

# The Price of the Current Civilisation

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## ABSTRACT

This paper is an extract from the public lecture delivered by Professor Dr. Jeffrey D. Sachs, at the invitation of Genting Berhad, in the Lim Goh Tong Lecture Hall of the Faculty of Business and Accountancy, University of Malaya. The lecture was the second in its series delivered on 23 October 2012.

The talk was a detailed examination of current problems in the world economy and provides pointers to sustainable development for the future. It begins with explaining four fundamental drivers to global change: 'economic convergence', 'rapid technological transformation', 'inequality', and 'environmental crises'. The fact that the US Government is under the influence of powerful private business interests, makes it unable to address the stated drivers to the global change required. Europe also faces similar issues with the added weakness of adopting a single currency without institutional support. All the four fundamental drivers to global change constitute issues for every part of the world, including Asia which is at the moment experiencing rapid growth in economic development, at the expense of social and environmental needs. There is a need for high taxes, a comprehensive social welfare system, public funded healthcare and investment for the young. Governments should have a long term economic plan that focuses on achieving the right balance of economic prosperity, social inclusion, and environmental sustainability.

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## 1. Introduction

Professor Sachs delivered this speech during the time when the U.S. was in the midst of preparing for the Presidential elections, and he expressed his support for President Barak Obama's re-election. He however remained sceptical about the country's circumstances and leadership. He contended that the situation in the U.S. is not an isolated case, but rather the failure of the prevailing economic system. The system affects many countries in world including India, Korea, and Malaysia; all of which are a part of a fast changing world economy, and buffeted by its dynamics.

In general, there are challenging questions requiring answers: Does democracy work? Can prosperity be shared by everybody? Is rising inequality inevitable? Can a society produce fairness, prosperity and environmental sustainability at the same time?

Malaysia experienced some decline in equality in 1970s and 1980s. However, in the last 20 years the inequality is rising. In the U.S., the inequality has been increasing in the last 30 years and potentially threatens its social stability. Professor Sachs believed that if the Republican Party programmes are enacted, it might push the U.S. into an open instability. He was also sceptical of the Democrats' ability to solve these problems, as the whole economic system is not geared to addressing these realities. The reasons for this will be explained later in greater detail.

Another two important questions to be answered are: can a government adjust in a propitious way to the dynamics of the world? Can a government break free from powerful corporate interests, so that it can truly represent the entirety of the society? In the U.S., which has the reputation as one of the world's great democracies; these questions are absolutely pertinent and unsettled. The country is yet to see the kind of government which underpins a stable society. The present government is for the few, causing increasing inequality and is unable to address greater challenges.

## 2. Fundamental Drivers of Global Change

There are four basic issues which confront the world's economy today. These are economic convergence, rapid technological transformation, inequality and environmental crisis.

## **2.1 Economic Convergence**

To state that there is a global economic crisis is not entirely accurate. The crisis is largely in the high income world. In many developing countries, the economic dynamics are quite significant and positive. The real crisis is largely concentrated in the United States and Europe. Thus what we have is a world that grows at least twice slower in the high income world, and rather fast in the developing countries, including Malaysia. It means that poor countries are narrowing the income gap with the richer countries. This is termed as economic convergence. It is how it should be, as no region of the world should have any kind of monopoly of prosperity and material wellbeing. The North Atlantic domination of the world economy for almost two centuries was a historical anomaly. This is not a normal feature of the world and it is an anomaly that is gradually coming to an end. The rise of East Asia and South East Asia is the most significant fact of this changing reality. China of course, with its immense size, impacts heavily on the world's economy.

Economic convergence is on a bumpy road. In high income worlds - U.S. and Europe - economic convergence is discomfoting and the adjustments to it have not been smooth. This phenomenon is basically still not recognised in the U. S.. Almost all discussions are of a closed economy nature that is a legacy of intellectual laziness and not of the current reality. Thus economic crisis or economic convergence in the U. S. and Europe are largely discussed as internal matters, not as part of the globalisation process.

## **2.2 Rapid Technological Transformation**

The second basic trend is the rapid pace of technological change. Countries like Malaysia and China were 20 years ago far behind the technological frontier. However now, these countries are catching up with the adoption of improved technologies, substantially narrowing the gaps with the developed world. A lot of the technological change is true innovation. It is largely centred on the digital revolution which is the most fundamental driver of change in the world, together with the economic convergence.

The digital revolution is basically summarised by Gordon Moore in his Moore's Law of 1956. The Law states that the ability to concentrate transmitters in an integrated circuit will be doubling every 18 to 24 months, and this is likely to continue. Moore's Law can be restated in

a variety of related ways including the ability to capture information, the ability to process data and so forth.

Since about 1958 the information revolution through digital technology has continued to improve and double itself every 18 to 24 months. This implies that over a period of roughly 54 years, we have had a billion-fold improvement in the ability to store, process, and transmit data. It has revolutionised everything, not only making phone calls or being able to screen movies on demand, or the Internet, but it changes every aspect of our economies. This includes: how we produce and use energy; how we transport people and goods; how we use and design construction materials; how we fight pollution; how we educate children; and how we address public health needs. Moore's Law has had its greatest effects directly in computerisation, communications, the Internet and mobile telephony. In healthcare it affects genomics, telemedicine, and telemetry in monitoring health.

### **2.3 *Inequality***

The third fundamental trend in the world is the widening of inequalities within our societies. Societies are continuously at risk with ever greater change in inequality. The trend needs to find a basis of legitimacy and a sense of fairness, shared justice, and faith in institutions. It is certainly not easy because another part of the change is the very dynamic population growth in many places in the world. Our numbers are rising quickly on a global scale. Our population will increase another billion by 2024. There will be a huge strain to maintain social fairness, because many of these people have very little economic prospects, being born into very poor circumstances and without the chances for economic development. Thus, the income and wealth inequality is a major third dimension of our situation.

### **2.4 *Environmental Crisis***

The fourth serious unsolved aspect of global reality is the rising scarcity of natural resources. Economic environmental crisis is a worldwide phenomenon. Economic growth demands natural resources, and everywhere in the world, environmental crisis is intensifying. We have not mastered the art of economic development and environmental sustainability at the same time. We do not know whether sustainable development can be achieved, as there is no place on the planet achieving it. Our politics in handling environmental crisis is ineffective. We do

not have the institutions to protect the natural environment, and we do not have the global consciousness of the issue.

During the second presidential debate in the United States, the two candidates were asked about energy policy. They spoke for ten minutes about energy policy without mentioning once that all the drilling for oil and gas that they talked about is contributing to climate change. Neither candidate mentioned the word 'climate' and the environmental risks. This is because the oil industry is the most powerful political lobby in the United States. Any ambitious politician will avoid discussing the issue. This avoidance is political cowardice, because the politicians should tackle this very important issue that the world faces today. Politics has to be a vocation of problem solving.

So these are the four fundamental drivers which challenge every part of the world. Even the poorest countries cannot be immune to the challenge of environmental climate change. These four drivers are universal and need the attention of everybody.

### **3. The Price of Civilisation**

The book, *The Price of Civilisation*, authored by Professor Sachs, states that globalisation started in the 1950s and 1960s after World War II, when Asian countries (e.g. Japan, Korea, Taiwan and Singapore) became integrated into global production systems. Industries such as textiles, electronics, and appliances led the way, facilitated by better communication technology, containerisation, open trade and wise politics. Japan was a great pioneer, displaying technological leadership and innovation. Globalisation was already in its modern form in the 1960s and 1970s. The U. S. started to feel this when Honda and other companies began exporting cars to the U. S.. Americans felt that something nefarious must be on the way and Japan was charged with all sorts of misdeeds, misdemeanours and misbehaviour.

Perhaps the most significant event in the modern economic history took place in 1978, when Deng Xiaoping came to power in China. He opened the country to global trade and finance. This had a bigger effect on the world economy than any other action in modern times. By 1991, between East Asia, South Asia, and South East Asia, almost three billion people had become part of the global trading system.

At this point the U. S. and Europe began to feel the pinch from globalisation. Even Japan's economic bubble burst in the 1980s, as manufacturing moved to lower income countries in Asia. The U.S. never

recognised this phenomenon as affecting it. The country was still on a cold war mentality thinking that its competitor was the Soviet Union which was basically a defunct economy. The Soviet Union's mistake was that they tried to create their own technology and invent their own standards, rather than to be part of the world technological system.

### 3.1 *The U.S. Quandary*

In 1981 Ronald Reagan was elected as the United States' President. He made a fateful statement in January 28, 1991, "government is not the solution to our problems; government is the problem". Reagan came to leadership with the idea of dismantling the government just as globalisation was taking hold. Globalisation requires a dynamic response not only from the government but also the private sector. It requires the government to step up the provision of jobs, through - for example - better education and job training.

In American middle class society, the high school graduates would join a local factory. However, by 1980s, most factories had moved to China. Thus a high school diploma was no longer good enough to guarantee the life of the middle class. American middle class society needs help from the Government, to provide proper training, proper skills, a college degree and so forth. Yet the Government started to pull back all these helps. They pulled back infrastructure investment, research and development, taxes for the rich, regulation of energy and financial sectors and social benefits for the poor. It was a grave mistake in philosophy that the Americans have been living through in the last thirty years. There have been widening income inequalities, under investing on young people and a growing under class of youths without skills to compete in the world economy.

The deregulation in finance was a huge cost to the Asian financial sector in the late 1990s and in the world after 2008. It also gave a license to the CEOs in the U.S. to pay them anything they wanted. The CEOs' compensations are sometimes completely out of line with the rest of the world. Often they reach the peaks as the companies go bankrupt because their compensation is not correlated with the actual performance of the companies. The U. S. has already entered a decade of chronically low economic growth, as it can only employ the top 25 or 30 per cent of young people. The rest are desperate as their skills are not commensurate with their income aspirations. This is the legacy of tax cuts for the rich, social spending cuts, lack of public investment, lack of training and lack of regulation.

In response to the slow growth, the U.S. central bank tried to pump up the economy by lowering interest rates to near zero. This created a housing bubble that temporarily employed the young people. The construction sector was able to absorb high school graduates with reasonable pay. However, this bubble could only last three to four years. It crashed in 2007. Since then the American unemployment situation has been dismal. The Federation has reduced the interest rate to zero again and tried stimulants and everything else. None of it works. The one thing the country does not try is to take a true structural look at the situation. The structural look requires us to invest more in young people, raise taxes to pay for new government programmes, and reregulation. It requires a change in politics and the U. S. political system does not allow it.

In a nutshell the system has been taken over by the corporate sectors. These companies are the biggest political campaign funders by far. During the current Presidential election campaigns, both candidates would be spending one billion dollars each for their campaigns. The source of this funding came from wealthy people who will not help unless the Government promises some tax concessions. Generally wealthy Americans do not want to pay taxes for poor people.

The Government does not just cut the top tax rates, but also introduces various systems to avoid paying taxes. It legalises mass evasion of taxes, which is called avoidance of taxes. Perhaps 10 trillion dollars of wealth are secreted away in the Caymans, Bermuda, the Jersey islands, Mauritius, Hong Kong, Switzerland, and other tax havens. The world is broken in its morality. Both American political parties said "Well, we are going to cut the budget because we do not have the revenues, we have to get the budget under control". The way they are doing it is by squeezing spending rather than taxing.

The U. S. faces four significant problems: globalisation, massive technological change, high income inequality, and a growing environmental crisis. They do not deal with any of them. Neither of the political parties - Democrats or Republicans - has a programme to deal with them. In America, this is systemic in the political system. . That is the way a person becomes a candidate and wins the election.

### ***3.2 Negative and Positive Aspects of Europe***

In Europe, the situation is more complicated. Apart from having similar issues as in the U. S., it also has the Euro as a shared currency without the underlying institutions to manage the currency. Europe faces loss of confidence in the financial markets. Money has been leaving the

banks of Greece, Spain, Portugal and Italy, over the last three years, leading to a colossal financial and fiscal crisis in southern Europe. There is no institutional will to address the financial crisis. The banks are so powerful politically that, rather than taking the losses, the political system protects them

Europe is divided in its economic performance between Northern and Southern Europe. Southern Europe is in deep crisis, while Northern Europe is doing quite well. We should take a closer look at this. The countries that are doing well, both inside and outside the Euro zone, are the ones that have resisted the politics of tax cuts and persisted on social equality. Countries that have done best in Europe are the social democracies in Northern Europe: Netherlands, Denmark, Norway, Sweden and Germany. Germany calls itself a social market economy and the others call themselves social democratic economies. These countries collect more than 40 per cent of national income and taxes and use them to provide equality of access to quality education, infrastructure, child support, family support and so on. This is what the U. S. should have done. But they choose the opposite. Instead of taxing properly, to provide social services to ensure the ability to respond to globalisation, the U. S. cuts taxes and support for the poor. The social democracies of Northern Europe have maintained a democratic ethos. They have kept money out of politics. Their elections do not cost billions of dollars. They do not have big corporate contributions from their campaigners. Thus they still collect taxes and use them to ensure equality of access to education, healthcare and social services. Interestingly, they also pay attention to the environment as well.

Northern Europe is the most attentive region of the world to the need for a low carbon energy system, to prevent global climate change. Sweden introduced a tax on carbon for more than a decade of around 100 euros per ton of CO<sub>2</sub> emitted. They maintain their prosperity and equality at the same time. The US GINI coefficient is 0.45, about similar to Malaysia. The GINI coefficient in Northern Europe is 0.25 to 0.30. This shows that Northern Europe has considerably greater equality in household income. The region institutes a firm tax and transfer system that ensures that all families have the ability to be in the middle class and help their children to make it to the middle class as well.

Northern Europe is the most successful corner of the world. The quality of life is very high and the region combines a social and environmental spirit with its economic prosperity. We should learn from it, because they have mastered the three dimensions in the development: economy, society, and environment



### 3.3 *Situation in Asia*

Asia has been a great beneficiary of the catching up growth (also known as 'convergent economy') and technological revolution. The growth has been spectacular, averaging about 6 per cent per year. China's economy even grows faster at perhaps 9 or 10 per cent per year since 1980. The economy doubles in size every 7 or 8 years. There have been at least 4 doublings or possibly 5 doublings - roughly a 30 fold increase - in the size of the Chinese economy since Deng Xiaoping opened the country to the world's trade system.

Despite its spectacular success, Asia too faces all the same conundrums of how to ensure dynamic economic growth is shared across society; and how to make best use of these technologies to ensure the environment is protected along the way. Asia's growth has been tremendously carbon intensive, polluting and damaging its rivers and air. The region by far is the centre of gravity of the global climate change that determines the world climatic future. China at the moment is the world's largest emitter of greenhouse gases. Greenhouse gases in Asia have continued to soar, along with rapid economic growth, and the biodiversity and the natural environment are at a tremendous risk.

Inequality is also rising significantly within most of the fast growing countries. Simon Kuznet predicted this phenomenon about 60 years ago. He said when one begins with a poor agrarian starting point, economic growth will widen inequalities, at least for a while, because those in the rural sector may be left behind those in the urban sector. However what is happening now is much more than the simple Kuznets' curve of inequality and development. Largely in Asia, not every child has the same chances and the gaps of life opportunities for children born into affluent families and children born into poor families is widening. That is certainly the case in the United States, but it is the case here and in other regions as well.

A market economy by itself will not solve social challenges unless there is an active role played by the Government, in collecting taxes and providing support and help for the human capital development of the poor and the minority groups within a society. This is certainly the most important lesson of Europe's successful social democracies. It is the most important negative lesson learned from the U. S. which has designed a system that should not be followed, because it is too dangerous for the bottom half of the society. It is probably the most important choice that Malaysia and other countries who work to achieve the status of high income countries to decide on the answers to the following questions:

what kind of society we want to be? Do we want to have inequality? Do we want to have fairness? Do we want to cater for the rich and leave the rest behind? Do we want to be transparent? Do we want to bring all of society together?

Asia also has to decide on its politics. Will democracy be driven by corporate interests as in the U. S.? Or will it be a democracy that really reflects the needs of the society and the future generations? Society should make a clear division between wealth and politics. Politics is about one person, one vote. That is not what business is about. Business does need to pursue profits, but it should not pursue profits through the political process. This division is vital, because business needs to compete within the rules of its own game, not to make the rules of the game. If business makes the rules of the game, we will never solve these social and environmental issues. We will never get on the top of this crisis.

Malaysia is absolutely remarkable in its bio and cultural diversities, as diverse as any place on the planet. The country needs to protect and promote the cultural diversity and biodiversity. This requires as much focus on the environment as it does on the GNP. It requires seeing these problems in their holistic view. Malaysia is on a path of rapid development, but it is not yet on a path of sustainable development.

#### **4. The Chinese Wonder**

China's growth is a perfect example of the catching up growth (convergent economy). It grows so fast because it has started so poor. China was the richest country in the world for a thousand years, from about 580 to 1580. Historically the country already had sophisticated navigation in 1420 that allowed it to discover the entire world. Its fleets were so sophisticated, large and dramatic, that they could sail to East Africa and command the Indian Ocean. However, China made a fatal mistake in 1424 when it decided: "we are going to stop these expeditions" and dismantled the fleets. That was actually the first protectionism of China that most historians agree led to 100 years of the country's economic decline.

The next time China really came in the contact with the rest of the world was in 1839 in the Opium war with the British Empire. The British fought the war to let the world be free to allow the drug into China and it was on the losing end of that. For the next 100 years roughly,

China's history was incredibly unstable: colonial power in the coastal regions, Japanese invasion and civil wars. In 1949 the People's Republic introduced an economic strategy that was as costly in human terms as any in history, until Deng Xiao Ping came to power. There is no general theory that could explain all that had happened to China, but China went from being the world's richest and most powerful country to being one of the poorest countries, over a period of 500 years.

Starting in 1978, China began the most incredible catching up in world history and that is what we are experiencing right now. China has a great civilisation. It has an unbelievable capacity to educate the population, and to speed up technological upgrading, and we are watching it. We have never seen anything like it before, and it is happening so fast that it is changing every assumption of geopolitics, and having a fundamental effect on the world economy. But as an economic phenomenon, we have seen this before, on a smaller scale. 100 years ago, the Meiji modernisation took place in Japan. The country invented the catching up that soon would be followed by some others, including Malaysia. It is the same model which consists of rapid technological upgrading, the government builds infrastructure, the government improves the education and the government taps into global production technologies. The wisdom of this approach is the idea of catching up through becoming part of the global technology, and not reinventing or separating from it. China's long term development looks optimistic. It is a part of the world's production system, and a very dynamic one. The country's economic growth is slowing down now, a familiar phenomenon of the catching up, as had been experienced in Japan.

To be a country at a technological frontier is very hard. No country at the technological frontier has ever demonstrated a capacity to grow more than 2 per cent per year for the long term yet. The technological lead is hard, because invention is usually hard. You have to invent, spend a lot of resources and have a lot of smart people over a long period of time. We hope this task will be taken over by China in the near future, as it has begun now. As an example, China invented the best cure for malaria. Taking from a traditional Chinese cure -the worm wood tree which contains anti-malarial properties-they have perfected the anti-Malaria medicine, which saves million lives in Africa. We hope China will also innovate in clean energy. The country has a huge responsibility to clean up its energy system. It has to master the challenge of water, energy, and land use.

## **5. Long-Term Planning**

Focus should be on designing economic planning for a ten year horizon. It should look into the long and medium term, and not exercise too much control over every business cycle. Among important questions in formulating economic plans are: where should we be in 10 years and 20 years from now? What kind of public investment? What kind of education, what kind of training, and what kind of environmental management do we want? By answering these questions, we will end up closer to where we want to be. Regardless of our training, we should not be worrying about the next quarter's ups and downs, and lower and higher interest rates. Keynes was not right, in his most famous quote that "in the long run we are all dead". In fact, in the long run as he was counting it, our children are alive, and their children too, and we should be worried about that. All countries must get the long term economic planning perspective right, as the basic starting point, for at least 5 to 10 years ahead.

## **6. Social Welfare System**

The countries in crisis today are not the ones with the largest social welfare system. The largest social welfare systems are in the Northern Europe. Those countries are doing the best. They pay taxes more than any other place in the world, and they have a kind of election campaign which is unheard in other parts of the world. In Sweden one of the biggest charges you can make against your government is to say they are going to cut taxes. The reason is they really like their social welfare system, and they are willing to pay for it, and they do not want to dismantle it. The first rule of social policy is to pay for it, and not to borrow. Do not do it unless you are going to charge the taxes to pay for it. The second rule is not to build a system that is going to have greater charges in the future that are off the book today. In other words sometimes the social security systems do not pay as you go. The young pay for the old and then today's young are going to be paid by their children and so on. It becomes like a Ponzi scheme where eventually you cannot afford it because of the increasing aging population and the slowing population growth. There are too many people who are retired. The social system needs to have a long term perspective. The actuarial perspective should be 50 or 75 years, and the system must pay for itself, build up funds, and have affordable means.

The other important point to consider is the health care system, as it is very expensive to run. The U. S. has the most privatised health care system, and it is by far the most expensive in the world. Americans pay 18 per cent of GNP for healthcare, and 5 per cent of GNP is paid for the abuse of this privatised system. A public health care system is preferable to a private healthcare system. The latter is often too expensive, unfair, and becomes politically so powerful that basically politics has organised around paying for the systems rather than around health care itself.

## 7. Concluding Remarks: Sustainable Development

Generally, the world needs a large scale technological transformation to sustainable energy and agriculture systems. The systems are in urgent need before the planet becomes ruined, as it is very close to at the moment.

Malaysia needs to pay attention to its unique biodiversity. It will be a tragedy to the future generation, and humanity, if the *Orang Utan* is lost. A lot of damage is being done to the ecosystem which is of profound and irreversible character. Generally societies are thoughtless about this, simply because profits are over-powering. We do not measure the environmental damage in the market prices systematically unless we choose to. We do not choose yet to put taxes on carbon dioxide for example, which should be the first order of business. We should have a price on carbon emissions, so that every time a utility is planned we will be asking: "should we set up a wind turbine, should we set up a solar generator, or should we burn coal". We need an approach that is based on the idea of sustainable development and should measure our progress in that way.

Sustainable development has three pillars which are: economic prosperity, social inclusion, and environmental sustainability. Each one of these can be measured. We tend to only focus on the first one right now, and even there we only measure GNP per capita whereas we should be measuring many different aspects of our material wellbeing. For social inclusion we should be tracking the GINI coefficient every year, the extent of inequality, gender inequality and inequality across minority groups or across regions of a country. We should be measuring the environmental sustainability by examining the annual carbon dioxide emissions, the other greenhouse emissions, the amount of protected land, biodiversity, threatened species, and so forth. So

the government should be reporting on each dimension every year just like every report in GNP per capita right now. This should be by professionals using independent statistical accounts.

There are three other important aspects for a country. First, a society should state clear goals. Where should Malaysia be in the year 2030? It should not just be a high income country, as that is not good enough. The objectives must be stated clearly, and every year, assessment of whether or not we are on track should be carried out. Second, Presidents give a state of the union address in the U.S.. The President should also deliver the future address. There should be one address every year: how is the generation that will reach 2050 doing? What are we doing for the future? They cannot vote. It is our unique responsibility as human beings to look after the future. The third is along the line of Gross National Happiness. It is recommended - like Bhutan, France, United Kingdom and Canada are starting to do- to ask people every year "how are you doing?", "are you happy?", "are you satisfied with your life?". It is called subjective wellbeing (SWB). We could then determine why people are happy or unhappy. There have been hundreds of studies by now of what kind of answers people give to these questions. It turns out that money only explains a small amount of the variation. People really care about their family life; they care about whether they are happy at work, whether they are unemployed involuntarily, their physical and mental health, level of trust in the community, and the perceived level of corruption in the government.

We could learn a lot, and so one of the things that we are promoting in a new sustainable development solution network, is that every country ought to be measuring the things we care about and then our governments and our companies need to be held responsible and accountable. Good governance is not only about the Government. It is about companies, because the companies are more powerful than the governments. The multinational companies are the most powerful organisations in the world. The Government often takes its direction from them. These companies are very important for prosperity and they need to be transparent. They cannot hide behind anonymity in the Cayman Islands. We cannot have companies raping the rain forest, or that on record is a post office box in Bermuda. That is an abominable, destructive approach created by humans. We need to know who is responsible all the time. We need to hold the boards responsible as well as these companies.