Gary Martin has proposed a good question. But for me it is the wrong question. The time horizon is far too short for a professor. Anyway business usually knows what it is doing over the next 12 months. I am better equipped to cast a net farther out from shore. The more immediate issues are clearly the ones for cross table discussion. For my presentation to have any real purchase it needs to be provocative and thought provoking. I propose to throw out a few comments around the broader challenges and opportunities that drive the rhythms and prospects for the global political economy more generally. Note here I say political economy, not simply economy. We only provide ourselves with a partial picture of the state of global affairs if we focus solely on economic issues.

If I were to focus on the immediate then the sound bite headline for the talk would be: ‘Which way to the Grexit?’ And how do we cope with life after the Eurozone, or what is left of it after the crisis of Greece and now also Spain and maybe even Ireland and Italy is contained. And there is no doubt that containing this crisis, or rather crises, is the major immediate global event of the day and we do indeed need an emergency plan for this eventuality. But time is running out for an orderly Greek exit—the amicable divorce scenario as it is often referred to.

Do you not sense that the approaching northern hemisphere summer of 2012 offers an eerie resemblance to the summer of 2008? Perhaps more precisely given that it is sovereign debt we are talking about, the capital flight from the Club Med countries is, for those of you who remember back, reminiscent of the crises of Latin America in the 1980s and Asia in the 1990s. But the effects of Greece’s departure from the Eurozone, if that eventuates, are difficult to predict precisely; except to say that, just as Lehmann’s collapse in 2008 had unexpected, as well as expected, consequences, Greece’s exit will have consequences beyond
simply an expected collapse in other Sovereign Euro assets and a sapping of economic output and confidence elsewhere, including Asia and Australia. The greatest ‘known unknown’ is the prospect of resurging nationalist sentiment and politics in Europe—that very phenomena that the European Union was established to combat at its inception. If we look at Greece and some central European members of the EU such as Hungary this is a real and disturbing prospect.

At this stage we simply do not know whether the ECB can contain the Euro crisis (although the omens are not good) and the IMF and other global leaders through bodies such as the G20 will be able to help contain the inevitable unexpected collateral consequences at this stage. The assumption must be, if the markets are our guide, they won’t. What is clear at the time of writing is that the approach that has been adopted over the last 2 years, the ‘austerity’ approach, is thought not to have worked and pressure is growing to resort to a more Keynesian strategy—particularly apparent in Nobel prize winner and influential columnist Paul Krugman’s new book *End this Depression Now*.

The dilemma over which strategic choice to make occurs because these are not simply questions of a technical financial nature, they are fundamental questions about the ability of the key global actors (both national and multilateral) to engage in successful collective action problem solving and these are as much political and philosophical questions of policy choice questions as narrow economic ones. At the technical level there is the problem that the more bank debt government’s guarantee the less room there is for future manoeuvre. At the intellectual level the problem is that there is no unequivocal agreement within the policy community over what the correct extent of state involvement in the processes should be. By way of shorthand, let me say that the debate between Hayek and Keynes is still very much alive and this is definitely something worth understanding.

What I want to do today therefore is provide you with an overview of what I see to be the principal issues that will drive both thinking about and practice in global economic and political affairs in the short to medium term.

The unifying question running through my comments today is simple. Can, and indeed to what extent should, the global economy try to govern itself in the early 21st century? How do we calibrate what is clearly a destabilising asymmetrical relationship between a hyper active
and at times irresponsible global financial system (since whether we like it or not, that is what many of the actors in it have been of late) and our under-developed ability to regulate it appropriately. And by ‘appropriately’, I mean in order that the economy overall (not just the financial sector) serves the well being of the ‘commonweal’ or a good society without stifling innovation—the seemingly unreachable equilibrium for human society.

If ever there was ever a time for reflection on the global distemper and the shortfall in global leadership, it is now. This reflection is as important in Australia (a lucky country in spite of itself rather than because of itself) as in those other parts of the world exhibiting not only economic tribulations but also existential crises about their very structure and identity—notably but not exclusively, Europe. We actually need deep and considered thinking on the antecedents and drivers of the current global distemper as much as short term fixes and coping strategies. These should not be seen as discreet activities nor are the longer term questions simply the luxurious theoretical musings from within the sheltered academy. They cast long policy shadows and we need to get them right

So, I want to put 2 big key issues on the table that will grab our attention at the global level over the next months, indeed years to come.

1. One issue is with us for the rest of our lives. We are at the beginning of what I and others would call the ‘coming global turn’. Let us note that in the space of just 30 years we have shifted from an era of a comfortable and (ironically) stable bi-polar global order, through the collapse of the cold war (the triumph of the West in the battle against communism if you like) to a brief uni-polar moment of unparalleled US global hegemony, through the short lived, and naive Brussels driven fantasy of a multi-polar global order based on a triangular understanding of power built on the US, Europe and East Asia acting as the 3 pillars of that order. We are now in an era of at times equally silly fears of an emerging Chinese uni-polar order (remember how the US thought about Japan 30 years ago.) But I think what we are really moving into is a new global political and economic order that we might describe as ‘no one’s order’.

2. I also want to say a few things about the prevailing economic paradigm; which is clearly under stress. I will focus on the inability of actors (individuals, groups and institutions) to learn from the past and the corrosive problems of group think and the
herding instinct that underwrites and fuels the trend towards iterated economic (for which read financial) crises. We need to ask what we can do. Yes the financial sector has behaved badly and irresponsibly at times but rather than continue blaming it we need to reform it and house train it and as Robert Shiller says ‘reclaim it for the common good’. As I will suggest when I get to it, what we need is to articulate the necessary relationship between ‘Finance and the Good Society’.

The world is outgrowing the international economic order we have known since WWII and especially since the collapse of the Soviet Union. As the distribution of power becomes less uneven, it becomes harder to reach international agreement—as we see with the failure to secure the conclusion of the Doha Round of multilateral trade negotiations, any global agreement on climate change and the failure of the G20 and ancillary bodies such as the Financial Stability Board (FSB) to move on from their initial roles as reactive crisis busters to vehicles for managing the global financial system.

We have witnessed the decline of multilateralism and are forgetting the lessons we learned in the second half of the 20th century about the role of institutions (that is functioning institutions). We developed the IMF, World Bank and GATT/WTO system as transaction cost reducers, sources of information sharing and transparency, trust builders, norm generators and, albeit to a limited extent, rule enforcers and compliance agencies.

We seem to be entering an era where, unlike in the post world war 2 era of US dominance of the liberalisation of the global economy and under-writer of the global security order, no one country has either the power or the political will to underwrite collective action problem solving in an era when most problems transcend the control of the national sovereign state. We are backing away from collective action institution building. Rather than G2, 7, 8 or 20 problem solving we are effectively entering an era of a G-Zero global order.

Some of you will say that we have have seen these kinds of conversations about the waning of American hegemony emerge before. Recall all the fuss about Japan threatening American economic dominance in the 1980s. It died down when Japan’s growth slowed as it's GDP/per
capita reached similar levels to the U.S. leaving its aggregate GDP a fraction the size of the U.S.’ But for a range of reasons this time it is different. Specifically with China it is different. China's economy will be five times the size of that of the US by the time it's GDP/capita reaches similar levels—although this date is of course a long way off. Similarly, if population projections prove accurate, India will wind up slightly larger than China, and Sub-Saharan Africa might wind up bigger again.

We do not have to accept the hysterical hyperbole of the imminent demise of western civilisation and influence implicit, indeed explicit, in the writings of pundits such as Kishore Mahbubani in order to recognise Fareed Zakaria’s description of how the ‘rise of the rest ’ will eventually give birth to a new order, as the economic influence of rising powers grows to re-shape the geo-strategic landscape.

But this does not mean we will wind up under a Chinese hegemonic order. There is no alternative world order emerging along with the emerging great powers. There is for example, no common BRIC position on the key issues of finance, trade, environment and security. Key actors such as China, India and Russia know what they do not want (the continued hegemony of the west) rather than what they do want. There is no Asian Consensus or Beijing consensus replacing the short lived Washington Consensus. The re-emerging great powers are, for the time being at least, still more comfortable as veto players rather than as either individual or collective leaders.

So how do we manage, a G Zero global order? Effectively the international economic and political orders are changing more rapidly than our ability to understand them. Transitions in the balance of power are historically unstable and dangerous moments. The principles for the next world order, a more inclusive rather than Western driven world order, are not yet agreed. For a new order in order to be stable requires the following:

- Redfining Legitimacy. Here we may need to let our essentially western commitment to the expansion of Liberal Democracy to other countries slip a little in favour of a more pragmatic, pluralist approach. Responsible governance (a la contemporary Singapore style systems with less emphasis in individual rights and liberty for example) rather than accountable governance (a la the US, UK and Australian systems that are arguably excessively laissez faire) may need to be our standard for
accepting which states are legitimate participants in the new order—as opposed to those which are not—those brutal rentier, extractive states of the North Korean and Syrian variety. We need to get beyond what Kishore Mahbubani calls this kind of ‘western groupthink’; that anything that falls short of our understanding of democracy will somehow not work as a system of government. Clearly, this is not the case. Self serving western narratives, narratives towards which many in Australia subscribe, do not provide us with an adequate description of the new world that is emerging.

- **Redefining and re-stating Sovereignty.** We need to accept that economic globalisation is not leading to a borderless world on the other—far from it. National borders are very much alive and sovereignty is reasserting itself.

- **Balancing the relationship between efficiency and representation.** Aspirational moves from G7 to G20 are all very, and indeed appropriate in representational terms, but we must recognise that the more seats at the table the more difficult the deal making. Task specific commissions of a critical mass of players in a given issue area (minilateralism) will need to become the order of the day. We will never see another round of multilateral trade negotiations. Depending on the issue (trade, finance, environment, IP, arms control or whatever) it is likely that it will be those states with the greatest interest and capability that will drive the agenda with a critical mass approach to decision making.

- **Need to facilitate Regional Devolution.** The East Asian regional project is a case in point but also a work in progress. Regionalism without blocism has to be our leitmotif. We need to multilateralise regionalism

2. **Rethinking Global Economics: Finance and the Good Society**

In recent decades, economic actors have demonstrated an inability to learn. The global financial system is beset by and challenged by herd mentality and group think as the iteration of economic and financial crises become more common. Across the old industrial world, debt, stagnant median wages and looming unfunded entitlement liabilities cast doubt upon the viability of "business as usual". And this is not just a European problem.

For sure, over the past century we have made huge strides in our understanding of how economies work. And yet, we are only beginning to understand the importance of how we govern them. If management is how we achieve certain goals, such as low inflation for
instance, then governance is how we work out what our goals should be, their relative importance, and who bears the costs?

Candidly, and I know this is provocative, I am not always sure that the distinction between economic governance and management is as well understood as it should be in the corporate sector. Economic management has long tried to pass itself off as a technical matter, best performed by independent experts with MBAs and kept away from politics. Politicians and political parties compete to be seen as good economic managers rather than answering the perennial political question of what the goals should be—specifically, ‘who gets what when how?’ But as I have suggested, these questions are not simply the preserve of academic philosophers they cast massive policy shadows over the legitimacy and stability and workability of political systems in the present era.

Political deadlock, uninspiring leadership and low voter confidence all add up to suggest that Western political systems are currently incapable of dealing with the ‘who, what, why’ questions. This is because they are not simply narrow technical questions. This is perhaps our major failing of the current era. Smith and Hume gave us the liberal market society. The progressive liberalisation of trade and the partial de-regulation of finance constructed the global economy. But the welfare benefits that accrued from these processes have been challenged by some of the latest ‘innovations’ in finance; principally because it is now empirically understood that they have fostered inequalities in OECD countries in recent years. The demand that prosperity needs to be shared more equally (or conversely that the current pain be shared equally) is growing and will become a potent, if not indeed toxic, political force.

Equality, or more precisely less manifest polarised inequality and the possibility of equal opportunity should concern us more than they do. Why do I say this? It is not because I am a closet socialist. To the contrary, I am an ardent supporter of a liberal democratic market oriented society. I say it because I think we are in danger of undermining the principles and stability of such a society by the way we are running it at the moment.

The continuing cascade of global financial crises we are living through have demonstrated clearly how intimately interconnected the economic and the political really are. Deeply entrenched and seemingly intractable economic problems plague many industrialised
economies, raising questions as to the viability of the dominant economic paradigm. Perhaps most problematically, Western political systems seem to be presently incapable of dealing with these serious issues. We are at a turning point in history, where the old way of doing things is less and less effective.

Nowhere is this dilemma better illustrated than in the recent and continuing financial crises. In many ways they represent the touchstone of the limits of state policy capacity (state sovereignty in fact) in the face of de-regulated capital markets. Connections between people and financial institutions are fundamental for the development of the good society. Yet recent behaviour in the financial domain has been marked by the detachment of financial activity from the wider public interest, and, candidly, the separation of merit from reward. For some this behaviour reflects a ‘broken social contract’.

Avoiding the highly emotive and emotional nature of this current debate let me address an equally important issue that has accompanied the now well documented empirical shift in wealth and rising inequality in OECD countries; that is the equally significant transformation ‘…of morals and manners … [and] … deeper changes in norms of responsibility and self-restraint’ where rent seeking has replaced value creation and wealth is created risk free (for the few) as moral hazard rips. The short termism and the search for immediate returns that can be dated back to the Big Bang in London and the repeal of Glass-Steagall in the USA in 1999 has not only appeared to undermined long standing norms of fairness more importantly, it has given rise to a challenge to the moral basis of capitalism that the second half of the 20th century had done so much to dispel. As a UK Conservative MP notes in a recent pamphlet:

‘The result is that real capitalism – the greatest tool of economic development, wealth creation and social advance ever known – has been wrongly identified with rampant financial speculation. ... Ever since Edmund Burke, conservatism has seen society not merely as a means to satisfy individual wants, but as a compact between past, present and future generations to preserve and enhance the social order.’ (Norman, 2011: 4-6)

At the risk of sounding overly dramatic, the future of capitalism is at a crossroads. The current crisis in western liberal capitalism—free markets and limited government coincides with a new form of emerging state led capitalism. This is not a contradiction in terms. Not only can state capitalism claim the most successful recent state in its camp (China) but also
some of the world’s biggest companies. 13 of the biggest oil firms, comprising 75% plus of world oil are state backed; as is the world’s largest gas company-Gazprom.

In part the current crisis has been fuelled by a near abdication of sovereignty by the state over the control of their financial sectors as they have become progressively freed of ‘appropriate’ regulatory constraint. ‘Appropriate’ here means not regulation for regulation’s sake; but regulation to ensure that the social contract that developed over the last three centuries to underwrite the social bond between states and their citizens does not become progressively unravelled.

The dual failure of markets and regulation prior to the US crisis is now, by and large, acknowledged. Our current ability to develop an appropriate path of future regulation is less clear. This is not surprising. It is not easy. Time and again, in the aftermath of financial crises policy makers vow to get it right. This is a well-known pattern. State authorities put new regulation in place in the hope that this time will indeed be different. But simultaneous with new regulation, the financial sector begins, unsurprisingly and invariably successfully, to explore new avenues to circumvent regulation. Although a new actor, the G-20s efforts to introduce new regulation reflects an historically similar pattern to that found in the responses to earlier crises.

Two main factors account for these repeated failures. First, financial regulation by definition is based on past experience. Reform is an exercise in shutting the stable door after the horse has bolted. New regulation invariably fails to envisage, or is pre-empted by, new developments.

Second, rules, be they national or global, can be and frequently are undermined by successful lobbying. Time and again bankers have succeeded in pressuring policy makers to accede to what Gordon Brown in the UK famously called “light touch regulation”. As we know, the US banking community’s successful lobbying of the US Congress from regulating the derivatives markets in favour industry standards for self regulation is now widely understood to have been the major contribution to the 2008 GFC.

The message to take from this bit of history is to recognise the limits of global regulation and the importance of domestic regulation. For more than two decades, the dominant view in the
debate on financial regulation has suggested that global rules, and only those, can make the financial system safer and more stable whilst at the same time not stifling innovation or undermining the prevailing neo-liberal ideological impetus of the globalised era.

But an emerging contrasting view gives preference to tailor-made national and/or regional level solutions. A diverse, not a one-dimensional, regulatory landscape would be the result. While such an approach will not automatically prevent financial crises, the effects of turmoil might be mitigated because, as we know from biology, diversity stabilises complex systems, whereas monocultures transmit and more easily exacerbate shocks.

Of course, if the record of regulators and academics in identifying future risks were better than history tells us it has been, then the case for diversity would be weaker. But as numerous crises have demonstrated, the assumption that authorities learn from past mistakes has time and again not only been wrong, it has led to hubris and turbulence. There is no evidence that our ability to predict future risk is so well developed that the implementation of more global standards in finance will contain it. Standardisation does not equal stabilisation. This is a cautionary note for our time.

3. Conclusion

The basic question of modernity has been how to reconcile capitalism and mass democracy. The system that emerged from the wreckage of two World Wars in the C20th was a hybrid structure that combined economic and political liberalism within a mixed economy-- what came to be known as the ‘embedded liberal compromise’. A mix of Keynes at home and Smith abroad that as Harold Laski noted “... provided enough solid benefit to ordinary citizens to make its preservation a matter of urgency to themselves”. It was capitalism, but capitalism tempered and limited at home by the power of the democratic state and sensitive to the goals of social stability and national solidarity." At the international level, there was a postwar order of mutually supporting liberal democracies with mixed economies. The system stressed not transcendence but compromise, not utopia but (only) a framework within which citizens could pursue their personal betterment. It has been a massive historical success.
But it was always, and still is, a work in progress. The structure still stands, but it has seen better days. We have to decide if it is worth saving. Can we build a new liberal compromise? This is not a scholarly question it is an empirically practical one the answer to which casts massive shadows over the way we will live our lives. The question is double barrelled. It is about both what to do and how to do it. It goes to the heart of the relationship between the citizen and the state in the early 21st century—and in many parts of the world (including the USA, Europe and the UK) this is an increasing angry and unstable relationship. This question might not be quite as urgent in Australia as it is in say Europe. But as Laura Tingle has suggested in a recently provocative essay on Australia—that some of you may have seen alluded to in the Weekend AFR—it is a question for us nevertheless and it is as structural, if not yet as deep seated, in Australia as it is in other parts of the world. What I have called in this presentation the end of the embedded liberal compromise she calls the dismantling of the ‘Australian Settlement’ in the face of the exigencies of globalisation.

We need to build a new 'liberal compromise' in the minds of a new generation, a changed compact, for a changed world. The fundamental message of the success of the post-war order that we seemed to have lost over the last couple of decades is that economic and financial systems, every bit as much as our political systems, are social constructions created by societies in theory, if not always in practice, to meet the needs of society. They should be built as much by philosophers as Wall Street’s so-called rocket scientists. We need to move beyond what has been the central problem of the financial sector over the last decade or so—that capital necessary for substantive, and low risk, economic and commercial activity and insurance has been given to speculators to play with. We need to secure a better balance in the relationship between finance and ‘real’ economic activity. Provocative for some of you I know but I am happy to debate this. We, as a society, must debate such questions.

The solution to our problems is as easy to identify as it is difficult to achieve. We need to get the relationship between the market and the state right. The market as an instrument of allocation and coordination surpasses all other mechanisms devised by man. But it is no more than a mechanism or machine. And like all machines it requires steering, regulating and servicing every now and then if we are to get the best, as opposed to the worst out of them. Markets, like cars can come in different shapes and sizes—there is no one size fits all, as some fundamentalists would have us believe. Markets, like cars, can function for good or evil depending on how they are used. Markets, like cars, can be improved—better breaks,
bigger engines, improved fuel. Markets, like cars, can be driven better if driving habits are improved (Ha Joon Chang, 2010: 253). Markets, like cars can satisfy needs. But they need to be looked after. We have not looked after them.

Understanding, and making provision for how we satisfy these needs—particularly inter-generational justice, cross-national justice and social justice more generally (and note by justice, I do not mean equality, I mean fairness) must be part of our wider equation. Meeting these needs more effectively is the key to maintaining the legitimacy of our system. Political and economic systems that are not flexible enough to maintain their legitimacy are eventually challenged by alternative systems, historically with disastrous consequences for all concerned; as inter-war Europe demonstrated

I am not naive, I know that there are pressing problems that demand short term fixes and of course as leaders we must address the exigencies of the day. But we cannot do this and flourish unless we have a set of well-defined ideals and principles (dare I say a philosophy) within which we operate. As leaders, we have a responsibility to not only think about these issues ourselves, but to encourage their consideration and discussion in society at large. When we talk about encouraging the next generation, about creating a knowledge economy, about long-term planning and corporate social responsibility, when we talk about governance we should also think about how our actions either facilitate solving these central questions or hinder them. Not to do so is a complacency that we cannot afford.

4. Some Relevant Reading

Charles Kupchan, No One’s World: The West, the Rising Rest and the Coming Global Turn, Oxford: Oxford University Press, 2012
On Australia
