Building Blocks for Ethical Market Economies in the 21st Century

A background paper on qualitative growth.

BertelsmannStiftung

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Background Paper

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"After the global economic crisis, many people are feeling that capitalism must mature toward the future. Then, what is "maturity" of capitalism? To know the answer, we should ask this question: What is "matur-ity" of the human mind? The answer to this question is clear. To become able to see "invisible values." As the human mind matures, it becomes able to see "invisible values." Such as wisdom inexpressible in words, human relationships through sympathy, trust between humans, reputation in the world, cultures of organizations or societies, and so forth. If so, what is "maturity" of capitalism? The answer to this question is also clear. To become the capitalism that emphasizes "invisible capital." Then, how can we realize this? By taking off old glasses and look around. The old glasses of "monetary economy."

Dr. Hiroshi TASAKA, Professor of Tama University, Tokyo, and President of both Think Tank SophiaBank and the Japan Social Entrepeneur Forum, at the expert hearing "Asian perspectives on Qualitative Growth" co-hosted by the Austrian Federal Ministry for European and International Affairs, the Lee Kuan Yew School of Public Policy and the Bertelsmann Stiftung in June

I The urgent need to revisit ethics in market economies

As the global economy begins to recover from one of the most severe series of financial and economic crises it has faced since the great depression, the ethics underlying market activity have come under intense scrutiny. The first series of crises, which included the steep rise in food and commodity prices in 2007 and the collapse of Lehman Brothers in 2008, affected millions of people around the world and threatened to bring the global financial system to a near standstill. In 2009, the volume of world trade plunged (-12.2%), and world output in GDP terms saw its first year-on-year decline (-2.3%) since the end of the Second World War.[1] The output of developed economies fell in 2009 even more dramatically (-3.5%). In terms of falling GDP for the year 2009, Japan suffered the largest decline (-5.2%) followed by the European Union (-4.2%) and the United States (-2.4%). Also in 2009, all Black Sea countries, with the notable exception of Azerbaijan, saw their economies contract considerably (-6.2%).

Black Sea Region Annual Real GDP Growth Figures
(Calculated at Market Rates, not Purchasing Power Parity, in %)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010 Proj.
Albania	13.5	6.7	7.9	4.2	5.8	5.7	5.7	5.4	6.0	7.8	2.8	2.3
Armenia	3.3	5.9	9.6	13.2	14.0	10.5	13.9	13.2	13.7	6.9	-14.2	4.8
Azerbaijan	7.4	11.1	9.9	10.6	11.2	10.2	26.4	34.5	25.0	10.8	9.3	3.5
Bulgaria	2.3	5.4	4.1	4.5	5.0	6.6	6.2	6.3	6.2	6.0	-5.1	0.2
Georgia	2.9	1.8	4.8	5.5	11.1	5.9	9.6	9.4	12.3	2.3	-3.9	4.5
Greece	3.4	4.5	4.2	3.4	5.9	4.6	2.2	4.5	4.5	2.0	-2.0	-4.0
Moldova	-3.4	2.1	6.1	7.8	6.6	7.4	7.5	4.8	3.0	7.8	-9.0	1.5
Romania	-1.2	2.1	5.6	5.0	5.3	8.5	4.1	7.9	6.3	7.1	-7.1	-0.6
Russia	6.4	10.0	5.1	4.7	7.3	7.2	6.4	7.7	8.1	5.6	-7.9	4.8
Serbia	-11.2	5.3	5.6	3.9	2.4	8.3	5.6	5.2	6.9	5.5	-3.0	1.5
Turkey	-3.4	6.8	-5.7	6.2	5.3	9.4	8.4	6.9	4.7	0.7	-4.7	5.0
Ukraine	-0.2	5.9	9.2	5.2	9.6	12.1	2.7	7.3	7.9	2.3	-15.1	3.5
Black Sea Region GDP Growth (Weighted Average)	1.0	7.2	2.4	5.0	6.4	7.7	6.2	7.3	6.9	4.1	-6.2	3.5

Source: Panayotis Gavras, www.blackseacom.eu

[1] World Trade Report 2010 (http://www.wto.org)

This trend revealed several structural vulnerabilities and affected the energy sector. According to experts serving on the Commission on the Black Sea, "The damage was all the more painful since the region as a whole had witnessed one of the highest growth rates in the world over the past decade."[2] The consequences of the turmoil of 2008 and 2009 have been devastating for countries like Greece, which now must pay the price for continually rising public debt in the context of a shrinking economy. Finally, British Petroleum, which has been willing to take ever greater risks in procuring oil, has indeed hit the walls of a narrowing funnel that is shaped by increasing demands and the planet's diminishing capacities to meet these demands.

Having shaken our confidence in the ability of consumers, corporations and governments to adapt to the 21st century and having undermined relations of trust among stakeholders, the events of recent years have exposed the limitations of the economic models we rely on. According to accepted theories of self-correcting and efficient markets, the problems faced in recent years should never have transpired. But they did. Indeed, the drivers of economic growth in recent decades have opened up Pandora's box.

Fearful attempts to shut the box will only fail. Instead, we need greater faith in human capacity to address the root causes of unsustainable development, and we need to cultivate a global economic system more suited to our future needs. All over the globe, questions related to these issues are being raised: Which way goes capitalism?[3] Is there room for a more humane, [4]more mature new paradigm economics?[5] Are elements or attractors conceivable that might make it possible for the emergence of new economic systems to benefit humanity?[6] At the same time, however real or imagined signs of recovery may be, the resistance to change and the desire to return to "business as usual" remain potent.

With these considerations in mind, the authors of this paper call for a closer look at the root causes of the recent market failures (chapter II) and offer recommendations on how to build more ethical market economies (chapter III).

II Root causes

The recent series of crises, most notably the commodity price crisis (2007-2008), financial crisis (2008), economic recession (2009), debt crisis (2010) and the oil disaster in the Gulf of Mexico (2010), are closely interrelated events. Until very recently, each of these crises was treated as distinct phenomena that raised unique issues with their own platform for debate. NGOs, experts and other single-issue actors addressed these crises at conferences and summits designed to get at the root of the problems. However, as Otto Scharmer has pointed out, the well-intentioned efforts of these change-makers have failed to create "a discourse across all these silos about how these issues are interconnected" and "a discourse about the root causes that continuously repro-

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2 Quote by Ambassador Sergiu Celac, member of the www.blacksea.com.eu as well as former Romanian Minister of Foreign Affairs

3 Daianu, *Which way goes capitalism?* (Central European University Press, Budapest 2009)

4 Minister Dr. Michael Spindelegger, *Austria and Europe: love at second sight?* (Vienna University of Economics and Business, January 21, 2010)

5 Hiroshi Tasaka, Invisible *Capitalism: Beyond Monetary Economy and the Birth of New Paradigm Economies* (Jorge Pinto Books, New York 2009)

6 A Real-Time Delphi among 270 participants from 35 countries summarized by Jerome C. Glenn, Theodore J. Gordon, Elizabeth Florescu in 2009: *The State of the Future* (The Millennium Project, Washington 2009)

duce the whole cluster of crises mentioned".[7] Some progress has been made in terms of the former case, as was demonstrated by the conclusion drawn at the 2009 Salzburg Trilogue that global challenges require a systems approach in which each interrelated challenge is of equal importance. Exploring the interdependencies of megatrends, the Bertelsmann Stiftung's Internet platform www.futurechallenges.org also echoes a growing awareness in civil society and academia of the systemic nature of the challenges ahead.

However, we are just beginning to understand the rhizomatic character of the underlying causes of these crises. In an effort to explore this more thoroughly, the Bertelsmann Stiftung participated in a 12-month learning journey, the Whence & Whither into Uncharted Waters project initiated by the Tällberg Foundation, examining the driving forces of the recent turmoil and co-hosting a number of conferences and workshops with the World Future Council, the Lee Kuan Yew School of Public Policy, the Black Sea Commission and the Austrian Federal Ministry for European and International Affairs. These conversations have yielded much in the way of developing our understanding of the increasingly limitless and unbalanced nature of human activity.

1. The growth paradigm

"Every society clings to a myth by which it lives. Ours is the myth of economic growth." This is the claim made by Tim Jackson, Professor of Sustainable Development in the Centre for Environmental Strategy (CES) at the University of Surrey and Economics Commissioner on the Sustainable Development Commission UK, at the beginning of one of the most controversial and thorough assessments of the growth paradigm.[8] According to Jackson, for the past five decades, the pursuit of growth has been the single most important policy goal observed around the world. He finds an abundance of theories stating that our societies are structurally reliant on economic growth.[9] According to these accepted ways of thinking, material possessions play an important existential or symbolic role in people's lives and allow them to participate in society. Economic growth provides new jobs, which improves individuals' well-being and leads to prosperity for all. Profits generated by growth also allow for improved environmental custodianship and handling of social externalities. In short, without growth, societies will lack the stimuli and investments needed to develop. However, as Jackson points out, there are several reasons to question the veracity of this paradigm.

a) Insufficient redistribution

First, Jackson questions the potency of the trickle-down effects of growth, often postulated in public discourse either metaphorically as "the rising tide lifts all boats" or more theoretically as "a strong positive relationship between growth and reduction of inequality," by pointing to the question of the redistribution of wealth and resources. In contrast to the image of Adam Smith's "invisible hand" in which the combined forces of self-interest, competition, and supply and demand automatically allocate resources, the reality is that government intervention has become a necessary and fixed feature of contemporary markets. German thinkers behind the idea of the "social market economy" such as Walter Eucken, as well as free-market advocates such as Deirdre McClosky, have called on governments to introduce limited redistribution devices (e.g.,

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7 Otto C. Scharmer, *Seven Acupuncture Points for Shifting Capitalism to Create a Regenerative Ecosystem Economy* (Draft Paper, MIT 2009) www.presencing.com

8 Tim Jackson, *Prosperity Without Growth: Economics for a Finite Planet* (Earthscan, London: 2009)

9 Hans Holzinger, *Wirtschaften jenseits von Wachstum?* (Zukunftsdossier No. 1 im Auftrag des Bundesministeriums für Land- und Forstwirtschaft, Umwelt und Wasserwirtschaft. Vienna 2010)

instruments such as a “steep inheritance tax” and a modest minimum income for every individual). In their book, “The Spirit Level,” Richard Wilkinson and Kate Picket go as far as declaring inequality of income to be the key societal ill around which all other issues revolve.

In terms of social cohesion and equality, we face a mixed bag of trends throughout the world. Despite the recent global recession, we appear to be on track in terms of cutting in half the 1990 poverty rate by 2015 — except in sub-Saharan Africa.[10] Future forecasts regarding poverty remain high, but dramatically lower than they were just a few years ago. Today, the World Bank estimates that the number of people living on less than $1.25 a day could reach one billion in 2015, and drop to 826 million by 2020. However, in terms of distribution of income, growing evidence suggests both a decrease of inter-state inequality due to the rise of China and India, but a considerable increase of inequality within nations. Billions of people remain excluded from access to productive resources and basic necessities. Currently, the top 20th percentile (in terms of income) of the world’s population consumes 85 percent of the global output, or 60 times more than the poorest 20th percentile. Within OECD nations the gap between rich and poor has grown in more than three-quarters of OECD countries over the past two decades, despite the growth rates these countries have seen over the same period.[11] And even in the fast-growing economies, such as those in the Black Sea region, high growth rates have failed by and large to translate into higher employment rates.

Black Sea Region Official Unemployment Rates (End Period, in %)

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010 Proj.
Albania	18.4	16.8	16.4	15.8	15.0	14.4	14.1	13.8	13.5	12.8	12.8	12.7
Armenia	11.2	11.7	10.4	10.8	10.1	9.6	8.2	7.4				
Azerbaijan	1.2	1.2	1.3	1.4	1.4	1.1	1.1	1.0	0.9	0.8	0.9	0.8
Bulgaria	16.0	16.9	19.8	17.8	13.7	12.0	10.1	9.0	6.9	5.6	7.6	8.4
Georgia	13.8	10.3	11.1	12.6	11.5	12.6	13.8	13.6	13.3	16.5		
Greece	12.1	11.4	10.8	10.3	9.7	10.5	9.9	8.9	8.3	7.7	8.9	10.1
Moldova	11.1	8.5	7.3	6.8	7.9	8.1	7.3	7.4	5.1	4.0	6.4	
Romania	6.8	7.1	6.6	8.4	7.0	8.0	7.2	7.3	6.4	5.8	7.6	5.9
Russia	12.6	9.8	8.9	7.9	8.0	7.8	7.2	7.2	6.1	6.4	8.4	8.3
Serbia	26.5	13.3	13.4	14.5	16.0	19.5	21.8	21.6	18.8	14.4	16.9	19.6
Turkey	7.6	6.6	8.5	10.6	10.5	10.3	10.3	10.5	10.6	14.0	13.5	11.6
Ukraine	11.9	11.6	10.9	9.6	9.1	8.6	7.2	6.8	6.4	6.4	10.5	9.4

Source: Panayotis Gavras, www.blackseacom.eu

Considered together, these trends point to systemic problems associated with governance and redistribution. Progress, whether local or global, will depend on how effectively we can limit, if not reduce, inequality on several levels.

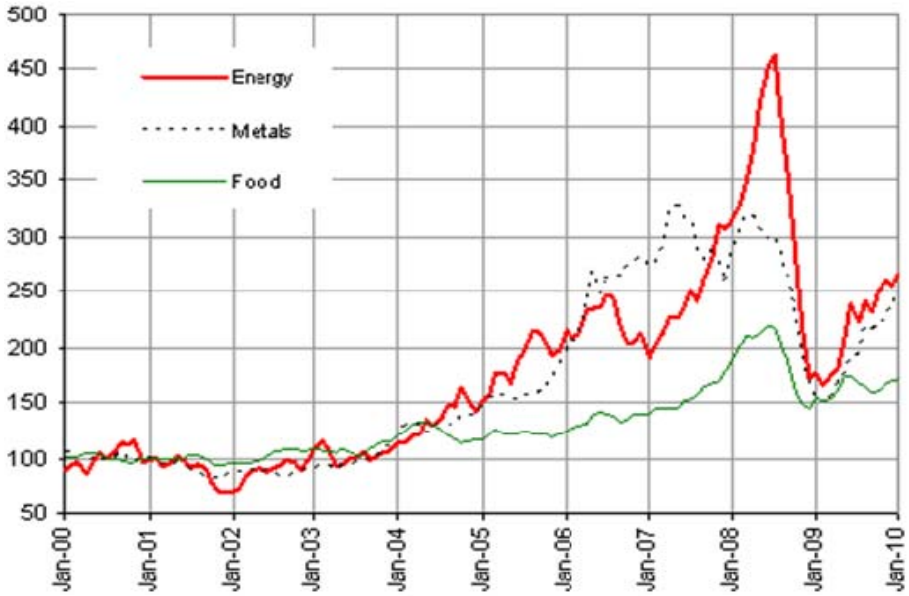
[10] Glenn, Jerome C.; Gordon, Theodore J; Florescu, Elizabeth; *The State of the Future* (The Millennium Project, Washington 2010)

[11] *Growing Unequal? Income Distribution and Poverty in OECD Countries* (OECD Publishing, 2008)

b) Debt-driven consumption

A second criticism leveled by Jackson highlights what he calls our "allegiance to growth" as the dominant feature of an economic and political system that led the world to the brink of disaster. It was this allegiance to growth which facilitated an inflation of asset values, which in turn created a hugely inflated — and unsustainable — asset bubble. Once it burst and financial asset prices collapsed, commodity prices rose sharply, peaking in 2008.

Export prices of selected primary products, January 2000-January 2010 (Index, January 2000=100)



Source :IMF International Financial Statistics

As consumer prices climbed and consumer demand fell even further, some expressed fears of stagflation.

Though the fiscal policies pursued by governments have differed, they have complemented each other in feeding this bubble.[12] Countries such as the United States, the United Kingdom or Spain increased domestic consumption rates by means of household borrowing and consumer debt, while at the same time risking speculative bubbles in asset prices. In contrast, countries such as Germany, Japan or China focused on export-led GDP growth. Driven by wage-moderation relative to productivity trends, this growth effectively increased consumption abroad. We then witnessed high consumer debt in the first group and rising global economic imbalances. When the asset price bubbles burst and governments turned to public borrowing in order to protect the banks and fund economic recovery programs, public sector debt and gross external debt rose sharply. The long-term costs are astronomical; according to IMF calculations, the total cost of the financial crisis will amount to $12 trillion or 20 percent of annual world output. As a result total public debt now varies widely across nations, but in 2009 it was particularly high in Japan (189.3

[12] Andrew Watt and Andreas Botsch, *After the Crisis: Towards a Sustainable Growth Model* (European Trade Union Institute 2010)

% of GDP), Italy (115.2%), Greece (113.4%), Belgium (97.6%), France (77.5%), Portugal (76.9%), Germany (72.1%), Austria (69.3%) to name a few[13].

In short, the roots of the financial and economic crises lie at least in part in a concerted effort to free up too much credit for economic expansion across the world. The challenge from now on is to make economies less dependent on debt and to identify the upper limits of credit expansion, in respect for the need to make growth consistent with long-term economic and financial stability.

c) Ignoring environmental constraints

Jackson also highlights a third reason to question the growth paradigm: it is unsustainable in terms of material and environmental resources. We are already facing the implications of this fact sooner than expected. The world is warming faster than even the latest projections indicated.[14] Changes in weather patterns not expected by the Intergovernmental Panel on Climate Change (IPCC) until 2020 are currently underway and some worst case scenarios are already becoming a reality. In addition, the Millennium Ecosystem Assessment (led by the United Nations Environment Programme, UNEP) found that 60 percent of a group of 24 ecosystem services examined are being degraded or exploited beyond ecological limits.[15] There are also fears that we face a significant decline in key resources reserves—particularly oil—within the next decade.[16]

Further important research conducted by the Stockholm Environment Institute and others suggests strongly that the growing demands of nearly 7 billion people on the planet are stretching its resources to the limit.[17] Identifying "planetary life-support systems" that are vital for human survival, the research then quantified how far we have pushed the sustainability of these systems in terms of processes such as climate change, biogeochemical flows, biodiversity loss and so on. The research is alarming, as it shows that humanity risks causing "irreversible and abrupt environmental change" that could make the Earth a much less livable place.

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13 CIA World Factbook - cumulative total of all government borrowings less repayments that are denominated in a country's home currency

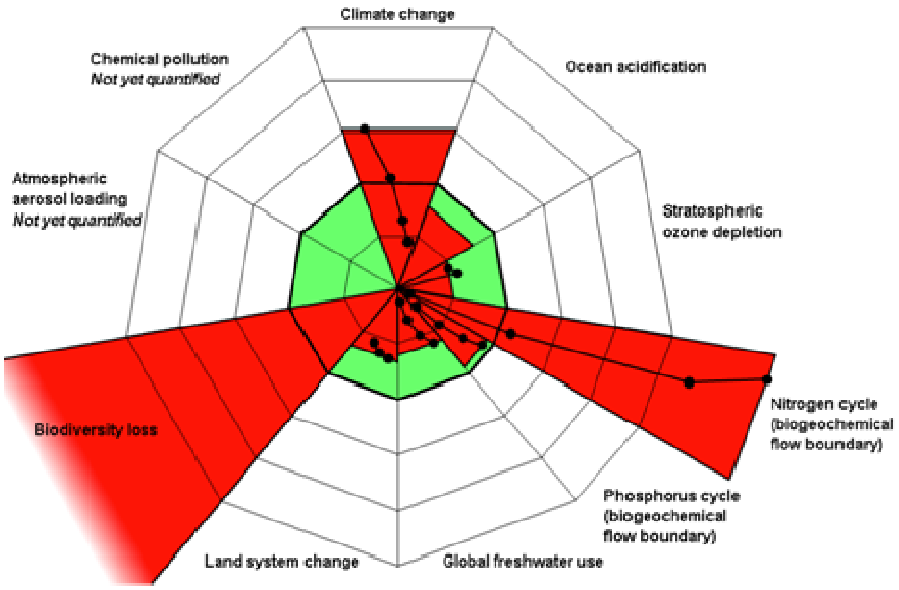
14 According to IPCC data the atmosphere's CO2 concentration level increased 1.55 ppm each year from 1970 to 2000. For the years 2001 to 2008, it increased 2.1 ppm each year, but reached almost 3 ppm in 2009, reaching 392.4 ppm by April 2010

15 http://www.millenniumassessment.org

16 http://www.worldenergyoutlook.org

17 http://www.nature.com/news/specials/planetaryboundaries/index.html

Estimate of quantitative evolution of control variables for seven planetary boundaries from pre-industrial levels to the present



Source: http://www.stockholmresilience.org/planetary-boundaries

The inner (green) shaded nonagon represents the safe operating space with proposed boundary levels at its outer contour. The extent of the wedges for each boundary shows the estimate of current position of the control variable. Points show the estimated recent time trajectory (1950-present) of each control variable. For biodiversity loss, the estimated current boundary level of > 100 extinctions per million species-years exceeds the space available in the figure. While climate change, ocean acidification, stratospheric ozone depletion, land use change, freshwater use and interference with the phosphorus cycle are boundaries defined as the state of a variable (concentration of atmospheric CO2, aragonite saturation state, and stratospheric ozone concentration, % of land under crops, maximum amount of global annual freshwater use, cumulative P loading in oceans, respectively), the remaining boundary, biodiversity loss, and the component of the biogeochemical boundary related to the human interference with the N cycle, are defined by rates of change for each respective control variable (extinctions per million species per year, rate of N2 removed from atmosphere for human use).

Of the nine boundaries identified, humanity has already transgressed three: climate change, biodiversity and nitrogen fixation. We are close to reaching the limits of fresh water and land use, and a transgression of the ocean acidification boundary is looming in some oceans. For two of the remaining three boundaries, science has yet to provide the data and experience that would permit researchers to identify where the boundaries may lie.

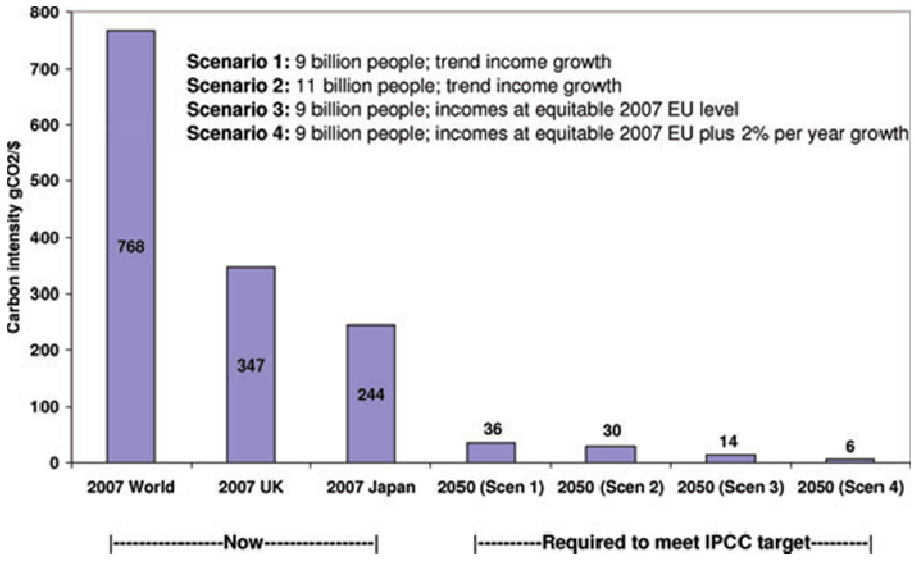
We are clearly living beyond our limits in several ways and are borrowing (in some cases heavily) from the future.[18] As pointed out by Martin Lees, former Secretary General of the Club of Rome, in our overuse of existing resources and capital, we are passing on to future generations vast and perhaps crippling financial, social and ecological debts.

[18] Surendra Munshi, *Voices for the Future: Global Crises and the Human Potential* (Trilogus Salzburg 2009)

2. The spread of Western aspirations

Far from losing ground, western consumption levels are growing rapidly worldwide. The culture of consumption that has influenced an increasing number of societies over the past five decades has been a powerful driver of economic growth, leading us toward what James Gustave Speth has called the "Great Collision" between a finite planet and the seemingly infinite demands of human society. The global economy has expanded fivefold in the last fifty years. At the current rate, it will have expanded 80-fold by the year 2100. According to the 2010 State of the World report, the 65 high-income countries where consumerism is most dominant accounted for 78 percent of consumption expenditures but only 16 percent of world populations.[19] In other words, in a world of some 6.8 billion people, the majority (more than 5 billion) consume on a per capita basis one-tenth of the resources consumed by the average European — and they are eager to follow in the footsteps of the world's affluent.[20] Add to this the fact that the world's population is projected to grow by another 2.3 billion by 2050, the demand for fossil fuels, metals and non-metallic minerals will most certainly accelerate. Jackson rejects simplistic faith in capitalist efficiency providing technology that will allow us to protect against resource scarcity, stating that "The scale of improvement required is daunting. In a world of 9 billion people, all aspiring to a level of income commensurate with 2% growth on the average EU income today, carbon intensities would have to fall on average by over 11% per year to stabilize the climate. By 2050, the global carbon intensity would need to be only 6 grams per dollar of output, 130 times lower than it is today."

Carbon intensities now and those required to meet the 450 ppm target



Source: Jackson, p. 81

Shifting technologies and stabilizing population growth are undoubtedly essential strategies in limiting the scale of resource consumption. But they will fail unless we base them on vigorous democratic debate, and develop a new set of assumptions and values that translates into behavioral change.

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19 Erik Assadourian, *The Rise and Fall of Consumer Cultures* (State of the World, Washington 2010)

20 Christopher Flavin (State of the World, Washington)

3. The dilemma of growth

We face a profound dilemma in our discussions of the root causes of the financial, economic, social and ecological crises. This dilemma of growth is outlined by Jackson as follows:

- "Growth is unsustainable — at least in its current form. Burgeoning resource consumption and rising environmental costs are compounding profound disparities in social well-being
- 'De-growth' is unstable — at least under present conditions. Declining consumer demand leads to rising unemployment, falling competiveness and a spiral of recession."

This dilemma arguably poses the single biggest challenge to our current form of economic undertakings, as the kind of growth we have seen over the past decades has ushered in a magnitude of negative externalities that the welfare state and the European-style of stakeholder capitalism are increasingly unable to manage. Obviously, we need a more ethical system compatible with the material and social limits of our globalized world.

In the following chapter, we discuss the concept of an "ethical market economy," and how we might go about facilitating such an economic model in society. It should be noted that although the terms "ethics" and "morality" refer technically to different things, we use them somewhat interchangeably because we are interested in the pursuit of both. Whereas "ethics" refers to a branch of philosophy that analyses, formulates and often justifies moral principles, "morality" refers to the customs and rules that evolve to restrict excessive individualism. We call on decision-makers to help cultivate an ethical framework for market activity in which moral principles of a more balanced human activity can be instilled for the benefit of a much broader realization of progress, human flourishing and well-being. The concept of an "ethical market economy" therefore refers to an economy that secures quality of life for all without jeopardizing future generations' quality of life.

III Constructing an ethical market economy

In May 2009, the Millennium Project conducted a Delphi study that surveyed futurologists' and world citizens' opinions as to the likely components of the next global economic system. In this study, 217 participants from 35 countries rated on a scale from 1 to 10 (10 being the most important) the relative importance of 35 elements needed to improve the human condition.

The table below lists the five elements given the highest rank by participants. The top two included the anticipated increase in the societal role of ethics and an expansion in the definitions of national well-being, issues which are addressed by this paper.

Elements most highly ranked by futurists

Rank	Importance	Element
1	8.36	Ethics becomes a key element in most work relations and economic exchanges
2	7.96	New GNP/GDP definitions include all forms of national wealth: e.g., energy, materials, ecosystems, social and human capital
3	7.75	Global commons (air, climate, etc.) supported by small (less than 1%) tax on currency trading and international travel
4	7.74	Collective intelligence – global commons for the knowledge economy
5	7.64	On-line and in educational systems: continually updated curriculum on the evolving economic system and its elemtens

However, this survey offers no guidance as to the specific form of ethics or moral principle that is called for. Below, we propose at least four broad building blocks which we believe can be useful in constructing ethical market economies, although this is necessarily an incomplete list.

1. Building block one: a more balanced conception of human nature

From the outset, we believe it will be necessary to question the prevailing assumptions about human nature as contained in economic models. The move toward ethical market economies should be based on a more realistic and balanced idea of man than currently holds. Decision-makers should cultivate behavior and incentives that lead to socially and environmentally benign behavior, and be aware of incentives that hamper the desired changes.

Many influential economic models today are founded on the idea of the "Homo economicus" model—an idealized version of the individual who rationally seeks to optimize his or her well-being with reference to a well-defined utility function. This conception of the individual decision-maker is contrasted with that of the "Homo sociologicus" –a person whose values, tastes and actions are solely determined by surrounding social forces so that individual, idiosyncratic preferences basically disappear from the analysis. In reality, humans are complex beings with a multitude of characteristics that take on different weights depending on the context of a decision. Although the list of such characteristics is for practical purposes endless, the five listed below illustrate the challenges facing individuals, policymakers and institutions in laying the foundations for a good society. The five characteristics we choose to highlight include some positive ones useful in constructing ethical market economies, as well as some more problematic ones which decision-makers seeking to develop ethical market economies may seek to ameliorate.

a) Compassion

Humans are self-interested, but not nearly to the extent that economists may suggest in their Homo economicus model. As early as1759, Adam Smith conceived human behavior in a way that psychologists would certainly recognize today: "How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it except the pleasure of seeing it."[21] This is a strong positive trait on which ethical market economies can build. However, physical proximity is important if compassion is to play a role, and the circumstances of life in our modern times often increase physical distance between people, or prompt interactions in an "augmented reality." This highlights one of the challenges of life in the 21st century, which is often defined by the effects of information technology and globalization.

b) Justice and fairness

Humans also have a strong orientation toward justice and fairness, an aspect of behavior which tends to puzzle economists who focus exclusively on issues of efficiency. Again, Adam Smith saw as much in 1759: "All men, even the most stupid and unthinking, abhor fraud, perfidy, and injustice, and delight to see them punished. But few men have reflected upon the necessity of justice to the existence of society, how obvious soever that necessity may appear to be." Today, more than 250 years later, human beings' strong sense of fairness has been proven again and again in the famous "ultimatum game" experiments undertaken by psychologists. In these studies, a person is given a sum of money and asked to share it with a second person whom he has never met.

[21] Adam Smith, Theory of Moral Sentiments (1759)

If the second person agrees to accept the offer, the first can keep his share as well. Otherwise, both go home empty-handed. A pure homo economicus in the role of the second person should in theory accept any amount, no matter how small, which makes him better off than before. However, actual participants in the experiment tend to reject offers in which they would get less than a third of the money. This trait may seem objectively irrational, but probably has wider evolutionary benefits associated with the benefits of a fair distribution of resources. This strong inherent sense of fairness is a second trait on which good societies can be built.

c) Overconfidence

One human trait regularly serving as an ingredient in crises is overconfidence. Humans sometimes —especially in situations where the probability of future events cannot be determined by hard science — tend to be optimistic, wishful thinkers. This trait tends to fuel bubbles and leads to decisions with ultimately troublesome consequences, as is seen in the case of many corporate mergers. Overconfidence is a dangerous human trait that needs to be restrained in one way or another.

d) Irrational prioritization

Humans are not fully rational and lack access to limitless information and perfect cognitive ability. Thus, they regularly make mistakes. Some of these mistakes predictably recur, as with the focus on money and material things as a path to happiness. What modern psychologists such as Daniel Kahneman call a “focusing illusion” was called a “deception” by Adam Smith. However, Smith also saw that individuals’ attempts to maximize their own wealth provided the impetus for much welfare-improving activity — even if wealth ultimately failed to be a lasting source of happiness. In seeking to develop ethical market economies, the human tendency to appeal to material things as a foundation for happiness needs to be and can be restrained.

e) Myopia

Finally, humans seem to have a hard time taking the long-term future into account. Psychologists and neuroscientists have shown that the parts of the brain responsible for emotion consistently undervalue the future; life is short and humans appear to value the certainty of present pleasure more highly than the potential of future pleasure. Behavioral economists such as Richard Thaler have shown that quick feedback on our actions is important helping us to make good choices. However, when decisions contrast short-term gratification with long-term costs (unhealthy eating habits, not providing for retirement), we often opt for today’s pleasures. Therefore, any issues related to the longer term require special attention by individuals and society.

2. Building block two: acknowledging “planetary boundaries”

Our second building block in founding an ethical market economy is a consideration of the scale of the economy in relation to the carrying capacity of the ecosystems. Planetary boundaries research calls on us to consider financial and economic systems as they are embedded in the ecosystem. This can best be illustrated as concentric circles with ecological limits as their outer barriers. If the economy is an open, dependent, growing sub-system of a materially closed, non-growing, finite ecosphere, this has the following critical implications:

As long as economic growth is associated with the ever- greater use of non-renewable materials and energy, a progressive build-up of chemicals and compounds, or an ever-increasing degrada-

tion and destruction of nature and natural processes, economic growth erodes the very ecosystems upon which finance and economy depend.

In order to avoid collapse, economies therefore need to acknowledge planetary thresholds. In an ethical market economy consumption of resources neither systematically exceeds absorption capacities (e.g., CO2, nitrogen and phosphorus, atmospheric aerosols, chemical pollution), nor an ecosystem's regeneration capacities (e.g., exhaustion of fresh water supplies, acidification of oceans, overuse of land and life stock). Establishing clear resource and environmental limits, and integrating these limits into economic and social functions becomes essential.

Relevant policy recommendations that contribute to these objectives include:

a) Resource and emission caps, and targets for reduction

The identification of scientifically endorsed resource and emission caps, and the establishment of reduction targets associated with these caps, are critical for ethical market economies. Taken together, the ideas of fairness and ecological limitations, lend themselves to the development of a set of "contraction and convergence" strategies, which would include globally equitable per capita allowances based on an overall cap and convergence toward a globally sustainable level.

However, actors in Asia and other developing economies criticize the "contraction and convergence" model as a spectacularly weak form of equity. If, as the Global Carbon Project suggests, developing countries accounting for 80 percent of the world's population still account for less than 20 percent of the cumulative emissions since 1751, equity can only emerge if developed countries take responsibility for offsetting their cumulative stock of historical emissions before advocating a convergent global threshold, as Kishore Mahbubani, dean of the Lee Kuan Yew School of Public Policy, argued at a recent expert hearing in Singapore hosted by the Austrian Federal Ministry and the Bertelsmann Stiftung.

b) Fiscal reforms

Tax policies could facilitate real progress in our ability to acknowledge planetary boundaries. Given that markets tend to undersupply goods with positive externalities but oversupply those with negative externalities, at least from a broad societal perspective, and given that managed or "social" markets not succeeded in tempering these failures, there is today a strong case for getting prices right. If we fail to properly account for energy and material flows, we will not be able to assess whether the economy performs within the true constraints posed by nature.

Therefore, fundamental shifts in taxation policy are under discussion—primarily, in the sense of moving from the taxation of labor to the taxation of resource use.[22] However, finding tools able to adequately assess external costs remains a challenge, as will be implementing these policies in the face of considerable opposition.

c) Support for ethical development paths in developing economies, e.g. Black Sea countries

The aforementioned "contraction and convergence" strategies would entitle every human being to equal rights with respect to the consumption of planetary resources within necessary constraints. However, one has to admit that global use is very unequal today, with richer countries taking the

[22] New Economics Foundation, The Great Transition (October 2009)

lion's share. To give an example: According to the statistics released by the International Energy Agency in 2009,[23] the current average annual carbon dioxide use per person on a global basis is about 4.38 tons per capita.[24] However, only 33 percent of the global population (yet all OECD countries) is responsible for carbon emissions greater than the world average. Current global discussions assume a need to strive to reach an annual global per capita average of 3.3 tons CO2 emissions within the next 20 years if we are to stay within the planet's environmental capacities. Under this model, all nations would converge to this global average by 2030. But what would this development path look like?

"Regardless of when and how the fallout of the crisis is going to be overcome, it has become obvious that the prevailing pattern of growth that used to rely on excessive and uneconomical use of resources with little concern for social and environmental impacts is bound to change faster than most people think. That is why the EU Strategy for smart, sustainable and inclusive growth is highly relevant for the Black Sea area. While the targets set for the year 2020 are certainly not binding for the countries outside the EU membership, it is clear now that the underlying conceptual approach begins to resonate throughout the region.

There are several valid reasons that induce the Black Sea countries to look forward to a closer relationship with the European Union, which is already the principal trading partner for most of them. Some were detailed in the recent report of the Commission on the Black Sea A 2020 Vision for the Black Sea region (www.blackseacom.eu, May 2010). The incentives for the EU to take a more comprehensive view of its interests and responsibilities in the wider Black Sea region are of strategic nature and should be treated as such. The region is now part of the EU maritime space and of the trade and energy routes to the East, to the northern tier of the Middle East, Central Asia and beyond it to the dynamic markets of China and the Indian sub-continent. Furthermore, it is the area where the political substance of the European Union's future relationships with the Russian Federation and other regional powers such as Turkey is likely to be shaped.

What makes the Black Sea region unique is its remarkable diversity in terms of the size and sheer weight of the state actors, levels of socio-economic development, systems of governance, maturity of democratic institutions, sophistication of business culture and financial structures, human development indicators and membership in different, though not necessarily antagonistic, political-military or economic forms of association. Therefore, while regional integration in a classical sense may not be a realistic proposition, it is worthwhile to undertake an imaginative and pragmatic effort toward an advanced type of constructive regionalism based on clearly identified mutual interests and flexible accommodation of various political cultures. On that assumption the following recommendations for EU regional action could really make a difference:

1. *To design, as a matter of priority for the European External Action Service, a forward looking strategy for the wider Black Sea region by weaving together and building upon the viable elements of the European Neighbourhood Policy, Black Sea Synergy, Eastern Partnership, the Danube Initiative, and programmes for Central Asia and the Caspian basin. In order to augment the credibility of its constructive offer, the EU should consider including a dedicated chapter on that subject in its financial planning exercise for 2014-2020.*
2. *To develop the EU's own draft document as an alternative to the proposals advanced by the Russian Federation on a new European security architecture in a comprehensive but phased approach that should start with the test-case of specific arrangements for the wider Black Sea region to cover both hard and soft security aspects, including protection of critical infrastructure.*
3. *To support the home-grown regional initiatives and cooperative frameworks as valid partners for further EU engagement. In particular, the EU should clearly spell out its expectations in the run-up to the 20th anniversary summit of the Black Sea Economic Cooperation Organisation (BSEC) in 2012.*

[23] http://www.iea.org/co2highlights/CO2highlights.pdf

[24] Ibid p. 115

4. *To promote the concepts and practice of sustainable development, good governance, transparency, accountability and social responsibility as guiding principles for regional cooperation and for the further commitments of the EU in the region.*
5. *To encourage and support those projects that are most likely to produce value added through cross-border action in a multilateral format. This applies especially to transport and energy infrastructure, water supply and treatment, waste management and disposal, joint use of certain utilities, etc. An obvious subject for cooperative action is the protection of marine environment and rational exploitation of its resources.*
6. *To consider seriously the feasibility and economic rationale for vastly enhanced technology transfers to the wider Black Sea region. For instance, improved performance in countries with a poor record of energy efficiency generates much higher returns on the initial investment at relatively low cost in terms of reduced emissions leading to substantial economic and environmental benefits."*

Amb. Sergiu CELAC
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To be ethical, developed market economies, such as the OECD countries, with their current annual average of 10.27 tons of CO2 emitted per capita, should have an interest in making steep and swift cuts or contractions in their own use. But in addition, in order to make room for growth in developing economies, where growth still really does make a difference (such as in the 10 Black Sea countries,[25] which today have an annual average of 4.9 tons of CO2 emissions, in China with 4.68 tons or India with 1.18 tons), the developed economies should arguably support and empower the developing economies in the goal of decoupling future development from the intensive use of resources and environmental degradation, as has been associated with the conventional development path of industrialized nations.

More specifically, any such support for ethical development paths in emerging economies calls for robust funding mechanisms to make resources available, and a transfer of technology to developing nations. Doing so would help avoid further "peaks" originating from these developing economies that took planetary consumption beyond the safe limits.

In the case of the Black Sea region, this strategy would also offer significant potential for energy supply diversification, a prospect that would serve the interests of countries in the region and those of the European Union. With external dependence on energy imports forecast to grow steadily up to 70 percent by 2030, the EU set a goal in its Black Sea Synergy communication of helping the region's countries to develop "a clearer focus on alternative energy sources and on energy efficiency and energy saving, which will release important energy resources." [26] As former Romanian Foreign Minister Sergiu Celac argues, this largely pays tribute to the "expectation that the transition to a new pattern of energy production and consumption worldwide in the 21st century will be long and complicated, entailing continued competition, if not confrontations, for the control of energy resources and transit routes, and increased vulnerability for some states as a result of political manipulation of energy markets, opportunistic arrangements and broken promises." European Union action or inaction will therefore carry significant weight. The EU package of directives on energy and climate change sets specific targets, including a 20 percent reduction in carbon dioxide emissions, a 20 percent improvement in energy efficiency, and the development of a 20 percent renewable energy share in the overall production of electricity by 2020. Naturally,

[25] Average per person CO2 emissions (in tons) in Armenia (1.6), Azerbaijan (3.22), Bulgaria (6.57), Georgia (1.17), Greece (8.74), Moldova (1.98), Romania (4.27), Russia (11.21), Turkey (3.59), and Ukraine (6.77)

[26] http://ec.europa.eu/world/enp/pdf/com07_160_en.pdf

the non-EU Black Sea countries are not bound by these commitments. “However,” Celac concludes, “they are, inescapably, part of this process. Since most of them have to face a set of daunting problems that have been largely overcome in other parts of Europe, such as overdependence on a single source of primary energy, aging power production facilities and transportation networks, poor grids and cross-border pipelines, there is a lot of room for promoting regional cooperation.” Implementing ethical market economic principles as a guiding philosophy of regional cooperation in this area would provide a win-win approach, particularly as Black Sea actors have to date failed to produce a shared vision for the future.[27]

d) Transforming consumerist lifestyles

Finally, bringing market economies into an ecologically sustainable position will require a further fundamental shift in our economic system’s shared ideas and basic assumptions. Fortunately, human priorities can change over time in a predictable way. Abraham Maslow's hierarchy of human needs points the way to the required shift. This model postulates physiological needs (food, water, sleep) and safety at the bottom of the pyramid of needs. Once these needs are satisfied, individuals seek love and a sense of belonging (relationships with family and friends), followed still later by respect for others, a concern with morality, and the quest for self-actualization. In a similar vein, Pope Paul IV in 1967 described the human condition as “the rise from poverty to the acquisition of life’s necessities; the elimination of social ills; broadening the horizons of knowledge; acquiring refinement and culture. From there one can go on to acquire a growing awareness of other people's dignity, a taste for the spirit of poverty, an active interest in the common good, and a desire for peace.” Walter Eucken offered a parallel construction, arguing that market economies satisfy basic material needs and thereby create the conditions for intellectual, non-material concerns. In sum, fulfilling our material needs is just a precondition for much broader progress.

While the transformation of cultures is no small task, it is already underway. In his book, “Blessed Unrest,” author Paul Hawken assesses the worldwide movement for social and environmental change as the largest movement in the world. The World Values Survey, in which a global network of social scientists has surveyed the basic values and beliefs of citizens in more than 80 nations across all six inhabited continents, has found ample evidence that in post-industrial economies priorities are increasingly shifting from an overwhelming emphasis on economic and physical security toward an emphasis on subjective well-being, self-expression and quality of life. As wealth grows and levels of education improve, people grow increasingly individualistic but also show more trust in other people and demonstrate greater tolerance toward people who are different (e.g., foreigners, homosexuals etc.). “These values lend themselves to a less materialistic and more ecological consciousness,” said Professor Chris Welzel at an expert hearing recently co-hosted by the Bertelsmann Stiftung and the Tällberg Foundation. But more needs to be done. Consumerism remains a cultural paradigm with a high degree of influence. As British economist Paul Ekins has demonstrated, consumerism is the cultural orientation in which “the possession and use of an increasing number and variety of goods and services is the principal cultural aspiration and the surest perceived route to happiness, social status, and national success.”[28] Considering the social and ecological costs that come with consumerism in its current form, a key task in the development of ethical market economies is to transform consumerist lifestyles. More

[27] For details cf. Report by the Commission on the Black Sea. http://www.blackseacom.eu/a-2020-vision-for-the-black-sea

[28] Quoted by Assadourian l.c.

specifically, this cultural change has to be founded on an assessment of people's real needs. Doing so will help battle strategies of planned obsolescence.

The first of these strategies, often called "psychological obsolescence," refers to the attempt to render a product obsolete in the mind of its owner. It is based on the restless desire of the consumer for novel material artifacts, which is the perfect complement to the restless innovation of the entrepreneur.[29] Arguably, in ethical market economies this fixation on novelty should be transformed into a demand for "lasting" goods, goods, or those that remain necessary, are designed to be used for a long period of time, and are completely recyclable (i.e., "cradle to cradle").[30] Thus, for instance, cell phones might remain functional, upgradeable and fashionable for a decade rather than a year.

The second strategy, "physical obsolescence," refers to patterns of excessive consumption. Religious communities can play a pivotal role here, as they have all addressed the deprivation of a life focused on material gain.[31] Underscoring the difficulty in communicating the environmental and social barriers we face, Worldwatch Institute's Gary Gardner argues that world religions can play a critical role, "since they have always advanced the idea of boundaries as the key to a successful life."

3. Building block three: Tangible successes and outcomes associated with better quality of life

If we are to cultivate ethical market economies, we must re-assess the idea of true progress and develop a broader, more balanced way of assessing what constitutes successful, desirable outcomes. Focusing solely on material measures such as GDP, profits or income clearly fails to capture all the dimensions of value or progress that people experience as important in their lives. A number of encouraging measurement initiatives are being undertaken at the individual, community, company and national levels to develop indicators that really matter. In some sense, putting a number to something somehow endows it with a greater reality. In effect, what gets counted, counts. These various new approaches are complementary to each other, and are consistent with research on what matters in producing individual life satisfaction. The examples cited below offer a few snapshots of attempts to develop appropriately broad indicators, and illustrate what kind of measurement techniques can be used in judging societal developments.

> *"Many approaches are possible to measure societal progress, but they generally fall into three broad types: the extension of the basic national accounts schemes to cover social and environmental dimensions; the use of a wide range of indicators referring to economic, social and environmental dimensions (the use of composite indicators to summarise them in a single number is also possible); and the use of "subjective" measures of well-being, life-satisfaction or happiness. Each approach has some strengths and weaknesses, but the most promising (and feasible in the medium term) approach seems the second one – the use of indicator sets – with two important qualifications:*

[29] Jackson, l.c. p. 87ff

[30] http://www.mcdonough.com/cradle_to_cradle.htm

[31] For more on this, see the discussions on this topic among religious leaders at the forum hosted by the World Future Council in and the Bertelsmann Stiftung. http://www.bertelsmann-stiftung.de/kulturdialog and Christopher G. Weeramanthry, *Tread Lightly on the Earth* (Stamford Lake Ltd. 2009)

***First**, the use of both objective and subjective indicators is now considered more positively then some years ago. Our knowledge of how to measure subjective wellbeing is growing, and the measures can give important information to policy making;*
***Second**, the selection of key indicators is a political process and needs to be carried out in a democratic way, i.e., with the involvement of all components of the society (government, opposition, trade unions, business associations, civil society, etc.), to provide a "bipartisan" legitimacy to the indicators set, a necessary condition to have it owned by society."*

Measuring the Progress of Societies
Jon HALL, PARIS21, OECD

a) Individual level

The field of positive psychology, peopled with researchers such as Ed Diener, Martin Seligman and Sonja Lyubomirsky, has gained increasing importance in recent years and has produced insights relevant to our discussion here.[32] In short, researchers have found one important component of prosperity to be the ability to participate meaningfully in the life of society. Instead of focusing on human deficits, these researchers identified key recurring contributors to human well-being, quality of life and happiness, which have been ranked by the authors of this paper in the following table. Health appears twice, in its mental and physical form. Education (item 7) is important too, although the effect on happiness appears to be indirect, manifested through the choice of more happiness-enhancing activities. Items 2, 6, 14 and to some extent 12 all relate to work or engagement with one's daily activities, which is crucial for human happiness. The other items relate to social interactions with others (e.g., friends, giving), the lack of interaction (e.g., television) or individual feelings (e.g., reflection, gratefulness).

Key elements of individual happiness

Rank	Direction	Item
1	fix	Gene
2	-	Unemployment
3	+	Mental health
4	-	Television
5	+	Friends
6	+	Work satisfaction
7	+	Education
8	+	Physical health
9	+	Reflection on happiness
10	+	Greatfulness
11	+	New activities
12	+	Sense of meaning
13	+	Giving
14	+	Effort, hard work

Source: Own ranking

Material issues do not rank highly, which supports the idea of measures restraining the human tendency to accumulate material things.

[32] See, for example, Diener and Seligman (2004) and Lyubomirsky, King and Diener (2005)

b) Community level

Regular social interaction takes place at the level of the community. There are several impressive examples of participative processes that both define goals at the community level and outline ways of achieving them. Just three examples may suffice to show the commonality of focus, as well as the promise shown by engaging in a structured dialogue on indicators. Each of the following initiatives has a broad scope that is not based on materialism, but is more or less in line with the insights developed by positive psychology.

The Community Foundations of Canada have set up the so-called Vital Signs program, in which input from citizens, policymakers and researchers is combined to identify what is important in a number of Canadian cities and where improvements are most needed. For example, the Vital Signs of Vancouver program focuses on, measures and funds measures in the following 12 areas: work, learning, health and wellness, belonging and leadership, housing, safety, environment, getting started, getting around, the gap between rich and poor, arts and culture, and changing demographics.

The Community Assessment Program (CAP) in California's Santa Cruz county is a joint effort of public and private organizations to measure and improve the quality of life in the region. Through a broad and participative process, goals have been set in 6 topical areas (i.e., the economy, education, health, public safety, natural environment and social environment). Progress toward these goals is tracked each year through measurable quality-of-life indicators.

In one of the most far-reaching examples of community-based efforts to enhance the quality of life, Tasmania Together 2020, has taken an integrated, informed and interactive approach in setting goals for this Australian island. Thousands of citizens and organizations have collectively engaged in creating a vision of where and what Tasmania should be in the near future. The program's 12 goals, defined in 2006, focus on living standards, education, health, work, open government, community, innovation, safety, aboriginal rights, natural heritage and the environment. Experts have subsequently developed a large number of related indicators that help to measure progress in achieving these goals.

c) Company level

An increasing number of initiatives have aimed at measuring success at the company level by looking beyond simple profits as standard. In the late 1990s, sustainability indices became popular, combining economic with social and environmental criteria for the assessment of listed companies.

Over the past 10 years, the Global Reporting Initiative has developed standards for corporate and government reporting which also capture much more than an organization's level of profitability. These guidelines were developed in a broad and participatory process, and are already used by more than 1,500 organizations across 60 countries. Categories of assessment include economic performance, environmental records, labor practices and the provision of decent work, human rights records, societal engagement, and product responsibility. Again, these categories go far beyond strictly monetary measures such as profits and are consistent with the initiatives taking place at other levels.

d) National level

Some of the best-known efforts to measure success more broadly than by using monetary indicators alone can be found at the national level. However, these top-down approaches typically run by a small number of academics or statisticians face the danger of being detached from the population they are supposed to serve.

In February 2008, France's President Nicolas Sarkozy established a commission of prominent academics tasked with developing better measures of economic performance and social progress. The commission's final 292-page report, published in September 2009, received a significant amount of media attention around the world, although it did not provide any assessment of whether the French are better off than they were 10 years ago, for example, or whether today's French are better off than the Germans. The eight domains of well-being suggested by the commission are shown in the table below (identified as Stiglitz-Sen-Fitoussi, after commission members Joseph Stiglitz, Amartya Sen and Jean-Paul Fitoussi). Again, the conceptual similarities to the analyses taking place at other societal levels are clear.

In Canada, the privately funded Institute of Wellbeing began to construct their Canadian Index of Wellbeing in the late 1990s. They compiled a composite index with a time series, but only for Canada. The domains of this index are also shown in the table.

The OECD hosts a global, networked project aimed at "measuring the progress of societies."[33] No index had been constructed as of summer 2010. However, in late 2009, the project published "Measuring the Progress of Societies: An Introduction and Practical Guide." The domains used by this group to structure its work are slightly different than in other projects and include human well-being: outcomes for people; the economy; ecosystem condition; resource, use, development and preservation; culture; and governance. But at a more detailed level, the indicators used in the OECD project also appear in the approaches taken by France and Canada.

The United Nations Development Programme began publishing its Human Development Index (HDI) in 1990, covering a large number of countries. This is a composite index consisting of gross domestic product, life expectancy and education levels, three of the areas also deemed important in the French and Canadian projects. The most visible missing component in the HDI is the environment. In 2007, the HDI ranked Norway, Australia, Canada and Ireland among the most highly developed countries. Austria and Germany were somewhat behind, while the Black Sea countries were ranked significantly lower.

[33] http://www.oecd.org/progress

The domains of broad measures of well-being

Stiglitz-Sen-Fitoussi	Canadian Index	Human Development Index
Material living standards	Living standards	GDP
Health	Healthy populations	Life expectancy
Education	Education	Education
Environment	Environment	
Social connections	Community vitality	
Personal activities (incl. work)	Time use	
Political voice and governance	Civic engagement	
Insecurity (economic & physical)	Arts, culture and recreation	

Source: Own ranking

e) Policy recommendations

Policy recommendations associated with these measurement initiatives include the following:

i Funding for research and the identification of best practices

We cannot achieve our targets without first measuring progress toward them. A substantial number of initiatives are developing indicators aimed at helping to measure and induce real progress. However, the field is fragmented and evolving. Further research is needed to map the field of community indicators, corporate reporting and national initiatives, as well as to identify, connect and exchange best practices. Which initiatives can produce real behavioral changes? What is the best way to weight objective and subjective indicators? The Global Project hosted by the OECD and the EU's "Beyond GDP" initiative are promising undertakings aimed at this end.[34]

ii Engaging people in developing broader measures of progress

There is growing evidence that engaging people in participatory processes and structured dialogue on goals and indicators helps societies to thrive and become more vibrant. A wider diversity of concrete projects is needed in order to mobilize people to think about and articulate what kind of societal progress they would like to see.

iii Revising national accounts

GDP was given prime place in the field of indicators with the development of the United Nations Sys-tem of National Accounts in 1947. At that time, focusing on GDP made sense, and it remains an important metric for central banks that are trying to stabilize economies. However, economic growth per se has become a less pressing need in developed countries over the past 60 years. Many decision makers nevertheless consider GDP to be the key indicator in assessing economic wellbeing and societal progress. The shortfalls of this approach are well documented: "These include the failure of GDP to account properly for changes in the asset base; to incorporate the real welfare losses from having an unequal distribution of income; to adjust for the depletion of material resources and other forms of natural capital; to capture the external costs of pollution and long-term environmental damage; to account for the costs of crime, car accidents, industrial accidents, family breakdown and other social costs; to correct for 'defensive' expenditures and positional consumption, or to account for non-market services such as domestic labor and volun-

[34] http://www.beyond-gdp.eu

tary care."[35] The time is ripe, it seems, to develop broader measures that are both new and credible, and which move beyond simple measures of economic resources. The Istanbul Declaration, signed in July 2007 by the United Nations, the OECD, the World Bank and several other organizations,[36] calls on statistical offices to work with other stakeholders in forwarding this agenda. These new measures, while not replacing conventional economic indicators, provide an opportunity to enrich policy discussions. As stated by Jon Hall, who has led the OECD's Global Project on Measuring the Progress of Societies, at the recent expert hearing in Singapore co-hosted by the Lee Kuan Yew School of Public Policy, Austrian Federal Ministry and the Bertelsmann Stiftung: "A well-designed set of progress measures can ensure a country is better able to manage its development and also remain conscious of the economic, social and environmental changes (good and bad) that development can bring."

4. Building block four: Resilient forms of governance

This fourth building block refers to the social institutions needed to balance the role of the market economy. That fact that many markets need to be regulated—ideally in an intelligent way—has long been understood by moral authorities. But societies often seem to need repeated reminders of this fact. Not much needs to be added to the 1991 papal encyclical "Centesimus Annus": "The free market is the most efficient instrument for utilizing resources and effectively responding to needs. But this is true only for those needs which are 'solvent,' insofar as they are endowed with purchasing power, and for those resources which are 'marketable,' insofar as they are capable of obtaining a satisfactory price." The needs which are not endowed with purchasing power today are those of very poor people, future generations and the environment. Markets are unlikely to serve the needs of these groups or interests. This situation "demands that the market be appropriately controlled by the forces of society and by the state, so as to guarantee that the basic needs of the whole of society are satisfied." Therefore, the market sector has to be "circumscribed within a strong juridical framework which places it at the service of human freedom in its totality." The precise character of ideal regulation in a specific market cannot be determined at the outset, and will probably change over time as societies and technologies develop. However, the principles mentioned here can provide important guidelines.

In the global perspective taken by this paper, the regulatory mechanisms in place at the beginning of the 21st century have failed to provide legitimate or effective solutions to a number of market failures. While global governance aimed at addressing the recent crises has to date been reasonably well coordinated, with short-term activity agreed upon at the Washington, London, Pittsburgh and Toronto G-20 summits, the ability of the international system of financial and economic governance (much less elements of governance concerned with other aspects of development) to respond to future crises is unproven. The Copenhagen environmental summit failed to make significant progress beyond the political deal already agreed upon at the Bali summit in 2007. And the Rio process, a global action plan (Agenda 21) for sustainable development emanating from the 1992 Earth Summit in Rio and revised by the Johannesburg Plan of Implementation in 2002, has been marked by slow progress in meeting the internationally agreed-upon goals, with almost none of the Rio commitments fulfilled. As a final, trade-focused example, efforts to further the Doha Development Agenda, which was "designed to ensure that developing countries, and especially the least developed among them, secure a share in the

[35] Jackson, l.c. p. 179

[36] www.oecd.org/progress

growth of world trade commensurate with the needs of their economic development," have been stymied. In his speech to G20 business leaders on June 26 in Toronto WTO Director General Pascal Lamy recently assessed the situation as follows: "Although 80 percent of the job is done, negotiators are considering the remaining 20 percent, staring at each other waiting for the other side to move first. Obviously nobody wants to move first, for fear that its moves would be pocketed by others without obtaining anything in return."

Obviously, politicians and policy developers are more often than not faced with problems of complexity, uncertainty and change, and fragmentation. Problems of complexity are presented by the interdependencies between great challenges that are transnational in nature, and are characterized by differing spatial reach and temporal dimensions. Problems of uncertainty and change refer to the incomplete comprehension of earth systems science and its interrelations with social sciences. Existing knowledge may not be fully understood, as is the case with positive feedback loops; may be contested, as was the case with allegedly manipulated data from the Intergovernmental Panel on Climate Change (IPCC); or may even be wrong. Problems of fragmentation are related to the flawed design of the international system, and its deep reliance on the concept of national sovereignty, a characteristic that still bears testament to the Westphalian Order.

The scope of this paper does not allow for a comprehensive examination of the various approaches to defending, reforming or transforming existing regulatory frameworks. Rather, we offer the observation that debates on the character of governance are increasingly focusing on the idea of resilient regulatory systems.[37] Ethical market economies require forms of governance that are resilient to the extent that they are able to withstand and absorb shocks without producing significant crises or shortages,[38] and which are able to reorganize while undergoing change, so as to retain or enhance their effective function, structure, identity and sensitivity to feedback.[39] According to the Brookings Institution, a perspective focusing on resilience has various advantages. First, it would encourage policymakers to take seriously the idea of systematic failure. In other words, ethical market economies would consider certain "externalities" as risks to the system rather than as mere costs, which was still the case in the prominent 2006 report on global environmental dangers by Sir Nicholas Stern.[40] Second, the idea of resilience focuses attention on the functions delivered by the international system, rather than its form.[41] Instead of engaging in perpetual debates over democratization and fairness, in particular Asian representation of the G8, G20 or GX, policymakers seeking to develop ethical market economies would direct their attention toward results and outcomes, as the discussion in this section has indicated. In this framework, the predominant question would be: What should regulatory frameworks deliver? Only

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37 Alex Evans, Bruce Jones, David Steven, *Confronting the Long Crisis of Globalization – Risk, Resilience and International Order* (Brookings Institution/Center on International Cooperation, New York University: 2010); c.f. http://www.stockholmresilience.org/research/researchthemes/adaptivegovernance.html

38 Michael Sedlacko, Gerald Berger, Nisida Gjoksi, *Towards an Economy Compatible with Sustainable Development Principles* (Discussion Paper, European Sustainable Development Network (ESDN) Conference July 2010)

39 Evans et al.; l.c.p. 25

40 The Stern Review on the Economics of Climate Change is a 700-page report released for the British government on October 30, 2006 by economist Sir Nicholas Stern, chair of the Grantham Research Institute on Climate Change and the Environment at the London School of Economics. The report discusses the effect of global warming on the world economy. The Stern Review's main conclusion is that the benefits of strong, early action on climate change considerably outweigh the costs. It proposes that one percent of global gross domestic product (GDP) per annum is required to be invested in order to avoid the worst effects of climate change, and that failure to do so could risk global GDP being up to twenty percent lower than it otherwise might be

41 Evans et al.; p. 25

when resources and markets are managed in ways responsive to human social, economic and environmental needs as well as to the functions of the earth's ecosystems will ethical market economies be in place. Third, resilience pushes us to adopt a broader understanding of the term governance. Although we are used to thinking of governments as the principal providers of governance, this is not the whole story. This is significant in a world in which there is not only no government at the global level, but in which an increasingly complex network of interactions has left states as important actors, but in which the actions of non-state actors and even of global civil society have also emerged as major forces. Resilience prompts policymakers to recognize the collective nature of both the problems they face and the solutions to them. A primary objective of policymakers in ethical market economies therefore should be to stimulate investment in coherence: A "whole system of actions" must cohere to deliver efficient outcomes that are seen to deliver mutual benefit.[42]

Relevant policy recommendations that contribute to resilient forms of governance would include the following:

a) Functions – serving society as a whole

Governance agendas have to be transformed from single-issue objectives into multiple, interacting social-ecological ones. The challenge is to increase coherence and integration at both the national and international levels. The recent crises have triggered an intensive reform debate about the "means" and "ends" of the financial and market economic systems. In an attempt to better prevent human subsystems from becoming ends in themselves, some observers have called for making finance and economic systems function better by enabling them to serve the human population as a whole. Amartya Sen suggests that the goal of an economic system should be support for people in realizing their own capabilities. Tim Jackson sees its primary function as providing people with the opportunity to flourish, while numerous other scholars speak about quality of life, well-being and happiness. The recent policy agendas aimed at reform of the international finance and economic system resonate with these broader goals to a considerable degree.

When the G-20 Toronto Summit declared: "We are building a more resilient financial system that serves the needs of our economies," the statement alluded to the new bottom line. Jacques de Larosiere argued along a similar line in the recent report by the high-level group on financial supervision in the EU, one of the main documents driving the current discussion on a new European financial supervisory framework.[43] De Larosiere's report proposed enhanced, pragmatic, sensible European cooperation in the development of a new regulatory agenda, in the creation of more deeply coordinated supervision of financial actors, and in the development of effective crisis management procedures, "for the benefit of all to preserve an open world economy."

As economist Robert Kuttner argued in "Reforming Finance," one can divide the financial system into three broad functions: a) extending credit to businesses and households; b) connecting investors to entrepreneurs and c) pure trade and speculation.[44] The first two functions add value to the economy. But since the 1970s, with the advance of deregulation, more and more of the financial system and an increasing share of its profits have been based on the third function. As Kuttner wrote: "Pure speculation and trading adds nothing to net economic welfare. At best it is a

[42] Evans et al.; p. 26

[43] http://ec.europa.eu/internal_market/finances/docs/de_larosiere_report_en.pdf

[44] Robert Kuttner, *Reforming Finance´* in Wat et al., p. 32ff

zero-sum game. At worst, as in the recent crisis, it simply allows middlemen to take immense risks with other people's money." Many of the financial regulation proposals under discussion therefore focus on discouraging or prohibiting excessively risky practices.[45] Some are aimed at preventing financial institutions from threatening the stability of the entire global economic system or, if they are too big to fail, preventing the need for bail-outs from taxpayers.[46]

Reinforcing economic policy coordination, primarily in the euro area but also in the European Union as a whole, is without question one of Europe's highest priorities. Currently, three major initiatives are under discussion, all aiming among other objectives to contribute to the realization of the Europe 2020 strategy, which was proposed by the European Commission following a large consultation process, and formally adopted at the Council meeting on 17 June 2010.[47] This itself is a coherent framework aimed at allowing the EU to mobilize all of its instruments and policies, and at encouraging the member states to take enhanced coordinated action designed to deliver concrete outcomes along the triple bottom line in regards to employment, research and innovation, climate change and energy, education, and the fight against poverty. Specific initiatives range from "Reinforcing economic governance in the euro area," presented by the European Central Bank on June 10, 2010,[48] to a European Commission communication on "Enhancing economic policy coordination for stability, growth and jobs: Tools for stronger EU economic governance," which was announced by European Commissioner for Economic and Monetary Policy Olli Rehn on June 30, 2010,[49] and include a task force on economic governance that consists largely of EU finance ministers, headed by the president of the European Council.[50]

All initiatives providing governance for Europe 2020 have been influenced by the concept of resilience. The European Central Bank is tasked with strengthening oversight of budgetary policies and economic balances, and with designing an appropriate euro area framework for crisis management. The European Commission is responsible for proposing early policy coordination, oversight, and a series of corrective and preventive measures designed to "minimize the negative spillover effects where member states do not stick to agreed limits and ultimately, sanction those who endanger the common good through unsustainable national actions." The European Council Task Force will contribute to regulation that allows institutions "to act more quickly and in a more coordinated and efficient manner." Of course there is still a long way to go. Many experts argue that the reforms have a piecemeal nature, and that a stronger alignment of policy agendas would be advisable. However, it is clear that the overall strategy is contributing to the principles of resilience.

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45 This includes measures such as the European Alternative Investment Fund Managers (AIFM) Directive that would improve transparency and regulatory oversight for hedge funds, credit rating agencies and over-the-counter derivatives; measures aimed at addressing and resolving problems associated with systemically important financial institutions; and proposed financial trans-action taxes (FTT) or financial activities taxes (FAT) (For more on the latter two, see the IMF publication, *A fair and substantial contribution by the financial sector* (Final report for the G20; June 2010) para 28ff and 32ff

46 This category includes so-called narrow banking initiatives; new standards developed by the Basel Committee on Banking Supervision (BCBS) focusing on higher levels of bank capital and liquidity; the introduction of a European systemic risk board; and institutional levies (so-called financial stability contributions) to pay for the fiscal cost of any future government support for the sector

47 http://ec.europa.eu/eu2020/index_en.htm;
http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/115346.pdf

48 http://www.ecb.int/pub/pdf/other/reinforcingeconomicgovernanceintheeuroareaen.pdf

49 http://ec.europa.eu/economy_finance/articles/euro/documents/com_2010_367_en.pdf

50 http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/114606.pdf;
http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/114979.pdf;
http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ec/115798.pdf

b) Foresight – investing in capacities to anticipate

Implementing foresight systems will also strengthen policy-making and make it more sensitive to long - term needs. We must be able to "learn from the future as it emerges" if we are to achieve trans-institutional cooperation on a mass scale.[51] By implementing foresight, we create shared mental models that allow for a more sound understanding of problems, a common will and more coherent interactions in terms of solutions.[52] However, as described above, humans have a tendency to discount the future quite strongly. Therefore, long-term thinking and consideration for future generations do not come naturally, posing a constant challenge for individuals, societies and the global community. Establishing the appropriate institutions to ensure long-term thinking is therefore essential to a sustainable ethical market economy.

Governmental bodies tasked with developing and communicating future strategies are one of the many possible institutions needed. Jerome Glenn, pointing to the need for improved linkages between stakeholders and the creation of collective intelligence systems, says "Local and national leaders should make these new systems as transparent and participatory as possible to include and increase the public's intelligence and resilience. As a result, more future-oriented and global-minded voters might elect leaders who are sensitive to global long-term perspectives."

Making this a reality is not a trivial undertaking and requires new forms of communication beyond the traditional one-way formats of lectures, speeches, papers—and even roundtable discussions. We need to develop more participatory approaches, focus on common intent, and provide a framework through which deep-seated values and narratives can be expressed.

Scenario analysis offers one such means of expanding the parameters of thinking. Scenarios here refer not to upside or downside scenarios relative to an 'official' future. Rather it refers to first exploring the two major uncertainties an organization faces and then tell stories about the organization in each of the four possible (high-low) combinations of these two uncertainties. Allowing us to better understand ourselves and our collaborators, scenario analysis builds bridges between organizational silos and fosters mutual understanding, enhancing our ability to handle surprises in the unpredictable future. The goal of scenario analysis is to develop our capacity for making better decisions about the future—not to develop an accurate picture of tomorrow.[53]

Developed by the RAND corporation for long-term policy analysis, "robust decision-making" offers another useful tool by augmenting systematic human assessment with powerful modern computers. Humans have a unique ability to detect patterns and hypothesize, but they also tend to ignore "inconvenient" data or linkages that computers can easily highlight. The aim of robust decision-making is to look for robust, near-term policy options, that is, those that perform reasonably well across a wide range of unpredictable futures. Applied to the challenge of global sustainability, the RAND publication "Shaping the Next 100 years" demonstrates how we might reconcile different views "to better define what it is we wish to do and how we can best go about it in a variety of realms that currently resist our attempts at analysis and navigation."[54]

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51 C. Otto Scharmer, *Theory U: Leading from the Future as it Emerges* (San Francisco: Berrett-Koehler Publishers, 2009).

52 Evans et al., p. 28

53 Peter Schwartz, The Art of the Long View (Currency Doubleday: 1991)

54 Robert J. Lempert, Steven W. Popper und Steven C. Bankes, *Shaping the next one hundred years – New methods for quanti-tative, long-term policy analysis* (The RAND Pardee Center: 2003)

C. Otto Scharmer offers a third approach of "deeper listening," calling on leaders to slow down and pay closer attention to the needs and desires of their constituents. Lamenting the tendency of decision makers to respond to problems by "pulling all of the usual triggers," he demonstrates how leaders can reflect deeply and connect to their "inner source of knowing," thereby developing their capacity to sense "what really wants to happen."[55]

c) Systemic – freeing macro economies from a structural requirement for growth?

Because the sharp contraction in global demand has been commonly identified as one of the primary causes of the economic crisis, policy responses have been more or less unanimous in targeting economic growth for recovery. In Toronto, the G-20 declared that its highest priority "is to safeguard and strengthen the recovery and lay the foundation for strong, sustainable and balanced growth... We therefore welcome the actions taken and commitments made by a number of G-20 countries to boost demand and rebalance growth." The Europe 2020 strategy lists three priorities that serve as a European definition of "qualitative growth." The first, smart growth, aims to develop an economy based on knowledge and innovation. The second, sustainable growth, promotes a more resource efficient, greener and more competitive economy. The third, inclusive growth, entails fostering a high-employment economy delivering economic, social and territorial cohesion. As mutually reinforcing priorities, they envision a social market economy for Europe in the 21st century. Similar approaches are also taken at national levels.

In terms of sustainable growth, and under current short-term and long-term economic and political conditions, "green growth" arguably offers the best way forward. It offers jobs and economic recovery in the short term, energy security and technological innovation in the medium term, and a sustainable future for our children in the long term. However, it is not clear how far green growth can bring our societies. As discussed earlier, it is unclear, for example, whether absolute decoupling of natural resource consumption from economic growth is feasible.

A more consistent policy proposal, put forward by Jackson, is to introduce today a macroeconomic framework that no longer requires growth for stability, ensuring that the right policies are already in place once the era of growth comes to an end. In his view, there is an urgent need to develop steady or non- growth economies and to prove that "for the advanced economies of the western world, prosperity without growth is no longer a utopian dream. It is a financial and economic necessity."[56]

According to Jackson, we must begin by challenging our assumption that perpetual growth in consumption is the only possible basis for stability, and by identifying the conditions that define a sustainable economy. These conditions for non-growth thinking will still entail a strong requirement of economic stability as the basis for the protection of people's jobs and livelihoods. However, he argues, this condition will need to be supplemented by further conditions that address distributional equity, sustainable levels of resource throughput, and the protection of critical natural capital. In operational terms, this new macroeconomic framework will require enhanced investment in public infrastructures, sustainable technologies and ecosystem maintenance. It is likely to demand a different balance between public and private goods. It will also require us to reframe our concepts of productivity and profitability.

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[55] Otto C. Scharmer, *Seven Acupuncture Points for Shifting Capitalism to Create a Regenerative Ecosystem Economy* (Draft Paper, MIT 2009) www.presencing.com

[56] Jackson, p. 185

The authors of this paper do not believe in abandoning growth universally or finally. The role of human agency in shifting economies toward so-called knowledge societies that are more or less independent of material throughput must not be underestimated. As Jackson notes: “A massive technological shift; a significant policy effort; wholesale changes in patterns of consumer demand; a huge international drive for technology transfer to bring about substantial reductions in resource intensity right across the world: these changes are the least that will be needed to have a chance of remaining within environmental limits and avoiding an inevitable collapse in the resource base at some point in the (not too distant) future.” However, as long as there is uncertainty about entering a longer phase of no growth, we need to better understand the implications for the economic models at hand and policy areas affected. Frontier research in this direction is needed and deserves full support. In this respect, the “Growth in Transition” project initiated by the Austrian Federal Ministry of Agriculture, Forestry, Environment and Water Management (Lebensministerium) serves as an influential example.[57]

IV Concluding remarks

We began by defining **ethical market economies** as economic systems in which the production, distribution and consumption of goods and services are not ends in themselves but serve the purpose of providing quality of life for all without jeopardizing future generations’ opportunity to experience the same. In light of the root causes of the financial and economic crises, namely debt-driven and resource intensive consumption patterns and growth coupled with the rise of new consumer classes in emerging economies, we identified four building blocks that contribute to more ethical systems:

First, we need to employ a more balanced conception of human nature, which allows us to transcend purely materialistic aspirations, and build on the strengths and weaknesses of people and their real needs.
Second, we need to acknowledge environmental constraints, which allow us to live within the planet’s limits.

Third, we need to target tangible successes and outcomes associated with a better quality of life, delivering qualitative rather than quantitative results.

Fourth, we need to develop resilient forms of governance, which allows us to manage better the inevitable crises ahead.

Effective market economies remain crucial for social progress. However, as Otto Scharmer has illustrated, there is a strong case to be made for all economic actors to operate with a broader worldview in which market outcomes are judged less in terms of one’s own needs and more in terms of the needs of a given socioeconomic and finite ecological system. To be sure, adapting this view entails the capacity to internalize the concerns and issues of all other stakeholders in one’s own decision-making. After all, there is a role for everyone to play in working toward a transformed worldview. Citizens need to articulate what kind of progress they would like to see. Governments need to implement the appropriate incentives and disincentives. Statisticians need to develop tools to measure what really matters. Engineers must develop carbon-neutral and low footprint solutions, so that we may meet the needs of an estimated 9 billion people in 2050. Busi-

[57] http://www.growthintransition.eu

nesses need, as the Bertelsmann Stiftung's founder Reinhard Mohn argued, to consider what their goods and services yield not only in terms of profit, but in contributing to genuine human progress. Social change agents, finally, need to change aspirations, consumption patterns and behavior at a mass scale. If all of these actors target such goals, they will facilitate greater adherence to modes of sustainable development among producers and consumers alike. The selling argument here is that the quality of life will improve along with the scale of the changes witnessed.

From a European and a Black Sea region perspective, we can conclude the following points:

First, if the Black sea region lacks a shared vision for increased integration, as the Commission on the Black Sea has established, the building blocks of ethical market economies should become a guiding philosophy of regional cooperation in the Black Sea.

Second, the European Union and its member states should go beyond pipeline politics, without playing down their continued significance, and concentrate on developing a resilient and sustainable Black Sea energy market .

Finally, while European member states as well as non-European countries in the Black Sea region should implement the ethical principles outlined, it is the advanced European economies that bear a special responsibility in initiating broader change and demonstrating their economic leadership. If the European Union does not meet the priorities regarding qualitative growth set forth in the Europe 2020 strategy, it will neither be in a position to add value to the global level, nor be a power of attraction to the Black Sea region.

Global Visions

As the world grows smaller, new and ever more complex challenges are arising, bringing with them dangers that threaten both the planet Earth and its inhabitants. These challenges are highly interdependent and can only be solved on the global level, yet the global community lacks the awareness, values and institutions necessary to respond to them. In its "Global Visions" focus area, the Bertelsmann Stiftung is therefore taking stock of current global knowledge while promoting international cultural dialogue on issues relating to sustainable development.

Responsible

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