Is The Age of Plenty Over?

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Ed D'Agostino:

Bill, I've been really looking forward to this conversation because I know we share a concern about interest rates and inflation, remaining, if not high, certainly higher than they were pre-COVID, which seems like a real simple thesis, but the reasons behind this are highly complex. I touched on one recently talking about how the need for the US to become more resilient is going to result in some inflation, some pain, and then you followed up in an email to me saying that there's actually five important drivers behind this. If you would be kind enough to take us through those five, that would set the stage for I think what's going to be a great discussion.

Bill White:

Well, thank you for inviting me today. I'm really, really glad to be here. Yeah. My concern is that people are far too short-sighted when they start thinking about inflation and what the problems are likely to be. It's all to do at the moment with the near term, what's going to happen to wage growth in the services sector, these kinds of issues, which are very important. I don't deny that they're very important, but there are some deeper, more secular issues that I think also need to be thrown into the mix. As you said, I think there are at least five grounds and potentially more for believing that we've been through an age of plenty and we're actually going to move into an age of austerity.

I know it doesn't seem like we've been through an age of plenty because a lot of people didn't get the benefit. But when you look at the underlying trends, that I guess richer people have somehow monopolized the benefits… but when you look at the underlying trends, we have in fact been living through an age of plenty, and I can give you at least five good reasons for thinking so. I mean, one of them is globalization. It's had an incredible impact in terms of reducing prices, increasing the availability of things. China coming into the global trading system was very important, but the fall of the Wall, Eastern Europe, India… all of those things contributed to the process of globalization, which has been really important really since 1990, I guess, with Xi Jinping and the euro. That's how I date the beginning of the globalization thing. It's been very important.

Second thing that happened in this whole period leading up to I'd say around 2019, so the year of plenty, let's say from 1990 through until COVID, let's say, the second big thing was demographics. My friend Charles Goodhart, my first boss at the Bank of England, has written a whole book with his colleague Pradhan called *The Great Economic Reversal*, in which he talks about the early period and then what comes after. I'll talk about that in a moment too, but the point is that we had the Baby Boomers coming through. We had urbanization in China. We had increases in women's participation in the workforce, all sorts of reasons why the demographics were favorable to people being productive in the workforce. So, that was the second thing about the era of plenty.

The third thing was environmental, and I won't say that it was a positive period, but we didn't worry about it. There was a doubling of energy demand during that period, and yet prices didn't rise astronomically. The industry managed to pull out the coal and the gas and the oil and everything was fine. Then we had the whole question of production processes, I think an unparalleled period where people were just focused like a laser on efficiency of production. Also, the globalization played into it, the efficiency of supply chains. So, we had all of that, and it was all positive.

Then we had the technology. You can't forget about the fact that the internet was essentially invented, Moore's law, the price of processing and storing data went just down like a rock. All of these things contributed to prosperity and low prices, disinflation, and I believe that all of these things are going into reverse. So, when you look at the globalization, it's going to be replaced by deglobalization. I don't have to say much about that. You read the newspapers. We have no idea how far this is going to go. Both Janet Yellen and Mr. Sullivan suggested a while back, that national security was the absolute number one priority. So, who knows what the cost of the sacrifice will be? We simply don't know.

The demographics, I mentioned that book, *The Great Demographic Reversal*. The urbanization is finished. The Baby Boomers have gone through. The number of workers is declining in virtually every country in Europe, in the US, aside from immigration. Japan, Korea, China, the world global labor supply of those workers that are part of the global process is all declining. So, that's gone into reverse. The environment, and I think the environment is just a huge issue. We now absolutely have a constraint. As you look forward, whether it's adaptation, accepting the reality of climate change, or whether it's mitigation, doing something about it, it's going to be very expensive.

If you think for example, just about the costs of it proceeding, there have been a number of recent studies that show that the costs of climate change, negative costs in terms of... I'm not talking about doing anything about it. I'm talking about if it happens, how much will it cost through destroyed ports, destroyed sewage and transit systems, violent weather, rising oceans, all of this stuff. It's going to be extremely costly. Some of the recent studies, stuff has just come out in the last month or two. I mean, there's a study here that I was just looking at by Bilal and Känzig, "The Macroeconomic Impact of Climate Change." They concluded that a 1% increase in temperature is going to cut global GDP by 12%, 12 percentage points.

Ed D'Agostino:

Wow.

Bill White:

Okay?

Ed D'Agostino:

Wow.

Bill White:

So 12%, I'm sorry. These are really, really big numbers, and there's two or three other studies. I won't go into the details. They all seem to point to the fact that the estimates that we've seen thus far vastly, vastly underestimate the overall cost of this happening. It's going to be a huge negative supply shock. On the production processes, it's the same thing. People are backing off efficiency. Your stuff about resilience, they're starting to realize now that they can't carry on in the same way. It's not safe enough. Then you add the national security stuff and the deglobalization on top.

So, we've got all of this stuff coming down the road. And on the technology, which is I guess the fifth of the things that I've been worried about, I was actually surprised. McKinsey Global Institute recently came out with a big study that basically said they think that the low-hanging fruit has been picked. If you look at somebody like the World Bank, for example, you look at their medium-term projections. Basically, what they're saying is that productivity growth has been falling, and they are confidently predicting it will continue to fall. So, all of this stuff that was so positive in the past isn't going to be there. So, on the supply side, I'm saying we are going from good times to times that are going to be much tougher.

The second aspect that I don't think gets anywhere near enough attention is that those negative supply shocks are going to arrive at the same time as positive demand shocks. Now, let me take you through how I see that. Over the last 20, 30 years or so, we've actually been pretty fortunate. The needs for investment were not so great, and they weren't so great in large part because wages were low. So, you didn't have to have capital expansion to increase your production. You just relied on people who were available and not so well paid. So, that was something that we really, really benefited from. I think that is going to change in the future. So, when you start thinking about that now people are not readily available to work, we're going to have to have capital to replace them.

Well, what that means is we're going to need more investment to replace workers that aren't there. So, that's one thing that's going to go into reverse. When you think about the investment requirements associated with deglobalization, which you've touched on, resilience in your systems, we're going to have to have investment at home to replace the investment that once took place abroad and then you start thinking about the environment. So, each one of those negative supply shocks almost automatically calls for a big positive investment response in turn.

So, when I talked about the cost of climate change before, okay, negative supply side shock, you could just live with it. You could just live with it, not do anything. When you look at all the numbers, it makes absolutely no sense to do that, [inaudible 00:11:49] try to cut the thing off.

Ed D'Agostino:

It's interesting you say that too. Bill, I had dinner a couple of years ago with Francis Suarez who at the time was the mayor of Miami, and he was talking about how, from his perspective, doing nothing is not an option because his city will become unlivable in a matter of a few short decades. So, it's interesting. No matter where you fall in the political spectrum, he is a Republican, he's saying, "Look, I live it. I see it every day. Miami's going to get washed away unless there's a huge investment made."

Bill White:

Absolutely. These studies that I was referring to before, most of them really talk about "What's the cost of letting climate change rip and what's the cost of doing something about it?" When you look at the numbers, the cost of doing something about it is huge, but the costs of not doing something about it are vastly higher. So, it's that you don't want to be in this situation of having to do something, but we do have to do something. So, what I'm suggesting is that the relatively weak investment picture in the past that we could put up with, that's not going to be the case in the future. Those investment requirements to deal with demographics, deglobalization, and climate change are going to be huge.

Then, in addition, we have the guns and butter problem. So, in the age of plenty, that was when we were all getting the military dividend, and we didn't have to do much for poor folk because we all believed in the trickle-down theory. Well, it is not like that anymore. So, when you look at the military side, it's the very opposite. You can see it now. You can see it in Europe. You can see it everywhere. Everybody is starting to rearm, and that's going to be very expensive. Now how far it has to go? I have no idea, but it will be very expensive. And then you get on to the butter issues. So, before, we didn't worry too much about redistribution stuff because life was reasonably good, but now we've gotten to a point where there's a lot of angst and there's a lot of anger and there's a lot of recognition.

In the UK, for example, there'd been a massive cutback in welfare support and stuff like that, and starting to realize that the costs of that are far greater than you had originally anticipated, so all of that stuff. So, I've got all these five negative supply side shocks. I've got these two really important positive demand side shocks, which is investment, both public and private, and the guns and butter stuff, which is going to have to be dealt with. So, when you put all that together, this goes right back to the question when you started: What does this mean for interest rates? What does this mean for inflation?

To my mind, I just find it very hard to believe that this is not going to be very inflationary over an extended time period. That will have implications for the conduct of monetary policy… and interest rates, in that environment of continuous and extended shocks, you will need to have tighter money in order to prevent, on top of all those difficulties, a kind of needless wage price spiral that will eventually benefit nobody. So, I think we're going from an age of plenty to an age of scarcity, and we have not focused on these secular issues. I don't think we're doing ourselves any favors.

In fact, I mean I don't want to be overly Biblical, but if one had read the parable of the seven fat cows and the seven lean cows in the Old Testament, you remember that story where Pharaoh's dream gets interpreted by Moses. He says, "You're going to have seven fat years in the land of Egypt, followed by seven lean years." Pharaoh says to Moses, "Start building the silos." Unfortunately, we haven't. So, I think we should be thinking rather more seriously about some of these really deep secular problems that are coming down the road. I certainly hope they're not, but it seems to me that the probability of my being correct is high enough that one should at least be thinking about mitigation, resilience. What are you going to do when the time comes?

Ed D'Agostino:

Bill, we've talked in the past about Keynes and how his thinking factors a lot into how you're looking at this. We're coming... Go ahead.

Bill White:

Yeah, no, I mentioned I think before the recording started that, in a way, I was motivated by Keynes's tract that he wrote in 1941, which is called "How to Pay for the War in a Socially Just Way." I think what we should be thinking about is precisely that because we are in a war. We're in a war to preserve our market-based, capitalist, democratic system in an environment that is going to be very, very difficult to navigate.

Ed D'Agostino:

So Keynes would say that in good times, the government should put money away, and that in bad times, the government should be there to help the economy get back on its feet, spend so that it accelerates the recovery. He gets so demonized. His thinking is so demonized because everyone forgets about the first part of his equation. This is a tangent, but why do you think that is?

Bill White:

Oh, shucks. I think because it's so hard to do, and this is the fundamental problem in a way at the macro level. If you look back over the last 30, 40, maybe even longer years, is that when we've done the easing, okay, when you've run into a recession or something of that nature, you ease monetary policy and you ease fiscal policy, but you never reverse the movements as much. There's been a fundamental asymmetry. What's that meant is recession after recession, the interest rates during the age of plenty ratcheted down because it was so much easier to lower them than it was to raise them.

It's exactly the same thing in the government deficit side. What the government should have been doing was when the economy went into an expansionary phase, they should have been trying to run surpluses that matched the deficits… albeit, accounting for the differences that you were on a positive growth track, you hoped… which may now as I say, be coming to an end. But there should have been much more symmetry in the policy responses, and there weren't. Now, and this is really the heart of the matter, it's that whereas in the past when things turned down, you could simply ease monetary and ease fiscal. Now, we've got huge problems of doing that. We've now got a bit more room on the monetary side to ease if things turned tough. But on the fiscal side, we're starting off with such huge debts, both public and private, that when I start talking about the need for consistently higher interest rates over an extended period, any thoughtful person has to start with, "What's that going to mean for the private sector and financial stability?" When I start talking about higher interest rates for the government that's already heavily indebted, it's a question of "What does that imply for debt service requirements for the governments going forward?" So because we didn't do the right thing over the last 20 or

30 years, that we were not prudent enough, indeed, perhaps even imprudent in certain respects, we now find ourselves in a place where we don't want to be.

We're facing all of these requirements, a lowered potential to produce stuff on the supply side and yet an increased demand for investment implying… and you don't need to be a rocket scientist… if aggregate supply is going down and aggregate demand is going up because of investment, there's only one thing left that can square the circle. That's consumption and that becomes politically extremely difficult. That's where you get into the question of, "What are the broader implications of trying to deal with these problems?" So we really do have some difficult circumstances to deal with going forward. I'm not saying it's going to happen tomorrow, but these are secular forces that are already in train and will continue for an extended period of time. There should be more thought going into that and how we deal with it than is going into it in my judgment.

Ed D'Agostino:

Yes, and you've made it clear in past writings and speeches that this is a highly complex situation, that simple fixes aren't going to work here. Yet in the US, the stock market is near all-time highs. I don't know how many times we've hit an all-time high this year, but it's been many times. The market remains elevated. From the investor's perspective, times are good and politicians are funded primarily by people who are investors or the extremely wealthy. So, I don't hear any US politicians giving real airtime… I think I heard one nod in a speech recently where one of the presidential candidates mentioned the debt in passing maybe all of three seconds in a long speech. No one's talking about this.

Bill White:

Well, to me, although I guess I have been worried about this range of territory for many, many years, the Liz Truss episode, I spent a lot of time in the UK, and the Liz Truss episode really hit me. There were two elements of it. The first element was when they came down with this wildly imprudent budget, which they had not passed through normal channels. The cabinet hadn't heard about it. The budget office hadn't heard about it. They just did it. It was, in itself, imprudent and the way they did it was imprudent. The gilts market went mad, and there was a huge spike in bond yields. Then the Bank of England had to...

Well, that was step number one. Step number two was that that big increase in gilt-edged interest rates had enormous implications for pension funds that had followed investment strategies using derivatives. What happened was that there was a huge call for margin, and the only way that they could do it, the only way they could get the cash was by selling more gilts. Gilts were already in freefall. You get the picture. This is a complex-

Ed D'Agostino:

Yes, death spiral.

Bill White:

That death spiral. The Bank of England, even though they were committed to quantitative tightening, had to go in and expand their balance sheet to buy still more gilts to stabilize the situation. Well, in the end, they did it. They did a good job. Things went more or less back to normal. The Prime Minister got sacked basically. But the point that I'm making is that this is a big "well-run country" that suddenly was at the edge of a problem.

Ed D'Agostino:

Within what, two weeks?

Bill White:

Oh, shucks. Yeah, two weeks. John Mauldin's always going on about the complex systems and sand piles and stuff. In these complex systems, everything is fine until it isn't. We've seen this. I mean, I can remember econometric studies years and years ago about GARCH processes. Basically, what it meant was... This is traditional, the data goes back for hundreds of years... when the stock market goes up, it generally goes up in a relatively calm way for an extended period of time. But when it falls, bang.

A lot of these systems tend to have that characteristic, and the decline can come out of nowhere. I mean, I'm thinking about 1921. It was a huge recession in both Britain and in the United States. Jim Grant's written a whole book about it. There was a famous economist, and his name is now going to escape me, who when he tried to describe what happened, he said, "It was the failure of an anticipated inflation to materialize. It is exactly the feeling you get when you walk up the steps in the dark and put your foot on a step that isn't there."

Ed D'Agostino:

It's just beautiful stuff.

Bill White:

But that's the way these systems work. The problem is that as long as things are going good… this is back to your resilience point, but it applies much, much more broadly than just inventories. As long as times are going good, people expect them to continue to be good and they won't be. We know this over and over again. We've seen this so many times in history that, all of a sudden, stuff stops. Well, Larry Summers years ago got off a wonderful line at a meeting in Prague, "One, two, three, what comes next? The answer is four, because it's obvious."

Then he said, "No, it could be three because the best predictor of tomorrow is always today. It could be two because, in the end, everything reverts to the mean. Not so fast, it could be one, because everything that goes around comes around." There's a terrible tendency on the part of everyone, governments and private sector to say, "The world works one, two, three, four, but it really works sometimes two and sometimes one." We give very little thought to these issues, and I guess it's because governments don't get reelected for avoiding bad outcomes. So, they do stuff. And all that's noted is "Boy, that's costing a lot of money."

On the military side, there's an expression. I wish I could do the Latin, but I forget it. But the English translation is "if you want peace, prepare for war." The UK wasn't prepared, nor the US for that matter wasn't prepared prior to World War I, then they made the same mistake by not being prepared for World War II. I guess people are now kicking themselves a bit saying maybe we're not prepared for what's coming down the road. Just keep making these mistakes over and over again.

Ed D'Agostino:

So let's talk a little bit about some of the potential consequences from all of this, Bill. There's some potentially good consequences, I guess. If you're an investor, there might be some pockets of investing like automation that you'll do well in, but there's a lot of negative. I mean, you mentioned the UK cutting back on social programs. In Europe and in the UK, there's a more socialized form of medicine than we're more familiar with in the US. What could happen in the healthcare space?

Bill White:

Yeah, absolutely. I mean, the healthcare space, we talked before about demographics and I put the emphasis on these people used to be working and now they aren't working. But the other thing I didn't mention was they're also old sick people.

Ed D'Agostino:

Right, the demand for healthcare is just going to go through the roof.

Bill White:

You start thinking about things like Alzheimer's. The fact is that there's going to be a lot of people who are going to be in very ill health who will need care. The question is how do you provide it? Of course, there's a big discussion in the UK at the moment, and there is in my own country, Canada, about how do you improve the system that we've got? How do you increase efficiency? Not least of which through more fervent embrace of digital technology to try to deal with the problems that are coming down the road. I think that's got to be a high priority everywhere too.

Certainly, in the US. I mean the system that you've got, as you're well aware, just huge costs and relatively little to show for it in terms of mortality rates and baby mortality and all that stuff. Insurance and administration, it takes up so much of the overall... So, I think if you talk about what needs to be done, I would say that improving efficiency of government has got to be pretty high up on the list. You want to go in there and look very carefully about how you're doing things. On the tax side, I think there's absolutely no question the taxes have to go up. Particularly in America, you've got much more room than in other countries. The tax burden is already much higher. If you said, "Which taxes?", I guess I'd say property and energy would be high on my list.

I'd want to go and look at tax expenditures very, very carefully. In many countries, of course, you get the subsidization of energy in a way that's really inappropriate. Well, once you've done some of these things, it becomes extremely difficult to turn it around. You look at some of the problems that are going on in Nigeria right at the moment, which is really very, very difficult. So, anyway, you'd have to look at all of those things in terms of the government. I mean in expenditures, I think there ought to be much more reliance on means testing.

So, all of the universal programs, I think, should be looked at very, very carefully. Means testing, we have the digital capacity to do it. I mean, if the Indians can provide identity cards and digital identities to a billion people, we surely will be able to rise to that challenge ourselves. So, all of those things, I think, need to be done. None of the possible solutions to these problems are going to be easily done, nor are they going to be quickly done. But at the very least-

Ed D'Agostino:

Nor are they going to be popular.

Bill White:

Nor will they be popular. So, I think we have to start talking about this as an issue coming down the road. All of these things are coming together. All of these supply shocks and all of these necessary investment requirements all coming down together. The question is “What will be the implications for prices and interest rates?” I think we know that. How do we mitigate the fallout? How do we try to gradually stabilize the situation so we can get back to some? So we can deal with the problems that we face in a reasonably sensible way. I am not Pollyannish about this. I mean, I absolutely understand that we're in a place...

Well, do you know that old joke about the guy who's lost in Ireland? He wants to go to Dublin. He's lost in tiny little lanes of Ireland. He sees an old fella in the field and he says to him, "I'm totally lost. I want to go to Dublin." The old man says to him, "Well, sir, if I were you, I wouldn't start from here." The problem, and this is a characteristic of all these complex adaptive systems, is they're all path dependent. You can't start from anywhere else except where you are. It's important to look at where you are and where you're going and decide: If where you are and where you're going is not to your liking, what are you going to do about it?

I guess my major worry, I mean, I can see a way out, as I said before, talking about various steps that we can take to improve structural reforms in the economy, making it a lot easier. It's less true in the US than in Europe and other places make it a lot easier for people to go bankrupt in an orderly way because there'll probably be a lot of that going down the road. We really do need to work on legislation, administrative facilities. I've been saying this and others have been saying this for decades. There's all sorts of things that we can do to get through this, but a lot of people have to be convinced up front that this is necessary. Because we talked earlier about why people don't tighten up in the good times because it's easier not to.

Well, to really start tightening up now because it's bad times, we have to convince people that this is the way we should be thinking about things. There's three groups of people that are crucial in all of this, and you've got to get the donkey's attention with respect to each of the three. One of them is obviously the guy in the street who's going to bear a significant portion of the burden of adjustment of supply side getting poorer or getting rich less rapidly than they've gotten used to. Ordinary voters have to be convinced that there's a problem, and we have to vote for people that have got solutions. The rich and the powerful have got to be convinced that they've got to take half a loaf as opposed to no loaf, because if things get bad enough, there will be a form of revolution.

Have you read Walter Segal's book... shucks, I've forgotten the name of it now… but it's all about distribution over the ages. When distribution becomes so maldistributed, going back 5,000 years, it ends in one of the four Horsemen of the Apocalypse. So, that those who are rich and powerful will have to make perhaps... I won't say great sacrifices for them, but what would be great sacrifices for others? Okay. We'll have to make a significant contribution in the interest of having half a loaf as opposed to no loaf, because that's where it'll end up if there's not compromise and the right things are not done. Then lastly, you need politicians who are also prepared to look at it and say, "I have to do hard things and I have to take the risk of not getting re-elected."

Okay, these two things go together. The ordinary guys got to get it, and the politicians have got to get it. Leadership, it is a symbiotic process between the citizens and the leaders that we have a problem here and we have collectively to try to deal with it. So, I don't doubt that there's going to be a lot of political difficulties in selling the product. One of the things that worries me is that absent the changes that are required to somehow muddle through this thing, we're going to choose other ways to do it. One of the obvious ways, I don't think people will give up on mitigating climate change and worrying about national security. I think the demands there are so great and become so obvious that it will happen.

But I do think that there's a reasonable probability that people will say, "Well, we don't have to pay for it. What we'll do is we'll just print the money." Of course, we're already in a state as you start to think about the interest rates are higher and debt service is now going to be higher, and there's going to be not too willing a market to buy all of those government bonds in those circumstances. So, what happens traditionally is you've got the big expenditure requirement on the public side, but you just fall back into the central bank.

Central bank buys the bonds, and that's just inflation. That's inflation tomorrow, if not inflation today. That's the Latin American solution, and it's a possible outcome to all of these problems. You just try to print your way out of it and it won't work. It'll just add to the problems. Another possibility, and I know other people have thought about this.

Ed D'Agostino:

Go ahead.

Bill White:

Sorry. The other possibility is that governments-

Ed D'Agostino:

No, no, go ahead.

Bill White:

I was going to say that as the interest rates go up, then the government's debt service problem becomes greater and greater. There will be a tendency, and it may come sooner rather than later, to go back to what they did at the end of World War II, which is financial repression, which is you print enough money to get the inflation rate up, but not wildly up. We're talking higher digits than the digits we've got. You use financial repression, various kinds of administrative controls over what pension funds can do, what banks can do. You dress it all up as prudential policy, but basically, it's a way of saying the interest rates will be kept down by the force to buying of government debt.

You do that for a reasonable period of time. I think at the end of World War II, it took six or seven years where the debt ratio just went down like this, but in large part, one, because they had more growth, but also because they had more inflation. This time it will be more difficult because we're not set up for more growth. We're set up for less growth.

Ed D'Agostino:

Right, and it was also a different time in the world. So, I mean, the world probably would not have the confidence in the US dollar that maybe it did after World War II.

Bill White:

Yeah. But having said that, the interesting thing, I mean if you want to go back to the US, you read so much stuff about how the US dollar is vulnerable because the debt problem is getting out of control in the US and they're worried about this, you're worried about that. You know as well as I do that currency is a question of who's got the dirtiest shirt in the laundry. When you look at some of the problems some of the other countries face, okay, Japan in particular, China, Europe has got very special problems, which I think they can manage. I certainly hope they can manage, but I think they can manage. But some of these other guys, compared to them, the dollar looks good and the dollar is still whatever anybody says, it is the vehicle for international exchange and reserves.

So, yeah, I worry about the US dollar, but I worry about some of these other people as well, which raises some interesting questions that we needn't get into today about what the implications will be for countries like China and Japan if the US dollar continues strengthening and their currencies continue weakening. There's some interesting questions there as well. So, from a national security point of view, it might actually be a good thing. I don't know. It's too early to make a judgment, but anyway.

Ed D'Agostino:

Bill, that's a good cliffhanger to end it on, and that gives me a good excuse to badger you to come back and have a follow-up conversation.

Bill White:

Well, I hope I continue to be in good health and both eager and prepared to do so. So, it's been a lot of fun, Ed. Thank you.