

**THOMAS I. PALLEY:**

**America's Exhausted Paradigm: Macroeconomic Causes of the Financial Crisis and Great Recession**

This paper traces the roots of the current financial crisis to a faulty US macroeconomic paradigm. One flaw in this paradigm was the neoliberal growth model adopted after 1980, which relied on debt and asset price inflation to drive demand in place of wage growth. A second flaw was the model of US engagement with the global economy, which created a triple economic hemorrhage of spending on imports, manufacturing job losses, and off-shoring of investment.

Financial deregulation and financial excess are important parts of the story, but they are not the ultimate cause of the crisis. These developments contributed significantly to the housing bubble, but they were a necessary part of the neoliberal model, their function being to fuel demand growth by making ever larger amounts of credit easily available.

As the neoliberal model slowly cannibalized itself by undermining income distribution and accumulating debt, the economy needed larger speculative bubbles in order to grow. The flawed model of global engagement accelerated the cannibalization process, thereby creating a need for a huge bubble that only housing could provide. However, when that bubble burst, it pulled down the entire economy because of the bubble's massive dependence on debt.

The old post-World War II growth model based on rising middle-class incomes has been dismantled, while the new neoliberal growth model has imploded. The United States needs a new economic paradigm and a new growth model but, as yet, this challenge has received little attention from policymakers or economists.

**SEBASTIAN DULLIEN:**

**Towards a Sustainable Growth Model for Europe: Institutional Framework**

The current framework of the European Stability and Growth Pact is focused on monitoring public debt trends. As the current economic and financial crisis has

highlighted, however, concentrating solely on public debts is not enough to guarantee a sustainable growth framework. Instead, private debt trends must also be monitored: since a debt crisis in the private sector can also be expected to lead to a public-sector debt crisis, neglecting private-sector debt trends means missing important risk factors with regard to public debt trends. As partners in the European Union will be strongly affected by the default of one member state (and the disruption of economic activity that would follow), and might even be forced to bail out an insolvent partner country in order to prevent contagion, unsustainable debt trends thus have to be considered an issue of common concern.

Three pillars are proposed to prevent such unsustainable debt trends. First, a common EU financial supervisory body should monitor financial institutions and prevent them from incurring excessive leverage. This supervision must take place at the European level, otherwise each country would have an incentive for regulatory forbearance.

Second, a new external stability pact for Eurozone countries should limit current account deficits and surpluses to, at most, three percent of GDP. It should be applied symmetrically to surplus and deficit countries and include early-warning elements and sanctions. Thus, countries would be forced to use their national policy instruments, such as fiscal policies, general economic policies, and income policies towards achieving a more balanced growth path and preventing unsustainable debt trends.

Third, the existing Stability and Growth Pact should be reformed to target medium-term debt sustainability and give national governments more freedom for short-term stabilization using fiscal policies.

## **ADALBERT WINKLER:**

### **Unbalanced But Converging – The Pre-crisis Growth Process and its Implications for the Post-crisis Recovery**

Pre-crisis growth was strong but unbalanced. Several countries ran high and rising current account deficits, while others recorded high and rising surpluses. Many observers blame the crisis on this unbalanced growth pattern and link it to policy mistakes in mature and emerging market countries. Accordingly, the key policy challenge for each individual country in shaping the recovery is to ensure more balanced growth.

An alternative interpretation holds that the unbalanced pattern of pre-crisis growth was an outcome of the different strategies of emerging markets with regard to integration into global financial markets. While emerging Asia took a cautious approach, with current account surpluses and reserve accumulation serving as key instruments in limiting risks associated with a sudden halt in capital flows, emerging Europe opted for full-fledged integration with mature Europe,

facilitating strong capital inflows, domestic-demand led growth and current account deficits.

Accordingly, a more balanced post-crisis recovery depends crucially on fundamental changes in the global financial system. Without these changes, the global economy runs the risk that policies aimed at reducing imbalances might also lead to subdued growth.

While this risk is a global one, it might be most pronounced in Europe. This is because emerging Europe has been hit hardest by the global financial crisis. Moreover, in comparison to emerging Asia, countries in central, eastern and south-eastern Europe have little leeway to conduct traditional anti-cyclical policies. Hence, they might be inclined to forgo their growth model of the past and follow the Asian model, implying a fall in European aggregate demand. If this is not compensated by rising demand in surplus countries, recovery in Europe will become increasingly export dependent.

Given the limited ability of the United States to act as a spender of first resort and the reluctance of Asian countries to spend, the prospects for a strong recovery look bleak.

## **BIRGIT MAHNKOPF:**

### **The Hunt at the Horn of Africa.**

#### **On the Political Economy of a Pirate Conflict and its Geopolitical Significance**

For years, the international community has neglected the fact that the coastal inhabitants of civil-war torn Somalia have been deprived of their livelihood through over-fishing and the dumping of toxic waste, for which economic actors in the rich industrialized countries are responsible. The international community took action only after a local economy emerged based on maritime piracy and the extortion of ransom money – tied in, in a variety of ways, to global flows of goods, information and money – in a number of Somali fishing villages in reaction to the loss of prospects experienced by young men on the coast. In contrast to earlier threats, of comparable size, to international shipping by pirates – for example, in the Strait of Malacca – NATO and the EU have reacted with military force since 2008, despite the fact that this is definitely a non-military problem, whose social and economic causes are indisputable.

The large-scale military deployment has given rise to considerable doubts. This applies both to the effectiveness of the deployment and the legitimacy of the NATO and EU operations. Also disconcerting is the fact that the warships in the Gulf of Aden are tasked with a policing mission and that the division of powers between different security services and police forces is becoming increasingly blurred. Links between the mostly young Somali pirates and Islamic terrorist

networks, not to mention any involvement in international organized crime, have so far not been proved. Nevertheless, the talk is of a threat to global security.

It is difficult to avoid the suspicion that the multidimensional military operation at the Horn of Africa has more far-reaching aims than the UN mandated protection of World Food Program ships and international merchant shipping. On the one hand, the deployment of the largest anti-pirate armada of recent times provides an opportunity for a test run of NATO's latest strategies, and on the other hand, for the EU it is a matter of establishing its own autonomous military force in order to demonstrate its ability to act effectively on the world stage, as envisaged in the Lisbon Treaty. Thirdly, however, within the framework of the new geopolitical discourse, the Horn of Africa plays an important role with regard to who will dominate the region of the Greater Indian Ocean in the future, and thus be in a position to weaken economic rivals (and potential enemies). That is why the military presence of Western and Asian naval forces in the waters of the western Indian Ocean can also be seen in the context of the rapidly changing balance of power between the »old« (Western) and the »new« (in particular Asian) powers, as well as in connection with China's growing influence in Africa.

#### **ANIKA OETTLER / PETER PEETZ:**

#### **Coup in Honduras: Malfunctioning of a Defective Democracy**

The debate on the coup against Honduran President Zelaya risks running aground on an illusion concerning the functioning of Honduran democracy. Conflict dynamics there at present are directly related to the country's political culture, which since the 1980s has been shaped by the deal struck among the elite and shows clear signs of »defective democracy.«

Zelaya was regarded at first as a liberal politician with oligarchic roots and a social bent. While to begin with he obeyed the informal rules of the political process, for example, in terms of his personnel policy, from 2008 a clear political about-turn set in: Zelaya reshaped the media and announced his country's accession to ALBA, the integration alliance launched by Hugo Chávez. The trigger (but not the cause) of the coup against Zelaya was an opinion poll on whether there should be a referendum on convening a legislative assembly at the same time as the elections on November 29, 2009.

With his commitment to the opinion poll, Zelaya not only contravened the rule of law with regard to the separation of powers (for example, by flouting the decisions of the Supreme Court), but also violated the informal rules of Honduran »elite consensus-based democracy« with his provocative actions. Compared with Zelaya's legal infringements, however, the military coup was something much more radical and a totally unjustifiable violation of the democratic rules of the game.

The coup in Honduras must be seen in connection with the issue of failed presidencies which affects the whole of Latin America. In contrast to many other cases in which presidencies in Latin America were terminated prematurely, Zelaya was not overthrown as a result of social protests. Rather escalation mounted due to inter-institutional and inter-personal clashes. In the run up to the coup, Zelaya was becoming increasingly isolated from the rest of the state, political and socio-economic establishment (parties, parliament, judicial system, military) and had begun to pursue the populist ideology of *Chavismo*.

By means of the coup in Honduras and its consequences, a social protest movement has a broad – if not a majority – base in the population for the first time in decades. In this way a weakening of the traditional, elite-governed two-party system in Honduras has become possible. On the other hand, the forces of inertia appear largely unimpaired. The shady negotiation of the agreement between Zelaya and Micheletti in October 2009 gave reason to fear that backroom deals among the elite in the grey area between authoritarianism and »real« democracy are still the political modus operandi in Honduras.

## **SINAH MARX:**

### **Power at the North Pole. The Likelihood of War**

Interest in the North Pole among certain states is increasing because it will soon be possible to mine its mineral resources and because military-strategic advantages go hand in hand with influence over the region. Whether military conflict looms in the Arctic is disputed, but since nothing has yet been decided about access rights, a vacuum has developed which, pre-eminently, the five countries bordering directly on the Arctic Sea – Canada, Denmark, Norway, Russia, and the United States – are keen to fill. In support of their positions they are putting their trust in a range of strategies.

On the one hand, they are trying to gain ground with shows of force, while on the other, legal approaches are being tested. Further development depends on whether juridification of the disputes can succeed. To be sure, there are no generally recognized, binding laws capable of bringing about conclusive clarification of the territorial quarrels. This may also be explained by the fact that territorial questions largely represent an anachronism: with a few exceptions, the carving up of the world came to an end with the colonial phase of European expansion. As a result, the conflict is unlikely to be solved by means of (maritime) law. It is more interesting to look at the political means by which the bordering states are trying to assert their claims.

First, they have shut the door to claims from other states. Further cooperation is unlikely, however, particularly because appropriate institutions are lacking. Instead, power maneuvers are being indulged in, primarily at the symbolic level –

such as the hoisting of the Russian flag at the North Pole in summer 2007 – which are intended to advertize and legitimize claims.

In this way, legitimacy is reduced to hard facts. Using power to assert state interests always harbors the danger of military force and counter-force, however. For example, in spring 2009, Russia's plan to establish a special paramilitary unit for the Arctic under the authority of the internal security service became known. The other bordering states are also readying their forces for the North Pole and preparing them for deployment in the Arctic.

Power politics dominates, however, also because the legal regime is inadequate and enforcement and sanction agencies are lacking. The juridification of international politics in the direction of global governance is therefore not a foregone conclusion. At least, conflicts between large states cannot simply be converted into legal affairs. The law has not become sufficiently independent of power. As a result, it is to be feared that the disputes at the North Pole will intensify into open conflict and even war.

## **HEIKO KRETSCHMER / HANS-JÖRG SCHMEDES: Enhancing Transparency in EU Lobbying? How the European Commission's Lack of Courage and Determination Impedes Substantial Progress**

The intermediation of different kinds of interests between policy-makers and society is an important feature of pluralistic political systems. Both political decision-makers and the general public, however, have to know whose interests they are confronted with so that they can put their demands into perspective. In light of the proliferation of both interest organizations and forms of interest representation over the past few decades, lobbying transparency has increasingly been regarded as an important precondition for public confidence in the integrity and legitimacy of the political process.

For two decades now, the European Parliament and the European Commission have been engaged in a debate on whether and how to enhance transparency in EU lobbying. As early as 1989, Parliament discussed the regulation of lobbyists. For the first time in 1992, a Commission Communication called for a directory of lobby organizations and a code of conduct for lobbyists. In 2001, the Commission's White Book on »European Governance« put transparency issues high on the agenda.

In several respects, however, the Commission's »register of interest representatives« that emerged in 2008 as a component of the transparency initiative, goes in exactly the wrong direction. The register is completely voluntary, financial disclosure requirements are imprecise and sanction mechanisms are unclear. In fact, the only sanction consists of a temporary removal or a complete exclusion from

the register – with no indication of how this measure might effectively improve the offending registrant’s transparency.

International experience suggests that the success of any lobbyist registration scheme hinges upon clearly defined and mandatory registration and disclosure requirements, including straightforward complaints and sanctions mechanisms. The rationale for the mandatory approach is quite simple: a voluntary system leaves the question of registration directly with the lobby organizations that trade transparency with supposed competitive disadvantages. In fact, less than one-quarter of Brussels-based lobbyists had voluntarily registered by the end of May 2009.

Nevertheless, the Commission claims enormous progress: due to its initiative, at least some transparency has been achieved where previously there was no transparency at all, seems to be the argument. As a result, the Commission is maintaining a solution that claims transparency but, as a result, impedes *real* transparency. Unfortunately, the Commission’s attitude could not even be modified by a resolution of the European Parliament in May 2008 that called for a common mandatory register by Council, Commission and Parliament, with full financial disclosure. According to a High Level Working Group between Parliament and Commission, representatives of both institutions agreed that there is currently no specific legal base for a mandatory register.

After two decades of discussion on transparency in EU lobbying, this conclusion is both surprising and disheartening. A more courageous Commission would strive, along with Parliament, first, to establish the necessary legal base and second, to implement and enforce an obligatory registration mechanism among Brussels’s interest representation community, even against the fierce resistance that can be expected. Yet if the Commission sticks to the voluntary approach, its effort to effectively enhance transparency in EU lobbying will be rendered null and void.