Environmental Opportunities in times of the triple crises in Financial, Energy, & Ecosystems.

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Rationale for a 3 Crises Analysis

• The 3 crisis are interconnected, but often dealt with in separate worlds
• Environment can reach across to Finance with common concepts/language.
• Need to identify and understand underlying causes to design and implement effective measures
• Mutual Learning about how to live with complex socio-ecological systems.
Summary of Presentation

- Learning from History
- Some Common underlying Causes of the 3 Crises…
- Key Differences…..
- Some Common Avenues for Action on the 3 Crises
...100 years to return to a sustainable level—can we do better....?
Homo Stupidus as Slow Learners, 1896-2000?
EEA, 2001
Learning From Financial History, 1934?

“Boom and slump.. has gone on decade after decade.. as every fresh crop of small accumulators saved sufficient to invest.. there appeared plausible leaders of finance with a get rich quick scheme, casting it before his victims as an angler casts his flies for trout”.

Learning from History 2007-10: "look beneath the surface..."

...the mistake of most of the economics profession was a failure to see what was really going on beneath the surface”

Financial Meltdown, 2007-10: Kotlikof’s, “surface” & personal causes........

- implicit *bribing* of rating agencies;
- *incompetence* of regulators;
- *complicity* of corporate directors,
- *collusion* of bankers & politicians
- *naivete* of investors..”
- *greed & corruption*
- sales based *compensation* of management........
- “*complexity* of securities;

- A “web of interconnected financial, political, and regulatory *malfeasance*..
culminated in financial meltdown.. a system designed for *hucksters*”

L.J. Kotlikoff, former Senior Economist, President’s Council Economic Advisors; Boston Uni., in “Jimmy Stewart is Dead: ending the world’s ongoing financial meltdown with Limited Purpose Banking”, 2010, preface, p4.
Beneath the Surface: Twelve Common Causes of the 3 Crises

1. Free market ideology and deregulation
2. Early Warnings & late lessons ignored
4. Imbalances between stocks & flows
5. Socially malign private incentives
6. Misleading market prices that exclude many costs & risks
7. Misplaced faith in models
8. Intransparent products & impacts
9. Poorly understood complex systems
10. Lack of knowledge of tipping points & systemic risk
11. “Toxic” Debts/Risks created but passed on to “distant others”
12. Not accounting for what really matters
1. The free market, deregulatory, ideology that failed

- Financial deregulation 1980-99 especially of US Regs created to deal with malign banking activities that helped cause the Depression 1929-33.

- eg US Financial Modernisation Act 1999 which repealed Glass-Steagall Act, 1934

Source: “Circle of Greed”, The spectacular rise and fall of the lawyer who brought corporate America to its knees”, Dillon & Cannon, 2010
2. Early Warnings Ignored: Financial Crisis, 2003-6

« This credit bubble based on nothing more than expectations, cannot be maintained forever,

There will be a crash. People will no longer be able to pay their debts, particularly if the values of the assets they hold against those debts start to fall. »

(Real World Economic Outlook, NEF, 2003, p29)

See also “early warnings” from Borio & White 03; White 06, of Bank of International Settlements; Stiglitz; Nourbino etc.
Early Warnings: Climate Change

• Arrhenius (1896) estimated that a doubling of the quantity of CO$_2$ in the atmosphere would raise the average global temperature by about 5°C.

• The National Academy of Sciences of the USA report on global warming (Charney et al., 1979) concluded that the impact of doubled atmospheric CO$_2$ concentrations, would increase global mean equilibrium surface temperature increase of between 1.5°C and 4.5°C.

• Largely confirmed by IPCC in 2007: likely range 2.0 to 4.5°C.
Early Warnings: Fish Ecosystems

The Newfoundland Cod fishery is being overfished (Keates, 1986) ...

...dismissed by Canadian Dept of Fisheries & Oceans as “biased pseudoscience written to support a political agenda”.

MacGarvin, “Fisheries: Taking Stock”, in Late Lessons from Early Warnings (EEA, 2001)
Why are early warnings routinely ignored?

- Powerful economic/political stakes in *status quo*
- Unethical behaviour, e.g. greed
- “We don’t want to know” / “Don’t spoil the party”
- Early warners sidelined or silenced
- Short term thinking/decisionmaking
- “Things are different now”
- Uncertainties create real and “manufactured” doubt about realities of risks
- Group think
- “Immediate past predicts the future”
- Limited use of scenarios

4. Imbalances between Stocks & Flows

- **Finance**: focus on *flow indicators* eg interest rates & inflation not on quantity / quality of financial assets (led to “Troubled Asset Relief” etc.)

- **Energy**: focus on *stocks* of fossil fuels not on flows of renewables

- **Ecosystems**: focus on *flows* of food & fibre not on environmental assets.
GDP and the stock of financial assets in G7 minus Japan and UK

© nef (new economics foundation), Real World Economic Outlook, 2003
© nef (the new economics foundation)
6. Misleading market prices...

- “low interest rates and low apparent risk created strong incentives for financial institutions to become highly geared..” (Bean, Bank of England, Barcelona, 09).
- AIG: “we didn’t know how to price our financial products to capture full risks & “toxic debts” (“Fortune” Mar. 10);
- **Energy & Ecosystems** externalities not in market prices
7. Misplaced faith in models: Financial

- **Keynes**: “Too large a proportion of mathematical economics are a mere concoction, as imprecise as the initial assumptions they rest on... which allows authors to lose sight of the complexities and interdependences of the real world... 1936.

- “Beware of geeks bearing formulas”
  
  **Warren Buffet** 2008.
“Harris likened Fisheries science to the Ptolemaic model of the solar system where when observations did not fit the theory, an additional layer of complexity was added, rather than questioning the basic theory”

“Increasingly complex maths and computational power created optimism that past mistakes of the 70s could be avoided..

(“Fisheries: taking stock”, Macgarvin, EEA Late Lessons, 2001)
8. Intransparent Products & Impacts

- Complex & ill understood Financial products
- Full costs of Energy and Ecosystem products not visible at point of purchase.
A complex system is characterised by many small elements/components (e.g. atoms, molecules, cells, consumers, investors, particles) which interact at the local/micro level and produce emergent properties at the system level that cannot be understood or predicted from the actions at the micro level.

“Bug, not cog, worlds”
Complexity and Uncertainty

Complex financial, biological & ecological systems...

eg bee colony; herding in financial markets; tumours, clouds, climate systems etc. are characterised by:

indeterminancies, uncertainties and ignorance, thresholds, tipping points, and unstable, non-linear dynamics.
Some implications of complexity

• “Paralysis by Analysis” needs to be avoided and the precautionary principle used to justify action when there is plausible risk of serious and irreversible harm to peoples, ecosystems or the planet.

• Actions taken in the face of uncertainty/ignorance/complexity need to be based on broad not narrow assessments (see biofuels case);

• activities/policies need to be resilient, and adaptive in the face of surprises and unintended consequences
Resilience thinking for Sustainable Resource Use?

• Short term optimising part of a system can cause system failure in longer term

(See Everglades; Caribbean corals; Wisconsin Lake; Murray-Darling basin; Kristianstads wetlands: “Resilience Thinking”, Walker & Salt, 2006)

• Resilience Alliance case studies
Features of “Resilience Thinking”

- Socio-ecological diversity & variability
- Combining components with coherence.
- Strong & overlapping social networks at local, regional, national levels
- Tight feedback of consequences (monitoring for “surprises”)
- Adaptive management
- Humility & precaution
11. Debts/Risks passed on to “distant others”

- “toxic” financial debts passed on & on… within complex products

- Ecological debts & risks largely passed onto to the poor & future generations
Some key differences between the 3 Crises

- Financial and energy systems are (hu)manmade… the biosphere is not.
- Financial crisis is visible; short term; largely reversible … Climate and biodiversity crises are not so visible; longer term; mostly irreversible.
- Financial systems are more volatile: perceptions, expectations & behaviour rapidly change the systemic risks-a lesson for Energy & Ecosystems
- Financial, energy, and social systems depend on ecosystems, not vice-versa

René Passet, 1979
# Some Common Avenues for Action

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<td>DECISION-MAKING</td>
<td>Tools for taking competing values into account Participatory methods. <strong>Rebuilding Trust.</strong></td>
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Health and Social Problems are Worse in More Unequal Countries

Index of:
- Life expectancy
- Math & Literacy
- Infant mortality
- Homicides
- Imprisonment
- Teenage births
- Trust
- Obesity
- Mental illness – incl. drug & alcohol addiction
- Social mobility

The Current Meltdown of Trust in Elites

“There has been a massive breakdown of trust: trust in the financial system, trust in bankers, trust in business and business leaders, trust in politicians, trust in the media, trust in the whole process of globalisation—all have been severely damaged, in rich countries and poor countries alike.”

“Reflections on Money, Morality, and an Uncertain world” (Green, ex chair, HSBC, 2009, p x1).