tax cuts, if spending targets infrastructure and social transfers, and if tax cuts, in turn, target lower-income groups, which generally have a higher propensity for spending.

Fiscal expansion, by increasing the level of activity and income, raises the revenue stream and reduces the debt-to-GDP ratio, in particular if interest rates are relatively low compared with GDP growth.

In this sense, problems associated with the growth of public debt, particularly when that debt is not primarily related to fiscal problems, are best resolved by a strategy of fiscal expansion. Further, if it is argued that, for economic and/or political reasons, there is little space for fiscal expansion, there is always the possibility to redirect spending and taxes to support more expansionary measures. Again, this suggests that spending should be given precedence over tax cuts, and that both measures should benefit low-income groups in particular.

'A more equitable distribution of income would make economic recovery more self-sustaining and improve the chances of achieving fiscal consolidation. In this sense, increasing real wages in line with productivity, and, especially in developing countries with large informal sectors, government transfers to the low-income segments of society, are important complements to fiscal expansion.'

Beyond the notion that growth is the best solution to reduce public-debt-to-GDP ratios, it is important to emphasise that higher ratios of public debt per se, particularly in developed countries after the crisis, do not pose a threat to fiscal sustainability.

The public debt today is much more sustainable than the private debt before the crisis. As long as interest rates are low and unused capacities exist, there is no crowding out of private investment, and the globally higher public debt ratios do not pose a problem for recovery, the report stresses.

'For the world as a whole, and for the big economies, the only strategy warranted is one of consolidation through growth. Growth, combined with low interest rates, will bring an increase in revenues and a fall in debt ratios over time. This implies that monetary policy should continue to maintain low interest rates in order to keep the burden of interest payments for the public sector bearable.'

If inflation is perceived to be a serious threat to economic stability, and given that in most economies the pressures on prices have originated largely from the financialisation of commodity markets, the subsequent, second round effects (such as a price-wage spiral) need to be dealt with by an incomes policy rather than by adopting restrictive macroeconomic measures.

There are instances when an external constraint (e.g., when lack of competitiveness brings about current-account deficits) prevents fiscal expansion because it would aggravate the external imbalance. In such cases, priority should be given to resolving the balance-of-payments problem rather than introducing austerity measures, the report concludes. ◆

Kanaga Raja is Editor of the South-North Development Monitor (SUNS)*, which is published by the Third World Network. This article is reproduced from* SUNS *(No. 7215, 12 September 2011).*

COVER

Restructure banking for more balanced and diversified system – UNCTAD

In its latest *Trade and Development Report*, the UN Conference on Trade and Development (UNCTAD) has called for the re-regulation of the financial sector and the restructuring of the banking system to make it more diversified and balanced.

Chakravarthi Raghavan

Protesters at an 'Occupy Wall Street' march in New York. The global crisis has prompted debate about re-regulation and restructuring of the financial sector.

THE three-year-old global economic crisis, which originated in the financial sector but quickly spread to the real economy and resulted in the 'Great Recession', underscores the need not only for effective re-regulation and supervision of the sector, but also for restructuring it for a more balanced and diversified banking system with public, private and cooperative banks, according to the UN Conference on Trade and Development (UNCTAD).

In advocating this view in its *Trade and Development Report (TDR) 2011*, UNCTAD says that 'the ongoing financial and economic crisis, which originated in private financial institutions, has significantly undermined many of the arguments repeatedly advanced over the past few decades against publicly-owned banks. In Europe and the United States, large private banks have been subsidised based on the belief that they are too big to fail. Indeed, when the crisis struck large banks were able to survive only because they received government funding and guarantees.'

GATS misunderstanding

In promoting the re-regulation of the financial sector and restructuring of the banking system, the UNCTAD report has a section analysing the WTO's General Agreement on Trade in Services (GATS), to argue that it would or could come in the way of re-regulation and restructuring of the financial sector.

However, the analysis of the GATS provisions appears to be based on a mixing up and misunderstanding of the GATS articles, rules and frameworks.

GATS has rules applicable to all members, provisions for negotiating market access and modalities for scheduling commitments by member countries (Articles XVI and XVII) – applicable to the entire trade in various service sectors in the four modes of supply – and there are provisions in separate annexes relating to particular service sectors (Air Transport, Financial Services, Maritime Transport, Telecommunications, and Basic Telecommunications).

While GATS has provisions for developing disciplines on domestic regulations, the GATS Annex on Financial Services has some provisions relative to trades in this sector. These include special provisions on domestic regulations in the sector, a very wide 'escape clause' (prudential measures defence, or PMD), a definition of financial services with an illustrative but non-exhaustive list of such services, and provisions for dispute settlement panels having needed expertise.

While modalities under Articles XVI and XVII apply also to the scheduling of market access commitments in financial services (used by most of the developing countries excepting three or four), at Marrakesh, some countries (mainly those belonging to the Organisation for Economic Cooperation and Development) negotiated an additional or alternative modality: the Understanding on Commitments in Financial Services or, in short, the

Understanding.

The use of this additional modality, but on an MFN (Most-Favoured Nation) basis, was a voluntary option. A group of countries did so at Marrakesh and subsequently in Geneva in 1997 in the Financial Services Agreement.

However, unlike Articles XVI and XVII, the Understanding is not part of the Uruguay Round (UR) legal texts, nor even a part of the UR protocol. Those who used it did so by either referencing the Understanding in a headnote and only entering limitations in their schedules, or using the methodology/language of the Understanding in entering market access commitments for each of the modes of supply and the limitations, if any.

[A forthcoming (and soon-to-be-published) paper by Ambassador Bal Krishan Zutshi (Indian ambassador to the GATT from 1989-1994 and a key negotiator who also coordinated the positions of developing countries in the UR GATS negotiations, and acknowledged by trade officials as one of the key architects of the GATS regime) deals in detail with all these aspects. The paper points out that none of the GATS provisions precludes the proposed financial reform and regulatory measures (either enacted or under consideration in the US, under the Dodd-Frank Act, or those in Europe), and that even for those who scheduled commitments using the Understanding, the PMD would be a defence. In any event, members who find their scheduled commitments coming in the way of reforms can invoke Article XXI and modify their schedules – much easier procedurally and substantively than a similar course on trade in goods under the General Agreement on Tariffs and Trade (GATT). Also, this is the only way that any member can revise its commitments under GATS and take the reform and regulatory steps.

[Zutshi, in his paper, has analysed the *TDR* and some (more nuanced) civil society views, including those cited by the *TDR*, about the alleged contradiction in the wording on domestic regulations in GATS Article VI, and that relating to financial services in the Financial Services Annex. He explains that the purported contradiction is based on a misunderstanding of the rules of interpretation of public international law: that signatories to more than one agreement are expected to abide by all of them, that clarification and interpretation of such provisions must be done harmoniously by dispute panels, that the words and phrases used in any agreement have to be given their 'ordinary meaning', and that no particular provision or part could be made superfluous or inutile.]

In the case of Article XI of GATS (relating to payments and transfers), the *TDR*, on page 100, purports the article as stipulating that 'unless a serious balance-of-payments situation can be claimed, no restrictions on international transfers of payments related to a country's specific commitments are permitted.'

However, Article XI:1 actually says: 'Except under the circumstances envisaged in Article XII [on balance-of-payments safeguards], a Member shall not apply restrictions on international transfers and payments for current transactions relating to its specific commitments.' The omission of the words 'for current transactions' in the *TDR*, perhaps inadvertently, gives a different meaning.

The *TDR* also purports that Article XVI, on market access commitments, stipulates that once a commitment of market access has been made for a specific kind of service, capital movements that are 'essentially part of' or 'related to' the provision of that service are to be allowed as a part of that commitment.

In fact, what Article XVI does is to define what is full 'market access' for a services transaction (where, unlike in goods trade, there is no physical movement across borders): it sets out an exhaustive and closed list of six types of measures whose absence as limitations in a member's schedule constitutes full market access. In other words, in undertaking a specific commitment, a member can set out as limitations on market access, any or all of these measures, fully or partially. If the member has not mentioned in its schedule any limitations, such measures cannot be applied, where a commitment has been undertaken.

In this context, one of the six measures is: 'limitations on the participation of foreign capital in terms of maximum percentage limit on foreign shareholding, or the total value of individual or aggregate shareholding.'

Put another way, any member giving a market access commitment, but wanting to restrict foreign capital participation, must set down these limitations in its schedule. This is different from what the *TDR* rendering suggests is the stipulation of Article XVI.

In terms of capital movements and transfers, Article XI:2 asserts International Monetary Fund (IMF) jurisdiction on capital transactions, including exchange actions, but permits restrictions on capital transactions only for balance-of-payments reasons under Article XII, or at the request of the IMF.

Article XI:2 also prohibits restrictions on capital movement in cases where a specific commitment undertaken is for a service involving capital transactions – as for cross-border capital movement under mode 1 of service delivery or foreign direct investment under mode 3. This is logical and clarified in Footnote 8 to Article XVI.

On the main issue of the need for stronger re-regulation and enforcement, this is being blocked in the US and Europe, not by any GATS provisions but as a result of the regulatory capture (by powerful financial firms) of legislative, executive and even the judicial pillars of the state.

UNCTAD, or civil society groups (whose advocacy views have been adopted by UNCTAD), whether on financial sector reforms or on regulating capital flows, should thus focus on these forces (and the IMF roles) and not on GATS – which did not contribute in any way to the financial crisis and is not coming in the way of reforms, except maybe in some cases of scheduled commitments.

These commitments, if any, have to be renegotiated and changed, but that too only in cases where the regulations are not for 'prudential reasons' or 'to ensure the integrity and stability of the financial system' (Paragraph 2(a) of the Annex on Financial Services).

On the wider issue of the role of finance, the *TDR* points out that financial markets are supposed to mobilise resources and allow their efficient allocation for productive investment. In addition, they are expected to facilitate transactions and reduce transaction costs, as well as reduce risk by providing insurance against low-probability but high-cost events. Therefore, those markets are often seen as instrumental in promoting economic growth and broad social development.

The Bank of North Dakota in the US is an example of a publicly owned bank which has done well for itself and for local communities in the state.

However, the hard reality is that they often serve as a means of speculation and financial accumulation without directly contributing to economic development and improving living standards, and throughout history they have been fraught with crises.

Also, the increasing financialisation of the world economy (strongly driven by securitisation) has led to the growing dominance of capital-market financial systems over bank-based financial systems – a process that has strengthened the political and economic power of the rentier class.

There was also an explosion of financial trading, associated with a myriad of new financial instruments aimed at short-term private profit-making. However, such trading was increasingly disconnected from the original purpose of financial markets, that of allocating resources for long-term investment.

The global financial and economic crisis, the *TDR* notes, has prompted a debate about re-regulation and restructuring of the financial sector so as to avoid crises in the future, or at least crises of such magnitude. To a large extent, this debate, at both national and international levels, has been about strengthening of financial regulations and improving supervision of their implementation.

However, says the *TDR*, re-regulation alone will not be sufficient to prevent repeated financial crises and to cope with a highly concentrated and oversized financial sector that is dominated at the global level by a small number of gigantic institutions.

In addition, even if the sector were to be better regulated and less prone to crisis, there is no guarantee that it would be able to drive growth and employment, particularly in low-income countries, or to make credit more easily available to small and medium-sized firms or to the population at large.

The case for public banks

As for the desirable restructuring of the banking system, UNCTAD points out that whereas during the boom period private institutions and individuals enjoyed large profits and bonuses, during the bust, governments – or the 'taxpayers' – had to bear the costs. Hence, the criticism against state-owned banks that they have the advantage of access to public resources is no longer valid.

Governments generally have had full control of the operations of public banks throughout both boom and bust cycles, whereas private banks have retained their own management and control and have continued to pay themselves handsome bonuses, even when they have received large government bailouts. The allegation that state-owned banks are 'loss-making machines' is more appropriately applicable to large private banks.

As for alleged differences in efficiency between public and private banks, the crisis has revealed that even the largest private banks failed to collect and assess information on borrowers and to estimate the risks involved in lending. The latter function was transferred to rating agencies instead.

In making the case for the restructuring of the banking sector and for state-owned banks, the *TDR* highlights three beneficial aspects of state-owned banks.

The first one relates to their proven resilience in a context of crisis and their role in compensating for the credit crunch originating from the crisis. A second aspect is that they support activities that bring much greater social benefits than the private banks and provide wider access to financial services. Finally, they may also help promote competition in situations of oligopolistic private banking structures.

Under certain circumstances, says UNCTAD, cooperative and community development banks might also be an important component of the restructuring of the banking sector. During the global financial crisis, small savings banks, such as the Sparkassen in Germany, did not have to resort to central bank or treasury support.

Moreover, these institutions may give greater attention to small businesses and other agents that do not normally have access to banking credit.

While the *TDR* has cited examples of publicly owned banks in Europe and many more in the developing world which have done well by themselves and their communities, and have not needed taxpayer-funded aid and guarantees, perhaps an even more important example is the state-owned bank in North Dakota (in the US heartland), namely, the Bank of North Dakota (BND).

In a recent article (www.webofdebt.com/articles/north_dakota.php), Ellen Brown, author of the book *Web of Debt*, has brought out how the 'economic miracle' of North Dakota – an unemployment rate of 3.3% (in contrast to the over 9% in the US as a whole) and fastest job growth rate – is due not to its oil sector as mistakenly characterised by the *New York Times* recently, but to its state-owned Bank of North Dakota.

The BND, she says, does not compete with local banks, but partners with them, helping with capital and liquidity requirements, participates in loans, provides guarantees, and acts as a sort of mini-Fed for the state. In 2010, the BND provided secured and unsecured Federal Fund Lines to 95 financial institutions, with combined lines of over $318 million, as well as a Flex PACE loan programme enabling local communities to provide assistance to borrowers in areas of jobs retention, technology creation, retail, small business and essential community services.

The BND has also contributed to state revenues – $300 million to the state treasury over the last 10 years, an amount equal to the oil and gas tax revenues of the state.

The *TDR* meanwhile notes that from a regulatory point of view, information asymmetries could be overcome if the authorities had complete access to information, which, at present, is often retained as confidential by private banks.

In addition, 'if private banks are making significantly higher profits than public banks, this may provide a warning signal [to regulators] that they are taking too much risk or exploiting their monopoly power'.

The *TDR* further notes that in spite of large-scale privatisations during the 1990s, state-owned banks continue to play an important role in the banking systems of many developing countries. In 2003, these kinds of banks accounted for over 30% of total assets in the transition economies, more than 20% in Africa and slightly less than 20% in Latin America. But there were large variations within each region. In Argentina and Brazil, for instance, almost a third of the banking assets were held by state-owned banks.

Restructuring private banks

In addition to stronger public banks, restructuring of private banks, UNCTAD says, would create a more balanced banking sector. As previously discussed, the loss of diversity of the banking system has been one of the major factors behind the latest crisis.

Some responsibility for this development, the *TDR* says, lies with the regulatory bodies, most specifically the Basel Committee in its misguided attempt to design a 'level playing field' both within and across borders.

As barriers between different institutions fell, deposit-taking banks became involved in investment banking activities, and as a consequence, they were more fragile and exposed to contagion. Since these banks play a crucial role in the payments system, their higher exposure to systemic risk had the potential to make a greater adverse impact on the entire economy.

This problem could be addressed in two ways. First, deposit-taking and payment systems should be separated from investment banking operations, as was done under the Glass-Steagall Act in the United States in 1933. In other words, commercial banks should not be allowed to gamble with other people's money.

Second, and even more ambitious, large institutions should be dismantled, to overcome the too-big-to-fail or, as coined by Yaga Venugopal Reddy, the former governor of the Reserve Bank of India, the 'too powerful to regulate' problem.

There are many possible ways, UNCTAD says, to separate deposit-taking institutions from investment banks.

Some authors advocate 'narrow banking', whereby financial institutions should be forced to choose between becoming a commercial bank or an investment bank. The former would be allowed to take deposits from the public and other commercial banks, and place their funds in loans that carry a longer maturity while keeping them in their balance sheets.

These banks would have access to a discount window at the central bank, lender-of-last-resort facilities and deposit insurance. However, their activities would also be subject to strict regulation and supervision. On the other hand, investment banks would be required to avoid maturity mismatches, and therefore would not be able to purchase illiquid assets financed by short-term lines of credit from commercial banks.

A recent proposal that would grant commercial banks more latitude is based, according to UNCTAD, on the concept of 'allowable activities', along lines that also establish a separation between commercial and investment banks.

Thus, deposit-taking institutions would be permitted to underwrite securities, and offer advice on mergers and acquisitions as well as on asset management. However, they would not be allowed to pursue broker-dealer activities, or undertake operations in derivatives and securities, either on their own account or on behalf of their customers.

Neither would they be allowed to lend to other financial institutions or sponsor hedge funds and private equity funds. Separating the two activities could be an additional way to reduce the size of institutions, and would therefore address the too-big-to-fail problem.

In this vein, the Governor of the Bank of England has proposed splitting banks into separate utility companies and risky ventures, based on the belief that it is 'a delusion' to think that tougher regulation alone would prevent future financial crises, says UNCTAD. ◆

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Asia needs to confront new global crisis

The renewed global economic slowdown is putting pressure on Asian countries to review their export-based growth model and their vulnerabilities to the inflows and outflows of capital.

Martin Khor

AMID more and more signs that the global economy is slowing, possibly towards a new recession, Asian countries facing the adverse effects will have to consider their policy responses.

On 6-8 September, finance ministry and central bank officials and economic experts from Asian countries gathered in Manila for a workshop on Asia and the global crisis. It was organised by the UN Economic and Social Commission for Asia and the Pacific and hosted by the Philippines Central Bank.

It was a timely meeting, especially since the near-term economic prospects in the United States, Europe and Japan have worsened so significantly in recent weeks.

In the 2008-2009 'great recession', the region was affected by a sharp drop in exports which caused a dip in the Gross Domestic Product (GDP).

But the economic stimulus policies in the advanced developed countries and many Asian countries (including Malaysia, China and India) led to a quick recovery.

The switch in policies from fiscal stimulus to austerity in the developed countries is a major reason for the recent slowdown, which is likely to last longer.

Asia is vulnerable to a new downturn, because of its high reliance on exports. A South Centre paper estimates that exports contribute about 50% of China's recent pre-crisis growth. China is already preparing for reduced export and GDP growth.

The shared wisdom is that China has to increase domestic consumer spending as its future growth engine. But that is easier said than done.

In recent years the share of consumption in China's GDP has gone down from 55% in the late 1990s to 36% in 2008. A main reason is that wage increases lagged behind productivity increases. As a result, the share of wages in GDP has fallen to about 40% at present from 50-55% in the 1990s.

China is now taking measures to raise workers' wages, which can then spur domestic demand. But there is also a fear that higher wage rates may make Chinese firms uncompetitive as they have low profit margins.

Many other Asian countries are even more export-dependent. In Indonesia, Korea, Taiwan and Thailand exports contributed over 60% to growth, compared to 40-50% in China. The export dependence of Malaysia, Singapore and Vietnam is even higher.

They are very vulnerable to a slowdown in exports to developed countries as well as to China. For every $100 worth of processed manufacturing exports of China to the US and EU, about $35-$40 go to East Asian developing countries. They export a lot of the components that China uses to make its exported products.

Thus a slowdown of Chinese exports to the US and EU will also have a strong impact on Asian countries.

In many South-East Asian countries, a major problem is the seeming lack of investment opportunities, since investment is lagging behind savings.

In Malaysia, Singapore, the Philippines, Taiwan and Indonesia, investment rates have been around 20% of GDP in recent years, less than half the rate in China.

Their investment rates have not recovered to the levels attained before the 1997 Asian crisis. They are too low to generate a rapid growth of effective demand.

These countries need to plan for new sources of growth based on higher domestic demand, as well as expanded trade among the countries in the region and in other developing regions.

A key lesson learnt by many Asian countries from the Asian crisis is that they should not be caught in the vulnerable situation of having their foreign reserves drawn down to the point of facing a debt default.

Thus high current account surpluses and significant accumulation of foreign reserves have cushioned many countries during the 2008-2009 global crisis.

However, the region also faces a number of financial vulnerabilities that the new global turmoil may make more evident.

First, some countries in the region have significant current account deficits and rely on inflows of foreign capital to meet the deficits. They could face balance-of-payments problems should exports deteriorate, or if there is a reversal of capital flows.

Second, many Asian countries have been liberalising their capital flows in the past decade. They opened up to foreign capital inflows, including direct investment, portfolio investment and loans. They also allowed capital outflows by resident individuals, banks and companies.

Thus they are now more susceptible to surges of both capital inflows and outflows of funds by local companies and individuals.

In periods where capital inflows

are large, they balance out or exceed resident outflows. However, when a country faces a reversal of foreign capital flows, it would be difficult to bring back the local capital that went abroad.

As a result, the country is exposed to the risks of significant net outflows. If this is not adequately matched by a surplus in the trade and current accounts, its balance-of-payments position could deteriorate.

Third, Asian countries are exposed to surges of international funds searching for higher yield. The recent wave of capital inflows has caused problems such as currency appreciation (resulting in exports being less competitive), excess liquidity, inflationary pressures, and bubbles in equity and housing prices.

The countries are also vulnerable to a sudden reversal of capital flows, which can have devastating effects. Some Asian countries like Thailand and Korea have used capital controls to reduce inflows, but the pressures continue.

Fourth, many Asian countries have made losses due to the fall in value of their foreign reserves, much of which are held in US treasuries and bonds, as a result of the dollar's depreciation. The present lack of alternative to the dollar as a global reserve currency makes this problem more acute.

While Asian countries can take national policy measures to control or reduce the vulnerabilities above, these may not be effective unless there is collective action at the global level.

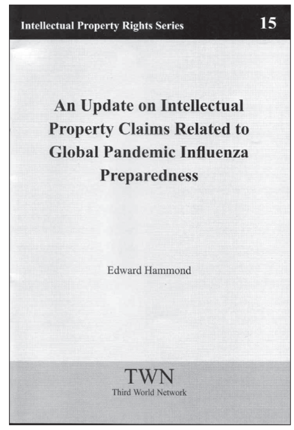
Thus, policy makers in the region should be more active in pushing for global financial reforms. This was one of the conclusions of the Manila meeting.

The new global slowdown has made it all the more urgent to rethink the national and regional growth models, and to have a strong regional voice in global economic policies and financial reforms. ◆

Martin Khor is Executive Director of the South Centre, an intergovernmental policy think-tank of developing countries, and former Director of the Third World Network.

An Update on Intellectual Property Claims Related to Global Pandemic Influenza Prepardness

By Edward Hammond



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Amid the continued threat of influenza pandemics, the field of pandemic influenza research is being subjected to increasing intellectual property coverage as new influenza strains appear and vaccine and diagnostic technologies change. Concern has arisen that this plethora of patent claims is impeding access to anti-influenza technologies and products, particularly vaccines, especially in the developing world.

Following up on a 2007 review by the author (published as Intellectual Property Rights Series No. 12), this paper provides an updated overview of trends in patenting activity related to pandemic influenza preparedness (PIP). Some specific patent applications are also briefly examined as representative examples of the patent claims currently being made in this area. In addition, the paper offers a critical perspective on a recent report by the World Intellectual Property Organization (WIPO) which similarly surveys PIP-related patenting activity.

In light of the patenting trends highlighted, this paper raises the need for equitable sharing of the benefits arising from pandemic influenza research, in order not to impair developing and other countries' responsive capacity in the event of a pandemic.

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Global disorder and the Indian economy

Given its heavy dependence on service exports, there is no way India can avoid the adverse impacts of an economic slowdown in the US and EU, says *Jayati Ghosh*. Besides, it faces the risk of high commodity prices if the US resorts to a loose monetary policy as a response.

THE world economy has clearly started on Act II of the possibly prolonged drama that began with the Great Recession of 2008-09. But if the Government of India is to be believed, the Indian economy is not likely to be very adversely affected by the current round of global financial volatility. Finance Ministry sources argue that the Indian economic growth story is so robust that the current uncertainty will cause no more than a minor blip in its confident trajectory.

Workers at a call centre in India. India can no longer rely on services exports to the US, like outsourcing services, as the means of generating economic growth.

But this is definitely an over-optimistic prediction, which makes one hope that the policy makers are actually more aware of the possible downsides, whatever their public pronouncements may be. One important downside is the likely diminished role of the US as a net importer. This is no longer a future possibility – it is already a process that is well under way and is likely to get even more accentuated in the near future. And it means that the rest of the world – including India – can no longer rely on exporting to the US as the means of generating growth in their own domestic economies.

It is true that the US current account deficit increased slightly in 2010 compared to 2009, and has been increasing slightly in the first half of 2011. Even so, in 2010 the deficit was 30% lower than it was in 2008, amounting to $2 trillion less.

More significant for countries like India, which have put so many eggs into the service exports basket, is the pattern of US imports of services. They fell quite sharply in 2009 compared to 2008, recovered in the following year but were still below the 2008 level. In the first six months of 2011, US service imports were only 5% higher than they were in the first six months of 2008, which implies a fall in real terms because of the depreciation of the US dollar in the intervening period.

All this occurred while the stimulus packages still included some amount of fiscal expansion in the US. Unfortunately, the political charade around the debt ceiling that just played out in Washington has almost completely ruled out the possibility of more government expenditure to combat the current fragility – instead, the current watchword is austerity and budget cuts. Quite apart from the implications for employment, welfare and inequality in the US, this is a further constraint on import expansion in the US economy. And the growing resentment among the people that is bound to be associated with these cuts will generate further protectionist pressures that will rebound on outsourcing and related tendencies.

Since fiscal measures are being ruled out by the politics, the only means left for the US to come out of this current stagnation is through monetary policy, though the effects of this are unlikely to be very positive. The real problem with the expansionary and low-interest monetary policy being followed by the US Federal Reserve in the wake of the crisis is that it has contained no measures to make sure that banks actually lend out in ways that improve economic activity, employment and the financial condition of the mass of consumers.

But still no such actions are planned. Instead, Federal Reserve Chairman Ben Bernanke has just announced that interest rates will remain at their very low levels (close to zero) for the next two years at least. This may be fun for banks, but is not likely to stimulate domestic output or demand in the US directly, especially because thus far the banks have shown little appetite for lending to small producers or distressed householders who are being forced to cut consumption. But this policy will surely contribute to a weakening of the US dollar, which indeed may be part of the intention.

And it will lead to yet another problem for emerging markets like India: the increased tendencies for inflow of mobile capital, in the form of carry trade to take advantage of interest rate differentials and because of perceptions of greater growth potential in these countries. In Brazil this is already seen as a major economic concern, as inflows of hot money push up the currency despite some attempts at capital controls. But policy makers in India are not necessarily as wise, and they may rather interpret the renewed inflows of footloose capital as a sign of the continued economic strength of India.

That would be a mistake, because

financial inflows in the current context will push up the exchange rate and further increase the trade deficit, which is already of significant proportions. It will further shift incentives in the economy away from tradable goods to non-tradable activities including real estate, construction, stock markets and debt-based personal consumption.

These are classic signs of a bubble economy. As long as the bubble is in progress, it feels like a boom, but all bubbles do burst eventually. In the Indian case the bursting is likely to be even more painful, because even in the boom the growth process is simply not generating enough productive employment. So a quick 'recovery' from the current volatility need not be something to celebrate in India if it is because of renewed capital inflows, with their attendant unfortunate consequences.

Meanwhile, in Europe (the other major market for Asian exports), political tensions continue to simmer over the extent to which economic and monetary integration necessarily require fiscal federalism and greater protection of the 'weaker' segments of the European Union by the stronger countries. At present, the countries with deficits (whether these deficits are public or private) are being forced into massive internal deflations based on swingeing fiscal cutbacks and falling real wages, but thus far these are not contributing to rapidly reducing deficits. Instead, some imbalances are getting worse simply because GDP continues to fall. Meanwhile the stronger surplus countries are also intent on domestic austerity and continue to look to external markets as the source of growth.

Obviously this is not a sustainable situation, and something must give fairly soon. But in any case this means that this region also cannot provide the impetus required if global output is to be on a genuine track of recovery, and indeed the pressure is more likely to be downward.

There are those who argue that the US and EU are no longer the significant sources of global demand anyway, and that the future growth for the world economy will come from the BRIC countries (Brazil, Russia, India and China). Jim O'Neill of Goldman Sachs, who coined the term 'Brics', has pointed out ('Panic measures will ruin the Bric recovery', *Financial Times,* 9 August 2011) that 'In the decade that finished in 2010, the Brics added around $8,000bn to global gross domestic product, equivalent to about 80% of that of the Group of Seven leading economies. The Brics will probably add around $12,000bn more over the next decade, double the US and the eurozone combined.' He believes that if domestic growth in these economies is not thwarted by inflationary pressures, the world economy can treat these economies as the engine of future growth.

But this misses the point that despite some moves towards greater stimulation of the domestic market especially in China, these economies are also dominantly export-driven. Manufacturing exports from China, oil exports from Russia, agricultural exports from Brazil and service exports from India are all crucial in driving domestic growth in these economies, even in the countries that are currently running trade deficits. Any slowdown or reduction in exports to the US and EU is bound to have some depressing effect on both output and employment in these and other neighbouring countries. If it also affects investor expectations, then this can turn into a cascading effect.

Commodity price hike

The other potentially dangerous effect of the fact that loose monetary policy in the United States has unleashed lots of cheap liquidity on global markets has to do with primary commodity prices. At this moment oil prices have fallen globally, but this may be just a temporary respite, and for other important commodities there is no clear decline. Gold prices are rising because of a flight to safety, but investing in other commodities may also keep increasing simply because investors do not know where else to go with their money, and because interest rates are so low that there is little to lose.

This means that further increases in global commodity prices are possible and even likely. The dramatic increase in global food prices has already created havoc and adversely affected consumption of the poor across the developing world. The pressure on food prices in India is already so intense that the country really cannot afford another trigger in the form of renewed global price increases. And this is compounded by other pressures on domestic prices, so much so that when the dust created by the anti-corruption agitation settles, it is likely to become evident that inflation in food and other basic goods is the single most important problem in the perception of most Indians.

Despite macho claims to the contrary, the Indian growth process is a potentially very fragile one. It has been heavily based on global integration, in terms of both new markets for goods and services and the effects of inflows of mobile finance capital that have enabled disproportionate expansion of some sectors, especially finance, real estate and construction.

The threats to this growth process are usually seen as internal, in the form of social and political unrest driven by the greatly increased asset and income inequalities and the growing gap between material aspirations and reality especially among the youth. But the extent to which even these social variables can be affected by signs of external vulnerability should not be underestimated.

Employment in exporting sectors in India has still not fully recovered from the falls during the global recession, though output barely dipped. And the large numbers of young people who have invested heavily in expensive private higher education in the hope of a better future are increasingly entering the labour market only to find that there are simply not enough jobs being created for them, especially in the formal sector. The pressure cooker in India is clearly simmering, and even small signs of external vulnerability and economic fragility can cause it to explode. ◆

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From crisis to crisis: The Philippines amid the global turmoil

The Philippines, anchored on an export-oriented and foreign investment-led model, was already hard hit by the 2007 crisis. Worse may come with the new global crisis that is brewing, says *Sonny Africa*.

Growing poverty is one of the consequences of decades of globalisation policies in the Philippines.

AFTER declaring late last year that recovery was under way, the International Monetary Fund (IMF) now says that the world has entered a 'dangerous new phase'. The inability of the Fund to maintain its earlier optimism underscores the deep problems of the global economy. Yet despite this, many governments of the Third World, such as in the Philippines, persist with long-discredited globalisation policies instead of the radical reforms that their economies and people so desperately need. This in turn points to the urgency of directly challenging the domination of big foreign powers and domestic elite interests for things to even just start changing for the better.

The Philippines is in the geographic middle of South-East Asia and has a population of 102 million people. It is the 12th largest country in the world by population – second only to Indonesia in South-East Asia – but only the 45th largest by gross domestic product (GDP) and 124th by GDP per capita (both in nominal terms).

Because of decades of globalisation policies, the country was actually already deep in crisis by the time the global financial and economic turmoil erupted in 2008. This turmoil appeared to have relatively less impact on the Philippine economy than its neighbours in the region with, for instance, low but still positive economic growth. The government and many mainstream economists distorted this as indicating 'resiliency' and 'solid economic foundations'. The reality, however, is that the impact of the turmoil was on top of what was already a very difficult situation to begin with.

The Philippines upon the crisis in 2008

Globalisation policies have been implemented since 1979 when the Philippines became the second country in the world, after Turkey, to enter into a structural adjustment programme (SAP) with the World Bank. Since the 1980s, tariffs have been reduced deeper and faster than in most countries in the region (with perhaps the exception only of Singapore). Regulations and restrictions on foreign investment were removed wholesale and 100% foreign ownership has been allowed in all but a few sectors since 1991. In short the country aggressively globalised throughout the 1980s and 1990s and quickly became among the most formally open economies in East Asia (i.e., in terms of policies if not outcomes). This of course did not lead to real development.

Certainly some economic results were played up by the government and the international financial institutions (IFIs): larger exports, rising foreign investment and rapid growth. The country had $8.2 billion in exports equivalent to 27.5% of GDP in 1990 which rose to average over $40 billion annually in the period 2000-2008 (some 46% of GDP). Foreign investment in turn rose from $3.3 billion (equivalent to 7.4% of GDP) in 1990 to $21.8 billion in 2008 (13.0% of GDP). Economic growth was also relatively rapid and the 7.1% clip in 2007 was hailed as the fastest in three decades.

But these are not the economic results that matter. In contrast, local manufacturing and agriculture were in decline. The manufacturing sector was shrinking throughout this globalisation period and the sector was reduced to as small as it was in the 1950s as a share of GDP and of total employment. Agriculture meanwhile fell to its smallest share of GDP and employment in the country's history. Domestic food production per capita is lower than in the early 1970s and import dependency has worsened across the range of basic commodities. The highest average increases in food prices have been in the case of rice and corn, which greatly contributes to the declining purchasing power especially of the country's poor.

The collapse of the country's two most important productive sectors explains why joblessness was high and rising even before 2008. The average unemployment rate of 11.1% in the decade before the crisis was already the worst period of sustained high unemployment in the country's history. Real wages, taking inflation into account, were lower in 2008 than at the start of the decade. All this had forced record numbers of Filipinos abroad for work to sustain their families; some 4,000 Filipinos were already leaving the country every day, leading to some nine million Filipinos overseas by the time the crisis erupted in 2008 – the largest number of whom were in the United States and other hard-hit centres of global capitalism.

Poverty was consequently already widespread and far more than the low 28 million official estimate before, which was less than a third of the population. The government arrived at this figure using an absurd official poverty line of just 41 pesos (PhP) per person per day – or the price of a 1.5-litre bottle of Coca-Cola – with which the government expects a Filipino to meet all of his or her basic needs for food, clothing, housing, utilities, education and health.

Using a more reasonable poverty line of PhP104, however, would count some 65 million Filipinos, or some seven out of 10 Filipinos, as poor. This aggregate figure does not even capture how the poorest 30 million people struggle with just PhP22 or PhP35 or PhP45 per day. Inequality is also virtually unchanged from decades ago – in 1988 and today, the poorest half of the population accounts for less than 20% of household income, while the richest 20% of families hold more than 50% of household income.

Impact of the crisis in 2008

The long period of globalisation policies defined the situation of Filipinos when the crisis hit in late 2008 as well as the main channels of its impact. The global turmoil worked its way through the economy in three main ways: weaker exports, slowing overseas worker remittances and volatile investments.

The Philippine export sector has grown in the last decades but is still relatively smaller than in its neighbouring countries, at just some 45-50% of GDP in recent years. Out of around 37 million jobs in the country only some 250,000 are in manufacturing for export, a sector which consists mainly of low-value-added electronics exports; electronics account for over two-thirds of exports but 85-90% of their value is estimated to be imported. Merchandise exports fell 22% in 2009 to $38.4 billion from $49.1 billion in 2008.

By the middle of 2009 the Department of Labour (DOLE) had noted 164,831 manufacturing workers in 717 establishments affected by the crisis – consisting of 63,216 'displaced' and 101,615 forced into 'flexible work arrangements'. These manufacturing workers accounted for some 85% of all workers affected by the crisis, with the remainder found in real estate (3.3%), mining (2.5%), trading (1.0%) and others.

Overseas worker remittances from some nine million Filipinos abroad totalled $18.8 billion in 2010 and are equivalent to some 10% of GDP. Monthly year-on-year growth in remittances was reaching peaks of 35-40% in the period 2005-2008 but this fell to just between 7-10% from 2009 to the present and at one point even slowed to just 0.1% growth (January 2009). Remittances from the US in particular actually fell by some 6.4% or $502 million in 2009, from $7.83 billion in 2008 to $7.32 billion in 2009; this only weakly recovered to $7.86 billion in 2010. It is also increasingly likely that the limits of the migration-and-development hype are being reached, with the share of remittances in GDP apparently reaching a plateau in the last five years, especially with so many other countries having been pushed onto the migration-and-development bandwagon.

Foreign direct investments are generally erratic on a year-on-year basis but, nonetheless, the decline after 2008 is evident. Total foreign equity investment was at $2.0 billion in 2007 – largely in manufacturing, utilities and mining – then fell to $1.2 billion (2008), $1.7 billion (2009) and $848 million (2010).

All of this was reflected in overall economic growth rates, with GDP growth falling from 7.1% in 2007 to 3.7% (2008) and 1.1% (2009). The impact of the crisis was also evident in a 2.2% quarter-on-quarter GDP contraction in the first quarter of 2009, which was the most drastic contraction since seasonally-adjusted quarterly growth rates were recorded. There has been a notable rebound to 7.3% annual GDP growth in 2010 but this has been largely attributed to temporary election-related spending and the unsustainable pseudo-recovery globally following massive stimulus programmes.

Overall unemployment also increased by 244,000 to 4.4 million in 2009 (from 4.2 million in 2008) and the number of underemployed by 357,000 to 11.1 million (from 10.7 million in 2008). Gross domestic fixed capital formation meanwhile fell from 14.9% of GDP in 2008 to 12.9% in 2009. The national government deficit also drastically worsened from being equivalent to 0.9% of GDP in 2008 (at PhP68.1 billion) to 3.9% of GDP in 2009 (PhP298.5 billion).

Signs of worse to come

The recent US credit rating downgrade is just the latest sign that the global crisis which erupted in 2008 has not been resolved and will continue for years to come. The Philippine government and its economic managers are unfortunately oblivious to this reality in their medium-term planning and budgeting for 2012, which undermines the country's prospects for development.

The historic credit rating downgrade of the US was dramatic, sending a shock through global financial markets, but still only symptomatic of a deeper problem. The world economy is still struggling to find sources of growth to replace the merely debt- and speculation-driven growth of the 1990s and early 2000s. The US downgrade is at the same time significant for highlighting the unravelling sovereign debt crisis which is the next financial flashpoint for the world economy.

A semblance of stability and recovery was manufactured in the last two years only because of massive fiscal and monetary stimulus especially by the big economic powers. The total value of this stimulus reaches $10.8 trillion if we count all new financial support measures including bailouts, public loans and guarantees, public assumption of private sector debt and other liabilities, and nationalisation of private capital – this is equivalent to almost a fifth of global GDP. The US's two rounds of 'quantitative easing', for instance, totalled $2.3 trillion.

The benefits, however, are clearly shortlived. The global economy is slowing again as of the third quarter of 2011, with world economic growth projected by the IMF in its September 2011 *World Economic Outlook* to be just 4.0% in 2011 compared to 5.1% last year.

The slowdown is also not just in the advanced capitalist economies but also in the supposed alternative growth centres – China's growth is projected to fall from 10.3% in 2010 to 9.5% in 2011, India's from 10.1% to 7.8%, and Brazil's from 7.5% to 3.8%; only Russia, which is less than one-fourth the size of China, is seen to grow slightly from 4.0% to 4.3%. These countries are still dependent on the major capitalist centres for a large part of their demand, exports and investments, aside from also having their own internal economic troubles.

Indeed, the shortlived benefits have created new fiscal and financial sector imbalances. Sovereign debt problems are particularly marked, with advanced capitalist countries facing huge burdens that are leading to greater austerity and further depression of growth. The IMF also estimates that US gross public debt is going to reach $15.2 trillion or 99.5% of GDP in 2011. Other important economies have even bigger projected debt burdens in 2011, including Japan (229.1% of GDP), Greece (152.3%), Italy (120.3%) and Ireland (114.1%). For others it is relatively smaller but still considerable: France (87.6%), the United Kingdom (83.0%), Germany (80.1%) and Spain (63.9%).

Growth remains not just imbalanced but weak around the world. Economic activity is slowing and the risks are, if anything, increasing, as the US downgrade, to take a particular instance, shows. The situation is still very fragile despite repeated claims in the last two years of the world having dealt with the crisis and now slowly, if unevenly, recovering.

The biggest dampener on growth is the persistently high global unemployment and persistently weak productive investment (i.e., non-financial). At the same time, the mounting sovereign debt troubles mean fiscal austerity which further dampens demand especially in the US, Europe and Japan. This also makes the political situation in these countries volatile. The clash in early August between the Republican and Democratic parties on the US debt ceiling is only just one example, and is less explosive than the upsurge of protests by citizens across Europe, the Middle East and North Africa.

The US credit downgrade is meaningful not yet for any immediate impact but for possibly marking the start of another severe economic slowdown or new stage of recession there. A worsening of the US economic situation will quickly impact on the Philippines in terms of weaker remittances, lower exports, and more problematic investments.

The problem with the US downgrade is not just in the immediate financial terms of an impact on interest rates, the foreign exchange rate, Philippine debt and the stock market. More importantly, it shows the depth of the long-term problems of the US and the other advanced capitalist powers. They are all facing slowing growth due to public debt troubles, austerity, high unemployment and the lack of productive domestic investment opportunities. Other economies such as the so-called BRICS (Brazil, Russia, India, China and South Africa) and even the Philippines have roughly the same problem and every country is looking for sustainable sources of growth.

All is not well for the world economy and this is the single most important economic feature in the current world situation. The Philippine government's Philippine Development Plan (PDP) 2011-2016 and national government budget for 2012 however seem oblivious to this and assume a world economic situation that is long past. They are anchored on an export-oriented and foreign-investment-led model that is no longer viable.

The Philippine government's development blueprint merely affirms and continues past policies of globalisation.

The PDP 2011-2016 is the government's development blueprint and cannot but strongly reflect the dominant economic and political forces in the country. And because these elite forces remain entrenched, the government's economic plan cannot but be recycled and anti-development. The plan merely affirms and continues past policies of globalisation by now familiar to all: trade and investment liberalisation, privatisation and deregulation. There are only two additional stresses: first, more extensive and deeper privatisation (through public-private partnerships, or PPPs), and, second, covering up failures of globalisation with multi-billion-peso anti-poverty gimmickry (especially conditional cash transfers, or CCTs).

Privatisation is intensified with even greater incentives for big business, especially foreign investors, through so-called regulatory risk guarantees. Its coverage is also greatly expanded into health, education and housing – reducing these vital social services into opportunities for profit and foreshadowing making them unaffordable and inaccessible to the country's poor and poorest. It does not seem that any area of the economy will be spared PPPs and the administration's list is long: power, telecommunications, information technology, highways, roads, railways, ports, airports, transport systems, irrigation, canals, dams, water supply, sewerage, markets, warehouses, slaughterhouses, government buildings, land reclamation, tourism and industrial estates.

The administration of President Benigno Aquino and its PDP is forced to acknowledge the unavoidable consequences of decades of globalisation: low and volatile growth, record joblessness, falling incomes and growing poverty. However, rather than deal with the roots of the problem, it instead seeks to merely cover up for these with a multi-billion-peso CCT programme that is expensive, debt-driven and unsustainable aside from being prone to abuse, patronage and corruption. There are also already reports of CCTs being used less for anti-poverty than counterinsurgency.

And more than just relief without reform, the CCT programme actually seeks to use the relief precisely to cover up for the lack of reform. Families may receive PhP9,000 to as much as PhP15,000 a year for a maximum of five years but the question remains: after five years will they have jobs, steady incomes, steady livelihoods and decent public education, health and housing?

The sooner the country's economic directions are focused on building the domestic economy, the better. Job creation and poverty reduction will not happen if the same failed globalisation policies of previous administrations are retained. There must instead be more democratic income, asset and wealth reform and greater assertions of economic sovereignty in the country's international trade and investment relations. ◆

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COVER

Brazil's 'Wall Street' problem

In the following piece written earlier this August, *Mark Weisbrot*, while focusing primarily on Brazil's bloated financial sector, also questioned the wisdom of cutting public expenditure 'in the face of the growing headwinds and risks in the global economy'. With a global crisis now more evident, the concerns raised assume greater significance.

BRAZIL's economy is slowing, but the government is increasing its primary surplus by cutting spending, which could slow the economy more. In June, industrial production fell by 1.6%, and economic activity fell for the first time since 2008. Although monthly figures are erratic and don't necessarily indicate any trend, the overall picture raises questions about whether government policy is appropriate in the face of the growing headwinds and risks in the global economy.

Brazil's financial sector is too big and too politically powerful. Picture shows the financial district in Sao Paulo.

Don't get me wrong: Brazil's economic policy and results since Lula da Silva was elected as president in 2002 have been a huge improvement over the Fernando Henrique Cardoso administration. Cardoso, who was the object of much love and affection in Washington for having implemented the neoliberal policies of the 'Washington consensus', presided over an economic failure. The economy grew a mere 3.5% per person during his eight years in office. Lula's record was vastly better, at 23.5% per capita growth; and with a 60% real increase in the minimum wage, and considerable reductions in unemployment and poverty, there really is no comparison. Current president Dilma Rousseff's term is likely to see even better results.

Financial sector influence

But Brazil has a structural problem that is similar to one of our biggest problems in the United States: The financial sector is too big and too politically powerful. Since this sector does not have much interest in growth and development – it is much more obsessed with its own profits and minimising inflation – its control over the Central Bank and macroeconomic policy keeps Brazil from achieving its potential. And the country's potential is huge: from 1960-1980 Brazil's economy grew by 123% per person. If Brazil had maintained this rate of growth, Brazilians would have European living standards today.

Inflation is currently falling in Brazil – it was 4% at an annualised rate over the last three months, as opposed to 7% for the past year. There is no reason – other than the narrow interests of Big Finance – to sacrifice any growth or employment to reduce inflation.

The financial sector is also the major villain behind Brazil's overvalued currency, which is hurting Brazil's industry and manufacturing. The Central Bank targets inflation by raising the value of the real, thus cheapening imports. And even when the government tries to bring the currency down to a more competitive level, the financial sector's trading in various derivatives prevents it from doing so.

For the years 2002-2011, Argentina has grown by 90%, Peru by 77% and Brazil by 43%. There is no reason that Brazil cannot have one of the fastest-growing economies in the region, or even the world.

In the last four years, Brazil's financial sector has grown by about 50%, three times faster than the industrial sector. Salaries for top managers are now higher than in the United States. This is not only a huge waste of resources, but much more destructive because of the sector's political influence. ◆

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NATO intervention in Libya: Acting beyond the UN mandate

What has transpired since March when the UN Security Council gave its go-ahead for the use of force to protect civilians in Libya should never have become an occasion for cheering despite the military and political outcome of the intervention. Instead, says *Richard Falk*, we should learn from the Libyan experience and reject it as a precedent.

UN Security Council members voting on Resolution 1973 which gave the go-ahead for the intervention in Libya. The resolution contained such ambiguous and vague language as to raise a red flag over the scope of the proposed authorisation.

IN Western circles of influential opinion, the outcome of the NATO intervention in Libya has already been pronounced 'a victory' from several points of view: as a military success that achieved its main goals set at acceptable costs, as a moral success that averted a humanitarian catastrophe, and as political success the creation of an opportunity for freedom and constitutionalism on behalf of a long-oppressed people. This is one of those rare results in an international conflict situation that seem to please both conservatives and liberals. Conservatives because it was a show of force that reaffirmed Western primacy based on military power. Liberals because force was used with UN backing in accordance with international law and in furtherance of human rights and liberal values.

Qaddafi and his loyalists are apparently a spent force, and the future of Libya now becomes a work in progress without any clear understanding of who will call the shots from now on. Will it be the Libyan victors in the war now battling among themselves for the control of the country? Will it be their NATO minders hiding behind the scenes? Will it be the NATO representatives doing the bidding of the oil companies and the various corporate and financial interests that make no secret of seeking a robust profit-making stake in Libya's future? Or will it be some combination of these influences, more or less harmoniously collaborating? And most relevant of all, will this process be seen as having the claimed liberating impact on the lives and destinies of the Libyan people? It is far too early to pronounce on such momentous issues, although sitting on the sidelines one can only hope and pray for the best for a country substantially destroyed by external forces. Even before the dust of the original conflict settles, it is not too soon to raise some sceptical questions about the unconditional enthusiasm in mainstream Western circles for what has been done and what it portends for the future of UN peacekeeping.

What has transpired since March when the UN Security Council gave its go-ahead for the use of force to protect civilians in Libya should never have become an occasion for cheering despite the military and political outcome of the intervention. This unfortunate triumphal spirit was clearly voiced by the normally critically sensitive Roger Cohen. Writing in the *New York Times,* Cohen insists that the Libyan intervention should be viewed as a historically momentous discharge of the global moral responsibility that somehow rests on the shoulders of post-colonial proactive leaders in the West: '...the idea that the West must at times be prepared to fight for its values against barbarism is the best hope for a 21st century less cruel than the 20th.'

This rather extraordinary claim cannot be tested by reference to Libya alone, although even narrowly conceived the grounds for such confidence in Western uses of force in the global south seem stunningly ahistorical. But if the net is enlarged, as it must be, to encompass the spectrum of recent interventions under Western auspices that include Vietnam, Iraq, and Afghanistan, the selfabsorbed gaze of Cohen seems like a dangerously misguided form of advocacy relating to the use of force in international relations. Looking at this broader experience of Western intervention makes one squirm uncomfortably in reaction to the grandiose claim that the willingness of leading Western countries to police the world is humanity's 'best hope' for the future. Cohen is not timid about insisting that the Libya operation up to this point provides a positive model for the future: 'The intervention has been done right – with the legality of strong backing, full support of America's European allies, and quiet arming of the rebels.' A contrast is drawn with Iraq, presumably an intervention 'done wrong.'

There is a heavy dose of implicit paternalism, condescension, and passé consciousness, not to mention wishful thinking, present if the West is to be identified as the best hope for the future just because it managed to pull off this Libyan intervention, that is, even assuming that the post-Qaddafi experience in the country is not too disillusioning in this one set of circumstances. What about putting the failed interventions into the balance, and then deciding whether it is helpful or not to encourage the West, which means mainly the United States, to take on this protective role for the rest of the world? I seem to remember not that long ago such self-empowering phrases as 'white man's burden' and 'civilising mission' being used by colonial apologists with a straight face. The West has quite a record of barbarism of its own, both within its geographic confines and in its encounters with others. It seems arbitrary and contentious to situate barbarism geographically, and it certainly seems strange to think that the long exploited and abused non-West generates a new breed of barbarians at the gate.

Anti-Qaddafi forces flashing the victory sign. It is premature to conclude that what happened in Libya has been a success before acquiring a better sense of whether the winners can avoid a new cycle of strife and bloodshed.

And let us not be too quick to heap praise on this Libyan model. It is certainly premature to conclude that it has been a success before acquiring a better sense of whether the winners can avoid a new cycle of strife and bloodshed, and stick together in a Libya without the benefit of Qaddafi as the common enemy. Or if they do, can they embark upon a development path that benefits the Libyan people and not primarily the oil companies and foreign construction firms? Any credible assessment of the Libyan intervention must at least wait and see if the new leaders are able to avoid the authoritarian temptation to secure their power and privilege within the inflamed political atmosphere of the country. The majority of the Libyan people undoubtedly have strong expectations that their human rights will now be upheld and that an equitable economic order will soon be established that benefits the population as a whole, and not the tiny elite that sits on the top of the national pyramid. These are expectations that have yet to be satisfied anywhere in the region. The challenge is immense, and perhaps is beyond even the imagination and aspirations of the new leaders, posing a challenge that exceeds their capabilities and will.

International law concerns

Yet such worries are not just about the uncertain future of Libya. Even if, against the odds, Libya turns out to be the success story already proclaimed, there are still many reasons to be concerned about the Libyan intervention serving as a precedent for the future. These concerns relating to international law, to the proper role for the UN, and to the shaping of a just world order have been largely ignored in the public discussion of the Libyan intervention. In effect, once NATO helped the rebels enough to get rid of the Qaddafi regime, it has been treated as irrelevant to complain about aspects of the undertaking and such issues have been completely ignored by the media. In the rest of this article I will try to explain why the Libyan intervention is far from providing future diplomats with an ideal model. I believe we should learn from the Libyan experience, and reject it as a precedent.

As the World Court made clear in the Nicaragua decision of 1986, modern international law does not allow states to have recourse to force except when acting in self-defence against a substantial prior armed attack across its borders, and then only until the Security Council acts. The United Nations, normally the Security Council, but residually the General Assembly, has the authority to mandate the use of force under Chapter VII of the UN Charter on behalf of peace and security, including on the basis of UN evolving practice, for humanitarian ends under extreme circumstances of the sort that arguably existed in Libya during the latter stages of Qaddafi's rule. This humanitarian extension of UN authority has been challenged as opening a loophole of indefinite dimensions that can be used to carry out a post-colonial imperialist agenda. Even granting that humanitarian ends should now be understood to have been legally incorporated into prevailing ideas of 'international peace and security', a crucial further question exists as to whether the force used by NATO remained within the confines of what was authorised by the Security Council.

The Security Council debate on authorisation indicated some deep concerns on the part of important members at the time, including China, Russia, Brazil, India, and Germany, that formed the background of Security Council Resolution 1973, which in March 2011 set forth the guidelines for the intervention.This extensive resolution articulated the mission being authorised as that of protecting threatened Libyan civilians against violent atrocities that were allegedly being massively threatened by the Qaddafi government, with special reference at the time to an alleged imminent massacre of civilians trapped in the then besieged city of Benghazi. The debate emphasised the application of the norm of Responsibility to Protect (R2P) endorsed by the Security Council a few years ago that sought to allay fears about interventions by the West in the non-West by refraining from relying on the distrusted language of 'humanitarian intervention' and substituting a blander way of describing the undertaking as less of a challenge directed at the territorial supremacy of sovereign states and more in the nature of a protective undertaking reflecting human solidarity. The R2P norm relies on a rationale of protecting vulnerable peoples from rulers that violated basic human rights in a severe and systematic fashion.

But once under way, the NATO operation unilaterally expanded and *qualitatively* shifted the mission as authorised, and almost immediately acted to help the rebels win the war and to make non-negotiable the dismantling of the Qaddafi regime. NATO made these moves without even attempting to explain that it was somehow still acting primarily to protect Libyan civilians. This was not just another instance of 'mission creep' as had occurred previously in UN peacekeeping operations (for instance, the Gulf War of 1991), but rather mission creep on steroids!

Libyans inspect the rubble of a house in Tripoli said to have been destroyed by NATO airstrikes. Almost immediately once NATO launched its Libyan operations, it was clear that an entirely new and controversial mission was under way than what was acknowledged in the debate preceding the Security Council authorisation.

Dilemma

It would have been possible during the Security Council debate to explain in a forthright manner what obviously must have been the real intentions all along of NATO. It would have been possible and respectful of the integrity of UN discourse to have made the attempt to convince the members of the Security Council that the only way the Libyan people could be protected was to help the rebels win the civil war and to be sure that Qaddafi was taken out of the picture. Presumably such forthrightness was avoided by the pro-interventionist states because it would almost certainly have turned several of the already reluctant abstaining five countries into negative votes, including, in all likelihood, those of China and Russia that are permanent members whose votes have a veto effect, which in this case would have prevented the Security Council from reaching a decision. So the pro-interventionists admittedly faced a genuine dilemma: either dissemble as to the ends being pursued and obtain the legitimacy of limited advance authorisation from the UN, or reveal the real goals of the operation and be blocked by a veto from acting under UN auspices. If so blocked, then the further issue arises as to whether to intervene in the absence of a UN mandate.

A similar dilemma faced the intervening governments prior to NATO's 1999 Kosovo War. It was resolved by ignoring the legalities altogether, with NATO acting without any Security Council authorisation. It was also a controversial precedent, and some blamed the Kosovo reliance on 'a coalition of the willing' or on a military alliance as providing a sufficient authorisation, for the later claim of de facto authority to carry out the Iraq invasion without gaining prior UN approval. In both Kosovo and Iraq circumventing the UN's legally prescribed role of deciding when to authorise non-defensive force on behalf of international peace and security was criticised, but the unlawfulness of the action led to no clear repudiation of either intervention after the fact, and rather highlighted the weakness of the UN. In both cases the UN after the fact acted to ratify the results of uses of force that clearly violated the UN Charter's unconditional prohibition imposed on all uses of non-defensive force by member states. The rogue recourse to force was especially disturbing in Iraq as the attack legally amounted to a war of aggression, a crime against the peace in the language of the Nuremberg Judgment rendered in 1945 against surviving Nazi leaders after World War II.

Responsibility

With regard to Libya, the culprits are not just the states that participated in this runaway operation; the members of the Security Council that abstained from supporting Resolution 1973 and the Secretary-General of the United Nations have a special duty to make sure that the limits of authorisation were being respected throughout the undertaking. It would seem to be a matter of constitutional responsibility for all members of the Security Council to ensure respect for the UN Charter's core effort to prevent wars and seek peaceful resolution of conflicts. When exceptions are made to this generalised Charter prohibition on the use or threat of force they should always be strictly formulated, and then continuously monitored and interpreted, and if limits are exceeded, then the supervisory authority and responsibility of the Security Council should kick in as a matter of course, and in a spirit of upholding the autonomy and legitimacy of the United Nations. The Secretary-General also has secondary responsibility to take appropriate steps to call the attention of the membership to such blatant departures from an authorising resolution as an essential aspect of his role as custodian of the integrity of UN procedures and as the UN's de facto ombudsman in relation to ensuring fidelity to the Charter.

This allocation of responsibility seems more important when it is realised that the actions of the Security Council are not subject to judicial review. This controversial doctrine of judicial self-restraint within the UN system was ironically decided by the World Court in the 1992 Lockerbie case involving sanctions imposed on Libya in apparent violation of relevant treaty law. The majority of the judges concluded that whatever the Security Council decided needed to be treated as authoritative even if it went against international law, that the Security Council always had the last word in shaping UN policy even when it was acting unwisely or irresponsibly.

Against this background, the abstaining states were also derelict at the outset by allowing a resolution of the Security Council involving the use of force to go forward when it contained such ambiguous and vague language as to raise a red flag as to the scope of the proposed authorisation. Although Security Council Resolution 1973 did seem reasonably to anticipate mainly the establishment of a No Fly Zone and ancillary steps to make sure it would be effective, the proposed language of the resolution should have signalled the possibility that action beyond what was being mandated was contemplated by the NATO countries and would likely be undertaken. The notorious phrase 'all necessary measures' was present in the resolution, which was justified at the time as providing the enforcers with a desirable margin of flexibility in making sure that the No Fly Zone would render the needed protection to Libyan civilians. Almost immediately once NATO launched its operations, it became obvious that an entirely new and controversial mission was under way than what was acknowledged during the debate that preceded the adoption of 1973.

The US Supreme Court has often invalidated Congressional action as 'void for vagueness', and this is something in the UN setting that Security Council members should have been prepared to do on their own in their role as final guardians of constitutional integrity in relation to war-making under UN auspices. Given the Charter emphasis on war prevention and peaceful settlement of disputes, it should be standard practice that exceptional mandates to use force would be interpreted strictly to limit the departure from Charter goals and norms, but the UN record even before Libya has been disappointing, with geopolitics giving states a virtually unlimited discretion that international law purports to withhold.

There is a further related issue internal to best practices within the United Nations itself. The Security Council acts in the area of peace and security on behalf of the entire international community and with representational authority for the whole membership of the Organisation. The 177 countries not members of the Security Council should have confidence that this body will respect Charter guidelines and that there will be a close correspondence between what was authorised and what was done, especially when force is authorised and sovereign rights are encroached upon. This correspondence was not present in the Libyan intervention, and this abuse of authority seems to have been barely noticed in any official way, although acknowledged and even lamented in the corridors and delegates lounge of UN headquarters in New York.

This interpretative issue is not just a playground for international law specialists interested in jousting about technical matters of little real-world relevance. Here the life and death of the peoples inhabiting the planet are directly at stake, as well as their political independence, the territorial integrity, and economic autonomy of their country. If the governments will not act to uphold agreed and fundamental limits on state violence, especially directed at vulnerable countries and peoples, then as citizens of the world, 'we the peoples of the United Nations', as proclaimed by the Preamble to the Charter, need to raise our voices. We have the residual responsibility to act on behalf of international law and morality when the UN falters or when states act beyond the law. Of course, this imperative does not imply a whitewash for tyrannical rule. ◆

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Rwandan genocide survivors still waiting for reparation

The survivors of one of the worst genocides in modern history are fast losing hope that they will ever be compensated.

Juergen Schurr

ALMOST two decades after the genocide in Rwanda, in which up to 1 million people died, hundreds of thousands of survivors are still waiting for reparation.

At a conference organised in Kigali in August by three organisations that work with genocide survivors – REDRESS, African Rights and IBUKA – survivors stressed once again that they considered that justice without reparation is not justice.

Failed attempts

Attempts to provide reparations for survivors have largely failed so far. Before 2001, Rwandan courts awarded millions of dollars in compensation to thousands of survivors who had brought civil claims against individual perpetrators and the Rwandan government, which were heard at the same time as domestic genocide prosecutions. As of today, none of these judgments have been enforced and survivors have yet to receive reparation.

Similarly, awards made by local gacaca courts to compensate survivors for material damages were only enforced in a few cases, as perpetrators were indigent, refused to pay or bribed those in charge of the execution of judgments to avoid payment.

After recognising that compensation awards could not depend only on the perpetrator's ability to pay, in 2001 the Rwandan government drafted a bill on compensation that sought to establish a compensation fund. However, this bill was never adopted and no compensation fund was ever created, though a humanitarian fund to support needy survivors has been in operation for some time.

At the international level, the International Criminal Tribunal for Rwanda (ICTR), established by the UN Security Council in November 1994 to try the masterminds of the genocide, doesn't allow survivors to claim compensation. Their role before the Tribunal is limited to that of witnesses.

In 2000, the then president of the ICTR, Judge Pillay, urged the Security Council to consider establishing a specialised agency to assist survivors to receive compensation. According to her, compensation for victims was essential if Rwanda was to recover from the genocidal experience. However, this was never put in place.

Right to reparation

The right to reparation for survivors of the most serious crimes is well established in international human rights and humanitarian law. Even though it is impossible to fully compensate for crimes such as genocide, compensation is important for survivors as it can serve as an acknowledgment of the crimes that were committed and allow survivors to move on with their lives in dignity.

In their response to the genocide, the Rwandan government and the international community have prioritised until now the large task of bringing genocide suspects to justice. As part of their efforts, 1.5 million perpetrators have been convicted in Rwanda so far, according to the Rwandan government, and a further 38 by the ICTR in Arusha. Less vigour has been applied to finding avenues for reparation.

The Rwandan government has stated that it simply lacks the means to afford reparation. It has also emphasised that it already contributes 6% of its budget to the national FARG fund. The Fonds National pour L'Assistance aux Rescapés du Génocide provides critical education, health and housing assistance to those survivors most in need, yet the vast majority of survivors do not qualify for the funds.

Survivors participating in the conference in Kigali said that they believed the government of Rwanda should be responsible for establishing a compensation fund. They also thought that resources of the fund could come from the state budget as well as contributions from third countries, the international community, and assets of convicted perpetrators.

Survivors also expressed their fear that with the closure of the gacaca courts this December their right to reparation will be ignored forever. Then, genocide cases will be prosecuted before ordinary courts, and it is still unclear what impact this will have on survivors' right to claim for compensation.

The fact that the government is drafting legislation to establish a mechanism that will handle issues that have not been addressed by the gacaca courts offers an opportunity to include at last a clear provision for compensation. These efforts should be encouraged as without adequate reparation, accountability efforts run the risk of being meaningless to survivors. ◆

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'Until the day I die': A Haitian peasant woman leader speaks

Gerta Louisama, a member of the Executive Committee and National Women's Committee of Tèt Kole Ti Peyizan Ayisyen (Heads Together Small Producers of Haiti) – the country's largest and oldest peasant group – is head of its local women's committee in her village of Savanette. Here, she speaks to *Beverly Bell* about the struggle of her organisation for economic and social rights for rural Haitians, especially women.

I AM a peasant woman and the daughter of two peasants. I've been a victim of this society which ostracises women.

My father was a member of Tèt Kole and I chose to follow him and join the organisation. I've gotten all my knowledge through Tèt Kole. I'm illiterate, but thanks to the organisation, after women helped me for three months, I could even spell my name and write a little. Even though I'm getting older, I'll keep going to school.

Beverly Bell

Gerta Louisama.

Tèt Kole started on 6 September 1986 and the Jean-Rabel massacre was on 23 July 1987. We lost 139 peasants [when the two largest landowner families in the region hired hitmen to stop Tèt Kole's work for land reform]. Then we had a second massacre in Piatte in 1990. The big landowners, the army, and the local police are responsible for those bloodbaths. It was asking for these necessities that got the peasants slaughtered. They were well-planned massacres to subdue us.

It's like the peasants have no rights because they don't have access to clean water, no access to roads, no access to health care, no access to free schooling. And if we protest for those rights we're entitled to, they will send in the police or MINUSTAH [UN peacekeeping troops] and they'll spray tear gas, arrest people and beat them up. You don't even have the right to protest for your rights.

Legally speaking, both men and women have the same rights. In this country, we have plenty of laws. They're on paper, they've just been set aside. Part of our movement is to get these laws respected.

Challenges

Us Haitian women, we have a lot of challenges, but as peasant women we have even more. We truly carry the burden of society. We're the ones who hustle to feed the household and send the sick to the hospital if need be. We women, we work the land, we raise cattle, we transport merchandise like plantains, yams, and black beans to the capital. If we don't work, there won't be any flow of goods.

One of the priorities of the women in Tèt Kole is to get things working in our favour. We have to address economic problems and social problems. We need ways to process the foods we produce, we need access to seeds. We need to help women who've been victims of domestic violence get support in the courts.

What the women do in Tèt Kole is to group ourselves together in teams of 10 to 15 women. We work in the fields together, we do laundry together. We do personal development training. The chances for peasant women to go to school are small because they don't have the financial means, so the trainings are designed to remind them that they're also human and part of the society, even though society has marginalised them. They help peasant women understand their strength in society and understand that as for those services they're entitled to, the government's not doing them favours, they're their rights.

We're asking the government to do a thorough agrarian reform. Most times, the peasants don't own the land they are working on. The peasants should have ownership of the land they're working. Land needs to be taken away from people who aren't using it, and the state needs to let go of land it holds on to that could be used for farming and be given to the peasants who are working it, with the other [agricultural] resources they need to farm.

Actually, the women have been tirelessly working the small plots of land they've been able to get their hands on, so we should be the ones to own them. We peasant women think the government has to have in its agricultural plan a way to help us hold onto our land in the mountains so we can produce food, and help us get seeds and tools. We don't have tools to work with, we don't have seeds, we don't have technical support.

The problem is even worse for women because both the family and the society keep us from owning land or other big assets. We're not entitled.

If the land isn't in the hands of the government or the church, it's mostly for the sons.

Say my father dies. If he owned three hectares of land and he had two sons and me as a daughter, he'll never say that I can have one hectare and each son receives one hectare. Me, I'll only be entitled to 1/4 hectare or at most 1/2 hectare, and the extra will be divided among my brothers.

Haitian peasant women 'truly carry the burden of society'.

And if I was living in common-law with a man, if he died, I'd need to race to get myself off the land, even if I didn't have anywhere else to sleep. I wouldn't have any right to stay on the premises.

Another priority for the Women's Committee is all the people who don't have birth certificates. The state has no respect for the peasants. People may have a piece of paper but it might not be valid, because the number on it might be the same as on 15 or 20 other certificates; only one person has the actual birth certificate and all the others are just photocopies. This comes out when the children of the peasant women have to go study or take care of something [legal]. Also, they used one birth certificate for people from urban areas and one for those from the countryside [this has since been changed]. I'm 42, and to this day, I don't even know if my birth certificate is valid. Maybe if I go to get a passport one day, I'll find out.

The lack of respect for peasants is also why today cholera is spreading throughout the country. There was no plan from early on, and that's why it's killed so many in all the departments [states], especially the poorest who can't get medical care for themselves. In remote areas, people might need to carry the person with cholera four to five hours on a stretcher to make it to the hospital. [Cholera can kill within four to six hours after infection.] Where I'm from there's a joke: since [the village of] Savanette has no roads, cholera can't travel there. Actually, if it were to hit Savanette, no one would survive.

They talked about sending Clorox, but we haven't gotten any. They've told peasants to use soaps to wash their hands but some of them don't have the money to buy soap, which costs 12 gourdes [33 cents]. Cholera is an even bigger burden on peasant women because they're the ones who have borne their children and who are responsible for the household.

If there were to be cases of cholera in Savanette, we as an organisation would have to get involved. We'd have to go to the local radio stations and tell people to do preventive medicine.

'We are responsible for changing the conditions of our country so we'll continue to fight.'

Where we are, we only see outsiders when there are elections and the public officials need votes. Once the officials have been elected, you won't see the senators again. Let's not even talk about the president.

The fight to change the conditions of women living in the country is coming from men as well as women of Tèt Kole. This isn't a movement of women against men, but really against the society which has isolated women. Women and men have to join together to fight. Generally as peasants, whether men or women, young or old, we're all fighting for our rights, and men have to have that same mindset of aligning themselves with the women in this struggle.

You find there are men who really misunderstand women. They assume that the women are increasing their strength against men. But in Tèt Kole, we've made lots of efforts to show that our work is to change the conditions of all peasants. We're showing that this isn't a movement of women against men but rather a movement against the society which has isolated women.

Based on how things are going, we can almost say we're losing the battle fast. We are slowly but surely going backwards. But as long as we are breathing, we can't get discouraged. We are responsible for changing the conditions of our country so we'll continue to fight.

But so far, we haven't seen any real positive outcome. That's why we say we'll continue to fight, even though we won't see the changes; our kids will see them.

I have one daughter and I have given all my energy to the organisation. I have given back what the organisation has done for me as a peasant woman who struggles against a society that excludes us. If it wasn't for Tèt Kole, I wouldn't have any value in this society. I never have thoughts of life after I leave Tèt Kole, because I see myself being involved until the day I die. ◆

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A surprise victory for the Phnom Penh lakeside protests

After four years of courageous protest, residents living around Boeung Kak Lake in Phnom Penh have won their struggle against an illegal, but officially sanctioned, land grab. But this victory against unlawful eviction by rapacious developers was not sufficient to save one of the Cambodian capital's most picturesque lakes.

Tom Fawthrop

IN an extraordinary turnaround, about 3,000 Cambodians threatened with mass eviction from land skirting Phnom Penh's once-beautiful Boeung Kak Lake scored a landmark victory in August.

Shortly after the World Bank had taken the unusual action of freezing all future loans to Cambodia over this issue, Prime Minister Hun Sen, who heartily dislikes conditions attached to aid or loans, surprisingly issued a sub-decree on 17 August awarding 12.44 hectares to lakeside residents.

People living in the Boeung Kak Lake area demonstrating outside the Phnom Penh Municipality building against plans to evict them to make way for an upmarket residential and retail project. Their protests led to a turnaround by the Cambodian authorities.

The many months of rolling protests and complaints filed by non-governmental organisations (NGOs) against the World Bank's original collusion with the authorities over mass evictions had brought about two dramatic policy reversals: 1) the Bank was forced to change course by 180 degrees; and 2) an equally dramatic change by the Cambodian authorities.

David Pred, Cambodian director of the NGO Bridges Across Borders, hailed this sudden change of government policy as 'a human rights victory that has stopped a massive forced eviction and a land grab.'

In March this year thousands of residents received eviction notices. Investors backed by the governor of Phnom Penh were determined to clear the way for a controversial new 'City of the East' designed to replace a park and urban poor area with a posh residential and leisure complex.

Land prices in central locations in the Cambodian capital have soared on the back of a business and speculative boom. Local tycoons have worked with the government to clear areas occupied by the urban poor, leading to a wave of mass evictions.

The Housing Rights Coalition of NGOs has repeatedly appealed to the municipal government to examine the land claims of these urban poor communities and negotiate, instead of treating them as de facto 'squatters'. However, all appeals for justice had fallen on deaf ears, until this victory for residents around Boeung Kak Lake.

This pattern of arbitrary eviction with only paltry offers of compensation was succinctly summed up by Pred: 'Phnom Penh is rapidly being transformed into an exclusive city for the rich, devoid of public spaces, while the poor are deported to the periphery of the capital, where there are no jobs and no amenities.'

The demise of Boeung Kak Lake

Boeung Kak Lake, once a major attraction in the heart of Phnom Penh, is dying a lingering death as it is gradually filled with sand paving the way for an upmarket residential and shopping complex.

Back in the 1980s, Phnom Penh residents flocked to the lake as the biggest green space in the capital to enjoy picnics, live open-air music and theatre performances. But that is now no more than a nostalgic memory for the besieged residents.

In March around 10,000 people were served with eviction notices to make way for China's Erdos Hongjun Investment Corp to build the so-called 'City of the East'. There has so far been no public disclosure of the plans. This obscure Chinese company can neither be found in business directories nor discovered via a Google search.

Local authorities granted 133 hectares (330 acres) of the Boeung Kak site on a 99-year lease to a ruling party senator, Lao Meng Khin, director of Erdos Hongjun's joint venture partner, Shukaku. He is closely linked to the prime minister's right-hand man Sok An, the minister in charge of the

Residents standing by as an excavator works at a village near Boeung Kak Lake. Thousands of lakeside residents had received eviction notices in March.

cabinet and foreign investment.

Lao Meng Khin made a killing acquiring the 133 hectares for a mere $79m – about 4% of its estimated true market value.

Shukaku is strongly linked to Pheaphimex, a company well known for its huge land concessions.

As it is illegal to lease out public land, the nature of the land surrounding the lake was re-classified by a dubious sub-decree without any reference to parliament. Hence an important protected park zone was made available to dubious investors and speculators without any public debate or accountability.

Mok Mareth, the environment minister, initially raised concerns that filling in the lake would do serious damage to Phnom Penh's drainage system. An Australian study has also shown the lake has played a crucial role in reducing flooding of the inner city during the rainy season.

The city authorities offered the lakeside residents only meagre compensation, much less than the true market value of the land, with resettlement far out of the capital with few amenities and bleak prospects for employment.

The angry residents defied the eviction notices and refused to leave. Angry protestors took to the streets and demonstrated outside the City Hall.

One of them, Mrs Pol Nay, can well remember how Hun Sen had promised in an election speech over 20 years ago that the people would be recognised as the legal owners after five years (of occupancy). This principle was later enshrined in the 2001 Land Law.

However, Hun Sen and other Cambodian People's Party leaders readily ditched their pledges and promises to the urban poor when the land values around the centre of Phnom Penh soared, and the authorities excluded the lakeside residents from the rights bestowed by the new land law.

World Bank collusion

The stench from uncollected rubbish, rubble of destroyed tenements and lack of proper sewerage around the lake today, is matched by the foul smell of dubious deals and a land-grabbing scandal.

What made matters far worse for the people protesting the land grab was the complicity of the World Bank's Cambodia Land Management and Administration Project (LMAP), which had colluded with the Cambodian authorities in the arbitrary exclusion of the Boeung Kak Lake residents from the Bank's programme of mapping land claims, rights and titles.

One of the many terrible legacies of Khmer Rouge rule in the 1970s is based around the regime's abolition of money and private property. Nearly all documents about land claims and titles have been either lost or destroyed since 1979.

After liberation from the genocidal Pol Pot regime, there was a restoration of family life and the basic norms of society. Many lakeside residents had settled around the lake way back in the early 1980s.

The 2001 Land Law in theory allowed them to apply for a land title for the first time, and it appeared the World Bank's programme in partnership with the government would assist them. However, the authorities arbitrarily declared various urban poor sites in the centre of the city off-limits in 2007, and the Bank accepted without protest this erosion of the programme's integrity.

Housing rights groups were furious about the Bank's complicity. David Pred from Bridges Across Borders and other NGOs filed complaints to the Bank headquarters, prompting an internal audit and investigation. The report on the investigation, released in March, concluded that 'poor management and a lack of monitoring by the World Bank had left thousands of Cambodians at Boeung Kak Lake vulnerable to forced eviction.'

This stinging criticism prompted the Cambodia office of the Bank to move into reverse gear and apply pressure on the government to stop further evictions and provide for on-site land rights, as the condition for future loans. A lack of response from the government led to a very unusual policy move by the Bank – in July it froze all future loans to Cambodia.

It appears that the 17 August sub-decree by the government to finally recognise the land claims of around 3,000 lakeside residents is the successful outcome of four years of courageous protest combined with NGO pressure which forced the eleventh-hour change of World Bank policy.

The victory was hailed by Pred as 'an incredible testament to what an organised, empowered community can achieve against the forces of unbridled greed and power.'

Sadly the protests were not able to save the lake itself, but at least 3,000 residents will no longer be forcibly dumped on the outskirts of the city with little or no compensation.

NGOs argue that this outcome flies in the face of the conventional wisdom among Cambodia's international donors, who are ever reluctant to hold the government and themselves accountable when flawed development projects end up harming people and violating their rights. ◆

Tom Fawthrop is a journalist and filmmaker who has been based in South-East Asia for 30 years. His latest documentary is Where Have All the Fish Gone?: Killing the Mekong Dam by Dam *(Eureka Films).*

The poet laureate of South Africa, *Mazisi Kunene* (1930-2006) was particularly well known for his work on Zulu tradition and literature. An early opponent of apartheid forced into exile, he returned home in 1992 after the end of white rule.

Was I wrong?

Mazisi Kunene

Was I wrong when I thought
All shall be avenged?
Was I wrong when I thought
The rope of iron holding the neck of young bulls
Shall be avenged?
Was I wrong
When I thought the orphans of sulphur
Shall rise from the ocean?
Was I depraved when I thought there need not be love,
There need not be forgiveness, there need not be progress,
There need not be goodness on the earth,
There need not be towns of skeletons,
Sending messages of elephants to the moon?
Was I wrong to laugh asphyxiated ecstasy
When the sea rose like quicklime
When the ashes on ashes were blown by the wind
When the infant sword was left alone on the hill top?
Was I wrong to erect monuments of blood?
Was I wrong to avenge the pillage of Caesar?
Was I wrong? Was I wrong?
Was I wrong to ignite the earth
And dance above the stars
Watching Europe burn with its civilisation of fire,
Watching America disintegrate with its gods of steel,
Watching the persecutors of mankind turn into dust
Was I wrong? Was I wrong?