

# “If Something Cannot Go On Forever, It Will Stop”

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## A. INTRODUCTION

Thanks to the Canadian International Council and the Konrad Adenauer Stiftung for the invitation to speak.

I understand that my paper was circulated to you beforehand so that only a short introduction (about ten minutes) will be needed. I will take some part of that time to tell you why I would reorientate the paper were I to rewrite it today. In the paper, I give essentially equal billing to problems in our **economic, environmental, health and political systems**. Increasingly, however, I am inclined to believe that our political systems are key to seeing whether we can avoid a systemic meltdown of all the systems I mention in my paper. I find myself agreeing more and more with the great economist, Joseph Schumpeter who, when asked “What is the essence of economics?” replied “Politics, politics, politics”.

Why do I say that? Four related points.

First, **political fault lines make democratic societies vulnerable**. They impede the adoption of the policies needed to deal with problems of whatever sort.

Compromise is the essence of democratic politics, or as Rab Butler once put it “Politics is the art of the possible”. But if compromise is not possible, then societies with political fault lines fall into political disorder and social unrest. All states can be failed states.

My second point is that our **democratic societies are showing increasing signs of such political fault lines**.

- Growing inequality of income, wealth and of opportunity
- Growing sense that “Its not fair” and an associated sense of anger and exclusion

Growing suspicion that the “rich: and the “elites” are gaming the political system for their own advantage

- The internet (domestically) and “hybrid warfare” (internationally) are reinforcing those sentiments

This has already led to

- Declining trust in governments
- Declining appetite for international cooperation
- An increase in “us” versus “them” thinking
- And growing support for populists in the polls

And my third point is that there is ample historical evidence that these **political fault lines can be triggered by failures in each of the other systems I refer to in my paper.**

- Political crises and financial crises. Funke, Schularick and Trebesch (2015) document this polarisation in 20 AME’s over 100 years and 800 elections. Also Hayek (The Road to serfdom) and Snyder (The road to unfreedom)
- Political turmoil and pandemics. Cholera and the Paris uprising of 1832: Bubonic plague and political change in Venice in 1630: IMF “Reported Social Unrest Indicator” is closely associated with the frequency and severity of epidemics.
- Political crises and climate crises. Jared Diamonds book (Collapse) has many vivid examples. Moreover, climate change results in immigration patterns that cause conflict everywhere.

Fourth and finally, **each of our economic/financial, environmental and health systems is showing significant signs of stress.** Moreover, because they are all interrelated, a breakdown in any one will have implications elsewhere. As Tolstoy said at the beginning of Anna Karenina “All happy families are the same but each unhappy family is unhappy in its own way”. In short, we have pressing challenges on all fronts that might demand “Total Reset” rather than just “Build Back Better”. Collectively, we have an enormous challenge on our hands.

My paper explains why we are on an unsustainable path, what a good or sustainable path might look like, and reflects on some of the policies that might

be needed to make the transition from one path to another. Briefly, it makes the following points

## **B. WE ARE ON A BAD PATH**

Irish joke “If I were you, I wouldn’t start from here”. Each system is under stress

**Environment:** GHG still rising, not falling towards net zero. Biodiversity worsening, acidification etc. Worries about tipping points ((Arctic fires, methane etc)

**Economic/financial:** Ratio of global debt to GDP rose from 280% in 2008 (pre GFC) to 320% at end 2019(pre pandemic).By 2021 Q1 had risen to 360%. Public and private debt ratios at record levels. Involves both AMEs and EMEs. 50 % of LIC are at or near “debt distress” according to the IMF. Quality of debt has been going down constantly, particularly for corporate debt. Rising FX exposure, particularly in EMEs. Debt service at risk

Worries about financial stability. Financial institutions vulnerable. Financial markets not functioning properly (anomalies, flash crashes, illiquidity, overvalued asset prices, including houses). Another potential tipping point? Unpaid debt service threatens financial institutions who cut credit that decreases growth that....

Fundamental problem has been asymmetric monetary and fiscal policy. Since the 1980’, monetary policy was always eased more in downturns than tightened in upturns. Same with fiscal. Thus, interest rates ratcheted down to zero and government debt levels have risen to record levels.

**Political** Will not repeat above, but there are faultlines: not least, growing inequality

**Health** The pandemic has made all of the above worse. More debt. Has hit the poorest worst (EMEs, women, people of colour) and increased threats to the environment.

And there are **grounds for belief that things will get still worse** on the economic/financial side. Supply side factors will slow growth

The pandemic is not over. In AMEs, anti vaxers mean herd immunity recedes only slowly. In EMEs vaccinations have hardly begun. Fear of infection will also hold back demand

Scarring from the pandemic when it is over. All downturns have scarring effects (Cerra and Saxena in the JEL), and this pandemic might be especially harmful. Efficiency gives way to resilience. Differing fortunes of goods and services industries shift relative prices and raise “frictional unemployment. Participation rates fell and may not fully recover

Demographics. Goodhart and Pradhan have recently published “The Great Demographic Reversal” Growth will slow worldwide because of a shortage of workers. More workers will be required to care for the elderly.

Environmental factors. Mitigation and adaptation are both costly. Their will be less left over for raising living standards.

Deglobalisation. In addition to supply chain adjustments due to the pandemic, the growing rift between China and the West will cut productive efficiency and or growth.

Digitalisation and productivity growth. This could work in the opposite direction, but the jury is still out (Solow’s quip?). Moreover, would raise important issues re inclusiveness and inequality. See “The second machine age” by Brynfoldsonn and Macafee.

And slower growth potential also raises other problems like **more inflation and the need for higher interest rates** which could cause the whole debt edifice to come tumbling down. If the policy response was then “still more of still more of the same”, the end game could be very high inflation indeed.

So, if I were you, I wouldn’t start from here.

### **C. WHERE DO WE WANT TO GO?**

This is reasonably easy to spell out. A sustainable future world would have to have the following characteristics

A sustainable **environmental system**? Global temperatures stable at 1 ½ -2 celsius points above pre industrial average

A sustainable **economic/financial system**? Lower and inherently stable debt ratios, implying more equity and less debt financing. More reliance on investment to ensure sustainable future consumption. More symmetrical use of monetary and fiscal policy. Easier entry and exit of firms from competitive markets

A sustainable **public health system**? One in which ex ante preparations were made to cope with future pandemics. One more focussed on disease prevention (obesity, exercise etc.) than on treatment. Adequate sanitation for all.

A sustainable **political system**? One in which there is trust in government

#### **D. HOW TO GET THERE FROM HERE?**

This is not so easy to spell out.

One important complication is that policies designed to improve the functioning of one system could well have negative effects on other systems. Need a multidisciplinary panel to assess the merits of suggested policies. Seek out the low hanging fruits that have stabilising effects on a variety of systems. Be careful to weight properly shorter-term and longer-term effects since this has been a crucial deficiency in the past. We need a paradigm shift in how we think about problems (accept CAS and “systems not silos), but this will not be easy to achieve (Kuhn and Kahneman)

A second complication is that each proposed policy change will be costly or in some way unpalatable to some vested interest. Getting over that hurdle implies the need for strong popular support for new policies. As I said right at the beginning, this implies giving heightened importance to measures to stabilize the political system and measures to get the public “onside”.

Subject to a multidisciplinary review, let me look at policies directed to increasing the sustainability of systems individually.

**Working towards environmental sustainability:** Cut fuel subsidies and raise carbon taxes, perhaps with rebates in a progressive fashion. Toughen regulations (worked for London smog and preserving the ozone layer). Use ESG investment criteria to “nudge” investment intentions

**Working towards economic/financial sustainability:** Debt levels are too high and must be reduced. In principle financial repression (higher inflation but suppressed

interest rates) might help, but is it possible to do this, and what are the risks (out of control inflation/deflation)? Need explicit and voluntary debt reduction schemes agreed between debtors and creditors, but court and administrative procedures need to be improved. Longer term, both monetary and fiscal (later?) policy need to be normalized.

**Recovering from the pandemic:** The need to “live with the virus” will continue for some time. So too will “social distancing” (whether mandated or voluntary) which arises from fear of catching covid. Unfortunately, social distancing has major costs (economic, social, mental health, physical health costs, distributional etc.). Fortunately, there are policies that could reduce the fear of getting covid. Must target both the **fear of infection** (vaccinations, vaccination passports, rapid testing for some events etc.) and the **fear of serious illness if infected** (vaccinations, more care facilities and better treatments. Excess capacity today is resilience tomorrow.

**Political stability:** Restoration of trust in government means tackling the inequality of distribution and the influence of vested interests. Companies should narrow the wage gap between ordinary workers and management, restrain share buybacks, and shift the balance between shareholder interests and stakeholder interests. Governments should focus legislation on “levelling up” and reducing the influence of big corporates and special interest groups (revisit minimum wage legislation, provide safety nets for workers not companies, etc.) A move towards Danish “flexicurity”.

## **E. CONCLUSION**

Society faces numerous, interrelated challenges. Nevertheless, there is a way forward. Generating the political will to do what needs to be done, and generating the popular support required will be the biggest challenge of all.

