The New Economy
A Financial Climate for Climate Finance
Prof. (Emeritus) Yehuda Kahane
kahane@ykcenter.org

How to finance the New Economy
Capitalism has driven substantial economic growth during the last two centuries. But it has caused severe damage to social and environmental frameworks, to a level that now threatens the continuation of the human species on Planet Earth.
The outbreak of COVID-19 has forced countries to take critical economic steps. That may make it the best time to start correcting past mistakes, and start off on the right foot in the new economy. One thing is clear, the greater part of government spending will be in healthcare, unemployment, education, and building infrastructure.

The compass – Multidimensional Metrics and the SDGs
We are not just living in an era of change, but rather through a change of an era. Changes are occurring in ways of thinking and philosophies: while people are beginning to believe not that they should serve the economy, but rather that the economy should support their basic values. In such an economy, "doing good" (socially, environmentally, and ethically) should support, rather than stand in contradiction to, "doing well" (economically).

While this drastic transformation is underway, there is no way to solve the environmental and social threats that are developing at an exponential rate. One cannot solve a problem by following the same principles that created it. Metrics do not merely serve as tools for measuring results. They actually act collectively as compasses or a dashboard, leading us on our way.

Using inappropriate metrics leads us in the wrong direction[1] .There is an urgent need to add non-economic dimensions to the dashboard. This is the way to move from an industrial world to a post-industrial world. We must replace the current focus on the "maximization of economic values" with a multidimensional framework that includes consideration of **Economic, Societal, Environmental, and Consciousness factors ("ESEC")[2].**

Consensus on targets is difficult in a world where each individual, company, organization, and state uses their own private compass. The OECD countries, for example, have developed what they called "Well-being Indicators," while others such as the Kingdom of Bhutan have suggested a "Gross National Happiness" index. In addition, many corporations around the world have developed and used the GRI rules (Global Reporting Initiative) to try to measure and report on their non-economic impacts, in addition to issuing regular financial statements based on traditional accounting[3].

---

[1] The theoretical beauty of capitalism is that the process is not just automatic, but it is predicted to lead to the (Pareto) *optimal* allocation of all resources, products and services. Such violations of the principles of capitalism have led Joseph Stiglitz (2012), a Nobel Prize laureate, to argue that the invisible hand is invisible because it is not always there!

[2] I believe that adding the component of Consciousness (ethical values, civil consciousness, consumer consciousness, etc.) to the earlier "triple bottom" approach is essential.

[3] One obstacle to reaching a practical international consensus about environmental and social issues has been the conflict between developed and developing countries. In moving from poor to rich, a country does not have to go through the "dirty" stage (Von Weizsacker et al., 2005). They can "rich and clean" by using circular models like the well-known "Cradle to Cradle" (Braungart and McDonough 2008) or K.H. Robert's "The Natural Step".

In 2015 The United Nations achieved a remarkable agreement were all the members committed to reaching 17 Sustainable Development Goals (SDGs), by 2030. These SDGs include the aforementioned ESEC parameters.

$B to $T by 2020 target

The relevant planning horizon for most leaders and executives is quite short due to regulation that drives short-termism and egocentric forms of motivation (limited terms for positions, elections, etc.). Moreover, the former typically think in terms of hundreds, millions or billions, but seldom in terms of trillions of dollars.

Leaders and executives should learn to operate with the new metrics on a completely unrecognized scale (multiplied by thousands), in order to achieve the SDGs. However, there is a need to meet some interim goals in the near future, to change the scale of thinking from billions of dollars to trillions, and to create the needed managerial skills and tools for stimulating reform.

My partners and I created a slogan (before 2015): “From $B to $T by 2020.” We saw that the message of the first part of the slogan had already been absorbed and used over and over again. But if we do not accomplish interim goals by the end of 2020, there is no chance of reaching the required outcomes by 2030. As they involve big infrastructure projects that typically require long periods of planning, preparing and building. Reaching the defined goals by 2030 is quite ambitious, and any delay will mean having less time to reach them, implying the need for greater effort.

How can we get the capital that is needed?

This paradigm shift requires an immense investment: trillions of dollars per annum in impact investments (mainly in infrastructure). The only source of long-term financing is retirement-related money in the public sector (social security programs) and, the pension plans (retirement and savings programs, and long-term life insurance). All these bodies require the backing of their long term liabilities towards their savers. The ideal investment for them is the long-term bond of 25-40 years plus a hefty interest rate. High yields are a necessary condition for attracting more savings, and for raising the large amounts of money that are required for impact investment. Interest rates play a key role in creating attractive retirement plans.

The financial institutions of the private sector currently manage for their customers an immense portfolio of approximately 80 trillion dollars (prior to the Covid-19)! That seems like enough to achieve a major part of the SDGs, but the entire sum is invested elsewhere. There is little chance to start negotiations between so many countries and so many institutions. Only regulation can do it.

There are, however, two other things to consider:

First, for quite some time, we live in a world of very low (near-zero) interest rates. There is little incentive to save money, and little appetite for financing impact investments. Financial experts turn to short term profit (by the use of trenches and finance combinations), and it is enabling them to give a positive yield. In a system like this, every few years there must be a crash (that takes the system below zero) and then a climb up again, with a positive yield, during the following years[4]. One can think back to the .Com crisis, the mortgage crisis in 2008, and now the Covid-19 crisis of 2020, to see the process. This is essentially the reason for the instability of world financial markets.

[4] One of things that brought up these phenomenon happened some 30-40 years ago. Insurance and the pension were worrying about the deficits of the funds (which was basically a defined benefit –DB - program). The risk of the fund had been distributed between the employee, employer, government and the fund. And it move to be a defined contribution – DC – one. Which turn the risk to the shoulders of the employee himself.

Second, social and environmental benefits (such as a reduction in carbon emissions, a positive impact on population health, job creation, etc.) are regarded as “externalities” i.e., others such as the government or the public, but not the investors, get the benefits.
There are ways of revealing the implicit yields on impact investment, or in economic terms, ways of “internalizing” (endogenizing) these externalities so that they can may be added to the yield of the investor. Public investors such as governments, and especially funded social security plans, could easily consider these externalities as contributions to the yield on their investments, but they have to adjust their accounting methods to measure and reflect these benefits. Most of the SDGs can be considered as “externalities”. Unfortunately, the government lets volunteers and non-profit do its job for them. The SDGs and the endogenizing of externalities must become the job of government.

More sophisticated tools are needed to transmit the benefits of these externalities to private investors. It is possible, for example, to use certain market mechanisms (such as emissions trading), and to include these in investment yields. Other mechanisms (such as tax incentives or other subsidies, public guarantees on minimum yields, etc.) can also be used depending on local circumstances and on ideological differences.

The Israeli Case

The Israeli example of public financing is especially relevant in this case. Soon after the state of Israel was established, government coffers were empty due to the cost of the War of Independence, and the unusual challenges that stemmed from the need to absorb a large number of Jewish refugees from Europe and Arab countries. The population was very young and there were no jobs. There was an urgent need to invest in infrastructure, factories, housing and, job creation, and to deal with “melting pot” educational challenges. The government encouraged the creation of insurance and pension arrangements as well as established a social security system to take care of the population that was due to retire several decades later.

The government issued to retirement institutions long-term bonds bearing high yields, and created tax arrangements that enabled these institutions to offer very attractive retirement plans with high yields to savers. This created a very high rate of savings in the country. In addition, the government introduced a funded social security plan that invested its funds in quite similar government bonds. The funds raised through these special long-term bonds fed a “development budget” (separate from the government’s regular budget) that activated a number of specialized sectoral-level development banks that undertook the impact investments. This was a major tool for financing the country’s growth during its first four decades.

Governments must help pay for the achievement of the SDGs. This can be done through long term investments in the pension and social security funds. Many countries, especially developing countries, can learn from this example of public-private collaboration and can adapt it to their needs. This is also an opportunity for countries with no social security to create such infrastructure. In countries where there is are existing pension and social security systems, they may expand their funds for the whole of the labor market, including, freelancers.

Objection

Such ideas may face ideological criticism from people that resist governmental intervention in the economy and prefer privatization at any cost, as well as those that mistrust the willingness and ability of government to honor long-term goals. On top of this, there are whole industries such as oil and gas that may lose their subsidization due to these shifting of funds. Opponents of any government intervention typically emphasize the potential inefficiency and even corruption of government systems.

Such initiatives were often discovered to be a means of transferring important and valuable public properties at low prices into a few private hands. In the case of Israel, there have also been complaints about problems with capital allocation, inefficiency, and even corruption, despite the efforts to run a very "clean" system. A certain degree of disorder seems to exist in both government and private-led systems around the world and can be reduced and mitigated through education, regulation, and efficient controls.

The ability to offer a high yield on impact investment will create a self-perpetuating cycle: higher returns on retirement plan portfolios will increase the attractiveness of retirement schemes. This, in turn, will motivate larger long-term savings and thereby enable financial institutions to finance more impact investment. As long as these investments continue to yield high returns, this cycle of positive feedback will continue.

Educational challenge (SDG no. 4)**:**
Educational challenges at this stage are centered on the need to train leaders, managers, engineers, designers, accountants, planners and, strategic departments. One way of doing this within the short time frame is by taking a "top-down" approach and training executives. To make a rapid global impact we suggest first training the leading consulting firms and large accounting firms with the help of experienced business mentors who know how to make a transformation happen quickly and then joining forces in preparing leaders and executives.

At YK Center, we have gathered international teams of senior business mentors and experts and developed tools for what we call "Trans-Form-Nation". This is a method of preparing governments and large organizations to deal with these challenges effectively and with urgency.

The education of very young generations (kindergarten children) is also important. At this age, children can easily learn how to use a higher level of language, and can also be shown how to use their creativity and become attracted to the study of sciences[5]. Fostering a higher level of speech that comes from the frontal part of the brain supports co-operation driven by logic and better emotional control.

Conclusion
A country can do what an individual cannot: lift itself off the ground by pulling its own bootstraps! These mechanisms can be established and activated within a short period. We can simultaneously deal with three major and pressing global challenges: The mitigation of major social and environmental threats through the appropriate impact investments, the creation of jobs and reduction of job insecurity for millennials, and the re-establishment of retirement security for millennials and future generations.

In this paper we showed that there is a relatively simple way to reach the solution for these pressing problems:
1. The inclusion of Social, Environmental and Conscious metrics alongside economic metrics (such as the SDGs).
2. The acceleration of the SDGs by investing in infrastructural change to basic economic activity ("B to T by 2020").
3. Governmental investments should be done through long term bonds (with a minimum 5% indexed yield) as in the Israeli example.
4. Investment into social aspects may stop fluctuations in capital markets (Social security, private pensions and insurance).
5. A unique call for education and "Trans-Form-Nation".

[5] Watch a conversation between Prof. Dan Shechtman, Nobel Prize Laureate, and myself at: https://www.youtube.com/watch?v=666iG_RPjic

In short, we have the chance to hit several ambitious and extremely urgent targets with a single arrow!
Shimon Peres, the late President of Israel, once said that optimists and pessimists die in the same way, but the way they live is very different. That is why I am an optimist.
Can we create this “Trans-Form-Nation?”
Yes we can!

The "Old" and the "New" economy

Just to name some of these key differences between the old model and the new economy.

- Traditionally, we have assumed that three major resources are involved in production: land, labor, and capital, each of which is limited. Accordingly, the economy was based on the principle of scarcity. In the modern economy, we have new “unlimited” and fast-growing resources: data, information and knowledge, and sophisticated computers and robots that can do many things more efficiently than human beings.
- Rapid urbanization and significant demographic changes are affecting birth, mortality, longevity, and population age structure. The ease of transferring disease.
- The rapid increase in population triggers "exponential storm": the depletion of minerals, oil, wood, water, animals… and the horrifying degree of polluting the air, land, water.
- The climate change. The loss of a variety of animals and flora.
- The global disparity between the ecology means and the demand of food.
- We have sophisticated communication and transportation systems that enable us to move large quantities of products, as well as people and ideas, rapidly and at relatively low cost (rapid trains, ships and aircraft, delivery by drones, autonomous cars, etc.).
- We do not need huge factories to manufacture things in mass quantities. The internet of things already enables us to manufacture many things at practically near zero marginal cost, in small amounts.
- The ability to obtain the rights to services (rather than ownership of assets) has paved the way to rapid growth in the “sharing economy” (Airbnb rooms, shared bicycles and cars, etc.).
- Many services can be supplied electronically, and this process is rapidly replacing traditional transaction methods (e.g., digital currencies and digital banking, artificial intelligence and blockchain-based contracts and legal services, and intermediation activities, autonomous cars, personalized medicine, etc.).
- There have been rapid and significant scientific and technological discoveries in a variety of areas: space, medicine, biology, agriculture, materials, etc.
- For the first time in human history, people today can live simultaneously in both physical reality and virtual reality.

References

Braungart, M, and McDonough, W.
(2008). *The Next Industrial Revolution.* EVA, Hamburg.
Conscious Capitalism (2018) https://www.consciouscapitalism.org/about
Kahane, Y. (2019) "New Metrics for a New Economy: The B2T by 2020 Project." In Setter,O & Zsolnai, L ed. *Caring Management in the New Economy.* Palgrave Macmillan
New York Times (2014). https://www.nytimes.com/2014/11/12/world/asia/china-us-xi-obama-apec.html
Stiglitz, J. (2012). “There Is No Invisible Hand” *The Guardian* December 20, 2002
Von Weizsacker, E et al (2005). *Limits to Privatization: How to Avoid Too Much of the Good Things*. Earthscan, London.
YKCenter (2018). www.ykcenter.org