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Research Report

Global Economic Solutions: Proposals from the Global Economic Symposium. GES 2009/2010

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Global Economic Solutions

Proposals from the Global Economic Symposium

Edited by Alessio J.G. Brown and Dennis J. Snower,
in cooperation with Romesh Vaitilingam and Micaela Kulesz

Selected Solutions—Shorter Run

ECONOMY

- Create “solvency-convertible debt” for large financial institutions.
- Give more voting rights to longer-term equityholders.
- Tax short-term profit-taking more than long-term profit-taking.
- Harmonize internationally financial institutions' leverage ratios.
- Introduce IOUs requiring farmers to pay only in good harvests.
- Encourage knowledge donation through IPR redesign.

SOCIETY

- Replace CSR by “shared value creation.”
- Make aid to families depend on children's school attendance.
- Promote rainfall insurance and social insurance by foreign aid.
- Enhance financial literacy through universities and charities.
- Promote woman entrepreneurship by property rights and education.

POLITY

- Establish a World Climate Organization for climate agreements.
- Combine agricultural trade deal with food security agreement.
- Make financial capital requirements size- and cycle-dependent.
- For failed states, pool donor funds to manage programmes locally.
- Use existing informal institutions to rebuild fragile formal ones.

ENVIRONMENT

- Price water. Decouple land ownership from water rights.
- Specify fish quotas in number of fish, rather than weight.
- Convert fish subsidies into retraining subsidies.
- Facilitate the uptake of biotechnology for poor countries.
- Grant GHG emission credits for carbon storage.
- Promote Improvement residential building insulation.

Content

About	4
1. Global Problem Solving	4
2. The Role of the GES Participants	6
3. Global Economic Symposium (GES)	7
4. Global Economic Solutions	11
5. Global Economic Fellows: Intergenerational Dialogue	14
6. Popular Solutions	17
THE GLOBAL ECONOMY	20
1. Balancing Risk-Taking and Financial Regulation	22
2. The Psychology of Financial Crises	30
3. Managing the New Global Imbalances	38
4. The Post-Crisis Global Division of Labor	44
5. Fighting Against Poverty in the Crisis Aftermath	50
6. New Knowledge Creation Regimes	58
THE GLOBAL SOCIETY	66
1. The New Wave of Social Entrepreneurship	68
2. Content and Limits of Corporate Social Responsibility	74
3. Making Migration Work after the Crisis	84
4. Overcoming Inequality through Education	88
5. Dealing with the New Social Divides	96
THE GLOBAL POLITY	108
1. Fixing Failed Multilateralism	110
2. Towards Global Trade under Global Rules	116
3. Exit Strategies from the Financial Crisis	122
4. The Future of Global Financial Governance	128
5. Repairing Failed States	134
6. Democracy and Development	142
THE GLOBAL ENVIRONMENT	148
1. Preparing for the Blue Revolution	150
2. Managing Marine Resources	160
3. Rethinking Agriculture	168
4. Bioenergy and Land Use in Developing Countries	176
5. The Energy Crisis and Climate Change	184
6. Establishing a Global Climate Regime	190
Organizers, Sponsors, and Partners	198
Imprint	200



1. Global Problem Solving

By Dennis J. Snower

To understand what motivates the Global Economic Symposium—the GES—let's ask ourselves a straightforward question: How much progress has the world's population made in tackling our major global problems?

- Greenhouse gas emissions? Virtually none.
- Water management? Mainly regress.
- Securing access to sustainable energy? Not enough.
- Narrowing the gap between the world's richest and poorest people? Nothing.
- Stabilizing the international financial system? Slow and incomplete.
- Failed states? More regress than progress.
- Eliminating corruption? Not much.
- Halting terrorism, proliferation of weapons, and war? Hardly anything.

These problems are all long-standing. We have had lots of time to monitor, analyze and evaluate them. And these problems are all deadly serious. The longer we let them fester, the greater the danger to our next generation. These aren't problems that governments are going to solve on their own. For if they could, they would have done so already. Nor are they problems that businesses will solve on their own, as a by-product of maximizing shareholder value. For if our global problems were simply an array of profit opportunities, we wouldn't realize that these problems ever existed. And they certainly aren't problems that academics will sort out single-handedly. And the same can be said of other groups acting on their own—international organizations, trade unions, religious groups, NGOs and other civil groups, and so on.

We must face the stark truth that humanity is generating global problems that lie beyond the reach of our conventional instruments.

- For most policy measures are in the hands of national governments, while these problems are global.

- Many of our international governance institutions were established in the immediate aftermath of the Second World War, and their structures have been slow to adjust to the new political, economic, and social realities of the 21st century.
- Traditional philanthropy, traditional corporate social responsibility, and traditional social activism have often done little more than scratch the surface of our global problems, and sometimes have even done more harm than good by preventing people from helping themselves.
- Free economic enterprise has helped many to escape poverty and achieve material well-being. But free enterprise is largely helpless in the face of *public goods* (such as greenhouse gas abatement), *common-property resources* (as witnessed through deforestation, over-grazing, and over-fishing), and *inequality* in income and wealth.

We face a strange paradox: On the one hand, we have raised our living standards by interconnecting the decentralized economic activities of billions of people around the world. In the process, however, we have created interconnected global problems, and these problems often cannot be overcome through decentralized responses. While the global *economy* can be powered by individual self-interest, the resulting global problems require us to respond as a global *society*. And despite the huge possibilities of cooperation arising from the new information and telecommunications technologies, our consciousness of being a global society is still in its infancy.

The Global Economic Symposium is an attempt to make a humble but unique contribution to this challenge. An effective way of motivating us to think and act as a global *society* is to *enable people from different countries, cultures and professions to work together to tackle the global problems they all share*. We are more likely to find our common humanity by tackling common problems than in the daily pursuit of national and interest group politics. And if we are able to formulate common solutions to common problems, this effort may inspire us to cooperate voluntarily.

2. The Role of the GES Participants

By Alessio J.G. Brown

One of the inspiring facets of this Symposium is that it includes people from many different walks of life. While we have all come together to make a contribution to tackling global problems that concern us all, the way we do so will differ in accordance with our professions, countries, and cultures. The only way for us all to gain as much as we can from this meeting of minds seeking solutions is for each of us to make the GES our own.

The GES is a facilitating movement. The underlying idea is that if we all join forces to solve problems that affect us all, we are more likely to recognize our common humanity and our common destiny than if we address global problems from the perspective of special interest groups or focus all our attention on national, cultural, and religious rivalries. In order for a true meeting of minds to take place, we need to give ourselves the internal space to think anew about the solution of global problems from a global perspective. And we need to have the opportunity to develop the GES in ways that we, in each of our various walks of life, find promising and valuable.

So as you go through these solutions of the GES, keep in mind what your work from your unique standpoint can contribute to this effort.

As business leaders, you will know which ones of your profit-making activities also contribute to the global public interest and you also know that employees are energized and customers are encouraged when they recognize that. As policy leaders, you will know what forms of cooperative efforts are needed to enhance actions supporting the global good across nations, generations, and cultures. As academics, you know how to challenge the solutions and generate resulting new research agendas for solving new challenges or evaluating proposed solutions.

As civic leaders you will know which partnerships are needed to create new action agendas and turn solution proposals into actions. Finally, as a representative from

the media, you will know how to debate and publicize proposed solutions to global problems.

Together, we all will need to think about the appropriate division of labor. The GES is an opportunity for the global public interest perspective of your work to receive its due recognition. The GES also illustrates the direction of the longer-run environment relevant for your work with the passage of time. You will be invited to see this larger picture from various viewpoints—the Global Economy, the Global Society, the Global Polity, and the Global Environment.

I would be grateful if, as you read through the solutions, you would ask yourself how you can contribute to making this meeting of minds more fruitful. It will also be a way for you to have your say as a member of the GES community in developing the GES of the future.

In formulating solution proposals for global problems, we all need to be courageous, yet concrete and practical. We must value intellectual integrity and practical usefulness, not political correctness.

3. Global Economic Symposium (GES)

The Global Economic Symposium (GES) 2009 addressed the question “Where do we go from here?” Once the crisis is over, the world is not expected to return to business as usual. What new trajectories are we likely to follow? What dangers lie ahead and what opportunities? What policies, business strategies, and civil initiatives are likely to be globally desirable under these new circumstances?

The GES 2009, for example, addressed issues such as these: The global financial system needs a new framework of regulation and supervision and new forms

of macroeconomic coordination. How should the future of global financial governance be structured? What guidelines can we formulate to strike a desirable balance between risk-taking and financial regulation? What exit strategies should governments pursue in the aftermath of the financial crisis? The international trading system is threatened by new forms of protectionism. How can we sustain global trade under global rules? The upheaval of the world economy is likely to create new social divides. How should governments, businesses, international organizations, NGOs and other civil organizations respond? Given the disparities in countries' national debt burdens, financial sector exposures, export-orientations and raw material dependencies, new forms of global imbalances may arise in the future. The global division of labor is also likely to shift. How are these developments to be addressed in advance? What is the appropriate role of social entrepreneurship in helping the market system serve the public interest? In many different respects, broadly speaking, the world community appears to be suffering from the consequences of failed multilateralism. Are there common causes for these failures, associated with common guidelines toward solutions?

The Global Economic Symposium is meant to give a new impetus to global problem-solving. Our world has become increasingly interdependent and its problems—climate change, financial crisis, failed states, vicious cycles of poverty, educational deficits, unsustainable energy demands, water management and many more—are interdependent as well. These problems can only be addressed through global cooperation.

But such cooperation is often not forthcoming for many reasons: policy instruments are predominantly national; voting constituencies are narrow, not global; pressure groups pursue parochial goals; international forums often articulate national, rather than global, interests. To overcome this global cooperation deficit, we need to create shared visions of the future, inspiring people from different professions, countries and cultures to work together.

However, visions are not enough; they need to be embodied in concrete action plans—policies, business strategies, civil initiatives, and research agenda. These action plans should emerge as the outcome of a dialogue among leading academics, businesspeople, policy makers, and representatives of civil society. For

without such a dialogue, the action plans would lack credibility. And the action plans must be based on state-of-the-art research. Our ideas must go through the crucible of rigorous analysis and evaluation.

The GES seeks to meet these needs.

- It is a *solution* symposium, not a discussion forum. The focus is on proposed solutions to global problems.
- It is a *research-based* exchange, resting on the Virtual GES (the internet platform of the GES), containing background research, policy and strategy proposals, and discussion forums. The Virtual GES—which is supported by the German National Library of Economics (the world's largest economics library)—has the objective to become an international repository of proposed solutions to global problems, together with underlying analysis.
- It is a *multi-stakeholder* initiative, since it initiates a strategic dialogue between leaders from the worlds of academia, business, politics, and civil society.
- It seeks a *long-term* perspective, as its aim is to make the world a better place for the next generation.

The GES is meant to be daring and foresighted. It values intellectual integrity, not political correctness. We are not concerned with marginal improvements of existing arrangements; instead, we seek radically new proposals that could put our future, as a global economic community, on a better course. These proposals need to be concrete and implementable. In short, the aim is to think out of the box; to be visionary, but simultaneously practical.

The success of the GES depends on the efforts of the GES communities that support it:

- The Advisory Board deals with strategic issues of the GES.
- The Kiel Institute provides underlying research and supporting services.
- The German National Library of Economics produces a knowledge base for the GES. Thereby, we seek to build a central repository of existing solutions to global problems, on which basis the new solutions can be developed and evaluated. Through this repository the Virtual GES is meant to become an

ongoing platform of communication among academics, policy-makers, business leaders, and civil society advocates.

- The session expert teams, comprising renowned specialists from around the world, select panelists for each session.
- Global Economic Partnership seeks to help business leaders to align their activities with the solutions to global challenges. A central aspect of this Partnership is the “global stewardship initiative” which encourages companies to identify opportunities that allow them to take advantage of their core competencies to tackle specified global problems.
- The Global Economic Association aims to create an international community of economists devoted to the analysis and treatment of major global policy problems.
- The resulting research may be submitted to our path-breaking electronic journal, called *Economics*, which adopts an open-access, open-review, interactive approach to publication.

Importantly, all these communities stand to gain by communicating with one another. Business leaders frequently need opportunities to think of long-term trends and scenarios and to relate their business challenges to global economic challenges. Policy makers and civic leaders need to keep abreast of the latest thinking on policy responses to global problems—such as ageing societies, social welfare provision, employment creation, development of skills, etc. Academic economists need to remain in close contact with business and policy leaders in order to analyze global problems and their interconnections effectively. The GES aims to meet these needs.

4. Global Economic Solutions

The proposals resulting from the GES—small but useful steps in a constructive direction, supported by decision-makers from diverse walks of life—we label “Solutions.” This label is obviously not meant to imply exhaustive answers, but rather insights concerning concrete actions that could move us up the ladder of global collaboration.

This document summarizes some prominent, innovative proposals generated by the GES 2009. The proposals achieved sizable agreement from the GES panelists and the wider GES community. The proposals aim to provide shared visions of the future, which are meant to inspire cooperative efforts to address global problems. Where possible, they are also meant to be practical, feasible actions towards well-defined goals.

The proposals are grouped into four broad areas, each subdivided into topics corresponding to the sessions of the GES:

THE GLOBAL ECONOMY

1. Balancing Risk-Taking and Financial Regulation
2. The Psychology of Financial Crises
3. Managing the New Global Imbalances
4. The Post-Crisis Global Division of Labor
5. Fighting Against Poverty in the Crisis Aftermath
6. New Knowledge Creation Regimes

THE GLOBAL SOCIETY

1. The New Wave of Social Entrepreneurship
2. Content and Limits of Corporate Social Responsibility
3. Making Migration Work after the Crisis
4. Overcoming Inequality through Education
5. Dealing with the New Social Divides

THE GLOBAL POLITY

1. Fixing Failed Multilateralism
2. Towards Global Trade under Global Rules
3. Exit Strategies from the Financial Crisis
4. The Future of Global Financial Governance
5. Repairing Failed States
6. Democracy and Development

THE GLOBAL ENVIRONMENT

1. Preparing for the Blue Revolution
2. Managing Marine Resources
3. Rethinking Agriculture
4. Bioenergy and Land Use in Developing Countries
5. The Energy Crisis and Climate Change
6. Establishing a Global Climate Regime

Needless to say, there is a lot of overlap among the four areas, for the simple reason that the GES places particular emphasis on global economic problems, many with environmental consequences, with important implications for global society, whose solutions can be addressed through global polity. Nevertheless, the reader may well find the four areas useful for organizing ideas about global issues.

The topics in the area of “The Global Economy” are primarily economic; those in the area of “The Global Polity” are primarily political; and so on. So, for example, the topic “Establishing a Global Climate Regime” is first and foremost an environmental issue, even though it clearly has massive economic, social, and political consequences.

Naturally we do not claim that all the proposals made here are new. We do not aspire to novelty per se, but to usefulness. Myriads of new policies and strategies are invented in response to global problems each year. Our aim is not to add to their number. Rather, the epochal challenge we face today—in this world of

missing cooperation under growing interdependence—is to identify a coherent set of insights that can provide a basis for concrete cooperative action.

These insights should ideally satisfy a number of basic prerequisites:

- The insights should be internally consistent. All too often policies and strategies are created in mental silos, each formulated without reference to the others. For example, pension policies are often designed independently of employment policies; redistribution policies are usually formulated independently of growth-promoting measures; energy policies often conflict with the objectives of environmental policies. The GES strives to avoid this pitfall. It seeks awareness of the interconnections among global problems, along with the consequent interconnections among the policy and strategy responses.
- They aim to serve the global public interest in the widest sense. In particular, they are meant to be inclusive in geographical terms—relevant to the countries of the world, whether developed or developing. They also aim to be occupationally and socially inclusive—relevant to the business, policy-making, academic, and civic communities, to the employed and unemployed, and to the rich and poor.
- They focus on actions that are meant to make the world a better place for the next generation. This means that the underlying problems are lasting ones, not those that are likely to disappear in a matter of years. The insights involve the longer-term thinking that is often displaced by the urgent day-today issues with which business leaders, policy-makers and other representatives of civil society must deal. They aim to provide a picture of the future towards which we must strive through concrete policies and strategies.

Needless to say, this is a tall order. Success can only be achieved through the cumulation of many small steps in a coherent direction. The GES is meant to contribute to this process. The insights presented here are the product of a prolonged exchange of ideas—during the GES and in the months before and after it—among leaders from the business, policy-making, academic, and civic communities. Although the GES participants come from diverse walks of life, they share the belief that we need a reawakening of global cooperation in our current multi-polar world.

All past instances of global cooperation began as ideas in the heads of individuals that grew into visions that aligned people's diverse efforts. The GES seeks to help generate such ideas. While none of us can make a substantial difference in isolation, each of us can make limited, concrete changes towards the common good, and the sum of all these changes will be our legacy for the next generation.

We hope that this document will stimulate further research, debate, and policy initiatives. If the GES is to have real value, it must be merely the beginning of a continuing process—a process of creating a shared framework of thought that can inspire diverse decision-makers to pull in the same direction.

5. Global Economic Fellows: Intergenerational Dialogue

Since the aim of the GES is to bequeath a better world to our children, the GES needs to initiate an intergenerational dialogue. It is not sufficient for experienced leaders to formulate plans for what they consider to be a more promising future. The GES needs activists of the next generation to tell us whether this is indeed the future they hope for.

On this account, the GES launched a new initiative at the GES 2009: the Global Economic Fellows Program. The GES 2009 hosted ten Global Economic Fellows, exceptional young leaders (aged 35 or younger) who have already begun to make outstanding contributions towards addressing major global problems. The Fellows were nominated by the GES community, submitted project ideas, and were selected by a jury drawn from the GES Advisory Board. Their job is to engage with the experienced leaders here to help the GES create blueprints for the future.

And this is only the beginning. The Global Economic Fellows Program has hopefully initiated an ongoing international effort that taps some of the brightest minds of the next generation to address global problems.

The 2009 GES closed with an intergenerational dialogue on global problem-solving, in which eminent leaders from business, politics, academia and civic organizations exchanged ideas with the Global Economic Fellows, representatives of the next generation, on two key questions:

- Does our global problem-solving lead to a future that is genuinely in the interests of the next generation?
- And what are the most important guidelines for future policy, business strategy and political and civil initiatives that the GES Fellows wish to communicate to their predecessor generation?

Three major themes emerged that the GES Fellows felt should be kept in mind when formulating solutions for the future:

Apply a holistic and forward-looking approach in tackling the world's most pressing problems.

The question of how to deal with failed states demonstrates this point most vividly. The origins of state failures can be quite different, involving, for example, drug issues, poverty, the "resource curse," and resource scarcity. Solutions to such problems must also be nuanced, while at the same time taking account of possible interactions between social, economic and environmental issues.

Financial regulation provides another case in point. As future financial crises may look quite different from the crises we have experienced in the past, it will be crucial to acknowledge the "unknown unknowns" and design regulatory regimes that are robust in a changing financial landscape.

Empower individual and private enterprise action in addition to strengthening institutions.

Modern information technologies can empower civil societies and serve as a catalyst for economic development. By mobilizing grassroots movements based

on common ethics and shared values on a global scale, such movements can apply significant pressure to governments and policy-makers and enable global collective action.

At the same, information and communication technologies—such as mobile phones—are an effective means to reach out to the more remote areas and bring about key services in the areas of banking, health, or market information. To leverage individual and private enterprise action, widespread access to information and communication technologies should be promoted, especially in the developing and emerging world.

Ensure the implementation of proposed solutions by creating a sense of urgency.

Negative effects of our actions today will often be felt only in distant future. The projected physical and economic effects of climate change are the most notably example of such intertemporal inconsistency.

Tackling potential global problems in time requires not only the right solutions. A broad consensus and commitment among policy-makers, private corporations, and the broader public in implementing these solutions should be at least as important. Towards this end, it is essential to create a sense of urgency in making the necessary changes.

Grassroots movements based on common ethics and shared values on a global scale may create that sense of urgency. The increasing availability and widespread use of information and communication technologies will help empower collective action and apply significant pressure on governments—for example, to follow through on their commitment to tackle global warming.

6. Popular Solutions

At the end of each GES 2009 session, all members of the public were asked to describe the solution proposal they found most promising and inspiring. While these proposals were debated in the session, they were not necessarily ones that the panelists chose to agree on and include in their “Global Economic Solutions.” The public’s choice is significant in its own right. Thus, the most popular proposals, in each of the four GES themes, are published here.

The Global Economy

- Regulate the banking and shadow banking sectors by the same standards.
- Correct myopic behavior in financial markets through taxing short-term relative to long-term profits.
- Formalize employment relationships in developing countries, thereby enabling workers to gain access to social security.
- Governments should facilitate the creation of knowledge groups, including innovators, knowledge partners, and funders to promote knowledge creation on health, environmental, and poverty issues.

The Global Society

- “Reverse engineer” social entrepreneurship by giving conventional commercial entrepreneurs incentives to become social entrepreneurs.
- Replace traditional “corporate social responsibility” by “shared value creation” among business, customers, employees, and society in the long run.
- Liberalize migration regulations for those who do not compete with vulnerable host groups; home and host countries should coordinate migration criteria for other groups.
- Use publicly funded grant schemes to provide cheap access to education for the poor, particularly for girls.



The Global Polity

- Establish a World Climate Organization to supervise the implementation of climate change agreements.
- Break the impasse in negotiations on agricultural trade by complementing a trade agreement with an agreement on food security.
- Give the IMF and the Financial Stability Board more surveillance power through greater autonomy and restructuring of voting rights.
- Legalize the consumption of narcotics under policy supervision, thereby undermining the drugs trade.

The Global Environment

- Price water and decouple land ownership and water rights, so that water rights can be allocated equitably.
- Specify fish quotas in terms of number of fish rather than weight, thereby protecting baby fish.
- Give priority to measures that can increase energy efficiency, such as better insulation of residential buildings, new vehicle engines and improved manufacturing processes.
- Combine a global cap-and-trade system with an adaptation fund and access to emission-saving technologies for poor countries.

Disclaimer

The proposals summarized in this document are meant to provide insights for action to promote global cooperation in addressing major global problems. These insights have received sizable agreement from the GES panelists, participants, and the wider GES community, but they do not reflect the views of any particular panelist, participant, or community member. Nor do they reflect the views of any organization to which these individuals belong.



The Global Economy 20

1. Balancing Risk-Taking and Financial Regulation 22
2. The Psychology of Financial Crises 30
3. Managing the New Global Imbalances 38
4. The Post-Crisis Global Division of Labor 44
5. Fighting Against Poverty in the Crisis Aftermath 50
6. New Knowledge Creation Regimes 58

The Global Society 66

1. The New Wave of Social Entrepreneurship 68
2. Content and Limits of Corporate Social Responsibility 74
3. Making Migration Work after the Crisis 84
4. Overcoming Inequality through Education 88
5. Dealing with the New Social Divides 96

The Global Polity 108

1. Fixing Failed Multilateralism 110
2. Towards Global Trade under Global Rules 116
3. Exit Strategies from the Financial Crisis 122
4. The Future of Global Financial Governance 128
5. Repairing Failed States 134
6. Democracy and Development 142

The Global Environment 148

1. Preparing for the Blue Revolution 150
2. Managing Marine Resources 160
3. Rethinking Agriculture 168
4. Bioenergy and Land Use in Developing Countries 176
5. The Energy Crisis and Climate Change 184
6. Establishing a Global Climate Regime 190

1. Balancing Risk-Taking and Financial Regulation



Challenge

Many blame excessive risk-taking and inadequate regulation as the core causes of the global financial crisis. Consequently, in the aftermath of the massive government efforts to rescue financial institutions that were hard hit by the crisis, the re-regulation of global finance has been a central focus of policy discussions. There are many questions, including:

- How far should re-regulation of global finance go without stifling healthy risk-taking and financial innovation?
- Should tighter regulation be across-the-board or case-by-case?
- Which regulatory instruments require multilateral coordination?

GESolution 1

Consider the creation of “solvency-convertible debt” for systemically relevant financial institutions, ensuring that if such institutions become insolvent, their debt would automatically be converted into equity, on predetermined terms.

The size of the debt-for-equity swap should be such as to return the institution to solvency and restore its capital adequacy ratio to the minimum required level. What debt is converted and the terms of the conversion would depend on the seniority of the tranches.

This simple measure could ensure that all financial institutions that are “too large to fail” in fact do not fail. As soon as insolvency threatens, enough debt would be converted into equity for solvency to be restored. The institutions may shrink in size, but they could not go under.

Through solvency-convertible debt, these institutions would in effect have a solvency guarantee. But unlike the current bailouts, this guarantee would not be financed by the taxpayers, but rather by the stockholders of these institutions. Maximizing shareholder value would then mean avoiding excessive risk. (The bondholders would not be affected, since they would demand a risk premium



1. Balancing Risk-Taking and Financial Regulation

that covers their risk of loss through possible debt-for-equity swaps.) This proposal would help prevent the insolvency of systemically relevant financial institutions without requiring tax-financed bailouts.

GESolution 2

Create an internationally harmonized and countercyclical set of capital requirements for financial institutions.

The current crisis has made it clear that current regulatory frameworks are driven by domestic priorities and are weak when it comes to resolving cross-border banking crises.

International banks and financial institutions should be asked to meet the same simple and clear principles and ratios in their liquidity and capital provisions. Convergence of capital measurement and capital standards would be a decisive step in filling regulatory loopholes and reducing inefficiency, arbitrage and distortions in the competitive field.

An important part of this deal would be international agreement on the range of assets defined as being liquid. This global standard would support the financial system in terms of transparency and risk management.

Basel II pro-cyclical effects should be tackled with dynamic capital requirements: raising prudential reserves and restraining greater risk-taking during a boom period, and loosening some ratios in a downturn to enable banks to continue lending as conditions deteriorate.

GESolution 3

Create new retail financial instruments to insure consumers against risks, such as home equity insurance and house price futures.

Preventing the next bubble may or may not be possible, but we can reduce the risks and provide greater confidence to consumers. Spreading the scope of financial markets to cover a wider array of economic risks (for example, vastly expanded markets for managing real estate risk) would help. And improving the financial information infrastructure would empower consumers to make better and less emotional financial decisions.

For example, today the standard mortgage provides no protection against difficulties in repaying the lender due to changes in the marketplace. But mortgages could be designed to compensate for these changes by including provisions to ensure homeowners against their major risks.

Developing a liquid futures market, linked to an index of house prices, would enable homeowners to short-sell their home when home prices fall. If home prices fall sharply, the drop in the value of the home would be offset by an increase in the value of the futures contract.

Likewise, insurers could be encouraged to develop home equity insurance, which insures homeowners against drops in the market value of their home. The insurance should be linked to the overall house price index at the local level. Such insurance should be attractive to homeowners if it is offered as an add-on to their existing insurance policies.



1. Balancing Risk-Taking and Financial Regulation

GESolution 4

Introduce incentives for “patient capital,” giving more voting rights to investors who commit themselves to companies for longer periods.

A focus on short-term results has been a value-destroying practice, triggering excessive risk-taking. This was one of the sources of the financial crisis. Managers, stimulated by analysts and supported by weak corporate governance, have been trapped for years in a mad competition to beat quarterly performance, with little regard for the sustainability of their strategy and to longer and sounder targets. Shareholders’ discipline over financial institutions has been loose and often irrelevant.

The time has come to introduce new incentives to align business strategies with the social costs of risk-taking. For example, introduce incentives for patient capital. Investors that commit themselves to a company for a longer period should be rewarded with some form of stronger voting rights. By doing this, management would be led to balance the short-term pressures of the market with the interests of longer-term shareholders to take only sustainable risks.

GESolution 5

Establish an European Deposit Insurance Agency to insure deposits in banks.

During the financial crisis, Europe has found itself with one central bank and many different national regulators giving different answers to the requests of depositors about their savings, especially those kept by international banks. Individual governments have taken different decisions at different times, increasing confusion and concern in the most dangerous moment of the crisis.

Creating a single European agency, along the lines of the US Federal Deposit Insurance Corporation (FDIC), could preserve and boost public trust in the

banking system, assuring that even in the case of major shocks no one will lose any deposits. Its typical role would be to respond immediately when a bank fails, selling deposits and loans of the failed institution to another institution, in a seamless transition from the customer’s point of view.

In addition, by assuming some of national central banks’ powers, a European FDIC could assist national governments and the European Central Bank to assess “systemic risk” and provide a continuous and consistent news and dataflow on the banks that it will be supervising. It could be funded by premiums that banks and savings institutions pay for deposit insurance coverage.

GESolution 6

Consider establishing an institution with the power to approve or reject new financial products in accordance with their forecast systemic risks.

The purpose of the institution is to assess, detect, and prevent adverse economic effects of financial products. The originators of new financial products would be required to submit the relevant information about expected benefits and adverse side-effects, of new financial products and these products could be launched only with the institution’s approval.

These tasks could be conducted by an existing body (such as a central bank) or a new establishment. The institution would collect information about these products, analyse the systemic risks that they may generate, and submit the systemically relevant institutions that offer these products to the relevant stress tests.

The onus of proof concerning the safety of a new financial product would lie with the originator. In these respects, the institution would serve an analogous function to the US Food and Drug Administration and the European Medicines Agency working with the national competent medicines authorities.

1. Balancing Risk-Taking and Financial Regulation

The activities of the institution are meant to ensure that new financial products are not toxic and do not have perverse effects on the economy. With the benefit of this work, the solvency of systemically relevant financial institutions should become straightforward to assess. In this area, this work would effectively replace that of the rating agencies.

Clearly, the practical success of the institution would depend on its ability to find an appropriate path between the dangers of allowing excessively risky projects and of preventing useful financial innovation. Inevitably, the FVA will make both Type I errors (rejecting new financial products that generate a net gain to society) and Type II errors (accepting new financial products that generate a net loss to society). The important policy decision is to define the rules of the institution so that the size of each of these errors is minimized and the balance between them is clearly in the public interest.

Panelists



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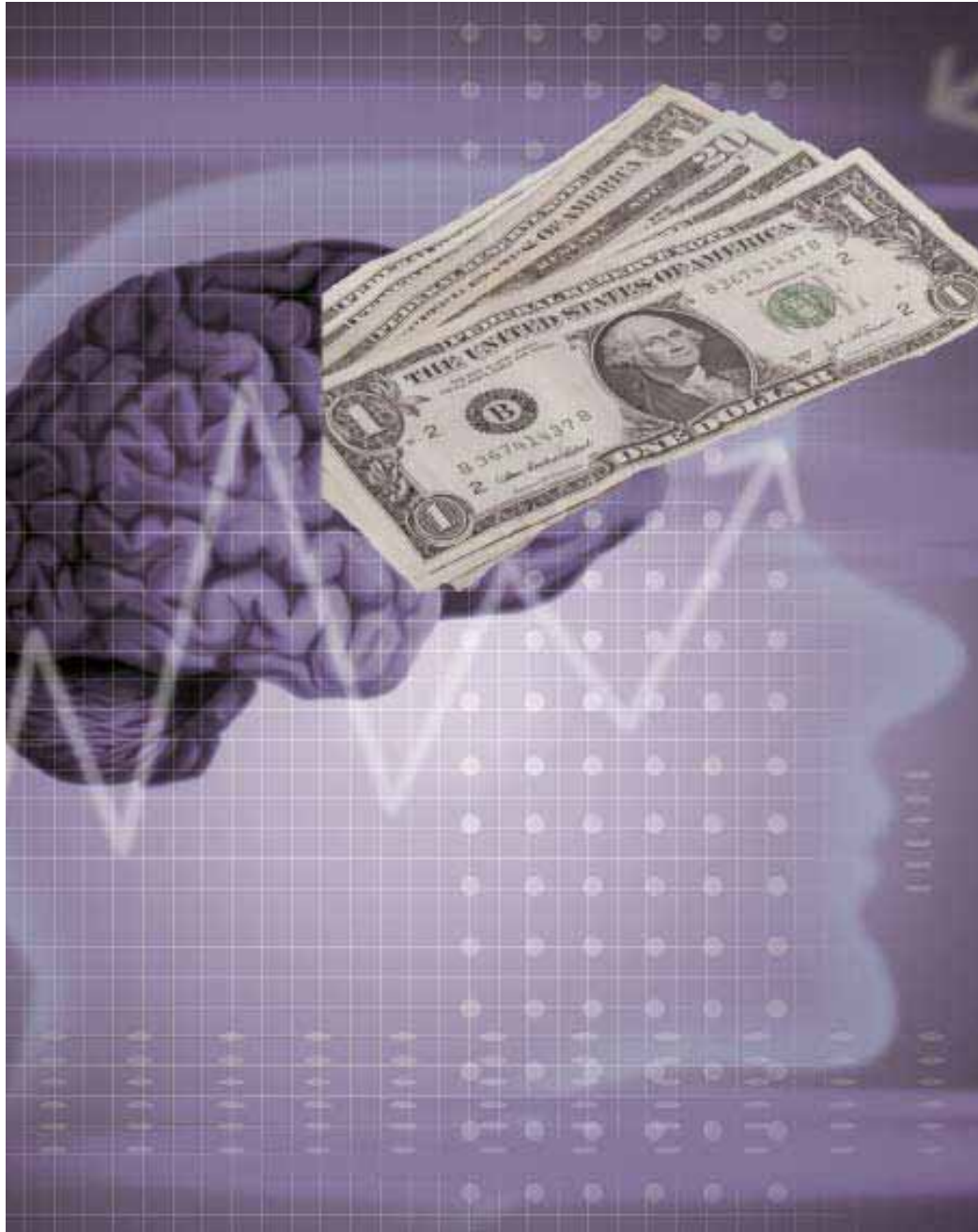


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2. The Psychology of Financial Crises



Challenge

Mainstream economists' accounts of financial crises are called into question by recent research in psychology and neuroscience. The latter portrays people's financial decisions as the outcome of emotional reactions to ambiguity and uncertainty, swings of confidence and trust due to "animal spirits," herd behavior and other social interactions, shifts in moral responsibility due to changes in social norms, and other mental, social, and anthropological forces.

There is increasingly widespread agreement that psychological factors, broadly defined, played a large part in setting up the conditions that led to financial crisis. This does not imply that all traditional economic models are now obsolete: their mathematical precision can generate important insights. But those insights are not always the whole story in describing the behavior of financial markets and the participants working in them.

Specific psychological drivers of financial crises that are important are: temporal myopia (our natural instinct to put a greater weight on short-term rather than long-term needs); collective momentum (our instinct to exhibit herd-like behavior); and the impact of the difficulty we have in making good decisions in when questions are very difficult and conditions are uncertain. These drivers raise a number of questions, including:

- When are psychological phenomena likely to play a particularly important role in financial markets?
- How should policy-makers, bankers, and investors be made aware of these circumstances?
- What are the implications of the psychological approach, alongside the traditional economic one, for financial practices and financial regulation?

2. The Psychology of Financial Crises

GESolution 1

In building financial models to be used by policy-makers and investors, recognize the importance of emotions in financial decision making under uncertainty, including excitement and anxiety that lead to groupthink and changes in states of mind.

While the traditional economic paradigm of the “rational agent” has proved serviceable in many areas of economic activity the abstract and frequently volatile nature of financial assets greatly complicates interpretations of what is rational when it comes to actual human decision-making processes in more or less permanent conditions of uncertainty. The valuation of financial assets is inherently uncertain. Excitement and anxiety about loss tend to be ongoing, so that decisions influenced by groupthink and current states of mind may be the norm merely rising to extremes stimulating extensive herd behavior and emotions like fear and greed when investors are confronted either with asset price inflation or financial crisis.

Although it is widely recognized that neglecting these effects leads to strongly biased results, there is still a lack of models that integrate the findings from behavioral studies (or at least some major aspects of them) into existing generally accepted economic models in a mathematically tractable and practically applicable way.

Once established and generally accepted, such models would naturally be of great value to policy-makers. But they should also influence the behavior of investors, as they would have more substantiated support for their decisions even in turbulent times.

GESolution 2

Implement policies that impede the development of temporal myopia, divided states of mind, and groupthink. For example, tax short-term profit-taking at higher rates than long-term profit taking. Instead of capping the bonuses of financial executives, require that their remuneration schemes reflect the sustainable long-term performance of their firms.

It is well-known from neuropsychology that humans tend to place disproportionate importance on short-term gains over long-term ones and are strongly influenced by the context in which decisions are made. Research into investor behavior also shows that divided states of mind get created in which excited anticipation of rewards gets divided off from fear of loss. In economic decision-making, this can lead to huge biases. When a price bubble arises, fully rational traders can feel forced to invest in overvalued assets due to a combination of myopic incentive schemes that do not accept performance worse than the average even for a short time period and a fear of missing out.

A promising and direct approach to counteract such “temporal myopia” is to create impediments to make professionals think twice; for example to tax short-term profits higher relative to long-term profits. At the company level, it is desirable to implement more sustainable incentive schemes, which reward long-term performance rather than focusing on short time periods and to examine ways to ensure directors of financial intermediaries are focused on a sustainable long-term future for their firms.



2. The Psychology of Financial Crises

GESolution 3

Since there are often multiple stable equilibria in political and economic decisions, design financial-crisis policies that are sufficiently broad (covering enough policy instruments) and deep (involving policy changes of sufficient magnitude) to move the economy to a new, socially desirable equilibrium.

A possibility that is often ignored is the existence of several stable equilibria in a financial market. These equilibria usually will not be equally desirable, and which of them is realized may depend heavily on psychological effects.

In a financial crisis, one of the major tasks of government should be to restore the confidence of the investors to move the market from a less desirable equilibrium towards a more favorable one. As a concrete example, the government should have the goal of lifting credit flows to the level that would have prevailed without a crisis instead of just ensuring the solvency of systemically relevant agents.

GESolution 4

Develop a new information infrastructure on psychological biases in financial markets, including indices of potential over-excitement and the psychological effects of new financial instruments and of financial reporting systems. Make this information infrastructure available to the monetary and regulatory authorities.

To reduce fluctuations in financial markets, it is of great importance to provide reasonable data on the extent of asset-bubble potential (potential over-excitement) present in the markets. This might involve introducing indices that could be based on sentiment data (raised by questionnaires) as well as measures calculated indirectly from market data (for example, prices relative to fundamental

data). Studies examining the likely psychological impact of financial innovations would also be useful.

As the public recognition and reliability of such indices is of crucial importance, they should be provided by independent authorities (for example, central banks), which also should have to take care for their public awareness.

Measures to promote transparency in financial markets more generally might contribute to greater stability, but they might also create instability. Transparency is broadly helpful to the behavior of institutions and markets, but with three caveats. First, too much transparency can exacerbate our myopic tendencies: for example, quarterly reporting and real-time benchmarking of traders' relative performance. Second, not all information generated or published is intelligent. Third, there need to be systems that follow up and use information that is published.

GESolution 5

Include indices of psychological excitement in the design of monetary policy and of financial regulation.

Existing insights from behavioral economics and neuroeconomics are sufficient to justify financial regulators taking psychology into account in designing monetary policy and financial regulation. For example, monetary authorities should use indices of psychological excitement in an effort to identify asset price bubbles. This will help central banks mitigate such bubbles and thereby improve financial stability.

Regulatory rules need to reflect concerns about financial exuberance. For example, bank capital requirements should be designed to respond to variations in indices of excitement.

2. The Psychology of Financial Crises

GESolution 6

Allow financial managers to be ranked in terms of long-term, but not short-term, performance.

Ranking of financial managers and advertising of mutual and other funds in a form that sets the financial market off in the pursuit of exceptionality encourages divided states of mind. Prevent the selection of some funds from the stable of funds that any financial manager has so as to advertise the highest performer.

Divided states of mind also arise when excitement about particular aspects of past performance are printed in big letters, followed by a disclaimer in small type about the link between past and future.

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3. Managing the New Global Imbalances



Challenge

The current crisis was preceded by a huge build-up of global imbalances in terms of current account balances. While several industrialized countries, notably the United States, ran excessive deficits, some emerging economies experienced remarkable surpluses.

These imbalances were connected to the asset price bubbles in the developed countries. The steady capital supply from emerging economies lowered interest rates in industrialized countries and supported the emergence of asset price bubbles. As the financial system transformed the savings from abroad into credit and mortgages and thus consumption within the industrialized countries, imports increased. This fueled export revenues in surplus countries and enabled them to increase savings further.

The financial crisis and the recession have unwound some of the old global imbalances. For example, US household consumption as a proportion of income has fallen, and Chinese government spending relative to GDP has increased. Nevertheless, the economic turmoil may give rise to new patterns of global imbalances.

Governments' ability and need to provide bank bailouts and fiscal stimuli have depended on the size of their financial industry and the size of the national debt, rather than on the magnitude of previous global imbalances. The severity of national recessions—along with the associated changes in trade flows and capital movements—have depended in part on countries' different degrees of export dependence, energy production capacities, and past financial regulations.

These differences may generate new imbalances—between countries with relatively large and relatively small financial sectors; between countries that are producers of raw materials and those that are consumers of raw materials; and between relatively open and relatively closed economies.

How should countries, both individually and collectively, respond to the prospect of new imbalances? And what exchange rate regimes would be useful to prevent the new imbalances from emerging?



3. Managing the New Global Imbalances

GESolution 1

Reduce global imbalances through an internationally harmonized reduction in financial institutions' leverage ratios, elimination of their off-balance sheet activities, and tighter monitoring of financial products.

Recent developments in financial markets and global imbalances are strongly interrelated. So regulation of financial markets that ensures more transparency and stability is one cornerstone of efforts to prevent unsustainable global imbalances.

Reasonable steps towards better regulation of financial markets include a reduction of the leverage ratios of financial institutions, implementation of a new structure for rating agencies to prevent moral hazard, tighter monitoring of new and existing financial products, ensuring better risk management of financial institutions with a special focus on eliminating off-balance sheet activities.

It is vital to implement new financial regulations that are internationally coordinated. This helps to avoid regulatory arbitrage. Furthermore, an international implementation would help to improve financial markets in emerging economies and therefore support a higher absorption of domestic savings in these countries.

GESolution 2

Monetary policy should monitor asset prices and be prepared to prevent the emergence of asset price bubbles.

Asset price bubbles interact with unsustainable global imbalances. In the United States and Spain, housing price bubbles fed credit-based domestic demand and exaggerated trade deficits.

An anticipatory monetary policy that takes account of developments in asset prices (alongside the main goal of price stability) and is willing to let asset price bubbles burst at the very beginning would help to prevent persistent global imbalances.

GESolution 3

Conduct international negotiations on exchange rates through the G20, using the IMF as intellectual backbone.

After the breakdown of Bretton Woods, exchange rate policies were uncoordinated and mainly unilateral. Several countries have currency pegs to the US dollar or a basket of leading currencies, some countries apply a managed floating system, and a few currencies float freely. This non-system obviously did not prevent the evolution of unsustainable global imbalances.

An international platform like the G20 should negotiate about exchange rate issues. If unsustainable imbalances become apparent, such a platform should urge the major economies to multilateral action to adjust exchange rates. An institution like the IMF might provide the intellectual backbone for such a task.

GESolution 4

Promote international cooperation between deficit and surplus countries, to induce deficit countries to reduce restrictions to foreign investments and improve the quality of their assets and to induce surplus countries to encourage procurement from and investment to deficit countries.

Domestic policies mainly pursue mainly goals such as price stability or low unemployment. Current accounts are often a kind of residual and seldom a major issue of concern of policy-makers compared to the above-mentioned goals. Additionally, even if countries unilaterally try to take actions to impact current accounts, the results are often frustrating, as the example of Japan proves.



3. Managing the New Global Imbalances

To keep global imbalances on the agenda, institutions are needed which remind domestic policy-makers of this dimension of economic policy so that they will regard global imbalances also when performing national monetary and fiscal policy or financial regulation and which ensure that the reduction of global imbalances occurs according to the free trade principles of the World Trade Organization (WTO).

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4. The Post-Crisis Global Division of Labor



Challenge

Recent changes in how different stages of the production chain are dispersed across the globe have led to the notion of a new global division of labor. This will have far-reaching consequences for the skills required from the workforce, their jobs, and the economy as whole in both developed and developing countries.

During the 1980s and 1990s, the global division of labor implied that unskilled jobs were done in low-wage countries, while skilled jobs were done in the developed economies. At the same time, the situation of unskilled workers in many developed countries deteriorated drastically and inequality started to rise.

Recent technological developments, such as the internet, have made it possible to relocate more and more tasks of the production chain abroad, including high-skilled jobs. Entirely new patterns of inequality could emerge as a consequence, possibly along with dwindling support for economic globalization.

The changing nature of the new global division of labor may entail that the content of jobs changes completely and that people are likely to work in more than one occupation during their working lives. It has been argued that workers need strong competences in social skills, problem-solving skills, and versatility to cope with such challenges. This raises many questions, including:

- Will education systems need to change to produce a workforce with such skills?
- How can the welfare state support workers in such a changing environment?
- What do workers in developing countries need most to benefit most from the new global division of labor?

4. The Post-Crisis Global Division of Labor

GESolution 1

Combine structural reforms with expansionary macroeconomic policies.

Structural reforms remain important to ease transitions in the labor markets and prevent potential skill shortages, especially in the light of rapid technological progress and globalization. Yet for such reforms to be successful, both, the supply of and the demand for labor need to be taken into consideration. Thus, the economic crisis requires them to be combined with strong expansionary macroeconomic policies. A crisis is usually a good time to push reforms, but only if the economies in the rest of the world are healthy and can generate sufficient aggregate demand to support such structural reforms. This condition is not met in a global slump. Hence, bringing the economy back is vital before reforms are started. National reforms are then again backed by global markets.

GESolution 2

Provide more finance to strengthen lifelong learning in companies and to teach basic skills in schools.

Basic skills and expert knowledge are undoubtedly crucial and should be taught in schools and universities around the globe. Yet technological progress often makes specific skills obsolete. So governments and companies should provide for lifelong learning so that the workforce is able to deal with the changes.

Companies should play an increasing role in education and training, especially with job-related skills. Governments should fund training if there are positive economy-wide externalities, which is the case with basic skills, but might also apply to job-related skills in some cases.

There are important interconnections with policies in other areas: for example, extending the retirement age makes lifelong learning even more crucial.

GESolution 3

Enact basic standards in child labor and health issues, but make sure that they do not lead to “backdoor” protectionism.

A globally interconnected world requires worldwide basic labor standards in areas such as child labor or health. This provides a level playing field for companies and helps to avoid a regulatory race to the bottom.

But labor standards must not be too strict and they should not regulate such details as working hours or wages as this could prevent growth-enhancing global competition. Rather, it is crucial to allow emerging and developing economies to make full use of their comparative advantages, which in many cases consists of an abundant labor force and low wages.

GESolution 4

Design welfare state reform around an explicit strategy of promoting measures that compensate losers from globalization, without undermining work incentives.

Even though globalization increases overall wealth, it also creates winners and losers. The welfare state needs to redistribute some of the gains from globalization to the losers. This will enhance political stability and help to keep protectionist pressures in check, as more people benefit from the advantages of an increasing international division of labor.

The redistributive policies should redistribute incentives for employment and skill acquisition to the disadvantaged, thereby mitigating the danger that incentives for work and search for jobs are undermined.

4. The Post-Crisis Global Division of Labor

Panelists



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5. Fighting Against Poverty in the Crisis Aftermath



Challenge

Poverty reduction has become the central objective of development policy, as reflected in the United Nations' Millennium Development Goals (MDGs). While economic growth is seen as an important ingredient in achieving sustainable poverty reduction, the emerging consensus is that growth has to be pro-poor to reach such ambitious targets as the MDGs.

Even with pro-poor growth, the poorest regions, in particular sub-Saharan Africa, are unlikely to cut poverty in half between 1990 and 2015 as required by the first MDG. The current crisis makes matters worse by reducing growth prospects all over the developing world.

The policy agenda for achieving pro-poor growth includes a number of fairly uncontroversial measures, such as universal primary education and the provision of social funds for the poor.

There is much less consensus about interventions to address inequality within developing countries, even though they might directly contribute to poverty reduction, especially in very unequal societies. For example, should a poverty strategy focus directly on growth or instead concentrate on empowering the poor to benefit from growth? How can inequality be reduced in ways that stimulate economic growth?

GESolution 1

To enable the poor in developing countries to cope with global recession, aid should promote employment, supported by workfare programs, and social protection through conditional cash transfers.

To respond to the challenges raised by the financial crisis, it is urgent that donors deliver on their official development assistance (ODA) commitments, and adopt and implement aid effectiveness principles.

5. Fighting Against Poverty in the Crisis Aftermath



Given its countercyclical nature, ODA can help poor people cope with the recession and contribute to aggregate demand (via spending on consumption and infrastructure) by supporting a combination of employment policies and social protection. The effectiveness of employment policies can be augmented through workfare programs and the efficiency of social protection can be enhanced through conditional cash transfers.

Donors should make productive employment and decent work a key objective of development cooperation and provide adequate, long-term and predictable financial assistance to underpin developing countries' efforts to build social protection systems. In addition, donors and recipients should jointly monitor and account for performance.

GESolution 2

Formalize employment relationships in developing countries, thereby enabling workers to gain access to social security.

About 60% of the global workforce is made up of informal workers, who have little job security or protection. The capacity of governments to formalize jobs needs to be built up. Policies focusing on the importance of "job quality" and improving skills should be introduced through a "progressive formalization agenda" in a bid to benefit the poor—and for the poor to be able to contribute to growth. This would help bring people back to the formal labor market by improving their skills and job quality.

GESolution 3

Provide well-tailored and certificated vocational training, especially for workers in the informal economies of poor countries. Include entrepreneurship training and provide start-up capital for new businesses.

Improving and extending vocational training to develop appropriate skills is crucial to facilitating transitions to more productive jobs and therefore improves the employability of the work force. Vocational training needs to build on basic education systems. Basic education and life skills development is vital for supporting the economic development process because it improves agricultural productivity and can facilitate the transition of workers from agricultural jobs to work in the secondary or tertiary sectors.

Helping employment seekers become entrepreneurs who create jobs (for example, through self-employment and micro-enterprise) is often a neglected path to entering the labor market. Employment and education policy should therefore include entrepreneurship training. Together with mechanisms that provide start-up capital, businesses can be created in a sound economic context.

GESolution 4

Promote "circular migration" by providing re-entry visas for migrants on renewable short-term contracts, reducing transactions costs for remittances, providing policy incentives for migrants to use their contacts to set up companies in their home countries, and policies to enable developed countries to pay for the training invested in migrants for poor countries.

This is an effective response to the "brain drain," which often deprives developing countries of their human capital and has serious consequences for the delivery of key services such as education or health care. Circular migration can be supported through re-entry visas for migrants on renewable short-term contracts, portable pensions, and other social benefits.

"Ethical recruitment" practices and measures to improve working conditions, infrastructure and career opportunities for high-skilled personnel in developing countries should accompany the acquisition of professionals from sectors exposed to the brain drain. On-the-job training and skill acquisition schemes affecting migrants' employability and knowledge transfer can also support circular migration.

5. Fighting Against Poverty in the Crisis Aftermath



The number of professionals could be increased through a trade-off with developed countries. For example, a developing country trains four nurses: a developed country takes one while the developing country retains three. Countries who take on skilled professionals from developing countries should pay for the skills and the training that have been invested in them.

Remittances will contribute more to job creation if policies help to create stronger incentives to save and invest in migrants' countries of origin—particularly in community development projects and small-scale labor-intensive business.

Policies should seek to create incentives to use more of the remittances for productive investments. Expanded access to money transfer institutions, a reduction in transaction fees and improved safety of money transfers should also be promoted. Remittances can counterbalance the deficiency of local insurance systems and function as social safety nets.

GESolution 5

Provide inducements for pharmaceutical companies to invest in the health of poor countries.

At present, 90% of global health investments benefit only 10% of the planet. Pharmaceutical companies are still not investing enough into researching and developing medicines for diseases that predominantly affect poor people in developing countries. More than 85% of world consumers are underserved or have no access to its medicines. This is bad for the industry and bad for poor people, who are still facing devastating diseases like malaria, tuberculosis, asthma, cancer, and HIV/AIDS without affordable medicines.

Overcoming the gap requires a change in the mindset of pharmaceutical companies to innovate and invest more in untapped markets. Providing policy inducements to invest more in these markets would benefit multinational pharmaceutical companies as well, as they could create substantial efficiencies through investing in fighting diseases that affect people in developing countries.

GESolution 6

Replace crop insurance with IOUs that require farmers to pay only when the harvest is good.

A major obstacle to the commercialization of small farmers is the increased uncertainty of the market place, compared with subsistence farming. The problem is exacerbated by the fact that small farmers have very little ability to absorb the risk of losses. Such risks are high as market volatility is an integral part of the world agricultural commodities market. High volatility, in turn, makes insurance an unworkable solution, as the premium rates, which depend on the probability of loss, to cover these risks appear to be too high.

Establish an agency that sells contingent claims on behalf of the household. Each claim promises to pay a specific amount if the farmer has a good crop and nothing if it is a bad year. This is like an IOU sold by the farmer to anyone who wants to buy it.

The major change from the insurance mechanism brought about by this proposed alternative is the sequence of cash transfers. With insurance, the farmer pays first and the company pays the farmer later and only if the farmer suffers a loss. Since premiums are high, this raises the problem of farmer liquidity or the inability to pay large premiums before the harvest when the farmer is cash-strapped.

In the proposed solution, the farmer pays only when the going is good or when the farmer has the ability to pay. This is brought about by simply making the buyer of the IOUs pay first and having the farmer pay after the good outcome has happened.

GESolution 7

Reform food policy by replacing the public distribution system with a system of food stamps for the poor, combined with private sector activity to purchase, store, move, and distribute affordable food.

5. Fighting Against Poverty in the Crisis Aftermath

In various developing and emerging economies, food subsidies are restricted to the poor and food distribution to the poor is often in public hands. For example, in India's targeted public distribution system (TPDS), introduced in 1997, subsidies are restricted to households below the poverty line. Restricting the public distribution system to serving the poor affects the economic viability of retail outlets. Thus, the government becomes deeply involved in the physical handling of foodstuffs (such as grain).

An alternative to this arrangement is a system of food stamps. In this scheme, the purchase, storage, movement, and distribution of grain is performed by the private sector. A food stamp is a cash voucher which can be exchanged by the recipient only for food. It is usual to restrict the list of foods by excluding alcoholic beverages, snacks, and other processed food.

GESolution 8

Fight poverty in developed countries through an expansion of welfare-to-work policies, supported by education and training measures aimed at enabling the poor to adapt to the skills required in changing labor markets.

The risks of being in poverty in developed countries vary across age groups. Older people now have a lower risk of being poor while the risk has increased for children and young adults. Single-parent households are three times as likely to be poor as the average family.

But the main dividing line is work. Six times as many jobless families are below the poverty line than working families, and the ratio is even higher in North America. Among all family types, access to paid work reduces poverty risks quite significantly. For social policies in developed countries, this means that active employment policies need to be complemented with welfare-to-work policies, which encourage people to work and supplement the income of working families. Better training and education measures should aim to equip people with the skills they need in tomorrow's labor market, thus creating greater equality of opportunity.

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6. New Knowledge Creation Regimes



Challenge

Recent developments in systems of intellectual property rights seem to involve a paradox: the “rules of the game” are becoming ever stronger, emphasizing enforcement and excludability; whereas the standards of the “play of the game” are loosening, with the wide use of open source technology and non-proprietary systems of intellectual property. At the same time, while the technological revolution theoretically facilitates the sharing of knowledge, this is hampered by regulations and made costly for firms.

The design of the most appropriate system of intellectual property rights is difficult. While the ideal system should create incentives and restrict rent-seeking, actual systems often seem to create incentives *for* rent-seeking. It is the role of policy-makers to prevent this behavior and align incentives with a socially beneficial outcome.

The international integration of markets does not make things easier. National rights often do not provide incentives large enough to stimulate investment, and thus governments seek to “protect” investments by national firms abroad—for example, in the form of agreements based on the principle of national treatment. But in the home market, governments typically aim for weaker rights, enabling fiercer domestic price competition for the benefit of consumers.

An effective system of intellectual property rights must seek to align the incentives of innovators, knowledge partners, and funders to induce a socially beneficial outcome. Ideally, these incentives should align national and international concerns, providing innovators with an appropriate level of protection on global markets without locking up patents for too long.

GESolution 1

Redesign the framework for international property rights (IPRs) to move from a system that encourages the maximization of royalties to a system that encourages the maximization of reciprocal knowledge donation. Use national labs systems to start this process.

6. New Knowledge Creation Regimes

Global negotiations should focus on the scope of the public domain as well as the scope of private intellectual property rights. There has been an “arms race” between countries, for example, in negotiations within the WTO on TRIPS (trade-related aspects of intellectual property rights), whereby the nation-state basis of discussions leads to a continual ratcheting up of protection for private intellectual property, copyrights, and patents. This race has led to an absence of emphasis on incentives for creating global public goods. It leads to a “prisoner’s dilemma” situation in which the resulting protection of IPRs is optimal from the standpoint of individual states but excessive from the standpoint of the global collective of states. The main effect is to raise the costs of innovation, and suppress adoption, throughout the world. It would be preferable to start a different dynamic in which countries competed to extract reciprocal donations to the public domain from one another.

The most natural place to start this process is the national lab systems that exist in most developed and many developing countries. A trial area—such as a specific public health issue—should be selected as the first area of international negotiation on the public domain as well as private intellectual property.

As the “play of the game” shows, the currently used system of intellectual property rights is not always appropriate. Firms use more and more informal non-proprietary systems, especially small and medium-sized enterprises.

Belief systems suggesting that only strong protection of intellectual property rights provides sufficient incentives for innovators do not take account of this “play of the game” by innovators and funders. Mutual access to innovations at low costs and positive network effects provide incentives for a non-proprietary system of intellectual property rights.

Intellectual property rights should build on international regulations with enough room for country-specific and sector-specific solutions. The important difference between knowledge creation and knowledge commercialization, with their different underlying motivation, should be explicit in the setting of new rules.

GESolution 2

Strengthen the legal base for intermediate regimes between proprietary and non-proprietary systems, such as general public licences, soft patents, public-private partnerships, and private philanthropy.

A less restrictive system can efficiently reduce the costs for innovators and funders and stimulate the flow of information. The legal base for intermediate institutional regimes between the poles of proprietary and non-proprietary systems, such as general public licences, soft patents, public private partnership, and private philanthropy, should be improved.

GESolution 3

Restrict public funding of research and development to projects that go into the public domain, supported internationally by reciprocal concessions.

Public funding is an important source of funding in many research projects. It stimulates innovative engagement and reduces the costs to consumers. But the international integration of trade and markets poses the threat that publicly funded research projects are perceived as a gift to the rest of the world.

It may therefore be desirable to fund only those projects in which the research results go back into the public domain. Such a selective process could sustain a viable pool of public knowledge, without being too costly for the taxpayer. The approach can be strengthened by international reciprocal concessions that prevent countries from wasting one-sided gifts on other countries.



6. New Knowledge Creation Regimes

GESolution 4

Enable the World Intellectual Property Organization (WIPO) to create an effective legal framework for intellectual property rights.

At present, intellectual property rights in international negotiations are seen primarily as an issue of trade policy. But they should be treated as an issue in their own right. At present, the discussion of intellectual property rights is more about rent-seeking than about setting the right incentives. International negotiations should focus on reciprocal concessions towards a regulatory disarmament, where trade negotiations on tariffs and quotas might serve as a blueprint.

A strong, progressive WIPO could have the ability to come up with an effective legal framework for intellectual property rights. In particular, this framework could support the development of the digital world, where markets for connected products are booming, but the appropriate regulatory regime is lagging behind.

The TRIPS agreement, which has been in effect since 1995, should at best be seen as only a starting point for negotiating an international framework for the system of intellectual property rights, providing incentives for the creation of global public goods.

GESolution 5

Governments should facilitate the creation of knowledge groups—including innovators, knowledge partners, and funders—to promote knowledge creation on health, environmental, and poverty issues.

Knowledge creation networks should operate as partnerships between government and private sector companies in specific countries or localities, particularly in developing countries, in areas of research such as health and education. The aim is to use these as concrete demonstrations of deliverables

in socially important areas, such as those targeted by the MDGs. Rather than seeking an ambitious global solution, which will be hard to deliver, the aim is to find incremental improvements in practice.

Improved interaction between the various participants engaged in creating knowledge can efficiently reduce operation costs, extract more value from business projects, and lead to more competitive companies and more new products. It is the role of the government—especially in developing countries—to enhance and facilitate this interaction by adapting the infrastructure and the functioning of the system of intellectual property rights to new business models, even taking part in the interaction through public-private partnerships.

So-called “knowledge groups” that emerge out of this process of enhanced interaction facilitate the dissimulation and transfer of knowledge. By allowing for the contribution of various people and their collaborative development, the innovation process in socially important areas such as education, environment, and health can become more dynamic, efficient, and hence profitable.

But the rules should be defined in a way that prevents excessive “closed-shop” situations in the value-added chain. Given the reluctance of innovators and knowledge providers to submit themselves to new rules, demonstration projects limited in scope and time should be offered by governments as a “training field” for wider all encompassing rules.

Rather than seeking a global, ambitious solution, which will be hard to deliver, the aim should be—for the moment—to find incremental improvements in practice. Such demonstration projects can be used to test which legal framework fits best to which industry—for example, e-learning in the education sector and e-diagnostics in the health sector.

6. New Knowledge Creation Regimes

GESolution 6

Create an Intellectual Property Agency to determine the optimal duration and width of patents on a case-by-case basis.

In a fully non-proprietary open source system, where no rights are granted to the innovator, it might appear that incentives are lacking when network effects are not large enough. But granting property rights as those currently used in patent law locks up patents for 20 years. Finding solutions that grant property rights for shorter durations should be the focus of policy-makers.

To determine the duration and width of each and every individual patent on a case-by-case basis is costly, and policy-makers often lack information to determine appropriate rewards needed by innovators to develop an invention. It would be valuable to have an institution, an Intellectual Property Agency, doing this determination process on its own.

The case of embedded LINUX (as well as examples from biology) show that it is possible to share core elements of research. With embedded Linux, private intellectual property is protected for 18 months—in between the 20 years of a patent and the zero protection of the full public domain.

Apply an open-source approach to sharing core elements of commercial biology/synthetic biology research, to ensure that results essential to human health are kept in the public domain and widely used as the basis for further products and innovations.

GESolution 7

Stimulate competition to share knowledge. For example, governments should make research-and-development grants dependent on commitments to waive intellectual property rights early.

Government agencies should create a new ground for competition based on how much grant recipients are prepared to waive IPRs that they would otherwise be

legally entitled to claim. For example, applicants could improve their chances of receiving a grant by promising to waive their IPRs early (e.g., after 18 months instead of 20 years) or offering to share royalty-free licenses with specific groups (e.g., academic researchers). Such a system would reduce intellectual property incentives to the minimum level consistent with eliciting discovery in the first place.

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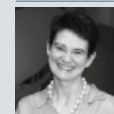
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The Global Economy 20

1. Balancing Risk-Taking and Financial Regulation 22
2. The Psychology of Financial Crises 30
3. Managing the New Global Imbalances 38
4. The Post-Crisis Global Division of Labor 44
5. Fighting Against Poverty in the Crisis Aftermath 50
6. New Knowledge Creation Regimes 58

The Global Society 66

1. The New Wave of Social Entrepreneurship 68
2. Content and Limits of Corporate Social Responsibility 74
3. Making Migration Work after the Crisis 84
4. Overcoming Inequality through Education 88
5. Dealing with the New Social Divides 96

The Global Polity 108

1. Fixing Failed Multilateralism 110
2. Towards Global Trade under Global Rules 116
3. Exit Strategies from the Financial Crisis 122
4. The Future of Global Financial Governance 128
5. Repairing Failed States 134
6. Democracy and Development 142

The Global Environment 148

1. Preparing for the Blue Revolution 150
2. Managing Marine Resources 160
3. Rethinking Agriculture 168
4. Bioenergy and Land Use in Developing Countries 176
5. The Energy Crisis and Climate Change 184
6. Establishing a Global Climate Regime 190

1. The New Wave of Social Entrepreneurship



Challenge

In the aftermath of the near collapse of the Western financial system, many observers agree that neither unfettered financial markets nor invasive regulation are able to ensure that financial and business leaders will necessarily act in the public interest. While governments are pondering how to provide a legal and political framework that better aligns the needs of business and society, a new class of economic actors has emerged that aim to give explicit consideration to both social and economic gains.

These are the social entrepreneurs. Armed with the tools of commerce and markets, they use their creativity, skills, and hard work to found and run social enterprises that deploy the methodology of capitalism for outcomes of a social nature.

Social businesses effectively create financial and social returns, in different measure. They harness capital from a new breed of socially minded investors, whose returns horizons have broadened from a focus purely on financial return and risk to one that also addresses the social element of returns.

Such investors have moved on from the “socially responsible investment” concept of the 1980s to become more proactive and positive in their investment. Two asset classes from the social investment arena—clean technology and microfinance—have already entered the traditional investment mainstream, which has greatly increased capital flows to social investment. This raises a number of questions about the potential of the new wave of social entrepreneurship, including:

- Which global problems can and should be addressed most effectively by social entrepreneurship and social investment?
- How can governments provide an institutional and legal setting to enhance the power of social entrepreneurship to address problems such as poverty, inadequate infrastructure, health problems, education and training, and welfare provision?
- How can social entrepreneurs interact with international organizations and non-governmental organizations (NGOs) to promote the global public interest?



1. The New Wave of Social Entrepreneurship

GESolution 1

“Reverse engineer” social entrepreneurship by giving conventional commercial enterprises incentives to become social entrepreneurs.

Over the past 10 to 20 years, investors have spent millions of dollars trying to build social enterprises from scratch. While this can be rewarding in a broader sense, the failure rates are very high and a great deal of money, time, and effort are wasted.

Instead of concentrating only on the “hard work” of early stage investment, social funders should explore ways to engage with mainstream businesses and encourage them to develop a social dimension. There are potentially numerous ways to provide such incentives. Businesses may, for example, be offered cheaper funding in exchange for agreeing to hire “hard to employ” individuals such as ex-offenders and those with disabilities. Or they may be encouraged to move to areas of greater economic need, enabling social enterprise to grow much faster while reducing the level of resource wastage.

GESolution 2

Expand debt advisory services, along the lines of those available in developed countries, for microfinance customers and investors to developing countries.

The microfinance sector has been one of the most rapidly growing segments of the social enterprise arena. Microfinance assets have increased from tens of dollars in the 1970s to in excess of \$100 billion today. Furthermore, microfinance as an asset class has entered the mainstream investment sector. Nevertheless, the current crisis will severely test the models of all the large microfinance institutions. In particular, there is concern about the ability of their customers to weather the crisis.

More services to investors are called for to prevent them from accumulating excessive debts and potentially facing bankruptcy. Debt advisory services, along the lines of some of those available in developed countries such as the UK, deployed throughout the world would reduce the likelihood of bad debts and delinquent loans of microfinance customers.

GESolution 3

Promote rural hand manufacturing in rural production centers to reduce poverty sustainably by increasing employment.

Poverty in the developing world is largely rural and employment opportunities are needed to reduce poverty while strengthening communities. Industrialization in many developing countries has led to economic migration to urban areas, which, in turn, has exacerbated rural backwardness and urban overcrowding.

Social business is an ideal vehicle for promoting rural hand manufacture by enabling the consideration of both for-profit production and social impact. There are many products from many sectors, including handloom textiles, hand knitting, or hand-made paper, which are ideally suited commercially to rural hand manufacture and which also offer the opportunity for increased rural employment in developing countries.

GESolution 4

Require foundations to invest at least 10% of their assets in social investments.

The current organization and regulation of most private foundations in developed countries is such that they are required to donate or grant only somewhere between 3% and 6% of their assets in any given year to charities. The other 94% to 97% of their assets are generally invested in traditional investment instruments that have no social purpose.

1. The New Wave of Social Entrepreneurship

An obvious source of significant new capital that governments could create for social investment (without having to put the money up themselves) would be to require that foundations invest at least 10% of their assets in social investments. This requirement alone would create a capital pool of tens of billions of dollars, which could be dedicated to affordable housing, microfinance, social enterprise, green energy, or other socially beneficial projects.

GESolution 5

Provide grants for promoting research on the factors that accelerate the development of social entrepreneurship.

Social enterprise, finance, and investment have grown rapidly over the past decades. Nevertheless, this growth has been makeshift and disorganized, resulting in a sub-optimal allocation the factors driving its success.

We need more systematic, multidisciplinary research that improves our understanding of which factors accelerate the development of the sector, and how these factors interact with each other. Particular attention should be given to successful industrial clusters around the world and how factors such as geographical proximity, fiscal policy, or the presence of institutions of higher education were essential to the success of these clusters. Attention should also be given to exploring the potential role of governments, international organizations, and NGOs for promoting and coordinating social entrepreneurship.

Panelists



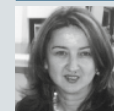
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2. Content and Limits of Corporate Social Responsibility



Challenge

Corporate social responsibility (CSR) represents a company's voluntary commitment to address the ethical, social, and environmental factors associated with its operations. Despite its potential for furthering social needs, CSR activities may come under severe pressure in an era of increased global competition and during economic downturns. The role of governments in facilitating and supporting CSR still remains unclear:

- Do we need joint action of firms and governments to agree on common CSR standards to prevent a race to the bottom where firms that engage in CSR are at a cost disadvantage vis-à-vis their competitors?
- What are the roles of the investor community, consumer movements, and NGOs in creating a stronger focus on CSR?
- Is it possible to achieve common international standards?

GESolution 1

Replace traditional “corporate social responsibility” by “shared value creation” among business, customers, employees, and society in the long run.

“Corporate social responsibility” is the means by which businesses structure their interaction with society. This means more than simply being a good citizen—it is about investing in society as an integral part of business. Thus, it should not be treated as an issue of voluntary contributions, but as basic a recalculation of how to create additional, long-term value. Thought of as a charity, CSR has limited potential. Instead, a “responsible” company looks at all impacts of its activities and thinks creatively about how it can help to drive sustainability across its value chain.

With this in mind, the concept of “shared value creation” is a more fundamental approach to business, which says that if you want to have long-term success, you have to create value for society. It is not an image-building exercise or philanthropy, but a way of viewing business development by simultaneously reviewing the needs of both shareholders and society.



2. Content and Limits of Corporate Social Responsibility

This concept presupposes fully integrating a clear and constructive understanding of our role in society into the mainstream activities of day-to-day business. Thus, taking social responsibility seriously means much more than investing a small fraction of profits into specific projects that serve social needs, as such an approach cannot have the same impact on communities and the environment than the processes of generating the revenues.

Instead, it means creating and designing a necessary partnership between the company and multiple stakeholders. This needs to be done keeping in mind a long-term perspective and going beyond existing legal norms and standards.

GESolution 2

The investor community must require corporations to pursue sustainability. Consumer movements must demand products that respect the environment and society.

Business corporations that do not anticipate the changing needs and norms of society run great risks. What was acceptable once can become no longer acceptable. Asbestos, cigarettes, polluters of water and air, and child labor are well-known examples. Corporate reputations have been ruined; licences to operate have been withdrawn; and financial value has been destroyed.

Corporations that track the changing needs of multiple stakeholders outside the investment community and respond to them ultimately protect the interests of their investors. Therefore, investors should value corporations that demonstrate strong capabilities for responding to demands for sustainability and inclusion and that feel responsible for the environment and the community. Demand from investors is always a good reason for managers to change their behavior, especially those whose philosophy is that the prime purpose of business is to produce results for its investors.

Managers who subscribe to the philosophy that the business of business must only be business may not see the need to respond to the needs of communities.

But they know they must deliver what customers want or they will be out of business. Therefore, strong consumer movements that demand a company's products are good for the environment and society, and can broaden managers' attention beyond the narrow focus on the financial bottom line.

GESolution 3

Require periodical, public reporting on companies' social and environmental impacts. Make reporting subject to independent scrutiny panels.

Business responsibility must not be measured by its activities, but by the contribution business makes by its products and processes, not merely to its investors and owners, but also to the environment and community.

To hold corporations accountable for their impact on the environment and the community they must be required to report their performance against a "triple bottom line": impacts not just on profits, but the planet and people too. Some corporations have begun to do this voluntarily. But for the reports to have value, they should conform to agreed standards. Then the performance of corporations can be compared as with financial reports.

For the information provided by the reporting to be trustworthy, it should be independently audited as with financial reports. Reports should be made public at regular intervals. This would enable the media to report authoritatively on the corporations' social activities. The development of independent auditing and analyses in the media needs to be not only a response to demand from the public, but it can stimulate demand, too.

Experience shows that independently appointed advisory boards are crucial to gaining trust in new areas of operation or in regaining trust where it has been lost. Furthermore, reporting will stimulate companies to think creatively how they can help to drive sustainability across their value chains.



2. Content and Limits of Corporate Social Responsibility

GESolution 4

Promote partnerships between business, governments, and NGOs to address sustainability issues and define appropriate common international standards to hold whole industries to account.

As companies take a more expansive view of corporate responsibility, partnerships with NGOs can help in many ways. NGO engagement can give credibility to a company's efforts. NGOs may have technical expertise that helps to identify issues and solutions, and they can challenge internal thinking.

More generally, NGOs bring complementary strength and capabilities—to educate consumers, to identify sustainable suppliers and to engage policy-makers. For a company serious about making a difference, a partnership with an NGO can offer new possibilities.

Common international standards allow whole industries to be held to account. A number of such standards already exist (for example, the Extractive Industries Transparency Initiative and the Voluntary Principles on Security and Human Rights) but industry-wide standards are rare.

In many cases, there are conflicting sets of rules and unclear messages about what business should be doing. Yet there is an obvious need for such standards. They provide a benchmark to which companies must aspire, while at the same time helping businesses to deflect undue criticism.

Third-party mediation from national governments, large NGOs, or transnational intergovernmental groupings can facilitate the creation of new standards with broad support and legitimacy.

It is unlikely that standards will develop and compliance come about through voluntary action by a few corporations, or even by the actions of voluntary associations of businesses of which there are several already. Indeed, the competition among these associations for recognition of their versions of

standards results in more noise and less useful signals for concerned citizens to rely on. There is a need for a process of convergence in which governments will have to play some role for the sake of providing citizens with reliable and comparable information.

Background

CSR has a long tradition. In an era of rapid globalization, CSR may have some potential to compensate for the loss of national governments' scope for action in balancing conflicting interests and in sustaining a reasonable reconciliation of interests within their own societies. Furthermore, CSR may help to define and implement a set of rules that may govern transnational relationships between firms and stakeholders.

The growing importance of CSR not only on a national but also on a global level recently found its expression in two transnational initiatives: Within the United Nations "Global Impact Initiative," 4,500 business participants committed themselves to aligning their operations to ten universally accepted principles in the areas of human rights, labor, environment, and anti-corruption. Within the Extractive Industry Transparency Initiative, major companies of 24 states worldwide committed to fight against corruption by establishing transparency for royalties to be paid to countries that export natural resources.

At the national level, governments of different countries treat CSR differently. While some actively support CSR activities (for example, the Netherlands, Sweden, and the UK), others are rather passive. Support ranges from awarding honours to corporations that engage in CSR (for example, Belgium), making CSR activities mandatory for firms that bid for public procurement contracts (for example, Italy), the financing of private CSR networks or even think tanks (for example, Denmark), to the explicit appointment of a minister for CSR (the UK). But it still remains unclear how to best allocate responsibilities between the governments, the third sector, and corporations.

If companies take an expansive vision of corporate responsibilities, including social ones, they will find that taking these responsibilities seriously can offer



2. Content and Limits of Corporate Social Responsibility

direct returns to the bottom line—reducing costs by driving efficiencies, for example, or leading to new products and new markets. Taking the needs of the environment and communities into account also leads to more fundamental rewards, as leadership commitment to action on sustainability is central to the overall perception of their companies, to the recruitment and retention of staff ,and, in some cases, to their social “license to operate.”

Business corporations affect the environment and communities by the products they produce and the processes they use to produce revenue and profits. On social performance, corporate responsibility efforts have naturally focused first on the impacts of a company's own operations. But often the biggest impacts are generated at other points of the value chain.

For example, the greatest “water footprint” of a liter of cola is not the 3-4 liters used in the bottling plant, but the 200 liters used to grow the sugar. The biggest carbon impact of a mobile phone is not in the manufacturing, or even often in use, but in the constant draw on power of chargers left plugged in.

Companies that accept expanded responsibility for the effects of their activities have to look at all impacts across the value chain and have to think creatively about how it can help to drive sustainability across the whole chain. Listening to societies may help to detect social needs and to identify appropriate measures to design sustainable value chains.

There may be trade-offs between making life comfortable today and securing sustainable living standards for tomorrow. As it is the next generation that will have to bear many of the future consequences of today's business activities, asking the young people about their preferences may help to clarify how to handle these trade-offs.

There are also questions for business and management teaching. Ethical skills should ideally be instilled in individuals before they reach the business world. Many managers within businesses and investment firms, most consultants who advise businesses, as well as many business analysts, are all products of business

schools. Thus, concepts that business schools teach are pervasive in the business world.

The prevalent theory guiding business practices is based on two premises: that a manager's prime responsibility is to deliver better returns for investors, and that human beings are motivated mostly or entirely by material objectives.

Business schools need a new theory of management to enable the change that has now become imperative in the pattern of human activity. Management teaching and practice must be informed by new theories that reflect the nature of humans more accurately as well as the systemic nature of the world in which each part is embedded. In this interconnected world, those who wish to lead must be responsible for the condition of the whole and for the consequences of their actions on the whole system. This must be the ethics of business leaders and theories and practices in business must be consistent with this ethics.

In addition, successful models for a socially responsible business must be developed and spread about the business world. Every business has a different impact on society and therefore has different responsibilities with regard to mitigating that impact and improving lives. But there are general business practices that can be adopted by any business to enable it to more easily achieve its “creating shared value” goals. When something is shown to have worked, best practice needs to be transferred and developed.

Once again, third-party NGOs and governments can play a constructive role in facilitating dialogue between companies, allowing them to learn from each other. For this to become reality, leadership on the part of the pioneers is needed to spread the word about the opportunities others miss. This is an educational process that can be enhanced beyond the corporations by the business schools and trade bodies.

2. Content and Limits of Corporate Social Responsibility

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3. Making Migration Work after the Crisis



Challenge

International labor migration promotes economic development in sending countries and can help to overcome skill shortages and demographic problems in host countries. Nevertheless, many of these potential benefits are not realized because immigration policies are often too restrictive and not harmonized between host and sending countries.

Two aspects appear to be crucial in making migration more beneficial for both sides:

- First, host countries should take more responsibility for economically and socially integrating immigrants in their societies.
- Second, host and sending countries should cooperate to provide migrants with more flexible migration opportunities and incentives to return.

GESolution 1

Use bilateral agreements between sending and host countries

- *to liberalize migration regulation for those who do not compete with vulnerable host groups,*
- *to expand legal migration, if needed by restricting access to social transfers in the host country, and*
- *to ensure safe and equitable treatment of migrants by establishing labor standards and certificates for intermediaries.*

In the absence of a multilateral policy framework for international labor migration, many high-emigration countries are now negotiating bilateral agreements with host countries. These should be used to expand migration opportunities, particularly for those potential migrants who cannot benefit from the privileged arrangements that exist in many host countries for high-skilled immigrants. At the same time, bilateral agreements should establish labor standards and certification for intermediaries to protect migrants from exploitation.

3. Making Migration Work after the Crisis

To expand migration with a minimal fiscal burden to host countries and thus render it politically feasible, circular migration schemes could restrict migrants' access to some social transfers in the host country.

GESolution 2

Conduct a full public debate on immigration and integration policy and promote a comprehensive benchmarking of good practices beyond European countries and regular migration.

In many countries, legal and illegal immigration occur in a largely unplanned fashion and therefore generate erratic incentives. Policies are difficult to reform because large parts of the electorate fail to acknowledge the reality of widespread immigration.

Host countries need to have a full and honest debate about how many immigrants to admit, whether and how to select them, and how to integrate them socially and economically. This debate can be helped by systematic benchmarking of good practices in national immigration policies. Existing efforts such as the Migrant Policy Integration Index (integrationindex.eu) are helpful but could usefully be extended to more non-European countries and to policies on irregular migration.

GESolution 3

Continue the expansion of migration opportunities with measures to provide information and support to migrants throughout the migration process, including by private sector providers of human resource services.

Private firms are already facilitating the movement of large numbers of workers across borders, through all steps from selection in the home country through visa and travel arrangements to job placement in the host country. When migrants go

through these steps without support by trustworthy parties, a significant risk of exploitation or worse may result.

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4. Overcoming Inequality through Education



Challenge

According to the International Labor Organization, income inequality has increased in about two thirds of countries world since the 1990s. The financial crisis and the accompanying global recession are expected to widen the gap further between the rich and the poor.

Different qualifications and skills are widely accepted as one of the major factors behind different income levels of individuals. Education is usually taken as the main way in which individuals can learn more skills and increase their potential earnings and employability. Despite other potential influential factors behind increasing income inequality worldwide, improving education quality is expected to make a substantial contribution to mitigating both interpersonal and even international income inequality.

- What are effective (and efficient) means for improving education quality?
- Can education quality be effectively improved solely by providing more financial support for education affairs in general?
- What is an appropriate division of work between government and the private sector in education?
- How could incentives of students and teachers be improved?
- Are successful education policies in a country idiosyncratic or can they be blueprints for education policies to be applied elsewhere?

GESolution 1

Bring together efforts from governments, schools, the private sector and civil society to initiate education initiatives and learn from promising education initiatives worldwide.

Reforming education to overcome inequality is not just an issue for government. A well-designed and functional education system is crucial for sustainable economic development and requires efforts from government, schools, the private sector, and civil society.

4. Overcoming Inequality through Education

Learning from promising private initiatives such as the Barefoot College in India and “Teach First” in UK and taking region-specific characteristics into consideration may help to identify the suitable way for different regions to cope with problems of inequality.

GESolution 2

Target policies at the type of inequality to be tackled to overcome inequality of opportunity, remove obstacles to education for children from disadvantaged backgrounds; to overcome inequality of outcome, increase incentives to teach and incentives to learn effectively.

To cope with different types of inequality, the measures required may differ quite substantially from each other. To cope with inequality of opportunity, a phenomenon of unequal accessibility to education among children, policies may focus more strongly on how to allocate more resources on removing impediments that hinder children with disadvantaged backgrounds from gaining adequate access to education.

To cope with inequality of outcome, a phenomenon of unequal learning results among students, policies may focus more strongly on identifying means to increase teachers’ incentives to teach and, above all, students’ incentives and capabilities to learn effectively.

There is no one-size-fits-all policy. Because of different cultures and different development status, inequality of opportunity may be more crucial in certain countries or regions, while inequality of outcome may be more critical elsewhere. Because different combinations of policies and measures are very likely required to cope with different inequality problems, it is important to identify clearly not only the inequality problem but also the corresponding educational environment.

This, moreover, makes it easier to clarify environment-embedded resources for and limitations on the application of education policies and private initiatives. In this way, a more efficient allocation of resources for education reform is more likely.

GESolution 3

Use publicly funded grant schemes to provide cheap access to education for the poor, particularly for girls. If financial impediments hinder children from going to school, provide financial aid to parents conditional on children’s school attendance. Policies must reflect the fact that girls’ and boys’ obstacles to education differ.

Lack of financial resources is one of the major impediments faced by children with disadvantaged backgrounds that hinder them from being adequately educated. Clearly identifying the disadvantaged groups to be supported and providing financial aid for them is probably the first step to helping them with financial limitations on education.

But the potential effects of financial aid alone on increasing education accessibility may be limited due to the biased incentives of parents. Thus, to ensure that parents indeed send their children, no matter whether they are girls or boys, to schools, financial aid should be made strictly conditional on children’s access to schools.

Since girls and boys often face different obstacles to becoming educated in many developing countries, policies that address these obstacles must differ as well. For example, it is much more likely that a young girl will be removed from school because she has to help the mother gather firewood, take care of younger children, or be married off at an early age. Toilet facility availability turns out to be crucial for girls in middle school. Without it, these maturing girls will often not proceed with their education. Publicly funded grant schemes must take these issues into account.



4. Overcoming Inequality through Education

GESolution 4

Promote adult education through adult universities and in the workplace.

Family backgrounds, such as parents' education levels, matter for children's educational attendance. Thus, educating parents and children simultaneously can be of critical importance. Adults should be encouraged to attend adult education, which may be connected with their workplace. Institutions like adult universities could help greatly to improve parents' education levels and therefore have a considerable, additional influence on their children.

GESolution 5

Refocus teaching content on encouraging students to learn actively, for example, by running experiments themselves instead of learning only predetermined textbook material, and teach students to be more self-confident and self-critical.

Active learning based on students' active participation and initiatives matters more for unfolding students' potentials than passive learning. Students should be taught to be able to think independently. Students should be given more opportunities to run scientific experiments on their own instead of just being asked to learn strictly predetermined materials from textbooks.

Such a learning process is more active. In this way students start from learning how to design the experiments, learning how to work with partners to keep the experiments running and, at the end, learning from the mistakes they made and the successes they achieved.

Students need to learn to be self-confident and self-critical when facing different challenges. Establishing partnerships between schools from extremely different regions or countries and developing exchange learning programs for students

from partner schools can help students to experience different cultures in different environments and learn how to solve different problems. Such experiences will help them to think and behave more independently.

Background

There are already several different private initiatives aimed at addressing problems of education inequality. Two are the Barefoot College in India and "Teach First" in the UK. In very different environments and with very different resources available for running the initiatives, different measures are adopted by these two initiatives.

The former focuses more on teaching the poor practical knowledge and skills, taking local traditions and strengths into consideration. The latter tries to attract top university graduates and train them to become excellent and motivated teachers in schools for children from disadvantaged backgrounds.

The successes of the Barefoot College and "Teach First" show the importance of applying different policies and measures to cope with inequality problems in different countries or regions.

4. Overcoming Inequality through Education

Panelists



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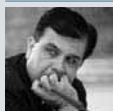
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5. Dealing with the New Social Divides



Challenge

Around the world, jobs are disappearing and wages declining in the aftermath of the financial crisis and the consequent economic downturn. Recovery remains uncertain. In Europe and the United States, many people are joining the ranks of the unemployed; in developing countries, millions of workers are being pushed into extreme poverty. At the same time, as a result of decreasing asset prices, millions of families have lost significant parts of their wealth and lifetime savings, and many lost their homes through repossession.

The consequences may be felt for many years to come. The immediate reduction of income and wealth could generate additional adverse long-term effects, notably through reduced investments in education, compounding children's vulnerability in the future. There are also fears that the crisis may lead to rising protectionism and even social unrest.

While the current financial and economic crisis is global, it is likely to have heterogeneous welfare impacts, with some countries and some people more vulnerable than others. The crisis, thus, threatens to reinforce existing social divides and even create new divides, for example, between generations, between men and women or between those who have safe jobs and those who do not.

- Which population groups, in developed and in less developed countries, are likely to be particularly vulnerable?
- How do social protection systems have to be developed to deal with the immediate and long-term social consequences of the crisis?
- What needs to be done to prevent the crisis from forcing vulnerable families to reduce investments in health and education?
- What are the most effective ways for rich countries and international organizations to support poor countries in dealing with the social consequences of the crisis?



5. Dealing with the New Social Divides

GESolution 1

Bridge the gender divide

- *by giving priority to empowering women and promoting woman entrepreneurship (e.g., through microfinance and by giving them property rights on the land), and*
- *by promoting girls' education (e.g., by making aid to families conditional on school attendance of their children).*

There is compelling evidence that the earnings of women are more likely to feed back into household well-being (educating and feeding children, for example) relative to their male counterparts. Stimulus measures in reaction to the crisis as well as long-term donor projects should, therefore, be concentrated on issues that support female income and improve the participation of women in the economy.

Programs that assist women entrepreneurship, such as increased microfinance to help women set up small businesses or maintain them in face of the crisis, may be particularly promising, both with respect to short-term poverty alleviation and long-term development perspectives. Enabling women to own the land they work—farming is in many countries predominantly women's work but only 1% of the world's landowners are women—would contribute to making agriculture thrive.

An especially promising measure would be investing in girls' education given that the educational attainment of children is disproportionately affected by the level of education of the mother. If girls are given an education before critical life decisions are made, they can break the cycle of poverty because they will get married later, have fewer children, generate income through skills learned at school, and become active players in their nation's economies.

There are some precedents for successful affirmative action programs that mandate female participation in business and politics. Most notably, electoral

quotas at the village-level in India and in national government in Rwanda; in business, Norway has instituted quotas on female board representation.

In many countries, there are cultural barriers against policies promoting girls' education and improving women's legal and economic status. To overcome resistance, governments and NGOs should encourage the implementation of certain minimum requirements in terms of women-friendly policies, for example, by conditioning aid. National governments should make aid conditional on families sending their children, particularly their daughters, to school.

GESolution 2

To respond promptly to severe economic crises, address threats to fiscal sustainability, and build capacities for a quick implementation of public investment projects, by developing an asset registry scheduling maintenance and rehabilitation of existing infrastructure as well as a portfolio of accepted, and readily implementable infrastructure projects.

The current crisis has highlighted that the capacity of governments to pursue appropriate countercyclical fiscal policies—including active social safety net policies—in response to an economic downturn is enhanced when the government's initial fiscal position is strong. In implementing a countercyclical fiscal policy package in the current crisis, many industrial country governments with higher levels of outstanding debt have already faced serious concerns and constraints, and the levels of public debt are further increasing substantially as a result of the crisis.

The obvious concern is that when and if the next crisis arises, governments will have dramatically reduced their degrees of freedom for an appropriate countercyclical fiscal policy response. Once the current crisis has passed, governments will therefore need to move expeditiously to reduce government debt ratios and address anticipated threats to fiscal sustainability.



5. Dealing with the New Social Divides

The current crisis has also illustrated the potential importance of public investment as a tool for countercyclical fiscal policy in the event of an economic downturn. But most countries have not been able to use this tool very effectively because of an absence of “shovel-ready” projects. Planning for infrastructure investments can take years, but in times of crisis there is a sense of urgency.

Governments should therefore develop an asset registry of existing government infrastructure, which specifies an appropriate schedule for maintenance and rehabilitation. Such a registry would not only help to guide government spending on maintenance of public infrastructural assets, but also be available for an accelerated program of rehabilitation and maintenance when there is a need for an active countercyclical policy.

Governments could also adopt the approach of Australia and China and move proactively to develop a portfolio of appraised, acceptable, and prioritized infrastructure projects, with a categorization of those projects that can be implemented relatively quickly. While the public investment program should generally be responsive to the challenge of enhancing growth, some consideration could be given to labor-intensive public works schemes, similar to those adopted by India in recent years, which might provide a form of social safety net for underemployed low-income workers.

GESolution 3

Promote micro-insurance (e.g., rainfall insurance) and income-smoothing assistance by governments and aid organizations; develop and elaborate social insurance systems for vulnerable groups.

The poor suffer not just from low incomes, but also highly variable income flows. Farmers face good years and bad. Street vendors are at the whims of suppliers and the flow of customers.

Part of bridging the divide between rich and poor is providing low-income individuals with the means to smooth their incomes. Currently, in developing countries, the poor have little option other than informal insurance through family members and friends. What is needed is more direct assistance from governments or—where necessary—the aid community.

While the emphasis in microfinance has been on small-scale enterprise, there is a nascent movement towards micro-insurance. Of course, any insurance product is subject to abuse—for example, a farmer insured against crop failure may be less diligent in tending his fields.

One potential solution to this dilemma is rainfall insurance, which pays out in cases of bad weather rather than being in response to the farmer's own outcomes. There already exist such insurance instruments, as well as others that are dependent on global commodity prices. But it is necessary to find ways to scale up such product offerings.

The aid community must be more proactive in coming to the assistance of the poor when crisis hits. One suggestion is that aid organizations should provide assistance when the rains do not come, rather than waiting for famine to occur.

Going beyond micro-insurance for the self-employed, emerging market and low-income countries should take the crisis as an opportunity to develop or elaborate systems of social insurance, particularly in the spheres of unemployment insurance and pensions. Well-functioning social security systems work as an automatic stabilizer, and in severe crises, they may be extended or adjusted to implement expansive macroeconomic policies or to support particularly vulnerable groups effectively. In many countries, policy-makers have extended benefits and implemented labor market programs that have gone considerably beyond what had been the traditional scope of these systems before the crisis.

Such policy interventions have included the provision of additional social benefits to vulnerable groups (for example, dependent children, female-headed households, the long-term unemployed); increasing the level, the duration and the coverage of



5. Dealing with the New Social Divides

unemployment benefits; extending existing work-sharing agreements; provision of training programs for the unemployed; financial incentives for employers to hire the unemployed (particularly among the older segments of the work force); programs dedicated to the creation of jobs for the young; a strengthening of employment search mechanisms for the unemployed; and extension of health insurance benefits to the unemployed.

GESolution 4

Promote more flexible defined benefit plans, increase resilience of pension systems to macroeconomic shocks, and reduce the exposure of individuals to financial risks in pension systems. Universities and charities should enhance financial literacy.

The global crisis has had a major impact on pension fund assets around the world, although losses vary significantly between countries. At the same time, the global recession will impose additional pressures on public pension schemes financed on a pay-as-you-go basis, which add to the sustainability problems they face due to aging populations. Consequently, private pensions still have a major role to play in maintaining balanced sources of retirement income.

But the crisis has also revealed that defined contribution plans (as well as insufficiently funded defined benefit programs) impose inefficient amounts of risk on individuals. Increasing attention should therefore be paid to reducing the exposure of individuals to the financial risks associated with private pension arrangements. In the developing world, where pension and retirement schemes often are still being developed, it is important to ensure that they are sensibly designed to protect the elderly in times of crises.

Furthermore, the levels of generosity in public defined benefit schemes should avoid putting governments in fiscally unsustainable positions that will force reneging benefit promises.

Policy should make it easier for employers to offer more flexible defined benefit plans that are customized to individual needs and circumstances but still provide the security that individuals need. And policy should think more long-term in the way pensions are regulated and contributions to pension funds are taxed.

In addition, it is imperative to enhance financial literacy in society, enabling individuals to make an informed choice about their provisions for old age. Governments should not leave this task to financial services providers. Rather, they should involve non-profit organizations such as universities and charities in the task of increasing the knowledge and understanding of pension and retirement issues.

It can be expected that this, plus the experience of the financial crisis, will lead to more appreciation of the benefits of guarantees and security that are offered by defined benefit plans. In addition, it may be wise for governments to account for the potential naiveté of employees and introduce regulations that limit the extent of risks, that households can take in the investment of their defined contribution portfolios, at least in cases where these private pensions are the dominant source of retirement income.

GESolution 5

To foster employment for the elderly, encourage job training and skill enhancement throughout people's working lives and increase legal and contractual flexibility as well as incentives to work beyond the regular retirement age.

In a number of countries, the financial crisis has highlighted the extent to which many workers' financial assets, coupled with any social security benefits, will be insufficient to allow full retirement at the early ages that have become the norm in many industrial countries.



5. Dealing with the New Social Divides

Increasing longevity and better health have both increased the amount of assets required for an adequate replacement rate and enhanced the capacity of the elderly to continue working beyond the point of eligibility for retirement benefits. And the mounting cost of social security benefits will encourage governments to push back the age of eligibility for retirement benefits.

But the ability of the elderly to find or retain jobs is stifled by a number of constraints in the labor market and by government policies. Elderly workers may also need to accumulate new skills to remain productive and competitive in today's labor market.

Strengthened policy initiatives are needed to foster the employment of the elderly. These include efforts at job training and skill enhancement; promoting labor market search initiatives; revised social benefit rules incentivizing work beyond retirement; promotion of flexible wage structures that are less seniority-focused as well as potential for part-time employment of elderly; elimination of mandatory retirement ages; and banning age discrimination in employment.

Background

Evidence from past financial and economic crises in low- and middle-income countries shows that reduced income as a result of downward pressure on wages and employment as well as falling migrant remittances from abroad may lead households to take actions to cope with the immediate crisis that prove to be harmful in the longer term.

In the absence of assistance, households may be forced into the sale of the assets their livelihoods depend on, the withdrawal of their children from school, inadequate use of health care, inadequate diets and resulting malnutrition.

At the same time, public expenditure in social sectors tends to be pro-cyclical in many developing countries rather than working as an automatic stabilizer. Even worse, historical experience suggests that it is the poor that are disproportionately affected by aggregate cuts in social programs.

Scope to undertake poverty alleviating policies will often be severely limited due to a deterioration of macroeconomic positions (fiscal and current account balances). Tight financial constraints require refocusing of government expenditures to safeguard education, health and nutrition outcomes. When designing programs for immediate relief, policy-makers should be aware of potentially adverse effects on recipient behavior and of the long-term effects on poverty reduction and human development.

Even before the current crisis, women made up a disproportionate share of the world's poor, and this share is likely to increase as a result of the crisis. The adverse impact of the crisis on employment and education seems to be especially severe on the female part of the population, particularly in developing countries.

This implies that prospects for growth and living standards are also hit disproportionately, given that the evidence that women are key to alleviating poverty. Female income is more beneficial for family welfare and female education has a stronger impact on future generation's education levels.

In the developed countries, past, comparatively mild recessions have shown that worsening labor market conditions can have longer-term adverse effects, particularly for the most disadvantaged labor market groups, which include women, young people, older workers, the low skilled, and migrant workers. They are often the first to lose their jobs and face serious difficulty in finding a new job, running the risk of becoming long-term unemployed or discouraged.

Several studies have found that youth unemployment in particular leads to a persistent disadvantage in the labor market that can take years to overcome. This may be socially harmful because unemployed youth tends to be more prone to crime or causing social unrest.

Given the extent of the current crisis, developed countries may need to reappraise their welfare programs and active labor market policies: often it may be necessary to expand them, but there may also be scope for significant efficiency gains within the existing programs. Any reform of the welfare system and of labor

5. Dealing with the New Social Divides

market policies should take account of its effects on recipients' incentives to work or to take part in education and training programs that give workers skills that will be needed as labor markets recover.

The financial crisis has severely affected the value of pension fund assets worldwide. The crisis has revealed that defined contribution plans (but also insufficiently funded defined benefit programs) impose inefficient amount of risks on individuals that may create new social divides in terms of pensions and retirement incomes—between those with defined benefit pensions, which provide guaranteed income streams in retirement, and those with very risky defined contribution pensions; between those who work in firms that have historically built up large unfunded pension liabilities and those who work in firms that do not have these legacy costs; and between the near retirees, who will have difficulties to make up for the losses incurred during the crisis, and everyone else.

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The Global Economy 20

- | | |
|---|----|
| 1. Balancing Risk-Taking and Financial Regulation | 22 |
| 2. The Psychology of Financial Crises | 30 |
| 3. Managing the New Global Imbalances | 38 |
| 4. The Post-Crisis Global Division of Labor | 44 |
| 5. Fighting Against Poverty in the Crisis Aftermath | 50 |
| 6. New Knowledge Creation Regimes | 58 |

The Global Society 66

- | | |
|--|----|
| 1. The New Wave of Social Entrepreneurship | 68 |
| 2. Content and Limits of Corporate Social Responsibility | 74 |
| 3. Making Migration Work after the Crisis | 84 |
| 4. Overcoming Inequality through Education | 88 |
| 5. Dealing with the New Social Divides | 96 |

The Global Polity 108

- | | |
|--|-----|
| 1. Fixing Failed Multilateralism | 110 |
| 2. Towards Global Trade under Global Rules | 116 |
| 3. Exit Strategies from the Financial Crisis | 122 |
| 4. The Future of Global Financial Governance | 128 |
| 5. Repairing Failed States | 134 |
| 6. Democracy and Development | 142 |

The Global Environment 148

- | | |
|---|-----|
| 1. Preparing for the Blue Revolution | 150 |
| 2. Managing Marine Resources | 160 |
| 3. Rethinking Agriculture | 168 |
| 4. Bioenergy and Land Use in Developing Countries | 176 |
| 5. The Energy Crisis and Climate Change | 184 |
| 6. Establishing a Global Climate Regime | 190 |

1. Fixing Failed Multilateralism



Challenge

Globalization has made the world interconnected as it has never been before. The dangers of this interconnectedness are becoming increasingly apparent in the face of the financial crisis, climate change, nuclear proliferation, terrorism, looming ethnic and religious conflicts, the breakdown of the Doha Round of international trade negotiations, and more.

But most policy decisions in these areas continue to be made at a national level. This raises many questions about how the world community can break out of this trap of “failed multilateralism,” including:

- To what degree does the interrelatedness of the global problems require interrelated institutions of global governance? How can global governance structures be accommodated to new geopolitical realities?
- What new institutions are required to rectify the gaps in world governance? And what changes are needed to existing institutions?
- What general policy guidelines are useful for the reform of national and international governance, so that the major global challenges can be addressed efficiently and fairly? And what is the role of academia, business, and organizations of civil society in the process of reform?

GESolution 1

Pursue “multilateralism light” rather than “heavy institutionalism” by devising new groupings for informal or semi-formal international governance.

Despite its failings, multilateralism remains the answer—fixing it means more rather than less multilateralism. Yet with a few exceptions, there is no realistic prospect of the creation of major new international institutions.

The failure to reform the United Nations Security Council to reflect the new international balance of power strengthens the argument that devising new



1. Fixing Failed Multilateralism

groupings and mechanisms for informal or semi-formal international governance is the next best option—what has been called “multilateralism light.” This would also be the most efficient way of drawing emerging global powers into accepting more responsibility for the management of global affairs.

Pursuing multilateralism light does not in any way exclude agreeing on institutional reform wherever it looks sensible and politically achievable, such as in the International Monetary Fund (IMF) or the World Bank. But the crisis has highlighted the urgency of improving international governance.

Swift, flexible and pragmatic solutions should be sought through enhanced multilateral cooperation rather than through overambitious plans for a fundamental redesign of the existing international institutional architecture.

A promising way forward is a strengthening of the mechanisms of “peer review” within groupings such as the G20. This could entail, for example, a vigorous monitoring of national economic and financial policies. Established and emerging global powers must act as leaders in this process.

GESolution 2

Establish a World Climate Organization to supervise the implementation of climate change agreements.

One area where effective international cooperation might warrant a more formal mechanism than can be provided by multilateralism light is the fight against climate change. A new World Climate Organization could supervise the implementation of climate change agreements and provide important impulses for the political process.

A new institution could also provide analysis, surveillance, and information on best practice, thus offering political backing for governments willing to do more to act on climate change but facing political resistance at home.

The main argument for investing political capital in establishing such a body is that the fight against climate change has no proper institutional anchor in the existing system of international governance. The United Nations is too unwieldy and its responsibilities are too wide-ranging for it to act as a dynamic leader in this field. Other international institutions have other priorities.

GESolution 3

Disseminate information and organize discussions on global issues to promote global citizenship and give a voice to the “global citizen.”

A well-informed and empowered global citizenship may become the driving force behind proposals and implementation efforts from informal groupings such as a new G5, comprising the United States, the European Union, Japan, China, and India. This requires the dissemination of information, for example, by independent international organizations. Setting in motion a worldwide discussion on global issues needs to be organized.

Today's policies treat citizens as national constituencies. This approach is not consistent with increasing mobility of labor and cross-border externalities that affect the well-being of citizens in other countries. That is why the perception of a global citizenship is vital. A global citizenship could push for multilateral actions from below by defining a common ethic, for example, on environmental issues.

In organizing public discussion outside multilateral organizations, think tanks like the GES can play an important role. Virtual platforms should be developed to encourage open access discussions on global issues with the aim of channeling them into the formulation of policy proposals.

1. Fixing Failed Multilateralism

Background

Taking account of the new geopolitical realities, groups like the new G5 (or other sub-groupings of countries within the G20) may provide the core of countries for initiating and implementing quick and practical responses to worldwide problems.

This implies that the new G5 has to be accepted as the driving force of multilateral cooperation. In effect, this is already happening in the Heiligendamm L'Aquila Process initiated by the G20. Heterogeneity is reduced by the small number of countries and the fact that none can act as a "free-rider." In addition, any solution to worldwide problems has to be accepted by this group to become effective.

This closed form of multilateralism implies that solutions defined by the new G5 may suffer from a lack of legitimacy and acceptance. Hence, support by both multilateral organizations and civil society is required. Thereby, governments should be pushed to act multilaterally on a voluntary basis.

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2. Towards Global Trade under Global Rules

The Getulio Vargas Foundation Session



Challenge

Until the current crisis, global trade was flourishing while, at the same time, rule-making on global trade was stagnating. This is a serious problem since without the setting, monitoring, and enforcement of trade rules, we risk a return to protectionism and economic fragmentation. Especially in times of economic turbulence and recession, unilateral actions against trading partners could trigger a spiral of retaliatory measures with grave consequences for all.

There are two major reasons for the widening gap between trade growth and trade governance: first, an increasing number of heterogeneous institutions at the level of governments, the business sector, and civil society; and second, an increasing number of conflicting targets that trade rules are expected to address. These developments raise many questions about how to support global trade under global rules, including:

- What policy approaches will encourage a broad-based commitment to global trade rules, while permitting the formation of groups with similar interests? How can stakeholders from the private sector and civil society be involved in negotiations?
- How can the problem of heterogeneity of issues be addressed through non-discrimination both across borders (market access) and within borders (national treatment)?
- How can the proliferation of regional trade agreements (RTAs) be reconciled with multilateralism, making them building blocks rather than stumbling blocks towards freer trade?

GESolution 1

Apply the principle of “variable geometry” or “integration at different speeds”: implement a binding set of core rules (“GATT 1947”) and voluntary rules for further issues (plurilateral agreements on investment, protection of intellectual property rights, etc.).



2. Towards Global Trade under Global Rules

The Getulio Vargas Foundation Session

For the time being, the World Trade Organization (WTO) is ill prepared for anchoring and operating rules for global business going far beyond world trade alone. The WTO needs to be made fit for an ever more complex international trading environment, dealing, for example, with global business issues around investment and protection of intellectual property rights.

GESolution 2

Break the impasse in negotiations on agricultural trade by complementing a trade agreement with an agreement on food security.

Until very recently, developing countries such as India, which have strong rural constituencies, have raised arguments of food security against agricultural trade liberalization.

To ease this impasse, an international agreement banning restrictions on access to food—such as export restrictions, food cartels and hoarding—could accompany a WTO deal. Such an agreement would essentially disallow food being used as a strategic instrument against any member country and address the concerns of many developing countries about exposing their domestic farm sector to international competition.

GESolution 3

“Multilateralize” rules in regional integration schemes by opening specific regulations to non-member countries.

The WTO has been permissive in accepting the proliferation of regional trade agreements (RTAs). Now we have them, efforts to re-establish global trade rules must work with existing regionalism not against it—and that means seeking to “multilateralize” regionalism.

A way to reconcile regionalism and multilateralism consists of urging RTAs to open specific regulations (such as “rules of origin”) to non-member countries and thus to multilateralize them. At the same time, bilateral RTAs should be consolidated into region-wide and, ultimately, comprehensive agreements. Regionalism must be viewed as a building block rather than a stumbling block towards multilateralism.

GESolution 4

Encourage countries to harmonize their rules of origin on a regional basis, but involve the WTO to ensure that harmonization is as multilateral-friendly as possible.

Much of the complexity of RTAs arises from highly technical provisions called “rules of origin.” To win duty-free status under an RTA, these rules typically require that a product contains a minimum share of parts and components produced in one of the partner countries.

Overlapping and intersecting rules of origin pose problems for businesses trying to set up competitive international supply networks. It is difficult to have one supply network meet the requirements of several rules of origin. Ultimately, this hinders industrialization.

In response to business pressure, various countries have harmonized or are trying to harmonize their rules of origin. The WTO has not been involved, but it should be since regional harmonization has spillover effects on countries outside RTAs.

Background

Multilateralism versus Regionalism

The world trading system is marked by a motley assortment of discriminatory trade agreements known as the “spaghetti bowl.” The rapid spread of RTAs across Asia and the Pacific has led to an Asian variant, the “noodle bowl.”

2. Towards Global Trade under Global Rules

The Getulio Vargas Foundation Session

Regionalism is here to stay. Even if the Doha Round finishes tomorrow, RTAs will continue to proliferate. This tangle of trade deals is a bad way to organize world trade.

One way to deal with this is to consolidate bilateral and plurilateral RTAs into large region-wide agreements. Consolidation can help mitigate the harmful effects of overlapping memberships of RTAs and different or opaque tariff schedules, standards and rules of origin. This pragmatic approach to regional integration supports consensus-building at the multilateral level, the building blocks of multilateralism.

The discrimination inherent in regionalism is economically inefficient and its costs are rising rapidly as manufacturing becomes ever more internationalized. Stages of manufacturing that used to be performed in a single country are now often geographically “unbundled” in an effort to boost efficiency. Supply chains spread across many borders. Unbundling, which has accelerated since the 1990s, is the most important new element in the regionalism debate. It is the reason why business is pushing so many countries to “tame the tangle.”

Preference-seeking regionalism is also unfair. While the spaghetti bowl is a problem for firms in big countries, it is much more of a problem for firms in poor countries. Rich countries have the resources and the negotiating leverage to navigate the tangle's worst effects. The governments of small and poor countries do not.

As the spaghetti bowl's inefficiencies are increasingly magnified by unbundling and the asymmetry of rich and poor, the world must find a solution. Since regionalism is here to stay, the solution must work with existing regionalism not against it—and that means seeking to “multilateralize” regionalism.

The GATT/WTO survived and flourished during its half-century's existence by adapting to new realities. When colonies became countries, the GATT expanded from a cosy club of two dozen members to become a global organization. When the distinct trade needs of developing countries were recognized, the GATT responded with the Enabling Clause. When non-tariff barriers began to replace tariff barriers, the GATT expanded its negotiating agenda. When the need for greater institutional stability became clear, the GATT was embedded in the WTO. For 50 years, the GATT/WTO has survived because it adapted to new realities.

Today's new reality is regionalism. If the WTO is to survive and flourish, it must adapt to regionalism. Embarking on a WTO “action plan on regionalism” would be an important move towards global trade under global rules.

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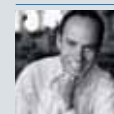
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3. Exit Strategies from the Financial Crisis



Challenge

In response to the financial crisis, some governments have bailed out the large banks and some of the large companies in their countries, thereby taking equity stakes in these enterprises. In the process, these governments have accumulated massive deficits.

At the same time, several central banks have also taken on assets that they would have preferred not to have on their books. They no longer just provide short-term credit to commercial banks against highly rated collateral, but have also bought bank assets of dubious long-term value as well as distressed corporate bonds.

None of these developments is sustainable in the longer run. This raises many questions about what might constitute socially desirable “exit strategies” from these policy traps, including:

- How should governments prevent their budget deficits from rising relentlessly relative to GDP over the business cycle?
- How can we avoid the danger of inflation once the current downturn is over?
- How can central banks ultimately divest themselves of problematic assets? And how can they maintain their independence?

GESolution 1

Achieve fiscal sustainability by reducing public overall national debt (in relation to GDP), while implementing those public spending cuts and tax reforms that promote economic growth.

If confidence in fiscal sustainability is lost, real interest rates will rise, reducing growth and further damaging government budgets. Thus, utmost priority must be placed on aiming to achieve a credible debt path.

Structural public deficits must be avoided in the long run. Social security systems in particular must be put on a sustainable financing structure. Measures to reduce public deficits must be of high quality.

3. Exit Strategies from the Financial Crisis

GESolution 2

To discourage countries from inflating away their foreign debt, convert existing government bonds into inflation-indexed bonds.

Reducing nominal debt through inflation must not be an exit strategy. Past periods of high inflation have shown that once inflationary expectations have increased and the credibility of the central bank has deteriorated, reversing the process requires drastic measures, forcing the economy into recession. In addition, large shifts in inflation differentials between countries would result in exchange rate disruptions.

To keep inflationary expectations in check, it is vital for governments and central banks to communicate clearly to the public that inflation is not a socially desirable option. On the international level, countries must coordinate and communicate credibly that inflating away foreign debt will not be considered.

A growing perception of a declining willingness to meet financial obligations by debtor countries could lead to an international debt crisis. To give countries the incentive not to inflate away foreign debt, governments should agree to swap existing bonds into inflation-indexed bonds.

GESolution 3

Conduct the disposal of toxic assets by central banks at a gradual pace, to prevent losses and to avoid affecting markets adversely.

Emphasis should be placed on ensuring the return to normality in the valuation of toxic assets. The price discovery process for these assets will take time. Asset disposal at distressed valuations would only undermine the recovery of markets

and result in unnecessary losses to the central bank. The de facto bankruptcy of a central bank would result in a massive decline in confidence in the underlying currency.

GESolution 4

Clarify the role of central banks in combating crises, in particular setting up mechanisms to maintain and reaffirm their independence.

One key feature of the current crisis has been the actions taken by the European Central Bank and the US Federal Reserve to increase their balance sheets. Particularly in the case of the Fed and the US Treasury, this has involved lending money to, or purchasing outright, failing institutions. Such actions have blurred the line between fiscal and monetary policy, and this problem will be particularly severe if the Fed takes a loss on these assets.

Central banks, finance ministries, and legislatures, such as the US Congress, must clarify through legislation the authority that each does and does not have during times of crisis. This must be done in such a way as to maintain the operational independence of central banks.

3. Exit Strategies from the Financial Crisis

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4. The Future of Global Financial Governance



Challenge

In their “Declaration on Strengthening the Financial System” made in London in April 2009, the leaders of the G20 have provided the foundations for reform of the global financial system. Important elements include the strengthening of the role of the IMF, and the expansion of the Financial Stability Forum into a Financial Stability Board with a stronger institutional base and enhanced capacities.

Important fields for reform identified in the declaration include international cooperation of supervisory institutions and strengthening of the international frameworks for prudential regulation. Also discussed are the scope of financial regulation and the inclusion of principles on compensation in the supervisory process, the setting of accounting standards and the regulation of credit rating agencies.

While there is widespread agreement on the importance of reforms in these areas, there is still a substantial need for concrete solutions, particularly around the issue of global supervision.

GESolution 1

Include regulators from emerging markets in international financial institutions. Narrow the discrepancy between national regulations through agreements on joint minimum objectives and standards of regulation. Implement countercyclical capital charges.

The current crisis exposed existing regulations to a stress test. They failed: regulations caused pro-cyclicality; they differed widely among countries, thus encouraging “regulatory arbitrage;” and they excluded important players from having a voice and responsibility.

International financial institutions will be strengthened first by including regulators from emerging markets, especially those operating sovereign wealth



4. The Future of Global Financial Governance

funds, and second by narrowing the discrepancy between national regulations through agreements on joint minimum objectives and standards of regulation.

The key objective should be to ensure that risks are dealt with most appropriately by those financial institutions that are best equipped to handle them. To reduce pro-cyclicality, regulators should lean against the wind in a boom, with countercyclical capital charges.

GESolution 2

Give the IMF and the Financial Stability Board more surveillance power through greater autonomy and restructuring of voting rights.

The IMF and the Financial Stability Board are seriously constrained in making full use of their analytical and conceptual capacities. They need more “teeth” to pursue their surveillance functions and to monitor national policies that risk a potentially contagious financial crisis.

Stringent reforms directed at balancing voting rights with the economic weight of member countries and improving the autonomy of the IMF staff against national veto players can help to enhance a major function of international institutions—that is, to identify mounting imbalances and to give well-founded early warning signals to financial markets.

GESolution 3

Introduce capital requirements that are progressive in the size of financial institutions’ business and prevent narrow banks and investment banks from engaging in activities that present potential conflicts of interest.

The size of the banks that got into trouble has proved to be the core of systemic problems. This suggests the need to adopt measures that prevent financial institutions from becoming “too big to fail.” These include strict competition policies, introducing capital requirements that are progressive in the size of the business, and preventing both narrow banks and investment banks from engaging in activities that present potential conflicts of interest.

Economies also need resolution plans for their banks in the event of failure. Under such “living wills,” regulators would have the power automatically to convert debt to equity in a crisis.

4. The Future of Global Financial Governance

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5. Repairing Failed States



Challenge

In a number of territories primarily situated in the poorer parts of the world, the state no longer performs its basic functions of providing security and supporting development. Above and beyond causing hardship for their own citizens, failed states provide breeding grounds for organized crime and terrorism.

The “failed states list” of 2008 published by the Fund for Peace and the magazine Foreign Policy is topped by Somalia, Sudan, Zimbabwe, Chad, and Iraq (in that order). These states have failed for different reasons. But there are often similarities in the mechanisms that lead to state failure, for example, the availability of natural resources or the anarchy resulting from violent regime changes or civil wars.

State failure causes massive movements of refugees and internally displaced peoples, severe economic decline and the spread of violence and crime. 9/11 has made the world realize that the effects of state failures may not stop at national borders.

Re-establishing state authority in these territories is one of the most challenging tasks of our time. In particular, in light of the experiences in Iraq and Afghanistan, pessimism is dominating today's discussion of the issue. This pessimism should be motivation for searching for innovative approaches to state-building in such difficult circumstances.

“Repairing failed states” requires solutions that are ultimately driven by the citizens of the country. Yet the global community—governments, international organizations, and multinational corporations—can (and sometimes must) assist the citizens in getting into the driver's seat. This perspective raises many questions, including:

- How can we transform disenfranchised populations into stakeholders in a process of state-building?
- Should external stakeholders adopt a new approach to “development aid,” as its current mode of delivery in weak states hampers state-building?
- Can we identify general lessons from the successes and failures of previous efforts to fix failed states, for example, in Iraq, Afghanistan, and former

5. Repairing Failed States

Yugoslavia? Where should we put priorities in re-establishing state functions and how can we sequence interventions and policies, such as security, infrastructure, and basic service delivery?

GESolution 1

Transform aid delivery by establishing trust funds co-managed by the state and donors, developing sector-wide approaches where donors pool funds, and giving management of sector programs to the local government.

The consensus was to repair failed states not by way of development aid. Aid in general does not go into development, as the history of development show. But in failed states, international moneys go to non-state actor, usually NGO's or agencies/companies of donor countries. This weakens these states even more.

Instead of bolstering the establishment of government systems for public finance and budgetary management, foreign aid often undermines them or preempts their creation. The channeling of aid to projects managed entirely by donors or non-governmental organizations (NGOs), although convenient and at time necessary, can have deleterious effects of enormous proportions in creating sites of patronage and decision-making beyond the reach of the state.

Budget support—or the direct transfer of resources to national treasuries in fragile states—is extremely difficult where skills are lacking and fiduciary risks are high. But the danger of establishing organizations “parallel to the state” (creating what is in effect a “dual public sector”) can preempt the creation of capacity within states and undermine states, including their representative organizations.

Donors should deploy aid in ways that enhance government systems of decision-making on resource deployment: establishing trust funds co-managed by the state and donors and developing sector-wide approaches where donors pool funds; but more importantly giving management of sector programs (health, education,

and infrastructure) to the local government, ensuring that projects are managed by officials under adequate and audited systems.

At any rate, institutional development that furthers a fragile state's ability to discharge the basic tasks—using force, using money, and protecting property—is the most important road out of failure and fragility.

GESolution 2

Demand excellence in execution of promised reforms.

Respect for sovereignty without performance is an illusion. The international community shows an amazing degree of tolerance towards poorly performing governments of failed states. Whereas countries aspiring to join the European Union have to undergo challenging legal, economic, and political transformation, failed states continue to receive support even in the light of lackluster performance.

GESolution 3

Target donor assistance and support at promoting economic production, especially in agriculture.

Discussion of donor assistance to fragile states and support for state-building has been concerned mainly with issues of governance and poverty reduction. Donors need to pay attention to how aid can promote possibilities for wealth creation, which are central to achieving elite “buy in” to the state, as well as the creation of jobs and incomes, which are pivotal to people's survival and maintenance of their loyalty to the state.

The financial crisis highlights the problem of allowing finance capital to become disconnected from the real economy and, for poor countries, the need for states, and even fragile ones, to begin creating state capacity to foster the expansion of the productive base within their territories.



5. Repairing Failed States

GESolution 4

Invest into research on the local socio-political context and unify donor assistance to leverage local capacities and social relationships to promote state-building.

Donors and international players pursue their own agendas when engaging with a failed state. These agendas do not necessarily include building or stabilizing a state as an explicit goal. There is typically no unified effort to support one powerful party. Rather, assistance goes to a number of stakeholders, further undermining the strength of the central government. Identifying local leaders and supporting them is essential to strengthening the state.

Most Western policy-makers and practitioners today pay lip service to the idea that states will not prosper unless they are built by local people using local resources, but the great majority of development projects continue to be implemented with inadequate attention to the local social, cultural, and institutional context. Appropriate investments for a better understanding of the local context are needed.

States cannot be made to work from the outside. International assistance may be necessary, but it is never sufficient to fix fragile states. Instead of seeking to impose a Western-style blueprint unsuitable for local conditions, international action should be first and foremost about encouraging the creation of governing institutions that better leverage or help form the cohesive societies necessary to promote development on their own. States work effectively when they are a logical reflection of their underlying socio-political, historical, geographical, human resource, and economic environments, and when they are deeply integrated with the societies they purport to represent, able to harness the informal institutions and loyalties of their citizens.

Foreign assistance needs to complement and reinforce local capacities and institutions and be disciplined enough to avoid undermining or warping locally driven arrangements, which is all too common today, especially with the tendency

of so many international programs to focus on financial aid targets, poverty reduction targets, and the importation of generic and typically centralized state models.

The international community therefore needs think much more creatively about how to better leverage local capacities and social relationships in how it seeks to repair countries that do not work.

Background

It is critical to distinguish between failed, fragile, and troubled states. There are actually not too many truly failed states in the world. Somalia comes to mind, possibly Yemen and Congo. In the past, the foremost failed state was Afghanistan, circa 2001/2002, when the state literally collapsed.

What is the test for a „failed state?“

1. The state loses the ability to use force (in the Weberian sense of having the monopoly of legitimate force).
2. The state loses the ability to raise and spend money.
3. The state loses the ability to protect property, and generally, to maintain the rule of law.

Poverty itself does not mark a failed state, for many countries are poor without having lost all or some of these three abilities.

In today's international systems states are not allowed to disappear or to be abolished (as was Prussia in 1945, by fiat of the Four Powers). Hence, the phenomenon of endurance: no matter how failed or fragile, these states persist at least in name and as geographical reality.

The NGO phenomenon and its impact on failed states has not been sufficiently analyzed, yet. But while in 1945, there were 16 NGOs all over the world; today,

5. Repairing Failed States

the number may well be a million. 60 percent of American food aid goes to NGOs. Other aid is channeled to global philanthropies like the Gates Foundation. International corporations are the third player in the game that is supervised by nobody.

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Challenge

Rich countries tend to be more democratic than poor countries. Understanding the link between democracy and development could be crucial for policy-making at the national and international level.

In addition to giving citizens more political freedoms, democracies are on average less likely to be at war with each other than dictatorships. A lack of democratic governance structures could also be an obstacle to sustainable development. Conversely, persistent poverty and a lack of economic development could hamper the establishment of democracy.

For policy purposes, it is important to understand the direction of causality between democracy and development. Key questions include:

- Does development lead to democracy, as envisaged by various multilateral development organizations? Or does democracy lead to development, as implied in the economic transitions of the countries of Central and Eastern Europe? Or does causality run both ways?
- What sort of democratic institutions are conducive to economic development and political freedom? How should the will of the majority be balanced by the protection of minority rights?
- Is there a general strategy for policy-makers that would help promote peace and prosperity on a global scale?

GESolution 1

Focus on the desired ends of democracy (institutional and human capacity), rather than on particular manifestations of democracy (e.g., free elections).

If history is any guide, countries that have achieved the status of a full democracy are unlikely to revert to an autocratic regime. But according to the same logic, democracy is unlikely to last in poor countries that have not developed a set of deep institutions that are conducive to sustained growth.



6. Democracy and Development

In this respect, the focus of international policy-makers should be on middle-income countries, where the degree of democracy appears to be rather volatile, sometimes even in the presence of strong economic growth. In these countries, the existence of voting and free elections has not always been a sufficient condition for deeply democratic decision-making processes.

Much policy attention is paid to elections as an end rather than as a means to an end. Rather than focusing on free and fair elections as a particular manifestation of “democracy,” governments and international institutions should focus on changes that will promote democracy in a meaningful sense.

The overriding aim should thus be to enhance human welfare. Political, macro-economic, and corporate governance frame the context within which human and social (including economic) development takes place. Effective public health care and education build the human capital to sustain it. Efficient water, power, transport, and ICT infrastructures are needed to underpin the economic growth that permits it. And environments that facilitate domestic and foreign investment and appropriate public-private partnerships help to stabilize development. Democracy appears to emerge when a certain level of human and social capital has been created.

GESolution 2

Place effective constraints on executive authority in fragile middle-income countries.

Placing effective constraints on executive authority appears to be the top priority if democracy is to consolidate and prosper in fragile middle-income countries. This is not to deny that there are many open questions on the details and implementation of such a strategy, which may require country-specific answers conditional on the historical, political, cultural, and economic context.

In any case, a successful strategy will also have to redistribute political and economic power. There is the general need to reduce horizontal inequities in the political, economic, and cultural spheres, to strengthen national social cohesion, and to ensure a wider distribution of resource rents. These problems are even more acute in deeply divided societies, where ethnic fragmentation and the extraction of resource rents may dominate the political and economic decision-making of the elites.

Strong economic growth is probably necessary but not sufficient to overcome the institutional status quo, which may be the very reason for the absence of a sustainable path of development in the first place. Scarce or narrowly concentrated human capital often encourages over-concentration of executive authority, nepotism and other forms of corruption. Displacement of one kin-based elite by another often replicates the earlier structures. Investment in building a broader, deeper stock of human, social, and institutional capital seems to be the only way to transform a vicious into a virtuous circle.

GESolution 3

Use existing informal institutions to build formal institutions.

Formal institutions and informal institutions can be at odds with each other. One sense in which this can happen is where the existence of formal democracy, in the form of governments elected by democratic votes, can nonetheless co-exist with deeply undemocratic ways of making political and economic decisions. At the same time, informal institutions of democracy may exist where no formal ones do.

Bridging the gap between these two can be done by trying to align them, perhaps by trying to remove the distance between what is legal and what people perceive to be moral and just. This also suggests using informal institutions, where they exist, as the basis on which to build formal ones.

6. Democracy and Development

But care has to be taken to protect the rights of women and minorities, who may not enjoy the status they merit in the public sense of what is “fair.” Thus, attitudes also have to change. The most productive way of thinking about this appears to be convergence over time, rather than a straightforward privileging of one or the other kind of institution.

GESolution 4

Identify and clarify operational concepts of “democracy” and “development.”

Acknowledging the immense diversity of countries in terms of historical, economic, political, and cultural factors, it is almost self-evident that there will be no one-size-fits-all solution for policy-makers that would help promote peace and prosperity on a global scale.

Democracy and development are contested terms, particularly when it comes to the causal links between the two. Democracy could mean voting as a means of selecting (and unseating) governments, or it could imply a greater and more equitable participation in decision-making processes. Development could mean a narrow focus on economic growth or a much broader focus on human development.

Without nailing down the definitions, it may be difficult to identify which policy initiatives to stress to make progress on both democracy and development. Rather than talk broadly about democracy and development as desirable goals, it is therefore important to identify operational concepts of democracy and development. International comparisons of existing measures of democracy and development may not be perfect, but they can certainly be used to provide a point of reference.

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The Global Economy 20

- | | |
|---|----|
| 1. Balancing Risk-Taking and Financial Regulation | 22 |
| 2. The Psychology of Financial Crises | 30 |
| 3. Managing the New Global Imbalances | 38 |
| 4. The Post-Crisis Global Division of Labor | 44 |
| 5. Fighting Against Poverty in the Crisis Aftermath | 50 |
| 6. New Knowledge Creation Regimes | 58 |

The Global Society 66

- | | |
|--|----|
| 1. The New Wave of Social Entrepreneurship | 68 |
| 2. Content and Limits of Corporate Social Responsibility | 74 |
| 3. Making Migration Work after the Crisis | 84 |
| 4. Overcoming Inequality through Education | 88 |
| 5. Dealing with the New Social Divides | 96 |

The Global Polity 108

- | | |
|--|-----|
| 1. Fixing Failed Multilateralism | 110 |
| 2. Towards Global Trade under Global Rules | 116 |
| 3. Exit Strategies from the Financial Crisis | 122 |
| 4. The Future of Global Financial Governance | 128 |
| 5. Repairing Failed States | 134 |
| 6. Democracy and Development | 142 |

The Global Environment 148

- | | |
|---|-----|
| 1. Preparing for the Blue Revolution | 150 |
| 2. Managing Marine Resources | 160 |
| 3. Rethinking Agriculture | 168 |
| 4. Bioenergy and Land Use in Developing Countries | 176 |
| 5. The Energy Crisis and Climate Change | 184 |
| 6. Establishing a Global Climate Regime | 190 |

1. Preparing for the Blue Revolution



Challenge

Water shortages are cropping up around the world—from Australia to South Africa, from Brazil to the Sahel. Many of the world's mightiest rivers run dry before reaching the sea. Perhaps half the world's wetlands have been damaged or destroyed in the past century as salt water has displaced fresh water. These facts are striking in view of the fact that the world's population withdraws less than a tenth of the water that falls to the ground and that—unlike fossil fuels—the world's water supplies cannot be used up.

Although some regions suffer chronic water shortages while others are repeatedly flooded, water shortages are not merely a local problem to be solved locally. There are powerful worldwide forces making water a global problem:

- First, climate change: this accelerates the rate at which water evaporates and falls, and thereby increases water management problems.
- Second, demography: in the last half century, the world's population has grown by 2.5 billion, and it is expected to grow by another three billion in the next half century.
- Third, diet: as people around the world become wealthier, vegetarian diets are replaced by meat, requiring much more water input.

Meeting these challenges requires more than local initiatives. What is called for is a "blue revolution," addressing such questions as:

- What is the role of water pricing and sale of water rights in supporting a blue revolution?
- How can we allocate water efficiently among various uses: agriculture, industry, services, personal use?
- How can we ensure that access to water is not inequitably distributed, amplifying the misery of the poor?
- How can the political obstacles to reform of water management be overcome?

1. Preparing for the Blue Revolution

GESolution 1

Price water. Decouple land ownership and water rights, so that water rights are allocated to assure access to clean water for drinking and sanitation as a fundamental human right.

To develop incentives and support for reform, water has to be seen as something that can be valued and ultimately priced. Access to clean water for drinking and sanitation is a fundamental human right that must be protected. But this human right accounts for a very modest amount of total water use. And while water is a basic right, this does not mean that it does not have to be paid for.

Once water rights have been defined, water and land rights should be separated from water pricing and water trading. A sufficient quantity of water should be allocated on a per capita basis to assure access to clean water for drinking and sanitation as a fundamental human right. Pricing should be based on long-run supply and demand. In particular, major users should be paying a price for water that reflects service and delivery charges based around quantity.

As a result, water will be allocated and ultimately “traded” from low to high value uses. As long as individual water rights and allocations can be defined, it provides farmers with opportunities and incentives to sell temporarily or permanently. It also gives governments opportunities to buy out system tail-end users, improve overall system efficiency and buy water for environmental flow purposes.

Better definition of water rights and better measurement of water are needed to contemplate better systems for valuation, pricing, and trade. Without these improvements, there will be few incentives to improve productivity whether by the use of economic or regulatory instruments. With such arrangements, managing down in an integrated way, all water allocation across agriculture, mining, and other uses becomes feasible.

GESolution 2

Establish transitional arrangements (rather than sudden policy shifts) to achieve efficiency and sustainability in water management. These arrangements must pay careful attention to reform sequencing; for example, investment must follow entitlement, allocation, and trading arrangements; and pricing must follow metering.

It is time to put in place a series of transitional arrangements—step by step—that will allow markets to send proper price signals to all involved in the use of water for production, for living and for processing waste without degrading the environmental processes. Well-designed arrangements allow change in a way that is consistent with a well-established set of hydrological, economic, and social principles nested within a set of absolute environmental constraints.

The transitional pathways will need to pay careful attention to the sequencing of reform. Practical policy reforms have to occur in the right order.

For example, investment needs to follow the development of robust entitlement, allocation, and trading arrangements. Metering systems need to be put in place before prices can be set. Marginal costs need to be understood to be addressed with technical options and through demand management measures and additional supply. Arrangements that promote investment security and reward innovation need to be in place before water suppliers, water users, and communities can be expected to respond. And subsidies have to be made transparent before they can be phased out.

GESolution 3

Foster more bottom-up, collective water action, and community-level governance approaches.

1. Preparing for the Blue Revolution

Government and firms are only two of the three key players in improved water management. Besides governments' public actions and the private sector's market-based actions, communities' collective actions need to gain more space to handle the often complex local issues of sound water management and water governance.

Water policies and laws must provide that space. This especially applies to water-related ecosystems services. Local solutions for efficient and sustainable water management work well when trust in local government is strengthened in decentralized political systems.

Water management problems are mostly handled at the central state level without taking full account of the importance of these problems at the community level. A successful partnership combines the interaction between many stakeholders, including government, industry, and academia as well as civil society.

To cope with the complexity of the problem, bottom-up solutions for which examples already exist should be put in place. These need to be supported by the cooperation of users. Supporting the establishment and implementation of self-sustainable water management systems at the community level can be instrumental in enhancing ownership and accountability at that level.

GESolution 4

Promote investment in technology hubs, research, and education on water management.

The complexities of sound water policies require a strong skill base at national levels to manage reform and implementation. Investment in technology hubs, research, and education to unlock future innovations in the water sector is urgently needed.

Innovation will be critical in generating new options and reducing the costs of water provision. Through grants and public-private partnerships, it should be

a high priority for policy-makers who must see this as a fundamental issue of national long-term sustainability.

Isolated investment decisions that neglect complementary actions needed for the successful implementation of projects are counterproductive. Many aspects influence the success of investment decisions, including infrastructure, allocation mechanisms, pricing, supply system and institutions. These are currently not fully considered.

Instead of only investing in water resource management, complementary investment in the development of entitlement and allocation systems is needed to facilitate autonomous change and low cost adjustment. Moreover, more attention should be paid to the sequencing of investments and incentives for innovation. Another important aspect is the availability of microfinance at the community level.

GESolution 5

Facilitate women's access to water and enhance their participation in the development and implementation of water management strategies in poor countries.

Women play a crucial role in water management in poor countries. Because of the traditional division of domestic labor, they are pivotal in the provision, management, and safeguarding of water. In rural Africa, for example, women spend much of the day fetching water, an exhausting and often dangerous task that deprives them of the chance to work and learn. Moreover, women are the main victims of unsafe water and poor sanitation. The education of girls suffers due to a lack of separate toilets at school and easy access to safe water.

Facilitating women's access to safe water is crucial to counteracting the interconnected problems of illness, child mortality, and low productivity in poor countries. It could contribute to improved education levels and development in those countries.

1. Preparing for the Blue Revolution

But women also need to be actively involved in the development and implementation of water management projects. Women need to be equally involved in decision-making and water resource management to avoid inequalities—for example, in the division of domestic labor—and to support their social inclusion within communities.

The implementation of water management projects will benefit from participatory, gender-sensitive approaches, which take account of the differing but interdependent needs of men and women at household and community levels.

GESolution 6

To adapt water management to climate change, strengthen the legal architecture and implementation of laws on water use, taking account of the entire “water chain;” and phase out water subsidies in the longer term.

Climate change alters rainfall patterns. Climate models predict a further decrease in water availability, especially for the dry areas of the world where water is already scarce and where many people depend on rainfall. As a consequence, a more flexible governance structure is needed, which can be adjusted to an ever changing world.

Government cannot solve the diverse set of regulatory problems on its own. There can be substantial inequalities in the allocation of water. But government is needed to reform the water sector and to provide an institutional framework, whereas markets are needed to bring about appropriate price signals. The strengthening of the legal architecture and implementation of laws around water use needs to be part of capacity-strengthening.

Functioning markets are necessary to induce the major water users in agriculture and industry to use water more efficiently. This implies that subsidies on water have to be transparent. Ultimately, they need to be phased out.

The successful adaptation of water management to a changing world needs to take account of the whole “water chain.” This chain encompasses water from the source to the user level, as well as its reuse, and sufficient water for the provision of environmental services.

GESolution 7

Set up a global database on water management and strengthen international forums to guide countries on sustainable water use, taking account of cross-border issues.

A strong forum for water resource management is needed. Such a forum could guide countries to more sustainable water use and to enable them to take account of the cross-border nature of water resources.

The forum would enable interaction and communication between stakeholders from different countries. Examples of successful project implementations or institutional arrangements could thus be identified and transferred to other countries. Such a forum could also be assigned to provide a global database on water issues, guiding and facilitating future decisions more easily.

1. Preparing for the Blue Revolution

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2. Managing Marine Resources



Challenge

Three quarters of the global marine fish stock are deemed fully exploited or overfished. Declining or collapsing fish stocks imply not just the loss of economic benefits but also the loss of livelihood for many people in developing countries. The global challenge is to come up with management approaches to sustain global fish stocks in the future without withdrawing the basic food for developing countries in the present.

Overfishing is driven by mismanagement. Approaches to overcoming the common property problem are still rare. They require a joint effort by academia, policy-makers and the business community:

- Researchers need to come up with solutions for the allocation and design of access rights systems, which have to be fitted to the various fish stocks.
- Policy-makers need to come up with solutions for the introduction of such systems within their economic zones and global agreements covering fish stocks in the open oceans.
- The business community needs to come up with solutions for the business opportunities of labeling sustainable fishing and including sustainable farming of non-predatory fish within global food system.

GESolution 1

Strengthen international governance by measuring the performance of fisheries managers, holding them accountable and comparing the performance of national legal frameworks, thereby promoting the adjustment of national fisheries laws to a global standard.

For too long, fisheries managers have done their job badly, including providing harmful subsidies and permitting competitive catch limits, without official sanctions. But there are a few examples, such as New Zealand, Norway and Iceland, which have succeeded in managing their fisheries

2. Managing Marine Resources

sustainably, without wasting resources on subsidies that stimulate overcapacity and overfishing.

The mismanagement of fisheries, particularly in developed countries like the European Union, is based not on missing knowledge but on missing political will. Those responsible for managing fisheries must be held accountable for their performance.

New management systems should be supplemented with an international system to measure, report, and compare the performance of fisheries managers and their national legal frameworks. This would make underperformance more public. It might also impel the adjustment of national fisheries laws to a global standard.

GESolution 2

Establish robust and effective management systems for responsible and sustainable fisheries. For example, secure long-term fishing rights for the fishers; set the costs from sanctions substantially higher than the market price from over-fishing; and specify fish quotas in terms of number of fish rather than weight, thereby protecting juvenile fish.

Management systems have to be improved, so that good incentives for fishers are in place. The most important long-term measure is to secure long-term fishing rights for the fishers to encourage fishing in a responsible manner, because they can be confident that they will receive future benefits from their stewardship.

The most important short-term measures are to address the problem of discards, to include sufficient sanctions, and to ensure that caught fish are of sufficient size. With discards, the more developed the underlying fishery, the more strongly discard should be regulated up to the level of complete prohibition. The potential problem of unused quotas with prohibition of discards in mixed fisheries can be addressed with a portfolio approach for the quotas.

Sanctions have to be set so that the costs related to them are substantially higher than the market price for overfishing, otherwise the sanctions become irrelevant.

Management systems must ensure there is adequate protection for juvenile fish to ensure that sufficient fish can spawn. For this purpose, in certain fisheries, giving quotas in numbers instead of weight should be explored as a possible solution.

GESolution 3

Divert current harmful fisheries subsidies to fund education and training, so as to provide alternative means of livelihood for poor fishers.

High levels of poverty tend to result in high levels of impatience and therefore high private discount rates. So in poor coastal communities in developing countries, conserving marine resources is simply a luxury, because people are hard pressed to “fill the stomach” now.

Reducing poverty and private discount rates requires offering alternative means of livelihood and providing training, education, and knowledge to implement collaborative and sustainable fisheries. A first step to realizing this solution is to turn bad subsidies into good incentives.

GESolution 4

Ensure responsible and sustainable aquaculture development by extending sustainable farming of non-predatory fish.

Aquaculture is a fast growing food production sector, providing income and employment as well as contributing to global food security. Aquaculture now accounts for nearly half of fish for food supply. (Over half of global aquaculture

2. Managing Marine Resources

production is reported to be in China.) Farmed fish can offer a safe and wholesome alternative to wild-capture fish. But where aquaculture is not properly managed, it has caused some negative social, economic, and environmental impacts, raising concerns about the overall sustainability of the sector.

Increasing worldwide demand for food, particularly for high-protein food with low carbon emissions in production, requires the inclusion of fish in the worldwide menu. Sustainable farming of non-predatory fish should be extended.

GESolution 5

Introduce eco-labeling for food safety and marine ecology.

Eco-labels are a market-based mechanisms designed to provide incentives for more sustainable fisheries management by encouraging buyers, from large-scale retailers to individual consumers, only to purchase fish and seafood certified as having come from a sustainable fishery. The value of this incentive in practice depends crucially on the criteria and the credibility of the eco-label. Therefore, it is important, that the eco-label implies clear and strict criteria and that the market is not flooded with a variety of eco-labels.

GESolution 6

Divert reduction fisheries toward human consumption.

Nearly a third of global catches are not used for human consumption, but rather reduced to fishmeal for animal feed, with typically poor protein-protein conservation ratios. Reduction fisheries include many species that can be consumed directly by humans, such as sardines, anchovies, sprats, and mackerels, and which are a traditional protein source for poor people in developing countries. Other species, such as sand eel, can also be processed into healthy products for direct consumption, such as the crabmeat surrogate surimi.

Although it may not be easy technically and economically, our longer-term goal should be for global fisheries to increase their role as a source of high quality low-cost protein by diverting reduction fisheries to human consumption.

Background

Fish are vital for world food security. One and a half billion people rely on fish for a fifth of their animal protein intake. Fish make up at least 15% of that protein intake for three billion people. Yet capture fisheries are under threat. Up to 80% of the world fish stocks are already fully exploited or overexploited. Access to fisheries must be restricted if they are to continue to feed the world's population, to generate wealth and to help alleviate poverty. Effective and efficient management of the world's fisheries is crucial.

A policy framework already exists to ensure sustainable use of fisheries, conservation of biodiversity, and ecosystem integrity. That framework includes a suite of legally binding and non-binding instruments. The Food and Agriculture Organization's Code of Conduct for Responsible Fisheries and the respective International Plans of Action for reducing the incidental catch of seabirds by fishers, for better managing sharks, for managing fishing capacity, and for combating "illegal, unreported and unregulated" fishing are some of the main thrusts toward responsible and sustainable fisheries.

The problem is that these instruments and the overall policy framework are still not being adequately applied across the globe. The challenge is to direct political will to achieve the dual goals of sustainable fisheries use and the conservation of aquatic resources and ecosystems.

The worldwide fishing fleets are much too large and technological progress continues to strengthen their abilities. A substantial reduction in capacity is necessary to obtain a sustainable industry. But if management systems are applied to fisheries where there is overcapacity (too many fishers and/or fishing vessels operating) and overfishing, the effects of making the transition to rationalized

2. Managing Marine Resources

fisheries need to be addressed. That means dealing with the impacts on livelihoods, employment, and the economies of local fishing communities.

But poorly designed subsidies further aggravate the problem of excess fishing. These subsidies need to be cut and refocused to support sustainable technologies and economic development in the fishing communities.

Subsidies for input costs such as fuel have already resulted in a vicious circle of overfishing. They have sponsored the use of better engines, improved hull designs, more efficient nets, and electronic gadgets, which lead today's fishing fleets to the fish much faster. It also results in a lock-in effect for the fishers. Decades of falling catches have induced them to travel ever farther to fill their holds. Subsidies support this self-destructive run on the remaining fish stocks and prevent the consolidation of the industry.

But not every subsidy is bad. Public funds should be redirected to support scrapping of capacity and development of more sustainable forms of fishery.

Current harmful fishery subsidies should be redirected to educate, train and equip these fishers for alternative, more benign livelihoods. The ultimate goal is for fishers and their communities to generate the wealth that fisheries have to offer sustainably, both now and in the future.

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3. Rethinking Agriculture



Challenge

2008 began with rapidly rising food prices that threatened lives in poor countries and created massive pressures in rich economies. The year ended with a financial crisis that sent food prices downwards and pushed poor countries' food problems down the policy agendas of the rich countries.

The world's food system should not remain hostage to such short-term turbulence. Producing enough food for the world's growing population and getting it to the people who need it requires rethinking global agriculture.

A long-term perspective requires that agricultural production and distribution look beyond the financial crisis and instead be guided by long-term considerations—political, economic, and social. The World Food Programme's funding needs are rising. Vulnerable countries have depleted their fund reserves and, hit by the financial crisis, have no resources left to manage potential future food shortages. Once the worldwide recession is over, a combination of rising population and incomes will once more push food prices upwards.

Now is the time to plan for a sustainable world food system, based on international cooperation. The main challenge is finding answers to a number of questions, including:

- What can be done to overcome the massive political impediments to a sustainable global agricultural system?
- How can we deal with the interest groups responsible for maintaining an inefficient agricultural status quo?
- How can we ensure that hungry people are fed without depriving local farmers of the incentives to become self-sufficient?
- What policy frameworks can simultaneously encourage innovation, agricultural productivity, and global equity?



3. Rethinking Agriculture

GESolution 1

Policy-makers must give agriculture the attention it deserves.

This may sound obvious, but the lack of attention to agriculture, particularly in the developed world, is astonishing. With more than nine billion people to feed by mid-century, the world will be in serious trouble if agricultural productivity does not increase markedly.

That will not happen unless governments place a higher priority on food security. Governments briefly began to pay more attention during the spate of food price rises in 2007/08, but that faded with the recession. Policy-makers must resume their focus on food.

GESolution 2

Start an “efficiency revolution” in agricultural markets of developing countries by promoting the development of new technologies, providing farmers with the associated training, and freeing them of credit, input, insurance, and information constraints. Development aid should target all of these issues.

Research and development (R&D) in the agricultural sector is too low, partly because Western governments have given farming too low a priority. But it is not enough to do more research—the means to train farmers in practices that will help them use their resources, such as land, water, and fertilizer, more efficiently will also be essential.

We need an “efficiency revolution” in agricultural markets. This can only be achieved by developing a multitude of technologies—such as better seeds (for example, drought tolerant, pest resistant), fertilizer use, information technology, better storage—and ensuring that farmers are able to adopt them.

Many farmers in developing countries have access to the goods and technologies they need to become more productive, such as fertilizers. Yet they do not use them. Why not?

In a study by Esther Duflo and colleagues, Kenyan farmers had spare cash at harvest time, but when the time came round to sow again, they had spent it and so could not buy fertilizer. If they had access either to a bank or a form of microfinance, or if they had the option to buy fertilizer at harvest time and receive it at sowing time, this could be solved.

Much more work needs to be done to discover such barriers to the take-up of available methods of improving productivity. Farmers in developing countries need to be freed from constraints that may prevent them from using these technologies. These constraints may be in credit, input, insurance, or information markets and are case-specific, requiring careful research on markets in developing countries.

Ensuring these markets work well and providing better extension services are important steps towards increasing productivity and efficiency in agriculture in developing countries. Development aid should pay more attention to agricultural markets in developing countries.

GESolution 3

Promote the building of infrastructure for food storage and transport in poor countries, and include this in the foreign aid agenda.

Without the means to process and store food, the bounty of the harvest, especially of perishable products, in developing countries goes to waste. These problems were solved long ago in the developed world, with storage facilities from grain silos to massive refrigeration and food processing units. Developing world farmers need a similar storage infrastructure, and they need better transport links to take food to markets before it can spoil.

3. Rethinking Agriculture

Foreign donors in cooperation with private and public local partners could be instrumental in making these investments by integrating food and agriculture into the foreign aid agenda.

GESolution 4

Facilitate the uptake of biotechnology—and, in particular, genetically modified products—for poor countries. Reducing the barriers of rich countries against imports of genetically modified food products or crops.

Genetically modified (GM) products can offer significant benefits to farmers in poor countries through higher yields and decreased requirements for inputs such as pesticides. But the trade policies of rich countries prevent making use of these benefits and undermine spillover effects of Western R&D on developing countries.

For example, the European consumer's refusal to countenance GM products is having a damaging effect on developing country farmers. These farmers are fearful that their produce will be rejected by rich countries if they are seen to be contaminated by GM products in some way. This has led to some misguided policies, such as the rejection of some food aid in Africa. There is a need to bring science into the GM discussion to combat unjustified consumer fear of these technologies.

Developed countries should communicate an unequivocal message to developing nations that their policy decisions on GM products will have no impact on aid or trade.

GESolution 5

Remove unnecessary non-tariff barriers and build partnerships with poor food-exporting countries to raise quality standards, where appropriate.

Europe and other developed regions have become expert in setting the bar ever higher for agricultural imports, placing unreasonable demands on poor world farmers. These measures are often simply protectionism under another name and those that are should be scrapped.

Sanitary and phytosanitary standards (SPSS) act as non-tariff barriers against agricultural products from developing economies. While some SPSS may serve as a legitimate way to address consumer protection, they are often defined and applied in an ambiguous way to act as trade barriers. The World Trade Organization (WTO) should play an active role in defining the legitimacy of SPSS (and other non-tariff barriers) and enforcing the rules.

Importing countries can be partners with poor exporting countries to raise quality standards through education, extension, and aid. This would increase investments in new agricultural markets in developing countries and support rural development.

GESolution 6

Resolve world trade talks, liberalizing world agricultural markets by granting developing countries unconstrained access to markets and by abolishing production and export subsidies in the developed world.

It is of vital importance that the Doha Round of international trade negotiations should be completed. A successful conclusion would be a massive boost to farmers in the developing world who want better access to rich world markets. Even if

3. Rethinking Agriculture

some compromises have to be made, the completion will provide credibility to the WTO and stability to international food prices.

The food crisis may well repeat itself as global warming destabilizes yields, and this will erode achievements in decreasing poverty and hunger yet again. At a time when we are re-regulating international finance, we should not shy away from rewriting the rules of governance in international food markets.

An international governing body with the power of enforcement should be established (or the WTO's mandate should be extended) to make sure that countries do not enact protectionist policies in times of crises. This body should also track, monitor, and publicize the production and stocks of all important food crops in the world, and make sure that market access is not impeded when stocks are tight. This will ensure that we do not face another situation similar to the food crisis, where export bans by producing countries led rice prices to rise by 200%.

Decreasing domestic support to agriculture in developed countries is also necessary for a well-functioning international agricultural market. The aim should be for a "do no harm" status, where more farm policies are decoupled and targeted to prevent distortions to the flow of food and agriculture products.

Furthermore, volatility in agricultural markets should be addressed through more open trade, grain reserves, and international institutional arrangements for risk pooling.

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4. Bioenergy and Land Use in Developing Countries



Challenge

Food security and promoting modern uses of biomass as a source of energy are two key goals in developing countries. Are these conflicting interests impossible to reconcile or two ends of a common strategy?

Biomass is the most important source of energy in many developing countries, most notably in sub-Saharan Africa. Although the bulk of biomass consumption is traditional burning of firewood for basic household energy services, there is growing discussion of the potential to build up modern biomass energy industries in developing countries, for example, biofuel and biogas industries.

On the one hand, biofuel production carries the danger of leading to competition for land use, potentially crowding out food production and leading to higher agricultural prices, which hit the world's poorest hardest. Thus, it might, at first sight, seem cynical to think about using agricultural goods for providing fuel.

On the other hand, high prices could provide incentives for agricultural development. This would ultimately promote food security and provide resources for biofuel production while benefiting rural areas in developing countries.

The environmental dimension is also crucial: change of land use that results in massive carbon emissions is undesirable from a global climate point of view. It could also aggravate problems of soil erosion and water availability.

To avoid problems of food provision as well as to preserve valuable natural areas and carbon stocks, it is proposed that mainly degraded land should be used to extend the agricultural area for biomass production. But many questions remain, including:

- What is the potential contribution of biomass energy to the future development of developing countries?
- How can we prevent the adverse effects from changing land with high carbon storage value to agricultural land?
- How can we prevent conflicts between the use of biomass and food security?

4. Bioenergy and Land Use in Developing Countries

GESolution 1

Start a “new green revolution” in the least developed countries by promoting the uptake of modern agricultural technologies, best practice procedures and the associated skills; development aid should focus on such agricultural development and the necessary finance.

A **crucial prerequisite** for improving bioenergy and land use in developing countries is higher investment in the agricultural sector to increase productivity and to raise the uptake of modern technologies, best practice procedures, and the associated skills. In other words, there needs to be a sequence of green revolutions, especially in the least developed countries.

This would enable developing countries to amplify their agricultural production significantly, and thus would contribute to food security as well as enhanced use of biomass for energy. As such, a virtuous cycle could be established, since sufficient energy supply and food security are essential for further economic development.

Getting there requires foreign direct investment (FDI) in the agricultural sector closely engaged with local communities. Development aid should also refocus on agricultural development. Technology transfer would also be beneficial, both from the developed world and “South-South” (for example, from Brazil with its longest history of ethanol production).

To foster production of and trade in biomass, the harmonization of technology and fuel standards is important as well as a reduction in trade barriers. Currently, a lack of finance prevents large productivity jumps. It is important to not reduce efforts even further as a consequence of the financial crisis.

GESolution 2

Modernize traditional biomass use by using biogenic waste and residues in decentralized biogas and electricity production and by investing in more efficient biomass-burning devices.

There is still considerable inefficiency and potential in the traditional use of biomass. Using biogenic waste and residues in decentralized biogas and electricity production would improve energy services in developing economies and would be instrumental in fostering and developing regional village communities. The same is true for more efficient biomass-burning devices, such as improved stoves.

GESolution 3

Grant emission reduction credits from conserving areas with high carbon storage value and provide an international certification scheme for sustainable biomass production. For this purpose, strengthen incentive mechanisms such as REDD (“Reducing Emissions from Deforestation and Degradation”).

The use of bioenergy is meant to reduce greenhouse gas emissions. But emissions will actually increase once land with a high carbon storage value—such as rainforest, peat and grassland—is converted into cropland to produce energy crops. To prevent such conversion, it is essential to reach an agreement during future climate negotiations on REDD mechanisms.

Through REDD, countries would gain emission reduction credits from conserving areas with high carbon storage value, which would serve as an incentive to do so. In addition, the commitment to enhanced technology transfer towards developing countries could be used in return for conserving high carbon storage areas.

Further steps are the development of an international certification scheme for sustainable biomass production, including a strict target for the reduction of greenhouse gas emissions.

4. Bioenergy and Land Use in Developing Countries

GESolution 4

Investment in bioenergy production in developing countries must integrate local farmers closely.

To reap the benefits from agricultural FDI, investors need to engage local farmers heavily in their operations and carefully take account of local conditions. Experience shows that it is vital for investors to have a long-term perspective, because low yields are likely to undermine any hope for quick profits.

Working closely with local farmers is easier in a small-scale setting, a fact that speaks against building large corporations and in favor of alternative institutional settings such as cooperatives. Looser forms of cooperation on a contract basis may also be a promising way of linking foreign processors and traders with local production.

Crop choice is largely dependent on the institutional setting and economic environment. The production of jatropha-based fuels is especially suitable for small farmers in developing countries because it can be combined well with food production, also on a subsistence level, and is very robust to unfavorable conditions.

High yield crops like sugar cane are suitable only for large corporations, which can produce on an industrial scale, especially in emerging or developed economies. Well-organized smallholders can compete with large-scale agro-industry corporations on the world market, if they are efficiently organized.

There is ample scope for increasing local energy supply capacities. Using local products for local supply of energy in developing countries could kill two birds with one stone, promoting rural development and providing outlets for local producers of bioenergy.

Background

According to the International Energy Agency (IEA), bioenergy (what the IEA calls “combustible renewables and waste”) amounted to about 10% of total primary energy consumption in 2006. Shares in different countries vary considerably: in Japan, it is only 1% while in some developing countries, it is well over 90%. Some emerging economies (Brazil at the forefront with about 30%) focus on bioenergy to satisfy their rising energy demand.

Both the production and use of bioenergy vary considerably. On the one hand, large agro-industries, as in Brazil, produce large-scale, high yield energy crops on vast plantations. On the other hand, firewood and other traditional forms of bioenergy remain predominant in developing countries.

This is also reflected in different ways of using biomass for energy services. Developing countries predominantly rely on bioenergy for domestic cooking and heating purposes. In emerging and developed economies, transport is the main use of bioenergy. Recently, attempts have been made to reconcile traditional methods of cultivation with modern requirements concerning the efficient processing of energy crops, for example, by growing jatropha complementary to food.

Food security and rural development are among the central goals of agricultural development, a fact that should be kept in mind when discussing the use of biomass for energy. The price spikes in agricultural commodities in 2007/08 led to the “food versus fuel” discussion, which illustrated the potentially severe consequences of coinciding shocks.

Bad harvests in the main grain-producing countries and low stocks coincided with increased demand from the biofuels sector and speculation on agricultural commodities markets, which together led to unexpectedly high price levels. That commodity price crisis revealed the urgency of adapting agriculture policies to changing realities.

4. Bioenergy and Land Use in Developing Countries

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5. The Energy Crisis and Climate Change



Challenge

The future global economy is likely to consume ever more energy, especially with the rising energy demand of developing countries such as China and India. At the same time, the tremendous risk of climate change associated with the use of fossil fuels makes supplying this energy increasingly difficult.

This challenge can hardly be addressed by single local solutions. Rather, it requires an interconnected global portfolio of energy sources that matches regional characteristics and that can satisfy the global energy demand in as efficient and carbon-free a way as possible.

While many developing regions are abundant in potential energy sources such as coal, solar power, wind, and water, state-of-the-art energy technologies are mainly developed in the industrialized countries, at least so far.

GESolution 1

Give priority to measures that can increase energy efficiency, such as better insulation of residential buildings, new vehicle engines, and improved manufacturing processes.

A substantial amount of carbon emissions in the short run could be reduced through improvements in energy efficiency that would incur little cost. These measures should be made a priority.

Implementing them requires a combination of incentives given by carbon and energy prices and technological standards. We can achieve large efficiency gains through better insulation of residential buildings, implementation of natural gas condensing boilers in houses, new types of engines for vehicles, and more efficient manufacturing processes. In particular, developing countries have high potential for efficiency gains given their currently inefficient energy use.

5. The Energy Crisis and Climate Change

GESolution 2

Reduce emissions from power generation, by exploiting available options in natural gas, bioenergy, and wind power; at the same time, increase public sector R&D on new technologies, including carbon capture and storage (CCS), photovoltaics, and nuclear fusion.

The private sector should be given incentives for emission reductions: a carbon price helps firms formulate business plans for the next 10-15 years. Currently available options for emission reductions include natural gas, bioenergy and wind power, which are either carbon-neutral or with a low emission intensity. These alternatives could be implemented at relatively low cost, and should therefore be given policy priority over more difficult choices, such as a complete phasing out of coal power generation.

In addition, the public sector needs to invest more in R&D on technologies that will play a significant role after the next decade, including CCS, photovoltaics, and nuclear fusion.

Renewable energies can open new opportunities for developing countries. For example, solar technologies can take advantage of the abundant sunlight near the equator.

GESolution 3

Pursue international cooperation to promote investment in new energy technologies, together with the associated training, in developing regions.

A key to worldwide reduction of carbon emissions is improved energy infrastructure in developing regions. It is necessary to remove institutional hindrances for the installation of new energy technologies in those areas as much

as possible. Policy-makers need to set up clear political and financial frameworks to facilitate investment in new energy technologies, both domestically and across borders.

Moreover, training and participation of the local population in the installation and application of new energy technologies can promote their understanding of the technologies and can fit the technologies to the local conditions.

The development, diffusion, and application of new energy solutions may be fostered through all channels of international cooperation. The main actors would be multinational companies and investors. For example, they might invest in large-scale solar energy projects in African deserts, in large-scale offshore wind parks in Europe, or in CCS-equipped power plants in China.

Policy-makers should set a sound legal framework to give the right incentives to business initiatives, possibly by specifying energy efficiency standards on products. Where an efficient allocation fails, scientific advisers should identify policy strategies to promote international private investment and technology diffusion, for example, by sorting out institutional barriers in implementing energy-saving technologies.

They should also provide guidance on effective public investment in R&D and foreign aid. Given the increasing demand for energy in developing countries, a particular focus should fall on efforts to transfer technologies to these countries.

Background

According to projections by the IEA, the growing size of the world population and the world economy will result in an increase in the world's primary energy demand by 45% by 2030 without any climate policy.

Such increased demand is not itself a threatening factor for the ultimate availability of fossil energy, the resource size of which exceeds 6,000 gigatons of carbon, nearly 1,000 times current global annual consumption. But the significant welfare consequences of climate change require us to take a strong line on carbon emissions.

5. The Energy Crisis and Climate Change

This makes it necessary to limit the total use of energy to some degree. Furthermore, we need to expand dramatically the use of clean, renewable energy sources, while continuing the exploitation of conventional energy sources to a substantial degree.

Regionally, the challenge will be more acute in the developing world. The IEA estimates that China and India alone will account for half the energy demand increase in the next quarter century. As for other regions, the population in Africa will increase by more than 60% from now to 2030 and could become an important factor in global energy demand.

The remaining large income gaps between the developing and developed economies would justify the former's increasing energy use to achieve better standards of living. While the industrialized countries are the main cause of climate change, the developing countries will probably suffer most from climate change.

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6. Establishing a Global Climate Regime



Challenge

There is no doubt that a global climate regime on the basis of international cooperation is needed to prevent some of the disastrous consequences of climate change.

The challenge is that it must include the commitment of the developed countries, such as the United States and the European Union, as well as the large developing countries with fast-growing economies and a rapid increase in emissions, such as China and India. This is difficult because it raises questions of global climate justice, historic liability and equal rights—whether developing countries should enjoy the same right to economic growth based on fossil fuels as the industrialized countries have experienced over the past century.

In addition to the different levels of historic liability, there are also differences in the environmental consequences of climate change for different parts of the world. Some countries face enormous challenges while others could even potentially benefit from climate change. Agreeing equitable global cost-sharing for mitigation and adaption to climate change is an enormous challenge.

So far, global responses have been reflected in the United Nations Framework Convention on Climate Change in 1992 and its principal update, the Kyoto Protocol of 1997. The regime introduced mandatory emission limits for the first time, but it has major shortcomings.

First, it only mandates minor greenhouse gas reductions by the developed countries. Second, major emitters among the developed countries, such as the United States, Canada, and Australia, did not sign the agreement. Third, fast-growing economies, such as China and India, do not face binding caps. Fourth, it does not include the right of sanctions against non-complying members or against non-signatories.



6. Establishing a Global Climate Regime

GESolution 1

Establish a new global climate agreement that specifies firm targets and commitments.

A **clear commitment** by the international community is needed, which sets climate change mitigation as a priority despite the financial crisis. Developed and developing countries must come to an agreement on international emissions reductions before it is too late for mitigation—no member of the international community can be exempt from reducing emissions.

The political agreement should specify clear targets and commitments to cut emissions that provide for planning security and a good climate for business investment. Progress in terms of climate change mitigation is dependent on government intervention and smart regulation, and cannot be left up to the business sector.

To mitigate climate change, we need to rebuild the economic system of the world, and that will need enormous investments, which the private sector will only commit to if there is planning security by means of clear targets in a global climate deal. Furthermore, the perception of “business as usual” must be changed into a perception of a low carbon future.

Global climate negotiations are unlikely to produce a perfect deal, but the perfect should not be allowed to become the enemy of the good. Governments must actively seek compromises that acknowledge the different challenges facing different economies around the world, and must not become bogged down in detail.

GESolution 2

Focus the targets on carbon dioxide, but aim to include other emissions, such as black carbon.

We must include other emissions, such as black carbon, in the climate deal, though the focus should remain on carbon dioxide. Geo-engineering may be necessary at some point in the future, but that prospect should not lead to less effort now in reducing emissions to prevent catastrophic climate change.

GESolution 3

Establish a global carbon price to give businesses a clear investment signal.

Establishing a global carbon price can be done through a carbon tax or through tradable permits, whereby other greenhouse gases are converted into carbon dioxide equivalents.

Companies need to know that they—and their competitors—will be constrained in the amount of carbon they can produce, and can make investments accordingly. If they are not given clear signals on investment as soon as possible, they will not begin to reduce their emissions and will continue to invest in high carbon infrastructure, which will lock the world economy into a continuation of high carbon growth for decades.

GESolution 4

Combine a global cap-and-trade system with an adaptation fund and access to emission-saving technologies for poor countries.

As the nations that have most benefited in the past from being able to produce emissions freely and the nations with the infrastructure best suited to coping with climate change, developed countries must take the lead in cutting emissions and helping poorer nations to cope.



6. Establishing a Global Climate Regime

An estimated fund of \$50–\$160 billion is needed for climate change mitigation and adaptation. It must be a reliable source of funding, preferably based on the proceeds of a cap-and-trade system because public funding will not suffice. A cap-and-trade system would have largely similar effects as a tax on carbon but is politically more feasible.

In the medium term (until 2020), the proceeds of a cap-and-trade system will come from industrialized countries because their markets will take the caps first. The proceeds should be redistributed into helping developing countries with adaptation and mitigation, and into projects such as reforestation.

GESolution 5

Give developing countries' perspective more credit.

China, India, and other rapidly developing countries are taking actions to curb their emissions, and this effort needs to be acknowledged in the talks. Developing countries should also be prepared to quantify their efforts.

Annex I countries of the Kyoto Protocol should not hold back with their efforts to reduce emissions waiting for higher commitments by developing countries. Instead, industrialized countries should lead the way and show that a low carbon economy is possible—developing countries will follow their example.

GESolution 6

Mitigate climate change by controlling population growth, by promoting access to family planning, and by investing in education and employment for women.

In 2050, the world population could be between eight and 11 billion people. Population growth is a major factor contributing to a rise in emissions and

hence family planning and incentives to reduce further population growth are necessary.

We should limit the population increase by providing access to family planning, by education and particularly by investing in opportunities for education and employment of women.

GESolution 7

Forestry will be an essential part of a deal.

Keeping the world's existing forests intact is vital, as they act as a huge carbon sink. They are currently being cut down at an unsustainable rate, but the developing countries that own these forests must be compensated for conserving them.

6. Establishing a Global Climate Regime

Panelists



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Director General, WWF



Jorma Ollila
Chairman, Royal Dutch Shell



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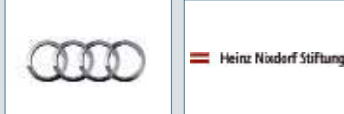
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Selected Solutions—Longer Run

ECONOMY

- Base monetary policy partly on psychological excitement indices.
- Rank financial managers by long-term, not short-term, performance.
- Support more lifelong learning in companies.
- Formalize employment relationships in developing countries.
- Provide re-entry visas for migrants on renewable contracts.
- Create an Intellectual Property Agency for case-by-case patents.

SOCIETY

- Give conventional business incentives for social entrepreneurship.
- Require independent reporting on companies' social impacts.
- Liberalize migration for those not competing with host groups.
- Promote adult universities, connected with the workplace.
- Provide incentives to work beyond the regular retirement age.

POLITY

- Promote “global citizenship” through international virtual platforms.
- Multilateralize regional trade rules by opening specific regulations.
- Convert government bonds to inflation-indexed bonds.
- Leverage local capacities for rebuilding failed states.
- Focus on the ends, not the means, of democracy.

ENVIRONMENT

- Set up a global database on water management.
- Measure the performance of fisheries managers.
- Give poor countries full access to world agricultural markets.
- Use biogenic waste and residues to produce biogas and electricity.
- Give poor countries a climate adaptation fund and technologies.
- Price carbon. Reduce emissions by remixing energy sources.

