INTRODUCTION

The Institutional Legacy of the Crisis of Global Capitalism

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1. GREEN SHOOTS OR FALSE HOPES

Two years into the first economic crisis of 21st-century capitalism, policymakers everywhere are anxiously awaiting signals of whether or not we have passed the nadir of the global downturn. Is the economy finally gaining traction after the worst economic crisis since the Great Depression? Will the 'green shoots' observed in global trade and US and EU equity markets, Chinese investments in public infrastructure, and Brazilian exports prove to be harbingers of a sustained economic recovery? As this book went to press in September 2009, economists from the Organisation for Economic Co-operation and Development, the World Bank, and the International Monetary Fund had come to endorse the view that the global economy was indeed stabilising (OECD, 2009).

The cascade into the greatest economic crisis since the 1930s began in 2006, with falling US house prices and rising defaults on US subprime and Alt-A mortgage loans. In February 2007, the Federal Home Mortgage Corporation, Freddy Mac, announced that it would no longer buy risky subprime mortgages and mortgage related securities. Next, the New Century Financial Corporation, a leading subprime mortgage lender, filed for bankruptcy in April 2007. By the end of July, investment bank Bear Stearns had liquidated two hedge funds heavily involved in mortgage-backed securities, and in August 2007, BNP Paribas, France's largest bank, halted redemptions on three investment funds. After a retail run in the fall of 2007, Northern Rock, a large UK mortgage bank, was eventually nationalised in February 2008. On 7 September, the two large semi-public mortgage banks, Fannie Mae and Freddie Mac, were placed in government conservatorship. On 15 September 2008, the American authorities let the 158-year-old investment bank Lehman Brothers fall, apparently without realising the consequence of triggering a worldwide credit freeze. Nobody knew which financial institutions (in the US or elsewhere) had bought into the dangerous subprime mortgages, and as a result, a severe crisis of confidence erupted in the fall of 2008. Because finance had become so globalised, when the housing and asset price bubble burst, the near collapse of the financial system spread rapidly across the entire world economy. The ensuing credit downgrade of AIG, the world's largest insurer, which had become involved in the Credit Default Swap (CDS) market, set the scene for a severe liquidity strain. This time, on September 16, however, the US government did come to AIG's rescue, with 85 billion dollars. In the midst of this predicament, a complete seizure of interbank money markets broke out, exposing the micro flaws of the internationally deregulated financial system. Morgan Stanley and Goldman Sachs ceased to exist as independent investment banks. Across the Atlantic Ocean, the Belgian-Dutch Fortis group was nationalised on September 28, and the next day the German Hypo Real Estate was saved, under government pressure, by a 35 billion euro life support injection from other financial institutions, while the Icelandic government nationalized the Glitner savings bank. A massive credit crunch subsequently threw the global economy into the worst financial crisis and recession since the 1930s.

While financial conditions may have started to ease, the jury is still out on whether 2010 will indeed bring a 'V-shaped' upturn, with its much hoped-for swift return to pre-crisis levels of growth. But given the severity of the crisis, we could also be heading for the beginning of a longer, more drawn out, slow and weak 'L-shaped' recovery. For the advanced economies, this would be akin to the experience of Japan's 'lost decade' of the 1990s. Worse still is the horrific scenario of a 'W-shaped' economic nightmare, whereby an apparently swift recovery, paid for by ballooning budget deficits, triggers runaway inflation which in turn can only be reined in with an aggressive hike in interest rates by central banks, setting the stage for a second deep recession in the aftermath of the present crisis. There is a fear that the unprecedented supply of cheap money from public authorities is setting the stage for another bubble. With such uncertainty, is talk of 'green shoots' premature? Perhaps it is only a mirage, a temporary fluke improvement in an otherwise severely battered and highly vulnerable global economy?

There is every reason to remain cautious about forecasting economic improvement. In the years ahead, various aftershocks, caused by the momentous economic contraction of the global downturn, will have to be reckoned with.

First, there is the aftershock of the looming crisis of unemployment. Unemployment usually lags behind general economic activity by roughly a two- to three-quarter delay, so labour market conditions in the advanced industrial world are expected to worsen in the coming years, even as stock markets improve across the globe. US unemployment is currently just below 10%, while in Europe unemployment has already reached double digits in many countries. Most worrisome is the surge in youth employment: in Latvia, Italy, Greece, Sweden, Estonia, Hungary, Lithuania, France, Ireland, and Belgium, youth unemployment has crossed the 20% threshold, and in Spain it is over 30%.

Even a tepid economic recovery will be insufficient to compensate for the job losses incurred during the crisis. Increasing unemployment will result in mortgage defaults and rising insolvencies, which will have an adverse feedback effect on the already weakened banking system. Their reduced appetite for lending could, subsequently, trigger another contraction in the financial sector with another round of disrupting effects for the real economy.

Second, there is the aftershock of the pension crisis. The sharp fall in equity markets has severely affected the value of pension fund assets, jeopardising pensioners' incomes in countries with large private pension provisions. In many western economies – especially the US and the UK – public pensions have been retrenched over the past two decades. Instead, people have been given incentives to choose their own private pension arrangements. Many have used real estate as investment for old age savings, feeding into the growth of the financial industry, which now has collapsed, bringing their savings down with it. For Europe, the dual challenges of the economic crisis, combined with the expenditure pressures of the ageing population, mark a real stress test for public finances.

Third, there is the aftershock of a fiscal crisis of the state. Costly bank bailouts, tax cuts, and other stimulus measures have drained the public purse. In Europe, the automatic stabilisers of comprehensive social insurance could result in a double bind of rising social benefit expenditures combined with declining government revenues. Declining population levels have already resulted in a shrinking work force, which significantly reduces tax revenues, even independently of the crisis.

Finally, there may be all kinds of political aftershocks. Once the recession subsides, elevated public debt-to-GDP ratios will make fiscal consolidation imperative. This will require tight fiscal control and painful cuts in Europe's cherished welfare programs. Yet retrenchment of social expenditures will certainly be met with strong public opposition, so it is politically unrealistic to count on rebalancing the budget solely through reductions in expenditures. In addition, taxes will have to be raised in the final stage of fiscal consolidation in order to pay down public debt even, though this could negatively affect growth prospects and leave little room for addressing newly emerging social needs.

Because of these likely economic, social and political aftershocks in the labour market, banking system, pension system, public finance, and social spheres, there is a real danger of the crisis persisting for more than just a few bad years. Japan's 'lost decade' following the crisis in the early 1990s provides a worrisome antecedent (Koo, 2008). Nevertheless, according to the OECD, we should count our blessings; a complete collapse of the world economy has been prevented. It appears that we are through the deepest waters of the economic contraction, and a nascent recovery is underway. However, caution is still warranted: a self-sustaining recovery in the real economy will only begin when private economic actors are again ready and willing to take over.

2. THE POLITICS OF ECONOMICS

The full political implications of the economic crisis are impossible to discern at present. Yet there has been one obvious shift: public authorities – especially governments and central banks – have taken an unprecedented hyperactive role in response to the credit freeze panic. Suddenly, in mid-2007, the state (re-)emerged as a key strategic economic actor. Faced with an exceptionally deep crisis, most advanced economy governments showed little inhibition in pursuing bold strategies of crisis management, on a scale truly unthinkable only a few years ago. This happened despite the standing hegemony of neo-liberal doctrine, which proclaimed unequivocally that government was the problem and markets the solution. Since the crisis, most observers would agree that the public authorities' activist crisis management strategies have succeeded in forestalling a much darker scenario – a rerun of the Great Depression. It is no exaggeration to claim that the state – or rather the taxpayer – has saved modern capitalism from meltdown.

The initial measures of crisis management concentrated on stabilising the financial system, often by bailing out overly indebted systemic banks. Meanwhile, central banks turned to reducing interest rates to close to zero percent, while simultaneously pumping hundreds of billions of euros and dollars into the world's weakened banking systems through quantitative easing. As the credit crunch started to affect the real economy, fiscal authorities turned to dazzlingly aggressive stimulus packages and tax cuts in the hope of further stimulating consumer demand. Many governments – especially China – invested heavily in public infrastructure projects. In Europe, numerous states have introduced wage subsidies, expanded short-term unemployment benefits in order to preserve existing jobs, and enacted new training programs and other active labour market measures. At the time of writing, governments on both sides of the Atlantic were considering tougher remuneration rules for bankers, regulatory caps on bank bonuses and golden handshakes, as well as a new regulatory regime for hedge funds. The EU is hoping to be able to enact more systemic and intrusive regulation of European financial markets, including credit agencies. In sum, public authorities have left no interventionist stone unturned in the face of the first economic crisis of 21st-century capitalism.

The powerful and unexpected resurgence of state intervention has reinforced the truism that without the state, market economies would not be able to thrive. Without public authorities capable of exercising legitimate coercion, capitalism would be impossible. This is what the economic anthropologist Karl Polanyi has called the 'embeddedness' of economics. Effective market allocation depends, first and foremost, on the political protection of property rights and contract laws. In his *The Great Transformation*, Polanyi shows that public intervention and regulation have historically played a decisive role in the institutional separation of society into an economic and political sphere by providing a supportive framework in which markets can prosper (Polanyi, 1944; 1985). The notion of embeddedness underlines the fact that economic activity is created and shaped by political decisions, social conventions, and shared norms and understandings. Although free markets are often misperceived as natural, sovereign, self-contained, and self-regulating, a market economy cannot exist independently of the society and rules in which it is located.

Embedding markets is essentially a political activity of institution-building. Institutions are enduring rules for making important (economic) decisions. The most important economic institutions are, of course, property rights. Property rights are assigned, restricted, qualified, and regulated by political decisions. Modern capitalism not only requires regulatory systems at the micro level, but also effective macro institutions, both monetary and fiscal. Although redistributive institutions such as unemployment benefits, public pensions, education, and health care are provided for through non-market arrangements, they are nevertheless intimately connected to the private market economy, through which they are financed and for which they perform stabilising and productive functions. Thus, social protection, despite not being market-generated, does serve to embed mature capitalist economies. All of the above institutional features of advanced market economies have a significant impact on production, resource allocation, regulation, economic growth, levels of productivity and employment, and the distribution of goods, services, incomes, and wealth (Granovetter, 1985; Swedberg, 1987; Maier, 1987).

As politics defines and qualifies property rights, it demarcates boundaries between the political and the economic realms of society. For advanced capitalism, it is imperative that the state allows the market to function relatively autonomously. Today, that very requirement commits the state to more rather than less activism, forcing it into expensive and radical measures of crisis management. Yet even during the neo-liberal globalisation period, it would be a mistake to think that the state withdrew from the management of advanced market economies. Admittedly, in most cases the dominant trend was toward privatisation and deregulation, but it should be emphasized that economic liberalisation is also a form of politically sanctioned state activism. There is also plenty of evidence of public interventions beyond liberalisation (Levy, 2006). Many European governments have been able to reconfigure labour markets and to re-orient social spending towards measures to promote employment through active labour market policies, while at the same time, for example, stepping up support for childcare in an attempt to encourage more women to enter the workforce (Hemerijck and Eichhorst, 2008).

In times of crisis, politics and economics become inseparably linked, and the precipitous return of the state to economic affairs is surely not the result of an unchallenged or widely shared political consensus. Severe economic turmoil always polarises political debate and economic analysis. Different economic and political actors disagree over what kind or how much intervention is called for in these unconventional times. In the op-ed pages of financial journals, a truly fierce intellectual dispute has emerged between the Nobel Laureate in economics Paul Krugman and the popular economic historian Niall Ferguson (2008). Krugman (2008) advocates a drastic Keynesian fiscal stimulus response to the crisis, whereas Ferguson – making a case for fiscal conservatism – critiques aggressive Keynesianism as a recipe for hyper-inflation, spiralling US fiscal deficits, and the ultimate demise of the dollar (Lynn, 2009).

In addition to these intellectual debates, governments have also come under fierce attack by their citizens. Mass unemployment, rising poverty and inequality, cuts in public sector pay and services, and reduced pensions and social benefits bring enormous pressure to bear on elected politicians. Moreover, governments have used tax revenues to bail out banks, whose CEOs continue to rally against more intrusive regulation. This confronts elected leaders with the daunting political challenge of communicating these 'pro-business' interventions (which arguably do avert further economic distress) to citizens in the real economy whose jobs, savings, and pensions are at risk. When banks receiving taxpayer support continue paying huge bonuses out to top executives and traders, such a political predicament can potentially become explosive.

Such pressures can even lead to the overthrow of ruling parties. The recent government turnovers in Iceland, Latvia, Hungary, the Czech Republic, and Greece are the first political repercussions of the crisis. The 2008 election of Barack Obama as President of the United States of America can also partially be attributed to the crisis. Similarly, the significant gains of the far right, populist, anti-EU, nationalist parties in Denmark, Austria, Hungary, the Netherlands, and the UK in the June 2009 elections for the European parliament reveal how the crisis and fears of unemployment can fuel xenophobia and protectionist sentiments. Finally, the landslide victory of the centre-left Democratic Party of Japan over the long-standing Liberal Democratic Party in the August 2009 general elections is the most recent example of such punctuated political change.

In addition, the crisis has led to a fundamental debate about the role of central banks. The goal of inflation targeting has, for at least two decades, been the neutral *modus operandi* of central bankers. However, with the crisis, this has become highly politicised. German chancellor Angela Merkel attacked the loose monetary policy of the European Central Bank (ECB), whereas Mervyn King, governor of the Bank of England, has been equally unconventional in his open critique of the huge fiscal deficits accumulated by the UK Labour Government.

Political strife over crisis management also features in the international arena. After the bankruptcies of Landesbanki and Icesave, which triggered the downfall of the Icelandic krona in the fall of 2008, Iceland has applied for membership of the European Union in hopes of joining the stable euro. The Netherlands and the UK, however, have made Icelandic EU membership contingent on a 4 billion euro reimbursement of British and Dutch savings lost in Landesbanki and Icesave.

On the European continent, moreover, most leaders prefer tougher, more intrusive, and systemic financial sector regulation. The Brits, on the other hand, fear that an overly ambitious European framework of financial market regulation will stifle the City of London's future room for manoeuvre in the global economy. An unresolved outstanding issue is the extent to which national rescues of ailing industries is in accordance with EU single market legislation.

Then there remains the fundamental disagreement between the US and the EU over the necessary aggressiveness of fiscal stimulus packages. European leaders, such as Angela Merkel and Nicolas Sarkozy, worry about the disturbing lack of attention paid to the medium- and long-term consequences of Obama's 800 billion dollar stimulus program. To the extent that the crisis is a crisis of excessive debt, which in the US is already three times gross domestic product, Europeans maintain that it cannot be solved by incurring further debt. What exit strategy does the Obama administration have in mind to restore fiscal responsibility and sustainable economic growth?

In short, the global financial crisis, together with its economic and social aftershocks, is very likely to fundamentally shape the narrative of politics and, as such, the outlook for social and economic policy reform in the decades ahead. Communicating and explaining policy measures, as well as finding effective and fair solutions of crisis management that citizens consider legitimate, form a key political precondition for a sustainable economic recovery. The political management of the social, fiscal, and emotive aftershocks of the crisis is surely a tall order.

3. FROM 'EMBEDDED LIBERALISM' TO THE 'WASHINGTON CONSENSUS'

Deep economic crises are moments of political truth. They expose both the strengths and weaknesses of existing policy repertoires and institutional structures. As a consequence, they encourage fresh thinking about the institutional arrangements embedding contemporary market economies. In the aftermath of both the Great Depression of the 1930s as well as the crisis of stagflation (low growth and high inflation) in the 1970s, economic and social policy regimes were transformed in quite fundamental ways.

The Great Depression and the Second World War have had a profound impact on the institutional architecture of North America and Western Europe after 1945. The experience of the deflation in the 1930s as well as the foolish adherence to the gold standard led post-war policymakers to embrace Keynesian economic management (Temin, 1989). The extent of market regulation and social protection differed from one country to the next, but governments in all advanced democracies took an active and strategic role in the stabilisation of the economy and the distribution of post-war prosperity. The lessons of mass unemployment and debt deflation from the Great Depression were taken to heart. Social protection came to be firmly anchored in an explicit normative commitment to granting social rights to citizens, protected by the nation-state. An impressive set of welfare programs was developed: an expanded education system improved the equality of opportunity; a comprehensive health insurance system spread the benefits of health care to the population as a whole; and a full range of income transfer programs – unemployment insurance, workers' compensation, disability benefits, old age pensions, survivors' benefits, children's allowances, and social assistance – were introduced to protect citizens from the economic risks associated with modern industrialism. The mixed social and market economy was based on the axial principle of full employment for male breadwinners and promoted a growth-oriented industrial policy to achieve this end. The dominant consensus among policymakers was that governments, collective bargaining, and the welfare state had key roles in 'taming' the capitalist economy through Keynesian demand management and market regulation. In trying to understand what went wrong in the Great Depression, Keynes introduced a completely new brand of economics focusing on the study of the behaviour of the economic system as whole, rather than the behaviour of individual actors. If the Great Depression gave rise to Keynesian economics, the 1950s and 1960s vindicated Keynesian demand management as a standard tool of economic policy. Keynesian macroeconomists in academia and public office proclaimed that enduring recessions would be a thing of the past.

The objectives of full employment and welfare protection were supported at the level of the international political economy by what John Ruggie later described as a regime of 'embedded liberalism'. On the one hand, governments encouraged the liberalisation of the economy through successive rounds of GATT negotiations that slowly broke down the regulatory regimes and trade barriers put in place during the Depression and the Second World War. On the other hand, the expansion of social programs compensated for the risks inherent to economic liberalisation. Western governments embraced the change and dislocation that comes with liberalisation in exchange for containing and socialising the costs of adjustment (Ruggie, 1982). As a consequence, the constraints imposed on national economic policies by the classical gold standard were relaxed, and the pursuit of 'free trade' was replaced by the goal of non-discrimination. Against the backdrop of the Cold War, the goal of price stability was sacrificed when this was deemed necessary to maintain an open international economy (Maier, 2009). The Bretton Woods monetary system of stable exchange rates laid the groundwork for the regime of embedded liberalism, allowing national policymakers freedom to pursue relatively independent social and employment policies without undermining international economic stability. It should be emphasised that the compromise of embedded liberalism was tailored to a world in which international competition remained limited and foreign investment was conspicuously based on a regime of capital controls.

The era of embedded liberalism was an era of institution building. The post-war domestic and international communities were resolved to contain the economic and political instabilities of the 1930s and 1940s. At the international level, the United Nations, the World Bank, the International Monetary Fund (IMF), and the European Community were established. Together, the Bretton Woods institutions, the national welfare state, and the European Community were all launched with an eye on avoiding the crises of the early 20th century. During the Golden Age of economic growth between 1945 and the early 1970s, each of the advanced industrial societies developed their own country-specific brands of mixed economy and welfare capitalism. What came out of the post-war era was therefore an international system of national capitalisms, not a global economic system (Berger/Dore, 1996; Berger, 2005; Rodrik, 2007).

Despite the historically unprecedented achievements of the post-war mixed economies in promoting civil liberty, economic prosperity, social solidarity, and public well-being, there is, of course, no such thing as an institutional regime for all seasons. In the late 1960s, the post-war celebration of unprecedented growth and social solidarity through democratic politics was already giving way to doubts. Rising inflation as a result of wage explosion and the resurgence of worker militancy and social protest confronted the sober and consensual political economies of the post-war era with a new political context, reflecting the new levels of economic prosperity and social expectations. The era of embedded liberalism came to end in the mid-1970s as the two oil shocks revealed contradictions in the mixed economy and welfare-friendly regime of embedded liberalism; specifically, its inability to contain inflation under conditions of near-full employment. Furthermore, increased international competition and de-industrialisation came to undermine the effectiveness of domestic Keynesian demand management. This led to a massive surge in unemployment, not seen since the 1930s. As Keynesian economists continued to analyse macro-economic performance in terms of a trade-off between employment and inflation, they lost their intellectual edge. After the second oil shock in 1979 led to tightened fiscal and monetary policies in the early 1980s, the world economy entered its severest slump yet. High inflation, mass unemployment, and sluggish growth provided an opportunity for an intellectual and political break with 'embedded liberalism'.

The crisis of stagflation thus set the stage for a political return to more unfettered market economies, away from public ownership, excessive regulation, and generous levels of social protection. The election of Margaret Thatcher and Ronald Reagan in 1979 and 1980 respectively, brought the belief in the primacy of self-regulating markets and a minimal state back into the limelight. The state was identified as the source of the problem of stagflation, as it was believed to distort the natural workings of the market. Beginning in the 1980s and gathering momentum in the 1990s, neo-liberal doctrines of fiscal discipline, low inflation, financial liberalisation, labour market deregulation, privatisation, and the marketisation of welfare provision from regulatory constraints gained precedence in the management of advanced market economies. However, it should be remembered that neo-liberalism did not spell the waning of state activism, but instead the redeployment of government initiatives to the new mission of liberalisation, deregulation and privatisation. State authorities shifted from a market-steering orientation to a market-supporting orientation.

Neo-liberalism lasted until the onslaught of the current crisis. What neo-liberalism stands for exactly is far from unanimously accepted. This is because neo-liberalism, unlike the academic concept of 'embedded liberalism', is most often used to denote an ideological political position. At a very general level, I associate neo-liberalism (based on the ideas of Wolfgang Streeck and Kathy Thelen) with the secular expansion of market relations inside and across the borders of national political economies. The key goal of neo-liberalism was to free up markets, institutions, rules, and regulations, which under the post-war settlement of embedded liberalism were reserved for collective political decision-making. With due caution, it would therefore seem justified to characterise neo-liberalism as a broadly based process of 'institutional liberalisation' of the fairly organised forms of capitalism that emerged out of the era of embedded liberalism. If the era of embedded liberalism was a time of institution building, then the era of neo-liberalism is best understood as a time of institutional disembedding. Important qualifications notwithstanding, the neo-liberal transformation in the 1980s and 1990s made modern capitalism more market-driven and market-accommodationist, releasing ever more economic transactions from public-political control, and turning them over to private actors and contracts. Throughout the advanced world, price stability rather than full employment became the principle objective of macro-economic policy.

As the global economy started to pick up in the second half of the 1980s, European economies were behind the curve compared to the stronger rebound in countries like the US and Japan. The European Commission, under Jacques Delors, rose to the occasion by introducing the concept of the Single Market, promoting privatisation and deregulation in an attempt to open up national markets. The Single European Market Act of 1986 was negotiated at a time when neo-liberalism was riding high. Neo-liberalism's view of the welfare state system was well summarised in the OECD Jobs Strategy, published in 1994, which launched a critical attack on the 'dark side' of double-digit unemployment of many of its European OECD members (OECD, 1994). Unemployment rates in France, Germany, and Italy were twice as high as in the US, and the 'prospect for survival' of the mixed economies of Western Europe was recognised as poor. The OECD economists singled out the accumulation of perverse labour-market rigidities that impeded flexible adjustment, blocked technological innovation, and hampered employment and economic growth. Downward wage rigidity was once again seen as the principle obstacle to full employment. Moreover, strong 'insider-outsider' cleavages with unfavourable employment chances for young people, women, the elderly, and the unskilled prevented the rigid European labour markets from replicating the higher employment rates of the US, the UK, or New Zealand. The fundamental European dilemma was conceived of in terms of a trade-off between economic efficiency and equality, growth and redistribution, competitiveness and solidarity. The policy recommendations that followed this analysis included retrenchment, deregulation, decentralisation, and privatisation. To its credit, in strengthening competition, neo-liberalism did help to lower prices and sober up public finances. It permitted higher rates of non-inflationary growth, and thus promoted prosperity in the US and the EU.

Because of neo-liberalism's emphasis on capital mobility, it is closely associated with the process of globalisation. Indeed, it was not until the 1980s that the world economy returned to the same level of capital mobility, foreign direct investment, and trade that it had achieved under the first wave of globalisation between 1870 and 1914. Globalisation is a catch-all phrase and a multifaceted concept. Broadly understood, it refers to the profound changes in the organisation of the world over the past quarter-century, especially with respect to the intensification of worldwide economic integration. Globalisation concerns the acceleration of the processes in the international economy and in domestic economies that operate toward unifying world markets (Berger, 2005). It describes the increasing cross-border flows of goods, services, and finance, the liberalisation of trade, geographically dispersed subcontracting and outsourcing of tasks, the increased propensity towards international migration, the spread of technological innovation, the increased role and weight of multinational companies, and the intensification of communication exemplified by the spread of internet use. A new wave of globalisation allowed for unprecedented levels of wealth, serving to lift millions out of poverty worldwide. Most economies around the world are in a much better position to respond effectively to external shocks than they were in the late 1970s.

During the 1980s, the Bretton Woods institutions of the IMF and the World Bank hopped on the bandwagon of neo-liberalism, to become the doctrine's most ardent advocates. Since the 1990s, neo-liberal structural adjustment programs engineered by the IMF and the World Bank have been implemented in almost every country across the globe, often by way of 'shock therapies'. In the 1990s, most Latin American countries firmly embraced the economic reform package that has come to be called the Washington Consensus (Kuczynski Godard/Williamson, 2003). These policies emphasised price stabilisation and structural adjustment measures such as fiscal discipline, privatisation, deregulation, trade liberalisation, reduction of tariffs, liberalisation of capital markets, and the opening of economies to foreign investment – all with the objective of making the economies more efficient and competitive, in the hope that resulting growth would trickle down. However, after more than a decade of such open-market reforms in Latin America and Sub-Saharan Africa, it should be noted that neoliberal adjustment failed to deliver much in the way of growth and social progress (Rodrik, 2007). As national controls over the movement of capital across borders disappeared, novel opportunities for both productive investment and speculation began to emerge. Once deregulation had taken place, however, national governments found it difficult to protect their economies when their currencies came under attack, as they did in crises like those in Western Europe (1992), Mexico (1994), Asia (1997), Russia (1998), and Argentina (2002).

In the final analysis, however, neo-liberalism did not completely undermine the institutions of embedded liberalism. Government ownership has been reduced through privatisation, and domestic and international market expansion has been encouraged through deregulation. However, neo-liberal politicians of various colours have been far less successful in retrenching the welfare state, especially in Europe. Notwithstanding the 'irresistible forces' urging for reform, the welfare state turned out to be a politically 'unmovable object' (Pierson, 1998; 2001). The distributive aspects of the welfare state have remained popular. In this respect, the neo-liberal program of institutional liberalisation and destruction was incomplete.

4. Conjecturing regime change in the face of persistent aftershocks

In democratic systems, it is ultimately politics that decides over matters of social and economic governance. Economic crises create windows of opportunity for extraordinary politics to transform existing institutions. To paraphrase Rahm Immanuel, President Obama's chief of staff, they mark important political junctures 'not to be wasted'. Once again, the current economic crisis is fundamentally redrawing the boundaries between states and markets, calling into question many issues of economic policy, ranging from central banking, fiscal policy, financial regulation, global trade, welfare provision, economic governance and assumptions about human behaviour and rationality. Many observers, experts, and policymakers are seeking new answers, and looking for solutions to the new questions posed by the crisis. So are we. Thus far, intellectual and policy attention has focused on immediate crisis management, especially with respect to financial sector risk management. Little systematic thinking has been devoted to the question of whether or to what extent the crisis creates momentum for more fundamental structural institutional change. Will the political rules of the economic game be rewritten? Does the current crisis mark a new opportunity to reinvent 21st-century capitalism? Or is a return to the status ex ante of less fettered liberalisation and globalisation just as likely? To be sure, it is still too soon to draw conclusions about the future economic, social, cultural, and political consequences of this momentous economic shock. On the other hand, these questions are among the most pressing of our times. A tentative exploration of these questions is thus both intellectually and politically imperative.

For argument's sake, the intellectual starting point of the interviews we undertook with the contributors to this volume was the historical analogy that deep economic crises alter the modus operandi of our economies, politics, and societies in more fundamental ways than the immediate imperative of crisis management. To be sure, we should not fall into the intellectual trap of historicism, assuming historical parallels to re-appear in the wake of the recurring crises. If history can teach us anything, it is that the last crisis is never like the previous one. Our motivation for exploring the economic and political context of previous crises is our desire to understand and analyze the *differences* in historical context, more than to highlight historical *similarities* per se. Nevertheless, historical analogy will be our starting point, as it allows us to explore the timely questions of our age in a guided, semi-structured and, hopefully, productive manner.

With this historical framework in mind, we approached 24 leading experts in the worlds of finance, macro-economics, economic and political history, globalisation studies, development policy, international relations, social protection, sociology, political science, and strategic policy. We interviewed not only academic experts with a keen eye for the governance dimension of economic management but also practitioners from the financial industry. We interviewed public policy strategists and two respected politicians, towering figures in the advancement of European integration. We asked our expert colleagues to partake in an open dialogue and exchange opinions on the subject, in interviews conducted between April and early September 2009. Based on the transcripts of these interviews, and with feedback from our interviewees, our editorial team put together the essays presented in this volume.

The 24 experts we talked to all share a particular sensitivity to the interaction between political and economic forces in the context of economic turmoil. As such, they tend to analyse the crisis (and economic developments more generally) from the vantage point of the governance relations and institutional arrangements within which economic decisions and crisis management measures are played out. In addition to their focus on governance issues, the majority of these experts, either implicitly or explicitly, utilise a comparative perspective. Whether they make comparisons across time, between episodes of economic crisis versus stability, or across regions and countries, they largely follow a dual strategy: as well as analyzing different cases for similarities, they also search for unique differences. By thus highlighting the 'particular' as well as the 'varying' regime characteristics of different market economies across time and space, they are able to situate the current crisis in a much wider historical, social, and political context.

The viewpoints captured in this volume should be understood as work in progress, snapshots of opinion at a particular moment in time. They are not definitive conclusions. They should be viewed as first attempts to understand the social, economic, and political transformations as they are presently taking place, pursued by different economic, political, and social actors in diverse institutional contexts across the globe. The contributors to this volume made their final revisions to their texts in September 2009, and as such, these pieces are necessarily historically limited by the information available at that time. In this collection of interviews, we have strived to produce a proactive, creative, and timely intervention in this overwhelming debate. In so doing, we have tried to go beyond the more reactive commentaries on the merits of concrete measures in the financial sector that appear in newspapers on a daily basis.

We will certainly not assume to have the final word on the crisis. To the contrary, at this juncture, raising questions is perhaps more important than answering them. We explicitly aim to broaden, rather than conscribe, the policy debate and repertoire of institutional choice before us. Much to our surprise, many of the interviews in this volume display interconnected, mutually supportive, and complementary arguments. However, in various ways different perspectives and judgements continue to differ. We aspire to communicate this intellectual engagement to the reader.

The volume is organised into five main parts. Each one explores different dimensions and aspects of the institutional consequences of the crisis. It begins with 'Diagnosing the Crisis', which introduces the fundamental dynamics of the recent crisis in contributions by Barry Eichengreen, Charles Maier, Jean-Paul Fitoussi, and Paul de Grauwe. Part 2, 'Exploring Policy Space under Low Growth', contains contributions that explicitly reflect on the room for manoeuvre of national social and economic policy institutions, and outlines options for international coordination. The contributors to this section are Peter Hall, Suzanne Berger, Stephen Roach, Willem Buiter, and David Soskice. In Part 3, 'Coping with Paradise Lost', sociologists Mark Elchardus, Amitai Etzioni, and Richard Sennett suggest different interpretations of the changing moral and cultural support basis for the modern market economy, whereas Dominique Moïsi focuses on issues of social malaise in the EU specifically. Part 4, 'Embedding a New Global Contract', contains a diversity of opinions by André Sapir, Dani Rodrik, Nancy Birdsall, Anthony Giddens, Tony Atkinson, and Amy Chua on what possible forms a new architecture of global capitalism might take. Finally, Part 5, 'Realigning Europe', is devoted entirely to the future of the European Union. It includes contributions by Loukas Tsoukalis, Fritz Scharpf, Helmut Schmidt, Maria João Rodrigues, and Jacques Delors. The volume ends with a contribution by co-editor Ben Knapen. Given the nature of the volume, this piece should not be read as a synthesis or conclusion of the arguments presented in the interviews, but rather as an epilogue, highlighting relevant ideas and debates from the book in an attempt to bring them into the current policy debate.

5. FROM CRISIS DIAGNOSTICS TO CRISIS MANAGEMENT

How to diagnose the crisis? Does the current credit crunch bear any similarity to the Great Depression, or is it more similar to the 1980s crisis of stagflation? People make history by constructing and transforming institutions that both constrain and constitute their social action. New institutions are hardly ever designed from a *tabula rasa*. Just as institutions shape the conduct of human actions, human conduct, in turn, reshapes institutions. Crisis management today may be critically informed by previous crisis experiences. Just as neo-liberalism did not lead to a return to the Roaring Twenties of unfettered capitalism, the current crisis is equally unlikely to bring about a restoration of the post-war regime of the embedded liberalism of national political economies.

The current downturn was triggered by a financial crisis not by a 'real' economy crisis, and in this regard, it is more similar to the Great Depression than to the 1970s crisis of stagflation. Barry Eichengreen and Kevin H. O'Rourke have concluded that today's crisis is surely as bad as the Great Depression. In 2008, industrial production, trade, and stock markets plummeted even faster than in 1929-30 (Eichengreen/O'Rourke, 2009). However, whereas after the 1929 crash, the world economy continued to shrink for three successive years, in the wake of the 2007 crisis, policy responses were much better, and led to a swift upswing in trade and stock markets in the first half of 2009. This suggests that the biggest difference between this crisis and the one in the 1930s was timely, effective, and coordinated crisis management to arrest economic collapse. Monetary expansion has been more rapid, and the willingness to run deficits is considerably greater. In short, policymakers were able to avoid the deflationary, protectionist, and nationalistic policy responses that aggravated the decline in the 1930s. There are two overlapping theories of why this has been the case. Dani Rodrik attributes it to the fact that policymakers in developed countries learned from the mistakes of the 1930s and are now firmly committed to open economies, whereas Fritz Scharpf notes that international economic interdependence has progressed so far (especially in the EU) that protectionism is simply no longer a viable option.

The crisis indeed revealed how much the world economy has fundamentally transformed over the past three decades, and this makes the crisis different from any historical precedent. The swift global fallout after the US sub-prime mortgage crisis demonstrates the stark reality of 21st-century global economic interdependence – hardly any country in the world has remained unaffected. The rapid response of public authorities, national governments and central banks attests to effective crisis management, which was sorely lacking in the 1930s.

In his inaugural speech, Barack Obama (2009) claimed that the economic crisis was "a consequence of greed and irresponsibility", a view which is shared in this volume by Amitai Etzioni and Amy Chua, who both allude to the soulless consumerism and decadence of credit-dependent Americans (Etzioni, 2004). For Etzioni, possessive individualist greed triggers demise in social capital and the erosion of trust in government. According to Charles Maier, the history of the current crisis is perhaps less a tale of improvident borrowing than it is a tale of profligate lending. Examining the *supply* of credit provides a far more telling analysis than looking at its *demand* by ordinary consumers. Maier claims that while governments adopted the imperatives of balanced budgets, inflation targeting, deregulation, and privatisation (thus constraining the money supply), the private financial sector was allowed to use financial innovation to create as much money as it saw fit. This led to massive – though fictitious – wealth creation throughout the 1990s. Indeed, Richard Sennett notes that the combination of this overly abundant supply of credit with the income stagnation of the middle classes meant that the dominant share of US consumer credit card purchases were spent on health care by Americans without insurance. It was not greed, but rather the necessity and availability of credit that led to the overwhelming indebtedness of American citizens. For Sennett, the culture of the market economy has lost its moral force for the foot soldiers of the new capitalism (Sennett, 2006; 2008).

Conspicuous consumption and greed are not new. As such, they cannot explain the speed or the depth of the global crisis after 2007. What then are the deeper, more structural and systemic causes of the crisis? Why did academic economists fail to anticipate the coming crisis? The full-blown crisis after the downfall of Lehman Brothers surprised everybody – policymakers, academic economists, and economic commentators alike. However, it had been building up for years, and preventing the collapse of Lehman would not have prevented a global crisis. In retrospect, three factors can be identified that began to merge in the early years of the 21st century, and eventually created an unforeseen but lethal combination: (1) loose monetary policy; (2) the global trade imbalance between the US and China; and (3) lax financial regulation as a result of the liberalisation of capital markets in the 1980. In addition to these, a fourth contributing factor was the theoretical bias that developed in the academic profession towards the economics of market efficiency and human rationality.

Loose monetary policy

The origins of the crisis date back to the aftermath of the 'dotcom' bubble in 2000. When the Fed realised that US aggregate demand was falling sharply and had the potential to throw the entire economy into a full-blown recession, it responded by radically lowering interest rates to one percent. Initially, the US housing sector remained stable, and there were no signs of overheating. However, after another interest rate cut by the Fed, a housing bubble began to expand. With lower interest rates, people could afford much larger home mortgages. Greenspan's loose monetary policy worked well in the beginning: The US economy remained strong – although this was largely thanks to the housing bubble – and companies diligently repaired their balance sheets. This cheap money created a very competitive environment for financial institutions, which could only get high returns if they made ever-riskier investments.

It would, however, be a mistake to single out American or British capitalism as the sole culprit of the crisis. Loukas Tsoukalis reminds us that although continental European economies may have been sceptical about American growth initially, they eventually allowed their banks to dance to the lucrative tune set by American and British capitalist structures. Many European banks invested in large quantities of securitised US mortgages and other innovative financial instruments, such as credit default swaps and collateralised debt obligations. In the end, European financial institutions ended up being more leveraged than their American counterparts. In addition, European monetary unification brought interest rates down dramatically in the previously high-interest Southern tier of EU countries and in Ireland, which, according to Barry Eichengreen, provided cheap funding to financial speculators. The result was an enormous housing and lending boom, which, combined with the lack of a pan-European system of financial governance, at least partially explains why the instabilities in American financial markets contaminated Europe so easily and quickly. Moreover, many contributors to this volume have argued that even the EU's Lisbon Agenda aimed to mimic a (grossly misperceived) US growth scenario.

In addition, the compression of incomes in the US throughout the neo-liberal period was compensated by a reduction in household savings and mounting private indebtedness, which allowed spending patterns to be kept virtually unchanged. At the same time, limited social safety nets forced the government to pursue active macro-economic policies to fight unemployment, which increased government indebtedness as well. Thus, growth was maintained at the price of increasing public and private indebtedness, adding to the already existing macro imbalance. In this respect, Jean-Paul Fitoussi points to the problem of competitive social deflation. In the era of neo-liberalism, structural inequalities were allowed to persist and widen further, both within and between countries. Indeed, Tony Atkinson finds that while many developed countries saw their GDP increase by up to 25% over the past fifteen years, median incomes barely rose at all (and in some countries even declined), revealing a highly skewed distribution of growth. In macro-economic parlance, increased inequality implies weak domestic demand: the skewed wealth distribution and high unemployment rates were bad for consumer demand and therefore for the economy as a whole. In addition, global demand contracted even further in the wake of the Asian financial crisis, when Asian emerging economies started to hoard reserves so as not to become dependent on IMF loans in hard economic times.

Global imbalances

This brings us to the second factor that contributed to the crisis: the macro imbalance in trade. This imbalance has accelerated dramatically over the past ten to fifteen years, partly as a result of loose US monetary policy. Asian emerging economies and the oil-exporting countries accumulated large current account surpluses, and these were matched by large current account deficits in the US, as well as the UK, Ireland, and Spain. A key driver of these imbalances was the high savings rates in countries like China, and Suzanne Berger believes that the run-up to the crisis should actually be traced back to the 1997 Asian financial market crash. Following this disaster, Asian governments (and citizens) felt increasingly insecure and ramped up their reserves – primarily in US dollars – in order to avoid becoming vulnerable to such a scenario in the future. This exacerbated the US debt burden, further perpetuating the trade imbalance.

Lax financial regulation

Loose monetary policy and the international trade imbalance were compounded by a third factor: the deregulation of the financial sector. With the liberalisation of capital markets, finance became global, but regulation remained national. In addition, throughout the neo-liberal epoch, even domestic financial markets were systematically deregulated, allowing financial innovations to evolve unchecked. As the financial sector grew and became truly global, insufficient latitude was reserved for domestic government regulation and international supervision (Posner, 2009).

Willem Buiter commented on this, noting that allowing the scope of the market and the domain of the mobility of financial institutions to exceed the span of regulatory control is a recipe for disaster. Financial sector deregulation allowed the macro imbalances in savings rates to stimulate a massive wave of financial innovation, focused on the origination, packaging, trading and distribution of derivatives, credit default swaps, and other securitised credit instruments. Since the mid-1990s there has been huge growth in the value of credit securities, an explosion in the complexity of the securities sold, and a related explosion of the volume of credit derivatives, enabling investors and traders to hedge underlying credit exposures. As securitisation grew in importance from the 1980s on, this development was lauded as a means to reduce banking system risks and to cut the total cost of credit intermediation. Securitised credit intermediation would be less likely to produce banking system failures. When the crisis broke, it became apparent that this diversification of risk holding had not been achieved. The deregulation movement had been aimed at the regulated industries in general, and encompassed the banking system only because it was highly regulated. The economists and politicians who pressed for deregulation were evidently not sensitive to the fact that deregulating banking has a macro-economic significance that deregulating railroads or telecommunications does not.

In retrospect, Stephen Roach wonders whether some of these new breakthroughs in financial innovation were in fact more destructive than constructive. Eichengreen explains how the politics of international deregulation, together with computer-based finance mathematics, finally extricated the capacity to produce money by credit from public control – which to some extent at least had tied it to the production and consumption capacities of the real economy. The financial industry thus acquired the capacity and the licence to make money out of money, and to generate claims to resources at a rate so rapid that the real economy could not possibly follow. It could even be argued that money ceased to a public institution directing economic activities into productive endeavors. Instead, it was reduced to being a commercial commodity itself, decoupled from its previous function for the real economy, no longer bounded by any national base, interest, regulation, or other direct or indirect requirement to commit itself to productive function beyond itself (Streeck, 2009). For the past two decades, increases in US debt came from financial innovation, rather than the real economy. Once upon a time, a home owner took out a mortgage, and household debt increased. But since the late 1990s, mortgages could be used to secure mortgage-backed securities, and those securities could in turn be used to secure a collateralised debt obligation. The end result was more borrowing, but no increase in real economy activity. Moreover, when assets, driven by cheap money, came to be bought not because of the rate of return on investment but in anticipation that such assets and securities could be sold at a higher price, the stage was set for an asset bubble of overvalued stocks in relation to real economy fundamentals. Privatized money production on a hitherto unknown scale, according to Fitoussi, should be understood as a response to the general stagnation of growth and profitability after the 1970s. The inevitable result was a rapidly growing debt pyramid vastly in excess of the real economy's ability to pay. The above three features of loose monetary policy, the savings and trade imbalance, and lax regulation ultimately exacerbated the pro-cyclical and self-reinforcing nature of the downturn.

Academic failure

Judged by Milton Friedman's method of positive economics, which holds that economists should be judged by the predictive powers of their theories and not by the validity of the assumptions they make in the construction of their economic models, the failure to anticipate the first major economic crisis of 21st-century global capitalism should be viewed as an utter failure (Friedman, 1962). Why were so many economists so blind? To be sure, a small minority of eminent members of the economics profession, notably Robert Shiller (2003; 2008), Raghuram Rajan (2005), and Nuriel Roubini (2006), did point to the great risks of an unchecked housing bubble. Dani Rodrik (2007) and Barry Eichengreen (2007b) warned against the negative fallout potential of the global imbalances. Yet the majority of mainstream economists failed to recognise what was going on. Or rather, what Chuck Prince of Citi Group said of the financial industry, that "… as long as the music is playing, you've got to get up and dance", also applied to the academic economists' profession.

Paul de Grauwe intimates that perhaps the root cause of this academic oversight was the error of modern mainstream economics in believing that the economy is simply the sum of micro-economic decisions of rational agents. The profession of economics was so caught up in this rational actor and market efficiency paradigm that it completely forgot some of the most elementary dynamics of economic crises: animal spirits. Fundamental to Keynesian economics is the idea that instead of rational actors, much economic activity is governed by animal spirits, best understood as waves of optimism and pessimism (see also Akerlof/Shiller, 2009). Animal spirits grip investors and consumers and thus, endogenously, generate self-fulfilling prophecies by influencing output and investment (Grauwe, 2008). Left to their own devices, capitalist economies will experience manias, followed by panics. It is the function of the modern state to sail into the wind of these excesses: when the population overspends, they should over-save, and vice versa.

If Keynesian economics was the intellectual product of the 1930s, the 1970s crisis of stagflation brought Keynesian paradigmatic hegemony (Hall, 1989) to an end. In its wake, anti-Keynesian monetarism gained respectability by being better able to explain the predicament of stagflation as the result of stop-and-go fiscal demand stimulus measures by governments and, following the 'new classical' macro-economics of rational expectations, wage hikes adapted to inflationary expectation. In the evolution of this paradigm shift from Keynesianism to monetarism and rational expectation macro-economics, the study of animal spirits has almost completely disappeared from mainstream macro-economics and the economics of finance. When expectations are assumed to be rational, intellectual models leave no room for waves of pessimism and optimism to exert an independent influence on economic activity. In rational models of macro-economics, it is the combination of exogenous shocks and slow transmission that creates cyclical movements in the economy. In this vein, Blanchard and Summers (1987) suggested a reason why wages did not fall when unemployment was high in Europe in the 1980s. They argued that 'hysteresis' in wage setting can prevent the real wage from falling enough to restore full employment, if wages are set to preserve the jobs of those people already employed, rather than to move others out of unemployment. In these mainstream models there is no place for endogenously generated business cycles. Likewise, the preoccupation of business-cycle macroeconomists had been to prevent inflation by keeping interest rates up, just below the level that would risk precipitating a recession. Modern macro-economics, especially within central banks, became excessively fixated on taming inflation and much too benign about housing price and asset bubbles.

Paul de Grauwe argues that even if prices and wages become more flexible, this will not necessarily reduce the business cycle movement in output. As a result, society's desire to stabilise output will not be reduced. Central banks that respond to these desires will face the need to stabilise output at the risk of reducing price stability. The efficient-markets hypothesis, which argues that deviations from equilibrium values cannot last for long, also fuelled the idea that free markets are self-regulating and self-legitimising, and that financial innovation is always beneficial to everyone.

As time went on, more and more professional economists were drawn onto the bandwagon of passive acceptance of the dominant intellectual paradigm. Barry Eichengreen observes that most academic economists shied away from probing the underlying vulnerabilities of loose macro-economics, financial deregulation, mortgage and pension markets, and distorted incentives and bonus schemes in the big financial institutions that exacerbated economic instabilities. Moreover, the high level of sub-disciplinary specialisation in the field of economics made it difficult for any single academic to put all the pieces together. This intellectual inertia and sub-specialisation blinded academic economists to the underlying causes of the crisis. In this respect, the current crisis is a wakeup call, re-introducing the concepts of animal spirits, imperfect information, cognitive limitation, and heterogeneity in the use of information back into macroeconomic and financial market modelling and analysis.

To some extent this lesson also applies to the more heterodox field of comparative institutional political analysis. In retrospect, Suzanne Berger pleads guilty to imagining that financial markets played a mere auxiliary function in her understanding of globalisation. The Varieties of Capitalism school, founded by Peter Hall and David Soskice, also failed to adequately conceptualise the institutional links between the real economy and the financial economy. Loukas Tsoukalis adds a political factor: as deregulation brought concentrated wealth to sectors that benefited from even further deregulation, accumulated wealth was efficiently translated into a strong financial lobby in London, New York, and Washington. The financial sector effectively bought political power. Therefore, the failure of politics lies in part in its inability to resist being hijacked by financial interests. Blaming neo-liberal ideology and intellectual inertia is insufficient.

6. THE POLITICAL CONTOURS OF THE NEW EMBEDDEDNESS

The fundamental insight that emerged from most of the interviews is that economic markets are not self-creating, self-regulating, self-stabilising, and self-legitimising. While this important lesson is certainly not new, in the past decades of neo-liberalism, policymakers do seem to have forgotten the fundamental truth that the benefits of global economic interdependence rely heavily on robust social and political institutions, reminiscent of the era of embedded liberalism. Domestic and supranational institutions must be able to bind, bond, and bridge advanced polities, economies, and societies. However, despite the temptation to think of the future of global capitalism as a global version of post-war embedded liberalism, this surely is not feasible, efficient, nor practical. Today, the process of globalisation is too far advanced to be able to go back to national economic management of the era of 'embedded liberalism'. As a consequence, some policy recipes that were successful before (including currency devaluations and trade protectionism) are no longer available to national policymakers, in part due to European and WTO economic integration. In this respect, concerted coordinated action at the international level is essential to effectively govern the global economy.

Unfortunately, once the genie is out of the bottle, it is far more difficult to re-regulate an economy than to deregulate it. The neo-liberal era may have come to an end, but whether the crisis indeed marks the ascendance of a new regime is an open question. Some of the rules of economic regulation and policymaking will be rewritten, as Charles Maier believes. The economic crisis has brought the world to a new policy crossroads, but it also needs to be acknowledged that the room for manoeuvre and institutional innovation may be fairly restricted, not only because of the likelihood of low economic growth, but also because of domestic and international political constraints and barriers. The question of institutional choice and regime change, for present purposes, encompasses two key dimensions. Internationally, the task will be to devise a stable and sustainable system for international cooperation and regulation, which addresses the diverse needs of advanced, developing, and the least-developed economies; domestically, institutional change requires recalibrating the role of the state in shaping a stable economy by combining economic dynamism with a more equitable distribution of life chances. Walking the fine line between protectionism and protecting domestic policy space will be difficult.

Effective solutions to the current global crisis require international cooperation, but no government is able to go ahead with an internationally coordinated plan without taking into account issues of domestic legitimacy. Nowhere is this double bind between international coordination and national allegiance more salient than in Europe. Any solution to the crisis has to be both effective and legitimate at the level of the global market as well as at the level of the nation-state. In his contribution, Peter Hall underlines the extent to which political shifts play a key independent role in the selection of policy responses and institutional adjustments. Previous crisis episodes have revealed how hard times exacerbate existing tensions, invariably decreasing satisfaction with existing governments. If the crisis results in an extended period of high unemployment, the voting public may grow disenchanted with the prevailing policy regime, which they identify as economic liberalisation. Facing the likelihood of relatively low growth, the key challenge that political leaders will face is therefore not so much how to manage growth, but how to manage expectations, Tony Atkinson contends. Suzanne Berger rightly underscores that even before the economic crisis there was no evidence that citizens were shifting allegiances away from the nation-state. In Europe, the 2005 referenda on ratification of the European constitution demonstrated the strength of nationalism. Various public opinion polls overwhelmingly reaffirmed that citizens held their national governments accountable for their security and wellbeing, and felt betrayed by the globalising ambitions of the EU. The economic crisis intensified these sentiments, thus bringing the centrality of the role of the nation-state back into the limelight. The European welfare state, following this line of reasoning, was introduced as a way of re-establishing this legitimacy and rebuilding the capacities of the state. Looking back, Suzanne Berger argues that the nation-state remained vital throughout the globalisation period. Whereas in good times the hand of the state may have been hidden, in hard times it re-emerged visibly and powerfully. Berger's central observation implies a fundamental re-thinking of the role of the state in the economy.

The crisis has affected different economies differently, as a result of their relative vulnerability to endogenous and external economic shocks and also because of the differing institutional capacities they were able to mobilise to address the economic duress. The smaller economies of Western Europe, which have been unable or unwilling to muster fiscal stimulus packages on par with those of Germany and France – for example Belgium, the Netherlands, and Sweden – are behind the curve of recovery. Ballooning budget deficits in Ireland, Greece, and Spain raise severe doubts about recovery. In August 2009, the Bank of England surprised everybody with another round of quantitative easing of 50 billion British pounds, admitting that the recession appears to have been deeper than previously thought. The economic crisis has hurt the new EU member states of Eastern and Central Europe the most. Hungary, Romania, and Latvia are surviving primarily on emergency aid from the IMF. The Baltic states, which predicted GDP declines between 13 and 17 per cent in 2009, have already been forced to introduce tough retrenchment programs in public finances. Other countries, like the Czech Republic, Slovenia, Slovakia, and Poland, are doing relatively well. The temptation to focus on the incipient recovery of the more advanced OECD countries, as well as on the so-called emerging BRICs – Brazil, Russia, India, China – runs the risk of glossing over the far more devastating effects the crisis has had on developing countries, which cannot muster the resources for a counter-cyclical fiscal stimulus. Even gas- and resource-rich Russia is likely to suffer a steep fall in GDP.

At the moment, there are a variety of competing models of capitalism: Anglo-Saxon, Rhineland social market economies, and new statist Chinese capitalism. However, as much as we can anticipate the policy debate about competing models to reach new levels of intensity in the near future, it is our contention that it is useless to couch policy responses to the current crisis in terms of a battle between warring alternatives. Triggering ideological strife and polarising advocacy coalitions do nothing to move the policy discussion towards better understanding or more effective policy solutions and economic governance. Moreover, models come and go. There is no 'one best way': institutional designs that underpin market economies will differ according to domestic and regional preferences and needs.

The 'Varieties of Capitalism' approach to analyzing the different domestic strengths and weaknesses of the advanced political economies can help us in understanding how different economies and economic regions will adapt to the post-crisis environment (Hall and Soskice, 2001). Compared to the US, European countries were slow in recognising the severity of the crisis. As a consequence, monetary easing and fiscal stimulus measures were implemented less aggressively than in the US. One reason why fiscal stimulus programs were less expansive in Europe is due to the fact that the EU is made up of many small, open economies. This creates free-rider problems, with the benefits of fiscal stimulus spilling over into neighbouring economies. While the US is more indebted, it has the advantage of being an immigrant economy with flexible labour markets, which will make it relatively easier to mobilise labour and other resources than in the ageing European and Japanese economies.

Under conditions of low growth, China as well as European export-oriented economies will no longer be able to rely primarily on industrial exports to drive their economies. In Europe, this means that domestic employment will need to be shifted towards services that are locally produced and locally consumed. Specifically, Fritz Scharpf suggests focusing on the potential growth industries of health care, childcare, care for the aged, and above all education and training.

Across Europe, many of the new member states of Eastern and Central Europe have been disproportionately damaged by the crisis. Peter Hall cites Wade

Jacoby (2002), who argued that former communist countries made the transition to the market economy at the height of the neo-liberal era and were sold the most radical version of the market model, particularly by the IMF and World Bank. Now they are suffering more than other countries as a result of this irrational exuberance. Emerging economies, specifically Brazil and India, are expected to do much better in the post-crisis period. According to Nancy Birdsall, this is partly due to the extent to which they were able to decouple themselves from financial globalisation. By contrast, lower-income developing countries, which traditionally have relied heavily on trade, will suffer severely from the crisis. Sub-Saharan countries sorely lack the economic resources and institutional capacities to implement counter-cyclical fiscal policies.

Dani Rodrik defends countries' rights to protect their own social arrangements and institutions. The objective of international economic arrangements must be to attain the maximum 'thickness' in economic transactions (in trade and investment flows) that is consistent with maintaining space for diversity in national and regional institutional arrangements. As a consequence, Rodrik concurs that markets must remain primarily embedded at the level of the nation-state, as long as democratic governance and political identities remain nationally embedded. Economic relations between states should be structured with the aim of opening up trade and investment flows subject to the proviso of maintaining heterogeneous national arrangements. Where national models conflict, what Dani Rodrik calls 'traffic rules' must be designed to manage the interface between domestic arrangements. Protected policy space would allow rich countries to provide social insurance, address concerns about labour, the environment, health, and safety consequences of trade, and also shorten the 'chain' of delegation. Meanwhile, poor nations should be enabled to position themselves to benefit from globalisation through economic restructuring. All nations must be given the space to create financial systems and regulatory structures attuned to their own conditions and needs. To this effect, substantive policy concerns would be brought to the table of international economic negotiations. Surely, this goes beyond the neo-liberal zeal to establish 'level playing fields'.

The global crisis has laid bare important changes in the global distribution of wealth and power. The power of the US is on the wane, and emerging economies such India and China have meanwhile become key global economic players. However, their economic prowess is not yet reflected by their representation in international bodies. At the same time, the EU is faced with a plethora of internal problems in the wake of Eastern enlargement. Quite surprisingly, the international community is already adjusting to this new multilateral reality. Whereas existing institutions usually continue to reflect the international distribution of power of the status quo ex ante, the IMF and the World Bank have recently allowed for far more domestic heterodoxy than ever before. The crisis has changed these institutions practically overnight. In terms of substance, the Washington Consensus rules no longer govern, and Dominique Strauss-Kahn, director of the IMF, realised that without change, China and other emerging economies would not stay engaged and therefore demonstrated flexibility in reform.

Since the economic crisis, the supranational Bretton Woods organisations that converted to the Washington Consensus, such as the IMF, the World Bank, and the WTO, have faced a crisis of legitimacy. In order for these global organisations to recover, they must reform by, firstly, fully integrating the emerging countries and, secondly, promoting equitable and sustainable models of globalisation. By 2009, in institutional terms, the elite club of rich industrial nations, known as the G7 – Britain, Canada, France, Germany, Italy, Japan and the United States, has been permanently replaced by the Group of 20, including China, Brazil, India and other fast growing developing countries, as the global forum for economic policy. The rise of the G20 marks an instance of profound institutional change. However, despite its successes, the G20, according to Barry Eichengreen, has problems. It is not clear why these 20 specific countries were appointed to represent the world. From a social justice perspective as well, the G20 insufficiently represents the poorest countries. One way of rationalising these arrangements would be by moving to a Group of 24, based on the representation in the International Monetary and Financial Committee of the IMF. Of the 24 representatives in this committee, five represent individual countries, whereas the others represent groups of countries. All this makes it a far more effective structure to supersede the G20. Another shortcoming of the G20 is Europe's inability to speak with one voice. The EU should come to recognise that two seats – one for the euro area and one for the rest of the EU – is sufficient, a view which is shared by André Sapir. This would streamline decision-making, both within the G20 and the IMF, while freeing up seats at the table for currently underrepresented developing economies and regions, as Nancy Birdsall points out.

A final political challenge is that this economic crisis coincides with a major environmental crisis, whose solution requires a complete transformation of our modes of production and ways of living. Anthony Giddens reminds us that regardless of the institutional changes following the crisis, the imperative to act on issues such as climate change, energy insecurity, and water scarcity will remain paramount (Giddens, 2009). He also notes that climate change policies can play an important role in revitalising economic growth. Averting climate change should be an important policy goal when prioritising stimulus spending. Investments should go towards clean energy, and the adaptation of green technologies should be given prominence, a view that is shared by Nancy Birdsall and Tony Atkinson. Thanks to the crisis, substantive global issues, such as climate control, water management, renewable energy, and other long-term concerns of sustainable development are now high on the world political agenda. This is a welcome correction.

7. EUROPE AT A CROSSROADS

Over the past two decades, ridiculing the so-called 'European Social Model' has been a favourite pastime of business leaders, political elites, and economic experts – especially at Davos. In 2009, this is no longer the case. A number of political leaders, chief executives, and top economists even seized the moment at the World Economic Forum by cautiously pointing out the relative merits of the European welfare states and the Rhineland coordinated political economies. As unbridled Anglo-Saxon capitalism was blamed for the financial crash, German Chancellor Angela Merkel openly endorsed the European "social market economy" – a free market tempered by a generous welfare state, consensus-building politics and industrial relations – as a model for the future. Only a few years ago, policy pundits could not have imagined such a future for Europe's social market economies. These regimes, which are known for reining in free markets with capital regulation, providing generous insurance benefits paired with high quality social services, maintaining stable industrial relations, and supporting comprehensive vocational training and education systems, seem to have been able to mitigate the hardship of the economic crisis. In the United States, where the stock market collapse has wiped out retirement savings and rising unemployment is leaving ever more people without health insurance, officials in President Barack Obama's administration are looking towards recent pension and health care reforms in the Netherlands, Sweden, and Switzerland for inspiration. In China, where the American economic demise has brought the perils of excessive domestic saving to the fore, the government announced a Keynesian stimulus program to deepen and strengthen social safety nets in the areas of pensions, health care, active labour market policy, vocational training, unemployment insurance, and close supervision of finance. Do these developments indicate a shift towards holding the much-maligned European welfare system up as a model for the new 21st-century global capitalism (Begg et al, 2008)?

How robust is the renewed conversion to the European social model really, even within the European Union itself? Can the European Union stay unified in the face of the crisis? Will the Euro grow stronger or weaker? Can Europe's problems be resolved without the creation of some form of economic governance alongside the European Central Bank? Does the crisis offer an opportunity for the European Union to become a stronger political force in world economic affairs? Or, on the contrary, will the Union continue to be jeopardised by joint-decision traps as the crisis polarises the ideological debate between different 'socio-economic models'? Moreover, since the crisis, anti-globalisation feelings have increased the support for right- and left-wing populist parties in national elections, and this is undermining the popular legitimacy of the European project. What kind of social Europe is effective and legitimate in the aftermath of the current crisis? European economic integration, to be sure, has been highly implicated by the neo-liberal consensus of the 1980s and 1990s (Dyson/Featherstone, 1999). As the current technocratic elite in Brussels have come to ascendance during the neo-liberal era, they may be unlikely to take the lead in promoting a new and embedded governance framework for the European political economy. Many of our Europe-based interviewees believe that the EU is increasingly becoming part of the problem rather than the solution to the crisis. Interestingly, our North American colleagues have a more sanguine perspective on the future of Europe.

From the European perspective, Peter Hall underscores the extent to which Europe's predicament is more political and institutional in nature than programmatic. Both Dominique Moïsi and Mark Elchardus believe that the all-pervasive cultural narrative of the European welfare state, in the light of the crisis, has bred media-triggered political disenchantment, demise in social capital, and fuelled the expansion of left- and right-wing populism, eroding confidence in the European project (Echardus, 2002; 2004; Moïsi, 2008). Many observers fear serious nationalist backlashes across the EU member states, which will make it ever more difficult to reach a political consensus over effective and legitimate domestic and European social and economic policy. Fritz Scharpf laments the neo-liberal judicial bias in the single-market policy repertoire, while Helmut Schmidt deplores the lack of political leadership (see also Schmidt, 2008). Jacques Delors laments the demise of the spirit of cooperation in the wake of eastward enlargement. Loukas Tsoukalis views intergovernmentalism and the unanimity requirement of the European Union as its most serious political setbacks, because of its tendancy toward institutional deadlock. Fritz Scharpf connects the inability of the EU to the vulnerability of a regime of completely liberalised markets. EU macro-economic, fiscal, and monetary policy repertoire is asymmetrically designed to serve only the purposes of price stability and fiscal sustainability, and has therefore served to undermine Europe's popular national welfare systems (Scharpf, 1999; 2004). It was designed to guard against the inflationary pressures of the 1970s and early 1980s, but the problems of a deflationary crisis were ignored. Moreover, Tony Atkinson observes that under the rhetoric of the Lisbon Agenda, structural inequalities were allowed to persist, by narrowly focusing on employment as the cure for all economic ailments (see also Atkinson et al, 2002). In the original vision of Lisbon, economic and social policy goals were placed on an equal footing (Rodrigues, 2009). Yet this was abandoned with the 2005 refocusing of Lisbon on growth and jobs. Nine years after the social accord of Lisbon, the conclusion is that the 'trickle-down' effect has not worked. Overall poverty rates have not decreased, and child and old age poverty have actually increased in some EU countries, notably in Germany, Poland, Italy, Latvia, Romania and Bulgaria.

Jacques Delors infers that as a result of the timely imperative of the enlargement of 2004, the programmatic deepening of the EU took a back seat (see also Delors, 2006). As a consequence, the EU now lacks the necessary unity to put forward a coherent package of supranational social and economic crisis management. According to Delors and Helmut Schmidt, this is also due to the overall weakness of the Commission. In hard times, national politics trump the European common good, as national leaders move to protect their own industries, workers, and voters.

However, looking at Europe from the other side of the Atlantic, the perspective is rosier. Peter Hall believes that European welfare states will weather the storm, noting that even a mere 2% per year of GDP growth will enable them to sustain their welfare systems in the long run. Nancy Birdsall and Suzanne Berger even conjecture that ultimately a transition towards a more European welfare system in the US is not unlikely, in spite of the American emphasis on low taxes and government expenditures (Birdsall, 2008). Amy Chua deviates from this perspective, however, by noting that American small-government values make a transition to a European welfare system highly unlikely (see also Chua, 2007).

Barry Eichengreen was positively surprised by the unanticipated flexibility of Europe's regime of macro-economic management. Prior to the crisis, there were worries that the rigidity of the Stability and Growth Pact and European monetary union would prevent the EU from responding swiftly to the financial crisis (Eichengreen, 2007a). In fact, despite the initial delay in cutting interest rates, the ECB responded very quickly, by providing essentially unlimited amounts of liquidity to the euro-area financial systems. At the same time, the Stability and Growth Pact was relaxed in order to increase governments' capacities to borrow in the interests of recapitalising their banks. These EU measures may have helped to offset the relative weakness of national stimulus plans.

What is perhaps most revealing is that the euro has become more attractive as a result of the crisis, by virtue of its stability and security (Eichengreen, 2007b; 2009). Despite mounting social problems, countries like Spain, Ireland, and other smaller European economies show no signs of wanting to abandon the euro-area. A fair number of traditionally euro-sceptical EU member states, such as Denmark and Sweden, now view the prospects of joining the euro-area far more favourably in the wake of the crisis. Hungary and Poland have both indicated that they want to speed up their transition to the euro as a result of the crisis. Iceland has already applied.

Dani Rodrik believes that the demise of the Washington Consensus will benefit the EU, with some of the EU's larger member-states possibly becoming significant international players. Throughout the second half of the 20th century, the EU has been a guinea pig for multilateral governance and has an unparalleled understanding of domestic social complements to the single-market process. This has created a healthy balance between domestic policy space and international trade efficiency. In the process, the EU developed an institutional knowledge base for successful international governance which knows no equal. To maintain its international legitimacy, it must, according to André Sapir, now use this knowledge and become a true advocate of multilateral reform in global governance (Sapir, 2007). Just as economic internal integration was the prevailing European narrative for the past 50 years, Europe must now develop a new narrative based on multilateralism and globalisation for the coming half-century. However, for the EU as a whole, its role as a credible advocate of multilateral reform can only come at the expense of renouncing some of its antiquated institutional privileges in global governance institutions. In order to benefit from the unity the EU has nurtured, it will be necessary that Europe learn to 'speak with one voice' internationally and thus give up outdated voting privileges in the IMF and the World Bank.

Although many of our experts highlighted the necessity of further European economic integration in the wake of the crisis, at the level of domestic European politics, the crisis has prompted a shift towards nationalism, undermining popular legitimacy for further European integration. In this respect, Peter Hall may be right in contending that ultimately, the biggest barrier to achieving an effective European response to the crisis is political. Already in the 2005 referenda on ratification of the European constitution, the rising strength of nationalism was clearly demonstrated. Citizens felt betrayed by the liberalising and globalising ambitions of the EU. The economic crisis heightened such sentiments and brought nationalism back into the limelight of European politics. In the past, national political leaders often misused EU regulation as a scapegoat for unpopular reforms. Popular support for the European project suffered as a result, but so did the credibility of political elites. Anti-EU, anti-immigrant, populist, radical right-wing, and anti-capitalist left-wing groups have gained influence in recent years. Their growing support puts pressure on existing governments and centrist parties to proclaim nationalist responses to the crisis and play down their commitments to European integration. As a result, it comes as little surprise that EU political legitimacy suffered tremendously in the wake of the crisis; it was discredited by its earlier role as champion of market liberalisation.

Loukas Tsoukalis claims that the old division of labour between EU and national institutions (the former generally concentrated on market liberalisation measures, while the latter retained a near monopoly over redistribution and welfare) has become politically unsustainable. Europe needs a new moral vision, a social narrative capable of restoring its legitimacy in difficult times. This is rendered more difficult by the absence of EU officials elected by Europe as a whole, as Peter Hall observes. Over the past decades, the EU has constantly reinvented itself, showing the creativity and dynamism needed to overcome the myriad of challenges it has faced since its inception. However, currently, in order for Europe to be an effective agent of reform, it must become a reliable political defender of collective interests and values with a stronger caring dimension. In short, the European Union, in the words of Loukas Tsoukalis, needs a breath of fresh political air.

8. Regime Change without the Punctuated Pendulum Swing

Will the gravity of the economic crisis trigger a moment of extraordinary politics and institutional reconstruction? Can we expect the crisis to usher in a more active economic role for government intervention, market regulation, and international coordination? Will there be a pendulum swing back to a stronger appreciation of market embeddedness?

Although most of our interviewees expect to see some degree of institutional change in the wake of the crisis, several of the authors have doubts about the likelihood of a swift and punctuated regime change occurring. Peter Hall notes that although market optimism took a severe beating, a new era of state intervention and optimism will not necessarily follow. Today, citizens have as little faith in the state as they have in the market, and because they are presiding over recession, whatever governments do during an economic crisis is usually seen as a failure. Therefore, states should expect some popular backlash. In addition, Barry Eichengreen believes that if the crisis created a moment for extraordinary politics, that moment is quickly passing. However, if in upcoming years, the resulting sense of insecurity is exacerbated by persistently high levels of unemployment and a perpetually unstable stock market, pressure may slowly grow for the American government to step in to undertake fundamental reforms. This would undermine the old adage that “government is the problem, markets the solution.”

Just as the current crisis is unlikely to trigger a swift pendulum swing of institutional design, it should be noted that neo-liberalism also did not attain institutional hegemony overnight. While the elections of Margaret Thatcher and Ronald Reagan may retrospectively have marked the beginning of the neo-liberal era, it was only with the fall of the Berlin Wall that this doctrine achieved global influence. The neo-liberal rise to dominance was largely evolutionary; it emerged gradually through a series of institutional transformations and policy changes over a long period of time. In contrast to the traditional belief that institutional shifts are always marked by rapid changes at critical junctures, it can be expected that future institutional shifts are likely to follow the logic of incremental transformative change through institutional evolution. By comparison, the rise of embedded liberalism indeed represented a far more punctuated process of institution building.

With this in mind, it is interesting to speculate about how the observed policy changes in the wake of the crisis will contribute to such a scenario of gradual institutional evolution. Specifically, five key policy changes warrant such an examination: (1) changes in central banks' mandates and modes of operation, (2) the resurgence of international policy coordination, (3) the reappraisal of welfare policies, (4) taking climate change seriously, and (5) the search for new economic indicators that go beyond traditional measures of GDP.

The crisis has pushed central banks into a broad range of new interventions, aimed at safeguarding financial stability. One intellectual lesson that has emerged from this crisis is that economists have to redefine what global and domestic financial macro-economic stability means. Macro-economic and financial stability is a much wider concept than price stability, and sometimes the two even conflict. Stephen Roach advocates a new mandate for the Federal Reserve; it should lean against the winds of financial excess and asset bubbles. Similarly, Willem Buiter, Paul De Grauwe, and Barry Eichengreen all argue that the ECB will in the near future be required to perform a variety of new functions, including undertaking liquidity- and credit-enhancing measures, becoming a lender of last resort, and maintaining general financial stability. In order to achieve financial stability, the ECB must be allowed to deploy new instruments, such as counter-cyclical adjustment of capital ratios for banks and minimum reserve requirements, which should be used to limit excessive credit creation by banks. However, if the ECB is to play a significant financial stability role, it cannot retain the degree of operational independence it was granted in the Treaty over monetary policy in the pursuit of price stability. Changing this will be difficult, because the ECB is based on the European Treaty, which is extraordinarily tough to amend (all 27 member countries must agree to any changes). As the crisis lengthens and deepens, the absence of close cooperation between the European fiscal authorities on the one hand, and the ECB bankers on the other, will make both groups progressively less effective. This comes in addition to the problems the ECB encounters as a result of the absence of even a minimal 'fiscal Europe'.

The ultimate litmus test of effective macro-economic regime change lies in the establishment of a new systemic risk regulator, an issue up for discussion at the G20 summit to be held in late September in Pittsburgh. Both the Turner report of the British FSA (2009) and the De Larosiere Commission (2009), reporting to the European Commission, have suggested the creation of a new European body for regulation and oversight of supervision, staffed by full-time independent professionals. They argue that these independent professionals would not come under pressure from the financial sector and other special interests to moderate efforts to coordinate the application of existing supervisory standards and would encourage cooperation among supervisors. Banking should be subject to a capital regime entailing more and higher capital requirements, more capital against trading book risk-taking, and a counter-cyclical framework with capital buffers built up in periods of strong economic growth that would be available in downturns. Already, powerful financial interests have rallied against the proposals of Lord Turner and De Larosiere, especially their proposals to curb pro-cyclical policies, bonuses, and remuneration packages in the financial sector. Given sufficient prudence and regulation, De Grauwe thinks there is no reason to fear that quantitative easing will lead to inflation, as extra liquidity will not promote inflation when liquidity is sorely lacking. Willem Buiter contends that if Europe truly wants to establish a single market for financial product services, it will need to delegate regulation to the supra-national domain of the EU. Ultimately, Europe must establish a powerful EU-level authority to which national supervisors report and whose instructions they carry out, in a manner analogous to the relations between the ECB and national euro area central banks (Buiter, 2008). Nonetheless, at the Pittsburgh summit of the G20 on September 25, some agreement was reached on a timetable for regulatory reform, serving to reign in executive compensation, to raise capital requirements and leverage ratios for financial institutions, and to reduce the imbalances between consuming countries like the US and export-dependent China, Germany, and Japan. Moreover, the G20 came together on new IMF voting rules with the added power and authority of the developing economies.

In many advanced economies, welfare policies are being re-assessed and re-calibrated. In Europe, the crisis has been, in many ways, a stress test for the welfare state. Although the crisis may put a strain on many redistributive institutions, this can also have positive consequences, as Tony Atkinson acknowledges. For one, social policy has resurfaced at the centre of the political debate. The crisis has reminded many Europeans of the importance of social programs to support the unemployed, the disabled, and the others most negatively affected by the crisis. In this respect, the economic crisis may reinforce, rather than undermine, the legitimacy of the welfare state. In China, the government has recently realised that internal consumption could be a new driver of growth, but they have yet to make the necessary investments in health-care and welfare to support such a development. In the US, on the other hand, the social debate since the onset of the crisis has focused almost exclusively on health-care reform. There are significant political hurdles to achieving such reform, as the bitter and even violent debates on the issue in the US demonstrate. Obama is cautious about taxes, but according to Nancy Birdsall, a shift towards a more European social model and a retreat from the 'cowboy' model of capitalism seems inevitable, in spite of the American emphasis on low taxes and low government expenditures.

Future productivity growth is likely to come from sources like green energy and low carbon path investments. However, the challenge, according to Nancy Birdsall, will be to find funding, from either the market or the government, to finance the R&D that forms the backbone of these new sectors of the low-carbon economy.

Going beyond welfare state recalibration and sustainable development as separate phenomena, Jacques Delors, Tony Atkinson, and Jean-Paul Fitoussi underscore the need for a different set of indicators of social and economic progress exceeding the traditional measure of GDP growth. In fact, the crisis is partially the result of the exclusive focus on economic growth. The formulation of a new portfolio of social and economic indicators (including, for example, various dimensions of adult numeracy and literacy, access to public services, poverty, environmental health, climate control) is especially politically opportune in the face of a period of lethargic and drawn-out recovery. GDP growth may no longer be an adequate proxy for 'doing well'. To address this issue, in early 2008, Nicolas Sarkozy put together a committee of leading economists, chaired by Joseph Stiglitz, Amartya Sen, and Jean Paul Fitoussi, to rethink GDP as an indicator of economic performance and to consider alternative indicators of social progress. The unifying theme of the report that came out in September 2009 is that the time is ripe for shifting measurement from indicators of economic production to one reflecting people's income, consumption, and wealth, with an emphasis on the household perspective. In other words, the Commission renders more prominence to the distribution of income, consumption, and wealth, in correspondence with sustainability indicators (Stiglitz et al, 2009). What is interesting to note here is that economic progress and international coordination, in the views presented by Delors, Fitoussi, Atkinson, Birdsall, and Rodrik, are made contingent upon substantive policy choices, such as poverty reduction and climate management, in much the same way as the regime of 'embedded liberalism' hinged on (male) full employment and adequate social protection. What these observers thus seem to advocate is perhaps best described as a form of 'embedded globalization'.

Periods of unsettled beliefs can thus inspire new politics. We have learnt this from the experience of the Great Depression in the 1930s, as well as the crisis of stagflation in the 1970s and 1980s. After two decades of neo-liberalism, a critical re-imagining of economy and society, including the role of public authority and political sovereignty, is underway. In addition, there is a fundamental need to offer a better understanding of the international constraints and possibilities for substantive concerted action in a new world order of 'embedded globalization' where national governments remain in charge for regulating a global economy. Even in the realm of international coordination, any sustainable solution to the global crisis continues to rely heavily on domestic legitimacy. Nowhere is this political challenge more apparent than in Europe.

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