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Paper by invitation

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Policies and Institutions for Moderating Deep Recessions, Debt Crises and Financial Instabilities

Summary: This paper outlines a long-term policy and institutional framework for reducing the intensity of recessions, debt crises and financial instabilities, especially for the Core nations and areas that bore the brunt of the anomalies during 2008-2013. We argue that institutional changes need to be systemic, amounting to the construction of a new social structure of accumulation (SSA) or mode of regulation (MOR), which we call an SSA of embedded communitarian liberalism. Five institutional spheres are introduced which are in need of systemic change, due to the entrenched contradictions and problems which the current set of institutions generate. These involve firstly institutions within the world-system of finance and production; secondly relating to finance versus industry; thirdly capital versus labor; fourthly state systems of production; and fifthly the interlinking of state, community and ecology.

Key words: Policies, Recessions, Debt crises, Financial instabilities.

JEL: B50, E30, F55.

We have had some seriously deep recessions, debt crises and financial instabilities in recent years, especially in the Core, most notably the US, Europe and Japan; and more especially Greece, Ireland and Spain. The world-system as a whole has also been adversely affected. Many parts of Asia have escaped the full brunt of the crises, while areas with relatively unsophisticated financial services, such as Sub Saharan Africa and much of the Middle East, have been much less affected by these problems. Anomalies of deep recession, debt crisis and financial instability are not parts of the body that can just be cut off while the patient recovers and regains health. Rather, these problems are associated with the heart, a systemic process of institutional decline and reduced growth and accumulation. Policy and institutional responses to these crises, therefore, need to be similarly systemic, decentred, and multifarious in nature.

Several articles from Panoeconomicus have analyzed aspects of this multifarious structural crisis. For instance, Howard Stein (2012) scrutinized the strong relationship between neoliberalism and the depth of the crisis. Angelos A. Antzoulatos (2012) went beyond the symptoms of the crisis to the underlying problems of unfettered finance. Kosta Josifidis and Alpar Losonc (2012) drew on the importance of asymmetric power relationships in the generation of the social control underlying involuntary unemployment, which strongly increased in numerous nations during the

crisis. This current paper looks more to the future, in terms of policies and institutions that can ameliorate these current problems of deep recession, debt crises and financial instability.

Specifically, in the environment of the current crisis, this paper sets out a systemic and institutional framework of reform for moderating recessions, debt crises and financial instabilities. Our governance program looks at the reconstruction of five sets of institutional spheres for the generation of much greater levels of economic and financial stability, enhanced levels of demand and innovation, plus socioeconomic development and cohesion for the world-system and its parts. We call this governance system an SSA of embedded communitarian liberalism (ECL) (Charles Gore 2000) since in order to have shallower recessions, fewer debt crises and less financial instability the world and its Core nations and areas, in particular, need systems of governance to generate numerous socioeconomic public goods which stimulate equitable and sustainable performance.

The current set of policies and institutions in motion, especially in Europe and the United States, are problematic since they fail to situate the crises as a failure of the whole set of institutions currently in play. Policies supporting austerity, the wealthy classes and speculative sectors fail to address anomalies of rising systemic risk and uncertainty that plague declining social structures of accumulation. Some of the policies forced on many nations and areas during the 2007-2012 crisis seem positive, such as the imposition/extension of deposit insurance, increasing liquidity and spending, as well as rethinking the decision to allow retail banking to be infected by wholesale “innovations”. The US overall seems somewhat more progressive in its policy stature than Europe, which has imposed austerity on many of its nations. What is needed is a structural scrutiny of the institutions/system and changes that address such big issues.

An outline of the institutions and policies advocated in this paper are shown in Table 1, below, where we situate the institutions studied, the contradictions involved, major problems impacting, and the policy/institutional reforms advised to solve or moderate the problems.

Table 1 Institutional Spheres, Contradictions, Problems, Policies

Institutional sphere	Major contradictions	Major problems	Policy reform advised
1. Global finance & production	Uneven development; low global demand (CAD adjustment).	Long wave downswing in Core, (upswing in parts of SP (esp. Asia), mixed elsewhere).	Davidson Proposal (CAS adjustment).
2. Finance & production (general)	Finance v. industry.	Finance dominates industry.	Asset-based reserve requirements; Tobin Tax.
3. Capital and labor	Capital v. labor.	Capital dominates labor.	Industry policy; wages-productivity link; CEO pay moderation; tax increase for rich.
4. State productive system	Capital v. state.	Neoliberalism: austerity, insufficient investment.	Infrastructure, education, health; functional finance; Chartalism.
5. State-community-ecology relations	Individual v. society, capital/humans v. ecology.	Decline in trust, decline in community, destruction of environment.	Community governance; economic democracy; ecological reconstruction.

Source: Author.

We start the paper by situating the crises and instabilities of 2008-2012 in the historical context of changing institutional styles and contradictions variously within the Core, Periphery and Semi-Periphery (CPSP), over the past several decades. Special reference is given to the contradictions involved in the evolution of the Core economies from Fordism and the Keynesian Welfare State onto supply side economics, monetarism, rational choice theory, neoliberalism and beyond. The relationship between these changes and the incidence of recessions, debt crises and financial crashes are highlighted through uneven development in the world-system.

Then we centre on the first contradiction of the world-system, namely, inadequate effective demand and high levels of uncertainty. At the world level the core problems of deep recession, debt crises and financial instability are closely linked to the global system of production and distribution, and particularly the large imbalances between current account surplus and deficit nations/areas. Several policies have been suggested to resolve this contradiction, the Davidson Proposal being perhaps the best known and most innovative. We advocate here the Davidson Proposal of reforming the international financial architecture to moderate these problems of lack of effective demand and asymmetric flows of funds.

A second contradiction is that between industry and finance, as nations and regions in the Core and most other regions underwent waves of financial stability and quite high growth during the 1950s to 1970s; versus financial instability, low growth per capita and debt crises, in the Core and numerous other regions in the 1980s to 2010s. The role of fictitious capitals is considerable in siphoning off a sizeable portion of economic surplus, which adversely affects productive investment and reduces stability through exotic forms of debt, financial “innovations” and speculative bubbles (see Wolfram Elsner 2012). Two policies and institutions are recommended for resolving these problems, including asset-backed reserve requirements and Tobin Taxes.

The third contradiction is that between capital and labor. With the relative decline of Fordism and the working class norm of consumption into the 1970s and 1980s and the rise of flexible production, robotics, and electronic systems through the 1980s to the 2010s, we see a change in capital-labor relations, especially in the US and Europe. The poor economic performance of the 1970s and 1980s led to the rising power of capital over labor, distributional adjustments to try and improve profits and investment, favoring the top tier of income earners while the vast majority suffered stagnating wages. The question is: how can a suitable regime of demand emerge that compliments the Davidson Proposal within especially Core national economies. In general it is necessary to promote: (a) wages in line with productivity (rather than stagnant wages with high levels of debt); (b) tax increases for the very wealthy; plus (c) industry policy to stimulate productivity and productive government spending to assist productive private investment.

The fourth contradiction, between the state and capital, relates to the ongoing stresses, strains and conflicts between the state and market/corporations, mainly concerning the extent to which these interests are supporting long-term profits, accumulation and growth. The state often runs a fine line between looking after various vested interests, fractions, sectors and sub-classes of capital and the general interests

of business. It also needs to balance these concerns with gaining legitimacy for the majority of the population (where liberal democracy operates), divided as they are between various classes, ethnic groups, genders, ages and regional groupings. While the Keynesian-welfare state managed to support these system functions moderately well for a few decades, the interface between neoliberalism and the institutional-historical environment in which it operated by-and-large failed to generate adequate stability and performance. The neoliberal state not only oversaw a declining ratio of productive to unproductive state spending, but also the tendency to privatise benefits (to profit) but socialize costs (increasing state debt). The state has become a redistributive institution as part of the military industrial complex, while the 2008-2012 crises and deep recessions led the state to buy up fictitious capital instruments that were of dubious value to help save the system. These trends lead to problematic government finances. Policy responses to these developments discussed in this paper include expanding productive state spending; functional finance; and the taxes-drive money approach (Chartalism).

The fifth contradiction – between state, community and ecology – is also important for the system of embedded communitarian liberalism. The state during the 1980s-2000s increased the severity of recessions, financial instabilities and debt crises by putting into practice austerity policies of reducing government spending; reducing the division between retail and wholesale banking; energetic interest rate targets that destabilized asset prices and long-term investment; and debt assistance to lower classes and ethnic groups who had little ability to repay the loans through employment income. The declining productive state spending, deeper recessions, debt crises and financial instabilities – along with the increasing commodification of social life, changing industrial landscapes and ecological destruction – have led to a decline in community, breakup of families, heightened individualism and climate change. To help moderate these contradictions we discuss several policies, including the building of trust and networks especially for the lower classes, economic democracy and ecological deepening.

But first we scrutinize the evolutionary changes in economic performance for the world system, continents/regions and nations over recent decades and how this links to debt crises, recessions and financial instabilities; as a necessary prelude to the policies and institutions required for socioeconomic advancement (see also Angelo Reati and Jan Toporowski 2004).

1. Institutional Contradictions Underlying the Crises

This section deals with the historical contradictions impacting on the uneven development of the world, including the structural conditions that led to the current crises and instabilities. It is well known in social structure of accumulation and regulation approaches that the postwar system of Fordism and the Keynesian welfare state (FKS) – also known as the postwar corporate system (PCS) – underwent development and demise. The postwar high rates of growth of the world-economy during the 1950s and 1960s moderated to medium rates in the 1970s and then declined majorly from the 1980s to the 2010s, culminating in the greatest crisis and deep recession since the Great Depression for numerous nations during 2008-2012.

The specific institutional spheres of the PCS or FWS that developed and then went through contradictory tensions, instabilities, metamorphosis and in most cases relative demise, include: (a) the international Bretton Woods System (BWS) and US hegemony; (b) Fordist systems of production and distribution (assembly line high productivity and high wages); (c) Keynesian welfare state systems of demand and stability; (d) capitalist moderation between monopoly and competition, (e) the regulated financial system; and (f) the family and community system (see Phillip Anthony O’Hara 2009a, 2010).

These five dominant institutional spheres underwent effective performance, maturation and deterioration. The BWS changed somewhat during the 1970s and 1980s as flexible exchange rates (with some regional pegging and monetary unions) were instituted in most areas and neoliberal ideology permeated most of the international institutions. The Fordist system of technology changed into flexible and/or “Taylorist”/subordination modes of regulation with much higher levels of capital control over workers. The Keynesian welfare-state declined somewhat as neoliberal ideology began to permeate most national-regional policy networks into the 1980s, 1990s and beyond. The modest degree of monopoly that existed in the post war boom of the 1950s-1970s declined majorly into the 1980s and 1990s as greater competition was instilled into Core areas such as Europe and the United States, from newly emerging nations of Asia and elsewhere; and domestically there have been high rates of competition in newer sectors such as electronics, telecommunications and information systems, which have generated lower rates of profit and investment. These lower rates of industrial profit, investment and wages in the Core plus the world as a whole occur simultaneously with rapid transformation and high growth, investment and profit in the Semi-Periphery of Asia especially. The regulated system of finance has evolved into the deregulated financial system in the Core (especially); much more so than in most of the Periphery and Semi-Periphery, especially through major reductions in capital controls, interest rate and exchange rate flexibility, plus tariff reductions; along with numerous financial “innovations” and exotic systems of liability management.

Decadal annual average growth rates (AAGR) of GDP per capita for the major regions/continents of the world are shown below, for the period 1940s-2010s, including for the crisis (mainly of the Core) in 2008-2011.

Table 2 Real GDP Growth Per Capita (Decadal AAGR), Stylized Model, World, Continents/Regions: 1940-2010, 8 Areas⁵

	Stylized model	World	MENA	LACA	SSA	Asia	WE	CEE	NA
1940-1949	2.25	1.96	n.a.	2.06	n.a.	-3.33	-0.65	1.24	3.55
1950-1959	3.25	2.68	3.49	2.03	1.82	3.82	4.03	3.68	2.09
1960-1969	3.25	3.09	3.90	2.59	2.09	3.77	4.03	3.68	3.21
1970-1979	2.25	2.01	5.77	3.19	1.32	3.39	2.94	3.26	2.62
1980-1989	1.25	1.36	-1.63	0.19	-0.68	2.96	2.00	0.22	2.06
1990-1999	1.25	1.22	2.07	1.18	-0.60	2.87	1.88	-3.71	1.91

2000-2010	2.25	1.49	2.42	2.35	2.34	4.32	1.18	4.46	1.08
2008-2011		0.37	2.07	2.12	1.54	7.74	-0.50	1.53	-0.62

Notes: n.a.=not available; MENA=Middle East & North Africa; LACA=Latin America & Caribbean; SSA=Sub-Saharan Africa; WE=Western Europe; CEE=Central & Eastern Europe; NA=North America.

Source: Adapted from O'Hara (2012a, p. 11).

Linking this data to decadal average growth taxonomies of (a) above 2.5 percent per capita (wave upswing), (b) between 2.0 and 2.5 percent (borderline performance between upswing and downswing), (c) below 2.0 percent growth (wave downswing), (d) single decade (short wave), (e) 2-3 decade (long wave), and (f) 4 decade-plus (secular wave) performance. We can “map” these taxonomies, linked to the data, for the major regions/continents over the past several decades, as in Table 3 below.

Table 3 “Map” of Wave Phases and Full Waves, 8 Regions Plus Stylized Model, 1940-2010

	Stylized	LACA	CEE	SSA	World	WE	NA	MENA	Asia
	Perfect full long wave 1940-2010	“Full” long wave 1950-2010	“Full” long wave 1940-2010	“Full” long wave 1960-2010	B-up needed 1940-2020/30?	B-up needed 1940-2020/30?	B-up needed 1950-2020/30?	Missing 1940s data 1940-2010?	Secular wave upswing 1950-2010
1940-49	B	B	SWD	n.a.	B#	SWD	SWU	n.a.	SWD
1951-59	LWU		LWU	SWD	LWU	LWU	B	LWU	SECWU
1960-69		LWU		B					
1970-79	B			LWD			B		
1980-89	LWD	LWD	LWD	LWD	LWD	LWD*	B	SWD	
1990-99							LWD*	BLW	
2000-10	B	B	SWU	B					

Notes: * 2008-2012 Great Crisis; B# =“Barely” Borderline; B=borderline performance; LWU=long wave upswing; LWD=long wave downswing; SWD=short wave downswing; SWU=short wave upswing; SECWU=secular wave upswing; n.a. =not available.

Source: Adapted from O'Hara (2012a, p. 15).

The Core economies of especially Europe and North America have been mostly undergoing borderline performance (B) followed by long wave downswing (LWD) over the past several decades. The way this manifests itself is through: (a) much lower growth during borderline and wave downswing (1980s-2000s); (b) major periodic financial crises, crashes and instabilities (1980-1982, 1987-1991, 2001-2003, 2008-2013); (c) recessions usually after – but sometimes before – specific financial crises; and (d) debt crises (especially during 2010-2013). In contrast, the Semi-Periphery of Asia has been undergoing secular wave upswing (SECWU) and relative financial stability as their growth and economic viability have been much greater than the Core. Other areas have experienced mixed results over recent decades, but during the 2000s three continents/regions – the Middle East and North Africa, Sub-Saharan Africa plus Latin America and the Caribbean – have moved into borderline (B) performance, which may foster upswing into the near future, while Central and Eastern Europe moved into short-wave upswing (SWU). Only North America and Western Europe were severely affected by recent crises and instabilities, which indicate that changes must especially occur in these regions (the Core). These are the structural conditions that cannot be easily surmounted through public

policy actions; although several institutional and policy changes should help, especially if they can modify the structures somewhat.

O'Hara (2012b) has shown how these variable growth rates have conditioned systemic risk, as lower decadal growth reduces the potential for debt repayment for the state as well as corporations and consumers. This rise in systemic risk in Europe and North America is closely connected with transformations beyond the postwar corporate system, Fordism and the Keynesian system through declines in aggregate effective demand and high levels of uncertainty. In short, the dominance of neoliberalism, deregulation and the rising power of finance over industry and capital over labor have led to the onus being placed on deficit units reorganising to solve the anomalous conditions. The rest of this paper investigates policy measures that can reduce the instabilities, recessions and debt crises arising from the current institutional dynamics, starting with the international financial and production system.

2. International Financial Architecture and Production

We saw in the previous section that there are contradictory dynamics between Core, Periphery and Semi-Periphery. The main one is that currently areas of the Semi-Periphery (especially Asia) are expanding through an A-phase (upswing) of the wave, while the Core (especially the USA and Europe) is dampening through a B-phase (downswing) of the wave, with most other areas undergoing modest performance (SSA, MENA, LACA) or short wave upswing (CEE). These uneven developments – given the current system of finance and production – are reflected in external imbalances, as shown below in Figure 1.

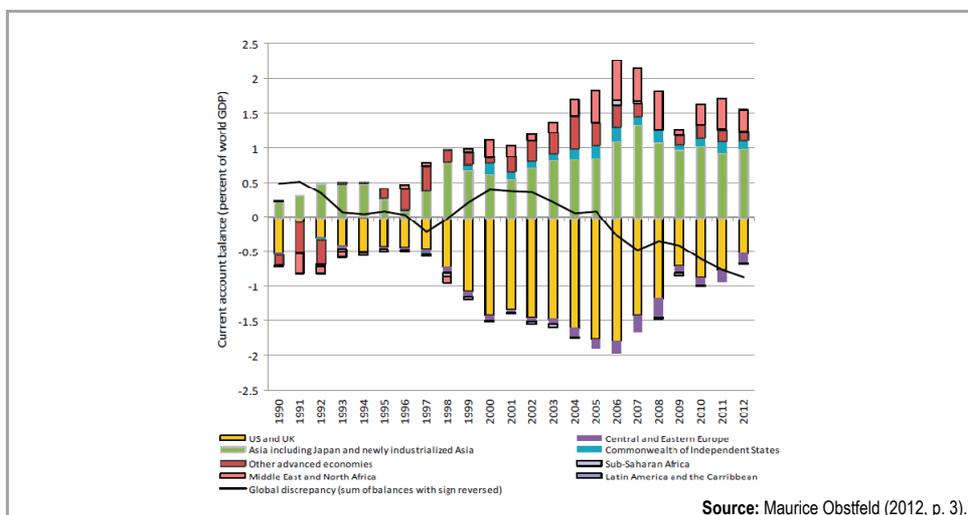


Figure 1 Global Current Account Imbalances, 1990-2012

This shows that imbalances (current account positions) were getting much greater from the late 1990s through to the mid-to-late 2000s, eventually in 2006 summing to over 2 percent of world GDP. These asymmetries of current account

deficits (CAD) and current account surpluses (CAS) are global in nature (e.g. Asia, Middle East in CAS, US, UK, CEE in CAD), but also regional as well (e.g. in Europe, Greece, Spain and Portugal having CAD, Germany, Austria in CAS). For Greece, Portugal and Spain, these CAD positions rose from relatively low figures in the 1990s to very much higher in the 2000s, culminating in deficit positions of -11.1 percent of GDP for Greece, -10.5 percent for Portugal, and -5.8 percent for Spain (average for 2008-11) (Philip R. Lane 2012, p. 53).

A major problem is that CAD positions, especially in the Core, have been financed often by external debt, which has magnified the depressive dynamics of the crisis through liquidity problems and sovereign debt instabilities. For instance, mean gross total public and private external debt as a percent of GDP rose for 22 Advanced Nations (Core) from around 26% (1970) to 65% (1990) to 253% (2011); while for 25 Emerging Markets it rose from around 26% (1970) to 70% (1987), but then declined to around 33% (2011) (Carmen M. Reinhart, Vincent R. Reinhart, and Kenneth S. Rogoff 2012, p. 73). For the advanced economies, most of the expansion of debt during the late 1990s and into the early to middle 2000s was private debt; but then a major increase in public debt occurred during the crisis of 2007-12 as public funds bailed out private banks in numerous nations and budgets were squeezed by recession; especially in Ireland, and Spain. Greece and Italy are the only two advanced nations that had public debt above 100% of GDP by 2006, as it expanded to 150% (Greece) and 120% (Italy) during the crisis and recession (by 2011) (Lane 2012, p. 73).

One important institutional change which addresses these problems is the Davidson Proposal. Paul Davidson (2004, 2009, 2011, 2012) has over many decades consistently proposed institutional changes to the global financial system that fundamentally reform the financial architecture. He regards the Tobin Tax as possibly a useful but ultimately a limited measure of reform. What is needed, he argues, is not simply a new tax to “fix the plumbing” but rather a useful institutional apparatus that promotes stability due to the coherent organization of its norms and rules. The core of his proposal is a threefold institutional system of preventing inadequate global demand, providing a mechanism of reducing surplus and deficit current account positions, and having a global monetary unit.

Stability is best obtained, Davidson argues, by ensuring that flows of funds do not cumulatively aggregate in certain nations at the expense of others. The best way to do this is supposedly to have a rule, an adjustment mechanism, whereby the onus is on current account surplus nations to expand demand sufficiently to balance their international payments. In this way, they would enhance demand for deficit nations' goods and services and thereby lessen global imbalances. This would reduce the need for deficit nations to engage in excessive debt and thereby likely moderate financial instabilities, debt crises and deep recessions. Davidson proposes to have an independent international reserve currency which is only held by reserve banks. This reserve asset has one-way convertibility with domestic currencies, and is used in exchange for international goods and services. There is also a fixed exchange rate between the reserve unit and domestic currency that changes only “to reflect permanent increases in efficiency wages” (Davidson 2004, p. 602). It is not helpful to have the

current “de facto US dollar system” because US domestic monetary policy may not be in the best interests of global stability (see Stephan Schulmeister 2000). The international reserve asset can therefore be used specifically for global transactions and cannot be controlled for US monetary policy purposes.

In his system, chronic surplus current account nations can spend “excess surpluses” on products of deficit member nations, new foreign direct investment (FDI) projects for deficit nations and unilateral transfers such as foreign aid for deficit nations. However, it cannot resolve the surplus by merely lending to deficit nations, which would not normally help them in the long-run. If a surplus nation fails to spend the excess, it can be redistributed by the clearing agency to deficit nations for development (or similar) purposes. Drawing inspiration from J. M. Keynes, Davidson (2004, p. 605) believes that “global depression does not have to happen again if our policy-makers have sufficient vision to develop this ... approach.” Clearly, such a system of institutions is a long-term project, but nevertheless, a positive one for global growth and stability.

The details of the Davidson Proposal are shown below in Table 4.

Table 4 Davidson’s Proposal for the International Financial System

Rule or institution	Acronym or unit	Chief process	Process in action		
Adjustment mechanism. CAS Burden of adjustment	CASA	Surplus nations Spend surplus→	(a) Reduce global CAS/CADs	(b) Stimulate global demand	(c) Reduce CPSP imbalances
1. International money clearing union (CU) institution	Global money unit	Money units held by union & domestic CB→	(a) Accounting credits & debits	(b) Res. ↑ by ↑X; reserves ↓ by ↑M	(c) Ultimate liquid reserve asset
2. Differential capital controls	DCC	Policy oversight (discretion), e.g., →	(a) tax on hot money (eg)	(b) Δi rates (eg)	(c) Δ bank reserve ratios (eg)
3. ST overdraft system for productive investment (credit)	OSPI	Expand industry→	(a) Finance productive activities	(b) Terms calc. by CU	(c) Not for fictitious capitals
4. Automatic stabilizing adjustment mechanism	Trigger mechanism	Excess surplus spent on deficit nations→	(a) Products (↑X)	(b) New FDI	(c) Foreign aid
5. Central Bank debit surplus nations	CB actions	If individual nation fails to let trigger work	CU confiscates excess credits	Redistributes to debtor nations	Unilateral transfer payments
6. Full employment adjustment Mechanism	FEAM	At FE & excess CAD→	(a) CASs spent on them if UDC	(b) Reduce TOT if HDC	(c) Other actions
7. Fixed exchange rates b’t local & UMCU	FER	Depend on efficiency wages→	(a) Link prod’y with wage growth	(b) LT CAD _{FE} → CAS nation help	(c) Currency unions possible

Source: Author.

i. International Money Clearing Unit (IMCU) (Clearing Union) as the ultimate reserve asset and unit of account held only by reserve banks (at the clearing unit institution). The reserve bank guarantees one-way convertibility from IMCU to domestic currency at the clearing unit institution (between different Central Banks etc). Private trading on IMCU is prohibited – thus trading speculation will not unduly develop.

ii. Different forms of Capital Controls (DCC), such as: (a) policy oversight and control of transactions; (b) taxes on specific financial transactions, such as hot

money or short term debt from overseas; (c) different policies will depend on conditions and institutions of specific nations and areas.

iii. Overdraft System to finance productive investment (OSPI), by using short-term unused creditor balances. These are specifically to finance productive investments rather than speculative trading in shares, bonds, real estate or foreign exchange.

iv. Global Spending Trigger Mechanism (GSTM), for excessive current account surplus nations or areas to go to deficit nations' (a) product demand (exports), (b) new FDI projects, and (c) incoming foreign aid. These measures provide an automatic stabilizing adjustment mechanism through changes in the current or capital accounts. This gives the surplus nations some limited discretion, although the measures in total represent automatic stabilisers. This is the most critical aspect of the Davidson-Keynes proposal.

v. Central Bank Debit Surplus Nations (DSN). If the surplus nation did not act accordingly, the Central Bank would put into practice a set of preestablished rules, and thus debit the surplus nations excess IMCUs and redistribute to deficit nations. This mechanism must be automatic in order to dampen any potential international liquidity crisis.

vi. Fixed Exchange Rate between Local Currency and IMCU; which varies according to efficiency wages of the various nations. There would thus be greater information developed in the market on efficiency wages, which would become a critical institution of the system. This will ensure that fundamental variables are the basis of exchange rates – i.e. wages that increase in line with productivity. This also helps to solve the conflict between capital/labor, as well as between industry/finance.

vii. Full Employment CAD Adjustment Mechanism (FEAM). If the nation is at full employment and still operating with a persistent international deficit, then obviously it does not have the productive resources to sustain its current standard of living. Thus if it is a developing nation, there must be an equation whereby surplus industrial nations transfer a proportion of their excess credits to them. If they are a rich, industrial nation then it must reduce its terms of trade with its major trading partners (exchange rate). These rules are built into the new global institutions. (If persistent, unsustainable debt occurs in tandem with positive balance of trade (but CAD – debt is paid from current account), then lengthening the debt period, reducing interest rates and/or debt forgiveness can be activated).

Reforming the international payments system in this way will likely impact positively on many of the other institutional spheres discussed in the following sections.

3. Finance and Industry

The second major contradiction adversely affecting especially the Core is that between industry and finance. During the postwar boom (1950s to early 1970s) industry dominated finance in North America and Europe, which enabled the effective realisation of economic surplus, especially industrial profits and some of the surplus being distributed to workers. The financial system served the interests of industrial pursuits, as relatively low interest rates, qualitative controls over banks, the separa-

tion of retail from wholesale banking, fixed exchange rates and interest controls helped the manufacturing sector and consumers to expand demand without introducing too much instability. During this time in the US and Europe there were no major financial crises, deep recessions or debt crises.

This all changed in the 1970s and 1980s as flexible exchange rates were introduced, interest rate controls dropped, qualitative controls declined, and a whole series of financial “innovations” brought into play. Monetarism was strong for a while as the efficient markets hypothesis and rational expectations theory dominated finance and economics. The rise of Thatcherism and Reaganomics saw greater deregulation of the financial system, which generated a whole series of cycles where asset bubbles rose and fell every decade. In the US, for instance, the 1980s saw the rise in asset bubbles linked to leveraged buyouts, followed by the biggest stock crash in 50 years in 1987 and subsequent recession in 1991-1992. The 1990s was the decade of the Internet, Silicon Valley and technology stocks, followed by the crash/decline of 2001-2003, the corporate crisis associated with Enron and numerous other firms of dubious ethics and financial control. The 2000s saw the continuation of real estate expansion, securitized mortgage bonds and subprime securities, which ushered in the financial crisis of 2009 and deep recession during 2008-2012.

Research on this contradiction centers on finance (when dominant) being a form of unproductive activity, as the surplus is redirected from areas where productivity and provisioning are the core concerns to those where speculative bubbles, over-indebtedness, and extreme inequality came into play. This core theme of periodic financial dominance of industry was developed by Karl Marx, Rudolf Hilferding, Thorstein Veblen, John Maynard Keynes, Joseph Schumpeter and Hyman Minsky. More latterly this theme has become a staple of political economy authors, including the work of Matias Binswanger (2009), Engelbert Stockhammer (2012), Philip Arestis and Malcolm Sawyer (2012), Randall L. Wray (2012), and numerous others who have provided empirical evidence for the general hypothesis of the dominance of industry by finance. From a policy point of view the significance of the theme is the need for a concern for “financial stability”.

Table 5, below, details some of the salient trends of financial versus industrial aggregates for the world, the UK and the US.

Table 5 Financialization Rising Trend, 1970-2010, World, Advanced Nations

	1970	1980	1990	2000	2010
Global financial assets as % global nominal GDP (Ω)	n.a.	120	195	293	356
Total gross external debt as % GDP: advanced economies (∞)	26	46	66	111	251
UK financial corp. surplus as % Σ UK corp. GOS (Φ)	n.a.	2.17	12.44	6.37	22.33
U.S. finance sector profit as % US nom. GDP (Ψ)	3.35	4.00	4.72	6.21	7.63

Source: Adapted from McKinsay Global Institute (Ω) (2010); Reinhart, Reinhart, and Rogoff (∞) (2012, p. 73); Brett Christophers (Φ) (2012, p. 281); Lawrence Mishel and Josh Bivens (Ψ) (2012, p. 11).

This shows that global financial assets have escalated from 120% (1980) through to 356% (2010) of world nominal GDP, an extraordinary increase over 30 years. Total gross external debt of advanced economies rose from 26% (1970) to 251% (2010) of advanced economies GDP; a similarly staggering rise over 40 years. Then for the two major financial centers, UK and US: UK financial companies gross surplus (profit) as a percent of total UK corporate surplus, rose from 2.17% (1980) to a 22.33% of total UK corporate surplus (profit) (declining during the crisis/recession of the early 2000s, and rising thereafter); while US financial sector profit as a percent of US nominal GDP rose from 3.35% (1970) to 7.63% (2010). Clearly, the rising trend of financial corporation profit compared with total corporate profit better illustrates the speed of the increase (than compared with GDP). All four of these indicators suggest the power of the financial sector compared with industry has undergone a remarkable expansion from the 1970s and 1980s to the current instabilities of the 2010s.

These escalating trends link to the movement from conservative accounting and regulated finance in the 1950s and 1960s through to financial deregulation in the 1980s and 1990s as shareholder value, short-term returns and speculation in numerous new markets gained in importance. This shift of economic surplus from industry to finance represents merely one aspect of the declining rate of industrial profit over recent decades (Christophers 2012; Dimitris Paitaridis and Lefteris Tsoulfidis 2012). The declining/dampened real wages, profit rates and government (tax) revenue as percentage of GDP enabled all three sectors – households, government and corporations – to expand debt to complement internal sources of income. This rising debt involving numerous dubious financial dealings and sectors that undergo speculative bubble rises and falls have contributed majorly to the dislocation of the circuit of social capital. Rising fictitious capitals of real estate, debt, equity, and collateralized debt obligations have crowded out industrial profit and wages in the productive sectors to some degree; and to the extent that this debt was financed from overseas this has exacerbated anomalies, as sovereign debt crises come into play.

It is not simply a matter of increasing regulation of finance, since one of the elements reducing industrial profit is the shifting terrain of industry from the Core to the Semi-Periphery (discussed above). Also, more regulation often comes with more resources allocated to evading the regulations, including (for instance) political lobbying, legal and accounting “innovations”, plus increasing income to CEOs. Furthermore, the state often contributes to instability of finance through interest rate targeting which increases the standard deviation changes in interest rates and hence also likely long-term investment; austerity; plus attempts to distribute debt to low income households for real estate acquisition which periodically backfire.

Nevertheless, there is some policy space that can be allocated to institutional reform, including various policies, institutions and technologies to construct a new regime of finance. Two such policies and institutions are discussed here: asset based reserve requirements and Tobin Taxes.

3.1 Asset-Based Reserve Requirements (ABRR)

One policy initiative that can simultaneously be used against hot capitals from overseas as well as domestic speculative bubbles is that of “asset-based reserve requirements” (ABRR) for prudential policy purposes. This is an initiative suggested in the light of the reduced importance of traditional bank deposits and the greater securitization, home equity lending and stock market or equity holdings of the community. The authorities potentially could control asset bubbles through interest rate changes, but reserve requirements are likely more effective for taming speculative bubbles. With ABRR, governments can specifically target these high growth and unstable markets without directly affecting broader aggregates.

For instance, if certain sectors or markets (e.g. new technology, real estate, derivatives) are generally expanding as well as showing signs of erratic behavior (typical of speculative bubbles) then the Central Bank may increase the reserves that financial institutions need to hold in an account with the reserve bank (based on their holdings of these bubble assets). This can have the effect of reducing the demand for these speculative assets and thus likely moderating growth and instability in the market, without negatively affecting aggregate investment and GDP. A similar policy could be put into practice where bank loans from overseas (hot capitals) or home loans/commercial property development loans are showing signs of excessive growth and instability. As Thomas I. Palley says:

“At the macroeconomic level, ABRRs can provide monetary authorities with multiple independent additional tools of monetary control that can supplement existing control over the short-term interest rate. In terms of Tinbergen’s ... targets and instruments approach to macroeconomic stabilization policy, ABRRs can provide additional instruments that allow policy makers to focus on additional economic targets (such as speculative bubble moderation). This can be especially useful when fiscal policy is constrained by budgetary concerns” (Palley 2004, p. 46).¹

Palley believes that the ABRRs are better than risk-based capital adequacy (RBCA) measures (a la Basel I, II, III) since ABRRs target assets rather than liabilities, and they have a positive impact during a slowdown, whereas with RBCAs financial institutions often need to find additional capital during slowdowns (when funds are scarce).² Some think ABRR can be placed on specific assets, such as real estate and mortgage credit (Michael Holz 2007); while likely their application needs to adapt to a broader canvas, changing according to the speculative assets peculiar to specific cycles. ABRRs need to be applied to all financial institutions, they can be used selectively on specific assets, and have a potentially international scope in terms of usage. They also need to be revised from time to time as financial institutions try to evade their reach through institutional and technological change.

¹ Palley presents a model to explain the operations of ABRR and how it compares to the current system of liability-based reserve requirements. The current system in most relevant nations is imposed on bank deposits and they tend to be stable through time. He argues that ABRRs, on the other hand, change the relative price of holding various types of assets and have an allocative impact similar to selective credit controls.

² For a detailed critique of Basle II and III, see Ranjit Lall (2012, p. 609), who argues that “Basel II failed to meet the Basel Committee’s original objectives and ...Basel III has met a similar fate”. Lall argues the problems emanate from problems with due process, informational asymmetries and problematic linkages between supervisory bodies and the banking industry.

3.2 Tobin Tax

Davidson's Proposal included a type of Tobin Tax on financial transactions (as part of the "plumbing" within his wider "global financial architecture"), so this is linked well to the earlier section. In the environment of global financial instability many have proffered the notion of a tax on the highly mobile and short term flows of finance. The Tobin Tax is the most famous of these proposals, originally suggested by James Tobin in his 1972 Janeway Lectures at Princeton (Tobin 1974) and later elaborated in the pages of the *Eastern Economic Journal* (Tobin 1978). Many others have followed the general idea and often changed the nature of the objectives behind it. Tobin proposed it as a measure to promote global stability by moderating the excesses of financial capital, with perhaps the receipts being used by national governments as required. He wanted to put "grains of sand into the wheels of speculative and hot capitals" to reduce volatility and dominance. Others have proposed the receipts be partly or wholly used as a global development fund to provide some combination of funding for continual development of poor nations and a lender of last resort facility (see Heikki Patamaki 2001).

Given the nature of the possible receipts from such a tax, and the potential for it to promote stability, this proposal may well function to aid global stability, growth and development. For instance, it could be operationalised in the following way:

- i. Be levied on highly mobile, short-term, speculative financial sectors or assets that are experiencing potentially problematic bubbles (e.g. real estate, derivatives, high-technology, financial innovations);
- ii. At a variable rate of between 0.2 and 0.4 percent of the value of financial flows, depending on the nature of the flows;
- iii. Be capable of being adapted through time to respond to attempts to evade or avoid the tax;
- iv. Be implemented through the United Nations, the World Bank, the G20 or unilaterally (specific nations/areas);
- v. With receipts being divided (depending on circumstances) between the nation that collects the tax (20 percent), a global development fund (50 percent), and international lender of last resort (30 percent).

With a likely annual dividend of about US\$150-300 billion for a global tax, this could be a highly effective policy in moderating the purely technical efficiencies and distributional inefficiencies of highly mobile financial capitals.³ On 22 January 2013 11 EU nations (Germany, France, Italy, Spain, Austria, Portugal, Belgium, Estonia, Greece, Slovakia and Slovenia) voted to introduce, likely by mid-2013, a fi-

³ Tobin (1978) proposed a 1 percent tax on global hot financial capitals, while Howard M. Watchel (2000) suggested a tax rate in the order of between 0.1 and 0.25 percent due to the fairly low margins of many financial transactions (of around 1 percent). Watchel concludes that the Tobin tax satisfied quite well the technical requirements of such taxes: for instance, that they be simple, easy to administer, linked to sound and sensible policy, and raise sufficient revenue to negate potential political backlash from politicians in need of taxation to counter the recent decline in their corporate tax base. Numerous types of Tobin taxes have been instigated or proposed over recent years, such as in Sweden, Canada and the UK; it may be useful to concentrate on national policies while at the same time hoping to have a global Tobin tax in the long-run to complement the other measures discussed in this paper.

financial transactions tax on stocks, bonds and derivatives trades (EU 2013). It is likely to raise 57b Euros annually, mainly as a way of financing some of the costs of the financial cleanup in the wake of the great crisis of 2008-2013 (Michael Neiner 2012); but it may have longer-term applications for stabilizing finance capital somewhat (Britain, Luxembourg, the Czech Republic and Malta abstained in the vote).

Next we link this finance-led regime to capital-labor relations and production-distribution dynamics, including policies to reconstruct this sphere.

4. Capital and Labor-Production and Distribution

Rising financial dominance links to declining production dominance and the increasing power of capital over labor, which link to the uneven distribution of income, wealth and power. Financial dominance manifests itself in rising debt, especially for consumers (due to declining real wages), business (due to declining profits) and government (due to buying infected securities and LLR; plus wars, crises, etc). Policies to moderate financial dominance should also stimulate production efficiency as well as moderate distributional inequality. In an ideal world, these related anomalies could be solved simultaneously, as financial dominance declines, productivity increases, and distribution becomes more equal. It is by no means inevitable that the Core will resolve their regime of accumulation anomalies while the Semi-Periphery and others expand their base, since global uneven development tendencies may be too entrenched in the flow of change for it to be rectified easily. However, policies and institutions can play some role.

Fordism and the consumption mode of demand were Core systems of aggregate demand and profit from the 1950s through to the 1970s in the US and Europe, in particular. Semi-automatic assembly line processes in manufacturing along with wages rising in line with productivity helped to stimulate supply and demand. Long wave upswing continued through twenty or thirty years of relatively high growth; the postwar boom of the golden age. The early 1970s generated a decline in productivity through technological maturity, declining investment, boredom on the job and high rates of labor industrial muscle, leading to numerous strikes and a decline in labor effort. The response through the 1980s and 1990s – greater levels of “capital control” - also include more power for financial firms and networks. However, this new form of control did not solve the problem of low performance, as debt instead of wages for the common people and the movement of industry offshore led to lower output and greater instability. The rich were getting richer, especially through speculative bubbles in the financial system, but the average person was getting worse off as wages stagnated and periodic unemployment became greater than in the postwar boom.

Especially relevant here is the practice of “getting something for nothing”, which Veblen discusses in virtually all of his books, especially *The Vested Interests and the Common Man* (Thorstein Bunde Veblen 1919). Getting something for nothing, otherwise called “free income”, is the process of the dominant powers expropriating the surplus from (re)production through a series of accepted institutions, such as for instance, being a CEO and receiving a rate of remuneration that is greater than the long-term corporate profit rate and/or higher than the rate of productivity growth.

There is a large literature on CEO remuneration, its relationship to the performance of companies, and the factors involved. For instance, Carola Frydman and Raven E. Sake (2008) show in their US study for the period 1936 to 2005, that CEO remuneration was relatively flat compared with share price up until the mid-to late 1970s, and then during the 1980s-2000s it increased enormously. Such remuneration includes (for instance) salaries, long-term bonus payments and stock option grants. David Peetz (2009) found in the Australian case (1978-2008) that CEO compensation was several times greater than both productivity and average pay, becoming disproportionately greater through time. Rui Albuquerque and Jianjun Miao (2013) present a model of CEO power where it originates exogenously and is influenced by practices such as the Sarbanes-Oxley Act of 2002.

The empirical evidence supports the tendency for a misallocation of resources towards certain CEOs away from more productive activities of an industrial nature which produces the surplus in the first place. Getting something for nothing can also relate to the activities of many others, including financial advisers and speculators who gain remuneration directly linked to high returns during a speculative bubble while often not being negatively impacted during the subsequent crash (because they change companies, sell stock, get bailed out by reserve banks, etc). To get an idea of the magnitude of the distributional problem, Table 6 summarizes changes in the distribution of income and wealth between the top 0.1 and top 1 percent of income/wealth gainers compared with the bottom 90 percent of the US population, plus rising financial profit.

Table 6 Changes in Distribution of Income, Wealth and Finance 1950-2010, USA

	1950	1960	1970	1980	1990	2000	2010
Cumulative % income growth for top 0.1% (1980-2007)				0	76	324	390
Cumulative % Income growth for top 1.0% (1980-2007)				0	53	190	224
Cumulative % income growth for bottom 90% (1980-2007)				0	-4	7	5
Ratio of mean CEO income to mean worker income (1970-2010)			25:1	39:1	68:1	299:1	243:1
Ratio of wealthiest to medium household wealth (1962-2009)		125:1	127:1	130:1	160:1	171:1	225:1
Finance sector profit as % GDP (1950-2010)	2.22	3.03	3.35	4.00	4.72	6.21	7.63

Source: Mishel and Bivens (2012, p. 3, p. 7, p. 9, p. 11).

This shows that income growth for the top tiers of households rose between 390% (top 0.1%) and 224% (top 1%) between 1980 and 2010; while for the bottom 90% it hardly grew at all (5% during the 30 year period). The ratio of CEO to worker income rose from 25:1 (1970) to 243:1 (2010), about 10 times, over the 1970-2010 period. The ratio of the wealth of the wealthiest 1% of households to medium household wealth started to rise in the 1980s, from 130:1 (1980) to 160:1 (1990), then continued the rise to 171:1 (1990) and then much more to 225:1 (2010). Much of this had to do with the expansion of financial compensation and profit (especially speculative bubbles) from a low level of 3.03% of GDP in 1960 to 4.00% of GDP in 1980,

and then almost doubling to 7.63% of GDP in 2010. Similar, though mostly less extreme, trends have occurred in numerous countries of Western Europe (see Christophers 2012). Two problems emerge from these trends, the first being the difficulty of developing a sustainable regime of demand, and the second being the general tendency for finance to dominate industry.

It may well be, as indicated earlier in the paper, that a new sustainable regime of production-distribution is not possible for the Core nations, as geopolitical and socioeconomic power moves majorly from the Core to the Semi-Periphery. The other, perhaps less likely option, is that major institutional changes can reconstruct a viable regime for long wave upswing for the Core, albeit with more emphasis on sustainability and equitable styles of production-distribution.

Nonetheless, it is certainly worth trying to see if a new regime can be established to build a suitable SSA for sustainable and equitable performance in the Core (along with other areas). Especially important in this respect are four policies and institutions.

i. The first is to build a productive and innovative economic structure to compete on the world market; special reference is given here to industry policy and productive government spending, and how public goods can assist in the process (see next section).

ii. The second is for wages and salaries to rise in proportion to the rate of growth of productivity; and for these conditions to be included in accords between the state, business and labor. This is required for the development of a consumption mode of demand, with lower debt, for sustainable growth (for areas that have no other effective demand mode).

iii. The third is tax increases on the wealthy, including lower deductions, evasion and avoidance, especially in the US, the UK and other nations that reduced taxes on the wealthy allowing them to have low marginal and average tax rates.

iv. The fourth is moderating CEO bonuses and similar excess remunerations; along with policies to moderate the speculative bubble expansions: that give them the incentive to cash out or leave the firm before or during the bubble crash.

Overall these policies seek to expand industry so that finance is assisting other sectors rather than financing bubbles, while a new viable system of consumption (or alternative) is required for expanding demand without excess debt.

5. Proactive and Productive Governments

It is necessary for the regime of embedded communitarian liberalism to promote a more productive and pragmatic approach to the role of the state. Industry policy is inextricably linked to developing a more proactive and productive role for government in order to complement private-sector development. But rather than advocating the more activist style of industry policy which targets specific sectors or even firms (Nikolaus Karagiannis and Zagros Madjd-Sadjadi 2012), the approach developed here links to general public goods provision by the state and state/private/community relations. This involves improving the underlying infrastructure of transportation, communication, information, education, and health, along with counter-cyclical automatic and discretionary policy, to assist people and institutions to undertake pro-

ductive and reproductive activities of their own choosing and reducing the instabilities of cycles and waves. Below we discuss how this operates through productive government spending, functional finance and Chartalist state policy.⁴

5.1 Expansion of Productive Government Spending

In the light of the current crises and recessions being experienced to varying degrees in Europe and the US, especially in Greece and Spain, James Bradford DeLong and Lawrence H. Summers (2012) raise the point that austerity may be a core problem since government spending can stimulate private sector investment along with other components of demand, and thereby assist recovery. In this light, over the past fifteen years, spurred on partly by David A. Aschauer's (1989, 2000) seminal empirical studies, numerous papers have investigated the degree/nature to which public spending impacts on private investment and growth. In general, the conclusions are that government spending that crowds-in (enhances) private investment concentrates on infrastructure, education, health, transportation and communications. Government spending that crowds-out (reduces or has no effect upon) private investment tends to be activities relating to the military, welfare and subsidies. The policy recommendations are that the neoliberal (and welfare state) tendency to cut productive government spending needs to be reversed.

A sample of studies come to the following conclusions, for particular areas and nations (see O'Hara 2009a for details). International Evidence for 39 nations found that public expenditure on welfare, social security and subsidies crowds-out, whereas spending on transportation and communications (developing nations) and health and education (developed nations) crowds-in private investment (Hamid Ahmed and S. M. Miller 2000, p. 33). Other international evidence for 74-95 nations found that "Government investment does indeed appear as an important factor in growth, with a significant estimated coefficient in most specifications". They conclude that "Government investment has been severely suboptimal in the recent international experience and ... scope remains for greater productive expenditures by the government sector" (Nigel James Miller and Christopher Tsoukis 2001, p. 1125).

Looking specifically at the USA and Europe: One study, for the US, found that the post-1970 slowdown in economic growth can be totally (in fact over-) explained by the large shift in fiscal policy from government purchases towards transfer payments. If policy-makers are serious about growth then they need to promote productive spending, especially on infrastructure such as roads, communications, transportation, education and health (Christian E. Weber 2000). Another study, for Europe, found that the era of privatization has resulted in a decline in productive

⁴ It is likely that the state had a coevolutionary role to play in the generation of the current crisis. This is especially the case with recent/current policies associated with: (a) austerity policy in Europe; (b) interest rate targets that help generate speculative bubbles and also reduced long-term investment; (c) schemes linked to Freddy Mac and Fanny Mae of trying to surmount the declining real wage of lower classes, especially Blacks and Hispanics, by reverting to blackmail, legal threats, overexpanding debt plus other dubious practices (see Helen Thompson 2012); along with (d) the rising spending on unproductive activities (defense, social security) as the state becomes a merely redistributive (rather than investment-oriented) apparatus.

government spending, whereas an increase in such spending crowds-in private investment (for Ireland, Portugal and Greece). The marginal product of public capital is high, and contributes to substantial scale economies in providing public goods. This is especially the case for pre-primary, primary and secondary education; hospitals, clinics, practitioners, medicaments, and prothesis; but also to some degree housing, recreation and cultural services, transportation and communication. Military spending, on balance, has no impact on private investment (Nikiforos T. Laopodis 2001).

The neoliberal philosophy, ironically, has resulted in the selling of productive government enterprises, and a redirection of spending to low impact projects. Thus while trying to make government “more productive”, neoliberalism has had the opposite effect through reducing the power of the public sector. Post-neoliberal governance recognizes that privatization of government activities may lead to sub-optimal results due to declining public goods and an expansion of private sector rent-seeking behavior. This is of critical concern for nations to expand investment and innovation for sustainable growth and development (Aschauer 2000)⁵.

This leads us to consider the role that government can play in enhancing aggregate demand, supply and reducing uncertainty. One thing that stands head and shoulders above other factors is the role that can be given to productive government spending in enhancing business investment. Such productive spending contributes directly to production and innovation through government corporations and departments enhancing leading-edge activities in communications technology. It also contributes indirectly through the advancement of knowledge, health, transportation and the flow of goods and services. Positive externalities are especially strong through agglomeration benefits in the form of the public goods of circulation, information, skills, knowledge and longevity. The new vision recognizes these potentially greater advantages of providing such public goods.

However, the “productiveness” of government spending also depends upon the economic environment, so that during times of financial crisis (Giancarlo Corsetti, Andre Meier, and Gernot J. Müller 2012) and deep recession (Peter Skott and Soon Ryoo 2012), even the unproductive spending discussed above can have large multipliers. Generally, it is a good rule of policy to build up funds during boom times (while preventing dislocative speculative bubbles) and spend them during crisis and recession (Corsetti 2012). However, if the economy is in a long wave downswing, when the average growth level declines on average for long periods, this negative dynamic pattern needs to inform policy-making as well.

⁵ For instance, Aschauer (1989) argues that the decline in government capital expenditure in the United States over recent decades is responsible for a large part of the long-term unemployed. Aschauer (1999) further investigates the effects of different means of financing government spending on economic growth. With respect to the influence of economic growth, a higher rate of public investment financed by money creation is shown to have a greater influence on economic growth than a higher rate of public investment financed by an increase in taxes. Capital expenditure is best financed via money creation, which has decisive influence on growth and employment.

5.2 Functional Finance Policy

If then, when an economy is in crisis and deep recession, both so-called productive and unproductive government spending are likely to stimulate private investment and hence taxation income, this raises the question of functional finance. Functional finance – initially developed by Abba P. Lerner in the 1940s – is important to the post-neoliberal ECL perspective because it takes a pragmatic approach to fiscal and monetary policy. Functional finance contradicts the “sound finance” doctrine, which stipulates that, regardless of economic conditions, the budget should be balanced in the long-run. In essence, government should not spend more than it collects in taxes. For sound finance, the maintenance of balance budgets over the course of the business cycle is said to increase prosperity and remove excessive debt burden on future generations (O’Hara 2000). In contrast to this orthodox view, the central idea of functional finance is that fiscal policy, in all its different aspects - taxing, spending, transfers, borrowing, printing money, etc. - should be undertaken not for financing government budgets but to achieve specific economic objectives, such as full employment. For instance, should total spending be lower than the full employment level, the economy will experience “unnecessary unemployment”. If an increase in spending does not increase inflation significantly then the economy has obviously not reached full employment.⁶

There are two “laws” of functional finance. The first is that governments have a responsibility to keep the total rate of spending on goods and services “neither greater nor less than that rate which at the current prices would buy all the goods that it is possible to produce” (Lerner 1943, p. 39). Associated with this is the notion that taxation should never be undertaken “merely because the government needs to make money payments. ... Taxation should therefore be imposed only when it is desirable that taxpayers shall have less money to spend” (Lerner 1943, p. 39); and, as indicated above, for equity/growth purposes (e.g. higher tax rates on the rich) to stimulate progressive distributional patterns. The second law of functional finance says that “the government should borrow money only if it is desirable that the public should have less money and more government bonds” (Lerner 1943, p. 39). Taxes regulate demand in the economy and bonds are necessary to regulate interest rates.

A change in policy perspective along the lines of functional finance will introduce more pragmatic policy-making rather than the fundamentalism of neoliberalism. It will ensure that policies are instituted that are historically situated in the problems that emerge in the social economy. It will also enable policies that centre more on social objectives and outcomes, in the context of changes along the business cycle. Many nations and areas are currently trying to “adjust” to deep recession, with austerity fully in place – Greece and Spain come to mind. But as Skott and Ryoo (2012) demonstrate, the inefficiencies and public debt implications of not adjusting government spending to full employment objectives can be major, since recession-level income itself generates debt problems and economic inefficiencies.

⁶ As Lerner himself said: “The central idea (of functional finance) is that government fiscal policy, its spending and taxing, its borrowing and repayment of loans, its issue of new money, and its withdrawal of money, shall all be undertaken with an eye only to the results of these actions on the economy and not to any established traditional doctrine about what is sound or unsound.” (Lerner 1943, p. 39).

5.3 Taxes-Drive-Money Approach to Policy

The neoliberal theories of fiscal and monetary policy are problematic. For this reason a new approach is required, one that recognizes the need to adopt more productive government schemes as well as to adjust spending to changes in economic activity through business cycles and long waves. Consistent with the above emphasis on government spending and functional finance is the Chartalist view about how government fiscal and monetary policies operate. That is, taxes and borrowing are not used to finance government spending, but to moderate levels of reserves in the economy and thus affect the level of aggregate demand. Increases in taxes reduce the level of potential private spending, while reductions increase the level of private spending. Government bonds are used to put into practice open market operations through changes in official interest rates. Government spending is financed through fiat money, since when the state spends it writes a check on its account with the reserve bank, thus increasing bank reserves (Stephanie Bell 2000). Hence, fiscal and monetary policies are not as distinct as is usually assumed.

The main methods by which “state money” is injected into the economy are via government spending on goods and services and transfer payments. Once the government spends and injects its own state money into the economy it is then available to be paid back to the government in the form of taxes (Wray 1998, p. 80). Taxes are thus required to generate a demand for fiat money and are not required to finance government spending (Wray 1998, p. 75). Bond sales are required only to drain excess reserves in order to achieve Central Bank interest rate targets. Thus, government outlays are not financed by bond sales and taxes, but by the creation of money or credit. Budget deficits thus do not normally (on balance, especially when “productive”) crowd out investment or cause inflationary pressures because government outlays represent a source of funds for private spending.

As Reynold Nesiba (2013) argues, the government is “normally” obliged to run a budget deficit in order to provide the state money to meet all tax obligations as well as meeting the hoarding needs of households and banks. Persistent government surpluses only reduce the amount of fiat money available in the economy. When there is public hoarding, persistent budget surpluses are a problem of demand inadequacy. Balanced or surplus budgets would only be considered when a serious level of inflation is expected, or during a long boom in the cycle/wave. Otherwise, deficits are required for a reasonable level of profitability for the private sector (but see Marc Lavoie (forthcoming) for a sympathetic critique of Chartalism).

6. State-Community-Ecology Relations

Recent research has shown how important trust, civil society and community are to long-term performance and quality of life. Trust in business networks enable investors to engage in production-circulation relationships with fewer legal and organizational costs. Civil society arrangements such as social clubs, worker cooperatives and community organizations tend to enhance communication, relationships and produc-

tivity. More latterly ecological issues have become important in preventing escalating carbon concentrations in the atmosphere. While during the 1950s and 1960s social capital was moderately high in the US and much of Europe and carbon concentrations were at bearable levels, all this changed during the era of neoliberalism, finance-led accumulation and capital dominating labor. Trust has been in decline while carbon concentrations are well above the level considered reasonable (see O'Hara 2009a, b).

Policies and institutions are required to reconstruct the community and ecological regime of society to embed society more within economy. Three areas are scrutinized, firstly programs for enhancing social trust, secondly worker cooperatives, and thirdly programs for ecological sustainability.

6.1 Governance Programs for Generating Trust and Networks

Institutions of trust, equality and stability relate to questions of strong reciprocity, participation and sociality. The expanding literature on social capital shows that trust, reciprocity and participation can emerge within and between markets, within and between governments and within and between communities. It is not necessarily a third area of governance in addition to markets and governments. Indeed, trust, reciprocity and participation may enhance all institutions to some degree if it is embedded within and between them. The wider communal forms of trust, reciprocity and mutuality that enhance the workings of institutions, networks or whole economies/systems are what Gabriele A. Huppe and Heather Creech (2012) refer to as “collective social capital” whereas the forms of trust, reciprocity and mutuality that individuals gain from their networks of relationships are called “individual social capital”. Both forms are important, but the collective forms have ontological privilege in political economy and policy-making.

Hence, much of what is called social capital is really sectional or relative social capital, in the sense that it advances the interests of a group or series of groups (or institutions), or even individuals, at the absolute or relative expense of others. Not all social capital is the type discussed by Robert D. Putman (2000), which is collective in nature and generally benefits everyone. Putman and others argue the case that civil society has been deteriorating in the US for a number of decades now. Familial and community capital have both been in decline as people spend more time in activities relating to work, travel to faraway places divorce from local issues, and concentrate on the concerns of the individual more than community.

One of his chief concerns, for instance, is the lack of participation of people in debates and activities relating to politics. In response to this, he suggests five main policies (Putman 2000). These include improved civics education in schools as a core part of the curriculum; greater flexibility in work schedules so that people can engage in more family and community activities; reorganizing urban and regional planning, including public space, so that there are more opportunities for casual socializing with friends and neighbours; a realignment of communications towards civic projects such as “civic journalism” to foster community engagement; and a greater degree of

decentralization of government authority to encourage participation of the public in areas that affect their lives.⁷

Pro-social capital also needs to be distinguished from anti-social capital. Anti-social capital is that which has historically promoted negative externalities, such as the activities of the Ku Klux Klan, the Mafia, urban gangs, militia movements, drug cartels, and crime syndicates (Paul Streeton 2002, p. 44). Pro-social capital, on the other hand, is the building of relations of reciprocity and networks that enhance community participation and sociality, such as local health centres, book clubs, musical societies, the Red Cross, and the Salvation Army. Governance systems should encourage pro-social organizations, although it is not always easy to ascertain what is pro-social and anti-social, since this may be clouded by social norms, popular culture, and political ideology.

Ben Fine (2010) critiques the notion of social capital for concentrating on proximate variables and ignoring ultimate factors. For instance, a social capital scholar may recommend increased social connections for children when the problem is lack of income or access to facilities for poor families. These sorts of problems need to be kept very clearly in mind, and indeed can be, without ditching the concept altogether. In addition, what might appear to be pro-social capital may be rent-seeking behavior. Some groups specialize in promoting linkages between members of a group for the benefit of the wider community, while others specialize in promoting linkages and benefits for members only. Both of these are likely to be either positive or benign in nature. However, other networks of people – which normally would not be viewed as anti-social – specialize in obtaining resources from the wider community without benefiting society in general. These may include businesses, lobbyists, single issue groups and speculative/shadow financial institutions.

Power differentials and group distinctions are a core part of the social capital equation (Leroy White 2002; Josifidis and Lošonc 2012). As Pierre Bourdieu (1997) recognizes perhaps better than anyone, the acquisition of social capital is one means whereby certain classes are able to advance their relative income, wealth and sociality – even if pro-social capital is apparently being generated in the process. In other words, much of social capital is less social than group or class in nature, since “Power relations are rooted in the system of social networks” (Michel Foucault 1982, p. 224). Typically this is undertaken through, for instance, entrepreneurial networks; networks of families, friends and associates involved in business; and business networks linked to financial instability. Class distinctions are reinforced through such networks and relations of reciprocity that are a normal and even an established part of civil society.

⁷ Some evidence for developing nations suggests that trusting elected representatives is very important. For instance, in Uganda it was concluded that “the only variable that bears a clear relationship to generalised trust is the perception that elected representatives care about the concerns of ordinary people” (Jennifer Widner and Alexander Mundt 1998). This indicates the critical importance for the development of political capital. Political capital may be defined as the development of a participatory political culture concerning the making of rules and institutions for community governance. However, it is true that “efforts to perfect the market or assure the success of state interventions have destroyed imperfect but nonetheless valuable community-based systems of governance, suggesting that policy paradigms confined to states and markets may be counterproductive” (Samuel Bowles and Herbert Gintis 2002, p. 429).

One set of policies that take these problems into account is the recent Irish “New Public Policy Agenda” to include social capital in governance (NESF 2003). First, it seeks to foster pro-social capital through government activities. This program seeks to build community capital through, initially, a formal social capital audit and the development of performance indicators. This program includes consultation of local communities in government decision-making processes, making impact assessments of policies on community networks and family-friendly practices, analyzing connections between different ethnic or social groups, a balance between community participation and government intervention, accountability, and the provision of infrastructure for local services.

This Irish policy agenda also recognizes the class and group nature of much social capital. As the National Economic Social Forum (NESF) report states:

“The ability to participate more fully in society and decision-making is not equitably distributed: some groups and individuals with important human, social and economic resources have greater access to decision-making and social advantage. Hence, the focus of much community development in Ireland is in advancing the development of groups who are disadvantaged or excluded” (NESF 2003, p. 80).

As a result, the program seeks to promote networks and relations of reciprocity for the unemployed, those with few social and workplace skills, homeworkers, those with ailments, ethnic minorities, and people who are disadvantaged. This problem of relative social capital and the group acquisition of social privilege and power is a critical theme to incorporate in the system of embedded communitarian liberalism.⁸

6.2 Worker Cooperatives and Economic Democracy

In a longer-term vision, trust and sociality may be promoted through a whole array of institutional innovations associated with what Bowles and Gintis (2002) call “community governance” (see Christopher Gunn 2012). A critical one is the development of proper legislation and tax incentives to encourage the expansion of worker cooperatives. There are many examples of successful cooperatives, such as the Mondragon Experiment in Spain, the Semmler systems of worker empowerment in Brazil, the Toyama Bay fishing cooperatives in Japan, and the plywood workers cooperatives in Oregon and Washington, to mention just a few of the more well known ones (Ramon Flecha and Ignacio Santa Cruz 2011).

⁸ The policies adopted in Kerala, India, to develop community capital and association, are especially germane here. The state of Kerala has one of the lowest income per capita levels in India but the highest standard of living in the country. A number of scholars, such as Patrick Heller (1996) have put this down to the leftist government promoting social capital through community. As he says: “Kerala’s caste self-help and social upliftment societies have a long history of active civil engagement. Its “library movement”, literary associations and film industry have earned it a reputation as a cultural center rivalled only by Bengal” (p. 1055). He concludes that “what is certain is that the synergy between working-class mobilization and state capacity has directly contributed to building the political and institutional foundations most likely to effectively ‘manage’ the contradictions of democratic capitalist development” (Heller 1996, p. 1067).

Worker cooperatives can help to restore community governance through increases in productivity which typically flow from tapping the creative energies of workers, increasing their incentive to work and innovate, and reducing the costs of supervision (William M. Dugger 2010). Cooperatives also tend to be embedded in local or regional structures of association, and thereby encourage reciprocity and networking, expand regional income multipliers, and create a sense of community-corporate pride and democracy. A critical need in the current environment is not only to promote participation in politics, but more especially to make the economy more democratic and participatory.⁹

Revisions to business law, for instance, could encourage cooperatives by making it easier for workers to band together in this way, and also for cases when ordinary firms change to cooperatives. A slightly lower rate of corporate taxation on cooperatives could encourage this form of business organization. The organizational provision of micro-finance specifically for cooperatives would help when workers lack start-up capital. Encouraging labor to employ capital requires institutional encouragement since it goes against the grain of many corporate structures and dynamics.

6.3 Ecological Governance

Obviously any successful policy for reducing the depth of recession, debt crises and financial collapse has to now include a core ecological dimension. This is in view of the scientific evidence for a multifarious ecological disasters if global temperatures rise as expected by about 4-7 degrees Celsius if nothing is done soon to start reducing concentrations of CO₂ (O'Hara 2009b). Without effective policy and institutional changes we are likely to see a serious rise in extreme events, such as more intense hurricanes, floods, extreme heat periods, as well as the trend of rising sea levels and higher temperatures. A three pronged policy framework is suggested here, in the form of: (a) global policies following the Kyoto Protocol but more effective and stringent, (b) national and regional policies of climate change governance, and (c) changing habits and institutions. These are briefly outlined below.

Global policies are required in the form of effective post-Kyoto Agreements for nations to adhere to now and in the future. These global policies must include commitments to reducing global temperatures to less than a 2 degree Celcius rise since 1850 by 2100. The actual policies advocated must include a price on carbon

⁹ Of course, some worker cooperatives would seek only to promote internal objectives to enhance the material welfare of the firm. But the type S of policies we are exploring here seek to promote a more community-minded sort of cooperative. Along these lines, Bowles and Gintis (2002, pp. 429-431) suggest some rules of thumb to promote community governance. These rules include: (1) "members of the community should own the fruits of their success or failure in solving the collective problems they face"; (2) "the unravelling of co-operation that often afflicts communities can be averted if opportunities for mutual monitoring and punishment for non-co-operators are built into the structure of social interactions"; (3) "well-working communities require a legal and governmental environment favourable to their functioning"; and (4) "active advocacy of the conventional liberal ethics of equal treatment and enforcement of conventional anti-discrimination policies". These rules should, however, be seen within the context of the promoting of many positive externalities, so that many things are not internalised into the monetary or property reward system.

that is significantly higher than established “market price” to internalize the externalities of climate change. Also global policies must stimulate changes in technology, especially so as to reduce the use of carbon-using techniques, and to improve the storage of carbon and other wastes. Such policies must be binding on the Core, the Semi-Periphery and the Periphery.

But likely there will be difficulties establishing such an effective policy framework unless the developed world is willing to finance some of the underdeveloped world's costs of mitigation, since the Core has been long-benefitting by trade and investment trends/patterns. These structural trends have left much of the Periphery producing the polluting resources while the Core is often left with the cleaner areas of high-technology and suburban consumption. Some progress was made late 2012 at the Doha Conference, especially in the provision of “loss and damage funds” for the Periphery; but much more is required before the planned treaty is to be signed by 2015 at the Paris conference, to come into effect by 2020.

National policies are also required, of a unilateral form, to reduce greenhouse gasses from the current 397 ppm stock of CO₂ to the required less than 300 ppm (O'Hara 2009b), including a price on carbon, changing technologies and institutions, as well as advancement of alternative technologies such as wind power, solar, hydrogen, bio-fuels, and so on (depending on local sentiment and scientific evidence). There are several problems with ecological policies at the national level. The first is that there is still a sizeable number of scientists, politicians and the general public who doubt the scientific evidence on climate change; these groups are large in the US, and several other nations. The second is that a succession of various crises can effectively crowd-out action on climate change, due to competition for public space and resources. The recent crises of terrorism (and subsequent wars in Afghanistan, Iraq and elsewhere) and the subprime crisis/recession are two crucial processes that have reduced the effectiveness of the ecological argument.

It is ultimately necessary for individuals to change their habits and tendencies, as well as for the institutions they operate in to modify their routines and rules, for the level of greenhouse gasses to moderate to necessary levels. Having consumers (including institutions) that are increasingly ecological in orientation is cheaper than habits changing via exogenous price adjustments; yet both levels of change are required. It may well be that modest changes in habits, technologies and production processes are insufficient and that we need radical changes in lifestyle for climate change mitigation to be effective. Ultimately, it is likely to require substituting quality of life (including ecological) issues for growth to reduce the carbon footprints of nations and regions. Increasing consumption, population and production are unlikely to solve the problem, and therefore new preferences will be required that do not use up resources so quickly.

7. Conclusion

This paper has outlined a policy program to moderate deep recession, debt crises and financial instability, so as to generate a new regime of accumulation for the world-system, and especially for the Core which has bore the brunt of the current crises. We studied five institutional spheres within which such policies should be activated, as a

system of embedded communitarian liberalism. The first was the system of global finance and production, which has been subject to protracted insufficiency of aggregate demand and extreme financial instability in recent decades. In response we outlined the case for the Davidson Proposal, which is a system of ensuring that persistent current account surplus nations expand demand for the world-system. The second institutional sphere is finance versus industry, where we looked at asset-based reserve requirements and Tobin Taxes for strengthening industry relative to finance. The third sphere is capital-labor relations or the system of production-distribution, where reform is required through industry policy, wages rising by the rate of productivity growth, moderating CEO remuneration and tax increases for the rich. The fourth was the system of productive governance, where we outlined policies for greater productive government spending, functional finance, and taxes-drive-money procedures. Lastly we scrutinized the system of state-community-ecology, and proposed systems for expanding social capital, economic democracy, and ecological governance. With these in place we are in a better position for long term sustainable and equitable performance for a new social structure or regime of accumulate.

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