Political Consequences of the Economic Crisis

10 The Success of the G20 as a New Global Governance Framework
   By Flávio Campestrin Bettarello

14 Argentina’s 2001 Crisis: Similarities and Differences With Europe
   By Ezequiel Barbenza & Nicolás J.B. Caputo

17 The European Union-Brazil Strategic Partnership in the Shifting International Context
   By Ana Isabel Rodriguez Iglesias

20 Globalization and Compensation in Hard Times: The U.S. Trade Adjustment Assistance Program and the Great Recession
   By Sarah Cleeland Knight

25 Patriotism and the Reassertion of Citizenship in the United States
   By Eli Lovely

28 The Accountability Loop
   By Pablo Estrada

Firing the Coach: How Governments Are Losing Elections in Europe

By Josep M. Colomer

Are state governments in Europe losing elections with increasing frequency in the last few years? Is this an effect of the financial and economic crisis that began by the mid-2000s? Does this imply a significant change in the voters’ evaluation of governments’ performance in comparison with past periods of higher economic and political stability? How are the different political parties suffering the effects of these changes?

Discussion

A high number of state-wide elections in European countries during the last few years have produced unprecedented results, particularly regarding the defeat of parties in government. In 2009, the incumbent Independence Party in Iceland, which had been in power for 18 years, lost a third of its support and went into opposition. In the United Kingdom in 2010, the incumbent Labour party obtained its worst result since becoming a government party for the first time during WWI. That same year, in Hungary, the Social-Democrats in government lost more than half of their previous electoral support. In Ireland in 2011, the Fianna Fail, the most common ruling party since the country’s independence, slipped to third in

Growth in a Post-Crisis World: the Future of the Washington Consensus

An Interview With John Williamson

The financial crisis of 2008 led to a dramatic loss of wealth in developed countries. For many, however, the long-term significance of the crisis rests in the debate it prompted over the nature of growth itself, and whether Western countries should rethink policies that for years have been considered axiomatic for economic progress.

Over two decades ago, these policies were presented as the “Washington Consensus” in a widely distributed article written by John Williamson, former chief economist for South Asia at the World Bank, and current senior fellow at the Peterson Institute for International Economics. Democracy & Society sat down with Mr. Williamson to discuss the impact of the crisis on the “Washington Consensus”, implications for policymakers, and the possibility that we are seeing a paradigm shift in models for economic growth.

Democracy & Society: Since the onset of the crisis, the U.S. and Europe have had different sets of solutions to their economic downturns. How do you evaluate the solutions and responses that have been implemented so far?

[Cont’d, Page 2]
votes. A few months later, in Spain, the incumbent Socialists received their worst result since the reestablishment of democratic governance in 1977.

This kind of upheaval is not completely new. Throughout the 19th and the 20th centuries, new financial crises were associated with high rates of political turnover in democratic countries, a trend that peaked during the Great Depression of the 1930s. More recently, the crisis of the 90s and its parallel increase in European integration concurred with the end of long periods of single-party dominance, as seen with the Social-Democrats in Sweden and the Christian-Democrats in Italy. Further transnationalization of the economy seems to be decreasing both the capability of state governments to face crises and the subsequent popular support for their rulers.

Still, that a sudden, deep recession would harm the electoral prospects for parties in government was not obvious at first sight. In fact, there were a few early analyses conjecturing that the international scope of the crisis might reinforce support for incumbent governments as a consequence of both a sense of government's impotence and a reaction to seek refuge in the hands of sitting rulers in times of emergency. This would have been a similar reaction to the one often observed with natural disasters, terrorist attacks, or external aggressions – that in a crisis citizens would forgive bad economic performance of governments that were seen as not fully responsible for domestic economic outcomes. One study found, for instance, that for the period of 1975-2002, “voters residing in more closed economies were likely to sanction national leaders for past performance outcomes, but voters in open economies were relatively less likely to attribute reward or blame to domestic politicians for economic performance”.

In more recent years, however, the ruling parties seem to have largely lost the traditional advantages of incumbency. A crucial development is that in the current crisis the economy has ceased to be a policy issue on which parties can compete with clearly differentiated policy proposals, and has instead become, at least for a while, a valence issue with party policy convergence. It might have been expected that such a big crisis of financial capitalism would favor leftist parties, as people would seek refuge in governmental protection. But the international scope of the crisis has particularly hurt those parties, like the Social-Democrats and Labourites, that have traditionally been more associated with an expanded role for state governments and support for state sovereignty. In fact, virtually all governments in European countries have adopted or have felt forced by the European Union to adopt “austerity” policies involving budget cuts, tax raises, cutoffs of public jobs, and labor deals and regulations leading to frozen or reduced wages. Pressure for such policy changes has compelled more leftist parties in governments to move rightwards than the other way around. Still, the crisis has had a negative impact on all government parties.

Two hypotheses have arisen regarding voters’ behavior in this context. As mentioned above, some believe voters may develop a reaction in favor of the incumbent government in a comparable way to what is usually observed for natural disasters and other unassailable events. To this end, governments can present themselves as victims of uncontrollable events. It is not that voters lack a “clarity of responsibility”, as has been argued for separation of powers regimes. This “natural disaster hypothesis” presumes that an international economic crisis may cast clarity of irresponsibility of state governments. Then, where transnational economic integration is high, like in the European Union, economic performance would have a smaller effect on the vote. This means that, under this theory, economic interdependence would reduce accountability and, thus, erode some crucial foundations of state-based democracy.

“Voters residing in more closed economies were likely to sanction national leaders for past performance outcomes, but voters in open economies were relatively less likely to attribute reward or blame to domestic politicians for economic performance”.

For others, a similar awareness of the transnational scope of the crisis and the voters’ capacity to clarify state government irresponsibility for poor economic performance may produce a political effect in the opposite direction – that is, to move voters away from supporting their incumbent governments. If voters feel that individual state governments are strongly constrained in their policy choices – in particular by the directives, agreements, and policy decisions of the European Union – they may doubt the ability of political parties to transform campaign proposals into actual policies. The electoral behavior of voters in many European countries during the last few years might be compared to “firing the coach” in sports when a team underperforms relative to previous performance and usual expectations. Although voters may be aware that governments are not fully responsible for bad economic performance, they exercise the option of holding governments accountable because the existing institutional setting does not facilitate better targeted decisions.

It’s not only that increasing economic transnationalization can hurt some of the government’s previous supporters, such as farmers and small businessmen, or that austerity policies with short-term spending reductions and unemployment increases may lead consumers of public services and new unemployed people to punish the incumbent government. It’s also that other voters more involved in inter-
nationalized economic sectors can now ponder the higher opportunity costs of maintaining support to inefficient or corrupt governments that might have been seen as lesser evils in the past. A general wave of growing distrust of elected politicians can indeed be observed in many countries in recent periods.

If voters cannot precisely target responsible decision-makers for the economic crisis, why should they refrain from wielding their democratic power to punish whomever they may have at hand? Most often, this means the government parties that face re-election. This behavior does not necessarily imply that voters are irrational because they may be targeting the wrong guilty actors. Rather, it may imply that voters simply do not have the appropriate institutional mechanisms for punishing more appropriate targets. Only more accountable European Union officers and other transnational decision-makers could make the relationship between voters, candidates, and elected politicians more attuned to actual responsibilities in public management.

**Empirical Analysis**

In order to test the relationship between economic performance and incumbent party electoral performance, the following empirical analysis incorporates data from 63 parliamentary elections in 29 member states and official candidates of the European Union from January 2004 to December 2011. The dependent variable to be explained is the change in electoral support for parties in government before and after the beginning of the crisis, which is set as September 2008. We operationalize this by measuring relative changes in percentages of votes between two successive elections according to the formula:

\[
\frac{(%V_{it} - %V_{it-1}) \times 100}{%V_{it-1}}
\]

where:

- \( %V_{it} \): percentage of votes for party \( i \) in election at time \( t \);
- \( %V_{it-1} \): percentage of votes for party \( i \) in the previous election.

We choose relative and not absolute change in percentages of votes because the loss of, say, 10 percentage points for a party with a previous support at 20% is a more significant loss (50% in our measurement) than the same absolute difference of 10 percentage points for a party with previous support at 40% (just a 25% loss). This measure permits us to grasp the degree of gains or losses with a single variable, instead of having to use both the absolute percentage of votes in the previous election and the absolute difference in percentages between successive elections.

The average relative change of votes from 2004 to 2011 for the prime minister’s party of all 29 countries was -11.4%, and for all the government parties it was -15.4%. In all, more than half (51%) of elections from 2004 to 2008 led to a change of the prime minister’s party.

### Table 1. Sample of Elections

<table>
<thead>
<tr>
<th>Country</th>
<th>Years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>2006, 2008</td>
</tr>
<tr>
<td>Belgium</td>
<td>2007, 2010</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>2005, 2009</td>
</tr>
<tr>
<td>Croatia</td>
<td>2007, 2011</td>
</tr>
<tr>
<td>Cyprus</td>
<td>2006, 2011</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>2006, 2010</td>
</tr>
<tr>
<td>Estonia</td>
<td>2007, 2011</td>
</tr>
<tr>
<td>Finland</td>
<td>2007, 2011</td>
</tr>
<tr>
<td>France</td>
<td>2007</td>
</tr>
<tr>
<td>Germany</td>
<td>2005, 2009</td>
</tr>
<tr>
<td>Hungary</td>
<td>2006, 2010</td>
</tr>
<tr>
<td>Iceland</td>
<td>2007, 2009</td>
</tr>
<tr>
<td>Italy</td>
<td>2006, 2008</td>
</tr>
<tr>
<td>Lithuania</td>
<td>2004, 2008</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>2004, 2009</td>
</tr>
<tr>
<td>Malta</td>
<td>2008</td>
</tr>
<tr>
<td>Netherlands</td>
<td>2006, 2010</td>
</tr>
<tr>
<td>Romania</td>
<td>2004, 2008</td>
</tr>
<tr>
<td>Slovenia</td>
<td>2004, 2008</td>
</tr>
<tr>
<td>Sweden</td>
<td>2006, 2010</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>2005, 2010</td>
</tr>
</tbody>
</table>

Note: This includes 27 member states at the moment of writing plus Croatia and Iceland, but excluding Macedonia, Montenegro and Serbia for lack of economic data and Turkey for not being ranked as a free electoral democracy by international agencies.

As explanatory variables we first choose economic performance. We operationalize this in two ways (by using data from OECD and Eurostat). First, for each country we take the average percentage of growth of the gross domestic product in the four quarters before the quarter of each election. This index can reflect the stronger impact of recent performance on voter information and motivation. The values are notably different for the two periods previously identified: 4.4% before the first election, and 0.7% before the second election.
Second, for each country we take the percentage of unemployment at the time of election (as given by the aforementioned sources for the month before). For this index the values are also worse for the second period, although by a lower margin than the previous index: 7.6% for the first election and 9.6% for the second.

In accordance to our previous discussion, we also select as a second explanatory variable the government's party ideology in order to check whether leftist or rightist parties suffer greater losses in electoral support. For this we use data of party ideology on a left-right scale from 0 to 10 based on expert surveys. We use these values both along the continuum and in simplified classifications of parties in clusters on left, center, and right positions.

Finally, we include the following additional variables of control:

**Time in office of the incumbent prime minister’s party.** With this we can capture the fact that longer tenures may entail higher likelihood of losing elections independently of other factors. We measure government duration in years. The average value is 6.1 – that is, barely one and a half terms (as legislative terms are of four or five years), which means that an incumbent government’s party may have only a 50% likelihood of being reelected. This also seems to confirm the vanishing of the traditional incumbency advantage.

**Post-communist countries in Eastern Europe.** With this we take into account the well-established observation that recent democracies tend to have less institutionalized party systems and experience higher electoral volatility. Indeed, a high proportion of elections in our sample (40%) have been in those countries, so the effect could be significant. We include this as a dummy variable 0,1.

The results of the statistical analysis, as presented in Table 2, can be summarized as follows. The rate of economic growth is a statistically significant predictor of relative change in the electoral support for the incumbents, especially for the prime minister's party and also for all the parties in coalition governments. More growth entails relatively better incumbent electoral performance; less growth or recession, worse electoral performance. Likewise, the negative impact of the level of unemployment is significant for both measures of incumbent electoral performance and higher for the prime minister’s party.

Leftist governments have performed systematically worse than rightist governments, as shown in Figure 3. Yet, when taking economic performance into account, we find no evidence of a relatively worse electoral performance for either left or right governments. This seems to suggest that left-wing governments can be associated with periods of worse economic performances, but the political consequences of bad rates of economic growth and unemployment hurt both leftist and rightist governments in similarly proportioned degrees. Even more clearly, the rise and decline in relative

<table>
<thead>
<tr>
<th>Table 2. Regressions of Relative Change in Incumbents’ Electoral Performance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A. On GDP growth and unemployment rate</strong></td>
</tr>
<tr>
<td><strong>Linear regression</strong></td>
</tr>
<tr>
<td><strong>PMrelchange</strong></td>
</tr>
<tr>
<td>Timeoffice</td>
</tr>
<tr>
<td>Postcom</td>
</tr>
<tr>
<td>Q1Growthp</td>
</tr>
<tr>
<td>Unemp</td>
</tr>
<tr>
<td>_cons</td>
</tr>
</tbody>
</table>

| **B. On Left-Right prime minister’s party ideology** |
| **Linear regression** | (Std. Err. adjusted for 28 clusters in Countrycode) |
| **PMrelchange** | Robust | R2 | Std. Err. | t | P>|t| | [95% Conf. Interval] |
| Timeoffice | -5.045329 | 0.40 | 0.606 | -1.161069 | 1.729496 |
| Postcom | -0.036925 | 0.712455 | -1.31 | 0.200 | -22.62211 | 4.954361 |
| Q1Growthp | 2.880731 | -6.104909 | 2.64 | 0.008 | .801364 | 5.133325 |
| Unemp | -1.931514 | 0.7225532 | -2.67 | 0.013 | -3.49107 | -1.449249 |
| Left | -2.653144 | 0.597651 | -0.41 | 0.688 | -16.0274 | 10.76091 |
| _cons | -1.603053 | 10.2379 | 0.16 | 0.877 | -22.60829 | 19.40459 |
Figure 1. Relative Change in Electoral Support for Prime Minister’s Party

Figure 2. Relative Change in Electoral Support for Government Parties

Figure 3. Left-Right Prime Minister’s Party Ideology and Electoral Performance

Figure 4. Left-Right Government’s Ideology and Electoral Performance
change of electoral support over time are very similar for leftist and rightist governments, as can be observed in the Figure 4. We have also tried a trichotomous classification for left, center, and right parties, as well as for parties’ membership in Europe-wide political groups in the European Parliament (e.g. the Socialist, Liberal and People’s groups), but the low number of cases for some of the categories makes the results not significant.

Regarding the control variables – time in office and post-communist country – although they work with the expected negative signs, they turn out not to be statistically significant. This also confirms the significance of the association between economic performance and incumbent’s electoral performance, which is the main result of our analysis.

Concluding Comments

In the light of this turmoil, some authors have speculated with a general propensity of voters to make their choices in reaction to irrelevant events that governments have nothing to do with and for which no government response would be expected. Some have gone so far as to try to estimate the electoral impact of disparate events such as local college football or basketball games, or of “acts of God” such as bad harvests, shark attacks, droughts or floods or pandemics. This speculation presumes that ignorant voters can believe in untested connections and can be victims to demagogues – although this does not necessarily include a presumption of irrationality.

We make a different reading of recent events related to the economic crisis, and want to suggest a comparison to the “firing the coach” reaction in sports. As elaborated, for instance, in the growing discipline of economics of football, firing the coach is analyzed as a ritual scapegoating. Sport club members or fans, like voters in state-level elections in our case, can be aware of the fact that underperformance is due to a number of factors that cannot be reduced to the failure of management. But managers and governments are regularly punished not only because voters, like fans, come to doubt the credibility of promises for the future, but also to ensure accountability and responsive government.

Nevertheless, like in sports with new management, the choice of a new governing executive by the electorate may make no difference for economic performance. In fact, increasing political instability can even add a new element of distrust to the previously existing factors for economic recession and high unemployment. In many elections in European countries over the last few years, voters have offered the prime minister’s head in ritual sacrifice. But as a change of prime minister may not improve the government’s capacity for facing the crisis effectively, further disappointments may still increase the frequency of governments’ turnover and the degree of political instability. Further studies will have to account for the attuning of this prediction.

Note: This paper summarizes research in progress by the author, together with Pedro Magalhaes, which was presented to the conference “Political Consequences of the Economic Crisis: Voting and Protesting in Europe”, held at Georgetown University, BMW Center for German and European Studies and Department of Government, in Washington, DC, on April 17-18, 2012.

Josep M. Colomer is a Research Professor in Political Science at the Higher Council for Scientific Research (CSIC), and a Distinguished Visiting Professor at Georgetown University. He is the author of 35 books and is a life-member of the American Political Science Association, from which he received the Leon Weaver Award for the best paper on representation and electoral systems.

Endnotes


3 See discussion in Kayser, “How Domestic Is Domestic Politics?”, 341-162


References

John Williamson: I think that, in the first place, the European sovereign debt crisis did not really start until 2010, although the bank crisis occurred before that, similar to the crisis of the banks in America. Prior to 2010, I would say [the crisis] was very much centered on the U.S. Now, the sovereign debt crisis is centered on Europe. [In terms of responses] where countries have had the room to fiscally expand, then I’m in favor of it. When they don’t have [room], which was true in Europe in the South, [then they shouldn’t fiscally expand]. [But] I think that the country that one can’t explain through this [logic] is Germany, because it did have room to expand in terms of fiscal policy, and chose not to do it. Instead, they chose a rigorous approach, which appears to be politically popular. None of us understand why the Germans are so different. But it seems to be a fact.

In the U.S., I think [responses have been] more or less appropriate. It was right to [take into account] the problem of debt and to not have an even bigger fiscal expansion. It was also right to prevent the recession from developing into a big depression, as it looked certain to do when [George W.] Bush left office. The initial stimulus was important, and it was worth it.

DS: Do you think the Fed could have been more aggressive?

JW: I was quite surprised with how aggressive they were. I couldn’t criticize them since the start of the crisis. I criticized them for the run-up to the crisis, for their excessive complacency.

DS: There has been some debate recently about the role of the Fed. Some Republicans, for example, are questioning if they should not take unemployment out of their basket of responsibilities. What is your opinion on that?

JW: Unemployment enters [as an issue for the Fed] anyway, because high unemployment, one assumes, will press inflation. So it enters anyway. I don’t think it does either great good or great harm to have it explicitly mentioned as one of the [Fed’s] objectives.

DS: Do you think that the re-emergence the so-called “Keynesian policies”, with heavier influx of capital into the economy sustained by larger deficits, represents a paradigm shift or is simply a temporary measure?

JW: Well I hope that Keynesianism wasn’t totally forgotten before [the crisis]. Keynesian tools were used when they were appropriate and needed. One hopes that they won’t be needed in the future, and therefore it will go into remission. If the price of that is people are talking nonsense about the end of Keynesianism, so be it.

DS: Do you think that, do you perceive a change in how we might think about developing countries, considering the rise of what has been called State Capitalism, with a much stronger, active role of the government in spurring economic growth?

JW: I think previously there was an excessive faith that the essence of free markets was getting government out of things. One may need an active government role to preserve and augment competition, and the objective should be to have a competitive economy rather than to have either a state or non-state economy. There has been some movement, yes, but more of degree than of kind. But I do think that there has been a movement towards a [more active] state role, though some of my colleagues disagree with me on that.

DS: The crisis sparked new discussions about the “Washington Consensus” and which policies might have contributed or not to the economic downturn, as well as which policies are going to survive as good measures moving forward. In a certain way, the “Washington Consensus” took politics out of the equation, suggesting that economic tools were technical and could be approached by any responsible government. Nowadays, we see that sometimes that is not feasible. Is there a new convergence of politics and economics?

JW: Prescriptions, to me, means economics. Then the means by which one does that is political. Politics is an end to achieving what I thought were rational policies. I think everyone would accept that.

If you look at the 10 points I had in the original Washington Consensus they were policies that could have been implemented by any government. But some of the more general, subsequent developments that were called the Washington Consensus were indeed highly political. It amounted to redefineining it as a right-wing set of rules. There is no way you can divorce that from politics. I don’t know that the crisis had a major impact on [how people view the Washington Consensus]. There’s still a big division between people who regard it as a set of specific recommendations for one area at one time, and those who regard it as a general ideological blueprint, along the lines of Reagan-Thatcher.

DS: Has the crisis strengthened those positions?

JW: I get the impression that people have forgotten the crisis of four years ago. Somebody just yesterday was telling me that he was canvassing in Northern Virginia, and was just amazed that if you talked to people about what the [Obama] administration was faced with when it first came in, there was just no recognition that there had been a crisis [in 2008]. People are interested in the current situation rather than in the situation of four years ago.

DS: You wrote, right after those 10 points came out, that issues of redistribution and inequality would be added to the Consensus if you were writing your own prescriptions. Those
issues have been either at the center of the crisis, according to some people, or at least grown in its aftermath.

JW: I think [the crisis] very much emphasizes the importance of [dealing with] inequality. And I quite like the argument that the availability of credit in the United States was essentially compensating for the inequality that had grown in income distribution. And therefore there was indeed a link between inequality and the crisis. I think that is generally right.

**DS:** Do you think those same 10 consensus points still apply for governments going forward – consider, for example, de-regulation...

JW: De-regulation was specifically de-regulation of entry and exit [of capital]. It wasn’t deregulation in the sense of burning all the regulations for the banks. That was Dan Quayle. That wasn’t in the Washington Consensus as I heard it. I think even in the first edition I was pretty specific on that.3

**DS:** So all of those 10 points still apply?

JW: If you take de-regulation of the airlines – I liked traveling by air much more before deregulation than I do afterwards. But then I have it paid for. If you're paying your own fair, you like the effects of deregulation much more.

**DS:** Do you think Washington Consensus adequately addressed inequality for developing countries?

JW: No, it didn't. Primarily it is a question of tax policy. That is the big instrument for addressing inequality – tax and expenditure policy, a combination of them. I don’t see a big alternative to that, maybe some minor things on the fringe. I hope [developing countries] will take on board some lessons. Primarily, [that they have to tackle the] question of taxes and expenditures. So I think one applauds the sort of expenditures on the poorest, which has been made in Latin America in recent years. One applauds also maintaining progressive taxes, and not following the attempts to eviscerate the taxation system.

**DS:** We see in Europe today many examples of a strengthening of fiscal policy, and a lot of pressure on countries on the margins to adopt austerity measures and be even more fiscally responsible to avoid increasing the debt. And you see the consequences in Greece and Spain. Is that adequate?

JW: I don't think there were any alternative for Greece, Spain, and those [peripheral] countries. They had to either leave the euro or tighten fiscal policy. I wish the euro hadn't been created. But given that it was created, I don't want to see it fall apart.

**DS:** Do you think tightening even more is feasible in the long-term for these countries?

JW: I'm not sure. I think most of the tightening they needed has now happened. They are in fact regaining competitiveness, but it's an awfully slow process. It's been argued [that having some countries leave the euro would be better for Europe], but I think it's wrong. I think the short-term effect would be disastrous on the countries involved, as well as to the partners. If one country leaves, I think that's the end of it. I don't think you're going to have one or two countries out, but not the others.

**DS:** And do you think at this point have we avoided this course?

“We think [the crisis] very much emphasizes the importance of [dealing with] inequality. And I quite like the argument that the availability of credit in the United States was essentially compensating for the inequality that had grown in income distribution. And therefore there was indeed a link between inequality and the crisis.”

JW: There's still a threat. I don't think it's going to happen. But I don't think it's going to be comfortable either.

**DS:** Do you think the European Central Bank (ECB) has had a positive role?

JW: The crisis was in a sense caused by the fact that the ECB didn't act as a central bank normally does to each of the individual countries. They therefore indebted themselves in what effectively was a foreign currency. There was no guaranteed backstop. The foreign currency aspect was inevitable. Then the response of the ECB, saying that they would like to engage and buy unlimited amounts of debt, was quite appropriate. It was also right to impose some conditions. And they should be political conditions rather than economic conditions.

**DS:** There is a discussion about the effect the crisis has had on the sovereignty of European countries vis-à-vis the ECB and other supranational institutions, which are basically dictating policies now. Do you think that is a positive trend?

JW: I think it was inevitable. It's the one common instrument that Europe has, and the one instrument that could
effectively address the crisis. I think the ECB wants to retain some instruments until one has fiscal unity corresponding to monetary unity. I think it will evolve that way [towards fiscal unity].

**DS:** To what extent is inequality today inhibiting growth?

**JW:** If there was more equality in the United States in particular, I don’t think it would help an enormous amount with growth.

**DS:** In terms of welfare regimes, we’ve seen expansions followed by retrenchment, and then there has been a steady line of maintaining the minimum status quo maybe since the 1980s. Do you think the crisis changes the way we see welfare systems?

**JW:** Depends on who “we” are. In Europe there has been a fairly big change. There is certainly no assumption that increasing welfare is a realistic possibility at this stage.

**DS:** But of course they were starting at a much higher level than the United States. So for the U.S. do you sense the same view coming about?

**JW:** The same view has been propagated, but I don’t think it has nearly as much force in the U.S. I think one could maintain roughly the present level of social expenditures without great difficulty if one was prepared to contemplate raising taxes.

**DS:** But in Europe, while there is pressure to cut public expenditure, people will need their safety nets even more. So how do we go about these two forces?

**JW:** An increase need surpasses the ability to meet those needs. That is true. That is the essence of the European problem. [They must seek] balance. That’s all you can say. They shouldn’t either think that you can bailout everybody as much as you want to, or go to the other extreme of cutting everything.

**DS:** To sum it up, has the crisis affected your thinking about how to best pursue economic growth — both in developed countries, and in the developing world?

**JW:** Certainly as far as the developed world is concerned, I’ve reduced my ambitions. I think it’s unrealistic to think about growth continuing to increase 1.8% a year for the next 100 years, and then our grandchildren will be six times better off, or whatever, than we are now. I just don’t think that’s going to happen. As far as developing countries are concerned, I don’t think the crisis has had a major impact on the way that we should think about it. I agree that there has been much talk about State Capitalism. Before the crisis I think we forgot how convenient it was to have state companies in one specific role. State companies in China were what increased expenditures, and got them [the Chinese] out of the hole very quickly. I think we more or less forgot that before the crisis, and now we are conscious of it. But if one thinks of a general attitude development, I think it’s much the same.

**DS:** What would you prescribe for the euro zone right now?

**JW:** For Europe in particular, I don’t know why the idea of incomes policy has totally dropped out of view. There’s been no mention of it as a tool for combating the euro crisis. Indeed, the resentment in Greece and Portugal has been particularly directed at things that were going to reduce unit labor costs rather than reduce demand further. And that to me is absolutely wrong. I would have advocated for them going much more on the lines of concentrating on reducing unit cost.

**DS:** Do the politics of the current situation allow for the policies you think are best?

**JW:** I doubt what I think is best would be a realistic possibility, no. For example, what I mentioned on incomes policy: I think of that as the best policy, but it seems to be the one most fiercely resisted. Portugal had what I thought was a very clever device for getting a fiscal devaluation by exempting employers from the social security charge and effectively imposing it on consumers. And that was resisted. That was one thing they backed down on. Instead, they raised taxes more. That seems to me just wrong. So I would do that the other way around. I would put much more emphasis on reducing wages, costs of those that were in work and going easy on the austerity.

**ENDNOTES**

1 The interview was conducted by Andrea Murta and Josh Linden at the Peterson Institute of International Economics, in Washington, DC

2 This framework included: Fiscal discipline, tax reform, financial liberalization, managing exchange rates to induce rapid growth in non-traditional exports, trade liberalization, increasing foreign direct investment (FDI) - by reducing barriers, privatization, deregulation, secure intellectual property rights and reduced role for the state.

The Success of the G20 as a New Global Governance Framework

Flávio Campestrin Bettarello

Introduction

After seven leaders’ meetings (Washington, London, Pittsburgh, Toronto, Seoul, Cannes and Los Cabos), there is little doubt that G20 Summits are currently the most important dialogue fora for discussion about the global financial system and the world economy. As Menkhoff and Meyer point out, “in response to the current worldwide financial and economic crisis, the so-called ‘G20’ group has emerged as the premier forum of economic policymakers”.

Comprising 85% of the global gross product, 80% of international trade, and two-thirds of the world population, the G20 witnesses, meeting after meeting, the broadening of its agenda. The first reunion of its Heads of State and Government summit was held in 2008 specifically to deal with the international financial crisis. At present, the group’s discussions include the reform of international institutions, climate change, food security, and anti-corruption, to name a few. Other topics that dominate the international agenda, as the current “currency wars”, are also regularly addressed at G20 summits.

Despite some criticisms, the overall evaluation is that the G20 meetings are capable of producing some concrete and effective results. Bradford and Linn even say that “in retrospect, it is likely that history will reveal the London G20 Summit (...) as being the most successful summit ever.” The previous 25 years of G7 and G8 summits have not delivered the same degree of results”. Moreover, at least as important as the summits’ ability to produce substantive results is the G20’s impact on the rearrangement of the global governance system.

Therefore, one should ask two important questions. First, how did the G20 manage to achieve such supremacy in international decision-making? Second, why has it succeeded in shaping new global governance when organizations such as the UN, the WTO, and the IMF have failed?

There are four independent variables that may help to explain the G20 success over others failures (see Figure 1). The proposed causal nexus and the relationships between its variables will be denominated global governance multi-determinant model.

1. Balance of world powers

The first independent variable that should be analyzed is the balance of world powers. Huntington indicates three classic models for the global structure of powers: unipolar, bipolar, and multipolar. However, according to Huntington, “contemporary international politics does not fit any of these three models. It is instead a strange hybrid, a uni-multipolar system with one superpower and several major powers” (the superpower, obviously, is the U.S.). He points out that “the settlement of key international issues requires action by the single superpower but always with some combination of other major states”. Consequently, we experience a unique moment in history, in which the major powers are increasingly asserting themselves to promote their own interests, which, in many cases, are distinct of the interests of the hegemon. In Huntington’s view, the U.S. cannot – or at least should not – act or talk as if this was a unipolar world: “To deal with any major global issue, the U.S. needs the cooperation of at least some major powers”.

Understanding the concept of a uni-multipolar system is the first step to answer why an enlarged forum like the G20 is needed, from a political perspective, in the 21st century. The second step is to understand how this system is evolving and how the hegemon and its historic allies are reacting to current structural changes.

Ikenberry calls the American-led and Western-centered system of global governance the “old order”. During the Cold War, this system – which shaped organizations such as the UN and the Bretton Woods financial institutions – dominated half of the bipolar world. It was not until the fall of the Berlin Wall that the “old order” attained worldwide proportion, allowing for the creation of a unified system of rules and institutions.

Nonetheless, Ikenberry indicates that the old order “appears to be increasingly out of sync with a world of rising states and new global challenges”. The rise of new states seeking influence – a reflex of the “economic power variable” of

Figure 1: Global governance multi-determinant model – Diagram of variables.
the global governance multi-determinant model – and new functional challenges to cooperation (e.g., climate change, terrorism, failed states) associated with the growth of economic and security interdependence suggest the need for a new international order. “The demand for governance is growing, yet the supply of governance remains uncertain”.10

This perception is in accordance with the view that the U.S. will not be able to maintain its supremacy in the international arena indefinitely.11 In Joseph Nye's evaluation, it would be inaccurate to describe the power transition in the present century as a traditional case of hegemonic decline.12 The U.S. is not in absolute decline, and in relative terms, it is probable that it will remain more powerful than any single state for decades.

However, the country will inevitably have to deal with the rise in the power of many others actors. In this sense, “the problem of American power in the twenty-first century, then, is not one of decline but what to do in light of the realization that even the largest country cannot achieve the outcomes it wants without the help of others”.13

Ikenberry asserts that the required changes to create a new international order do not need to shift the essence of the existing system, comprised of liberal-oriented rules and institutions, but must establish mechanisms for a more representative and broader participation.14 The composition of the G20 precisely addresses these concerns. Its core group is an extension of the G7 (U.S., United Kingdom, France, Germany, Japan, Italy and Canada), a forum created in 1976 that reflects the values of the Cold War old order.15 In 1997, the group added Russia, thus becoming the G8. Since the G8's 2005 Gleneagles Summit, the five most important developing countries (China, India, Brazil, South Africa and Mexico) participate in what has become the G8+5. The remaining countries that form the G20 also have singular importance in the contemporary international environment: Australia is a leader of international reform and an advocate of multilateralism; Korea represents a model country of long-term dynamic economic growth; Indonesia is the largest Islamic country in the world; Turkey is another Muslim country that is an historic bridge between East and West; Saudi Arabia is an Arab Muslim country and the world’s control room of oil; and Argentina, perhaps the only one whose membership in the G20 could be questioned, has an important role in South America's regional balance of power.

Comparing the G20 to the G7, it is clear that the former has built-in advantages in representativeness, diversity, concerted power, legitimacy, and effectiveness.16 However, criticisms about the group's structure still remain. On one side, it may be argued that the G20 is essentially self-appointed and lacks universality.17 On the other side, it may be argued that the group has not actually strengthened the influence of developing countries in global governance, as the developed countries still have preponderance inside the group.

2. Non-opposition of neighbor countries

One question that arises from the above exposed is: if more representative global governance is required, why have many of the existing institutions not adapted to this new situation? Or, in other words, why has the G20 succeeded in becoming an enlarged forum of discussion when deliberative boards such as the United Nations Security Council maintain its Cold War composition?

To answer this question, it is important to analyze the regional struggles for power and the dimension of the leadership-followership nexus. Schirrm affirms that “in order to perform successfully, any power projection and leadership in this regard must be accepted by followers, especially neighbors”.18

The Brazilian case illustrates this puzzle. Brazil, aside from its relatively rich endowments, lacks the hard power instruments to impose its will on other countries.19 It is not, and does not intend to be, a military superpower, and with its domestic poverty problems it cannot afford to indiscriminately “buy” other countries’ support. Thus, Brazil operates “without sticks or carrots”.20 Brazil resorts to instrumental or ideational resources of leadership; it uses its “soft power” to promote “consensual hegemony”.21 Even if Brazil is arguably the most important country in Latin America, it does not have the capability to impose its will over its neighbors.

If an emerging power like Brazil cannot coerce support from its neighbors, it needs to deliver incentives to ensure acceptance for its leadership and create spaces for assertion of its global power projection and international coalition-building aspirations. These incentives can be material or “shared norms and values triggering a common definition of the leader-follower situation, which includes the aims of the follower”.22 A potential follower will only accept the relative loss of its own power – implied in accepting the rise in power of another country – if it is compensated economically by the leader and/or legitimized by a shared idea that makes the interests of both leader and follower converge (or at least creates this impression in the follower’s perception).

Hence, it is not surprising that perhaps the most important reason for Brazil’s failure to achieve a more prominent role in institutions like the UN and the WTO is the opposition of its closest neighbors. One could take the example of the Brazilian pledge for a permanent seat in the UN Security Council. In 2004, a high level committee submitted to the UN Secretary General a proposal that called for the establishment of new permanent members. The countries of the so-called G4 (Brazil, Germany, India, and Japan) were the natural candidates for these seats, and they had the support of many countries.23 Brazil also has not faced a direct opposition from any of the five permanent members.

But a large group of countries opposed the creation of any new permanent seats, and proposed the introduction of semi-permanent membership. This group, initially called the Coffee Group and later renamed Uniting for Consensus, brought together the regional rivals of the G4: Argentina
and Mexico, South Korea, and Pakistan, among others. As it turned out, aspiring Security Council members could not sell to their home regions their bids for international recognition.24 According to Malamud, “the fact that Argentina, Brazil’s main regional partner, was simultaneously the staunchest opponent of its main international ambition dealt a heavy blow to its image as a regional leader”.25

In a similar episode to the Security Council enlargement debate, Uruguay, supported by Argentina, ran against the Brazilian candidate for the post of Director-General of the World Trade Organization. Both contestants were defeated by Pascal Lamy. A couple of months later, Brazil also had its candidate for the Presidency of the Inter-American Development Bank (IDB) defeated, this time by a contestant appointed by a neighbor country, the Colombian Luis Alberto Moreno.

What all this evidence shows is that, very often, secondary regional powers oppose the leadership ambitions of the major regional power. The G20 configuration demonstrates this issue very well. To take the Latin American example, the three big regional powers are represented: Brazil, Mexico and Argentina.

The Brazil-Mexico-Argentina example can be applied to other power relationships within the G20: the China-Japan-Korea case, for example, and that of the European countries. In fact, the customary practice of a summit’s host country inviting other participants to attend helps to ensure the representation of “potential opposing neighbor’s”.

3. Balance of economic power

The new balance of economic power that emerged in the 21st century is perhaps the single most important independent variable of the global governance multi-determinant model. The G20 itself was created due to the perception that global economic issues can no longer be handled without the participation of the emerging economies. Moreover, the economic variable of the share of global gross product and trade that now lies on the hands of non-developed countries (particularly the BRICS – Brazil, Russia, India, China and South Africa – the emerging markets that are projected to run the world economy by 2050) also influences the political independent variable of the “balance of world powers”.26

The G20 was originally created in 1999 as a forum for coordination between Ministers of Finance and Central Bank Presidents, in reaction to the crises in Asia, Russia and Brazil in the end of the 90s. At that time, with several economic crises occurring in the periphery of the world financial system, it seemed extremely important to create a proper mechanism to avoid that those and other countries got caught amidst an economic turmoil in the future due to lack of international coordination.

Ironically, the G20 was upgraded in 2008 to what some call the L20 – the group reunion at the Heads of State and Government level – due to another crisis, this time at the core of the financial system.27 In both cases, it is clear that the changes in relative participation of emerging countries in the global economy created an understanding about the need for more participation of non-developed countries in the economic decision-making fora. Kirton and Guebert, reviewing the first L20 Summit, evaluate that “by calling and hosting the summit, U.S. President George W. Bush admitted that America alone could not solve the problem and that it required more than the broadly multilateral IMF it controlled or even the exclusive G7 or G8 clubs to craft an effective response”.28

“The problem of American power in the twenty-first century, then, is not one of decline but what to do in light of the realization that even the largest country cannot achieve the outcomes it wants without the help of others”.13

An example that helps illustrate that the G20’s role as a participative decision-making board is only possible due to the economic rise of emerging countries, comes from the dialogues maintained between developing and developed countries in the early 70s regarding the reform of the international monetary system.29 After the monetary crisis of 1970, the Group of 77 – established in 1964 and comprising seventy-seven developing countries – argued that the non-developed countries should also participate in the efforts to design a new international monetary system. As a consequence, the Group of 24 was created to coordinate and unify developing countries in financial and monetary matters.

Some dialogue between the Group of 24 and the developed countries was maintained, but, due to structural changes in the end of 1973 and, most importantly, to the lack of political will of the developed countries, very few concrete outcomes were produced. Thirty-five years later, developed countries relied heavily on the new developing economic powerhouses to contain the 2008 international crisis. Today, the balance of economic power has changed in such a way that the developed countries cannot ignore the major emerging economies.

4. Consensus-building issues

Finally, it should be considered why the G20 is so effective in dealing with counter-crisis measures and economic stimulus plans, but much less effective in areas such as climate change and the WTO’s Doha Development Round.

Quite simply, one may say that a global governing body better deals with issues that have a higher degree of consensus than with issues that generate conflict between its members’ positions. This will be a great challenge for the
G20 in a post-crisis world, as the group moves from the role of a “crisis buster” to that of a global economic “steering committee.”

It is very difficult to attain consensus on international issues. The states’ representatives, even at the Heads of State and Government level, face at least three important constraints to their deliberative power: They must follow the major lines of their administration policies; they must answer to their domestic constituencies; and, as was pointed out previously, they should listen to the aspirations of neighbor countries that are “represented” by them.

As a result, it is evident that the G20 will operate in subjects that are in the interest of all of its members. Overcoming the 2008 crisis is a clear example. The decisions regarding tighter financial regulations were quite effective, since this was a consensus-building issue. Yet, the real test for the G20’s ability to become a real global governing body shall come in the form of decisions about polemic issues that divide the opinion of its members.

Flávio Campestrin Bettarello, a career diplomat, is Fall Professor of Economics at Instituto Rio Branco, the Brazilian diplomatic academy. He has a PhD in Behavioral Sciences from Universidade de Brasilia and a Masters in Diplomacy (International Law) from Instituto Rio Branco. From 2010 to 2011, he was a Visiting Scholar at the Georgetown University Law Center and a Fellow of the school’s Institute of International Economic Law. He was a delegate to the Pittsburgh and Toronto G20 Summits.

ENDNOTES

6. S. Huntington, “The Lonely Superpower,” Foreign Affairs, 18, no. 2 (1999): 35-49. The unipolar system (e.g., Ancient Rome, Ancient China) has one superpower, no significant major powers, and many minor powers. The superpower can effectively resolve important international issues alone, and no combination of other states would have the power to prevent it from doing so. A bipolar system (e.g., Cold War) has two superpowers, and the relations between them are central to international politics. Each superpower dominates a coalition of allied states and competes with the other superpower for influence among nonaligned countries. Finally, a multipolar system (e.g., Concert of Europe) has several major powers of comparable strength that cooperate and compete with each other in shifting patterns. A coalition of major states is necessary to resolve important international issues.
7. Ibid.
9. Ibid.
23. Even if China opposed Japan and the idea of another European country as a permanent member faced some resistance.

27 Some authors have called the “upgraded” version of the “Group of Twenty Finance Ministers and Central Bank Governors”, the original G20, as the L20, in order to indicate the Summit of Leaders (Heads of State or Government). It should not be confused with the ‘Labour 20’ (another L20), that comprises the elected representatives of trade unions from G20 countries, “the voice of workers”. Also of note is the existence of a B20, composed by representatives of business organizations from the G20 countries.


31 The first constraint is the easiest to overcome, as the Head of State and Government is the chief of his Administration. But even this “mild” constraint can become tricky. Political parties are involved, and many government officers have their own private agenda. Therefore, changes in the policies of the Administration do not depend solely on its Chief’s will. The other two constraints are much harder to overcome. In democracies, interest groups, lobbyists and the public opinion in general are the driving forces of a politician’s successes or failures. In non-democratic countries, as China, the elites, technocrats and members of the central party also play an important role. Regional interdependence also ties a country’s will to the interests of its neighbors. A major power is sovereign to take a course of action that goes against the interests of its neighbors, but this kind of decision has a cost that needs to be weighted.

Argentina’s 2001 Crisis: Similarities and Differences With Europe

Ezequiel Barbenza and Nicolás J.B. Caputo

With the escalation of the European crisis, several voices have started to propose an exit of the euro, accompanied by devaluation of national currencies. Advocates of this proposal suggest that it would allow for greater export competitiveness and thus a return to economic growth. To support this recommendation, the case of Argentina and its strategies for recovery from the 2001 crisis has often been cited. This article reviews the Argentine process and analyzes its similarities and differences with Europe’s current situation. It argues that an Argentine-style solution – as would be the case with other available options for peripheral European countries – has different winners and losers, and that such a choice would ultimately be political in nature.

The political and economic process of Argentina’s 2001 crisis

To understand the process of Argentina’s crisis it is necessary to go back to 1989, at the beginning of the presidency of Carlos Menem, from the Justicialista Party (PJ, Peronist). Like most of Latin America, the Argentine state was insolvent due to the debt created during the military dictatorship (1976-1983), a result of taking loans from foreign banks and granting subsidies in 1982 to 200 large companies that were excessively indebted. These decisions raised the share of public debt to external debt stock ratio from 53% in 1980 to 73% in 1983.1

The only viable option for indebted nations at the time was to accept the proposal made in 1989 by the U.S. under the Brady Plan. It consisted of a voluntary market debt restructuring through the conversion of bank loans to securities. The IMF and the World Bank would finance a fund to guarantee payments of interest, demanding in return structural reforms (trade and financial liberalization and deregulation, on the one hand, and privatization, on the other).

The Menem administration’s strategy was to produce a “shock of confidence” both in major local business groups, who had taken their capital out of the country during the 1980s, and in international banks, in order to restart the flow of foreign exchange into Argentina. The government had to reach a sustainable and credible financial program which involved: 1) implementing structural reforms demanded by the IMF and the World Bank; 2) stabilizing the economy; and 3) ensuring the political feasibility of reforms and economic stabilization.

Argentina implemented the most extreme and expedited structural reforms in Latin America, to the point that in 1991 they had largely been completed.2 However, the Argentine economy, with high levels of inflation, was far from stable. In 1991, neoliberal technocrats took over the Ministry of Economy and the Central Bank, and developed the new stabilization strategy, known as the Convertibility Plan. This meant a complete backing of the monetary base by Central Bank reserves through a fixed exchange rate of one-to-one parity between the Argentine peso and the U.S. dollar. That same year, monthly inflation was reduced from 27% in February to 1% in August.3 In practice, however, the government lost the ability to modify the nominal exchange rate, and as a consequence of the obligation to maintain a close relationship between the monetary base and reserves, the fiscal policy leeway was greatly reduced.

The political feasibility of this economic policy was assured by the PJ, a labor-based party with a weak central bureaucracy and no formal and effective rules or procedures. According to Levitsky, these features allowed PJ leaders to maintain their ties with their bases, and at the same time have the autonomy to adapt their program and alliance strategies to social changes.4 Thus, Menem guaranteed the political and social support needed to implement and maintain the structural reforms and the Convertibility Plan.
In 1992, under the Brady Plan, the Argentine government reached an agreement with creditors to restructure USD 23 billion of loans into securities. As a result, Argentina regained access to the international capital market after 10 years of isolation. Given the current account deficit and the end of privatizations in 1994, the government used the issuance of debt securities intensively in order to have the dollars needed to finance the Convertibility Plan.

The government had to reach a sustainable and credible financial program which involved: 1) implementing structural reforms demanded by the IMF and the World Bank; 2) stabilizing the economy; and 3) ensuring the political feasibility of reforms and economic stabilization.

As a consequence of the vulnerability of this balance of payments configuration, Argentina entered into a “confidence game”, as Santiso called it. The government relied on investors that bought debt securities (pension funds, mutual funds, insurance companies, local commercial banks) and risk evaluators that influenced investor’s decisions (rating agencies and investment banks). Meanwhile, both investors and risk evaluators were permanently monitoring the economic and political situation. This dependency blocked alternative economic policies and strengthened the position of the neoliberal technocrats, whose presence and decisions were considered a “sign of confidence” by the market.

However, this would prove insufficient. Investors and risk evaluators’ trust in the financial program sustainability deteriorated as a result of persistent fiscal deficit, increasing payments on debts, and the reversal of capital flows by external shocks (Russian crisis, deteriorating terms of trade, dollar appreciation and depreciation of the Brazilian currency, the real). In 1998, Argentina’s economy went into a recession that would last until 2002. The social situation was extremely impaired, with high unemployment (13% in 1998-99 according to the Argentine Institute of Statistics and Census - INDEC) and social protests.

The negative socioeconomic scenario benefited political forces in the opposition. In 1999, Fernando de la Rúa – the candidate from an alliance between the Radical Civic Union and a center-left coalition, the Front for a Country with Solidarity – was elected President. The new government supported the Convertibility Plan, but, unlike the PJ, this alliance offered low political assurances to investors and risk evaluators. Peronist unions returned to the opposition; the government controlled neither the Senate nor the main provinces, and internal dissent in the coalition was considerable.

In late 2000, the continuous increase in risk premiums led to an exclusion of Argentina of the international capital market. The government sought to reduce borrowing needs through a reduction of budget deficits (a mix of tax increases and heavy spending cuts) and short-term maturities (debt restructurings), supported by strong disbursements from multilateral lending agencies and local commercial bank loans. This strategy followed a catalytic approach, where the multilateral lending should encourage renewed investor confidence. It was a “market test”, according to the IMF. However, given the political inability to make more spending cuts, fiscal performance continued to deviate from the official targets. Finally, the loss of multilateral credit, after the withdrawal of IMF support, and social protests in response to high unemployment – which reached 18.3% in late 2001 (INDEC) – and freezing of bank savings led to the fall of De la Rúa’s government in December 2001.

The transitional Peronist governments (2002-2003) then declared a default on Argentina’s debt, the end of the Convertibility Plan, and a peso devaluation. Thanks to recovered competitiveness and rising prices of export products, in the second half of 2002 the Argentine economy entered a period of growth, with an annual average GDP increase of 7.5% over the past 10 years.

Comparing the current European crisis with Argentine experience is tempting due to the many similarities between the two, particularly the incapacity of governments to modify the nominal exchange rate. However, it is the differences that set limits for an Argentina-style solution for Europe.

Macroeconomics and politics in the European crisis-affected countries today seem to reflect the pre-crisis period in Argentina. On one hand, we have high and rising levels of unemployment, twin deficits (fiscal and current account), and a fall in the value of government securities. On the other, “reliable” technocrats control the command of the economic policy, and we find social protests, governments losing elections, and increasing political and social instability.

In Europe, the similarities with the pre-crisis Argentina occur mostly in the peripheral countries. In contrast, Germany has a healthy economy: current account surplus, balanced budget (-0.8% of GDP in 2011), and low unemployment (currently 5.5% according to the statistical office of the European Union – Eurostat). Moreover, since the euro entered into force, labor costs in peripheral European countries have increased to three times that of the central states (Eurostat). With a fixed exchange rate (the euro), this situation has led to loss of competitiveness and current account deficits.

Interestingly, the dominating fiscal model in Europe resembles the IMF’s “market test” strategy for Argentina. European Union (EU) peripheral countries, excluded from international capital markets, depend on multilateral credit used both to keep government finances afloat and as political leverage to force
spending cuts. In the medium term, the aim is to achieve a sustainable and credible financial program and regain market confidence – i.e. the trust of investors and risk evaluators.

However, as in the case of Argentina, this strategy exacerbates political and social instability. Its feasibility not only finds its limits in the economic incapacity to achieve financial sustainability, but, above all, in the political incapacity to produce structural adjustments against mobilized unions and increasingly adverse public opinion. Instead of market confidence, the real test of this strategy is the tolerance that a society can have regarding permanent adjustment without any perspective of improvement.

Nonetheless, it is in the very design of the economic structure that the main differences between the European and the Argentine cases lay. The Convertibility Plan generated a dependency on actors who lacked any commitment to Argentina's economy and fate. In late 2001, large investors and investment banks – major players in Argentina's debt issuance in the 1990s – pressured the IMF to force a default, as uncertainty was affecting investment in other emerging markets.7

By contrast, in Europe, the rigid design of the monetary and financial union has made peripheral countries dependent on Germany. Yet, this is an actor that, unlike the case of Argentina, has a greater commitment to the fate of the “dependent” ones. They are all members of the same club – the EU.

However, there are no supranational institutions that unify the EU's fiscal policy. The treasury of each country cannot borrow from the European Central Bank for fiscal purposes. The absence of an European Treasury prevents the issuance of European bonds to finance countercyclical fiscal policies.

Nevertheless, from the point of view of the current account, the fiscal issue appears as a secondary and endogenous factor to growth. This puts Germany in the center of the political decision-making to define Europe's exit strategy from crisis.

It could pursue two very different paths. The first would be adopting a "European solution" through the creation of supranational fiscal institutions, which would deepen the monetary union. It would implement an intra-European fiscal redistribution system that would allow lower deficits and thus open the way for the creation of European bonds as a new financial instrument. But if we consider that the cause of the fiscal problems of EU peripheral countries lies in growth and foreign trade, a deeper change in Germany's role would then be essential. It would need to absorb exports from the periphery and reduce its own trade surplus, and then become the engine of the region's recovery. The problem is that this would produce effects on the EU political balance that might not be acceptable to other large members of the union.

The second path, an "Argentina-style solution", would require that EU peripheral countries exit the euro, restructure public debt, promote a recovery of national currencies at lower prices, and change the economic structure in favor of specialization in tradable goods with high international prices. In this case, the big losers would be holders of these countries' debt – private banks that are in this case mostly German and French (even after the debt transfer to public sector produced by debt bailouts). In this scenario, the consequences for the EU of a non-voluntary debt restructurung (considering risk of contagion) and the exit of these peripheral countries from the Eurozone would be uncertain.

The current policy of fiscal adjustment represents a transfer of resources from the population into the financial sector. Its feasibility depends on the political ability to achieve a sustainable and credible financial program in a context of social protests. Essentially, a "European solution" would involve a transfer of income from Germany to the periphery of the EU, while an "Argentina-style solution" would hurt mainly private banks and produce major consequences for the European project.

Ultimately, the solution to the European economic crisis will be a political one, based on the choice of who will be the losers, and on the power of the eventual winners to impose their will.

EZEQUIEL BARBENZA has a BA in Economy from USAL and Paris I Panthéon-Sorbonne and an MA and PhD from the University Evry-Val-d’Essonne (France), where he also taught. He has worked at the OAS and at the Argentine Ministry of Economy. He currently is a professor at Universidad del Salvador and at Universidad Nacional Arturo Jauretche and is an advisor to the Economy Minister of Argentina.

NICOLÁS J.B. CAPUTO has a BA in Political Science from the University of Buenos Aires, MA in Security and International Relations from the Institute of Political Studies in Toulouse, and PhD in Political Science from the University of Strasbourg and Social Sciences at the University of Buenos Aires. He was a UNDP consultant and is currently an advisor to the Argentine National Congress.

ENDNOTES
3 Boletín de la Bolsa de Comercio de Buenos Aires, 25/11/91, p. 57
4 Steven Levitsky, Transforming labor-based parties in Latin America: Argentine Peronism in Comparative Perspective (Cambridge: Cambridge University Press, 2003)
7 Paul Blustein, And the Monet Kept Rolling In (and Out): Wall Street, the IMF, and the bankrupting of Argentina (New York: PublicAffairs, 2005) pp 159 - 162
The European Union—Brazil Strategic Partnership in the Shifting International Context

Ana Isabel Rodríguez Iglesias

The international economic crisis and the emergence of new global actors, such as China, India, or Brazil, have resulted in the displacement of the gravitational axis of the international economy from the West to the East and from the North to the South, with the corollary of an accelerated redistribution of structural power on the world scene. This shift creates a climate of uncertainty characterized by a paradox: the co-existence of a zero-sum competition for geopolitical influence and economic supremacy, and win-win cooperation due to the deepening of interdependence between traditional and emerging powers.

The world is today increasingly interdependent. That reality became evident when the crash of the U.S. subprime market triggered a worldwide financial and economic crisis in 2008. This current international interdependence is greater than that of the past because it not only includes more state actors, but also many more non-state actors, such as multilateral organizations, NGOs, militias, multinational corporations, among others. In addition, the evolution of communication and technology (Internet, phones, high-speed trains, planes, etc.) has greatly shortened the distance between economies, populations, and nations. In short, the new and traditional challenges states have to confront require cooperative solutions, since a lonely superpower cannot deal with global problems by itself.

The relationship between Brazil and the European Union reflects to a greater extent this phenomenon. Since 2007, their relationship has been mediated by a mechanism called the Strategic Partnership (SP), signed by both in order to strengthen and deepen their cooperation in an interdependent world.

When Brazil and the EU signed their SP in 2007, neither the Brazilian nor the European authorities knew exactly its implications. Back then, the SP was a “label” used to highlight the importance attributed to the relationship by both sides, but it had little practical meaning. Nonetheless, it resonated well in Brazil, since the EU already used this mechanism with other high profile countries, such as the U.S., Canada, Japan, and the rest of the BRIC countries (China, Russia, and India).

Like the EU, Brazil seeks a multilateral order; however, it starts from a lower position in the global arena. Brasilia tries to compensate for it by striving to implement an autonomous foreign policy agenda, with the final goal of increasing its international sphere of influence. Despite several nuances, the former president of Brazil, Lula da Silva, and the current, Dilma Rousseff, share the idea of a foreign policy oriented to the South and to emerging powers as a means to form a stronger Southern bloc capable of defying the established, imbalanced global order that exists today.

How compatible or confrontational are the foreign policies of Brazil and the EU? This article compares the logic of their respective external policies and looks into the implications for their own relationship, the Strategic Partnership, within the context of a reshaping of power in the international arenas that has accelerated since the economic crisis of 2008.

Are the Strategic Partnerships strategic?

Although its substantive meaning remains somewhat unclear, the Strategic Partnerships could be defined as instruments whose functionality consists of strengthening and deepening the EU’s relations with global, regional, and emerging countries – in this case Brazil – in order to confront the foreseeable waning of its power in the international system. Upon examination, this alleged “grand strategy” reveals that it does not work as a unified “umbrella” involving the ten existing SPs; rather, the EU has widened the number of SPs without following a clear criterion of selection, neither establishing a single, unified model of SPs, nor defining their implementation. This partial strategy, along with the complex structure of the EU’s foreign policy, weakens the EU position in global arenas, as the rest of its partners do not see it as a singular body, but rather as 27 poorly coordinated states. In that context, most third partners, in particular China, prefer to deal with EU countries bilaterally rather than with the union as a whole.

Although the SPs have been designed as a tool to strengthen relationships and create a climate of cooperation in a variety of fields, there is no expectation that the parties will converge in every dimension of their relations. Discrepancies, rivalries, and even conflicts could appear without undermining the original basis of the SP. Both partners move between values and interests: cooperation is pursued when both can benefit, and conflict is accepted as inevitable when they pursue different aims.

A rapid overview of the level of Brazil-EU coincidence in the multilateral system during the last four years shows irregular consensus. The most noteworthy disagreement took place at the Copenhagen Summit in 2009, during which Brazil, along with the rest of the BRIC, signed a bare agreement with the U.S. on climate change, leaving aside the EU’s more ambitious proposals on the topic. For the EU, this event led to a strong shock, known as Copenhagen’s syndrome, in which the EU first started to see the limits of its power. Until then, the EU’s self-esteem was very high, and it considered itself an international actor with a decisive voice on issues such as climate change.
The Iranian nuclear issue of 2010 was also a very controversial moment for the relationship. Brazil rejected the economic sanctions the U.S. and the EU had imposed on Teheran several times, alleging it was Iran’s right to be a civil nuclear power. Even worse, Brazil’s attempt to mediate the conflict alongside Turkey was frowned upon by both Washington and Brussels.1 Due to Iran’s unwillingness to halt its nuclear activities, Washington and the EU countries concluded that Iran had used Brasilia and Ankara to avoid new economic sanctions.2 The U.S. immediately put a new round of sanctions to vote in the UN Security Council, now counting on the support of China and Russia, while Turkey and Brazil remained against it.3

Although the SPs have been designed as a tool to strengthen relationships and create a climate of cooperation in a variety of fields, there is no expectation that the parties will converge in every dimension of their relations. Discrepancies, rivalries, and even conflicts could appear without undermining the original basis of the SP.

Brazil and the EU have also differed on many other issues, such as human rights in Cuba or humanitarian intervention in Libya, although for the latter there was no consensus within the EU.

In light of Brazil’s foreign policy, we can consider Brazil a partial – yet pivotal – strategic partner of the EU.

However, noting these disagreements should not prevent us from seeing a voting cohesion between the two within the UN. The EU and Brazil were on the same side of UN votes on security issues 60% to 70% of the time (from 2004 to 2009).4 Also worth mentioning is the wide variety of issues on which the two partners are continually making progress, with dialogues such as: air transport, competition, macroeconomic and financial issues, information society, disaster prevention and mitigation, and regional policy, to name a few.

The South axis: Implications for Europe

As mentioned, Brazil uses its foreign policy to create alternative governance fora through alliances with the South, such as the commercial G-77 within the WTO; regional integration, such as MERCOSUR (Mercado Comum do Sul, or Southern Common Market) or the recently established UNASUR (Unión de Naciones Sudamericanas or Union of South American Nations); partnerships with the more economically advanced emerging countries, BRIC or IBSA; and continental dialogues with African and Arab countries.5 Meanwhile, Brazil has discretely boycotted the international agenda of the U.S. and the EU, in an attempt to search for its own space in the global arenas.6

Brazil sees the BRIC forum as a platform to promote its goals, which are, primarily, a seat on the United Nations Security Council and a fair representation within other international institutions, such as the IMF and the World Bank. In addition, Brazil and the rest of the BRIC pursue better economic governance and a more stable and diversified monetary system. Those aims imply a zero-sum game, since to a certain extent the gains of Brazil signify losses for the EU, as in the case of the recent redistribution of power shares in the IMF and the WB.7

However, the challenge that the BRIC represents for the EU is only relative, as it is not a cohesive or coordinated forum; rather, it is a group of emerging countries with very different interests and perceptions of the global order, and with often conflicting ideas about how to achieve a more balanced system. Still the redistribution of power is indeed taking place, albeit slowly, and the EU and Brazil are fighting for the biggest prize.

Brazil also utilizes its region as a platform for major international visibility. The South American country is behind several regional integration processes, such as UNASUR or CELAC (Community of Latin American and Caribbean Countries), which aim to achieve more political cooperation, physical and energy integration, and social cohesion. The political logic of this new regionalism differs from the open-regionalism of the 90s, which was based on economic integration and had been supported unconditionally by the EU.

Accordingly, taking the new regional context into consideration, the EU is trying to update its traditional model of relations with Latin America. Brazil, as part of South America and the driving force behind the new regionalism, is a key element that the EU may consider when redefining its approach. The more horizontal and less paternalistic model of relations favored by Brazil could serve as an example for all of Latin America.

Another point of conflict/cooperation between the two partners is the cooperation for development. In a changing world with new emerging powers, and with traditional ones being strongly beaten by the current economic crisis, the drop in resources provided by the Western countries is coupled with the existence of new donors, such as Brazil, that contest the traditional OECD cooperation system and prefer to use their own methods, based on demand and without conditionality.8

Traditionally, Brazil has been an aid recipient, while the EU has been the biggest donor in the world (combining the contributions of the members states and the EU as a whole). Presently, the EU is about to approve a new agenda on cooperation, which seeks more efficient spending and concentrated aid to poorer countries. In addition, the Arab
Spring has captured the EU’s attention and has become one of its priorities in cooperation, as well as in humanitarian aid, in order to assure a stable and reliable Northern Africa. As a result, the EU may significantly reduce the resources given to the upper-middle income countries, such as Brazil.

Presently, the EU is about to approve a new agenda on cooperation, which seeks more efficient spending and concentrated aid to poorer countries.

Meanwhile, Brazil is taking room in this field, placing itself as a leader of South-South cooperation – mainly in Africa, but also in Latin America, both out of an interest in pursuing international prestige and out of solidarity.

Despite their different perspectives in the field of cooperation, which can be described as the Western consensus vs. the South-South cooperation, there is space for collaboration through triangular projects by complementing resources and abilities to assist a less developed third country. Similarly, the EU could look for a new kind of cooperation targeting more specific sectors, such as fiscal or institutional reform, so as to keep one of the links that has traditionally joined these countries, and prevent China from replacing the EU as a strategic partner.

Still strong trade relations

The SP does not include as one of its goals the achievement of a FTA (Free Trade Agreement) between the EU and Brazil, although the item is high on the agenda of both sides, each according to its own terms. However, the SP does make reference to the implementation of actions to develop trade, investments, and business between the EU and Brazil. Their economic relations were expected to improve thanks to the implementation of the SP, but the 2008 economic crisis, the Chinese booming demand for natural resources to the implementation of the SP, but the 2008 economic crisis, the Chinese booming demand for natural resources for development, which can be described as the Western consensus vs. the South-South cooperation, there is space for collaboration through triangular projects by complementing resources and abilities to assist a less developed third country. Similarly, the EU could look for a new kind of cooperation targeting more specific sectors, such as fiscal or institutional reform, so as to keep one of the links that has traditionally joined these countries, and prevent China from replacing the EU as a strategic partner.

The structural changes in the international system indicate the pressing need for traditional and emerging powers to redefine strategies to consolidate and configure their roles in global arenas. Although this search for a new space seems like a zero-sum game, the economic interdependence as well as other security challenges result in the search for more political cooperation in multilateral fora and bilateral agreements. In the specific case of the EU-Brazil Strategic Partnership, the structural character of the relationship will remain despite some temporary challenges, such as changes in government, the reform of the EU treaties, or even the current economic crisis. Nonetheless, discrepancies, tensions, and power bargaining are expected in the short and middle terms. Both actors should take advantage of the potential of their SP in order to overcome the current difficulties and exit the crisis with a stronger relationship.

ANA ISABEL RODRÍGUEZ IGLESIAS received a degree in journalism and obtained her MA degree in International Relations and the EU in Spain. Sponsored by the Fulbright Commission, currently she is a MA candidate in the Latin American Studies program at Georgetown University. She has worked as a journalist for different media outlets, and as a researcher and editor at the Institute for European Studies in Madrid.

Endnotes

1 Bruno Muxagato, “Les Relations Brésil/Iran et La Question du Nucleaire, Politique Etrangère 75, n.2 (Summer 2010).

2 Paulo Sotero, “Uma reflexão sobre a frustrada iniciativa Brasil-Turquia para superar o impasse nuclear entre o Irã e a comunidade internacional.” Política Externa, 20:3, Dec./Jan./Feb. 2011-12: 76.

3 Sotero, “Uma reflexão sobre a frustrada iniciativa Brasil-Turquia para superar o impasse nuclear entre o Irã e a comunidade internacional”, 76.


5 IBSA: India, Brazil, and South Africa.


7 Recently, emerging countries have achieved an increase in their power shares. Still waiting for the ratification of this revision of shares, the BRIC will see an increase in their representation within the WB of 2 percentage points (pp), and within the IMF of 3.8 pp. Brazil will gain 1 pp within the WB and 8 pp within the IMF. Consequently, the four countries will rank among the first ten countries in terms of power share. Most of these revisions took place within the G-20 meetings, which reveals that this new forum has institutionalized the emerging countries’ presence in the governance fora.


Globalization and Compensation in Hard Times: The U.S. Trade Adjustment Assistance Program and the Great Recession

Sarah Cleeland Knight

The Great Recession of the late 2000s ushered in a major change to the politics of globalization and compensation in the United States. This change illustrates that serious economic downturns can further extend what John G. Ruggie called the “compromise of embedded liberalism”, in which governments compensate groups that suffer losses associated with a free market in order to quell the anticipated political backlash on the part of those groups.1

The trajectory of the U.S. Trade Adjustment Assistance (TAA) – the most direct form of compensation the federal government provides to groups disadvantaged by globalization – has shown the depth of this change. Prior to the Great Recession, Congress had tied TAA program to legislation that pushed for further trade liberalization. Indeed, the program was originally established to compensate ex ante workers and firms who could demonstrate losses from the Trade Expansion Act of 1962, which gave the Kennedy administration broad authority to negotiate reciprocal tariff reductions through the General Agreement on Tariffs and Trade (GATT). Subsequent legislation on TAA over the past four decades was also tied to trade liberalizing measures such as free trade agreements and the granting of fast-track negotiating authority (also called “Trade Promotion Authority”) to the executive.

This tradition was interrupted in 2009, however, with the passing of the Trade and Globalization Adjustment Assistance Act, which doubled federal funding of TAA to nearly $2 billion per year and dramatically expanded the types of workers and firms that could participate in the program, without any accompanying trade liberalization. A close read of the legislative history of TAA program, including media reports and Congressional testimony from organized labor and business groups, reveals that the Great Recession was a necessary but insufficient condition for this de-coupling of compensation from further globalization. Although the political roots for this change stretched back earlier than the economic crisis, the crisis itself served as a necessary tipping point that broke the legislative limbo that until then had held TAA captive.

TAA’s Early Years: Enthusiastic Labor, Skeptical Business

The legislative vehicle that gave birth to the TAA was the Trade Expansion Act of 1962. The program during these early years was quite modest in terms of budget outlays. The criteria for participation in the program were exceptionally strict, so much so that no workers or firms actually received TAA benefits until seven years into the program, in 1969, when the eligibility criteria were first relaxed. Even with these restrictions, incorporating TAA into the Trade Expansion Act was welcomed by organized labor groups, while early skeptics included certain business groups and fiscally conservative Members of Congress from both sides of the political aisle.

The concept of a trade adjustment assistance program was originally proposed in the early 50s by one of organized labor’s leaders, David J. McDonald of the United Steelworkers Union.2 McDonald argued that direct government assistance – in the form of extended unemployment benefits, technical training, and health insurance, among other benefits – could compensate workers and firms injured by the increased import competition associated with lowering tariffs. Senator John F. Kennedy (D-MA) subsequently attempted to legislate McDonald’s proposal, and when he became president in 1961, he advocated for its inclusion in the Trade Expansion Act of 1962.3 As Kennedy wrote in 1962 in his “Special Message to Congress on Foreign Trade Policy”:

“Those injured by trade competition should not be required to bear the full brunt of the impact. Rather, the burden of economic adjustment should be borne in part by the federal government… [T]here is an obligation to render assistance to those who suffer as a result of national trade policy.”4

The concept of assisting groups disadvantaged by globalization was not universally welcomed, however. Certain business groups, which tended to be more fiscally conservative, and some Members of Congress from both the Republican and the Democratic parties were concerned that TAA could evolve into a permanent federal government subsidy. As Congressman Morris K. Udall (D-AZ) wrote in May 1962:

“I believe, too, that we must move with caution in the area of ‘trade adjustment’, the device designed to soften the impact of increased imports. I want to be sure any such procedures are purely temporary “adjustment” aid—and not the beginnings of a federal subsidy program similar to that in agriculture.”5

Some also questioned why workers who lost their jobs because of trade were entitled to benefits above and beyond those received by workers who lost their jobs for other structural reasons. These concerns were at least partially assuaged by creating strict participation requirements. Under the 1962 law, workers and firms were required to demonstrate both that they had experienced losses directly from “trade concessions” and that increased imports were a “major fac-
The Master of Arts in Democracy and Governance offers rigorous preparation for individuals interested in professional or scholarly careers in the field of democracy assistance and governance reform.

Georgetown's M.A. Program in Democracy & Governance is the most comprehensive degree of its kind in the United States.

- **Focused and Relevant Training**
  The program prepares students to understand the complexities of democratization and achieving accountable government.

- **Institutional Expertise and Reputation**
  Georgetown University is recognized around the world as a leader in educating and training students in research, public service, and the non-profit sector.

- **Opportunities for Practical Experience**
  Washington, D.C. is an ideal location to study how the theories of political change translate into the policies crucial to realizing it. Students gain first-hand experience through relevant internships, lectures, and conferences with leading policymakers and scholars in the field, and close interaction with a wide range of individuals working at the forefront of democracy assistance and political reform.

Visit us at http://cdacs.georgetown.edu

3240 Prospect Street, N.W.
Washington, D.C. 20007
202.687.0596
democracyresearch@georgetown.edu
tor” contributing to their losses. Only then would they could become eligible for TAA benefits.

Even with these restrictions, organized labor endorsed the TAA and signaled a willingness to accept further trade liberalization in exchange for the compensation. When the TAA was included into the Trade Expansion Act, George Meany, then president of the AFL-CIO, became an active and effective supporter of the trade legislation. Meany testified before Congress that the AFL-CIO supported the Trade Expansion Act, “…because we, and the nation … will gain far more than we will lose.” Meany even attended President Kennedy’s signing of the bill into law, and Kennedy thanked Meany personally in his remarks.

Organized labor’s support for the TAA did not last, however, and started to wane shortly after the passage of the Trade Expansion Act. For their part, business groups grew less skeptical of TAA, as long as such compensation was tied to legislation that pushed trade liberalization further.

TAA’s Later Years: Labor More Skeptical, Business More Enthusiastic

The chief complaint on the part of organized labor, which grew louder with each passing decade, was that the program represented, in essence, too little, too late for workers and firms experiencing losses from trade. A Democratic-controlled House and Senate responded to this complaint with changes to TAA embedded in the Trade Reform Act of 1974, which stipulated that no longer would workers and firms need to demonstrate losses directly from “trade concessions”; instead, they only needed to show that imports were a “substantial cause” of injury or the threat of injury.

Another large expansion to the program took place in the early 2000s with the Trade Act of 2002, passed under a Democratic-controlled Senate and a Republican-controlled House. Such expansions to TAA were always accompanied by some trade liberalizing measure, most often the granting of Trade Promotion Authority to the executive, which allowed the president to negotiate free trade agreements with other countries and submit those agreements to Congress for an up-or-down vote without amendment.

Due to this link between TAA and trade liberalization, business groups grew considerably more supportive of the concept of trade adjustment assistance. Broad groups such as the U.S. Chamber of Commerce and the National Association of Manufacturers became vocal in their support of TAA, along with industry-specific groups such as the American Paper Institute.

By the mid-2000s, however, a deep political divide had emerged between Democrats and Republicans over TAA, and further legislation on the program was held up at the committee level. Democrats, under pressure from the AFL-CIO and other labor groups, started pushing for expansions in TAA without any accompanying trade liberalization. Meanwhile, Republicans were not willing to decouple TAA from trade liberalization. This chicken-and-egg disagreement

<table>
<thead>
<tr>
<th>Name of Public Law</th>
<th>Changes to TAA Program</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade Expansion Act of 1962 (Pub. L. 87-794)</td>
<td>Established the TAA program to assist workers and firms dislocated as a result of reduced barriers to trade. Provided income support and funds for retraining.</td>
</tr>
<tr>
<td>Trade Act of 1974 (Pub. L. 93-618)</td>
<td>Expanded benefits and significantly eased the (previously rigid) criteria for those who could be compensated under the TAA program.</td>
</tr>
<tr>
<td>North American Free Trade Agreement (NAFTA) Implementation Act of 1993 (Pub. L. 103-82)</td>
<td>A “NAFTA Worker Security Act” established adjustment assistance for those workers and firms that suffered losses as a result of the NAFTA agreement (“NAFTA-TAA” program). Assistance to these workers and firms almost identical to that provided under the central TAA program.</td>
</tr>
<tr>
<td>Trade and Globalization Adjustment Assistance Act of 2009</td>
<td>Doubled funding for TAA. Expanded eligibility to include service-sector workers.</td>
</tr>
</tbody>
</table>

Sources: House Ways and Means 2003; Rosen 2008; Rosen 2002; GAO 2000
became so protracted that nearly all legislation concerning trade—including proposed bilateral free trade agreements, Trade Promotion Authority, and TAA—was held up on the House side with the Ways and Means Committee and on the Senate side with the Finance Committee.

As late as 2007, it appeared that any compromise on TAA was politically impossible. Republicans considered the option of first passing TAA as a stand-alone measure, with a promise from Democrats that Trade Promotion Authority (TPA) and possibly a bilateral free trade agreement would soon follow. But Senate Finance Committee Chairman Charles Grassley (R-IA) was suspicious that Democrats would not deliver on their promise: “They [the White House] should be very careful…we’ve got to look at whether or not we’re going to give the store away just to get [the TPA] reauthorized, and it may not get reauthorized.” Acting on this suspicion, President George W. Bush threatened to veto a stand-alone TAA-expansion measure that passed the House in October 2007. For their part, Democrats considered pairing TAA with a less politically-contentious piece of trade legislation, the U.S.-Peru Free Trade Agreement. But when Speaker of the House Nancy Pelosi (D-CA) publicly suggested such a possibility, the pushback from organized labor and other anti-trade groups was fierce. As Representative Marcy Kaptur (D-OH) vented: “They say, ‘We’ll put some Band-Aids on the casualties…But they don’t stop the pink slips.” Organized labor had become fully mobilized against trade liberalization in any form, even with TAA offered as a sweetener, and was only willing to support TAA as a stand-alone measure.

This legislative limbo ultimately was broken in 2008, when it became clear that the U.S. was heading into a deep recession. Congressional Republicans softened their position on TAA, at the behest of nearly all prominent business groups in Washington. These groups argued that passing TAA as a stand-alone measure would help to resuscitate the stalled trade agenda in the face of a major economic downturn and growing public dissatisfaction with free trade agreements. Groups active in the lobbying effort included the U.S. Chamber of Commerce, the Business Roundtable, the National Foreign Trade Council, and the National Association of Manufacturers. These groups, along with individual corporations such as Citibank, IBM, General Motors, and others, formed the Trade and American Competitiveness Coalition, which lobbied actively for TAA. Most of these groups had supported TAA in the past, but this was the first time they advocated for expansions to the program without accompanying trade liberalization.

Once Republicans made this first move to separate TAA from further trade liberalization, Democrats started making their own concessions. The first was an agreement to fund TAA at a lower level than the 2007 House bill had stipulated. This concession was initiated by Senate Finance Committee Chairman Max Baucus (D-MT) and Senator Charles Grassley (R-IA), a powerful Republican on the committee. Even so, the final markup essentially doubled federal funding of TAA to nearly $2 billion per year. The second major concession, brokered by (soon-to-be retiring) Senator Olympia Snowe (R-ME), an important Republican backer of the bill and a member of the Senate Finance Committee, was to fund TAA at this higher rate for only two years, rather than the 10 years originally proposed. Largely absent from this political process was President Barack Obama, who supported the compromise but did not actively advocate for it.

The Trade and Globalization Adjustment Assistance Act ultimately passed both the Senate Finance Committee and the House Ways and Means Committee by wide margins. In the Senate Finance Committee, the vote was 14 yeas to 9 nays. In the House Ways and Means Committee, the vote was 24 to 13. Such margins were remarkable given the bitter feud that had emerged between Democrats and Republicans over TAA.

Once the final markup on the House and Senate versions of the bill was complete, the Trade and Globalization Adjustment Assistance Act was incorporated into the economic stimulus package, also known as the American Recovery and Reinvestment Act of 2009. Beyond doubling the funding for TAA, the law also significantly expanded the types of firms and workers eligible to participate in the program. For the first time, service-sector workers, such as those in transportation and in the public sector, became eligible to participate. Also, in order to become eligible, participants no longer had to demonstrate that their losses (or threat of losses) were a direct result of imports. Rather, workers and firms injured by the movement of production to another country (including, importantly, China and India) could also apply for assistance. The law also broadened the types of upstream suppliers and downstream consumers that were eligible for the program.

Importantly, the Trade and Globalization Adjustment Assistance Act did not contain any provision on TPA, nor was it linked to a bilateral free trade agreement or any other trade liberalizing measure. Business groups signaled their satisfaction with the deal and its political necessity during the economic downturn. As John Murphy from the U.S. Chamber of Commerce told the press, “With this economic situation, everyone’s clearly drinking from the fire hose, but getting [Trade Adjustment Assistance] done should allow other work to begin on the trade agenda.”

Conclusion: A Return to the Pre-Crisis Equilibrium

The political roots of this de-coupling of compensation from further globalization reach back through the four-plus decades of the TAA program’s existence, particularly the growing dissatisfaction with TAA on the part of organized labor. The Great Recession served as a tipping point that broke the standoff between Republicans and Democrats over TAA. When Congress reconsidered TAA two years later, in a somewhat better economic climate, TAA was once again paired with a trade liberalizing measure, although this measure was quite modest in scope. In essence, there was
a return to the pre-crisis equilibrium on globalization and compensation.

The TAA Extension Act of 2011 funded the program through 2013, at only a little over $1 billion per year, or approximately one-half the funding level under the 2009 law. The 2011 legislation also included a provision to extend the U.S. Generalized System of Preferences (GSP), a program that allows duty-free entry of imports from certain developing countries. While not a significant measure in terms of its effect on overall trade volume, the extension of GSP was nonetheless contentious for organized labor groups, primarily because one of the GSP countries is Bangladesh, a major manufacturer of textile exports.16

Another indicator that the politics of globalization and compensation had returned to a pre-crisis equilibrium is the fact that one month after the passage of the TAA Extension Act, Congress approved three new bilateral free trade agreements, with South Korea, Panama, and Colombia. These agreements had languished for years at the committee level in both the House and the Senate. Back in 2009, Senator Charles Grassley (R-IA) had despaired of these agreements ever becoming law, and he blamed the Obama administration and Democrats in the House:

“The White House is not really interested in pursuing a positive trade agenda at this time, and neither are House Democrats. For the White House I think they know better, but they just don’t want to move ahead against different sorts of opinion within their own party. Maybe we’ll get to the Panama trade agreement next year, but I doubt that the current Congress will take up the Colombian trade agreement. And I have no sense that the administration has a plan of proceeding with South Korea.”17

Nonetheless, with a slightly better economic climate and a renewed TAA bill, Congress and the Obama administration moved forward on these agreements.

This case study of the TAA program during the Great Recession illustrates that serious economic downturns can extend what Ruggie called the “compromise of embedded liberalism”, in which governments buy the political will for a free market, including trade liberalization, by providing greater spending on social programs. The 2009 Trade and Globalization Adjustment Assistance Act, in contrast to earlier legislation on TAA, did not push trade liberalization further. But it is possible that by increasing TAA’s funding and eligibility in this way, the U.S. avoided the protectionist trade sentiment that the country had witnessed during the only directly comparable economic downturn – the Great Depression.
Patriotism and the
Reassertion of
Citizenship in the
United States

Eli Lovely

The Second Great Transformation

Karl Polanyi’s 1957 account of the transformation from agrarian to industrial modes of production argued that the destructive economic, social, and political consequences of the free-market experiment stirred vehement backlash in the form of nationalist fervor. Currently, we are witnessing how a shift from industrial to digital modes of production—the consequences of which were illuminated by the 2008 global economic crisis—has also fostered political backlash in the form of popular grassroots movements.

This transformation over time to digital modes of production has catalyzed the process of globalization, which has, in turn, also contributed to a deterioration of civic institutions, economic uncertainty, a declining middle class, a political environment beholden to corporate interests, and a mainstream media that limits discourse and fails to address the myriad of issues facing the citizenry. Such a confined discourse produced contradictions between a dominant ideology presented by mass media and people’s lived experiences. It also animated different “patriotic styles” among broad segments of the U.S. population aimed at reasserting citizenship within the polity and reviving a sense of belonging to something greater than oneself.

Variations in perceived wants and needs among members of the Tea Party movement and Occupy Wall Street reflected different patriotic styles used to reassert membership within the political landscape at a time of growing anxiety. The 2008 economic crisis converged with, and ultimately magnified, the political landscape at a time of growing anxiety. The 2008 crisis witnessed the deterioration of this sense of control; not only did it expose people to harsher economic conditions, but it also generated widespread fear, illuminated a powerful financial oligarchy, and animated a belief that the average citizen is unrepresented. Recent political malaise, then, stems from a not altogether different circumstance than the one illustrated by Polanyi. Citizens are upset by their inability to contribute to the political discussion. The perception of an out-of-touch political system confirms for many the belief that individual voices are meaningless relative to corporate interests, and have led some scholars to suggest that the very nature of U.S. democracy is threatened.

Recent movements responded to the contradictions between the dominant narrative projected by mass media, discussed below, and people’s lived experiences. Dislocating change sparked a response among politically active citizens concerned about the direction of the country and troubled by their feelings of disenfranchisement. Mass political mobilization in the United States converged around a reassertion of citizenship and patriotism as a method to not only “define the cultural shape” of the country, but to “claim the right to participate and influence political life” (emphasis added). The animation of patriotism is, somewhat ironically, an assertion of loyalty born out of desperation—a frantic waving of the flag in hopes of laying claim to one’s right as a citizen to be considered a valuable member of an egalitarian political community.

Such patriotic sentiments are naturally strongest among those members of society who feel most vulnerable to the sweeping tide of change. Members of the Tea Party feared the deconstruction of the traditional political hierarchy with the election of President Barack Obama, and came to equate economic and political woes with their diminished degree of influence within the American polity. The perception of a threatened political space strengthened the virulence with which activists voices proclaimed a need to “take back” America, and restore a traditional American society for which they felt a responsible attachment.

This is in contrast to another segment of the population that, despite similar feelings of disenfranchisement, interpreted their struggle as part of an effort to see the country evolve. Rather than obsess over a romanticized history threatened by Obama’s ambitious agenda for “change,” members of the Occupy Wall Street (OWS) movement were
disappointed by the lack of progressive change to a political system commandeered by corporate influence. Frustrations reflected not that Obama was different, but that he was not different enough, evidenced in his inability to actualize the “change” he expressed throughout the 2008 campaign. Above all, OWS promoted the need for elected officials to weigh fairly the preferences of everyday citizens against those of powerful corporate interests.

Despite vastly different styles of patriotism, both movements became a mechanism to assert the right to participate in politics within a political environment increasingly insulated and distant from the concerns and needs of the broader population.

Money, Media, and America

The transition to the digital age, characterized by an increasingly rapid flow of information and networking, as well as the rise of information-intensive industries at the expense of manufacturing infrastructure – has catalyzed the process of globalization, supporting the growth of global finance while at the same time rendering the U.S. more vulnerable to global economic shocks and downward trends. This latest economic transition is also characterized by the use of digital infrastructure at the expense of industrial modes of production, which traditionally provided jobs and served as the economic anchor of the middle class. The 2008 financial crisis brought into focus not only these issues, but also the extent to which powerful financial institutions controlled economic and political decision-making in the U.S. The crisis triggered deep-seated fear, anger, and confusion among a population that felt powerless to project their dissatisfaction.

The rapid financial sector growth over the last 25 years has given it greater influence over mass media, creating ideological biases that serve as a threat to deliberative civil discourse. While critiques of corporate or state-policy exist within mainstream media, discourse is generally confined, argues University of Massachusetts Professor Daniel Egan, to “relatively narrow terms of debate.” The phrase “corporate welfare,” Egan demonstrates, was transformed from a term introduced in the 1970s to highlight “structural inequalities in which corporate interests are privileged over human needs,” to a term “emphasiz[ing] free market principles and giv[ing] legitimacy to a politics of minimal state intervention in the economy,” thereby contributing to a dominant capitalist-motivated narrative at the expense of broad political debate. Media, it is argued, “while apolitical in formulation...has a conservative bias to the extent that the media are more likely to be seen as a means of maintaining society as it is rather than as a source of major change” (emphasis added).

Although mass media has a responsibility to help strengthen and support democratic processes, too often it has limited debate to a constricted channel of mainstream partisan dispute. While coverage suggests a wide ideological rift, U.S. political parties are less divided over “kind” than over “degree” of policy implementation. Politicians are polarized, albeit within the confines of a narrow debate. As Egan illuminates, discourse falling outside the confines of a conservative mainstream is repackaged, redefined by those who exercise power, and swept back into the current bearing a more acceptable meaning. Alternative political and economic solutions to contemporary issues – much like those touted by Tea Party and OWS activists – elude acknowledgement and are instead resigned to the sidelines. According to a 2011 article, “Newspapers and television networks have been rebuked by media critics for treating the [Occupy Wall Street] movement as if it were a political campaign or a sideshow.” Activists furthermore complain about the media’s unwillingness to accurately depict their reasons for protesting.

The rise of technology has increased the ability of those in power to disseminate ideology in service of political consensus. For many, the 2008 financial crisis exposed the hypocrisy of politicians that are deferential to corporate interests rather than to a population feeling threatened and excluded.

A recent article from the New York Times illuminates this point by demonstrating how sensitivity to large donors has weakened the Democratic Party’s accountability to Left-leaning voters:

“While some Democrats see [OWS] as providing a political boost, the party’s alignment with the eclectic mix of protesters makes others nervous. They see the prospect of the protesters’ pushing the party dangerously to the left...the protests should still make the party wary — in part because Democrats rely on Wall Street for significant campaign contributions.”

Once the representatives of the political left, Democrats have become as beholden to corporate influence as their Republican rivals. As Kupchan notes, “courting corporate donors and filling campaign coffers have thus become central ingredients — perhaps the central ingredient — in winning election to public office.” If political representatives are not pushing back against undue corporate influence, what means outside of mass mobilization exist to address the problem?

While the Tea Party and OWS share concern for economic woes and the wellbeing of their broader community, they diverge in their definitions of the U.S. and the nature of the threat against it. For the Tea Party – a predominantly white, male constituency – the threat against their idealized conception of the United States as a “Christian” nation is, by its very nature, existential, and adopts an illiberal, “nativist” character as a result. Nationalist symbols and mythology are frequently touted alongside virulent and often racially motivated anti-Obama propaganda equating him with former and contemporary U.S. adversaries. This resistance is a reaction to the perceived threat the Obama administration poses to the historic ethos of the country, and is evidenced by the convergence of the movement’s rise with both the 2008 economic crisis and Obama’s election to office. Further, the “birther movement” and its supporters contributed to
the projection of Obama as “the other”, at odds with their understanding of the country. In this respect, the Tea Party is an assertion “of an identity demarcating ‘us’ from ‘them’; the ‘them’ being… the authoritarian ruler suppressing civil society”, and the “us” being a assemblage of American patriots struggling to uphold “traditional” American principles found in the Constitution and imbedded in comforting ideas of “American exceptionalism.”7 Ignited passions against Obama also reflect his resounding success in the elections, and the feeling among many Tea Party members that traditional American values are at jeopardy. Whether Obama has actualized it or not, his candidacy alone embodied “change” over tradition, which to many meant the “transvaluation of values” that “denigate[s] the originally supreme values, replacing them with notions that… indeed bear on the original scale the negative sign”.8

Yet, as Polanyi explains, populations harboring anxieties and fears are subject to that narrative, promise, or ideology best able to provide an easy solution. Tea Party framing of Obama as a Manchurian candidate, an illegitimate outsider interloper, destroying the nation from within, is a more digestible explanation than the analysis provided by a host of scholars citing an inevitable U.S. downturn, regardless of the administration in power. These conspiratorial narratives exist within OWS circles as well, and have provided fodder for left-leaning extremists.9

For the OWS movement, patriotic sentiments were enflamed by the failings of the current system to live up to the country’s foundational democratic values and an uncertainty of the future. The hope of subordinating the economic crisis and its consequences to American democratic principles motivated the movement’s activism and, at times, its violence.10

The promise of democracy – characterized by “continuing responsiveness of the government to the preferences of citizens, considered political equals” (emphasis added) – and the failure to live up to it, provoked a strong reaction from divergent groups in the form of mass mobilization.11

The most recent protest movements highlight the failure of the “egalitarian promise of democracy” – the right to a political voice regardless of differences in social and/or economic standing.12 The 2008 crisis highlighted previously subdued structural fissures in the system, threatening that very promise. Enhanced corporate influence, for example, reflecting the contemporary digital age, called to question the salience of the individual citizen at a time of growing frustration and fear. Despite the right to vote, many American voters feel powerless, alienated, and subject to the pitfalls of economic circumstances that are beyond their control. The promise of political membership and the dominant political narrative projected through the mainstream media fail to correspond to a crisis-ridden environment characterized by the deterioration of citizens’ political voice and the exacerbation of economic, political, and social problems.

Cognitive dissonance resulting from the gap between the dominant narrative and lived experience fosters feelings of disenfranchisement that magnify the consequences of the latest economic transition and compel people to take to the streets to assert their political worth.

Patriotism is the mechanism through which activists make claims to their citizenship. In hopes of making their voices heard, members of the Tea Party and OWS have sought to use the authority of patriotism, imbued with the legitimacy it provides. Popular movements push back against the failings of the U.S. democratic experiment – the devaluation of citizen preferences relative to corporate interests – and illuminate the need for government to weigh equally the preferences of citizens “with no discrimination because of the content or source of the preference”.13 The danger is in the government’s inability to lessen the shocks of the transition to the digital age through democratic deliberation and political inclusion, making Obama’s 2012 election call for a “focus on nation building here at home” particularly pertinent. An inability to confront issues illuminated by the activists, followed by a subsequent loss of faith in the U.S. democratic experiment, may, as history bears witness, lead to the emergence of increasingly aggressive and malign demonstrations in the future.

Eli Lovely is a Masters candidate in the Democracy and Governance Program at Georgetown University. He was previously a Fulbright Scholar, and has worked at both the Department of State and the National Democratic Institute.

Endnotes


6 Ibid.


The Accountability Loop

For the past two years, almost any demonstration reported in the news has been, broadly speaking, in one way or another related to the economic crisis currently underway. People in Spain, Greece, Italy, Portugal, the United States, Chile, and Mexico went to the streets in response to the sudden inability of their governments to provide subsidies for basic food products, or because wages became too small to feed a whole family, recent graduates could not find a job, and taxes rose too much while social security benefits were being reduced. In most of these countries, ruling parties left office. However, this was in a way irrelevant. Given long-term trends of economic performance or existing agreements with financial supranational institutions, the crisis is not going to be resolved within an electoral calendar.

The demonstrations and the “punishment” vote against incumbents meant little more than a way for citizens to express their anger. On the one hand, this is a good sign: Even in moments of public distress and frustration democratic procedures were respected, as rallies did not include violence either by participants or by security forces, and elections maintained their free and fair nature.1 But on the other, questions remain about those being held accountable for the crisis, by which means, and if the democratic spirit is being maintained.

This article will address those questions by focusing on the U.S. and Europe. Non-elected actors of the crisis, including the heads of public financial institutions, banks, lobbyists, or bankers, have in general not been held accountable. How do we interpret this accountability loop? What are its implications? To what extent, and by which means, is it possible to find a solution? The argument that will be made is that the economic crisis has resulted in a weakening of democratic decision-making, as citizens have lost any means to either participate in that process or to hold accountable those who do participate.

Accountability and Public Agents

In its broadest perspective, accountability implies a principal asking its agent to explain decisions, actions, and results made and obtained in his or her name. Recent public policy approaches to accountability acknowledge that it appears in many stages of the agent-principal relationship, and that its success needs the active involvement of the agent, the principal, and any other intermediate actor. In that sense, Gordon Whitaker, Lydian Altman-Sauer, and Margaret Henderson suggest that it is considered as a four-stage process, disaggregated by answering four questions.2 Responsibility: Who is expected to carry out which actions or produce what results from whom? Discretion: Who is expected to invoke, interpret, or alter those responsibility expectations? Reporting: Who should provide what information to whom about how responsibilities are carried out? And reviewing and revising: Who is expected to use what information to make decisions about the future of the relationship? Furthermore, Philippe Schmitter proposes to analyze the attitude and behavior of citizens, representatives, and rulers before, during, and after a decision is made.3 For instance, citizen participation (before a decision), attention (during a decision) and obligation (after a decision) contribute to the success of accountability. Following the same timeline, this is strengthened if representatives mobilize their constituencies, compete with other actors to influence the decision-making process, and comply with the decisions taken. It is necessary that rulers are accessible to other actors, openly deliberate, and are responsive. On the other extreme, accountability will be more likely to fail if all those three actors exhibit opposite attitudes or behaviors during each stage of the decision-making process.

The current economic crisis can be interpreted as having two moments: first, the explosion of the financial bubble; and second, the adverse effects of the restrictive measures

12 Ibid, 111, 113.
16 Kupchan, 323.
17 Lydia Saad, “Tea Partiers are Fairly Mainstream in their Demographics,” USA Today/Gallup, April 5, 2010.
24 Huiskamp, 304.
25 Dahl, 2.
on public finances to try to correct the damage. Two sets of actors, elected and unelected, participated in these events. Elected politicians are the first set of actors that must be held accountable. In general, by action or omission they created the conditions which led to the breakdown of financial systems. In the U.S., for example, there are conflicts of interests between the private and public sectors. That reality became apparent in the exchange of personnel between Wall Street and governmental regulatory agencies; and in the poor detection of risky behavior such as excessive borrowing or lax lending standards, quick and substantial bailouts for troubled banks, and the maintenance of legislation that socializes losses. It might not be fair to blame politicians for the whole development of the crisis, but as citizen representatives they are endowed with the authority to design and implement national economic policies.

Elected politicians are voters’ agents, but in a limited fashion: Citizens grant politicians the responsibility to make decisions for them, but reporting is partial as voters might not know or understand what, why, or how the agent decides. In addition, elected officials have agent-principal relationships among themselves as executive agencies are agents of the legislatures; or, to use the scheme introduced above, the discretion of the executive power is limited by the legislature. In a democracy, this kind of relationship can engender more efficient accountability. Members of congress can mobilize their constituencies to explain what is at stake, they compete with the executive power to exert their influence over the decision being made, and they have more tools to require information from [other] elected politicians and officials. In parallel, rulers will be accessible to discretion and reporting requirements of legislatures, will deliberate with them, and will comply with eventual sanctions. While multiple points of contact between the two branches of government allow for an enrichment of accountability, citizens are the ultimate reviewers and revisers of the decisions made. They wield the powerful instrument of firing elected politicians by means of the vote.

**The Private Sector and its loop**

In theory, accountability of elected politicians brings about no major problems. The actions of agents will be (more or less) explained and rewarded or sanctioned. By empowering citizens, democratic procedures are nourished. In practice, however, things might not run that smoothly. Politicians can find ways to evade responsibility or to block accessibility to their decision-making processes. However, as mentioned earlier, at least in Europe, citizens held attitudes which could have led to a successful accountability (following Schmitter’s scheme, they participated and remained attentive to economic and financial policy decisions). This side of the equation is well understood. But on the other side, the situation is more complicated, and sometimes even bleak. The further we get from the citizen, the more diluted accountability opportunities are; that, in turn, makes actor’s contributions to the crisis more relevant, and in the process democracy fades.

Apart from politicians, a second set of actors that must be made accountable include the heads of national private financial institutions, which allegedly abused weak laws and regulations to achieve otherwise legitimate private interests. Though it is debatable whether they can be made accountable in the terms outlined above (what other action can their principals, people who put money in their banks, take other than to sue them?), they can be convicted in the courts. The problem is that legislation usually does not include provisions against certain kinds of risky behavior, and these actors took advantage of particular weaknesses of the law to obtain gains regardless of any future shared cost in which they could incur.

Elsewhere, we have the heads of supranational financial institutions, like the European Central Bank (ECB), or the International Monetary Fund (IMF). The latter along with the World Bank (WB) are infamous as the prime sponsors of the so-called Washington Consensus, which is viewed as a major cause for the severe crises of the 90s in Mexico and East Asia. These institutions, in theory, are the agents of governments that contribute to their budgets to maintain order and stability in the international or regional markets, and also countries that in stressful situations ask for their help.

But the implementation of the “contract” between actors and institutions suggests an opposite chain of events. In the current crisis, the IMF, ECB, and the European Union will review the reports from countries such as Portugal with regard to its expected unopposed compliance with cuts in public expenditure, tax increases, or wage reductions, which were the conditions to receive money to revitalize the economy. So far, unemployment and recession are still the trademarks of Portugal’s performance. In this inverted agent-principal relation, the citizen is not involved. The Portuguese liberal government was voted out of office and replaced by the conservative administration of Pedro Passos Coelho, but the conditions for the assistance were already negotiated and not much could be done by the Portuguese people. Citizens paid attention to the decision-making process, the government was responsible, and rulers were transparent. Conditions were thus set for a successful accountability, yet the crisis deepened and those agents, financial institutions, were not held accountable. Accountability presented a loop and democratic rules did not apply.

Finally, there is another group of unelected actors, the credit rating agencies, whose main role in the crisis was to, first, create illusionary confidence on debts and, second, to contribute to the “shock of reality” when liquidity problems already abounded. Initially, rating agencies granted good grades to mortgages that were worth nothing, as their value rested on further debt. As a result, banks had relative little capital in their books. The longer the chain of “debt-backed-by-debt”, the more diluted the real capital backup became, creating high levels of risk for the entire system. But it was not until the bubble exploded, around 2008, that the grades
for these instruments fell. Later on, governments acquired debt to re-capitalise the banks in order for them to meet their own debt obligations. However, over time confidence in governments’ capacity to repay their debts decreased, either because national economies did not grow as expected, or due to the emergence of other problems, such as the unsustainable ability of pensions systems (notably, as in Greece and Spain). Governments began to face the same situation that banks did some years earlier: they lacked the necessary liquidity to meet their debt obligations. As the situation grew more pressing, it became evident that national authorities did not reach an agreement on how to cope with these problems (like Italy before Berlusconi leaving office), which further undermined the credibility of governments to pay their obligations. The risker situation of sovereign debt led to credit rating agencies lowering the grades of such debts and governments raising interest rates. The result: governments asking for the help of international organizations, which set up strict austerity conditions for money lending.

The role of rating agencies in the crisis has two interpretations. First, these agencies were also caught within the original trap of debt, and as the financial markets became more complex, they were unable (or unwilling) to notice the deeply entrenched weakness of excessive lending. Second, they failed to update their financial markets analysis handbooks or observation methods, making them lose track of what was really happening. In either case, regulations over rating agencies are weak, leaving little space for potential sanctions. For private actors, opportunities to make agencies accountable are few. The banks, as principals of rating agencies, could try to bring about accountability by not hiring them again, or demanding a more careful observation of the financial environment.

Either because of this assumed pressure or to prevent their own credibility from falling, agencies were quick to notice governments’ problems in their sovereign debt. Governments-as-principals of rating agencies could not do much; agencies were doing their job. Citizens, once more, play no role here.

“Crime” and…

This article is an attempt to try to understand the challenges for accountability and democracy in the current economic crisis. It has been shown that the closer actors are to citizens, the easier it is to make them accountable, but the lower their responsibility in creating the financial environment which led to the financial crisis. This argument implies that currently citizens have little control over actors with real capacity to influence the public sphere and whose decisions directly affect them. Hence, the weakening of democratic decision-making procedures has become another by-product of the economic crisis.

However, would the absence of the noted accountability loop have prevented the crisis from occurring or attenuated its effects? More likely than not, the answer is no. Financial decisions are largely kept away from public discussion, and the expertise they require is usually unavailable to the average citizen. Furthermore, changing the personnel in charge of financial decisions during critical junctures (assuming accountability means firing incumbents and hiring replacements) might further contribute to instability and deepen the crisis; actors would not know what to expect from a new presence in the market, increasing its overall uncertainty and risk.

Thus, the argument made here is more a matter of political accountability than of financial accountability. Although the latter is not directly addressed, it is worth mentioning that the Third Basel Accord aims at increasing transparency in financial institutions, hoping to reduce the risky environment under which toxic assets were originally spread. Ulterior discussions could strengthen this aspect of financial markets. The problem discussed here is related to a political topic: Notwithstanding the permanence of democratic practices like the right to vote and protest, citizens have a reduced share in power distribution and exercise. Accountability loops show that, in the best case scenario, power has been dispersed due to the complexities of the financial market; in the worst case, it has been co-opted by private actors to achieve their goals at the expense of the public.

A way to counter this problem, as stated by Kunibert Raffer almost 20 years ago, is the enlargement of the decision-making process of the financial market and the creation of more spaces for contestation. Overcoming the accountability loop might or might not have a positive impact on the prevention of crises, but will certainly retrieve the idea that citizens are the most important principals in a democracy.

Pablo Estrada is a Masters candidate in the Democracy and Governance program at Georgetown University and is a contributor to the Democracy and Society blog of the Center for Democracy and Civil Society. The author would like to thank his fellow students at Georgetown for the discussions held on this topic and for the materials kindly shared from Barak Hoffman’s Politics of Economic Reform class.

ENDNOTES

1 The case of Italy is different. The President of the Council of Ministers Silvio Berlusconi was not voted out of office, but amid strong pressure from the financial market and debt-rating agencies, the President of the Republic, Giorgio Naplitano, asked him to resign. The formation of the new government was charged to Mario Monti, a former European Commissioner and made Senator for Life (a figure considered in the Italian law) some days before. A recount of the motives for Berlusconi’s fall is found in Rachel Donadio and Elisabetta Povoledo, “Berlusconi steps down, and Italy pulses with change,” The New York Times, November 12, 2012 http://www.nytimes.com/2011/11/13/world/europe/silvio-berlusconi-resign-italy-austerity-measures.html?_r=0. A rather critical view of Monti’s appointment is in “The Full Monti,” The Economist, November 19, 2011 http://www.economist.com/node/21538778.

2 Gordon Whitaker, Lydian Altman-Sauer, and Margaret Henderson, “Mutual accountability between governments and nonprofits: Moving


6 John Ferejohn, “Accountability and Authority: Toward a Theory of Political Accountability,” in Adam Przeworski, Susan Stokes, and Bernard Manin (eds.), Democracy, Accountability, and Representation, (Cambridge: University Press, 1999):133-134. In this paragraph I try to enrich Ferejohn’s scheme with the framework outlined at the beginning of this section.


9 A detailed account of the debt cycle that led to the crisis is in Jason Cox, Judith Faucette, and Consuelo Valenzuela Lickstein, “Why did the crisis spread on global markets?” in Global Money, the Good Life, and You. Understanding the Local Impact of International Financial Institutions, (Iowa: University of Iowa Center for International Finance and Development, 2010) http://blogs.law.uiowa.edu/ebook/sites/default/files/Part_5_2.pdf.


