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The Allama Iqbal Lecture

A Global Green New Deal for Economic Recovery: Addressing the Financial, Climate, Food, Jobs and Development Crises Together?

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ایک ہی صف میں کھڑے ہوگئے محمود و ایاز
نہ کوئی بندہ رہا اور نہ کوئی بندہ نواز

These immortal lines from Allama Iqbal make me very humble standing before you today to deliver the Allama Iqbal lecture.

Mr Chairman, Mr President, Excellencies, ladies and gentlemen, friends all, thank you very much for this honour and opportunity to speak to you on a very difficult subject. I would like to emphasise that, thanks to Professor Naqvi, this is not the first time I am appearing before the Pakistan Society of Development Economists, but it certainly is the first time, thanks to Dr Rashid Amjad, I have been invited to give this very distinguished lecture. Both men are very distinguished in their own right; they are people whom I have greatly respected over the years.

Professor Naqvi's contributions, particularly on ethics and economics, and the challenge of rethinking Islam reminds me of Allama Iqbal's *Reconstruction of Islamic Thought* and the relevance of it for the challenges facing the world today, as highlighted by Professor Saith's lecture yesterday. The lines from Iqbal that I began with are very relevant, of course, to the whole question of inequality.

I met Dr Rashid Amjad about three decades ago in the context of his work at the ILO. Over the decades, he provided sterling leadership in very different and changing circumstances. In a sense, it is his absence from the ILO today that is particularly felt because we face a very unique situation in the world today where, unfortunately, various forces seem to have successfully conspired to prevent a strong economic recovery. This is the subject of the lecture I would like to deliver.

CRISIS AND RECOVERY

The challenge of economic recovery reminds us to think back about what opportunities have been missed, the roads not taken. I would like to remind you of the Asian crisis, which mainly involved East Asia between the years 1997 and 1998. Contrary to most media and academic references to the Asian crisis, it was remarkably

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short, marked by, what is called, a V-shaped recovery—contrary to the IMF's prognoses then of a protracted collapse. Note the contrast with the current crisis and the views of most pundits in 2008-2009. It is important to recognise that the IMF's Independent Evaluation Office itself has made self-criticisms about the poor policy advice and unnecessary conditionalities imposed on countries which sought emergency loans then, and how these slowed down the economic recovery.

Unfortunately, after the crisis, we saw continued financial liberalisation and globalisation, including major increases in capital flows, which have played an important role in contributing to the current crisis. In East Asia itself, unfortunately, we did not learn sufficient lessons. We continued to sterilise these flows, which have reduced the purported gains of capital inflows, and developed huge buildups of reserves; this, in a sense, is fundamentally problematic because it contributes to the problem of global imbalances. These reserves have been built up for self-protection, or what is called 'self-insurance' by some. They reduce vulnerability, and are seen as part of the reason why developing countries in general, especially those in Asia, have done relatively well following the 2008-2009 crisis.

The crisis, as you all know, began with the collapse of the US housing market, after a market bubble which was clearly unsustainable, made possible by US Fed policy on credit availability, particularly for the subprime mortgage market. I have to be rather immodest in saying that the UN Secretariat, together with our UNCTAD colleagues in Geneva, as well as the Bank of International Settlements, were the only international organisations who had warned of the likelihood of the crisis following the inevitable bursting of the housing market bubble, but unfortunately, very little heed was paid to us.

The US financial crisis of 2008-2009, which began from the subprime mortgage sector in 2007, soon spread very quickly. There was so much money tied up in various types of securities, which meant that the banking system, which had been responsible for much of these loans, became severely distressed. This, in turn, resulted in massive asset price deflation as liquidity dried up after excessive and inappropriate lending to various asset markets, not only the housing market, but also the stock market. All this, as we all know, has led to a significant recession.

Over the last three decades or so, the system has become more fragile; part of the reason is that various safeguards—that we used to have in the macro financial system, which ensured counter-cyclicality in both institutions as well as instruments—have been very much eroded over the last three decades through deregulation by states at the behest of powerful financial interests, often encouraged by the international financial institutions; consequently, the system has become far more pro-cyclical.

It is now common in some Western circles to blame the Asians for the crisis, and to claim, as has been said in recent years, that this was an Asian induced crisis. Why? Because Asians were accumulating reserves unnecessarily and excessively; but to claim that Asian export success and reserve accumulation caused the crisis is one-sided, to say the least. Very often, of course, these reserves were in the form of US Treasury bonds or other US dollar assets. We have to recognise that, at root, the Bretton Woods system was flawed in the sense that it did not really do anything to deter issuers of major currencies from being able to use the international monetary system to their own advantage. It was this, rather than the alleged Asian tendency to over-save, which was at the root of the problem.

The crisis led to a sharp recession in the year 2009. The mechanisms are all quite well known now, and it led to a generalised financial crisis and recession, not only in the US, but also elsewhere. The asset price deflation, credit crunch and significant deleveraging caused economic contraction, less investment, less growth, less jobs and less consumption, all of which, in turn, have contributed to a vicious circle, which may be termed a deflationary spiral. This deflationary spiral led to depressed domestic demand and the collapse of various asset markets, with negative wealth effects all round. Contraction or reduced growth of world trade has been very problematic for developing economies which have been forced or have chosen to become more open in recent decades, thus accelerating globalisation over the previous three decades. National economies became less well integrated and domestic production capacities and capabilities collapsed in the face of cheaper imports, but most economies could not produce much to export beyond primary commodities, especially minerals and other natural resources.

Thus, the crisis has spread throughout the world, albeit in a very uneven fashion. Financial contagion also involves various elements. It is important to recognise at least three distinct vectors by which contagion has spread. There are important vectors or transmission channels within the financial sector, within the real economy, and between the financial sector and the real economy that have contributed to the crisis.

The baseline scenario in the UN's 2012 *World Economic Situation and Prospects* suggests a slight dip in 2012-2013, but more alarming is the prospect of a double-dip recession triggered by the Euro zone crisis. This baseline scenario assumes that the Euro zone crisis will soon resolve itself, but the prospects for this are bleak, to say the least. Thus, the possibility of a downside scenario is serious, and unfortunately, the downside scenario, rather than the baseline scenario, may be more significant in the period ahead. Even the IMF has revised its own forecast downwards a couple of days after we released our forecast.

There are two major challenges; first, we need a strong sustained recovery effort, and this can come about through no means other than fiscal stimulus. There is no choice. Secondly, these recovery efforts need to be much more coordinated because if we all think that we are going to recover on the basis of everybody else bearing the pain, it is simply not going to happen. Similarly, recovery on the basis of exports is simply not going to happen. Consequently, we need far more macroeconomic policy coordination. Unfortunately, however, the mechanisms for that coordination simply do not exist in the world today. In the last three years, much of the world has looked to the G20 to provide leadership and a solution, but unfortunately, the G20 has not been able to make any significant advance in terms of coordination for economic recovery since the London Summit of April 2009.

Most of us would like to think that a crisis will lead to reform, and that when you have problems and make mistakes, you learn from them. But if we look at what happened in the 1997-1998 Asian crisis, unfortunately, few lessons seem to have been learnt. One year after the Asian crisis began, President Bill Clinton called for a new international financial architecture, but little progress has been made since then, more than a decade letter. My old Professor Robert Triffin used to describe the situation after the collapse of Bretton Woods in 1971 as a 'non-system' but, unfortunately, that non-system continues to prevail because what we have seen is that various new developments in the four decades since 1971 have basically modified earlier arrangements in an *ad hoc* fashion. There has been no attempt to rethink what is needed in the new situation that we have faced since the collapse of the old system in 1971. No wonder, the Asian countries chose to self-insure with reserve accumulation, a lesson learnt the hard way from the 1997-1998 Asian crisis.

Also, it is now generally acknowledged that the various policy responses are inadequate and often characterised by double standards with more contractionary policies recommended for the South. We also find that regulation is inadequate and sometimes inappropriate in a very fast changing world. International cooperation has improved to some extent, with the relative decline of the G7 and its supersession by the G20 meeting at the leaders' level. However, after some significant achievements in April 2009, we have only seen relatively modest progress since then. The IMF did play a fairly positive role during 2009, but then endorsed the premature turn to fiscal austerity demanded by powerful European governments even before economic recovery was secure.

Despite quantitative easing, most companies have limited access to credit, reducing investment and job creation. Easy credit before the crisis enabled over-investment in most sectors, such as housing, believed to be profitable. The resulting over-capacity now discourages further private investment in these sectors. With inequality and unemployment higher, while incomes and domestic markets are shrinking, everyone expects to recover by exporting! Developing countries, long urged to export, are now told to produce for the domestic market and to import more after much of their previous productive capacity has been eroded.

With greater openness, many emerging market economies feel obliged to accumulate huge reserves for self-protection in the face of greater financial volatility associated with freer capital flows. Although financial globalisation has not enhanced growth, it has clearly worsened volatility and instability. Meanwhile, "policy space" for economic recovery has been diminished since the crisis. Public investment and basic social protection can help create millions of jobs. But the presumption that public investment crowds out private capital continues to deter state-led recovery efforts despite strong evidence to the contrary.

Many developed economies have had far greater fiscal deficits historically than now, and not only during wartime. Such deficits have financed strong, sustained and inclusive growth, not only in their own economies, but also abroad; e.g. the US Marshall Plan was central to post-war European reconstruction and recovery. Governments used massive funds to bailout selected, supposedly strategically important banks raising government debt rapidly. In turn, this huge debt has become the pretext for the turn to fiscal austerity ostensibly demanded by financial markets. Meanwhile, Eurozone countries are also constrained by their lack of exchange-rate flexibility.

Among international organisations, only the UN has championed a coordinated, strong, sustained and inclusive recovery effort. It is very important to recognise that whenever there is a lag in recovery efforts, the recovery is being delayed. The ILO's International Institute for Labour Studies has shown that when there is a lag of three months, recovery is slowed down by an average of nine months. So the lag since mid-2009, of more than three years, will delay recovery for an even longer period.

In the last two decades, there has been another troubling development, of output recovery without job recovery. In the case of the 1991 downturn in the US, for example, output recovery took about nine months, but job market recovery took two and a half years. With the 2001 downturn, output recovery took nine months again, but job recovery took four years. Therefore, we see a greater lag as far as job recovery is concerned, which is very troubling. In developing countries, the only way to overcome poverty is through creating decent work and productive employment opportunities. Therefore, the failure of job recovery and the phenomenon of job-poor growth have very serious implications.

FOOD SECURITY

As you know, food prices have become much more volatile in the recent period. For example, food prices rose in 2006, and especially in 2007. Then from the second half of 2010, food prices rose and then declined until the middle of 2011. There is a debate going on as to why food and other commodity prices have become much more volatile; this may be summed up as a debate between the so-called fundamentalists and those emphasising the 'financialisation' of commodity futures and options markets. In my view, this is a false debate: fundamental factors are important, but we also need to take account of the consequences of 'financialisation'.

One of the major factors affecting the so-called fundamentals is the advent of bio-fuels. In the interest of trying to mitigate global warming, there has been increasing encouragement of the production of biofuels, both bio-ethanol, especially in the US, as well as bio-diesel, especially in Europe, using vegetable oils. Secondly, recent oil price spikes have become more frequent, partly because of the situation in West Asia following the invasion of Iraq.

Food prices have become much more subject to market volatility. In recent years, commodity futures and options have become a new asset class. As other financial assets have fallen in value, funds flooded these markets, pushing up prices. Changing speculative investment strategies and rapid responses to changing market conditions have thus exacerbated commodity price volatility, including food and fuel.

Financialisation has therefore had complex implications. For example, there has been a massive increase in investment in commodity futures and options markets, in Chicago and Minneapolis in the United States, as well as in other countries. In the past, such investments did play a countercyclical, price-smoothening role. More recently, however, the huge infusion of funds, often running away from Wall Street and other traditional financial markets because of the collapses and greater uncertainties in financial markets, has raised the prices of commodity futures and other options, which have inevitably affected contemporary spot prices as well.

Secondly, there has been increased speculation because investors are not content with the traditional types of speculation, such as buying futures and options in anticipation of weather changes and other changes that might affect output. Instead, they are now using all kinds of new ostensibly mathematically sophisticated investment strategies and methodologies. For example, in 2007-2008, one other very important element, besides the flight from Wall Street to Chicago, was what is called indexed investment. For instance, the model used might require correlated investments to offset risk or maximise profitability. Hence, when much more capital was brought in, which is precisely what happened, all prices have gone up. For various reasons, the price increases have been higher for minerals compared to agricultural commodities.

But it also means that when there is disinvestment, all prices come down and often, very fast, as the speed of response becomes important for cutting losses or making the most from frequent trading. And very often, in such a market, there is a great deal of information asymmetry. One does not know what is happening; so, very often, people make decisions on the basis of whom they had lunch with, the rumours they picked up at or after work, as they hang around to socialise, etc. The result is that there are much greater and more rapid changes in investment positions, resulting in far greater volatility.

With the financial crisis, there has been greater interest in asset diversification, moving away from old types to new types of financial assets. Consequently, commodity futures and options became a new type of financial asset class. Another major development over the last three decades, since Mrs Thatcher and Mr Reagan, has been the reduced and different role of government. The government's role has been reduced in agriculture generally, for example, with much less resources going to food agriculture compared with the 1960s' and 1970s' Green Revolution.

There has also been much less government sponsored agricultural research, resulting in much more private ownership and control of profitable innovation by a few large agro-business corporations. When China had serious problems with what is called brown hopper, the government went to the International Rice Research Institute (IRRI) in Los Banos in Philippines hoping to get some assistance. There, they found only one professional entomologist and six lab assistants, a small fraction of the human resources during IRRI's heyday in the 1960s and 1970s. So, the technical capabilities are often simply gone, rather than devolved to the national level. While requiring many personnel, there are very few other mechanisms that have been proven to be more effective than extension services in terms of farmers' learning and adoption of new farming techniques.

Economic deregulation has been very important in recent decades. Countries seeking national level food security have been pressured to abandon such ambitions. Market liberalisation has been encouraged instead, ostensibly to replace 'inefficient' domestic food production with cheaper imports, even if from subsidised sources, such as most OECD economies. In many countries, especially in Africa, there was a dismantling of marketing boards, with devastating effects. In many countries, there has been a great deal of pressure to reduce controls on food prices.

But the continued supply of food at affordable prices is now increasingly under threat. While the world food market has become more oligopolistic, with a few dominant transnational corporations, there have been declines in agricultural productivity growth among smallholders due to reduced public investment in agricultural infrastructure, research and extension. At the same time, there has been farmland loss to urbanisation and other purposes. There has been significant environmental degradation, including deforestation, with inevitable adverse effects on crop output. Also on the supply side, climate change has been very important, with great effects on weather. For example, there was a drought in Australia, a major wheat producer, which lasted a decade. The availability of other food has also been threatened, e.g. with overfishing.

On the demand side, there has been population increase in Asia and most other parts of the world. Where there have been increased incomes as well, this has affected consumption preferences. There has also been a greater preference for meat, which also has implications for the amount of food available for human consumption as more food is used for animal feed. At the same time, there has been excessive food consumption by about a million people, resulting in obesity, malnutrition and other health problems, as well as greater wastage of food, especially in the West. The World Health Organisation estimated that in 2006, there were one billion overweight adults globally, with 300 million considered obese, while according to the Red Cross, 1.5 billion people worldwide were obese in 2010. Also, more maize, sugar and vegetable oils are being used for biofuels, raising the prices of these agricultural commodities. All this has meant various new pressures that have raised prices, while increased prices are the major cause of hunger and under-nutrition.

The data for the last two decades suggest that poverty has been going down over the last two decades; the MDG target for 2015 is said to have been achieved by 2010. However, the FAO and others suggest that in the past decade at least, except for the year 2010, hunger and under-nutrition have been going up. The World Health Organisation estimated that in 2006, 800 million did not have enough to eat while the Red Cross estimated 925 million undernourished in 2010. To say the least, it is rather strange for poverty to be going down, while hunger is going up at the same time. After all, the poverty line is supposed to be defined by what it takes to avoid being hungry.

Obviously, something is amiss. Furthermore, what is considered to be the consumption level to avoid being hungry has been adjusted downwards in some countries. It appears that the dollar-a-day poverty line, set two decades, was a statistical convenience. There is a great deal of evidence from all over the world that with the equivalent of a dollar a day, you cannot avoid being hungry in most societies. We also know from some recent randomised tests, a methodology which has become very popular in recent years, that people, rich or poor, do not necessarily ensure that their nutritional status is the greatest priority; very often, they do not have the information to ensure that, even if it their priority. Hence, hunger and under-nutrition remain serious problems that we need to continue to pay attention to.

CLIMATE CHANGE

It is quite indisputable, especially in developing countries, that climate change, global warming in particular, is having very serious implications for development. Most of the historical build-up of greenhouse gases in the atmosphere can be attributed to the industrialised economies. And in the contemporary period as well, richer people and countries are responsible for much more greenhouse gas emissions per capita. The question is whether we recognise different historical and contemporary responsibilities, given the different stages and trajectories of development of countries in the world.

Clearly, we need to do two things. First, we need to reduce emissions, particularly in the rich countries. But there is now an attempt in the climate negotiations, concluded in Durban in December 2011, to suggest that we all have equal responsibilities in this matter—contrary to the UNFCCC principle of common but differentiated responsibility. On this matter, almost alone, we are all equal in this world, and therefore, should all bear the burden of reducing global warming equally! This is the principle that developing countries have united to resist. But this view has become increasingly influential, espoused especially by Mr Todd Stern, the chief US climate negotiator. By this logic, China, which has a population five times that of the US, has to reduce its greenhouse gas emissions by as much as the US. Second, there is no doubt that we also need to slow down greenhouse gas emissions in developing countries.

The current fad is for ostensibly market-led approaches. For example, you will hear in most discourses that the solution is very simple. All you need is to impose a 15-20 percent carbon tax that will reduce fossil fuel use that will somehow lead to what is required. But what are the consequences of such an approach? The consequences will include, for example, the carbon tax being imposed on everybody. So the problem of energy poverty, of poor people not having access to modern energy, becomes more serious as we raise the cost of energy to them. Consequently, we have a situation where poor people in Asia, Africa and other parts of the world often use biomass, such as firewood, dung, etc., as a source of fuel. But the greenhouse gas emissions from such use of biomass are generally greater. Thus, by worsening the problem of energy poverty, you also worsen the problem of greenhouse gas emissions, something not well recognised.

The United Nations' *World Economic and Social Survey* for 2009 argued in favour of an investment-led approach. The policy implications are quite significant. It means that major investments—for example, in renewable energy—must be frontloaded in order to accelerate the transition to renewable energy generation as the new basis for economic development. Such an approach is consistent with the international community's commitment to sustainable development—in other words, ensuring *economic development*, especially for developing countries, particularly the poorest ones; *social progress*, e.g. by providing a universal social protection floor; and *environmental sustainability*, in this context, by keeping average global temperature increases to no more than two degrees Celsius. This is why we strongly favour an investment-led approach to achieve both climate change and development goals.

GLOBAL GREEN NEW DEAL

In early 2009, the UN Secretary-General Ban Ki-moon proposed a Global Green New Deal (GGND) to accelerate economic recovery, job creation and sustainable development. The GGND envisaged cross-border public-private partnerships to address climate change and food security challenges. Front-loading massive, multilaterally cross-subsidised public investments in developing countries in renewable energy and sustainable smallholder food agriculture should induce complementary private investments. After all, market forces alone will not generate the investments needed for climate change mitigation as well as affordable nutrition for all.

As noted earlier, following years of easy credit and over investment before the crisis, the world now faces underutilised over-capacity in most profitable economic sectors. In this situation, only well-coordinated cross-border public investments can fund needed 'green' public goods and induce complementary private investments, e.g., through public-private partnerships, to address these global challenges. Besides contributing to sustained economic recovery, such investments would also enhance climate change mitigation while advancing developing countries' developmental aspirations and ensuring affordable food security. The Green Revolution of the 1960s—with considerable government and international not-for-profit support—increased crop yields and food production in wheat, corn and rice, requiring a second Green Revolution for other food crops, especially water-stressed agriculture in arid areas.

Multilateral cooperation for global recovery has been disappointing since the 2009 G-20 London and Pittsburgh summits. For example, there has been little meaningful progress on the Global Jobs Pact since then. As a result, the past three years have witnessed little progress toward a strong, sustained and inclusive recovery. Instead, creeping protectionism has gone well beyond the familiar terrain of trade. Although inclusive multilateralism has been battered by various challenges, including its seeming messiness and slow progress, it remains the best option for various reasons. The United Nations system must be bolder, but powerful interests must also allow, or better still enable it to play a bigger role.