

What next for the global economy:
Could negative supply shocks disrupt other fragile systems?

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“Fault lines after Covid”

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What is the nature of the policy problem we face?

“All happy families are the same, but each unhappy family is unhappy in its own way” : Tolstoy

- Many objectives: sustainable, inclusive growth in a free society
- Requires well functioning economic, environmental, public health and political systems.
- Each of these complex, adaptive systems (CAS) is under severe stress.
- And problems in any one system could spill over into others.
- Today, focus on spillovers from the economy to the political sphere

Indicators of current economic and financial fragility

“If I were you, I wouldn’t start from here”

Old Irish joke

- Record high debt levels of decreasing quality
- Stability of some financial institutions questionable
- Many asset prices still historically high in spite of notable declines
- Markets functioning badly, including US Treasuries
- Resurgence of fraud and outright delusion
- Slow growth of investment, productivity and potential
- Uncertainties arising from covid and the Russian invasion

Policy solutions have contributed to the economic fragility

“ We have seen the enemy, and them is us”

Pogo, an American comic strip

- Against a backdrop of positive supply shocks and low inflation
- Expansionary monetary policy has encouraged private sector debt
- Government debt buildup has become increasingly unsustainable
- Financial regulation has encouraged evasion
- While ever widening safety nets have created “moral hazard”

Reasons to fear stagflation – negative supply side shocks

“Some say the world will end in fire, some say in ice”

Robert Frost

- Pre pandemic resource misallocations
- Post pandemic hysteresis and the search for “resilience”
- Population ageing in both advanced and developing economies
- Climate change and costs of mitigation and adaptation
- Commodity price shocks aggravated by Russian invasion of Ukraine
- Deglobalization aggravated by geopolitical tensions

Reasons to fear inadequate resistance to inflation

“Politics is not the art of the possible. It is choosing between the unpalatable and the disastrous”

JK Galbraith

- Real rates still remarkably low
- Belief higher inflation is “transitory” and expectations “anchored”
- Concern that tightening will expose fragilities (the debt trap)
- And central banks will be blamed
- Growing pressure from over extended governments
- The lure of “financial repression” to cure “debt overhang”

Both depression and high inflation are extreme but plausible outcomes

“When you come to a crossroad, take it.”

Yogi Berra

- In CAS cumulative processes (positive feedback) are common
- High debt levels increase vulnerability in good times and bad
- The Debt-Deflation process described by Irving Fisher
- The High Inflation process described by Sargent/Wallace and Bernholz
- Private and public debt each pose serious problems

Indicators of fragility in related systems

“If something cannot go on forever, it will stop”

Herb Stein

- Environmental systems stressed by population growth
- Political systems threatened by growing inequality and polarisation
- Public health systems threatened by covid
- An economic or financial crisis would threaten all the other systems
- With our democratic system perhaps most vulnerable

In theory, democracies are vulnerable to a number of threats

“Dedicated to the socialists of all parties”

F A Hayek

- Many essential features required (CAS) to support democracy
- Balancing individual freedom against the public good
- Factions threaten “instability, injustice and confusion” (Madison)
- But populism can tip into fascism (Albright)

In practice, political fault lines are starting to show

Well you can't actually get to Dublin from here"

A pessimistic version of an old Irish joke

- Growing inequality of income, wealth and opportunity
- Middle class threatened; Aristotle's warning in "Politics"
- Growing suspicion that rich and elites are gaming the political system
- Feeling of "it's not fair" leads to anger and retreat into silos
- Anger then diverted into cultural and racial resentment
- Aggravated by social networks becoming echo chambers
- And exploited internationally by hybrid warfare and dirty money

Raising fears for the future of democracy

“The global order is nearing a tipping point”

Freedom House 2022

- Shrinking number of liberal democracies
- Growing support for strong men and populist causes
- Declining trust in national government
- Increase in “us” versus “them” thinking
- Declining appetite for international cooperation

Could systemic fragilities be reduced?

"It ain't the things you don't know what gets you. It's the things you know for sure what ain't so."

Mark Twain

- The need for an analytic revolution: embracing complexity
- Reducing economic fragility through orderly debt restructuring
- Reducing environmental fragility through mitigation and adaptation
- Reducing political fragility through reducing inequality
- Reducing public health fragility through preventive medicine
- But need to convince everyone of the net benefits of costly change

How to make change happen

“Of course we know what to do. What we don’t know is how to get re elected after we do it”

J P Juncker

- Convincing the general public there are no easy answers.
- Convincing the powerful that change is in their own interest.
- Convincing politicians in democracies to lead again.
- Overcoming suspicions to promote international cooperation.

GOOD LUCK: WE ALL MIGHT NEED IT