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"The OSCE: Addressing New Security Challenges"

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“The economic crisis and security in the OSCE area”

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The World Financial Crisis

As the OSCE Parliamentary Assembly convenes its Eighteenth Annual Session in Vilnius, the world financial and economic crisis that erupted in the second half of 2008 is probably the most serious challenge affecting the whole of the OSCE area. This crisis was generated by the financial system itself and caused by an overstretch of financial liberalisation and a lack of regulations as well as lax governmental oversight of financial markets. This crisis has placed the world economy in severe recession, and it has serious political and social consequences.

The Organisation for Economic Cooperation and Development (OECD) issued in April 2009 a forecast that expects Gross Domestic Product (GDP) among its thirty mainly prosperous countries to decrease by 4.3% this year.

Given the global nature of the current economic crisis, an internationally co-ordinated response is absolutely essential, both to alleviate the strains on societies and to ensure that similar crises are prevented in the future. It is especially important that the OSCE participating States develop a coherent strategy to deal with the situation, because the OSCE includes some of the world’s largest economies, and their economic and fiscal policies have far-reaching implications for the planet as a whole.

While other international organizations such as the World Bank and the International Monetary Fund (IMF), as well as economic forums such as the Group of Eight (G-8) and the Group of Twenty (G-20), are addressing the crisis in their own ways, the OSCE and the OSCE Parliamentary Assembly are in a unique position to facilitate open dialogue between the participating States. As the collective voice of the OSCE’s parliamentary dimension, the OSCE Parliamentary Assembly can help guide the debate within the national parliaments of participating States and serve to help co-ordinate the overall international response to the crisis.

The OSCE Parliamentary Assembly’s 2009 Dublin Economic Conference, hosted by the Irish Parliament, will address the world financial crisis by focusing the debates on the responses to the crisis, financial regulations and the social consequences of the crisis.

Considering that in the *Helsinki Final Act*, participating States agreed to “to reduce or progressively eliminate all kinds of obstacles to the development of trade”, Parliamentarians should undertake to resist economic nationalism in all of its forms. The Parliamentary Assembly should therefore bring to the attention of national parliaments that various protectionist measures that have been implemented in the OSCE area may be in violation of these commitments and should be reconsidered.

The Financial Crisis as a Security Concern and a Threat to Human Rights

The global economic crisis of the 1930s led to widespread insecurity and provided the basis for the rise of authoritarian regimes and for demagogic leaders to exploit the fears of their populations. The crisis was used as a justification for provoking aggressive campaigns and blaming ethnic minorities, with well-known and tragic results.

In responding to the current crisis, it is important to keep our recent history in mind. Not only should those lessons provide a sense of urgency to national governments in implementing an effective and co-ordinated approach to economic recovery, but it is equally important to carefully monitor the related social and political upheaval, and respond appropriately. The consequences of failing markets and policies have already led to political instability in many OSCE countries. This, in turn, could generate insecurity throughout the OSCE area.

According to a recent Eurasia Group report, governments are sure to face an increasingly insecure population as unemployment increases and standards of living decrease. This situation would be ripe for rising crime, labour strikes, political extremism, and xenophobia.

Political and economic nationalism could also take hold, making consumers less friendly toward foreign products and foreign workers. In the worst case, the social ramifications of the financial crisis could push populations into regional ethnic conflicts. Due to the fragile situation in certain participating States, it is not difficult to imagine these conflicts spilling over into violent conflict.

Migration, as the Hellenic Chairmanship of the OSCE is underlining this year, is another concern. As unemployed workers are forced to leave home in search of employment, destination countries may be overwhelmed with the added economic burden. Furthermore, many migrants are also discovering that there is no employment to be found abroad, as economic activity has declined throughout the OSCE area. This has led to a sharp decline in remittances, which several participating States – particularly in South East Europe and Central Asia – rely on heavily.

The economic crisis also has a **gender-specific impact** in which the burden is disproportionately laid on women. Although both women and men have been affected by job losses, women are often laid off first, especially in less developed economies. At a 5 March 2009 meeting of the United Nations Commission on the Status of Women (CSW), participants noted that jobs are being lost mainly in female-dominated sectors, such as the care economy. Women in the informal sector – economic activities that are neither taxed nor monitored by governments are particularly being affected, as the crisis significantly reduces the demand for outputs produced in that sector.

Responding to the Crisis in the OSCE Area: Towards a Common Approach

National governments within the OSCE area have been implementing various measures to reverse the economic downturn, but thus far, the transatlantic response has been lacking a common approach.

European governments within the OSCE have generally called for tighter regulations and fiscal restraint, while the United States has introduced a broad spending package intended to stimulate the economy by creating jobs, increasing infrastructure spending, and encouraging alternative energy development. The U.S. government is also spending enormous amounts of money to bail out banks, financial institutions, and key industries such as car manufacturers. The thinking is that these institutions are "too big to fail", because if they were to collapse, the effects would be catastrophic.

European leaders have for the most part called for less spending and more financial regulation to turn the crisis around. In a joint letter to the Czech presidency of the European Union, the leaders of Germany and France recently said the EU should ensure that all hedge funds and other private investment firms be registered, regulated and supervised. "*The top priority is the putting in place of a new global financial architecture,*" stated French President Nicolas Sarkozy and German Chancellor Angela Merkel.

Considering this divergence of opinion, it is clear that global co-ordination and decision-making has not always kept up with the pace with economic globalization. Although the global economy is more interconnected today than it has ever been, the co-ordination of fiscal and economic policy is still implemented on an *ad hoc* basis and often in the narrow national interests of individual States.

Financial Regulations / The Role of Governments

Financial and monetary experts see the origins of this crisis as a regulation failure and feel that greater supervision of financial institutions is the answer. However, a major concern with the role of governments is how far the re-regulation will go.

Despite the appearance of a wide divergence of opinion, there is actually common ground and broad agreement that policies of excessive deregulation and lax oversight of financial markets are not serving the world well. Indeed, it is now widely accepted that the current economic crisis has its roots in misguided deregulation policies in the United States, and that any sort of economic recovery must include the reinstatement of regulations that were lifted over the past several decades.

Specifically, when the 1933 U.S. Glass-Steagall Act, which separated commercial banking from investment banking, was repealed in 1999, commercial banks began taking on risky activities that directly led to the current situation.

There were those at the time who warned that ignoring the lessons of the Great Depression would lead to a re-play of history. In one particularly prescient statement, U.S. Senator Byron Dorgan said in November 1999 that "*we will look back in 10 years' time and say we should not have done this but we did because we forgot the lessons of the past, and that that which is true in the 1930s is true in 2010… We have now decided in the name of modernization to forget the lessons of the past, of safety and soundness"*.

There now seems especially after institutions such as Lehman Brothers Holdings Inc. declared bankruptcy in September 2008 - to be much more appreciation for the "lessons of the past" and those notions of "safety and soundness."

U.S. Treasury Secretary Timothy Geithner has appealed for tighter regulations on investment and private equity firms in the U.S. in order to control their past unconventional practices. <u>U.S. officials have recognized the failure of certain financial regulatory policies</u> and have pledged to correct these in the weeks ahead. In late March, Secretary Geithner announced that he would work with the U.S. Congress to enact a more stable system that will lead to a more modern financial structure.

Many European leaders within the OSCE have called for <u>an increase in financial regulation</u>, with several suggesting that a reorganization of the European financial system is in order. The European Council passed an economic recovery plan in December 2008 intended to stimulate the economies of member countries.

In subsequent meetings, leaders in the European Union expressed diverse ideas on how to recover from this crisis, including infrastructure spending, restoring credit flows, and greater supervision of financial institutions. The European Council also called on Member States to develop individual country stimulus plans in line with the Council's objectives.

One interesting analysis of Europe's current financial situation was put forth by Nobel prize-winning economist Paul Krugman. He describes Europe's dilemma as a lack of co-ordinated fiscal decisions. According to Krugman, "*Europe's economic and monetary integration has run too far ahead of its political institutions"*. Most of Europe shares a common currency and a common central bank; however, each country is governed and led by a different political leader. Europe's economies are as tightly integrated as American states, but they do not have continent-wide institutions to deal with this crisis.

Stimulating Economic Activity / National and Regional Initiatives

Over the past several months, financial leaders and economists from every country have been discussing the ramifications of the current economic plans. While the United States and the United Kingdom's spending plans are likely to create debt and currency problems in the future, many are praising them as necessary first steps to spur production and consumption.

This free spending will be costly to taxpayers, although it might not be enough. The amount of money spent in such a short time period is intended to inject public money into the faltering economy. The consequences of this increase in spending are certain to have lasting effects on the value of the dollar as well as the U.S. national debt. Fortunately, the United States is seeing some signs of stabilization. In late March, it was reported that housing construction and orders for machinery and equipment began to rise. In addition, government loans to private sector companies have enabled them to balance their books, save jobs, and keep production moving.

U.S. Treasury Secretary Timothy Geithner also recently unveiled a plan to buy up "toxic" debt that many financial institutions have on their books leftover from the collapse of the credit and mortgage markets. On the monetary side, the Federal Reserve has consistently been cutting interest rates for several months. In addition, they have injected billions of dollars of capital to unblock the frozen U.S. credit market. According to U.S. Federal Reserve Chairman Ben Bernanke, fiscal and monetary actions taken by the U.S. government so far have "*averted the risk of a new American Depression*." He continued by adding, "*We've gotten past that… now the problem is to get the thing working properly again*".

Programs like government health insurance and high unemployment benefits are intended to stabilize economies during tough times. These programs are intended to be safety nets to steady jobs and companies when payrolls decrease. These previously established programs and stimulus packages may not be enough to avert a deepening crisis, considering their impact on an already subsidized public. The EU has called on individual governments to buy up portions of failing banks in order to provide some stability and capital. Unlike the U.S. Federal Reserve, the European Central Bank has been less aggressive in its rate cuts and it has been conservative on ways to unfreeze Europe's credit markets. Analysts believe this is sufficient for now, but they are also looking for global leadership to expand on programs and ideas to further strengthen Europe's economy.

One encouraging example illustrates how some countries are adapting to the crisis. Many financial officials have increased their desire for economic diversification. Recently, the Russian Federation announced its intention to diversify its economy from a minerals-based market system to one that enables domestic growth. Igor Shuvalov, Russian First Deputy Prime Minister, signaled his country's intention to move from an energy exporting capital to a more modern economy that will support an increase in domestic capacity for manufacturing and production. Large overhauls of economic systems will take time, but they are necessary for countries to have the ability to ride out these financial storms.

Stimulating Economic Activity / International and Multilateral Initiatives

The early April meeting of the G-20 in London concluded with several positive steps taken to alleviate the effects of the financial crisis, including the establishment of the

Financial Stability Forum to globally co-ordinate regulation and a stronger role for the IMF in lending to distressed countries. G-20 leaders also reached agreement to make $250 billion in trade credit available to importers and exporters to keep global trade flows from diminishing. This internationally coordinated response is essential to move forward through this crisis, and it should be the OSCE PA's objective to build off these decisions in the coming months.

An innovative proposal – **The Stiglitz Initiative --** submitted to the G-20 by a distinguished United Nations panel, led by economist Joseph Stiglitz (Nobel Prize in 2001) recommended creating a new Global Economic Council which would set the agenda for global financial and economic policy. In addition, the panel proposed a new global reserve system to regularly support developing nations which would not be subject to veto power by any developed nation. Furthermore, the panel called for regional co-operation agreements given their effectiveness at recognizing cross-border externalities and sensitivities to the distinctive conditions in neighbouring countries.

The Dangers of Protectionism and Economic Nationalism

In reacting to economic difficulty, some States have adopted protectionist and economic nationalist measures. This trend has the potential to be harmful as economies decouple and turn inward. We are seeing this financial phenomenon happen throughout the world as countries enact tariffs and restrict trade to avoid losses.

In a recent report published by the World Trade Organization (WTO), it specifically focused on the rise of protectionism in the last few months. According to WTO Director-General Pascal Lamy, the world has seen "*significant slippage*" toward the position of protectionism. He added, "*The danger today is of an incremental build-up of restrictions that could slowly strangle international trade and undercut the effectiveness of policies to boost aggregate demand and restore sustained growth globally*". Economic nationalism has created environments where governments are favouring local industry, thus creating an unequal playing field for foreign competitors.

The U.S. Congress, for instance, has established a "Buy America" clause aimed at restricting investment in anything but American goods and services. In a recent meeting of the European Council, leaders directly addressed this issue by underscoring the determination of Member States to adhere to the principles of the EU's single market.

In this context it is important to recall the importance of international trade in providing stability and prosperity. The debates and the conclusions of the OSCE Parliamentary Assembly's Fifth Economic Conference held in Andorra in May 2007 devoted to strengthening stability and co-operation through international trade underlined these facts and warned against the dangers of creating barriers to trade.

The Future Ahead

What remains to be seen is how these different economic plans will affect individual economies. Both sides of the Atlantic have introduced sweeping packages and reforms that will be needed to stabilize their own economies. Some of these policies will certainly complement each other, but others may impede progress.

Given the large amounts of bailout and stimulus packages to certain companies and sectors of the economy, these companies will likely be more open to doing business since they have greater resources. This may free up markets as intended but along with these stimulus packages and bailouts also comes government intervention. As governments buy up large segments of the private sector, greater government influence in business decision making seems likely. When combined with nationalistic and protectionist policies this influence could impede growth between countries and negatively affect the exports of less developed countries.

Also, there is the potential for environmental priorities to be cast aside in the pursuit of economic recovery. Economic stimulus packages could focus on the imperative of rescuing industries that are not necessarily environmentally friendly, which could in turn undermine efforts to curb climate change and other global environmental problems. But there is also the potential for using the current crisis to rethink economic and industrial policies. With high levels of unemployment, governments and international financial institutions could use their resources in putting people to work in environmentally friendly industries, including the development of energy efficiency and renewable energies.

In this respect, Parliamentarians have an important role to play in highlighting these economic and environmental debates in their own countries. Given the OSCE PA's role in advancing the debate on environmentally friendly policies with regard to business and industry, the Assembly should seek to reinforce these environmental discussions while generating economic solutions. This will ensure that issues such as climate change and energy efficiency are given equal status to economic recovery in each country's response to the economic crisis.

Beyond the emphasis on the environment, responses to the current crisis should keep in mind that those who are most affected by the crisis are not necessarily banks and investment firms, but rather, average people who have lost their jobs, their homes and their livelihood. Therefore, responses to the crisis must involve job creation, providing unemployment benefits where needed, and developing alternative industries that will spur growth and diversity in the markets. Infrastructure spending, designed to stimulate economies, will also have a positive impact as it addresses critical projects and creates employment. These actions will release cash into the markets and drive economies toward a fresh start. Several OSCE participating States have already developed plans aimed at absorbing the toxic debt associated with the failed mortgage giants. These plans intend to allow financial institutions to get these negative investments out of their portfolios.

It is especially clear that greater oversight and regulation are necessary. The final product might look different than what is intended and it will most likely involve a combination financial regulatory tools.

In conclusion, the OSCE Parliamentary Assembly can play a role as a contributor to the deliberation and debate regarding the current financial crisis and the recession we face. As legislators of all the OSCE participating States we have the unique opportunity to engage in a lively dialogue within the Assembly on constructive remedies to this and future crises.