Shaping a Green Political Economy

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As an economist, activist and advisor, I have spent the last 25 years encouraging businesses and governments to take on what has become known as "sustainability". Whilst poorly defined, I have always used this term as shorthand for acting responsibly, ethically, and with common purpose with those who have less, have been treated badly by history: those who should have more, more to eat, more to earn, and more to say.

The poor, numbering in the billions, are far more diverse than some aggregate, undifferentiated measure:

- The one billion disabled people across the world, most of whom are impoverished and marginalized.
- The 22,000 children who die each day of avoidable diseases, one roughly every four seconds.
- The increasingly impoverished proportion of the 12% of the world`s population aged 60 and above.
- The millions of Greek and Spanish citizens who for the first time in 5 decades cannot put food on their children`s plates.

These experiences are not equivalent, of course. What they have in common for our purposes here are that they are all symptoms of the flawed economy that we have created, a modern, global economy that delivers more than enough to a growing minority and less than enough to the vast majority.

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Just how broken is the prevailing economic model is also starkly revealed by an examination of its environmental scorecard. Everyone here knows this part of the story, but lets be very clear about how much risk we are taking.

- With respect to climate, we are currently "perfectly on track" to CO_2 concentration levels between 600-700 ppm, way above the 450 ppm so-called climate safety threshold.
- Over 30% of fish sticks are over-exploited and another 50% are fully exploited, spelling disaster for the 1 billion poor people on the planet who are dependent on fish for protein.
- We are losing the topsoil from over 10 million hectares per year – almost 1% of the world's land under cultivation.
- The current rate of species extinction is approximately 1000-10,000 times the natural "background" rate.

The reason for this assault on our planet's social and natural capital is straightforward. Our model of economic growth has been built on an assumption of open-ended, unlimited resource availability. Consider, in 1900, the world used 35 exajoules of energy, with one exajoule being equivalent to the annual electricity consumption of South Korea – or about the annual supply of power from 35 GW nuclear plants. By 2000, the world was using over 500 exajoules. And if the global economy continues to grow at its current rate, we will be using 670-700 exajoules by 2030. This would require the world economy to built an additional 5000, GW-sized power-stations!

Twenty years ago, when I worked with the radical economics think-tank, the New Economics Foundation, calls for a "new economy" that would be more inclusive, accountable and environmentally sustainable, fell largely on deaf ears. It was the heyday of the neoliberal revolution marked by massive privatisation, liberalisation of markets, and dismantling of major parts of the state. Rank opportunism, greed and outright theft masqueraded as freedom, individualism and entrepreneurism. Myopic technological optimism swept away any concerns about planetary boundaries, scarcity and pollution alike would be dealt with by the market. The state was a dinosaur, not merely ineffective but unnecessary for a modern, cool globalized, political economy.

Such views, needless to say, were not nurtured in South Africa, but in the hallways of Washington and London, distortions of long-dead political economists from Adam Smith to Frederich Hayek. Yet such views proved to be some of the finest Anglo-Saxon exports of the age, shaping political economies across Africa and Latin America and large parts of Asia.

Yet it would be dishonest to argue that there were no benefits from the last half a century over which the market has emerged as the powerhouse of the international political economy.

- Worldwide, life expectancy at birth has increased by twenty-one years since 1950.
- Poverty, by any definition, has fallen faster for more people in the last half a century than at any time in history.

And on the environmental side:

- The energy required to produce a ton of steel has fallen by over 30% over the past 25 years
- The CO_2 required for a KWh of European power production has fallen by 20% over the past 15 years.
- In US aviation, there has been a 50% reduction in fuel requirements per passenger mile over 25 years.

Unfettered, profit-seeking business, technological advances and globalized financial markets have played a crucial role in delivering these results, however uncomfortable that might be to some.

Yet the fact is that such advances remain incremental in the face of the scale of the challenge. Given all the time in the world, it is conceivable that our current trajectory would eventually deliver an environmentally sustainable economy, albeit one that would almost certainly not be inclusive. But we do not have the luxury of time on our hands. Whilst every windmill, each scrap of energy efficiency, and every ton of waste recycled does count, an incrementalist approach to optimizing our current economic model will simply not be enough.

We need to up our game, so what is stopping us?

Our challenge is no longer that we do not understand the problem; we are in fact overwhelmed with evidence that things need to change dramatically for the better if they are not to get an awful lot worse. Furthermore, it is not that this evidence is spoken only from the wilderness; we have many political, business and civil leaders who are shouting about this stuff from the rooftops. And whilst further technological advances can and will be made, we already have a chest full of technologies that could if deployed at scale move us rapidly towards a circular economy. And as for money, the world has never before been so awash with capital, some US$250 trillion by one measure powering our US$70 trillion global economy.

So what really is the problem, if we know what is happening and our leaders increasingly speak up, and we have the technology, and there is ample capital to invest?

I want to highlight three barriers to accelerated transformation, and offer for discussion associated solutions for making progress, (a) financial markets, (b) vested interests and (c) government.

Let me start with the financial markets. Anyone who has lived through the last five years needs no reminding that there is something wrong with our financial markets. Andrew Haldane, based at the Bank of England and one of the most authoritative voices of reason about our current situation, has estimated that the financial meltdown has cost the global economy, so far, roughly one year of global income, in the order of US$70 trillion. And that is before we know the outcome of Europe`s current crisis or the slow down across the developing world, including China.

Financial market reform to date has failed by its own measure of success in securing the resilience of financial markets. Continued failures to manage risks by the world`s largest banks, most recently UBS (again) following closely on the footsteps of Barclays and JP Morgan. Yet these failures have been amply matched by these same banks` success in their political lobbying to prevent reforms taking place that would limit their rights to, and rewards from taking asymmetrical risks with other peoples money, notably that of taxpayers.

But this shameful and worrying wobble in the democratic project pales into insignificance when one considers that the contested reforms, even if implemented, would not move the needle in ensuring that financial markets invest in the technology, energy systems, and infrastructure we need to secure tomorrow`s inclusive, sustainable global economy. The heart of the problem is that the reforms have been discussed exclusively with the "narrow" resilience of the financial markets in mind, rather than considering the resilience of the broader socio-economic and ecological system within which the financial system exists. Sir Nicholas Stern, writing in the Financial Times just before COP16 in Durban last year, summarised this fatal flaw in asking how we can allow fund managers to calculate risk adjusted returns with an inputted carbon price of zero, today`s pervasive practice, knowing that this means that they are betting on, indeed encouraging a carbon intensive economy that will threaten our very survival.

Capital markets have public as well as private purposes. Shorting entire economies, painfully experienced in the past by parts of Latin America and Asia, has become an endemic practice apparently without limits, threatening political stability and economic continuity. Moreover, the failure of capital markets to channel the estimated US$2 trillion a year needed to create an economy that can serve a rapidly growing global population within planetary boundaries is little less than shorting civilisation itself. No greater externality can be envisaged. No greater justification exists for today`s proposed financial market reforms to widen their scope to ensure that this historic market failure is overcome.

What might such a broader reform agenda involve? In particular, how can effective action be taken in the face of the financial industry`s ability to innovate rapidly beyond the reach of the rule of law, and likewise threaten regulatory arbitrage with impunity if host nations challenge their right to play dice with our collective futures?

First and foremost, it requires regulators that are not captured by the corporate coin. An IMF team has estimated that the US financial sector invested US$5 billion in lobbying inside the Washington DC "beltway" over exactly the same period that they were accepting large-scale bale outs on our account. Frankly, it is hard to imagine a US or UK government that is not at the beck and call of the financial sector, and the same can increasingly be said of the rest of Europe. However, this may not be the case for major emerging nations, even those with sophisticated capital markets, including amongst others South Africa, China and Brazil.

Put bluntly, financial market reform that takes sustainability issues into account is more likely to be driven by the collective efforts of emerging nations, especially at a time when it is these countries that have the greatest trading surpluses and the most attractive investment destinations. And the evidence of this potential leadership is already apparent. South Africa, after all, has the world`s most progressive corporate governance rules. Brazil, similarly, has gone far in embedding environmental aspects of governance into listing requirements. And on February 24th of this year, the China Banking Regulatory Commission released its "Green Credit Guidelines", securing China's global leadership in advancing environmental principles and rules across its banking sector, uniquely including corporate as well as project finance.

Beyond this, however, there are regulatory opportunities that could limit the type and extent of financial market innovation and that ban certain types of financial trading, such as the pernicious and unproductive activity of naked shorting. Furthermore, there are fiscal measures that could reduce endemic short-termism in investing, such as the wrongly maligned, financial transactions tax. Such measures could raise the relative return of longer over shorter term, and so advantage green over brown investments. Following this line of argument, there are many opportunities for raising the cost of "brown" investments relative to green. Requiring sovereign and corporate credit ratings to build in the intensity of natural capital and pollution as a factor in assessing solvency, for example, is a practical option being worked on as we speak, and would if widely adopted dramatically change investment decisions.

And finally, there is of course what for fiduciary experts would be the "nuclear" option, to mandate public policy objectives onto the boardroom tables of investors, especially the large institutional investors. As one major investor confessed in confidence to me recently, "unless you force us to invest long in green, what you will see will always be tokenism".

My remarks about the financial sector take me to my second barrier, the incumbents. This front line includes those businesses, along with their political allies, that make money out of the current economic model, complete with its inequities and the arising environmental tsunami. The financial sector certainly exemplifies the worst of the winner-takes-all culture that has emerged across the global political economy, with fund managers willing to trade off even the survival of the very institutions for which they work in return for a chance to hit the jackpot.

More worryingly, this Casino Economy has become part of a broader economic landscape. The share of the USA`S GDP taken by the top 1% earners has risen from 7.5% in 1970 to an extraordinary 22.5% today. Similar patterns can be observed elsewhere; as inequalities between nations have fallen significantly in recent decades, so have inequalities within nations escalated rapidly. With public finances under both cyclical and structural pressures, most governments do not have the capacity to mitigate this new form of structural inequality.

Incumbents, those that benefit from the current economic model, are unsurprisingly keen to sustain this situation, even in the face of the resulting social unrest, from South Africa to Egypt to California, and now also filtering into hitherto protected political economies such as China. And this willingness to protect unreasonable rents at all costs brings us to the struggle between advocates of green in the face of defenders of the brown economy.

Our brown, natural resource-intensive economy currently benefits many incumbents. Greenpeace's report, "Who Is Holding Us Back", served up at COP16 in Durban, provided a role call of the main protagonists defending the status quo. Saudi Arabia is not surprisingly attracted to the idea of a world dependent on fossil fuels. Russia, similarly, might well embrace a future with 'Siberia de Sol' as a sunny tourist destination. And of course then there are those companies, foremost amongst them it has to be said, the rump of the coal lobby, that are committed to preventing a green transition from happening.

National competitiveness provides a convenient veil behind which corporate incumbents benefiting from the status quo hide. "Why should 'we' make the change if the price is lost competitiveness, growth and jobs", they argue, referring to countries whose tax regimes and labour markets they are in quickstep abandoning. Yet the World Economic Forum's latest version of its leading edge, national competitiveness index removes this tacky veil. Building on earlier work on Responsible Competitiveness during my tenure at AccountAbility, the Forum has created a Sustainable Competitiveness Index of nations. The index highlights above all the vulnerability of countries undervaluing the competitiveness costs of failing to manage environmental externalities and social inequality (back to the issue of flawed sovereign credit ratings). Countries including China, India and the US each drop by more than 10 places in the sustainability-focused, competitiveness ranking.

Greenpeace`s error (or at least its campaigning approach), however, is to reduce this to a "bad-guy-good guy" issue. There are tens of trillions of dollars invested that depend for their returns on a carbon intensive economy. Penalizing natural resource hungry business models, from coal to cars to long-distance tourism and food systems, would dent if not crash the institutional investors that a growing portion of the world relies on. And such reliance is not only for old folks` pensions. These are the same institutional investors that are the "go to" source of capital needed to go green. Crash them and we can forget any thoughts of mobilizing the much-needed money to finance the transition.

We have become economically addicted to carbon and more broadly natural resource intensity. Polling a well informed, global middle class as to whether they would give up a major portion of their wealth and future security in return for collective survival, and of course a letter of thanks from the appropriate authorities, might deliver some disturbing results. That is, it turns out that *we are the incumbents*, more or less anyone with the time, inclination and access to listen to me or read this speech.

Welcome to the real world.

Overcoming the political power of incumbents is therefore not just about side-lining mean-spirited capitalists, it is about finding a way to transform what would otherwise become stranded and so devalued assets, the assets we need to live securely and invest in tomorrow`s economy. Such policy paradoxes may bemuse and confuse us, but they should not surprise us. When we talk about "system change", that is exactly what we mean. There are no so-called exogenous, or independent parameters to the overall system; we have no choice but to work within an entangled, inter-related reality.

Practically, there is much that can be done, dramatically, but not in ways that crash the system. Some of these I have already alluded to in my comments about reforms to the financial sector. But equally there are many changes that can happen in the real economy to transform stranded assets into productive ones fit for the 21st century. New product development, rentalization of products into services, virtualisation of delivery and communications, and the redesign of everything from building standards to public procurement specifications, are what is needed now, and what we all know how to do, at scale.

And that brings me on to the third and last of my barriers and points of intervention, the government. This is everywhere and always a contentious topic, and South Africa is far from an exception in this regard. This was the "hot topic" at a reception I attended in Johannesburg last week, during which one diner, a leading South African businessman, concluded in exasperation that *business in South Africa has succeeded despite, not because of government*.

The gentleman in question may well be historically accurate. However, I want to suggest that there is no way that this particular "business as usual" can drive the green transformation of South Africa or indeed any other economy. Contrary to much ideological myth, governments are and have always been a key driver of wealth creation. Governments play a crucial role in legitimizing wealth creation and its resulting distribution and use. And governments are the stewards of the rule of law that amongst other things protects and rewards those who do create wealth. These roles are pre-conditions for any successful, organized economy, from the African continent to the technology-powered pavilions of the modern economy, from California to Shanghai.

Beyond these roles, governments have to shape the political economy within which successful investments can be made in the development of technologically dynamic and diversified businesses, markets and sectors. This has been crystallized into the term "investment grade policies" by folks at Chatham House in London. But actually this term is deceptive as it suggests that a menu of policies can do the job, suitably enforced. In fact, government's role, whilst including the advance of specific policies, is crucial in shaping the more subtle fabric of the political economy within which trust, innovation and investments can take place.

What is similar about Singapore, South Korea, and Switzerland, for example, is that their governments have been successful in delivering these functions. What is similar about Russia, Saudi Arabia and, sadly, South Africa is that they have failed to date in this respect. And what is similar about Brazil, Turkey and Thailand is that the jury is out as to whether or not they are set to join the first group or languish helplessly in the second.

This crucial role of government is very apparent when one considers the countries that have progressed furthest in green transformation, in terms of both commitments and practice. The governments of Denmark and Germany, for example, along with Japan and Korea, have played a crucial role in advancing their country`s low carbon trajectory.

China`s government, perhaps must obviously, has driven both the massive growth in carbon intensive energy generation, and now the rapid increase in renewables. Today, China`s government is embarking on major fiscal and regulatory shifts that will attempt to swing the country`s huge economy towards a sustainable growth path.

China's 12th Five Year Plan sets out ambitious intentions for advancing a more balanced domestic economy, framed by out-going Premier Wen's characterization of the current economic model as "unbalanced, unstable, uncoordinated, and unsustainable". Evidence of the seriousness of China's stance includes its commitment over the plan period to invest in environmental protection to the tune of US$450 billion, and to put an extra US$450 billion into renewable energy and US$600 billion into smart grids. Ambitiously, it has recently announced plans to pilot seven domestic carbon markets covering hundreds of million of people, and hundreds of thousands of companies.

The uncomfortable reality is, however, that most governments appear unable to perform their historic function of creating the right conditions for sustainable wealth creation. Even the basics, maintaining the rule of law, civil security and clearly defined and enforced property rights, are beyond the reach not only of so-called "fragile and failed states", but of a growing number of more matured governments and societies. Corporate capture, as I have highlighted already, with the associated biases and shortfalls in public policy, is endemic in the US and increasingly across the OECD. Corruption in the public sector, in its broadest rather than its legal sense, despite the views of Transparency International, is pervasive in developed countries, and growing worldwide.

Rather than wishing for some non-existent past, we have to face the possibility that the governments of our dreams are not going to be part of our future reality. This is not a note of despair but a call for reflection, innovation and experimentation. Across Africa, we see "leapfrogging" in areas such as telecommunications, with the huge potential benefits that this will bring, for example, to education and health delivery. Yet Africa, and many of countries around the world, is creating governments in the image of their European and North American counterparts. Learning from others is of course right and proper. But South Africa cannot, and should not seek to emulate Europe or North America. Beyond the very limits of emulation, these models are themselves no longer fit for purpose, largely made up of inherited institutional arrangements that creak and groan and are integral to their originating continents` failing vitality.

Tomorrow`s governments will have to be up to the task of wealth creation and distribution. Regulation and fiscal interventions will remain important instruments, but only one piece of the pathway to success. It is indeed a time for experimentation in governance and its links to execution.

My role, for example, over the last two years in the newly established, Seoul-based, Global Green Growth Institute has been to advance the work of public-private partnerships that can promote green growth at scale. Let me mention just a few that are out there to illustrate the point.

- The *Water Resources Group*, for example, is a global partnership made up of international agencies and businesses, working with governments from Jordan to Mongolia to South Africa in improving water security and access conditions.
- The *Sustainable Energy for All* initiative, launched in New York just weeks ago by UN Secretary General Ban Ki Moon, and bringing together governments from 50 countries and many private sector players, aims to catalyse massive private and public investment in clean and largely distributed energy systems for the poor.
- Qatar has launched the *Global Drylands Alliance* in an effort to create a mutual risk-sharing, multi-country alliance involving the private sector to raise the ambitions and deliver food security to a billion people.
- Two international initiatives, the Global Subsidies Project and the Procurement and Public Policy Partnership, both hosted by the International Institute for Sustainable Development are aimed respectively at ridding the world of fossil fuel subsidies and advancing green public procurement at scale.

Government has to be reinvented if it is to play its historic role. Highlighted above are examples that blend governance and action by combining public and private actors, and working both across as well as within national boundaries. Yet this is not the only possible direction to go. Rhetoric aside, we are witnessing a renaissance in industrial strategy, abandoned last in the face of the neoliberal push from the 1970s. China is certainly the iconic, class master in this respect, but Germany, Japan, Korea and Denmark, *notably all leaders in green growth*, offer comparably successful role models.

State ownership, furthermore, is once again part of the mix in discussing how to gain policy leverage in global markets. Setting aside the specifics of the nationalisation debate in South Africa, it is important to recognize some basic facts from the international economy. State-ownership is most pronounced in the natural resources sector. Today state-owned oil and natural gas companies, such as Saudi Aramco, Petróleos de Venezuela and China National Petroleum Corp., own 73% of the world's oil reserves and 68% of its natural gas. Similarly, in 2008, state-owned share of global mining production value amounts to about 24%. According to the Inter-American Development Bank, the percentage of state ownership in the banking industry globally by the mid-nineties is over 40%. The BRIC countries - Brazil, Russia, India, and China - contain nearly three billion of the world's seven billion people, or 40% of the global population. The BRICs all make heavy use of public sector banks, which compose about 75% of the banks in India, 69% or more in China, 45% in Brazil, and 60% in Russia.

China, once again, is today`s iconic case of having dominant, state-owned enterprises. These SoEs exhibit many performance shortfalls by most traditional measures (e.g. return on capital, customer service and corporate governance). Equally, however, there is no doubt that China`s SoEs have played a crucial role in the country`s development, providing policy-aligned, investments and effective national stewardship across many markets. There is no doubt that such a policy has challenged, in fact undermined, the principles of non-discrimination, good governance, intellectual property protection and a host of other "untouchable" international norms and standards. Yet there is also no doubt that the existence of SoE`s has been part of a package of measures that has enabled China to emerge more or less peacefully as a global giant, despite the efforts of global incumbents.

My point here is not to advocate state-ownership, but to highlight a real time mega-trend that has benefited some of the world`s most successful economies, as well as dragging back some of the world`s worst performers.

State ownership and sovereign wealth funds are in some ways the opposite end of the spectrum to avant gard public-private partnerships. After all, one seems to be about more control whilst the other is about less; one is overtly an expression of national self-interest, whilst the other more explicitly embraces an internationalism and the "principle of Co", co-determination, co-design, and co-risk.

Yet in the face of these polarities, there are critical similarities. The role of government in both cases does not exclude regulation or fiscal measures, but goes beyond these narrow confines. Furthermore, both ends of the spectrum in fact are centrally about a re-engagement of the state into economic affairs, involving many forms of instruments including ownership, co-governance, and non-statutory ("voluntary") regulation. Amidst the rhetoric, ideology, and at times the violence, we are seeing a very messy experimentation in what forms of government can get the job done.

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Honoured participants, my message is in fact very simple, albeit about a complex topic.

- Firstly, we have everything it takes to solve the problems facing us. There is no empty chair at the table that we are waiting to fill, some leader or technology or crucial piece of information that will change the game altogether for the better. The cards, if you prefer the analogy, have all been dealt.
- Secondly, the obstacles to overcome are many, but I have highlighted just three, the crisis of capital, the power and legitimacy of incumbents, and the damaged nature of government.
- My solutions, thirdly, if you can call them such, offer a tough love, requiring leadership, risk taking, and a vibrant political economy in its fullest sense.
    - Capital markets, viral and parasitic in their nature, need a radical overhaul to align them to their public purpose to invest in tomorrow`s sustainable economy.
    - Incumbents, including us, need to be gently or otherwise moved to one side, allowing toxic assets to be depreciated or better still converted to other uses.

- And government, the uncelebrated key to wealth creation through the ages, needs to be reinvented to do its job at this critical time.

We started this journey talking about energy, poverty and the green economy. For some (perhaps all) of you, it may seem that I have meandered into muddy, muddled waters unrelated to the topic at hand. To those of you, I apologise and hope you have found at least parts of my story of interest. To others who can sense an underlying pattern to my madness, I hope that this story provides some clues in reflecting productively on the challenges of our age.

Thank you.