



With Realistic Radicalism

Which approach to the upcoming era of reforms?

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The acceleration and deepening of the financial crisis in mid September 2008 has led to a qualitatively new stage of the process. Also governments and the financial mainstream had to learn, that the crisis was more than a credit crunch, which could be treated with the injection of fresh money by central banks. They started to perceive the crash as a systemic one, and they understood that this system had run out of control. Some of them even took a self-critical attitude.²

Some speak of the collapsing system in terms of *financialisation*, others call it *asset or wealth driven economy*; the former German chancellor, Helmut Schmitt speaks about *predator capitalism*, others about *shareholder capitalism* or about *finance capitalism*. How ever you call it: this system has collapsed, whereas other models, such as Chinese capitalism seem to be relatively stable and at the same time very dynamic.

The crisis is not over. What heterodox economists, few politicians and some NGOs had predicted,³ the spill over to real economy is now fully under way. EU member states such as Hungary and the “*baltic tigers*” are at the brink of bankruptcy, the US and the major EU economies have entered recession.

Also, the theory of decoupling, i.e. that emerging markets would be immune, has proven to be wrong. Pakistan and the Ukraine are bankrupt, Argentina is at the brink of bankruptcy. Brazil, South Africa, Venezuela and a lot of other emerging markets suffer from the fall of commodity prices, and even Asian countries have to digest plunging stock markets and the roller coaster of exchange rates.

The highly vulnerable economies of the LDCs will be hit particularly. Poverty reduction programmes will suffer setbacks. Those, who believed until now, that the Millennium Goals for Development could still be reached, can definitively give up any hope.

And all this is not yet the end. The problems will continue at least throughout 2009. It is the heaviest crisis of capitalism since the Great Depression eighty years ago and a deep going historical break.

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² For instance, the German minister of finance admitted, that there had been too much liberalisation and deregulation in the past. He even said that “certain elements of Marxist theory are not that wrong” (DER SPIEGEL 40/2008. p. 34)

³ See for instance: Wahl, Peter (2008): Making Finance Work for People. Proposals for a paradigmatic change in the finance system in favour of human development. Paper, prepared for the 2nd ibase workshop on Financial Governance, Rio, 6-8 June 2008.

1. The times, they're changing

A consensus is emerging that the crash is also the bankruptcy of the dominant economic paradigm. Although it is always difficult, in particular for politicians, to admit errors, in practice they are abandoning more and more the neo-liberal concepts. In the course of the management of the crisis a fundamental turn occurred, and overnight sacred principles were thrown over board as if they never would have existed:

- The state had to save the markets, nobody is complaining about wide ranging interventions of the state, reaching out even to governance issues of banks including the salaries of the top management. The UK has nationalised half of its banking system, the US large parts of the real estate finance sector.
- Nobody talks any more about moral hazard.
- In the EU, the dogmas of the Maastricht criteria,⁴ crumbled, as if they never would have existed.
- The IMF is giving rescue packages without any conditionality.
- The Central Banks of the Western Countries are starting to coordinate policies. In the case of the common decrease of interest rates even the Chinese Central Bank was involved.
- Programmes to reflate the economy, which two months ago would have been considered as old fashioned and useless Keynesianism, are flourishing everywhere.
- The state is back, regulation is back and it is only a matter of time that what has been denounced as spectre from the past, such as a different type of distribution and others will return, too.

2. Cosmetics or substantial reforms ahead?

The Bush administration has invited the G20 leaders to attend a meeting in Washington for the 15th of November. The meeting will give a mandate to the *Financial Stability Forum (FSF)* and the *IMF* to design a new financial architecture beyond immediate crisis management. It is obvious, that the initiative aims at something which could be called a *Bretton Woods 2.0*.

Apart from the G7, countries like China, India, Brazil, Indonesia, Argentina, Mexico, Russia and South Africa are member of the G20. Far more than half of humanity is living in these emerging countries. Therefore, it would be simplistic to look at the G20 in the same way as civil society used to do it with the G7.

Nevertheless, some sectors of civil society are mobilising against the meeting, arguing that the *IMF* has been a key player in the last 30 years for the implementation of the neo-liberal project which now has collapsed. The pyromaniacs of the past should not lead the fire brigade nor should they be the architects of a new financial order. Of course, these concerns are very understandable. It is also true, that the discourse on a new financial architecture had already emerged after the Asian crisis. And nothing happened. Many civil society representatives also argue that the elites would only seek for some cosmetic changes and the casino should be reopened after a while.

However, we should remember that the *New Deal* initiated by the *Roosevelt* administration and implemented under the hegemony of the US-elites was a substantial re-

⁴ According to the Maastricht treaty, the maximum for the budget deficit is at 3% of GNP and the maximum of overall indebtedness at 60% of GNP.

form, which was, of course, not abolishing capitalism as such, but establishing - in the sense of *varieties of capitalisms* - a system quite different from the previous one - and from the one that followed. The *Great Depression*, just like the present crisis, was not the result of protest, pressure from social movements or class struggles, but the effect of systemic contradictions inside the economy in general and the finance system in particular. And Roosevelt reacted with his reforms from above on this systemic crisis and transformed the system. With far reaching historic consequences.

One important political motivation of Roosevelt was to prevent the Soviet Union and a rather strong political left in Europe to get more influence. Today, there is a similar factor at work: the Chinese model of capitalism serves, whether we like it or not, for many developing countries as an example to follow.

The *New Deal* came completely unexpected for the workers movement and the political left in Europe. While waiting for capitalism to collapse from its own contradictions or fighting for revolution, they had totally underestimated the capacity of the elites to substantial reforms and to regenerate and adapt the system to the new situation. The issue is not to romanticise the *New Deal* or to express the desire for a return to the past, but to remind us, that we should not underestimate the flexibility and capacity of capitalism to renewal.

It is too early to know, whether *Obama* will be the *Roosevelt* of the 21st century, but we cannot exclude this possibility neither. In any case, if he is intelligent, he will know that the only chance of the US to preserve the status of a leading superpower after the political, economic and moral decline of the Bush era consists in substantial reforms – not only in the financial sector.

3. Determinants of change

Nobody can predict the future. Therefore, it is neither possible to predict substantial reforms nor just window dressing. But what we can do is looking at existing factors which have strong influence on the possible paths into the future. The future is not completely contingent. Some of such strong determinants towards substantial change are discussed here.

If we look at important transformations inside capitalism in the past, such as the *New Deal*, but also the *Bismarckian* reforms at the end of the 19th century or the *Front Populaire* in France, the decisive driving force behind was the pressure of new and deep going problems.⁵ This pressure is able to overcome traditional ways of thinking and attitudes even from the elites.

Normally, the process is accompanied by a split between subgroups of the dominant forces and a fight for hegemony over reforms. A phenomenon which we can observe at present, too. These splits do not only exist between neo-cons and liberals in general and the US in particular. There are also cleavages between the EU or at least “*Old Europe*” and the US of Bush, and there are cleavages between China and other emerging markets on the one hand and the West at the other.

⁵ The Bismarckian reforms were a reaction from above to the ever growing success of the Social Democratic Party and the tremendous human/social costs of industrialisation. The *Front Populaire* in France 1936 was a reaction to the rising tide of fascism and implemented important social reforms in favour of labour. However, the process was soon stopped by the war.

3.1. The failure of the neo-liberal type of accumulation

The main problem for the Western elites is the fact, that the neo-liberal system in place is not capable any more to guarantee an orderly and stable accumulation. Growth stimulated by ever increasing debt through a lot of sophisticated tricks – from “innovative” instruments such as CDS and CDOs, via unlimited leverage, short selling and other types of speculation to new institutions like Hedge Funds etc. – has proven to be impossible in the long run. The Ponzi game simply does not function any more and some of the main gamblers, investment banks, are already buried.

The elites could have lived - at least for another while - with the negative effects of unequal distribution, i.e. redistribution from below to above. They could have lived with some social unrest in the centre of the system, in particular in Europe with strikes, rising social movements, protest and the failure of an ultra-liberal European constitution. All this remained at a level which was not yet really dangerous. But what they cannot tolerate such an annihilation of large quantities of their assets and shrinking profits and instability, uncertainty, financial turmoil and recession.

The US, in addition, cannot tolerate the further erosion of the Dollar as lead currency, which is one of the main pillars of their hegemonial position. All in all the crash has weakened the US economically and also morally.

3.1. Requirements from the new order to come

At least as much as the pressure from the failure of the neo-liberal type of accumulation the requirements of a new order will force the elites into a certain direction. Just to sketch some of the issues this will come up (without being systematic):

- Once the bubble is deflated, the basic question will be, from where new stimulus of growth could come. And if there is not some miracle, the only candidate in sight is the demand side, i.e. wages.
- Big current account deficits will have to disappear. In particular, it can be expected that the world is not accepting any longer two thirds of all global savings being absorbed by the US current account deficit.
- In order to keep inflation under control, governments will have to regain control over exchange rates. The reduction of exchange rate volatility is an unavoidable imperative.
- The global monetary system will have to change towards a multiple structure.
- Given the risks of contagion, capital controls, too, will see a renaissance.
- Multilateral cooperation of central banks, regulators and supervisors will have to be institutionalised. Either there will emerge new institutions, or the existing ones, in particular the IMF will considerably be transformed. It will depend very much on the attitude of China and the other BRIC states which option will be implemented. If they opt for the Bretton Woods institutions, these will not be any longer the exclusive instrument of the US. An IMF with substantial influence of the G20 and following a new paradigm is not the same as we have seen in the recent decades.

3.2. The impact of existing alternatives

Another important determinant for substantial change is the existence of a successful alternative in form of the Chinese model of authoritarian state-capitalism. Here again,

there is no reason to romanticise. It is very questionable how sustainable this model is. But in a situation of sharp crisis, where everybody is searching desperately for rescue, it is difficult to be choosy. This is particularly true for developing countries. Whereas those countries, which followed the receipts of the Washington consensus, had no economic success, China and to a certain extent India, recently Russia and some other Asian countries, which did not blindly liberalise and privatise, had an astonishing performance.

Of particular importance are the bilateral economic relations between China and the US. China is, through incredible dollar reserves of 1,5 trillion USD catering for a large share of the US deficit. On the other hand, the US is the main importer of Chinese exports. This constitutes an interdependence of both economies. In any case it gives China a big influence on the future shape of the global economy.

Also in Latin America the acceptance of the neo-liberal model has evaporated. Venezuela, Bolivia, Ecuador, Paraguay use more or less massive state intervention into the economy and try to promote more social equity. Even in the very individual cases of Argentina, Brazil and Chile the election of Lula, Bachelet and Kirchner reflects an anti-neo liberal trend.

The increasing economic plurality in Asia and Latin America is translated to the political level. A reconfiguration of the international system is under way. The era of the unipolar world, which started after the Cold War, was historically very short. A multipolar world is emerging, in which the US will still have a prominent role, but its exclusive dominance has gone – last but not least as a result of the collapse of Anglo-Saxon capitalism.

3.3. The pressure from the triple crisis

Another integral part of the present historic conjuncture is the pressure from climate change and the energy crisis. Both constitute a strong pressure on the Western elites, but also for the world as a whole. Together with the financial/economic crises they interlink to a triple crisis complex. Although triggered by social forces, the climate crisis follows very much the rationality of physical and chemical processes. This implies, that there might be - unlike in social processes - a point of no return, leading to irreversible catastrophes. There is a new quality for the time factor in politics. A *New Deal* of the 21st century with heavy investment in a Copernican turn towards renewable energy would contribute both to stabilising the economy and giving new growth perspectives and responding to the environmental changes.

Taken all these elements together, the Western elites and in particular the new US administration are confronted with a unique challenge, which makes business as usual impossible. Therefore, it would be a mistake to expect, that once the crisis is over, the world would remain the same as it was before. The question is not, whether there will be changes but which ones, how far they will reach and who has the hegemony in the process.

4. Realistic Radicalism for civil society

For civil society and all others, who have been fighting against the neo-liberal type of globalisation, the crash is the affirmation of what they have said since many years. Their prestige, their influence has increased and can further increase. A historic window of opportunity is opening for them to be more offensive. In particular in the US, where civil society was paralysed by the 9/11-shock, an unleashing of creative en-

ergy can be expected after Obama's victory. But nevertheless, we should not forget that the contribution of civil society to the new situation was not the decisive one.

Therefore, one has to remain realistic. What has come to a halt is a certain type of capitalism, but not capitalism as such. On the other hand we have to understand that the character of the crisis is much more radical than we might have thought two months ago. We are entering a period of transition where a fraction of enlightened elites have at present the economy. Some of them, such as Strauss-Kahn or Sarkozy and Obama are at least rhetorically more radical than some NGOs.

Therefore, civil society actor's strategy has to be at the level of the radicalism of the crisis. They cannot limit any more their strategy to questions, whether capital requirements for banks are 8% or 10% or if there is transparency for rating agencies and other technical details. They must seize the chance to influence the basic direction of the reform process towards a *New Deal* in favour of global social equity and environmental sustainability.

5. Systemic changes towards social equity and environmental sustainability

For the next months or even years there will be two parallel processes:

- a. measures and programs to mitigate the effects of the financial crisis and of the recession in real economy. This will very much happen on national level, may be in some cases on regional,
- b. the design of a new financial architecture. This will be a multilateral process, starting on November 15th in Washington and going on for months if not years.

Already in the emergency measures, the new paradigm has to be taken into consideration. They should be used to pave the way for the new paradigm.

5.1. Progressive emergency measures

All emergency measures should be looked at under the following basic criteria:

- a. Do they contribute to break the dominance of finance over real economy?
- b. Do they contribute to a change in the balance of power towards the demand side, labour and social equity both nationally and in its North South dimension
- c. Do they contribute to the ecological turn?

In the light of these criteria the following steps should be taken:

- The rescue packages of governments to guarantee financial stability are unavoidable. However, in order to prevent moral hazard, the "*Speculator Pays Principle*" has to be observed.
- A progressive one off duty on all capital assets above 100.000 USD (except pensions) to combat the crisis.
- Forced loans to banks and other institutional investors as reinsurance for institutions threatened by bankruptcy.
- Through progressive taxation of individuals and companies (except SMEs), the winners of globalisation have to contribute to the rescue packages.
- However, the *Speculator Pays Principle* should be applied in a differentiated way. In the case of pension funds and health care insurances for ordinary

people priority should be given to stability. Hedge Funds, Private Equity Funds, REITS and other highly leveraged institutions however, should not be bailed out. It is good if they disappear.

- In cases where bailouts of banks or financial assistance by the state is unavoidable it must be assured that public money is not used for remunerations of managers or dividends to the shareholders. In order to avoid wrong incentives, manager's remunerations for banks under state scrutiny have to come down to a level of at max. 20 times of the average salaries.
- Bail out for the victims of the US sub prime crisis.
- Present or future profits of bailed out banks have to be returned to the state.
- The ban on short selling has to be maintained permanently.
- Programs to stimulate the real economy have to foster the social infrastructure and on environmental changes, in particular renewable energy.
- Emergency funds of the IMF and the World Bank have to be without conditions, as it was the case for Ukraine and Hungary.

5.2. Building blocks of a new financial architecture

A new system has to be based on the following four basic principles:

- a. The dominance of finance over real economy has to be broken. Finance has to have a servicing role for the economy and the society as a whole;
- b. The new system has to be stable and predictable. It has to provide a reliable environment for the economy;
- c. the negative distributionary effects of finance capitalism have to be reversed. Salaries have to become the main driving force of accumulation.
- d. Financial markets need democratic control. The erosion of parliamentary democracy (finance as "fifth power") has to be reversed. In particular Developing Countries country must have enough policy space to decide on their own development path.

There are several measures which meet two or three of these criteria at the same time. For instance, neutralising Offshore Centres (OFCs) is improving systemic stability but also positive for distribution, because it is fostering tax justice, stopping capital flow and thus enhancing policy space for governments. Therefore the following classification should not be seen too strict.

5.2.1. Measures to break dominance of finance over real economy

- taxation of all capital transfers, not only currency transactions, to reduce the hypertrophy and power of the financial sector, slow down its speed and reduce short termism;
- establishing a strong public and cooperative banking sector according to the model of German or Austrian *Sparkassen* and *Raiffeisenbanken* and with public development banks. The present nationalisations have to be checked whether they should be permanent;
- privileging (for instance through taxation) the public and cooperative sector;
- deconcentration of the big private banks. If they are "too big to fail" they have to be downsized until none of them has any more systemic impact.

- creating incentives for private banks to (re)engage in company financing,
- all actors have to come under the control of regulation and supervision,
- the business model of *Private Equity Funds* as one of the most important conveyor belts of the logics and dynamics of financialisation to real economy has to be banned. Instead, public development banks should provide venture capital. Private banks must, through appropriate incentives, focus on company financing, in particular for small and medium enterprises.
- all countries should be allowed and encouraged to use national capital controls if they deem it as necessary in order to prevent contagion.

5.2.2. Systemic stability

Financial stability is a public global good. Therefore stability, combined with equity and democratic control of finance is integral part of an emancipatory reform of the finance system. Major cornerstones of a new order would be the following:

- Transparency is the precondition of any efficient supervision and regulation. Therefore all market participants are obliged to disclosure of all data and information which supervising bodies may require.
- OFCs have to be neutralised.
- Banks and other market actors lose their license if they maintain branches in OFCs. Banking with OFCs
- Capital flows from and to institutions and countries which refuse to lift the banking secrecy on request of the supervising institution of another country should be pressurized through extra duties – and in heavy cases an embargo – equivalent to the Helms Burton Act.
- Off-balance deals, which play an important role in the present crisis, must be immediately forbidden.
- Present accounting standards have facilitated opacity. Therefore an international system should be adopted, which closes loopholes.
- The capital requirements for banks have to be upgraded. In that respect Basle II was a step in the wrong direction.
- Disclosure on risk exposure has to be improved.
- Investment banking has to be separated from other financial services.
- OTC derivatives have to be banned.
- Only standardised derivatives can be traded publicly at the stock exchange and licensed by regulators.
- Supervision has to prevent all financial actors from OTC business.
- The emission and trade of CDOs and similar risky products has to be stopped.
- Hedge Funds and other highly leveraged institutions have no useful macro-economic function and should be banned.
- Leverage in credit business should be limited and strictly supervised.
- Stabilising exchange rates is on the long run a decisive tool for systemic stability. Free floating exchange rates are at the root of many problems of the finan-

cial system. Therefore, first the stabilisation of exchange rates and on the long run their replacement through fixed rates or the merger of currencies according to the example of the Euro should be envisaged.

- Steps towards solving the exchange rate problem are:
 - a. A two tiered currency transaction tax (CTT) as proposed already in the early nineties by the then IMF advisor Spahn. The tax is linked to a variable exchange rate corridor. As long as the real exchange rate remains inside the limits of the corridor, the tax is low (for instance 10 basis points). As soon as the limits are passed the second tax rate, which is of a prohibitive size enters into force, thus bringing the exchange rate back into the corridor. Technically the tax is unilaterally feasible. As recent studies show, the probability of circumvention is lower than for most other taxes.
 - b. Establishment of regional currencies like the Euro.
 - c. Political agreements on stabilising exchange rates (like in the Bretton Woods system).
- As basic as the exchange rate problem are the imbalances of current accounts. In particular the US deficit on the one hand and the surpluses of big economies like Germany, Japan and China are unsustainable. They are a permanent threat to stability.

5.2.3. Reversing the dynamics of inequality in the finance system

A post neo-liberal mode of accumulation will have to strengthen demand, salaries and labour.

- A key instrument for strengthening demand is strong progressive income taxation. The trend towards digressive taxation (reduction of corporate and wealth taxes, shift towards indirect taxes etc.) has to be reversed.
- Privatisation of social systems and of important infrastructure such as energy and transport has to be stopped and reversed. This is not only a matter of economy and equality but also very important from the point of democracy. The social problems underlying these systems such as aging, health, knowledge based society, mobility, climate protection etc. are that existential, that the world cannot afford to leave them under the commercial rod. As commons they require a public management.
- Reforms in corporate governance such as multiple voting rights for long term share holding are necessary.
- Labour rights have to be strengthened. International labour standards have to be agreed. For industrialised countries, the present core labour standards are too weak. They have to be adapted to the situation in industrialised countries. Anti trade union legislation like in the UK (Thatcher) and the US has to be reversed.
- Trade unions, consumers and other stake holders must be given mandatory participation in corporate decision making.
- A sustainable debt regime for developing countries has to be established. The upcoming downturn in global growth will bring new indebtedness. For the group of the highly indebted poor countries (HIPCs) the debt crisis of the eighties has

not come to an end. Their situation will worsen and even some emerging market countries could backslide to unsustainable debt. Therefore the debt issue has to be put again on the agenda:

- a. The HIPC's need an unconditioned and immediate cancellation of their unsustainable foreign debts.
- b. An insolvency regime for sovereign debtors should be established.
- c. New creditors, such as China and India, should be included into a multilateral debt regime.
- d. Such a regime should no longer be unilaterally determined by the creditors and their interests. The Paris Club has to be transformed into a body under the control of the new G23.

5.3.4. Democratic control over finance

- Multilateral cooperation between governments has to replace national competition.
- A kind of Bretton Woods II, of course adapted to the situation of the 21st century should be established.
- The central institution to govern the new financial system should be an enlarged G20.
- The G20 has to be enlarged to at least a G23, i.e. it should include at least one LDC each from Asia, Africa and Latin America.
- There should be an institutionalised participation of trade unions, consumer organisations and other stakeholders with the right to submit official statements and proposals.
- The G23 should become the central governing body. It should be embedded into the UN system. The IMF is transferred into an executive body of the G23.
- The voting rights are distributed on the basis of weighted procedure combining population and GNP without veto power and a high quorum near to consensus (for instance 75%).
- The WTO must hand over the competence for financial services (Annex to GATS) to the G23.
- At national level, regulation has to be strengthened and must come on top of the agenda of parliaments and public debate.
- Supervision has to be strengthened and given the financial means to really monitor the markets.
- Supervision should be internationalised.
- The rating agencies have proved to be part of the problem not of the solution. Therefore rating needs to be regulated and strictly supervised. As soon as a new architecture has made the whole system more stable and calculable, the role of rating will shrink. At long term it might be decriminalised and become part of public supervision.
- The World Bank should be decentralised. Its mandate should be redefined with reducing poverty, servicing global equality and general welfare as top priorities.

- The Bank should be democratised through balanced voting systems which prevent automatic majorities of donors and industrialised countries, without simply recurring to *one country one vote*.⁶ Governance should consider the stakeholder principle, including civil society, consumers, trade unions, indigenous interests etc.

5.3. Special contribution of the EU

There is practically no EU-system of regulation and supervision. The split between Euro-zone and non Euro zone is another problem. Only some political coordination, such as the ECOFIN, is in place. The French presidency also succeeded to coordinate crisis management on an ad hoc basis (Paris conference).

The ECB played the role of lender of last resort and was recently forced under the pressure of reality to lower - perhaps too late – its interest rate for the Euro-Zone.

As a lesson from the crash, the EU has to give up the dogmas of the monetarist paradigm, and to develop a more cooperative and demand driven approach. A system of common regulation and supervision has to be established.

The financial dimensions in the Lisbon and other treaties are shaped according to the hard core neo-liberal believes. Article 50 of the Lisbon treaty, which forbids any restrictions on capital flows and thus sets the perfect conditions for the overwhelming hold of finance on society, must be deleted.

Article 48 on the freedom of establishment, leaving capital free to migrate wherever conditions are most favourable and financial institutions free to seek asylum in fiscal paradises and Offshore centres anywhere else they choose.

Furthermore, it is necessary to alter the status of the ECB. It's monetary and fiscal policy is completely dependent on the neo-classical dogmas. Autonomy from the monetarist ideology is needed and democratic control over this institution. The lesson from the crisis should be learnt, that asset price inflation is as important as consumer prize inflation. Also growth and employment have to be added to the mandate of the ECB with the same importance as price stability.

Tax dumping has to be ended and tax policies have to be harmonized.

OFCs in the EU have to be completely closed.

A social dialogue between ECB and trade unions, NGOs and other stakeholders should be institutionalised. Priority should be given to a social Europe.

6. Conclusion

The coming months or even years will be characterised by an intense fight over the reforms. At present the hegemony lies with a fraction of the elites under the leadership of Obama's United States. Without lapsing into illusions, this is a dramatic improvement compared to the Dark Ages of Bush or the Stone Age which could have come with Palin. It will depend very much on the emancipatory forces themselves, whether they will be able to get hegemony over the further process. Responding to the challenges with the as much realism as necessary and as much radicalism as possible is the first step.

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⁶ The Global Environment Facility (GEF) could serve as a model.