

# **Understanding the crisis: an opportunity for global action for a sustainable future**

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Global problems require global answers. We are facing a global crisis: financially, economically, environmentally and socially. The crisis provides the opportunity, unique perhaps, for tying the loose ends of these problems together. Solving these problems will require action at a global level, a political challenge which concerns us all.

## **1. The instability of the system**

The core problem underlying the global crisis is a gigantic “money bubble”, signalling that the global real economy is increasingly and overly debt based. By now, these debts amount to the quadruple of the size of the real economy (GDP) of one year, in Europe even the quintuple. This is a situation of over-indebtedness in which the financial base (central bank money) stands vis-à-vis an increasing amount of “securitized financial claims”, e.g. bonds, debentures, stocks, shares in funds etc. The ratio between the two is currently at 2:107. This is a situation of extreme instability, invariably leading to crisis as the readiness to hold financial claims as assets diminishes. This is comparable to the “musical chairs” game. While the music plays, the players run happily around the chairs. When the music stops, the person who cannot catch hold of a chair, pays a forfeit. However, in the “game of games” of the global financial system, 107 players, among them a small number of very large asset managers (institutional investors), run around just two chairs. And by the moment the readiness to hold financial claims instead of cash or real values approaches zero, the music abruptly stops playing. Especially the institutional investors are hoarding liquidity; they are taking the “chairs” out of the game. They do not invest in debt obligations anymore because nobody knows which investments are still secure by that time. Doing this they are even – though unintentionally – putting their own capital at risk, as further companies in the financial network, of which they hold shares, incur financing difficulties. Central bank money no longer “flows”, and is

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no longer “afloat”. What follows? The “losers” in the game incur payment difficulties, e.g. because their loans are not rolled over. They have to give off real values as “pledge”, by selling them below their actual worth (fire-sales), to those who are solvent, the large institutional investors or their financial institutions. Financial capital is being exchanged for real assets.

Resolving this unfair “game” requires more than just bringing “new chairs”, i.e. central bank money, “into the game”. Money needs to circulate to “go around”, “the music needs to start playing again”. To that end, cash management needs to be regulated effectively to make liquidity available to the markets.

## **2. What are the most important reasons for this excessive indebtedness?**

The global market should regulate competition – instead, there is a competition of regulations. The financial, fiscal and social systems of national states are competing for value creation via national laws, even if those values have been earned in other countries. There is a “struggle for the tax substrate”, e.g. through, albeit legal, the ruse of “requalifying” gains. “Fair value accounting” has, especially in the last eight years, contributed to the generation of equity by financial institutions from nothing, from the future, and from profits that had not even been realized yet. These profits were taxed in the domicile countries of the financial institutions, even though nobody would or could know where – if at all – the profits would be gained. Of course the owners of this equity (pension funds, among others) wanted to see high returns on it too. For this reason, financial institutions have extended borrowing on a huge scale: e.g. for leverage investments or to debtors who were completely unable to repay (subprime), with risks being “relocated” wherever possible. Economic activity, profits and tax gains grew “on tick”.

## **3. Facing the crisis**

The German federal minister Steinbrück has aptly illustrated the efforts by the federal governments for saving the situation so far when he said: “fires need to be extinguished and then the incendiaries need to be prevented from rekindling it again”. This is certainly correct and important, but definitively not enough. Where will we get the fire water from? With what money will the state act? Without an increase of revenues, taking further debts will be unavoidable. The state will acquire fire water

from the incendiaries. Since forty years nation states have become more and more indebted, they are already short of water. The states are not able anymore to afford the necessary infrastructure; they cannot make sufficient investments into education, innovation and research. And general conditions for the middle-income sector are deteriorating. The “trees” are dry as dust.

This precarious situation needs to be fixed, but not through national economic stimulus packages “on tick” which are not capable of solving the problems behind the problems: the unconstrained competition of the national systems on the global market. Now is the chance for politicians to grasp the opportunity of setting the course into the right direction. To that end, however, the other “loose ends”, i.e. the various and ultimately interconnected problem areas, need to be looked at. These are the problems of climate and energy, and the incessant social dumping, exemplified among other things by child labour around the globe. The global market is definitely lacking appropriate agreements for rules in the fields of the environment, energy, and social concerns.. Especially in the WTO only quality standards apply, but no processing and production standards. Since these problem areas are interconnected and interdependent, they must be worked at and resolved in conjunction.

#### **4. What are the effects of the financial crisis on society?**

We are currently finding ourselves in a “near chaotic” situation. Scientifically speaking – in terms of decision theory – we are finding ourselves at a so-called “tipping point”. Our common future will depend on how we act now, what the consequences of that action will be for us, our society, and especially the middle-income sector. Unless we go about implementing the measures as indicated, i.e. especially the setting of rules on a global level for environmental and social standards and the harmonization of tax bases, society will be disrupted. There will then be a segment of citizens who hold deposits at banks. These deposits, in turn, will be “securitized” via public and governmental debt obligations. If the state then proclaims “the deposits to be safe”, this will effectively mean nothing but “if somebody fails everybody loses”. The other segment of society will consist of the large profiteers. Taking a global perspective, the middle-income sector will lose, with dire consequences for Germany, Europe and the world in total. The challenging and serious question if this occurs is: What degree of

inequality can a society sustain without radicalizing? Can one even speak of “winners” in such a scenario? Or will history repeat itself after eighty years?

It is in our hands now to grasp the opportunity of rendering the “game” fair again, so that everybody can win: through environmental and social rules for the globalized market, combined with a sustainable orientation of the financial and fiscal system.

Balance is attainable through fair competition, fair participation, and a broad distribution of wealth.

## **5. A global “New Deal” for overcoming the crisis**

The global financial crisis is, choosing a pragmatic approach, in all likelihood a unique opportunity for a big stride towards a global eco-social market economy, capable of reuniting many aspects, and for solving the problem in its entirety: The financial system is currently being used by globally acting companies and individuals to evade adequate taxation. Substantial funds could be made accessible soon, without burdening national budgets and the middle-income sector, if we succeeded in advancing and developing the harmonization of (the respective national) tax bases. These funds – if applied properly – could be the key to a “global contract” a “global New Deal”, to a seven point programme for a political solution of the global problem as a whole, and which the G20 could now launch:

1. **Environmental standards:** The window of opportunity is now open to come to a “cap and trade” approach within the current negotiations following the Kyoto-protocol, based on the principle of climate justice. A transformation process will have to be negotiated to that end, leading to equal per-capita emission rights in the medium term.
2. **Social standards:** all nation states have agreed upon the core standards of the ILO, which however – as is the case with environmental standards – are currently being undermined within the WTO framework. Child labour and pollution, for example, still constitute a competitive advantage.
3. **World economy:** A global recession cannot be prevented through national economic enhancement programmes alone, and especially not debt financed ones! Public investment e.g. into new types of energy production or environmental technology, education and infrastructure have to be part of a global implementation process for environmental and social standards, which

need to be laid down as **compulsory operational and production standards** within the **WTO**. Only then will there be an end to environmental and social dumping for the maximization of profits. That way the global market will become an eco-social market.

4. **“New Deal”**: How can such a “deal” be accomplished? The answer is co-financing, in a similar way as the EU has for a long time been co-financing via the so-called structural funds, so that weaker and new members were able to implement the community law – the *acquis communautaire*. Such a procedure – the **co-financing of standards** – is key at the global level as well. With their implementation the Millennium Development Goals will come within reach, too.
5. **Financing**: Where will the means for co-financing come from? The answer is: from a reform of the financial **and tax-systems** within the framework of the international plan for action of the G20 (“financial markets and the world economy”), which however must not be limited to the financial sector alone. Taxation systems too need to be **harmonized**. For only then can tax evasion be successfully prevented. The step of restricting tax havens needs to be added.
6. **Balancing**: A further contribution to the financing of the implementation of assimilation processes would be the taxation of global transactions – transport, trade, and cash flows. Also a kind of **VAT on all financial products**, in order to check speculative leverage transactions by finance market agents, would be beneficial. Such a **“leverage money tax”** could be constructed in such a way that those who profit most will pay their fair contribution to the necessary tax funds, like the middle-income sector and others who are at a disadvantage anyhow, because they already have to pay higher interests, e.g. for a securitized loan (a financial product). Those who profit most should therefore make a higher contribution out of the acquired “leverage money”, i.e. loans for leveraged investment and speculation. Economically less privileged agents, e.g. the middle-income sector should not be burdened further. Thus, the leverage money tax could be devised as a fair contribution capable of bringing the “super bubble” – the money bubble – under control.
7. **Financial crisis**: In direct response to the current “liquidity-crisis” the velocity of money in the financial markets has to be increased. One needs to restrict

the “hoarding” of liquidity (esp. central bank money) by introducing a mandatory “**maximum reserve ratio**” (e.g. 1%-2% above the required reserve ratio).

By doing this the needs of the environment, social issues, the economy and money/finance will be taken care of and tied together. The key points are:

First, to arrange the environmental standards within the framework of the post-Kyoto protocol negotiations, while simultaneously securing demands for alternative energies and their development.

Second, to connect the social standards of the International Labour Organization with the points held down in the Millennium Development Goals. This regards especially the areas of education for all children, food, water and health.

Third, we need to launch the necessary investments for a global implementation of these standards in order to tackle the threat of a global recession: for new sources of energy, environmental technologies, education and infrastructure in compliance with the new environmental and social standards. Such global investments are urgently needed by the global economy to successfully combat recession and avoid depression, not national programs only.

Fourth: there needs to be a global “deal” – a global contract, in which the ecological and social standards will be accepted as binding for WTO operational and production standards. And to reach acceptance to agree that the standards to become mandatory within WTO, the co-financing of their implementation has to be offered. Of course the question arises: where will the necessary means for co-financing come from?

This brings us to the fifth point: the reform of the finance- and tax systems with the special objective of closing loopholes for tax evasion through harmonization (of tax bases), so that those will justly have to afford the highest contribution, who have so far successfully managed to defy it.

To this, a sixth point is added: the stabilisation of the current financial crisis through measures of keeping the money bubble, i.e. excessive indebtedness, under control, through the middle-term reduction of public debts, and by restoring liquid markets. This can be achieved through a kind of VAT, on debt obligations and all other financial products. We call such a contribution a “leverage money tax”. It could be devised in such a way as to make precisely those who profit most, and who have

contributed to the crisis through their leverage deals pay more than economically less powerful agents, e.g. the middle-income sector, which already has to pay higher interest rates for loans taken up.

In order to restore the liquidity of the markets, as a seventh point a kind of “maximum permissible reserve ratio” for financial institutions needs to be introduced. All market participants should be obliged to pay in all liquidity (esp. central bank money), which goes beyond the maximum reserve, into a commonly sustained fund for which they are collectively responsible, and grant this liquidity as a loan. Debtors of the fund would of course have to meet all required criteria, e.g. solvency. Thus it would be partially up to the market participants to plead for stricter criteria if they cast doubt upon the quality of the fund. This programme should be put forward in the current G20 process “financial markets and world economy”.