



HARVARD Kennedy School

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TIME U.S. LEADERSHIP WOKE UP TO A NEW ECONOMIC ERA



[March] may be remembered as the moment the United States lost its role as the underwriter of the global economic system. True, there have been any number of periods of frustration for the U.S. before, and times when American behavior was hardly multilateralist, such as the 1971 Nixon shock, ending the convertibility of the dollar into gold. But I can think of no event since Bretton Woods comparable to the combination of China's effort to establish a major new institution and the failure of the U.S. to persuade dozens of its traditional allies, starting with Britain, to stay out of it.

This failure of strategy and tactics was a long time coming, and it should lead to a comprehensive review of the U.S. approach to global economics. With China's economic size rivaling America's and emerging markets accounting for at least half of world output, the global economic architecture needs substantial adjustment. Political pressures from all sides in the U.S. have rendered it increasingly dysfunctional.

Largely because of resistance from the right, the U.S. stands alone in the world in failing to approve the International Monetary Fund governance reforms that Washington itself pushed for in 2009. By supplementing IMF resources, this change would have bolstered confidence in the global economy. More important, it would come closer to giving countries such as China and India a share of IMF votes commensurate with their new economic heft.

Meanwhile, pressures from the left have led to pervasive restrictions on infrastructure projects financed through existing development banks, which consequently have receded as funders, even as many developing countries now see infrastructure finance as their principal external funding need.

With U.S. commitments unhonoured and U.S.-backed policies blocking the kinds of finance other countries want to provide or receive through the existing institutions, the way was clear for China to establish the Asian Infrastructure Investment Bank. There is room for argument about the tactical approach that should have been taken once the initiative was put forward. But the larger question now is one of strategy. Here are three precepts that US leaders should keep in mind.

To read M-RCBG Director **Lawrence Summers'** full op-ed in the *Financial Times*, in which he describes three important precepts for U.S. leaders going forward, visit www.mrcbg.org and click on our News page.

Seminars & Events

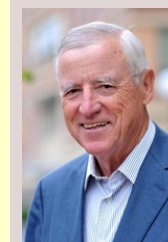
M-RCBG has over 80 seminars and events scheduled each semester. Many of them are recorded. To listen to recent seminar podcasts, visit www.mrcbg.org and click on the SoundCloud or iTunes links. Below is a sampling:

Confronting City and State Fiscal Crises;
Richard Ravitch,
former Chair of the
New York Urban
Development
Corporation.



Emotion and Financial Impatience;
Jennifer Lerner,
HKS.

Online Small Business Loans: Should They Be Regulated?;
Karen Mills,
M-RCBG Senior
Fellow.



Public-Private Partnerships in the Northern Ireland Peace Process; **John Cullinane,** Cullinnet founder and Frank Costello, Queens University, Belfast.



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M-RCBG awards summer internship grants

This summer, M-RCBG will help fund 15 students working in unpaid internships throughout the world – from the National Economic Council at The White House to the African Governance Initiative in Ethiopia. They include:

- Phil Barker – expanding social impact bonds in the UK
- Taniel Chan – National Economic Council Graduate Intern at The White House
- Larissa de Lima – Brazilian Ministry of Strategic Affairs
- Armand Babacar Dieng – Africa Growth Initiative at the Brookings Institution
- Clio Dintilhac – African Governance Initiative in Ethiopia
- Aviva Feuerstein – International Centre for Political Violence and Terrorism Research
- Christine Hou – Asian Development Bank
- Prabhat Mishra – MIT Energy Initiative
- Juan Obach – OECD
- May Samali – Tumml, an urban ventures accelerator in San Francisco
- Andrea Sorce – International Diaspora Engagement Alliance at Calvert Foundation
- Maja Sostaric – Lien Centre for Social Innovation, Singapore Management University
- Shweta Suresh – mPower Social Enterprises Limite
- Sarah Tesar – International Trade Centre
- Ingrid Wallin Johansson – Swedish Financial Supervisory Authority

HPCA releases two new discussion papers and a Viewpoint

Harvard Project on Climate Agreements (HPCA) affiliates have released the following three papers since March 2015:

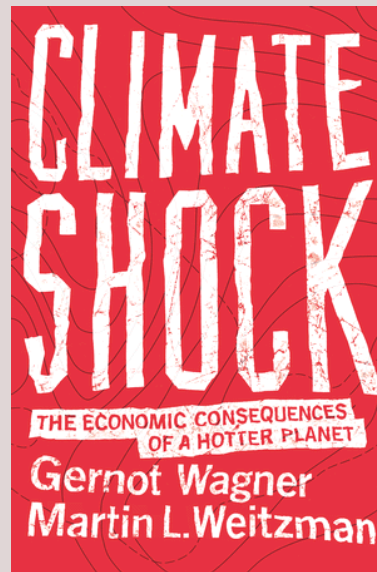
What Can an Economist Possibly Have to Say about Climate Change? **Robert Stavins** argues for an economic approach to solving environmental problems and explains why "environmental economics" is not an oxymoron.

The Role of Integrated Assessment Models in Climate Policy: A User's Guide and Assessment. Authors Gilbert Metcalf and James Stock released a new Harvard Project Discussion Paper that considers the role of integrated assessment models in estimating the social cost of carbon – an estimation that is important in the formulation of U.S. climate policy.

Why Finance Ministers Favor Carbon Taxes, Even if They Do Not Take Climate Change into Account. Max Franks, Ottmar Edenhofer, and Kai Lessmann find carbon taxes, which postpone extraction of fossil fuels and reduce cumulative carbon emissions, also have economic advantages over taxes on capital.

For more information, visit www.belfercenter.org/climate.

New book from HEEP fellows



Gernot Wagner, former Harvard Environmental Economics Program (HEEP) Pre-Doctoral Fellow, and **Martin Weitzman**, HEEP Faculty Fellow, have published a book entitled *Climate Shock*.

The book explores in lively, clear terms the likely repercussions of a hotter planet, drawing from and expanding upon work previously unavailable to general audiences. What we know about climate change is alarming enough – *Climate Shock* helps readers zero in on the unknown risks that may dwarf the known risks. The book also shows how the economic forces that make sensible climate policies difficult to implement can also make more radical approaches like geoengineering more likely to be attempted.

HEEP Faculty Fellow named full professor

Michael Toffel, a Faculty Fellow of the Harvard Environmental Economics Program, has been appointed a full professor at the Harvard Business School. Toffel is a former Associate Professor of Business Administration. His research examines how companies measure and reduce the environmental impacts of their operations and supply chains. He has also contributed to the HEEP Discussion Paper series.

Have you visited GrowthPolicy.org yet?

Where will the jobs of the future come from? What should we do about growing inequality? How do we prevent the next financial crisis? After months of culling the most compelling scholarship from around Harvard University, M-RCBG has launched *GrowthPolicy.org*, a website showcasing the work of Harvard faculty in addressing these questions. The site provides a carefully reviewed collection of what Harvard scholars are saying about the causes and cures for the most pressing challenges to economic opportunity and growth. Newly listed articles include:

- M-RCBG Director **Lawrence Summers** on secular stagnation
- Robert Putnam on the American Dream
- **Rohini Pande** on life expectancy gains in India with decreased pollution

Study uncovers a troubled pension landscape



The U.S. is not alone in dealing with pension issues. A recent study co-authored by M-RCBG Senior Fellow **Thomas J. Healey** and Catherine Reilly MPA 2014 uncovers a troubled pension landscape across the globe. From rising government debt ratios to poor investment returns to increasingly aging populations, meeting commitments to employees for their

retirement is becoming an increasingly difficult task.

The study, *Global Pensions Underfunding*, tracks the retirement programs in 33 countries across five continents. The researchers employed two metrics, *sustainability* (to determine the burden that projected spending for a pension system puts on public finances) and *adequacy* (to determine the ability of a pension system to provide a tenable retirement income).

“Our goal was not only to identify the pressures and problems these governments face, but to suggest practical ways they could provide for their retired citizens without putting an unreasonable strain on public finances,” said Healey.

They called the desirable balance between the two metrics *efficiency*. They found that countries that wish to be truly efficient can’t simply trade-off sustainability for adequacy, or vice versa. They must aim to improve both metrics simultaneously. For example, Korea, India, and China rank among the top five most sustainable pension systems, but also rank among the lowest in terms of adequacy. “If a large share of the growing elderly population has insufficient retirement income, this will turn into a public policy problem even if the pension system does not currently demand heavy public spending,” the study concludes.

Conversely, Austria and Hungary have two of the most adequate systems, but are among the bottom in sustainability. While they’ve made ample provisions for retirement, the projected burden on public finances is so high that they are almost sure to fall short of their promise to retirees.

Healey and Reilly suggest that new approaches to pension system design can help “thread the needle” between sustainability and adequacy in a number of ways:

- Notional defined contribution (NDC) plans where contributions are recorded in notional accounts, to which a rate of return, typically GDP growth, is applied
- Collective defined contribution (CDC) plans which pool contributions into a collective, centrally administered investment fund rather than individual accounts
- Advance funding for at least some pension spending and invest the funds with an appropriate risk-seeking mandate
- Introduction of compulsory, or at minimum opt-out enrollment with adequate contribution rates for all employees
- Calibration of pension payments to reflect increases in life expectancy

Those countries currently operating their pension programs efficiently (Sweden, Denmark, UK and Poland, for example) have recently undergone extensive and relatively recent reforms to get back on track. “They should serve as a beacon of encouragement for governments everywhere faced with inadequate pension programs in desperate need of change,” Healey said.

To read the full study, visit www.hks.harvard.edu/centers/mrcbg/publications/awp and choose Associate Working Paper No. 39.

Porter speaks on effective economic policies

In February, Roger Porter, IBM Professor of Business & Government at HKS, spoke at a Forum sponsored by MIT and the Organization of Economic Cooperation and Development (OECD), on “Effective Economic Policies for Challenging Times.”



M-RCBG Director **Lawrence Summers** and Co-Director **John Haigh** recently met with student leaders of the Business & Government Professional Interest Group (B&G PIC) to discuss research and career advice on the intersection between business and government.

Lessons from the Financial Crisis



Prof. **Joseph Aldy**, faculty director of the Regulatory Policy Program with Senior Fellow **Lewis Kaden**, former vice-chairman of Citigroup, at an April Regulatory Policy Program (RPP) seminar on the financial crisis.

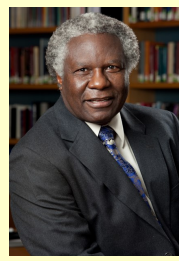
While the most recent financial crisis was caused by a variety of complex factors, there are many important lessons that can be learned that may help mitigate the impacts of such a crisis in the future. **Lewis B. Kaden**, retired Vice Chairman of Citigroup, M-RCBG Senior Fellow, and John Harvey Gregory Lecturer on World Organization at Harvard Law School, shared some of these lessons during a recent Regulatory Policy Program seminar. **Joseph Aldy**, Assistant Professor of Public Policy and Faculty Chair of the Regulatory Policy Program, moderated the discussion.

According to Kaden, many lessons concern the functions of the major financial institutions themselves. These include practices and policies related to risk management, information technology, compliance, and human resources. When it comes to risk management, for example, Kaden suggested that banks should make sure that their risk management models not only exist for each division, but also extend *across* divisions. That practice would have been valuable to many banks during the financial crisis, including Citigroup, allowing them to grasp the extent to which all divisions were concentrated in housing-related instruments and investments, and not merely how each division separately concentrated its risk in housing.

Kaden said that factors related to ethics, contagion, convergence, consumer education, bank governance structures, and regulatory structures also need to be improved to anticipate and prevent financial crises. For example, Kaden contended that too many agencies in the US have overlapping responsibilities when it comes to financial regulation, which creates challenges for banks. Or, to point to another example, Kaden argued that ethics, culture, and compensation need to align to avoid the ethical breakdowns that occurred during the financial crisis. Compensation sends important messages about an organization's values. If a bank's risk manager is paid substantially less than those who run its businesses, the risk manager will be considered less important.

The most recent financial crisis offers many lessons, both for the internal management of banks as well as regulatory policy. Understanding these lessons is the first step in preventing crises of the future. — *Elizabeth Burns, MPP 15*

Calestous Juma on an African reboot



We all know Africa is a continent full of innovation. Now policy makers at all levels must put this strength, along with scientific and technical development, at the centre of economic strategies. Fortunately, the African Union has recently adopted a strategy that seeks to do exactly that.

Strong demand for raw materials, especially by China, and a growth in consumption by an expanding middle class has driven Africa's growth in the past decade. Seeking sustainability, policymakers are shifting their attention from raw materials to an economic outlook that is driven by technological innovation.

The 10-year Science, Technology and Innovation Strategy for Africa (STISA-2024) recently adopted by the African Union (AU) embodies this vision. Its mission is to "accelerate Africa's transition to an innovation-led, knowledge-based economy." The strategy is part of the longer-term Agenda 2063 – the AU's development vision and action plan.

The strategy takes into account Africa's current level of development and its persistent challenges. It seeks to deploy science, technology and innovation to address six key challenges. These include building infrastructure, eliminating hunger, improving human development, protecting the environment, enhancing social cohesion and spreading prosperity. These priorities have been extensively discussed and are not new. What is different is the determination of African leaders to leverage existing and new technologies to address them in ways that are sustainable and inclusive.

To read **Calestous Juma's** full op-ed, in which he discusses infrastructure, technical competence and entrepreneurship, at newafricanmagazine.com/africa-rebooting/



Senior Fellow **Barbara Anthony** (seated) recently hosted a study group with **Martha Coakley** (standing), Massachusetts Attorney General (2009-2015) on *Reflections on and Future Plans for Beyond Obamacare*.