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Dipartimento di Economia
Università degli Studi Roma Tre
Via Silvio D'Amico, 77 - 00145 Roma
Tel. 0039-06-57335655 fax 0039-06-57335771
E-mail: dip_eco@uniroma3.it

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DIPARTIMENTO DI ECONOMIA

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Pasquale Tridico

Global Imbalances, Declining Hegemony and the Need for a New Global Governance

Pasquale Tridico[1]
University Roma Tre and New York University
tridico@uniroma3.it

The objective of the paper is to show that the recovery from the current economic crisis in US and in EU requires a new policy paradigm and a new global governance. I argue that, contrary to the recent austerity policies in EU and US, a new level of government involvement is required in order to keep aggregate demand stable, make full employment possible, and create a transparent financial sector, serving the real economy and encouraging productive investments. Moreover, at global level, two main issues seem to affect negatively the markets: first the lack of an independent international currency, and second the instability of one of the biggest market, the Eurozone. The first needs a wider international solution, the latter needs a political responses at EU level in order to deepen integration.

Key words: global imbalances, global governance, international currency
JEL: F02, G01, 016

[1] Pasquale Tridico is a Fulbright Scholar (2010-11) at the Center for European Studies (CES), New York University (NYU), and Assistant Professor at the *University Roma Tre*, Department of Economics, Rome, Italy. He wishes to thank the Belgium and Luxembourg Fulbright Commission and the US Government for the Fulbright-Schuman fellowship. He is also grateful to Larry Wolff and to all the staff at the CES (where he was Fulbright Visiting Scholar between October 2010 and March 2011) for the support, and to Richard Wolff and Giovanni Scarano for their comments. The usual disclaimer applies.

"*Yes, there have been differences between America and Europe. No doubt, there will be differences in the future. But the burdens of a global citizenship continue to bind us together*." (Barack Obama).[2]

1. Introduction

The economic crisis of 2007-2009 is still displaying its effects in terms of unemployment, slow economic recovery, lack of job creation and debt issues. The US and the EU are the most affected by these effects. Mass unemployment, sovereign debt crises and Current Account deficits, financial market volatility, are badly undermining US and EU recoveries. Prospect of economic growth are very low and a crisis of confidence seems to affect negatively their levels of investment. Such a scenario suggests a declining trend for the most advanced economies in the world and a declining hegemony for the US (Clelland and Dunaway 2010). On the contrary emerging economies and in particular China and BRIC grow consistently and seem already far away from the 2007-2009 crisis, which however did not affect them so badly as the EU and the US.

The objective of the paper is to show that the recovery from the crisis requires a new policy paradigm and a new global governance. The root of this crisis in the EU and in the US are strictly endogenous to their economic systems, and concerns in particular the specific path that these two economies embarked since the end of 1970s (as regards the US) and since the beginning of 1990s (as regards the EU). Such a path caused extreme financialization in the US and in the EU, profits soar and wages stagnation (Wolff, 2010; EuroMemorandum 2010; Ivanova 2010; Posner, 2009). The idea of a minimalist state, which was coupled with a financial system completely deregulated, financial activities, portfolio investments, and speculation free to float around the globe, has been the main theoretical paradigm for the past 30 years (Petit, 2009). Such a paradigm, eventually, created bubbles and global Ponzi schemes in the financial markets, which inevitably burst in 2007-08 (Rasmus, 2010). In the real markets this paradigm created lack of productive investments in particular after the burst of the dot-com bubble (in 2001) in the West (mainly US and some EU countries), saving glut, and global

[2] Presidential Nominee Barack Obama in Berlin speech "A World that Stands as One" July 24, 2008. URL (July 27, 2008): http://my.barackobama.com/page/content/berlinvideo

imbalances, characterized by huge deficit in the Western economies and surplus in Asia (mainly China) and few other emerging economies (Ostefeld and Rogoff, 2009).

I argue that, contrary to the recent austerity policies in EU and US, a new level of government involvement is required in order to keep aggregate demand stable, make full employment possible, and create a transparent financial sector, serving the real economy and encouraging productive investments. Moreover, at global level, two main issues seem to affect negatively the markets: first the lack of an independent international currency, and second the instability of one of the biggest global markets, the Eurozone. The first needs a wider international solution, the latter needs a political response at EU level in order to deepen integration.

The Governor of the Chinese People's Bank, Zhou Xiaochuan, has already argued against the use of the US dollar, and he has blamed its supremacy as reserve currency for the current imbalances and crisis. Zhou Xiaochuan seems to recommend the old Keynesian proposal of 1944 at Bretton Woods; with a global currency, the bancor, managed by an International Bank (the International Clearing Union) which would serve as the regulating institution of global surpluses and deficits. Zhou Xiaochuan (2009: 1) claims that, "The outbreak of the crisis and its spillover to the entire world reflect the inherent vulnerabilities and systemic risks in the existing international monetary system." The unique status of the US dollar underlines a latent political conflict and the need to revise a system of global financial governance which emerged immediately after WWII, when international politics and economics looked very different than now (Fuchita and Litan 2007).

In this context of reshaping international governance, EU and US relations seem to be stronger, although macroeconomic cooperation still remains limited. From one side politics, in the post-Bush scenario, is showing more interest for multilateralism[3], from another side, domestic constraints during crisis time prove to be tied. Nevertheless, a new

[3] "The time has come to start thinking of an Atlantic Agenda for Globalization. We have the transatlantic marketplace, NATO, the Transatlantic Economic Council, and other instruments that we should continue to leverage for maximum mutual benefit. But we should move beyond this and set an agenda of common action for a new multilateralism that can benefit the whole world." European Commission President Jose Manuel Barroso, September 24, 2008. URL (March 4, 2009): http://www.eurunion.org/eu/index.php?option=com_content&task=view&id=55&Itemid=43

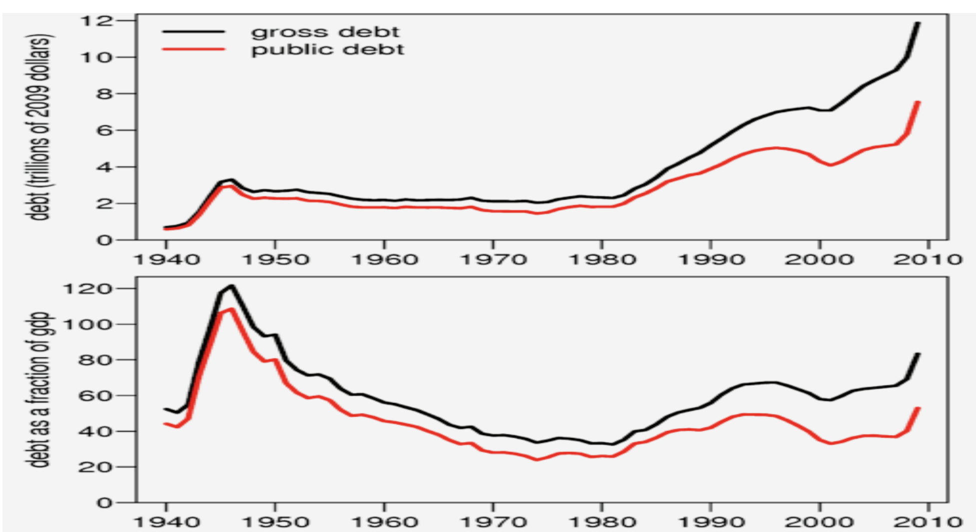
geopolitical order is emerging and, as called for by international consensus within the United Nations or among emerging economies, G20 countries, and oil-producers, progressive global responses are required (Stiglitz, 2010; Westbrook, 2010; Rasmus, 2010). However, the final outcome of this new wind of multilateralism is quite unclear.

The rest of the paper is organized as follows: Session 2 illustrates the main US public liabilities in US and tries to give both a Keynesian and a monetarist interpretation of the global imbalances; Session 3 examines the recent policies in the EU and in the US; Session 4 and 5 expose the status of the international currency and of the global order, and put forward some suggestions for a new global governance. Session 6 concludes the paper.

2. US Debts and International Conflicts: a brief Monetarist and Keynesian views

Today there is a growing consensus around the idea that the financial crisis of 2007-08 is strongly connected, if not caused, by the global imbalances and the saving glut issues (Skidelsky, 2009; Obstefeld and Rogoff, 2009, Bini Smaghi 2008; etc.). The explanation which follows such a consensus is that the financial meltdown of 2007-08 is rooted in the US's main liabilities and debts. Since the 1990s, the amount of US government's debt column grew impressively, reaching, on the eve of the crisis in 2006, more than 5 trillion dollars

Figure 1 – US Government Debt, 1940-2010

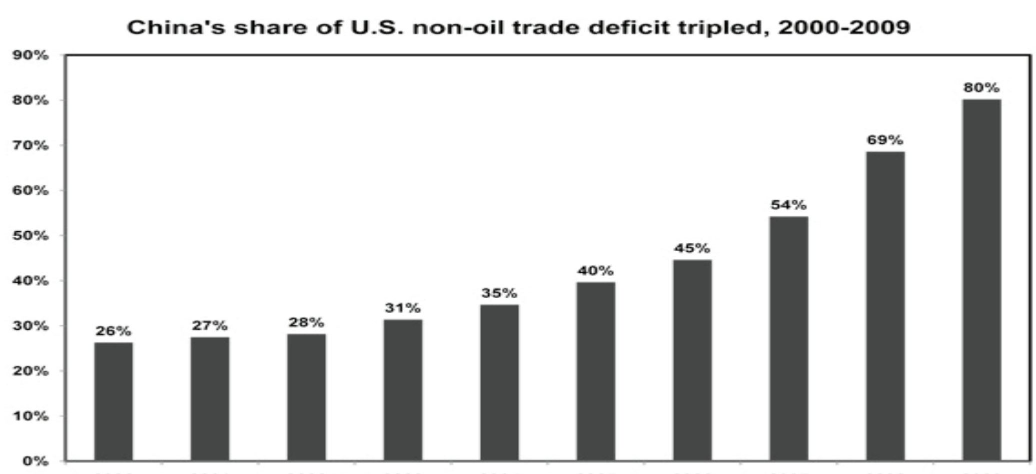


Source: United States Government

Long-term data sets show that this public debt started to emerge in the 1980s, increased dramatically during the 1990s, and was subject only to a small reduction in 2001; a drop which was not sufficient to offset the increasing trend. Today the gross public debt is around 93% of US GDP, and it is still increasing towards the record peak of the IIWW period, with a public debt in 2010 almost of $9 trillion (see figure 1 above). The process of extreme financialization which started in US since 1980s is a parallel phenomenon to this indebtedness. The international power of the US dollar favored such indebtedness, which allows the US to consume and live above its production possibilities (Ivanova 2010).

In 2010, the US economy was affected by a three separate $9 trillion debts, the national debt, the (non-bank) corporate debt, and the private mortgage debt. The financial institution's debt was even higher, with $12 trillion. Paralleling these trends, both the unfunded Medicare liability and the unfunded Social Security liability were very high ($30 trillion and $12 trillion, respectively). Worse than that, America's net investment position with respect to the rest of the world deteriorated dramatically at -$2.5 trillions (this is around 20% of US GDP) and the Current Account (CA) deficit reached the peak of $800 billion (over 6% of GDP) on the eve of the financial crisis. This seems to be the most troubling data, since it speaks to the big issues of a saving glut and global imbalances, in particular with China.

Figure 2 – US Trade Deficit vs. China



Source: US International Trade Commission and Economic Policy Institute

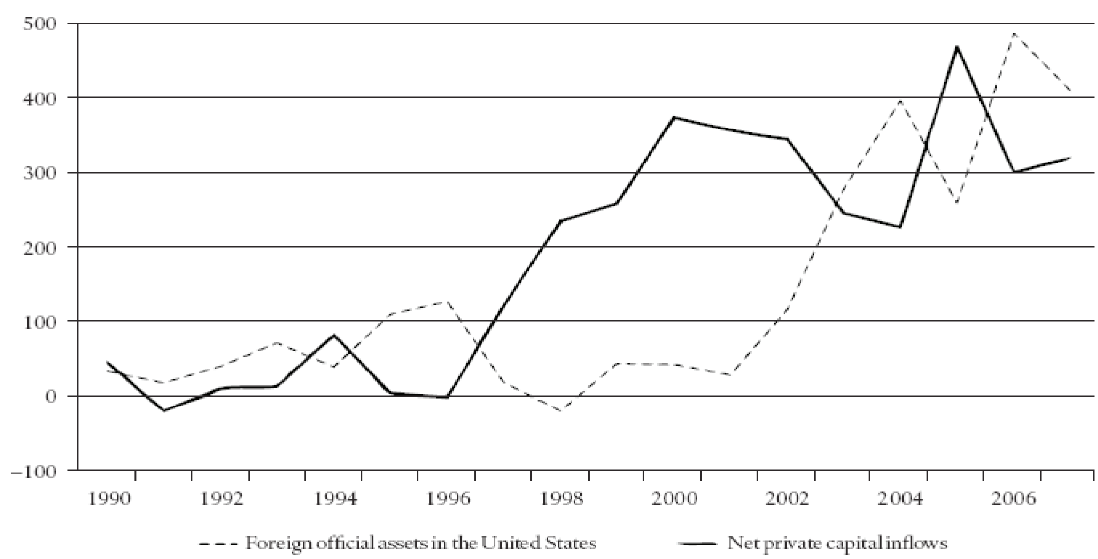
Trade with China in particular is the Achilles' heel. China's share of the US non-oil goods trade deficit has tripled since 2000, as shown in the figure 2 above. Even during the crisis, although the American CA deficit decreased from the peak of $800 billion in 2006, the trade deficit with China has increased. China's share of the US non-oil goods trade deficit jumped from 68.6% in 2008 to 80.2% in 2009.

How all this debt, deficit and global imbalances is connected with the financial crisis is then simple to explain. During the process of financialization, since the 1980s, wages in advanced economies and particularly in US almost stagnated, and profits soared dramatically (Wolff, 2010; EuroMemorandum, 2010). Simultaneously inequality increased sharply (OECD, 2010). In order to keep consumption up, the US maneuvered economic policies: used cheap money which allowed bubbles in the housing sector and private debt soaring; and allowed huge amount of cheap imports from China. This eventually ended up with huge CA deficit (IMF 2009). US financed the CA debt issuing US bonds which were bought in turn by Chinese, whose low level of consumption far compensates the American saving glut. This scenario suggests a declining hegemony of the US economy, because policy options seem to be restricted and the supremacy of the US dollar as the main international currency started to be questioned (Zhou Xiaochuan (2009). It underlines also new weakness of the financial system on the basis of which the US economies nowadays seem to rotate (Clelland and Dunaway, 2010). When the bubbles burst, mortgage companies and lenders fell down and international default correlations followed, since the securitazion of mortgages and loans was an international, and opaque, issue. Credit markets seized up as risk increased and expectations worsened. Consequentially, the financial crisis floated in the real markets squeezing now also productive investments, economic activity and employment.

Looking in detail at the global saving glut, in 2008 the global aggregate excess over investment was over $2,000 billion (IMF, 2009). This discrepancy underlines the current account imbalances.

If in the East (China and South East Asia), where there are emerging economies and growing middle classes with theoretically high consumption potential, people save too much, in the West (mainly US and UK), advanced economies have to stimulate extra-consumption, and therefore monetary policies are enacted which authorities hope will encourage spending. At least that is what the monetarists argue (Cooper, 2007; Caballero et al., 2008). In this way, the claimed money glut is just a consequence of the saving glut. To be more precise: a mistaken consequence. A more appropriate fiscal stimulus would be one based on increasing public investment. In the West (mainly in the US and UK), a well-developed financial system allows for extra-consumption, mechanisms of future repayment, and sophisticated forms of saving with high risk. In the East, safe and ordinary saving tools guarantee low returns and low risks within the framework of an underdeveloped financial system. Unfortunately, high levels of saving in the East do not manifest in the West as high levels of investment that could compensate the lack of aggregate demand. The lack of demand cannot be absorbed by the insufficient domestic investments. Paradoxically, net capital inflow to the US increased (see figure 3 below), but this did not help productive investments, but rather fed financial speculation and extra-consumption.

Figure 3 – Net Capital Inflow to the US (US $ billion)



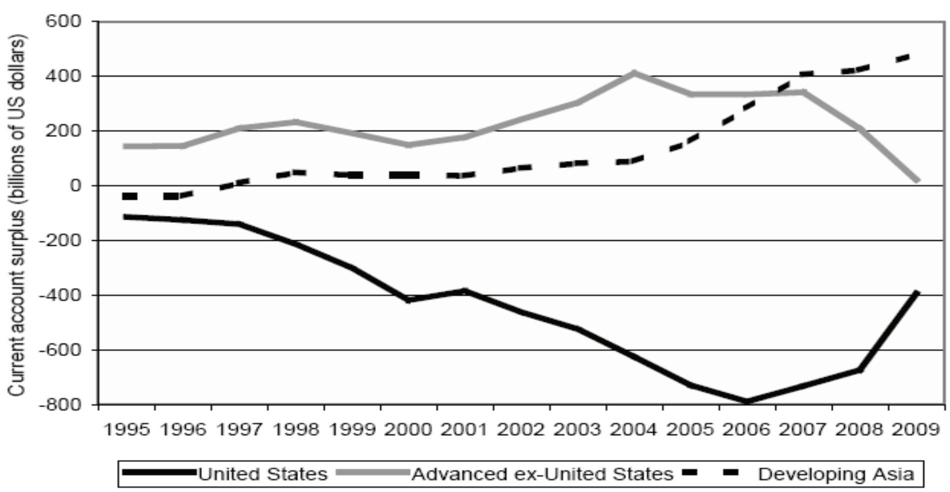
Source: Bureau of Economic Analysis, 2008

In the West, one can observe the increase in demand for finance from those goods and services which go un-bought because of high global saving (Lowenstein, 2009). Consequently, financing for consumption and portfolio movement has increased massively since 2001.

The main criticism monetarists put forward in opposition to the saving glut is the following: if there is a surplus there is a deficit, so deficit countries are as responsible as surplus countries. In the end, this is a matter of market efficiency, and natural re-adjustments will occur to cure temporary imbalances. This is because monetarists assume perfect capital, labor and goods markets; all tending towards equilibrium tendencies (Mendoza et al., 2007; Greenspan, 2007).

Conversely, in the Keynesian view policies matter; and, at a policy level, countries can decide to run a surplus current account with active policies, or a deficit current account, with passive policies attitudes and blind trust in markets. Exchange rates, export-led institutions, state involvement, government subsidies, protectionism, and other policies are all functional for running a surplus or a balanced budget.[4] Deficits, on the other hand, can be the consequence of bad or neutral policies and attitudes. Furthermore, deficit countries have negative incentives to reduce their deficits by means such as reducing external demand, because this would bring about lower income and higher unemployment levels. Contrast this to surplus countries, which are incentivized to increase their surplus by increasing exports, and therefore aggregate demand, since they would generate higher income and employment levels.[5]

Figure 4 – Global Imbalances, US and the Rest, 1995-2009



Source: IMF (2010), World Economic Outlook, online database

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[4] Obviously not all countries in the world can simultaneously operate with surpluses. Therefore, temporary and small deficits across the world can be sustained.

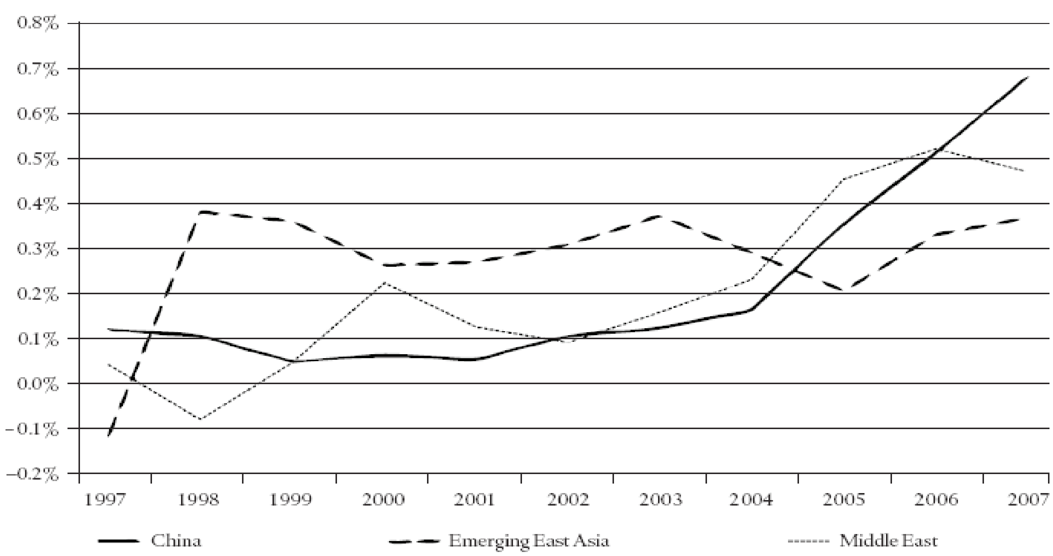
[5] Surplus countries are also incentivized to reduce surpluses by expanding domestic demand for goods, because they would get higher income and employment.

A very good example of these tendencies was the Asian crisis of 1997 (see figure 4 above). All of the Asian economies affected in 1997 (South Korea, Taiwan, Hong Kong, Singapore, Malaysia, Thailand, Indonesia) turned their current account balances from deficit to surplus (Walter 2008).

These shifts were planned decisions, as policymakers in those countries had learned the downfalls of persistent current account deficits. In fact, the abrupt withdrawal of capital from Asia by foreign investors was one of the leading causes of that crisis (Bello, 2010). After the crisis, and after paying their debts to the IMF, Asian economies turned back to mercantilist policies: personified by high saving, high surplus, and low consumption, in particular of imports.

This is the same strategy which allowed the accumulation and the economic development of the Asian tigers in the 1970s and 1980s (Ha-Joon Chang (2008) and of China since 2000s (see figure 5 below). It was easier for them to operate with surpluses than to fall into deficit.

Figure 5 – China and Other Emerging Economies Current Account Surpluses (% of World GDP)



Source: IMF 2010, World Economic Outlook, online database

Paraphrasing Lowenstein (2010:135), we can use an interesting metaphor to interpret conflicting relations between East and West, in particular between China and the

US. Somebody from the East, Chang, is offering goods and services for free to John in the West, the only expense being that John has to run a deficit. John accepts, and now he works less (or is jobless). However, he enjoys an even higher standard of living than before thanks to cheap goods from China and to a developed financial system in his home country. He uses credit (mainly from Chang) to make purchases and eventually to make financial speculations and generate profits. If he is able to make higher profits than the interest payments due on the debt he needed to run a deficit, he will be fine. If the available financing dries up he will be in trouble, as the debt that he is responsible to pay tomorrow will lower the standard of living that he is enjoying today to an even lower level than before he entered into the Chinese deal with Chang.

3. A Wrong Policy Tendency: Austerities after Fiscal Stimuli

In order to recover from the crisis, governments in Western economies, particularly US and EU, initially put in place fiscal stimuli and bank rescue packages (see table A2 and A3 in the Appendix). These policies were supported by a great consensus among the policymakers, politicians, and academics who had begun to look at Keynesian policies in a favourable way.

Monetary policies were simultaneously manipulated by Western central banks. A combination of actions by the Fed, the European Central Bank (ECB), and the Bank of England provided a huge amount of liquidity to the private sector, and to the banking sector in particular, in order to avoid the crunch of the inter-lending among banks. The first injections came in the summer of 2007, with the leading role going to the Fed. The Fed provided more liquidity in the first quarter of 2008, first with a plan to inject $200 billion into the economy, and then by assisting in the bail-out Bear Stearns by JP Morgan and the bailout of Merril Lynch by Bank of America.[6] All together, the US government enacted a $700 billion bailout for the financial sector, with the so called TARP Act (Troubled Asset Relief Program) in October 2008[7]. The ECB and the Bank of England

[6] As illustrated in the table A3 in the Appendix, the most important banking and financial institutions of American capitalism were assisted during the crisis.

[7] TARP was enacted by G.W. Bush on October 3, 2008, just before Obama's election, and allowed the Treasury to purchase illiquid, difficult-to-value assets from banks and other financial institutions as a first reaction to the subprime mortgage crisis. Posner (2009) estimates that the total amount of spending by the US federal government during the period 2007-2010 for the financial crisis was of $7.2 trillion ($5.2

reacted by releasing similar proportions of liquidity into their own financial markets. Moreover, the interest rate in the US had been reduced from 5.25 to 0.25 per cent. Similar action was taken in the UK. In the Eurozone, given the greatest priority of the ECB was to foster to price stability, the interest rate was lowered more slowly to 2.5% in 2009 and to 1% in 2010. In 2009, given the partial, unsuccessful results of the previous injections and the continuation of the crisis, the Fed undertook more drastic actions to provide more liquidity at a value of $700 billion (mainly buying back treasury bonds in order to inject liquidity into the market). A similar plan was undertaken in November, 2010.

Regarding fiscal policy, in the US, Obama's fiscal stimulus, known as ARRA (American Recovering and Reinvestment Act) entered onto the scene in February, 2009, after a huge debate in Congress.[8] The stimulus aims to promote, in the Keynesian tradition, job creation, investment, and consumer spending during the recession. To some extent it represents a breakdown of the main economic consensus which favored spontaneous recovery, i.e., recovery driven by the market or, in the less conservative case, monetary policy (quantitative easy) over fiscal stimulus.

There are at least two reasons to favor this stimulus: first, the need to prevent further output declines and job destruction, and second, the evidence that easy access to cheap money was not successful. The Fed cut interest rates almost to zero, and one can envision clearly a well known Keynesian liquidity trap, where monetary policies are ineffective. Many Keynesian economists argue that ARRA is a good step in the right direction, but they point out, critically, that it is far below what is needed to restore economic growth (Krugman, 2010; Zandi, 2010)[9]. Monetarist economists, on the contrary, worry that fiscal stimuli do not favor consumption multipliers because during recession individuals tend to save more and to postpone consumption (Taylor, 2010). Moreover, future debt needs to be repaid by taxpayers who are seeing future available income reduced (Giavazzi and Pagano, 1990).

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trillion by the Fed and $2 trillion by the Treasury Department). It is unclear, however, how much and where exactly all the federal money went at the beginning of the crisis, in the desperate attempt to save banks and financial institutions (Westbrook, 2010). Only in December 2010, while writing, did the Fed agreed to partially reveal the destination and amount of liquidity injections and favorable loans during 2007-08, while before they had appealed to national security reasons in order to hide such operations.

[8] No Republicans in the House voted for the bill, while in the Senate only three Republicans voted for it

While many economists agreed that a fiscal stimulus was needed under the current recession conditions of the liquidity trap, others maintained that fiscal policy would not work because government debt would use up savings that would have otherwise gone to investments - what is known as a *crowding out* effect. (Barro, 1989). However, counter-Keynesian arguments maintain that the negative effects of the crowding out are limited when investment has already stagnated (Romer and Bernestein, 2010).

The Obama measures are nominally worth $787 billion, or 2.7% of GDP. ARRA includes federal tax incentives, expansion of unemployment benefits and other social welfare provisions, and domestic spending in education, health care, and infrastructure, including the energy sector, which aims to promote green jobs. Such a plan, Republicans and neoliberals argue, was not useful because employment did not increase. Supporters of the Obama stimulus plan argue that, without the plan, unemployment would be even higher and recession deeper and longer, as during the 1929 Great Depression (Bartlett, 2010). This argument seems to be convincing (Romer and Bernestein, 2010). However, I maintain that economic recovery will not come without further direct government packages intended to support public employment. In fact right now, with GDP recovery already in process, job creation does not seem to be occurring. At least it does not seem to be occurring at the necessary pace to recover 10 million of jobs (Mishel et al., 2010) which would be needed in order to reach the pre-crisis level of employment. Direct public employment would contribute immediately to a recovery from high unemployment. A great example supporting this is the New Deal of Roosevelt, which created, before the US's involvement in the WWII, around 11 million new jobs, enough to restore America to a pre-1929 level of employment (Wolff, 2010). In order to do this, however, a new policy paradigm and a different approach is needed in the US. Such an approach should favor a public culture and a deeper government involvement in the economy.

In the EU, fiscal stimuli were fragmented and often uncoordinated among Member states. Moreover, the EU is a supranational organization with much less power than the US federation and little possibility of economies of scale. Seventeen countries adopted the Euro and, consequently, the ECB and the Maastricht criteria which regard common monetary policies, fiscal constraints and harmonisation. Ten other countries[10] maintain their own currency and sovereignty over their monetary policy, financial system and fiscal policies. This means that Europe has eleven different currencies.[11] This represents a concrete difficulty in policy coordination. However, the biggest problem relates to the fact that the UK is not part of the Eurozone. The UK is the second largest economy in the EU and the British Pound is still an internationally important currency, with London as the biggest financial centre in Europe (Wahl, 2010). Market capitalization in London is €1,962 trillion (2010 data), while Frankfurt and Paris have around €0.900 trillion each in market capitalization (Eurostat 2010). When national interests are on the table, EU members states, and in particular the UK, demonstrate a strong opposition to EU financial regulation and supranational power (UK Treasury Committee, 2010).

So far, the total EU fiscal stimulus was around 1.5% of the total EU GDP, but not all the countries acted on the suggestions of the EU Commission. Spain, which was one of the countries hit hardest by the crisis, put in place the biggest stimulus in Europe, favoured by a socialist government, of 3.7% of GDP. This plan focused for €40 billion to support infrastructure investments and the automobile industry. France's plan was smaller, €26 billion, which includes a boost for the construction and automobile sectors; moreover, the government has promised €20 billion for small businesses and the construction industry. Germany's package includes generous amortization rules for companies and incentives for climate-friendly home renovation; the total package is expected to reach €82 billion, including private investments. Italy proposes a nominal stimulus for unemployment subsidies and firm support that will only amount to €9 billion. The UK has announced a temporary reduction of the VAT rate from 17.5% to 15%. In addition, the government plans to invest €31 billion on infrastructure. The tables A2 and A3 in appendix summarize these data.

The outcomes of these stimuli were quite positive: in the second quarter of 2010, Germany grew at an extraordinary rate of 8.8%, and the UK at 4.8%. Similar stories, although of less magnitude, occurred in other European economies. The US recovered,

[10] Bulgaria, Czech Rep., Denmark, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Sweden, UK.
[11] The currencies of Bulgaria, Denmark, Estonia, Latvia and Lithuania are pegged to the Euro

too, with 1.6% growth for the same period. Nevertheless, after the spring of 2010, policy consensus switched towards austerity measures. After the Greek crisis, governments turned their interests, irrationally, toward budget cuts and policies of contraction (Arestis and Pelagidis, 2010). In the fall of 2010, the new Liberal-Conservative government in the UK announced an austerity plan with cuts in public expenditures and a freezing of public employment wages and jobs for the next three years. A similar plan was announced in the US by President Barack Obama in November, 2010, freezing federal pay for the next two years. Chancellor Merkel is proposing similar restrictive plans in Germany, and other continental European countries are preparing financial laws very much focused on restrictive fiscal measurements. The objective is to reduce deficits. This seems more like a reaction to the Greek and Irish crises, rather than a rational decision which would help economic recovery (Arestis and Pelagidis, 2010).

The Greek crisis showed how EU member states are much more concerned with national issues than EU integration, in particular during crisis times.[12] The lack of coordination and financial solidarity emerged dramatically, and the issue of European imbalances are wrongly regarded as a problem of laziness against effort, virtuous balance against bad discipline, Mediterranean corruption against northern European integrity (Cesaratto 2010). This does not help to look at the real problem behind the deficit-surplus issue within the EU: a single market (with many imperfections) and a common currency within a non-Optimal Currency Area (OCA) needs labour coordination, budget centralisation, and fiscal policy harmonisation, at the very least.[13] Beside that, the strong "internal devaluation" (i.e., wage moderation) that Germany carried out in the past ten years, along with other mercantilist policies and the cooperation of the ECB monetary policies, allowed German exports to increase dramatically (Cesaratto, 2010). Such policies were not really in the spirit of EU integration and solidarity. Consequentially the EU situation today looks fragmented. One side, Greece and the other Mediterranean countries suffer from the efficiency of northern Europe firms. Free competition and single market affected the domestic markets in those countries, which were lagging

[12] Media pointed out how an election in the small Lander of Lower Saxon in Germany during the Greek crisis in the Spring 2010 was enough to keep German chancellor Angela Merkel far away from an idea of integration and financial solidarity, which populists in Germany objected.

[13] Wray, L. Randall (July 2000). *The Neo-Chartalist Approach to Money*. Center for Full Employment and Price Stability. http://www.cfeps.org/pubs/wp/wp10.html.

behind in terms of competitiveness and technology at the creation of the Eurozone and the single market. Moreover, Maastricht criteria and stability pacts appreciated the euro and contributed to the declining foreign competitiveness of southern European economies. On the other hand, those poorer economies in the EU can't use monetary policies and exchange rate manipulation to gain competitiveness. They can't use state aids and firm subsides, nor fiscal policies which are constrained by Maastricht criteria. Hence, markets have to regulate imbalances despite the fact that labour mobility, single markets, and budget centralization are strongly limited in the EU. It follows that surplus and deficit are the two malaises of the same problem: an imperfect single market and an imperfect currency union. In the EU, Germany's surplus could not exist without Greece's deficit (and similar). Greece should accept, within the EU rules, the German market super-competition, which is historically rooted and state supported, despite the fact that she can't use policies to enhance her firms' competitive advantage. Unless these imbalances are covered by a central EU plan, it would not be convenient for Greece to accept European monetary union constraints.

As De Long (2010), Arestis and Pelagidis (2010), and many others underlined, at the global level surplus countries such a Germany and Japan need to implement expansionary policies rather than austerity measures, spending more and taxing less. In Europe, the ECB should lower the interest rate to the Fed level (which is near zero) and should have a big program of buying national bonds. The Tremonti-Junker proposal of issuing European Union Bonds should also be accepted[14]. The European Financial Stability Facility[15], which is today endowed of a fund of €700 billion, should become a permanent agency and should continue to buy government bonds of countries in crisis. A strong institution working as a lender of last resort should be created for the EU or at least for the Eurozone. The biggest European economies, such as Germany, the UK, and

[14] Jean-Claude Juncker and Giulio Tremonti made a proposal on the financial Times for a European Union bond, issued by a European Debt Agency (EDA). Each country can issue European bonds up to 40% of GDP. This would create, over time, a sovereign bond market of similar size to the US one. Initially the EDA would finance 50% of member states' debt issues – but this can be raised to 100% during crises. The proposal also envisions a mechanism to switch between national and European bonds for countries in trouble at a discount rate. This would avoid the problem that secondary markets in many EU sovereign bonds are not sufficient liquid during crises.

[15] This is a temporary EU fund which was created during the Greek crisis in the Spring on 2010, providing an initial support of €500 billion.

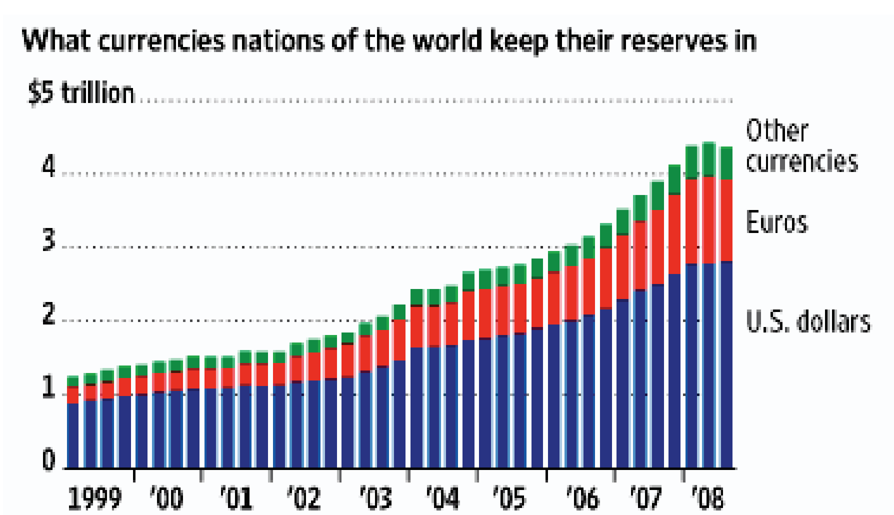
France should expand aggregate demand to allow for more imports from Mediterranean economies (Spain, Portugal, Greece, and Italy), in order for them to equalize the deficit in the current account. Current account deficit, in fact is, dangerously financed by German, British, and French banks, which buy national bonds from Mediterranean economies. In turn, if those southern economies cannot repay their debts, correlation default in northern European banks will follow.

4. A Need for a New International Currency

At international level, global imbalances and the saving glut theory call into question the role of the US dollar as a global currency and raise the issue of a possible new global currency and/or governance.

Clearly, there can be a conflict between international and domestic objectives. As argued by Zhou Xiaochuan (2009), monetary authorities may fail to meet growing global demand for money when they try to keep inflation low at home, and conversely, they may create an excess of liquidity at the global level when they try to over stimulate domestic demand (see figure 6 below). The current crisis, Zhou Xiaochuan says, is an inevitable outcome of the current institutional flaws which has the US dollar acting as a global currency for debts and international transactions.

Figure 6 – US Dollar Dominance over Foreign Debts



Source: Wall Street Journal

Many scholars, notably in the World System field, recognize the unique position of US as a hegemonic borrower (Frasnk, 2005; Clelland and Dunaway 2010). The US has the unique and indefinite capacity to sell Treasury notes for dollars, in massive quantities and practically without constraints, and became the key source of global liquidity. Obviously it has also the capacity to manufacture dollars indefinitely, in the last instance. US current account has been in massive deficit for the past 30 years. Therefore, every year, billions of dollars have been transferred from foreigners to US balance (Clelland and Dunaway 2010). Debt could rise to finance practically everything: government expenditures, military operations, private debts, because the unique status of the US currency ensured an international stable demand of its debt. At the same time private finance created tools which allowed for the recycling of the US trade deficits. In this way, over-consumption in US was guaranteed, even with stagnant wages (and profit soar) since the end of the 1970s (Wolff, 2010). The opacity of interconnection of massive transnational securitization and speculation brought eventually at the financial implosion of 2007-2008, which however was a natural outcome of such an institutional framework (Ivanova, 2010).

Very interestingly in 1965, when General De Gaulle already denounced the "exorbitant privilege" of the international seigniorage of US $, Rueff and Hirsch (1965: 3) wrote:

> *…when a country with a key currency has a deficit in its balance of payments – that is to say the United States, for example – it pays the creditor country dollars which end up with its central bank. But the dollars are of no use in Bonn, or in Tokyo, or in Paris. The very same day, they are re-lent to the New York money market, so that they return to the place of origin. Thus the debtor country does not lose what the creditor country has gained. So the key-currency country never feels the effect of a deficit in the balance of payments. And the main reason is that there is no reason whatever for the deficit to disappear, because it does not appear. Let me be more positive: if I had an agreement with my tailor (CHINA) that whatever money (IMPORTS) I pay him he returns to me the very same day as a loan, I (USA) would have no objection at all to ordering more suits from him (MORE IMPORTS).*[16]

The solution, according to Zhou Xiaochuan, has to be found in an international currency disconnected from any single nation. He refers explicitly to the unaccepted Keynesian project at Bretton Woods of an International Bank and a global currency (the

[16] Capitals words in bracket added to the authors' metaphor of the tailor, to emphasize the interesting parallel with today situation between China and USA.

Bancor). This would make exchange rate policies more effective in both objectives: adjusting imbalances and decreasing deficits. He recalls an old, never fully implemented IMF project dating to 1969, intending to set up an international currency unit (the SDR)[17] based on a basket of national currencies. In these international currency projects, (the bancor or the SDR) the international monetary authorities should come from a wide consensus which exercises control and lends prestige to the new international system. This should go beyond the current IMF framework, which is based on institutions designed in North America and Western Europe, with big countries (mainly G7), having more power, more vetoes and more right to votes than others. A good starting point could be the G20 or any other wider organization (see Stiglitz 2010).

In the Keynesian project of 1944, the International Clearing Union (ICU) was a global bank aimed at regulating trade between nations. The ICU would use a global currency, the bancor, for all the international payments. The bancor would have a fixed exchange rate against other national currencies and would measure the volume and the balance of trade among countries. Every good exported would add bancors to a country's account, every good imported would subtract them. Each nation would then be given large incentives to keep their bancor balance within an acceptable range. If a nation had too much bancor due to high export levels, surplus would arise and the ICU would take a percentage of that surplus and put it into the Clearing Union's Reserve Fund. This would encourage countries to maintain balance as close as possible to zero. Deficit nations, on the other hand, would have their currency deflated to encourage other nations to buy their products and make imports more expensive. A risk of inflation and a debt pressure would be an incentive for these countries to raise productivity and continue to strive for balance.

In regards to global imbalances, China would not volunteer, in the current institutional framework, to change from a quickly growing country to a slowly developing one in order to save international capitalism and eliminate global imbalances. China will not devalue exchange rate and loosen monetary and fiscal polices at the expenses of low employment and risk of inflation. Moreover, China knows very well the

[17] The SDR (*Special Drawing Rights*) is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves. Its value is based on a basket of four key international currencies, and SDRs can be exchanged for freely usable currencies.

causes of the Asian crisis in 1997, and with a population of almost 1.5 billion of people, and a delicate political situation, she prefers to stay on the safe side. International responsibilities should be passed to the richer countries, the ones which have already reached high living standards, unlike China. In this scenario the US economic hegemony would decline because its policy options would be restricted and its unlimited capability to finance the domestic debt would come to an end. On this line, world systems scholars have already opened a debate (Wallerstein, 2008; Wallerstein, 2009; Clelland and Dunaway, 2010).

The crisis itself proves that a Coordinated Market Economy (CME) may do more to shape a new global governance and may be more appropriate to help prevent further crises (Pontusson 2005). The CME would guarantee a more stable path of development and of accumulation, mitigating the risk of boom and bust cycles illustrated by Minsky (1986). Examples of CME can be found in the EU and in particular among continental and Scandinavian economies (the so called European Social Model), which combine interesting and functional elements of competitive markets economies such as competition and private investments, with useful market coordination systems such as financial regulation, public strategies of investments and Welfare and important public goods (Pontusson, 2005). However, when a new global governance needs to be put in place, global politics and power relations come into play, and this reveals that the EU's political position is weaker and less reliable than the US position, which may appear, to the rest of the world at least, more convincing and backed by the voice of a unique and powerful government.

5. A New Governance: Old European Tools for a Global Stable Development

The essential truth of Keynes's ideas is that even the most productive economy can fail if consumers and or investors spend too little. At the global level, it applies to the current crisis as follows: Asia, especially China, saves too much (and consumes too little), while the US saves and invests too little. Furthermore, at the policy level, the Keynesian theory states that sound money and balanced budgets are not always wisdom (Krugman, 2008, Arestis, and Pelagidis, 2010). Keynesism is not a theory which has to be used during a specific phase of the economic cycle. It is a general theory which, if implemented correctly, helps to prevent crisis and to maintain a steady path of development.

For this reason, however, policy makers need to pay attention to two economic policies: aggregate demand management and labor market policy. The first should have the objective of stabilizing the level of activity at full employment. The second, which is connected to the first, has to ensure that labor institutions are able to guarantee adequate wages and permanent income mechanisms to workers in order to sustain consumption and demand. In this respect, labor flexibility aimed at reducing labor cost would be inappropriate because it would put workers at the mercy of precarious jobs, unstable income, and would lower or destabilize consumption. Wage shares on income would decrease and consumption would then be obliged to rely on financial assistance and tools like credit and mortgage to be kept stable. These financial tools, however, could crash when workers do not have means (enough wages and jobs) to reimburse debts, and in turn the system could collapse.

In this light, one could find a good explanation for the beginning of the current financial crisis. The explosion of financial tools intended to sustain consumption, and the flexibility of labor markets in most of the advanced economies, two characteristics introduced during the last three decades, are two sides of the same coin. In the US, since the labor market is already very flexible, the main problem with regard to labor is that since 1975 wages have stopped increasing while productivity has increased consistently (Wolff, 2010). Overhauls to the financial sector must go hand in hand with a counter-flexibility agenda and wage increases in order to make jobs more safe, income and consumption more stable, to sustain aggregate demand.

What economies need today goes beyond monetary policies, fiscal stimulus, and the regulation of financial markets. We also need to create a stable accumulation regime which allows for productive investments and the increased sharing of productivity. This needs to be coupled with demand management policies and state intervention in order to keep the system on a path of stable development and full employment. The Welfare State is the necessary appendix of such a model, and it should provide for stable consumption, public goods, automatic mechanisms of wage compensation, and subsidies. In other words, to get out of the crisis, the solution cannot be found in temporary stimuli designed to rescue the economy from the current depression. The current financial-led model has been proven unstable. Therefore, any attempt to save this financial-led model by inflating liquidity and only temporarily raising the aggregate demand through fiscal stimulus will fail in the long run. What is needed is a complete restructuring of the economy, revising the fundamental institutional forms of the current financial-led regime with a stable demand management of the economy.

The new governance should address the fundamental issue of stable development, trying to avoid burst and bubble mechanisms, speculation, and unproductive investments. As I mentioned earlier, interesting parallels can be drawn between the different variations of the European Social Model (French, German, Scandinavian) regarding stable development, as they all still have the important tools necessary, like Welfare States, social policies, and demand management coupled with a strongly regulated financial sector (Skidelsky, 2009). The EU may carry out a global governance proposal based on its own experience. The European model is in fact, in its different variations, an example for sustainable development in the long run. The table 1 below is an ideal type representation of the kind of Coordinated Market Economy which is drawn partially from the European experiences during Fordism and partially from the lessons of the current financial crisis.

Such a model would be a stable strategy for growth, led by three important features around which the other institutional forms would operate:

1. Secure jobs: increasing wages and full employment policy commitments to sustain consumption;
2. Macroeconomic and industrial policies aimed at stabilizing aggregate demand, investments, productivity, and innovation;
3. Finance: regulated and transparent, which truly supports productive investments.

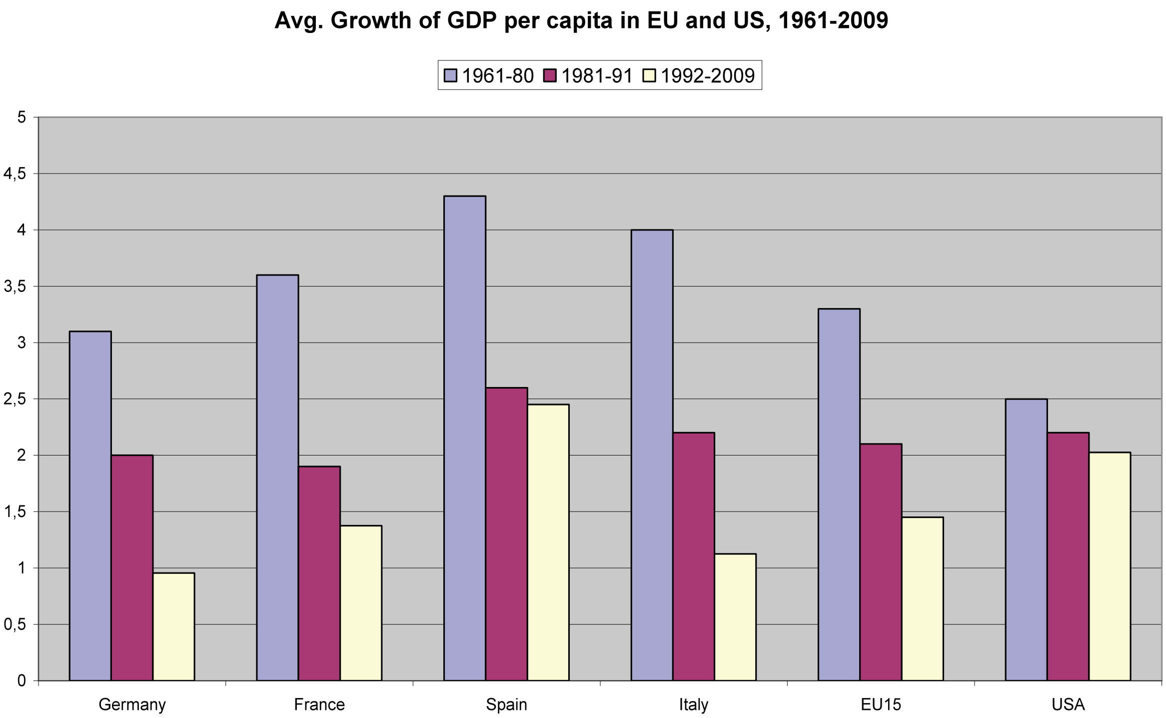
Table 1 - Post-financial Model of Accumulation and Growth

Coordinated Market Economies							
Institutional forms					Policies		Finance
Wage Relation	Form of competition	Monetary regime	Relationship between state and economy	International regime	Macroeconomic Policy	Social policy	
Sharing productivity gains. Collective bargaining; Promotion of norms of sustainable production & consumption; full employment objectives.	Limited and controlled form of competition; redesign and re-regulate markets to reduce risks of and to avoid unlimited competition.	Soft money constraints coupled with fiscal policies; Public credit management and credit money; State control over money.	Protection of strategic sectors; Management of international economic relations; State interventionism in economy, State ownership, investment planning, stimulate	National competition; Strategic Protectionism; Managing of exchange rate; "Global" and stable currency; limited movement of short term capitals.	Anti-cyclical Policy; demand side policy; State interventionism; promotion of economies of scale and sustainable development; R&D and productivity growth incentives for firms; taxes to restore stability, public finances and stimulate growth	Income redistribution, progressive taxation; protection of welfare rights and social needs; Strong Welfare State in Health and Education; promotion of inclusive policies.	Moderate finacialization of the system; Developed finance for Investments; extensive credit for firms; limited finance and credit for consumption; "Tobin tax" for financial transaction-speculation; financial regulation, transparency and protection of saving; higher taxes on financial corporation; Public entity status and for Credit Rating Agencies.

Following these radical changes, countries could better implement their economic policies, monetary ease, and fiscal stimulus, which would then produce more consistent results. This should, however, be decided within a complex framework of political economy, which would take into consideration the trade-offs, domestic and international constraints, social cohesion, and similar issues. The table A1 in Appendix, which would fit better for the political economy analysis of deficit countries, in particular the US, serves as a general representation of such a framework, and one could draw interesting observations from that. This is a synthetic classification of policy options that countries may put in place in order to cope with the crisis and to enact a recovery plan.

The European Social Model ensured better economic performance in Europe during the Fordist era of accumulation with respect to US. It was able to deliver better GDP performance for an extended period of time, at least until the end of the 1970s (see figure 7 below).

Figure 7 - GDP Growth in the EU and the US



Source: Eurostat

After that, the process of financialization began and a finance-led growth regime took over; the old Fordist regime went into crisis. Reasons for that are different as explained by many scholars (Lipietz 1992; Jessop 2002; Boyer and Saillard 2002)[18]. Under this model of development the EU, or more accurately the Eurozone, was able to outpace the US, thanks to a large public program of social expenditures, in social and economic benchmarking areas such as inequality, poverty, public education, and life expectancy (UNDP, 2010). The US, on the contrary, saw slightly faster GDP growth during the past two decades of financialization, but a concerning drop of important social indicators (inequality and poverty).

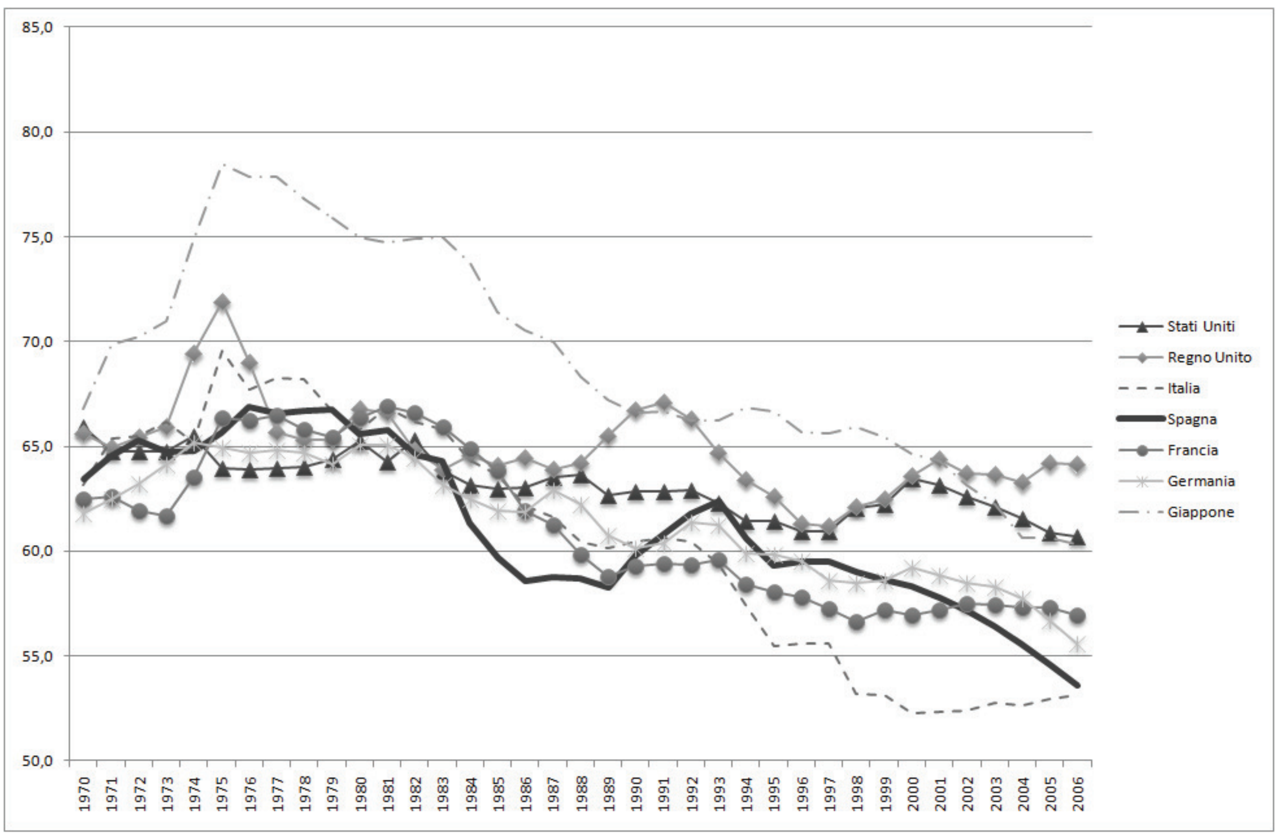
However, the EU was also growing over the past twenty years (albeit at lower rates than the US economy), and not simply maintaining their social indicators.

[18] In brief, the causes of the Fordist crisis are: a decrease in productivity, poor labor organization, the internationalization of problems through pressure on labor costs, and the resulting decrease in the demand. These are supply side causes, national and international ones, and exogenous to the core of Fordist economic doctrine.

Furthermore, the current financial crisis affected the US very badly in particular, putting into doubt the US model and its vaunted efficiency (Posner, 2009; Wolff, 2009). For these reasons I argue that the example of an European Social Model with a "fordist governance" able to combine demand management and welfare state, is not only able to produce better social performance but also socially more efficient and able to produce sustainable economic development in the long run. Moreover, it would help to prevent bubble and burst cycles and dangerous financial crises as the one we are experiencing now.

On the contrary, the financialization, since the end of the 1970s, caused a reduction of the share of the wage on the GDP among the most advanced economies (see figure 8 below).

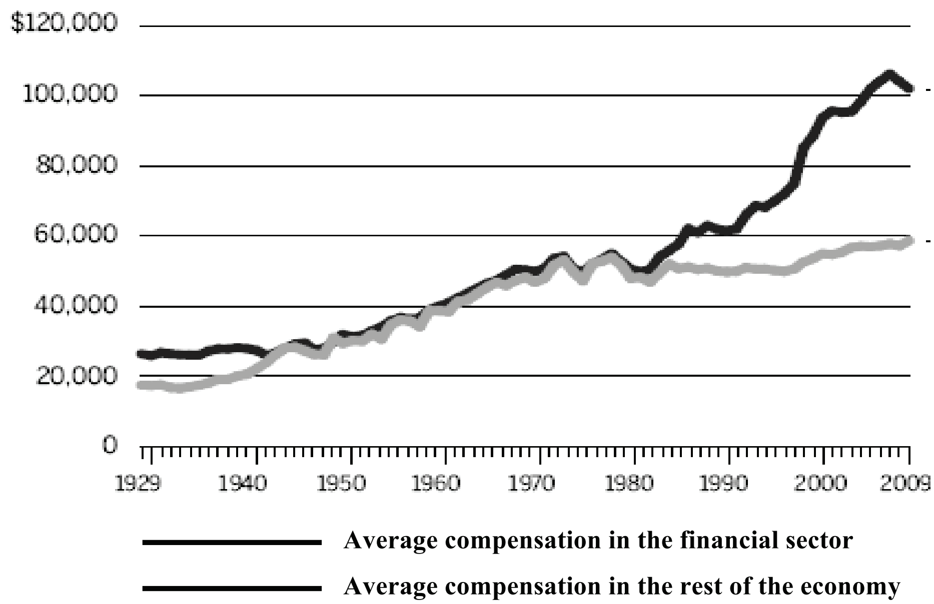
Figure 8 - Share of the wage over the GDP (1970-2006)



Source: OECD (2010)

The sharing of productivity gains, which was the basis of the Fordist compromise, came to an end, and inequality increased dramatically, bringing about a need, among workers, for demand of finance for consumption (see figure A1 in the appendix). In fact, income inequality is more marked than consumption inequality. As shown by figure A2 in the appendix, consumption inequality, thanks to finance, increased only of 6%, despite the fact that, during the same period (1980-2005), income inequality increases of 23%. This process, in particular in US, brought about (as shown by the figure 9 below) a soar of profits and a dramatic increase in the finance compensation with respect to the rest of the economy.

Figure 9 - US average compensation



Source: Financial Crisis Inquiry Commission (2011)

In the financial sector short term results and stakeholder dividends are favored over long term results and productivity. The ratio between manager's compensation and average wages of blue-collar workers increased steadily in the 1980s and in the 1990s. At the beginning of the last bubble, in 2003 it was 1 to 369 and at the eve of the financial crisis, in 2007, it skyrocketed to 521 thanks to bonus and compensation which do not find a proper justification (see figures A3 and A4 in the appendix).

In turn, such a demand of finance for consumption, coupled with cheap money, US dollar international power, and low interest rates, sustained growth, fueled the bubble and nourished a doped economic growth in US. The burst of the bubble disclosed all the weaknesses of this paradigm and the failure of the Greenspan policies. Simultaneously, a lack of productive investments was a great source of the international imbalances. In fact, Greenspan's loose monetary policies and the Bush administration's budget deficit were facilitators of the crisis and of the imbalances (Skidelsky, 2009; Lowenstein, 2009).[19] Therefore, a new international governance is needed in order to cure the international imbalances, along with a new government role able to manage the aggregate demand and to bring the economic system on a path of a stable development as it was during fordism.

6. Conclusion

In this paper I have argued that a new level of government involvement and public policy is required in order to go out from the crisis. This should be coupled with a new global governance and a radical change of the international order, introducing a new global currency. In the US and the EU a wide program of aggregate demand management, appropriate labour policies, and public employment are needed. This should allow for full employment and shared productivity gains. A coordinated market economy, similarly to the one existing in continental Europe and Scandinavia economies, can be considered good examples on the base of which national solutions and global governance can draw interesting lessons.

Regarding the EU, the solution can be found within the club. Since it would be practically impossible for poorer member states to enact mercantilist and protectionist policies within the context of the European Union, imbalances should be accepted within the EU. Germany enjoys a better position since it historically has a competitive and technological advantage, and enjoys free trade and free movement within the Union at much less cost. This cannot be the position of Greece, Portugal, and other Mediterranean countries, along with Ireland, France, and some others EU members. They could offset the German advantage if they could operate on the exchange rate or using monetary

[19] Greenspan was also a great supporter of sub-prime lending and derivatives, stating, "Derivatives have been an extraordinarily useful vehicle to transfer risk from those who shouldn't be taking it to those who are willing to and are capable of doing so" (US Senate Banking Committee, 2003).

policies. But within the EMU this is not possible. Moreover, since withdrawal from the Union is not politically practical, the reasonable solution must be found in a central budget, a common fiscal policy aimed at eliminating differences, or the toleration of reasonable unbalances within the EU. In the end, Germany cannot run a surplus if Mediterranean member states cannot run a deficit. In Europe, more than in the rest of the world, coordination is needed.

On the global level, a lot needs to be done, at least within the new framework of the G20. In particular, issues such as the contradiction and the tensions created by the US dollar as an international currency and the management of global imbalances need to be addressed. The creation of a new international currency as called for by the Bank of China's governor and the institution of an international bank of payment are issues to be addressed. As argued in the text, an international bank could work to large extent automatically, in order to deal with imbalances and crises, rather than operate on the conditions decided on by a few members.

Appendix

Table A1 - Political economy issues and trade-offs: recovery plans and fiscal stimuli

Policies / *Effects*	Monetary expansion	Fiscal stimulus	Direct public employment	Exchange r. devaluation/ protectionism	Price targeting	Industrial policies & incentives
Positive outcomes	Keynes' effect: ↓r ↑I ↑E ↑trust	↑I, Ag Demand ↑E & Income	↑E & Income	↑Ex ↑Ag Demand ↑E & Income ↓Im	Price stability no deflation & inflation	Boost in the industrial yield, ↑E&technology
Negative outcomes	Risk of inflation; Liquidity trap	↑Tax and/or deficit	Risk of low efficiency & tax	Beggar my neighbour & risk of currency wars		↑Hedge tax
Domestic Constraints	Debt: creditors do not want their real credits devaluated	Debt sustainability and lender availability	Sustainability of general taxation	Risk of imported Inflation; Imports become too expensive		Budget and tax
International constraints	With inflation int.nal debt becomes cheaper & int.nal lenders lose (this applies to US since int.nal debts are in its own currency, $. However this increases int.nal tensions)			Loss of int.nal credibility; No one is going to borrow money anymore		WTO and other int.nal organization may claim for State aid end and far competition; However all States may prefer industrial policies and state aids in crisis time
Firm issues and State/Market relations	Risk that the firms just hold money and do not do investments, if they do not trust	Crowding-out (very limited given the fact that firms during crisis do not invest anyway); On the other side firms prefer to lend money to the State (deficit spending) and not to be taxed	Down sizing of private sector (which however is not employing anyway during crisis)	National Firms abroad want fair exchange rate (for instance, US firms in China which export back to US)	Enforcement issues: govmt control and inspection over firms price policies	Cooperation & partnership for better technology, public incentives for innovation, easier access to finance for firms and productive investments
Workers and industrial relations	Inflation ↓purchasing power of wage; Distributional conflict over a stagnant GDP	Fiscal stimulus is considered superior, first best.Repayment issue: paid by upper classes or general taxation	Help to sustain fair industrial relations and higher Employment	Income differences with the rest of the world worsens (at the new devaluate level of exchange rate)	Help to keep purchasing power parity stable	↑Productivity gains Wage to sustain consumption (not finance)
Consumers	Liquidity may ↑consumption (Pigou's effect) or may postpone consumption, waiting for further ↓prices	Consumption ↑(keynesians) Or Saving may ↑(neoclassicals)	↑Consumption	↑domestic goods ↓foreign goods	↑Consumption eliminating saving increases risk and Pigou's effects	↑Consumption (not financial tools to sustain Consumption)

Source: own elaboration

Table A2 - Stimulus Packages 2007-2009

	Germany	UK	Netherlands	Italy	France	Spain	Tot EU	US
Bn. Euro	82	31	8.5	9	26	40	200 (approx)	775 USbn$
% GDP	3.3	2.2	1.4	0.6	1.3	3.7	1.5% (approx)	2.7%

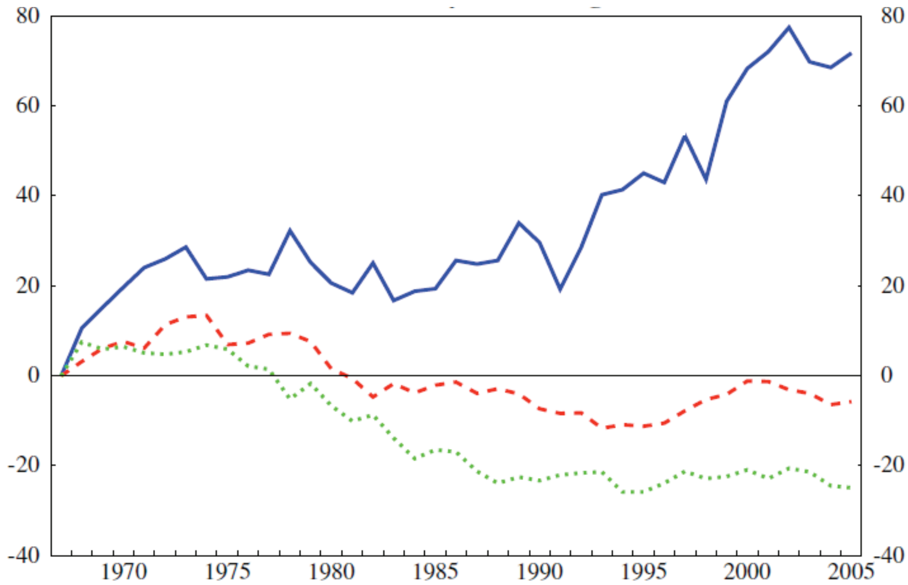
IMF (2008)

Table A3 - Governmental Bank Rescues, 2007-2009

US (bailing out, saving plans or govmt shares for firms and financial institutions)	EU
AIG Fannie Mae Freddie Mac Merril Lynch Goldman Sachs Morgan Stanley Washington Mutual Bank of America Maiden Lane Citigroup	**Govmt shares** ING (Netherlands) BNP Paribas (France) Unicredit (Italy) Swedebank (Sweden) Alpha (Greece) Lloyds and RBS (UK) Commerzbank (Germany) **Nationalisation** Fortis (Belgium) Anglo Irish (Ireland) Northern Rock (UK) Hypo Real Estate (Germany)

Source: IMF (2008); Wahl, 2010.

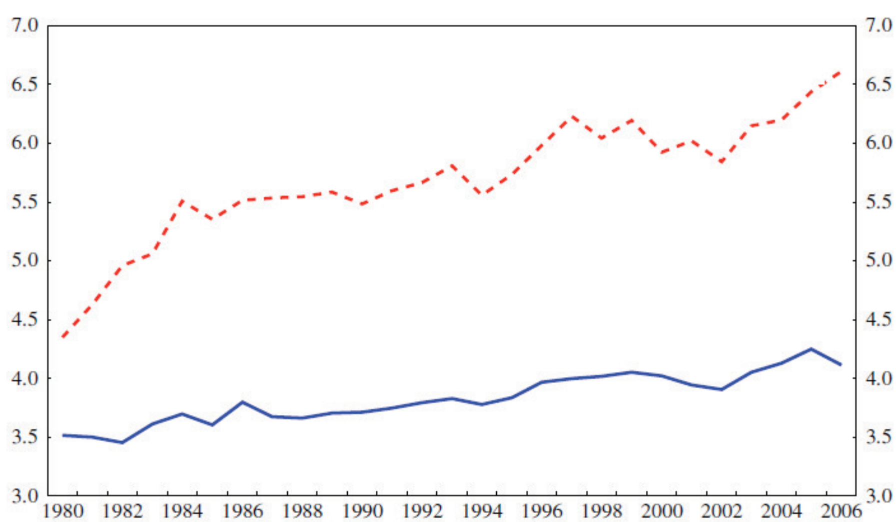
Figure A1: Evolution of hourly real wages, US 1967-2005



Top decil in the distribution (% change)
Median decil (% change)
Lower decil in the distribution (% change)

Source: IMF (2010)

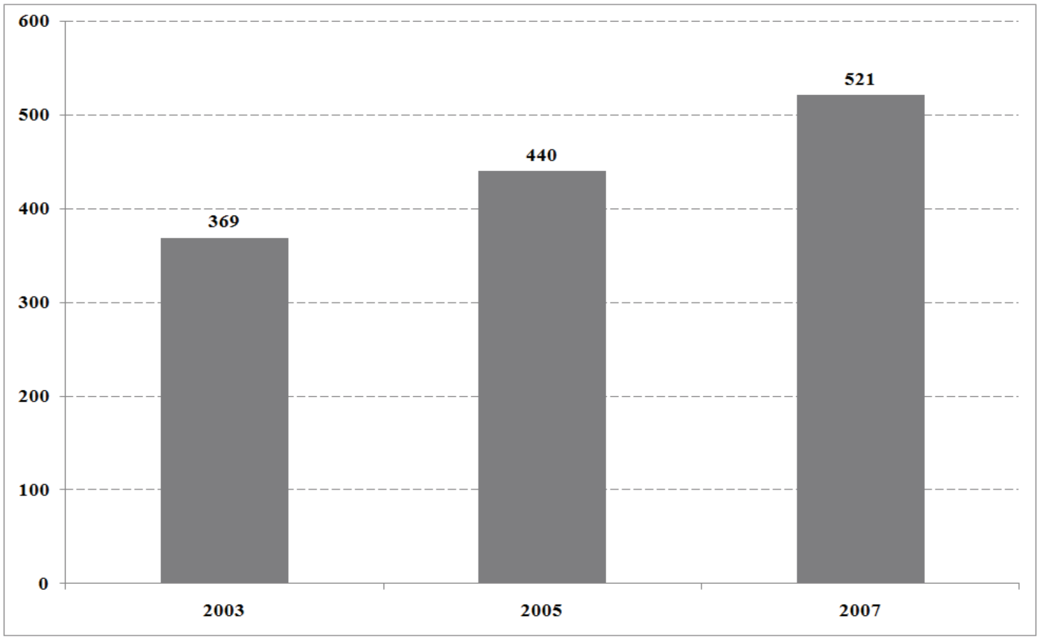
Figure A2: Income and consumption inequalities (USA 1980-2006)



Income inequality
Consumption inequality (non-durable goods)

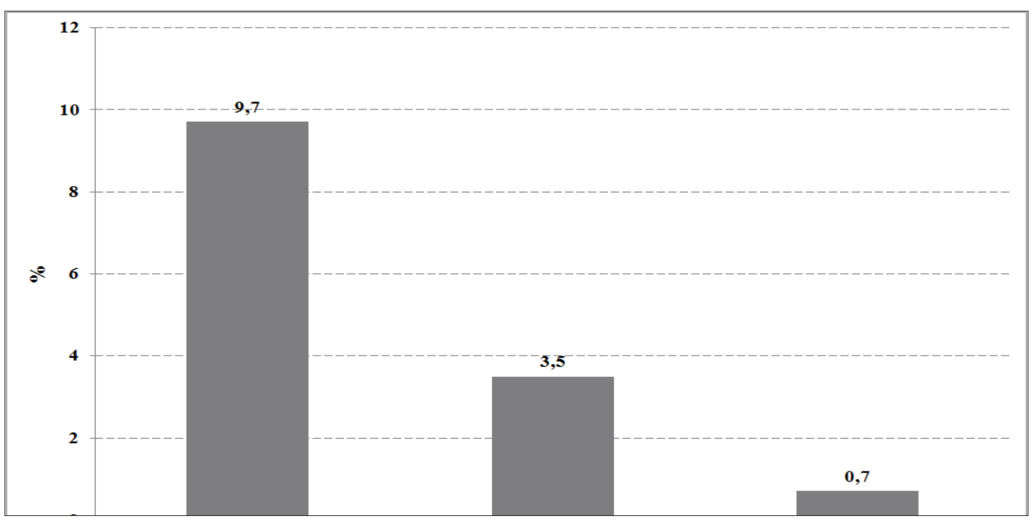
Source: IMF (2010)

Figure A3: Ratio between manager's compensation and average wages of blue-collar workers, US 2003-07



Source: ILO (2008)

Figure A4: Average wage increases, US 2003-2007



CEO Managers Workers

Source: ILO (2008)

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