Why did no one see the “blue eyed crisis” coming? *

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Tribal answer to title question

- On 5 November, 2008, during a visit to the London School of Economics (LSE, acronym dubbed *Let's See Europe*), Queen Elizabeth asked Luis Garicano, professor of management: **if these things were so large, how come everyone missed them?**
- On 31 March, during a visit of the UK Prime Minister to Brazil, President Lula made his celebrated comment about the crisis originating in rich countries: **this is a blue-eyed crisis**.
- Intermediated by science, and in particular by economists, the President's comment becomes an answer to the Queen's question:

  Q: Why did no one see the global crisis coming?

  A: Because everyone who could see belongs to the tribe that suppresses (blue-eyed) crises.
- This presentation, devoted to the intermediation process, shows how:
  - the interaction between globalization and governance (G&G) can be obscured by "group think" also known as "incestuous suppression", calling for **innovation** and **mutual knowledge**
  - an attempt by Portuguese-speaking economists might transcend the "silo curse…in a world that is both highly connected and **tribal**" (Gillian Tett, **Financial Times**, 9 October).

Together Alone

- Specifically, negative G&G interaction comes from cooperation failures within and between countries.
- If it fosters **governance innovation**, peer pressure may promote the global common good rather than that of advanced countries.
- At the OECD and the EU, though, peer pressure did not prevent the negative G&G interaction which brought about the financial crisis.
- Remarks to London Business School and Chicago alumni (on 25 September, 2008 and 5 May, 2009 respectively) titled **Together Alone** (after a song from the rock band *Crowded House* recorded in New Zealand in 1992) make the same point.
- In the text assigned for this course, the title of the song is used to frame the answer in interdisciplinary terms.

Economists bicker, need humility

- On 12 October, 2009 (the day the Nobel prize in economics was announced), a “global insight” by Alan Beattie appeared in the *FT* concluding that the economics profession needed humility, and that “anyone who thinks otherwise is an idiot.”
- As the awards testify, economics as a social science deals with institutional and governance issues.
- As popularized since last summer by articles in *Economist, FT, NYT,* etc, economists are often divided according to the location of their graduate training in the US:
  - freshwater (e.g. Chicago)
  - saltwater (e.g. MIT).
- Together with insights from natural sciences and humanities, this should help avoid “tribal” answers.
- Nevertheless, bickering goes on and perhaps even intensifies.

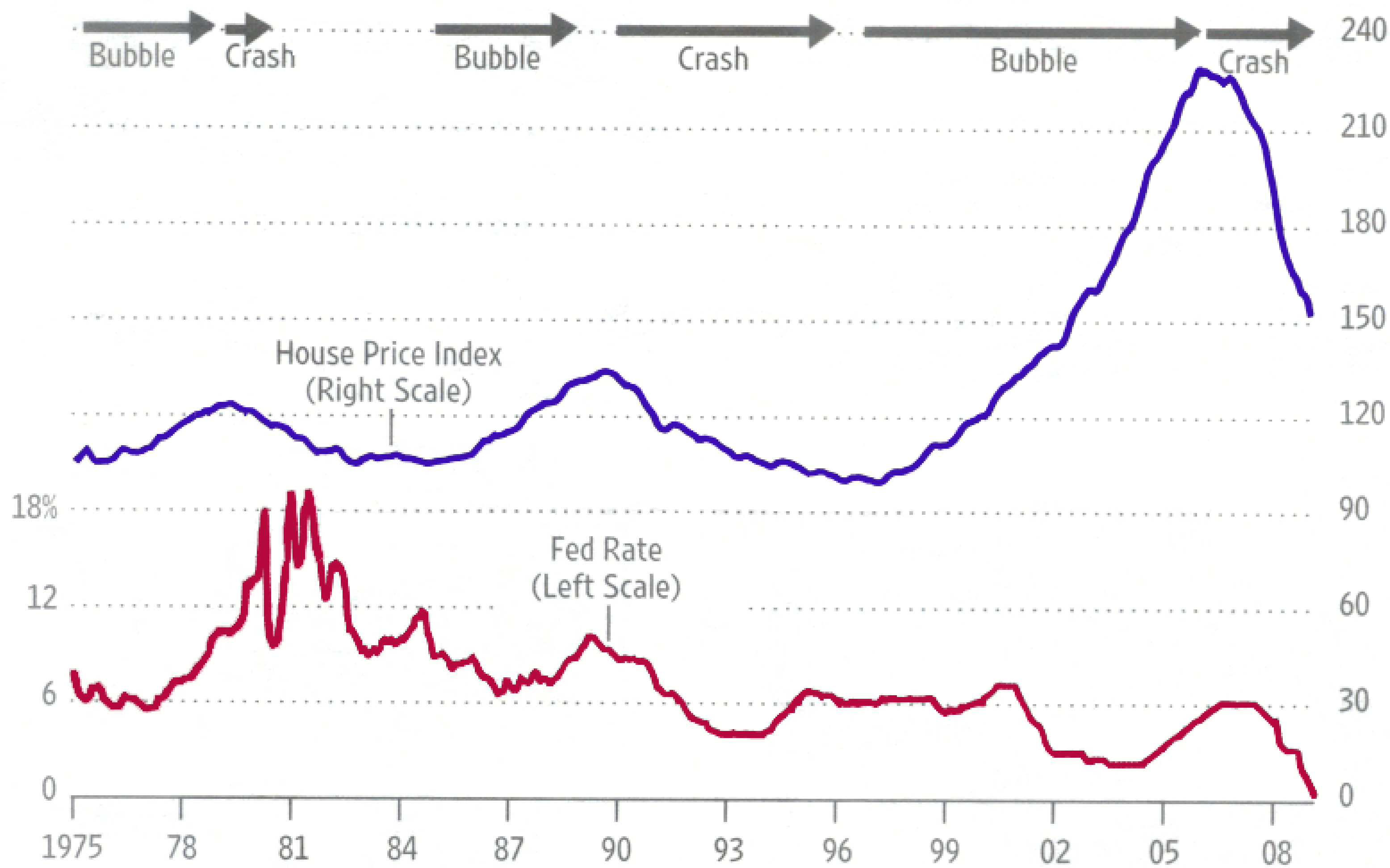
Tribes in economics waterland

- Yet another tribe might be called “turgid economics”, from what my dear teacher Carlos Diaz Alejandro called “turgid economics” had he ventured into generalizing from the description of Arghiri Emmanuel’s **Unequal Exchange** in his Yale graduate course thirty years ago.
- The Portuguese edition of **The Black Holes in Economic Science** by Jacques Sapir, ten years after, follows a revival of methodological quarrels in economics.
- These were disappearing around the time Harry Johnson visited Yale from Chicago and LSE.
- In fact, the only methodological debate I remember, between Paul Krugman (then at MIT) and James Galbraith (then at LBJ, who were both at Yale at the time), happened in **Slate** some twenty years ago.

Answer for US from two Nobel economists

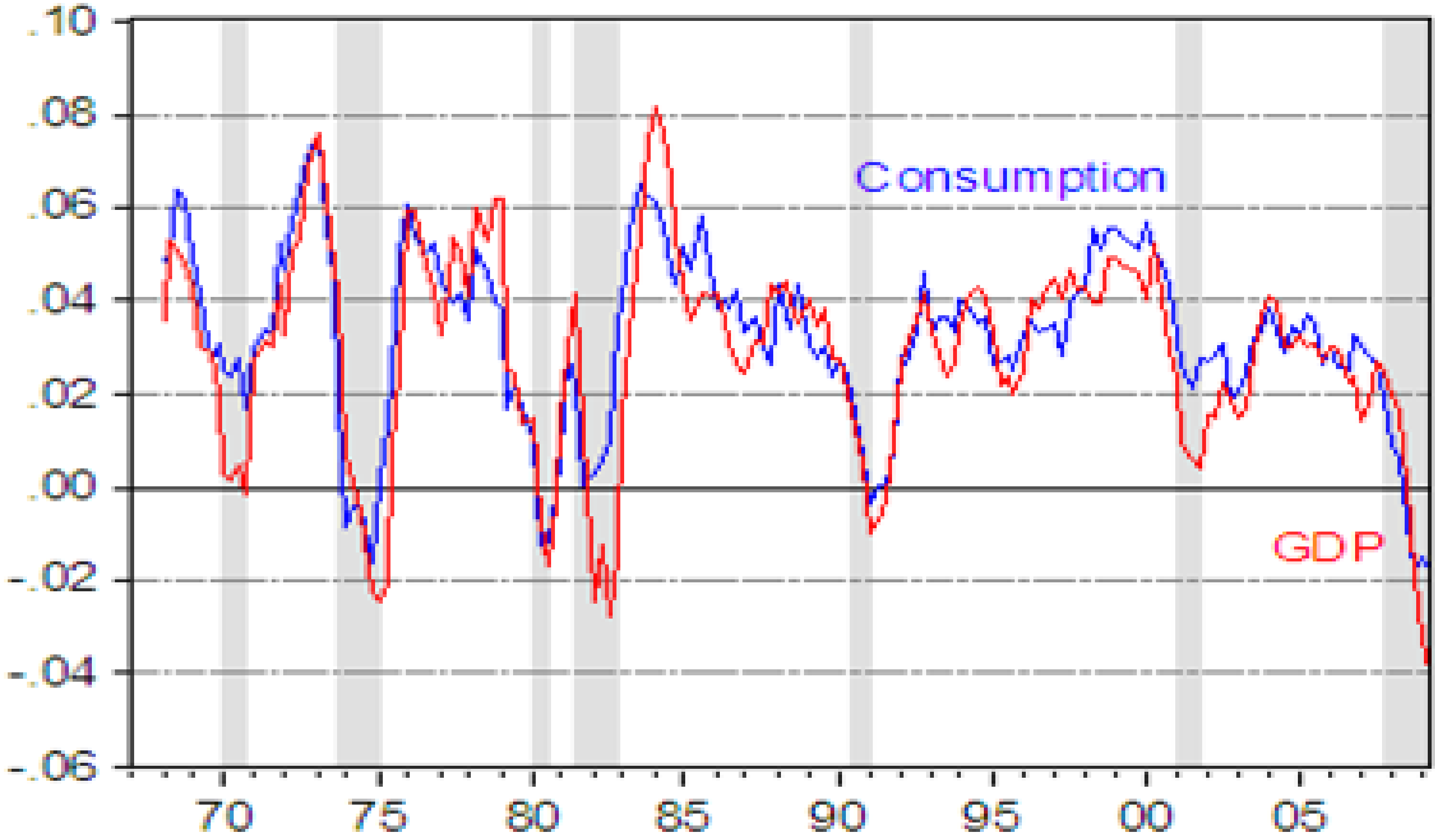
- The following two pictures illustrate the origin and effects of the crisis in the US economy.
- Nobel prize winner Vernon Smith's piece in *The Wall Street Journal* of 6 April includes the first picture, which certainly could motivate the Queen's question.
- In 2001, after four years of inflation-adjusted house price increases of 7,2%, the Federal funds rate began a descent to its lowest recorded level - reached in 2004.
- Nobel prize winner Paul Krugman's blog in *The New York Times* of 18 September illustrates the costs of the crisis for the US: compared with 2007 4th quarter, 2009 2nd quarter GDP was at 96 whereas it would be at 104 on previous trend.
- The 8 point fall, apparent in Menzie Chinn's graph (from his *econbrowser* blog), is accompanied by an equally unusual 6 point decline in consumption and an unemployment rate close to 10%.

The Fed (left scale) and the housing bubble (right)



Source: Steve Gjerstadt & Smith: *The Wall Street Journal,* 6 April

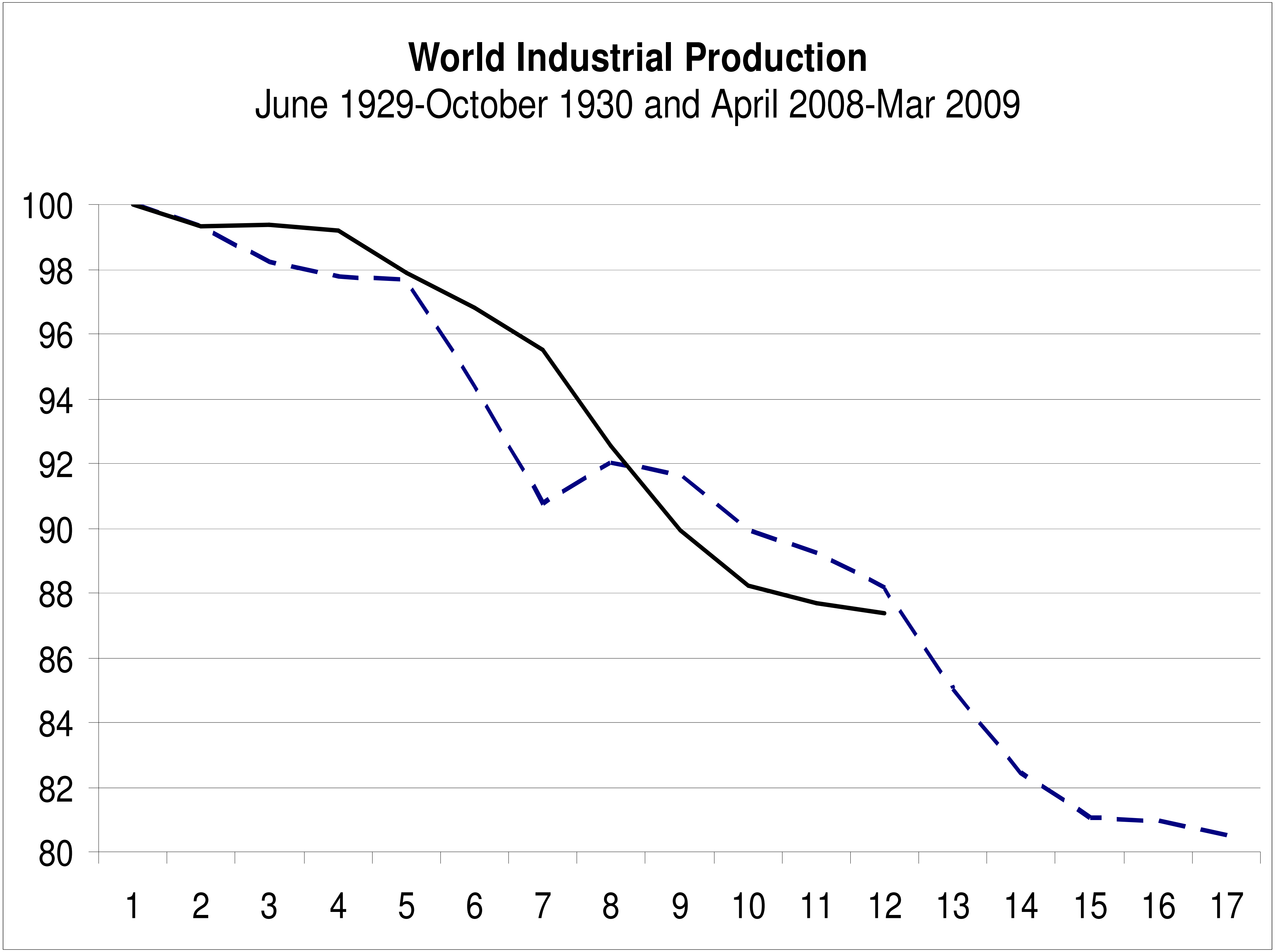
Tracking the decline in US GDP & consumption



Source: Chinn http://www.econbrowser.com/archives/2009/09/tracking_the_co.html

Challenge and response

- **US** two graphs illustrate how large the issue is (challenge):
  - The parallel with the 1920s - when residential mortgage rose from 10% of household net wealth to 29% - is striking.
  - The recession which began end 2007 is about half of the Great Depression in the US - but worldwide it is the same.
- Two World Depressions compared: Industrial Production,Stock Markets and Foreign Trade: it may have been ½ Great Depression for the US but for the World it is the same or worse.
- Data provided by Barry Eichengreen and Kevin O'Rourke used in the update of their 6 April, 2009 Vox column (which shattered all Vox readership records, with 30,000 views in less than 48 hours and over 100,000 within the week)
- http://www.voxeu.org/index.php?q=node/3421



World Industrial Production
June 1929-October 1930 and April 2008-Mar 2009
100
98
96
94
92
90
88
86
84
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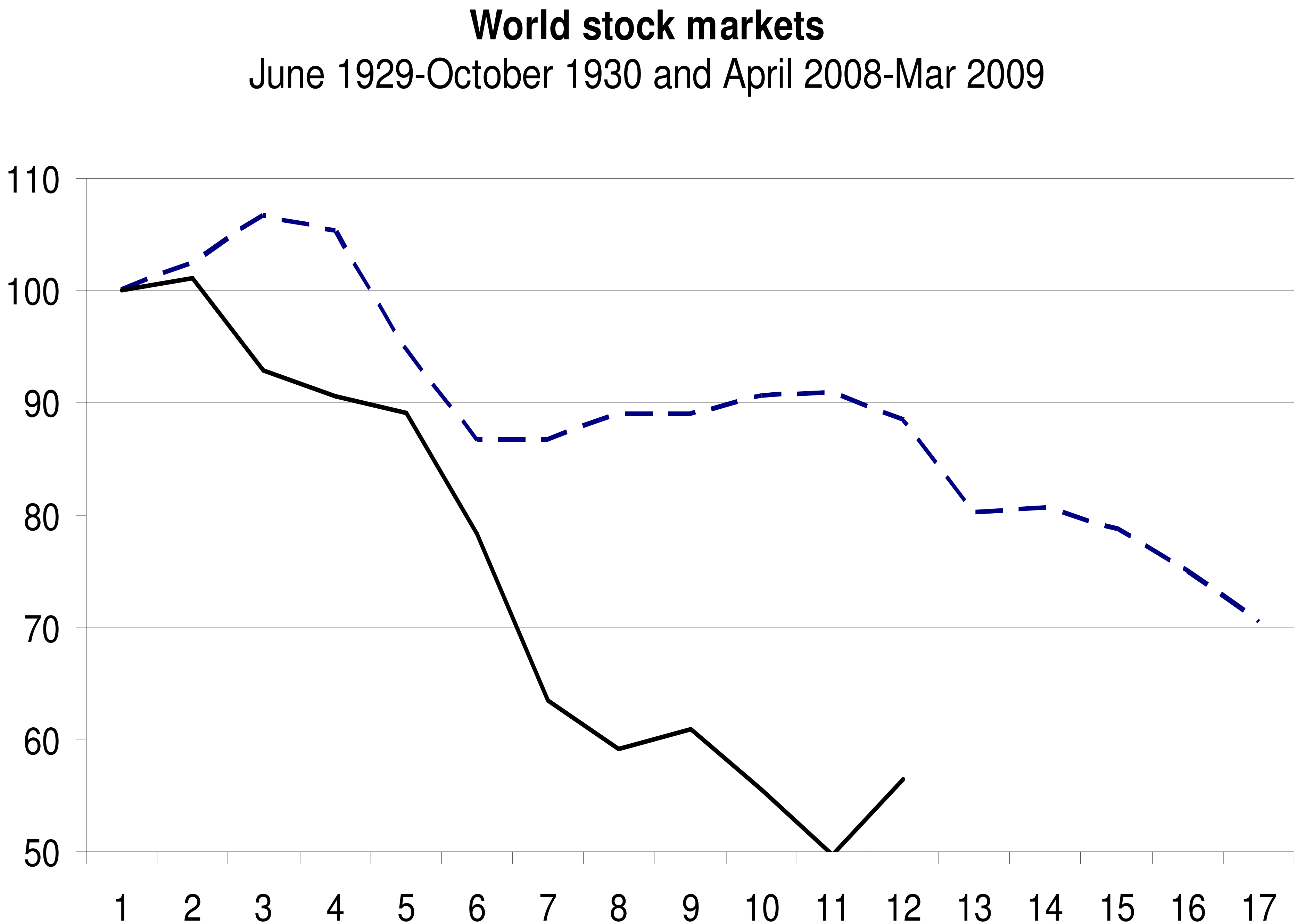
World stock markets
June 1929-October 1930 and April 2008-Mar 2009
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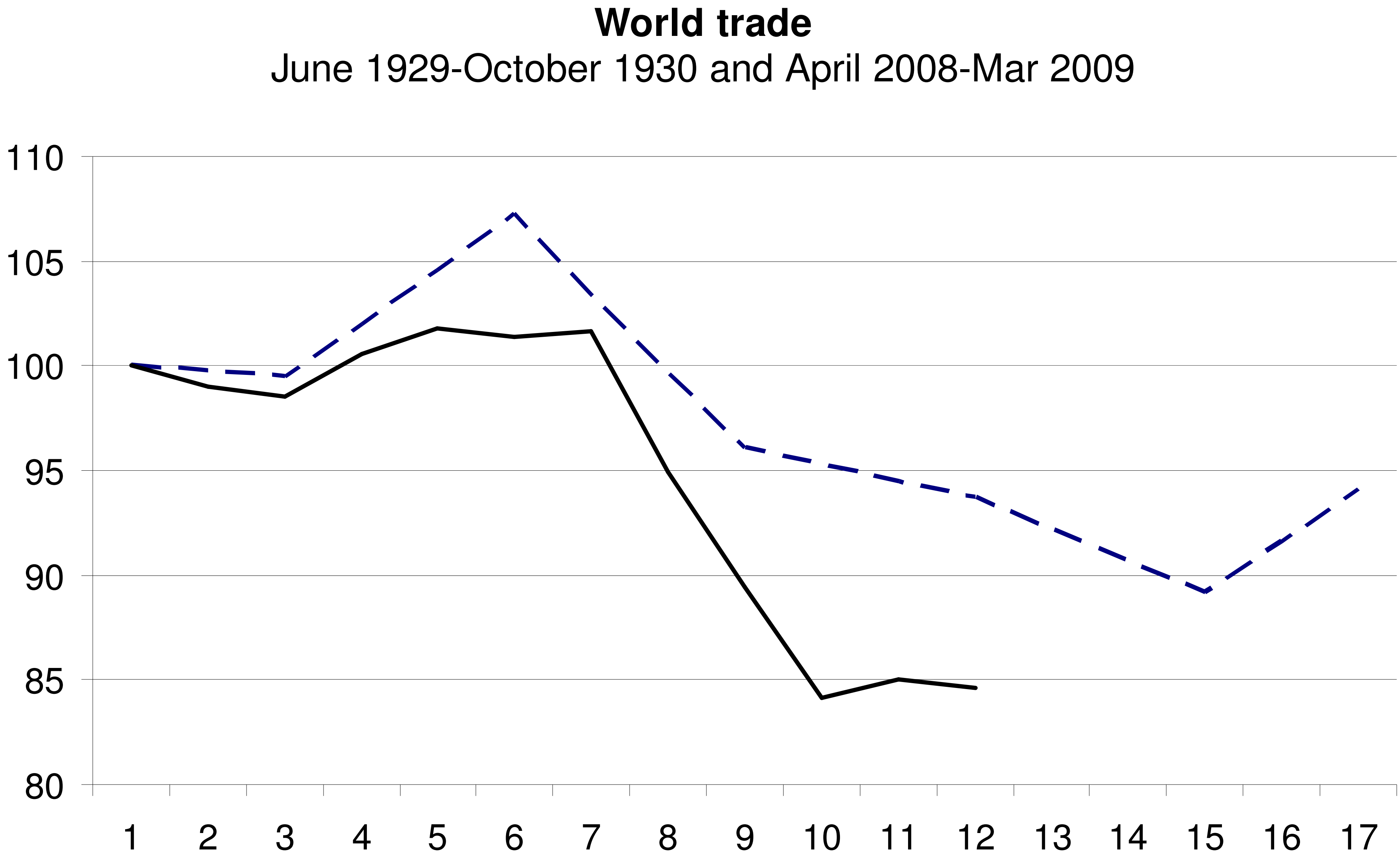
World trade
June 1929-October 1930 and April 2008-Mar 2009
110
105
100
95
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Credit crunch failure and Europe's world

- The British Academy responded to the Queen's question by convening a Forum and signing on 22 July a letter known as "Credit crunch failure explained to Queen" (*FT.com,* 26 July).
- The website of the British Academy quotes its chief executive and secretary: "The global recession is a huge development, and it is reasonable to ask to what extent it could have been foreseen. What's more, we can't say 'never again' if we don't fully understand what occurred".
- Why potential cooperative solutions are not applied domestically and internationally follows from the "together alone" paradox and goes towards the *never again* issue.
- An agenda to involve more economic and interdisciplinary work in public debate should be adopted by other European academies (Belgium, France and Sweden) but with a global rather than an strictly European view, with special involvement of economists from Brazil. It might be called Europe's world!

Approach

- Summary of ongoing debate on “what is the point of economists”, including media reports quoted above:
  - Title question and letter,
    - *Financial Times* editorial 27 July,
    - ft.com/arena (Robert Skidelsky, calling for the reconstruction of economics as a moral not a natural science on 6 August; Samuel Brittan, comparing economists to the “Titanic designers” on 7 August)
  - *The Economist*, 16 July (“macro and financial economists helped cause the crisis, failed to spot it and have no idea on how to fix it”, *contra* Robert Lucas, “In defense of the dismal science”, 6 August)
  - *NYT Magazine* 2 September (Paul Krugman, “Why did economists get it so wrong?”)

Motivation

- The *FT editorial* says “economists are needed in public debate” and I agree, as is clear from:
  - the introductory course on macroeconomics at Faculty of Economics, Universidade Nova de Lisboa (UNL, Spring 2010 syllabus already available at www.jbmacedo.com);
  - the weekly debate (broadcast on Wednesdays at 11pm; evaluation available at www.jbmacedo.com; comments welcome: contasavida@tvi.pt)
- The role of economic culture for citizenship when public opinion “calls into question the state of economics” (described in the *Ferragosto* presentation) reflects venues, such as:
  - Entrepreneurial Sessions @ Sintra, 14 August;
  - Instituto de Estudos Superiores Militares (IESM), Pedrouços, 17 September;
  - CIGI09 (“Towards a global new deal”), Waterloo, Ontario, 2 October;
  - Philosophy Department, Faculdade de Ciências Sociais e Humanas, UNL,13 October.

Motivation contd

- Other venues for parts of the *Ferragosto* presentation:
  - *Initiative for Development and Global Governance* IDGM Launch Conference, Paris, 6 November
  - *Les Rencontres Jean Monnet des Fondations Europeennes*, Cognac 14 November
  - Waterland Ten Years After, Lisbon Institut Franco-Portugais, 17 November
  - *Clube Tauromáquico*, Lisbon, 18 November
- Why potential cooperative solutions are not applied domestically and internationally goes towards the **never again** issue in the letter of the British Academy.
- An agenda to involve more economic and interdisciplinary work in public debate should be adopted by other academies and research universities, such as the Academy of Sciences of Lisbon (ACL), which includes members from the Community of Portuguese-speaking countries (CPLP), especially Brazil.

Argument and Annexes

- Argument:
  1. deconstructs the letter into 9 points
  2. applies a perspective based on G&G interaction, noting the **failure of cooperation within and between countries**;
  3. claims that **peer pressure** may promote the common good, if it also fosters **governance innovation**;
- Reference to interdisciplinary work by economists is included in annexes 1-4 (not shown):
  1. demography and gender (Raquel Fernandez, NYU);
  2. adaptive markets (Andrew Lo, MIT);
  3. development and conflict (Tim Besley),
  4. institutional design (Luis Garicano)..

Annexes 5-7: History, MDGs and Africa

- World economy is tracking or doing worse than during the Great Depression (presented at a neighbor's home in Almoçageme, Sintra):
  - Through the title question young European students participating in an entrepreneurial motivation course debated the fundamental trade-off in economic education:
    - let bygones be bygones;
    - do not neglect history (annex 5).
- Millennium Development Goals (MDGs) and culture-based multilateralism (presented at IESM in Pedrouços, Lisbon):
  - Portuguese and African senior military officers taking a course on *Development and state reform* were exposed to:
    - perspectives on global issues of the Community of Portuguese-speaking countries (CPLP) - so-called "**global *lusofonia***" (annex 6);
    - Cape Verde and Mozambique as African "development successes" (annex 7).

Section 1: Deconstructing the letter (watch out for *never again* issue)

1. Ferocity not foreseen, powers not available
2. Imbalances and risk neglected
3. Global savings glut and easy borrowing
4. Wishful thinking combined with hubris about risk
5. Politicians believed bankers were engineers
6. Feel good factor led to delusion
7. Lax regulation *(7a Don’t do bubbles after dot.com)*
8. Psychology of herding and no single authority
9. Forecasting failure: never again? *(another British Academy Forum is planned on this)*

Sum up: The **candor** with which we **dissect** the lessons of the events of the past year and **apply** them in future will determine whether this **salutary** shock will turn out to have been a **beneficial** one.

N.B. Points apply to UK, maybe US, but not world!

1. Ferocity not foreseen, powers not available

- Many people did foresee the crisis.
- However, the exact form that it would take and the timing of its onset and **ferocity** were **foreseen by nobody**.
- What matters in such circumstances is:
  – not just to predict the nature of the problem
  – but also its timing.
- And there is also:
  – finding the will to act and
  – being sure that authorities have as part of their **powers** the right instruments to bring to bear on the problem.

2. Imbalances and risk neglected

- There were *many warnings* about **imbalances in financial markets** and in the global economy.
  - For example, the Bank of International Settlements (BIS) expressed repeated concerns that risks did not seem to be properly reflected in financial markets.
- **Risk management** was considered an important part of financial markets.
  - But the difficulty was seeing the risk to the system as a whole rather than to any specific financial instrument or loan.
- Risk calculations were most often confined to slices of financial activity, using some of the best mathematical minds.
  - But they frequently lost sight of the bigger picture.
- *Many were also concerned* about **imbalances in the global economy**.

3. Global savings glut and overborrowing

- A period of unprecedented global expansion had seen many people in poor countries, particularly China and India, improving their living standards.
  - But this prosperity had led to what is now known as the ‘**global savings glut**’.
- This led to very low returns on safer long-term investments which, in turn, led many investors to seek higher returns at the expense of greater risk.
- The rise of China lowered the cost of many goods that we buy.
- Through ready access to capital in the financial system, it was easy for households and businesses to borrow.
- This in turn fuelled the increase in house prices.

4. Wishful thinking combined with hubris

- There were *many* who warned of the dangers of this.
- But against those who warned, *most* were convinced that banks knew what they were doing.
  - They believed that the financial wizards had found new and clever ways of managing risks.
  - Indeed, some claimed to have so dispersed them through an array of novel financial instruments that they had virtually removed them.
- It is difficult to recall a greater example of **wishful thinking combined with hubris**.

5. Politicians believed bankers were engineers

- There was a firm belief, too, that financial markets had changed.
- And **politicians** of all types were charmed by the market.
- These views were abetted by financial and economic models that were good at predicting the short-term and small risks, but few were equipped to say what would happen when things went wrong as they have.
- People trusted the banks whose boards and senior executives were packed with globally recruited talent and their non-executive directors included those with *proven track records in public life*.
- Nobody wanted to believe that their judgment could be faulty or that they were unable competently to scrutinize the risks in the organizations that they managed.
- A generation of bankers and financiers deceived themselves and those who thought that they were the **pace-making engineers** of advanced economies.

6. Cycle fueled by delusion

- All this exposed the difficulties of slowing the progression of such developments in the presence of a general **‘feel-good’ factor**.
- Households benefited from low unemployment, cheap consumer goods and ready credit. Businesses benefited from lower borrowing costs.
- Bankers were earning bumper bonuses and expanding their business around the world.
- The government benefited from high tax revenues enabling them to increase public spending on schools and hospitals.
- This was bound to create a *psychology of denial*.
- It was a **cycle fuelled**, in significant measure, not by virtue but **by delusion**.

7. Lax regulation

- Among the authorities charged with managing these risks, there were difficulties too.
- *Some* say that their job should have been ‘to take away the punch bowl when the party was in full swing’.
  - But that assumes that they had the instruments needed to do this.
- *General* pressure was for more **lax regulation** – a light touch.
- There was a broad consensus that it was better to **deal with the aftermath of bubbles in stock markets and housing markets** than to try to head them off *in advance*.

7a. Don't do bubbles

- The experience after the turn of the millennium **when a recession was more or less avoided after the 'dot com' bubble burst** fuelled the view that we could bail out the economy after the event.
- Inflation remained low and created no warning sign of an economy that was overheating.
- But this meant that interest rates were low by historical standards.
  - And *some* said that policy was therefore not sufficiently geared towards heading off the risks.
- *Some countries* did raise interest rates to 'lean against the wind'.
  - But on the whole, the prevailing view was that **monetary policy was best used to prevent inflation** and not to control wider imbalances in the economy.

8. Psychology of herding and no single authority

- So where was the problem? Everyone seemed to be doing their own job properly on its own merit.
- And according to standard measures of success, they were often doing it well.
- The failure was to see how collectively this added up to a series of interconnected imbalances over which no single authority had jurisdiction.
- This, combined with the **psychology of herding and the mantra of financial and policy gurus**, lead to a dangerous recipe.

9. Forecasting failure: **never again?**

- Individual risks may rightly have been viewed as small, but **the risk to the system as a whole** was vast.
- The failure to foresee the
  - timing, extent and severity of the crisis
  - and to head it off was principally a failure of the collective imagination of many bright people to understand the risks to the system as a whole.
- Given the **forecasting failure** at the heart of the question, government agencies might develop a new, shared horizon-scanning capability so that
  - **it never needs to be asked again**.

FT editorial: At your own risk

- No economic theory can perform the feats its users have come to expect of it.
- Economics is unlikely ever to be very good at predicting the future.
- Too much of what happens in an economy depends on what *people expect to happen*.
- Even state-of-the-art forecasts are therefore better guides to the present mood than the future. though they may also be **self-fulfilling prophecies**.
- Dabbling in paradox limits the use of economics as a practical guide.
- Today the profession's best advice must convince politicians and the public to combat a crisis born of insufficient thrift by a recourse to record borrowing.
- Those who saw danger had no easier task: **even reminding people of gravity's existence is a hard sell when everything is going up**.

Economists in public debate

- If predictions of physics-like precision are in demand, they will be supplied.
- Collective delusion must therefore be blamed as much on the consumers of economics – companies, investors, the media – as its producers.
- But **its irresponsible use does not mean economics is useless**.
- It is rather good at explaining the past and guessing unintended consequences of well-meaning policies – invaluable tools for cleaning up financial markets.
- So **we do need economists in public debate**, but ones not blinded by mathematical sophistication or paradoxes beyond the lay public's grasp.
- The public intellectual's virtues – curiosity about other fields, aversion to dogma – could do the discipline much good.
- Unfortunately these are no longer much valued in the academic hierarchy.

Section 2: Globalization and Governance (G&G) interaction

- The letter focuses on the advanced economies (especially US and UK) but mentions China and India in connection with the "global savings glut" in point 3. Point 5 (seeing bankers as engineers) pertains more broadly to "advanced economies" and leads to the 'feel-good factor' there as creating a "psychology of denial" (point 6).
- The "pressure for more lax regulation" (point 7) was also greatest in US and UK since "some countries did raise interest rates" (point 7a) but the "psychology of herding" (point 8) fed the *benign neglect* about rising imbalances in the US balance of payments. The view of the US and China as a *pseudo monetary union* reinforced the complacency about systemic risks (point 9).
- While the interaction between G&G became unsustainable in UK and US in early 2007, the spread of the crisis to the eurozone and the Rest of the World (ROW) is conventionally dated with the failure of Lehmann Brothers on September 15 of the following year.

Global and Regional Dominance

- The first and even the second waves of globalization (15th century and 19th centuries) did not involve as many players as the current one, complicating G&G interaction.
- Joe Nye suggested a “multi dimensional chessboard” to describe the domains of US dominance. This can be adapted to illustrate the positive or negative G&G interactions by dividing world GDP in 2006 (1990 international dollars) into three quarters:
  - North America (US, Canada, Mexico);
  - European Union;
  - East Asia (ASEAN plus China, Korea and Japan).
- The Rest of the World (ROW) accounts for ¼ of world GDP and ½ of the world population. It includes:
  - significant national actors, such as Brazil, Russia, India;
  - salient regions, such as Africa and the Middle East.
- These are the four columns of the dominance matrix.

Dominance matrix

	US (NA)	EU	EAST ASIA	ROW
Defense	**YES**	NO	NO	NO
Finance	**YES**	YES	NO	NO
Trade	NO	YES	**YES**	NO
Land	NO	NO	NO	**YES**

Regional and National Dominance

- The rows of the dominance matrix add to the three levels mentioned by Nye, security, diplomacy (intergovernmental cooperation) and civil society (transnational relations among private actors).
- Nye (2002) concluded that US dominance on security was accompanied by decline on the other two levels.
- A four dimensional chessboard in US, EU and EA illustrates the dominance of each one plus ROW on issues of defense, finance, trade and land, i.e. endowments both for agricultural and raw materials.
- The US dimension is key in the first two (in finance perhaps € getting close to $) but in trade EA dominate (perhaps close to EU), whereas the most endowed in people, land and raw materials should be ROW.

Financial reputation and peer review

- Taking a global (rather than a regional or national) view should foster **governance innovation**, but not enough is known about building global coalitions for change given that dominant players generate free rider problems and this prevents cooperation.
- The risk of cooperation failures is not just international but it is greater among abstract regions. Up until recently peer pressure was the preserve of advanced economies and such procedures were absent among emerging markets, in spite of the creation in 2003 of the African Peer Review Mechanism (APRM).
- External financial assets and liabilities are about 8 times the annual trade flows in 2006 but only 3 in EA. There is no data comparable to the table presented by Jean Pisani-Ferry at 8th ASEM EcoFin in South Korea.

Regional Finance to Trade Ratios

	EA	EA	EU	EU	NA	NA
	1996	2006	1996	2006	1996	2006
Finance* to Trade** Ratio	3	3	6	7	8	9

[*] Intra-regional foreign asset holdings and liabilities excluded; data available only until 2004; [**] Intra-regional trade excluded; Source: Cohen-Setton and Pisani-Ferry (2008)

Regions: historical vs geographical

- Because regions are **historical** rather than **geographical** it is easier to interpret NA and EU than EA.
- The list of sovereign defaults from Reinhart and Rogoff (2009, tables 6.1-2-4-6, pp. 86-99, updating *Brookings Papers on Economic Activity*, with Savastano, Spring 2003) shows the interaction between financial reputation and democracy in Europe.
- When political rights decrease the capacity to tax, countries become serial defaulters but they are also capable of graduating.
- The share of years in default since independence or 1800 is similar in Brazil and Spain (Table 10.2, p. 149) while France stands out for the share in a banking crisis.
- The change from 1979 to 2008 in the credit rating from *Institutional Investor* (Table 17.2, p. 285) shows similarities between Portugal and Spain.

Bankrupcies since independence

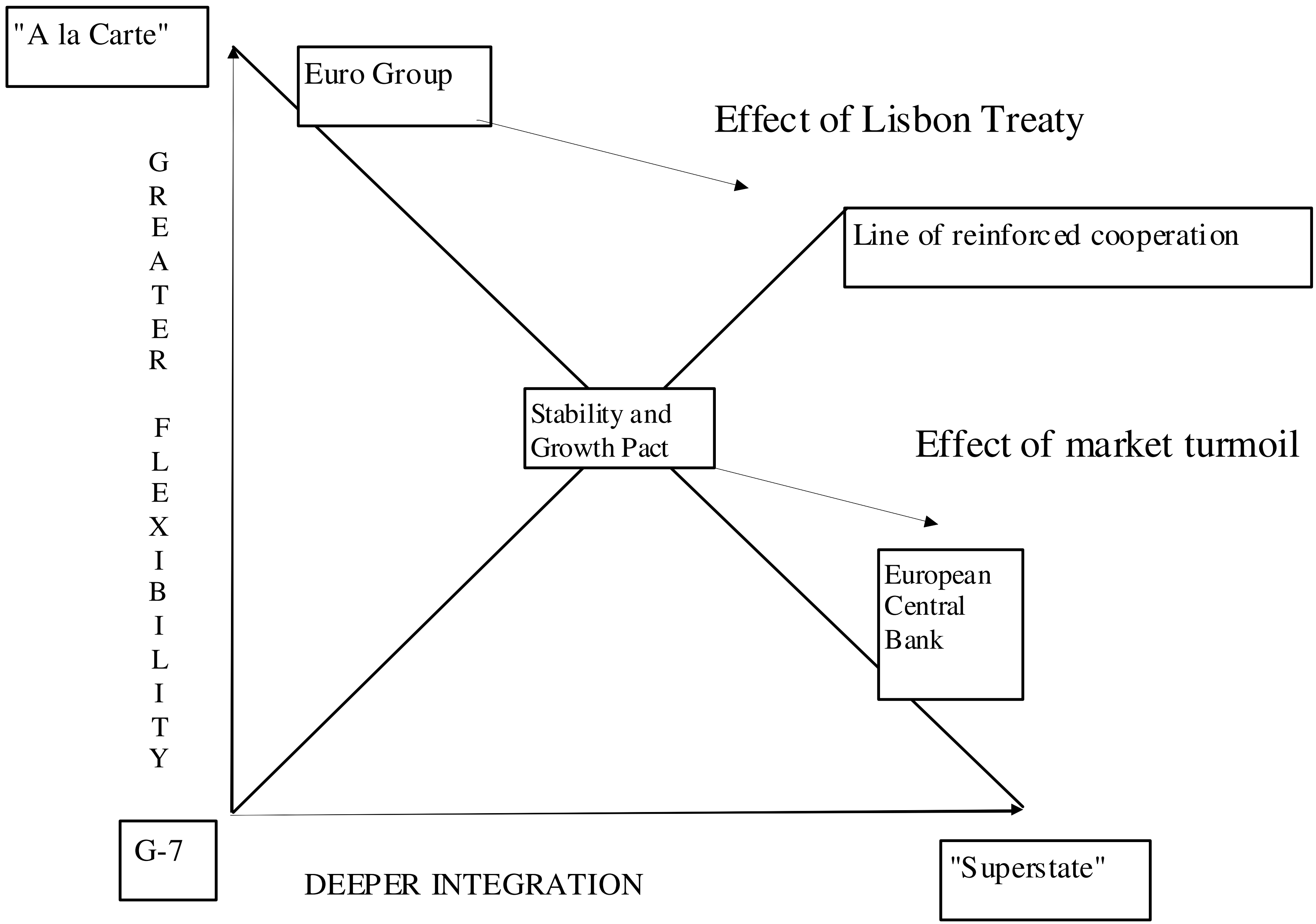
	1300-812	1813-90	1891-008	Total
Spain	7	7	0	14
France	9	0	0	9
Brazil	-	0	8	8
Germany	3	3	2	8
Austria	4	1	2	7
Portugal	1	6	0	7
Greece	-	3	2	5
UK	2	0	0	2
Netherl	0	1	0	1

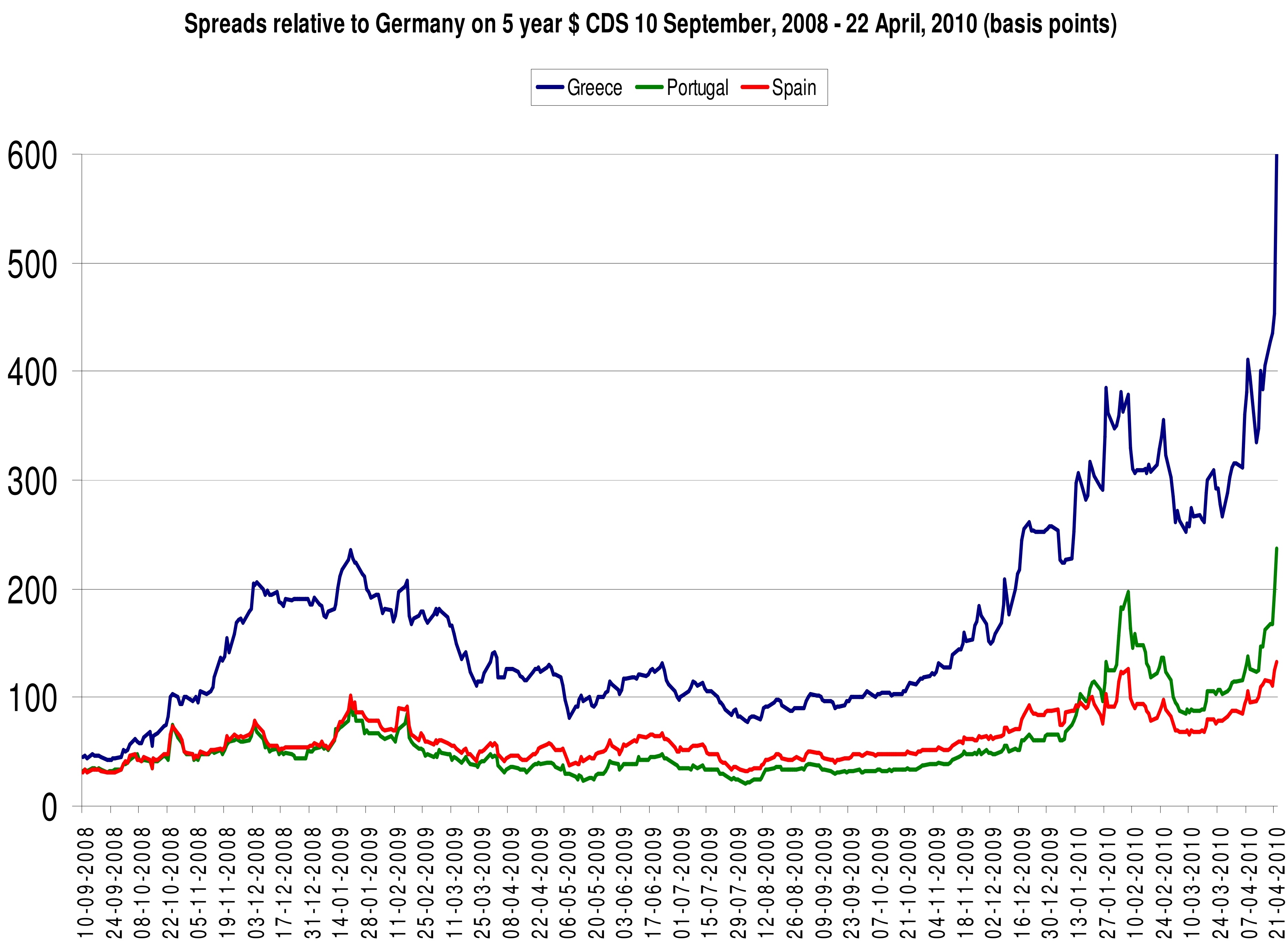
Source: Reinhart and Rogoff, *This time is different*, Princeton, 2009

Years in Default (1800-), Credit Rating (1979-)

	Yrs Def	Yrs Bkng	Rating	Δ Rating
Portugal	11	2	85	33
Spain	24	8	90	19
Greece	51	4	81	19
Austria	17	2	95	9
Netherl	6	2	95	5
Brazil	25	9	61	4
UK	0	9	94	3
France	0	12	94	3
Germany	13	6	95	-4

Source: Reinhart and Rogoff, *This time is different*, Princeton, 2009


"A la Carte"
Euro Group
Effect of Lisbon Treaty
Line of reinforced cooperation
GREATER FLEXIBILITY
Stability and Growth Pact
Effect of market turmoil
European Central Bank
G-7
DEEPER INTEGRATION
"Superstate"


Spreads relative to Germany on 5 year $ CDS 10 September, 2008 - 22 April, 2010 (basis points)
Greece
Portugal
Spain
600
500
400
300
200
100
0
10-09-2008
24-09-2008
08-10-2008
22-10-2008
05-11-2008
19-11-2008
03-12-2008
17-12-2008
31-12-2008
14-01-2009
28-01-2009
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18-11-2009
02-12-2009
16-12-2009
30-12-2009
13-01-2010
27-01-2010
10-02-2010
24-02-2010
10-03-2010
24-03-2010
07-04-2010
21-04-2010

Cooperation – when everything else fails

- Successive bailout programs on both sides of the Atlantic were conducted in an haphazard and incoherent manner in the face of financial panic. They were accompanied or followed by stimulus packages. This was surprising given the strong financial links across the North Atlantic but reflect fault lines in national and regional financial supervision.
- The recapitalization of banks using taxpayers money was finally agreed by the UK and adapted to the eurozone but the different systems of financial supervision continue to prevent a common position in the EU. This is not an issue of monetary policy but rather of information sharing about systemic actors, part of the **macroprudential framework** called for by the BIS (point 2).
- The German model prevents central banks from acting as lenders of last resort because using taxpayers money might compromise their independence. Central banks are closest to commercial banks and other financial intermediaries, yet *the ECB does not have information on the systemic banks in the eurozone!*
- This is particularly serious because attacks on weak currencies are now replaced by attacks on suspicious balance sheets: *nothing in left is right and nothing in right is left.*

Adaptive vs efficient markets

- Annex 2 shows that in the period immediately following the crash of the space shuttle Challenger securities trading seemingly singled out the firm that manufactured the faulty component.
- Yet the actual manner in which particular informed traders induced price discovery is not known so that it cannot be concluded that prices fully reflect all available information, as claimed by the efficient market hypothesis and firmly believed until the current crisis.
- The adaptive market hypothesis put forth by Andrew Lo implies that individuals make mistake, learn and adapt and that competition drives adaptation and innovation.
- Just like there are “rational herds” instances abound of the wisdom and madness of crowds.
- The way in which evolution determines market dynamics becomes specific to the institutional and organizational setup, as discussed in annex 3 and 4.

Section 3: MDGs and Knowledge

- Daniel Cohen shows in **Development is back** (OECD, 2002) that there is not a unique factor behind the poverty of nations.
- Poor countries are "slightly" disadvantaged in each one of the factors behind prosperity.
- But the combination of these slight weaknesses results in huge income gaps.
- This is why he claims that there should be more rather than less globalization: the issue becomes one of **G&G interaction**.
- Progress toward reaching the MDGs has been incorporated in the 2002 “Monterrey Consensus” but continues to face governance obstacles:
  - international organizations (UN, IMF, World Bank, WTO) do not seem able to work together
  - the EU is the largest donor but its policies are not consistent across the 27 members, hindering visibility.

Development, learning and demography

- Angus Maddison demonstrates that development involves:
  - an increase in productive capacity and rising per capita incomes,
  - rising life expectation from 1820 (24 years in 1000 and the rise was almost imperceptible until then): now the average infant can expect to survive 66 years and the projection for 2030 is over 70.

•For Raquel Fernandez, the evolution of US female labor force participation over a century reflects *culture as learning* (annex 1):

  - a mother who works increases the probability that man's wife works from 39% to 71%;
  - men brought up by working mother either prefer women who work or are preferred by women who want to work.

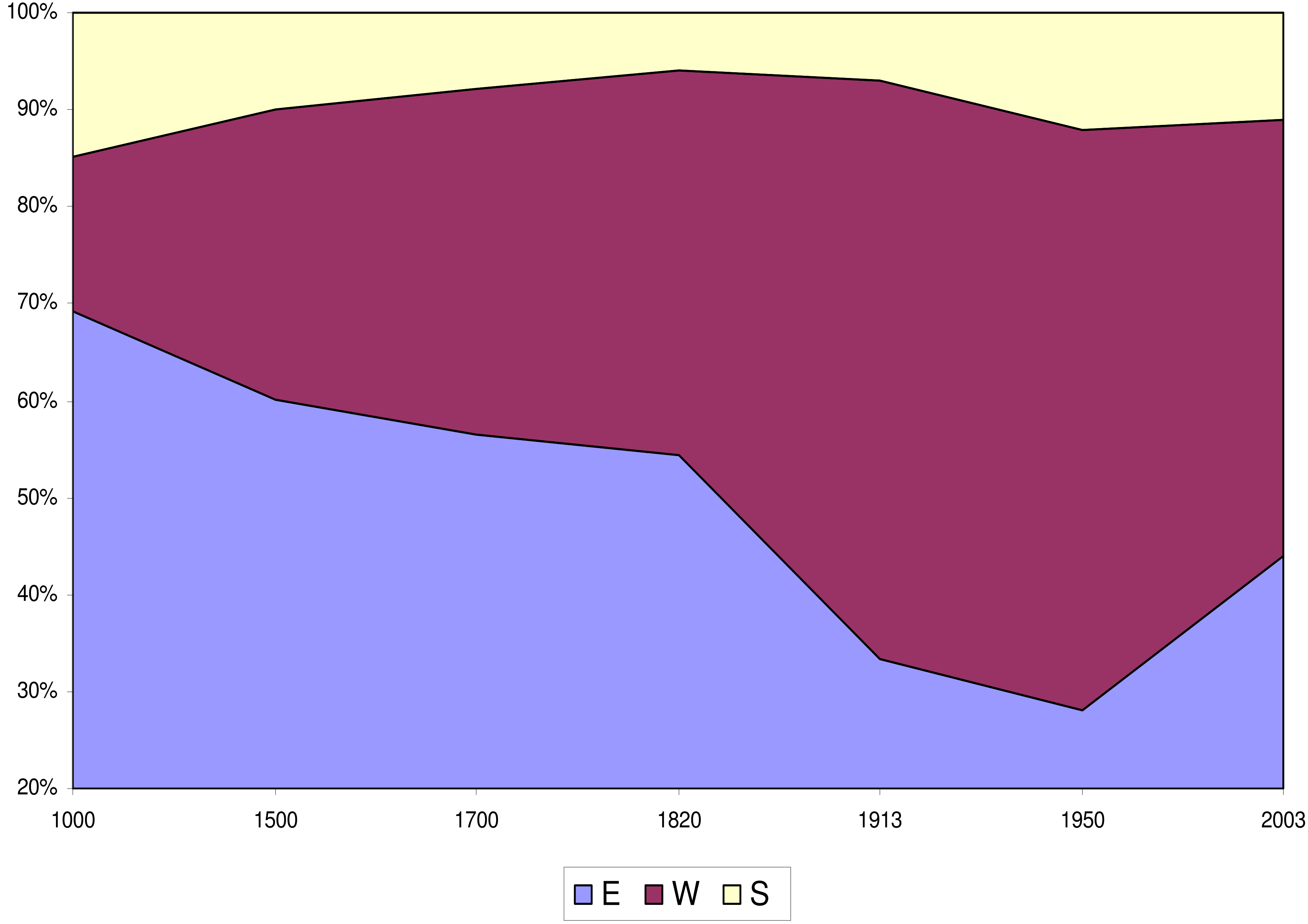
• Since development also involves the expansion of women's economic and political rights, then it implies:

  - declining fertility.

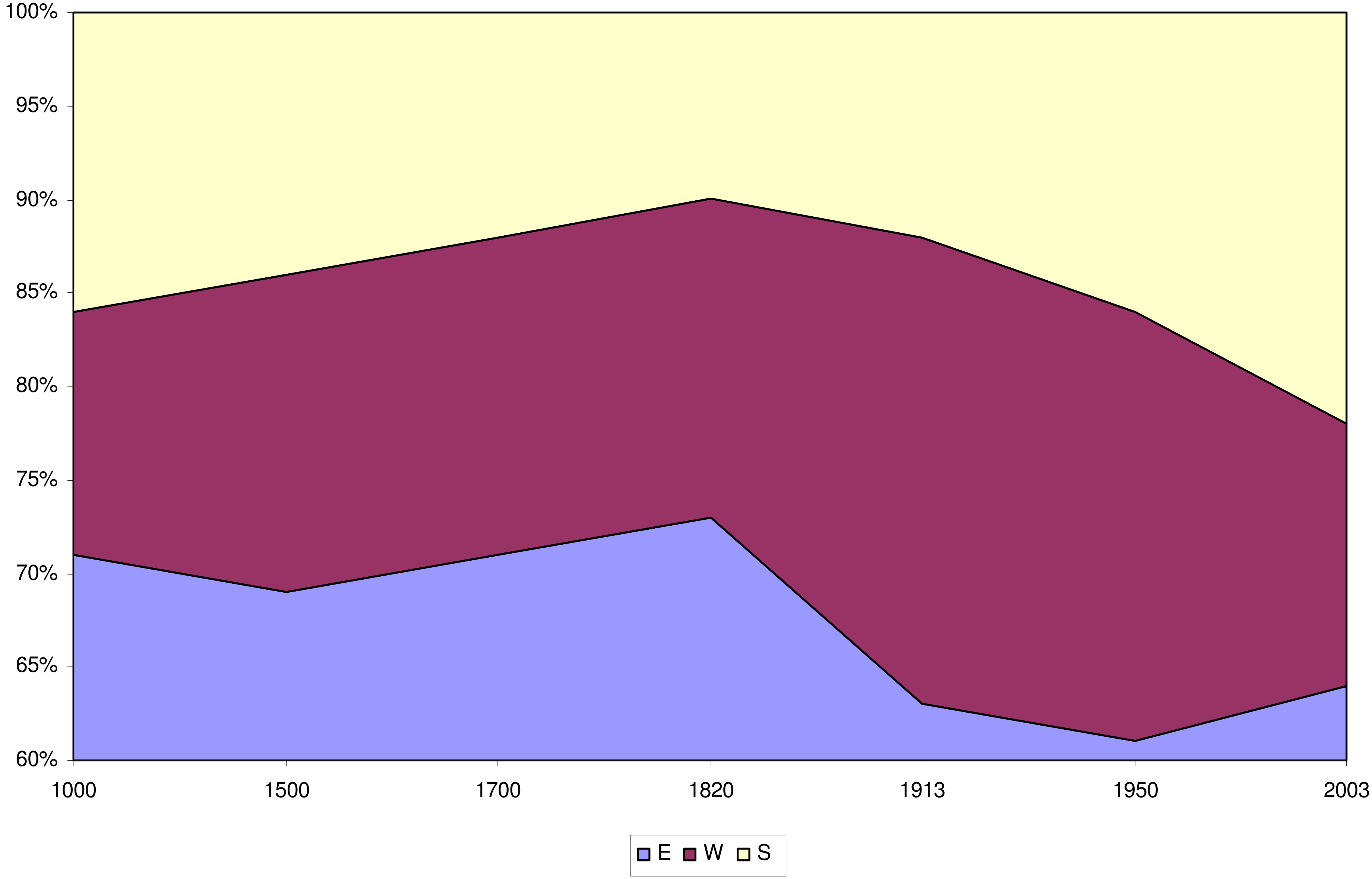
Shares of world GDP and population

- Comparable GDP data in 1990 international dollars (adapted from the Penn World Tables), population (UN) are available in Angus Maddison´s website and have become the benchmark for comparisons across time and space.
- Reinforcing a millennial pattern, the share of Asia (including Japan, Russia and Turkey) in world GDP fell almost 30 percentage points between 1820 and 1950, of which:
  - two thirds accrued to Europe/North America (West)
  - one third accrued to Africa/South America (South).
- Since then, the pattern reversed almost completely between E and W but the share of S remained around 10%.
- Even though there is an equally impressive reversal between rising S and falling W with respect to world population shares, the exclusion of S from income growth is evident.
- Note different lower bound in charts (GDP=20%; POP=60%).

SHARES IN WORLD GDP



SHARES IN WORLD POPULATION



Market economy and global common good

- According to Robert Sirico "Pope on Love in Truth", The Wall Street Journal, 13 July, **Caritas in veritate** is concerned with morality and the theological foundation of culture in the context of the global economic crisis, where the love of truth has been abandoned in favor of a crude materialism.
- Benedict XVI urges that this crisis becomes "an opportunity for discernment, in which to shape a new vision for the future"
- The Pope attributes the crisis itself to badly managed and largely speculative financial dealing but he resists the current fashion of blaming all existing world problems on the market economy.
- Two practical implications of **love in truth**:
  - Moral priorities of generosity go beyond rights and duties
  - The **common good** extends the good of individuals who live in society.
- The worldwide diffusion of prosperity should not be held up by projects that are protectionist: *more not less trade is needed*.

Culture and Science for Global Development

- In *Caritas in veritate* the defense of **multilateralism** goes hand in hand with the realization that structural insecurity generates anti productive attitudes wasteful of human resources.
- Thus human costs always include economic costs and economic dysfunctions always involve human costs. According to Sirico, this is in the tradition of St Thomas Aquinas, Frédéric Bastiat, Willem Roepke and even Friedrich von Hayek.
- The Ministers of Science, Technology and Higher Education of CPLP gathered in Lisbon on 29 August 2009 called for **common sets of indicators** in their fields, along the lines of the multistakeholder declaration approved at the workshop on "Science for Global Development" convened one year before by Jean-Pierre Contzen together with the Consultative Group on International Agricultural Research (CGIAR), the United Nations University (UNU) and research institutions in CPLP.

CPLP mutual friendship & mutual knowledge

- CPLP has European headquarters, strengthening secretariat Portuguese presidency of the council 2008-2010. Like Portugal as a tourist destination in the early 1970s, CPLP remains a “well kept secret” of culture-based multilateralism: “the mutual friendship among members” mentioned in the treaty is not enough to build a *global partnership for development* (=MDG 8 or **global *lusofonia*** as the group is known).
- Contribution of Brazil decisive in creation, joint presidency of the secretariat and of the council in 2003/2004, creation of Business Council (CE) with a secretariat at ELO. The two more advanced members feared that an economic dimension would trigger expectations of larger development assistance towards PALOP (and Timor Leste since 2000). Yet Herfindahl number equivalent=1,4 – same as NAFTA and GDP shares of the 4 larger countries never smaller than 99.75%.
- The **Bissau declaration** aims at monitoring progress with respect to reaching MDGs. It emphasizes that the underlying philosophy is one of “genuine partnership for development”, based on “mutual knowledge” , an original concept which suggests **governance innovation**.

Lisbon declaration (30 September, 2008)

- Recognizes that academics, policy makers, the business community and civil society face the common challenge of learning, through joint endeavors, to use scientific knowledge for sustainable development to improve human well-being, based on effective governance for inclusive economic globalization;
- Maintains that governance responses to globalization are more likely to promote sustained development if they are rooted in local cultures and that shared values are critical for fostering cooperation based on trust and mutual accountability, as expressed in the vision of a “Global Partnership for Development”.
- On 18 June, 2009, ELO and CE/CPLP discussed the effect of the global crisis on the role of Science and Technology (S&T) for Development, suggesting innovative responses.

Jean-Pierre Contzen on effect of the global crisis on the role of S&T for Development

- Reinforce further the **knowledge base** by capacity building in S&T, using all forms of partnership, North-South-South, regional, public/private
- Develop **technological infrastructures**, notably in ICTs
- Stimulate more **local innovation** which contributes to a good capacity utilization through four complementary approaches:
  1. Giving more emphasis on innovation driven by local demand, notably the societal demand
  2. Devoting more attention to organizational innovation adapted to local conditions
  3. Reaping the benefits of new innovative developments, notably in the energy and environmental fields, arising from the stimulus packages of developed countries
  4. Using the model of “non R&D innovators” developed successfully in Europe (cloud computing, for ex.)

State capacity, global governance and G-20

- At any level of income, state capacity can be looked at from an organizational economics perspective: less centralized organizations adapt less well to a changing environment. With respect to intelligence, decentralization will reduce herding, but it will also reduce sharing.
- The dangers of "group think" are apparent in this crisis but have not been analyzed in connection with global, or even regional, governance.
- It is in Lisbon that Paul Krugman first spoke of "incestuous suppression" in connection with resistance to health reform in the US (paper appeared in book edited by Francesco Franco).
- Global governance needs criteria for the system efficient procedures along the lines of what Robert Triffin proposed for the reform of Bretton-Woods (Martin Wolf, *FT* 14 October). The generalization of peer reviews seems contained in the G20 Pittsburgh communiqué (#5 how our national and regional policy frameworks fit together).

A letter to the “global *lusofonia* queen”

- A letter avoiding “group think” of advanced (blue-eyed?) countries might result from a debate encompassing:
  - humanities and social sciences as well as natural sciences;
  - a diversity of CPLP perspectives (possibly including Macao forum).
- Building on the development success of Cape Verde or Mozambique your group can attempt to present such a (short) letter on Friday, taking into account the essential elements of the G&G interaction implicit in the “together alone” paradox:
  - What is development success?
  - What makes a country “African”?