The Globally Financial Crisis and Covid – What Next?

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In April 2009, the leaders of the world's major economies – the Group of 20 - met in London under the chairmanship of the British Prime Minister, Gordon Brown. At a critical time, a year after the global financial crisis, Brown turned to the past as inspiration and warning. 'There was a world economic conference in 1933, and it took place in Britain. People came to London to get agreement, partly on trade, partly on other aspects of the economy. It failed. And partly as a result of that failure the rest of the Thirties was blighted by protectionism'.

I started my first lecture with that failed meeting in London in 1933. Would 2009 be any more successful? The G20 faced demonstrations and the world was again teetering on the brink of a second Great Depression: world industrial production and trade was dropping from the peak in April 2008 at the same pace as from the peak in June 1929. Then, after 11 months, at about the time of the meeting in London in April 2009, matters started to improve. Trade and industrial production increased; there was not a turn to protectionism as in the 1930s. Between Oct 2008 and Oct 2010, new trade restrictions were only 1.4 per cent of total world imports.

Many economists and political scientists breathed a sigh of relief that the multilateral institutions created after the war had stopped the slide into trade warfare. Some envisioned a new world - an end of great power conflict, the growth of economic interdependence, the incorporation of Russia and China, and a willingness of other countries to allow the United States to operate as a 'liberal leviathan'. Paul Kennedy, a leading historian of international relations, claimed that the situation was unlike 1933, for 'I don't think anyone is busy with revengeful, pre-war militaristic feelings. Certainly not any in the G20'. In 2022, these predictions appear as naïve fantasies.

My argument in this lecture is that seeming success in avoiding a second Great Depression masked rather than solved deeper problems. The result was new difficulties of populist politics and lack of resilience in the face of the pandemic. The failure to reform capitalism in the decade after the Global Financial Crisis meant that neo-liberalism continued - a set of policies defined by fiscal and monetary discipline; tax reform to reduce marginal rates; financial liberalisation and free flows of capital; privatisation and deregulation of business; and a belief in the efficiency of the market. The question now is whether the pandemic – and the crisis in Ukraine – will mark the point at which a new global economic order emerges as it did after the Second World War and the 1970s. What form might it take – will the result be a decline of globalisation and a turn to self-sufficiency and regional blocs as in 1933, or a more balanced relationship between global and national economies as after 1945?

How, then, did governments respond to the Global Financial Crisis?

Responding to the Global Financial Crisis

When the G20 met in November 2008, it pledged to 'use fiscal measures to stimulate domestic demand to rapid effect', and this commitment was renewed in April 2009. Brown proclaimed that 'this is the day that the world came together to fight recession not with words but with a plan for global recovery and reform'. There was talk of a return to Keynesianism.

The German government was not sympathetic. Peer Steinbrück, the German finance minister, criticised

Brown's 'crass Keynesianism' for 'tossing around billions' that would burden future generations. Brown's approach was also rejected closer to home by Mervyn King, Governor of the Bank of England. He worried that a fiscal stimulus would increase the size of the deficit, boost consumption and hinder the long-term need for the British and American economies to save and invest. He informed the Treasury Select Committee that 'monetary policy should bear the brunt of dealing with the ups and downs of the economy'. His intervention exceeded the remit of the Bank for controlling inflation and was condemned by one LibDem MP as 'a very British coup d'état'.

The story of the response to the Global Financial Crisis is the defeat of fiscal stimulus in the United States and Britain after a short experiment, with a turn to austerity or what was euphemistically called 'expansionary fiscal contraction' - the belief that the impact of cuts in public spending on consumption would be outweighed by gains in confidence. In June 2010, the G20 announced a commitment to what it called '"growth friendly" fiscal consolidation'.

Why Was Fiscal Stimulus Rejected Between 2009 and 2010?

In a recent BBC documentary, Nick Clegg – deputy prime minister in 2010 – said that one of the greatest myths and falsehoods about economic policy is that there was a dispute over whether fiscal savings were needed. He is wrong – it was contested. The real question is why these critics were marginalised. The belief that cuts were necessary was constructed by various rhetorical devices and ideological assumptions.

1. Economists argued fiscal stimulus would be harmful.

Alberto Alesina argued that cuts in spending were more successful than increasing taxes in reducing deficits, removing uncertainty, restoring confidence, encouraging investment, and avoiding an unfair redistribution between present and future generations. Cuts in spending could lead to increased output because gains to private consumption and investment were larger than cuts in government spending. The general assumption amongst economists was that public spending was less efficient and drove out private investment.

Carmen Reinhart and Ken Rogoff and the 90 per cent rule. They claimed that historical data showed that a debt above 90 per cent of GDP led to a fall in the median growth rate by 1 per cent and even more in the average rate.

2. Politicians took up these arguments:

Paul Ryan, the Republican chairman of the House Committee on the Budget, drew a stark choice between two futures: a path to prosperity, with debt completely paid by the 2050s; or a path to economic disaster as debt rose to almost 900 per cent of GDP by 2080. This view was powerfully expressed by the Tea Party.

In 2010, George Osborne – shortly before he became Chancellor of the Exchequer - referred to Reinhart and Rogoff as the most significant contribution to understanding the crisis.

In Germany, a constitutional amendment in 2009 introduced a 'debt brake' or *Schuldenbremse* that limited the federal deficit to no more than 0.35 per cent of GDP. The German demand for a balanced budget was in part a response to internal fiscal transfers after reunification. The policy also reflected Merkel's concern that the German – and European – population was ageing. Boosting domestic demand would undermine competitiveness and pass the burden to future generations, so that the solution was to export and accumulate a surplus.

3. Structural change in political economy.

Financial interests have been more important since the 1970s. The financial elite captured the state. In the United States, there was a revolving door between government and Goldman Sachs. In May 2009, Simon Johnson, recently the chief economist at the IMF, saw a 'quiet coup' by leading banks. He had been involved with the IMF in Russia, South Korea and Thailand where business oligarchs formed a close relationship with governments. Johnson saw similarities in the United States where,

> *Financiers … played a central role in creating the crisis, making ever larger gambles, with the implicit backing of the government, until the inevitable collapse. More alarming, they are now using their influence to prevent precisely the sorts of reforms that are needed, and fast, to pull the economy out of its nosedive. The government seems helpless, or unwilling, to act against them.*

Rather than bribes and corruption, Johnson saw a more insidious process: 'the American financial industry gained political power by amassing a kind of cultural capital – a belief system…. It benefited from the fact

that Washington insiders already believed that large financial institutions and free-flowing capital markets were crucial to America's position in the world'.

Capture was possible because more people were implicated in financial services through loans, pensions, equities, insurance. The result was a larger 'bailout constituency' of middle-class voters aligned with financial elites to protect their assets and access to credit.

4. What was going on was a process of 'bait and switch'.

- The right ignored private debt and debt from bailing out banks and blamed high levels of public debt which had not caused the crisis.
- Blame was passed to the improvident behaviour of the state and generous welfare which was easy to explain to electors.

As Mark Blyth put it, 'Austerity is the penance – the virtuous pain after the immoral party – except it is not going to be a diet of pain that we shall all share. Few of us were invited to the party but we are all being asked to pay the bill'.

Flaws in the Argument Against Fiscal Stimulus

Critics at the time who were marginalised. After the pandemic, there have been some buyers' remorse. At the G7 summit in Cornwall in June 2021, Boris Johnson said that it was vital not to repeat the mistakes after the last great economic crisis of 2008, and Ian Duncan Smith – former leader of the Conservative Party - commented in 2022 that 'George Osborne needs to stop drinking the Kool-Aid. He got it wrong'.

The economic case was flawed.

Alesina ignored the distributional consequences of tax increases versus spending. At no point did he ask what the political and economic consequences of austerity might be in provoking discontent, harming the prospects of the young, increasing mortality for the elderly, or encouraging economic nationalism. Fiscal stimulus might have assisted recovery by bringing forward investment at a time of weak demand and idle resources, so compensating for cuts in private spending and stimulating growth that would reduce the ratio of debt to GDP. Instead, cuts in spending led to a recession and an increase in the debt to GDP ratio.

The 90 per cent rule misused history. It aggregated countries and periods without attention to context. Take the case of Britain: debt has been high on three occasions – Napoleonic and First and Second World Wars, with different effects on growth. Exceeding 90 per cent was associated with rapid as well as low growth.

- After 1815: debt fell because growth was rapid; changes in prices had no impact.
- After 1918: growth was slow because of lost export markets and world depression; interest rates were high; and prices fell. It was difficult to escape the burden of debt.
- After 1945: debt was less problematic. Growth was high; interest rates were low; and modest inflation.

The real lesson is that the impact of debt depended on policy choices – interest rates, inflation and policies for growth. The solution might have been – as after 1945 – investment in growth rather than harmful cuts in spending that weakened growth and increased the level of debt to GDP. Where debt is serviced by taxation that shifted income to poorer members of society, increased consumption and allowed improved education/training, it might encourage growth. A cut in public spending might lead to growth where debt, interest rates and taxation were all high – such as Italy in 1990s – but not in other circumstances.

The case for spending was not only made by progressives. The International Monetary Fund argued for fiscal policy as a tool for economic stabilization, and pointed out that if all countries were committed to bring debt and deficits down at once, it would harm global growth. It urged an approach of 'not too fast, not too far', with surplus countries boosting global demand and postponing fiscal adjustment until the downturn was over. In 2013, Olivier Blanchard – the chief economist of the IMF – accused Cameron and Osborne of 'playing with fire' by adopting harsh austerity. He found that a cut of spending of one euro reduced GDP by almost two euros – a reversal of the 90 per cent rule. Lower – not higher - spending harmed growth.

There was a major exception to the rejection of fiscal stimulus: China. Its massive fiscal stimulus was crucial in preventing the Global Financial Crisis becoming a second Great Depression.

- In November 2008, the Chinese government announced a spending package, and local and regional governments competed in ambitious infrastructure projects. It risked ineffective investment in sectors with excess capacity, unnecessary infrastructure projects, and corruption.
- The Chinese government also boosted consumption in December 2008 with subsidies to purchase large domestic appliances.

It was the largest stimulus in the world economy. For China, continued growth was vital to the legitimacy of the Party's rule and political stability. It marked, as Adam Tooze commented, a fundamental change of 'world historic proportions, dramatically accelerating the shift in the global balance of economic activity towards East Asia…. In 2009, for the first time in the modern era, it was the movement of the Chinese economy that carried the entire world economy'.

The Turn to Monetary Policy

Instead of fiscal stimulus, the United States and Britain – and reluctantly the European Union - turned to monetary policy. A repeat of the Great Depression was avoided without fixing underlying problems. Trends that existed before the crisis were exacerbated.

Monetary policy took two forms: Quantitative Easing which was more visible and swaps which were under the radar and just as important.

Quantitative Easing: the Fed bought mortgage-backed securities and Treasury bonds from banks; hence they were in shorter supply and their price rose and yield fell. Lower interest rates meant that investors switched to equities which rose in price. The purchase of bonds meant the banks had more cash and could, in theory, provide easier credit. The Bank of England also adopted this policy – the European Central Bank delayed until it reluctantly followed in 2015.

QE prevented the collapse of the financial system – and the global money supply continued to grow which avoided the problems of the Great Depression.

QE was criticised from both ends of the political spectrum:

- Right: lead to inflation and currency debasement. Paul called for the abolition of the Fed 'because it is immoral, unconstitutional, impractical, promotes bad economics, and undermines liberty'.
- Progressives: rise in asset values when wages stagnant – in Britain, average real wage only returned to level of March 2008 at the start of 2020.

Certainly, the outcome was inequitable.

- Wall Street was saved and holders of equities gained. In the words of one City of London financier, 'Owners of assets have all made out like bandits'.
- Austerity harmed welfare recipients and in the United States, homeowners faced foreclosures.

Steve Bannon was clear of the consequences: populism that he and Trump exploited.

Swap networks were less visible but just as important. The Fed provided vast sums to other central banks which could support private banks. Nicolas Sarkozy thought the Global Financial Crisis marked the downfall of the dollar. He was wrong: the dollar became more important, and the Fed acted as the central banker for the world. The Fed helped European banks which were deeply involved in the US sub-prime market - 52 per cent of mortgage-backed securities purchased by the Fed came from Europe.

What did not happen was tighter regulation of banks – the action of the Fed made Systematically Important Financial Institutions still larger and intensified the 'too big to fail' problem. After the Great Depression, regulation was tightened by the Glass-Steagall Act of 1933. It was repealed in 1999. The attitude to financial regulation at this time was captured by Howard Davies, chair of the Financial Services Authority from 1997 to 2003. 'Consenting adults in private? That's their problem'. He was referring to the argument to decriminalise homosexuality – a mistaken analogy. What consenting adults do in private is indeed their concern; what banks do hurts others.

With few exceptions, economists believed that financial crises came from external shocks and not within the system. Central banks were concerned with inflation targeting rather than financial fragility. At the Fed, Ben Bernanke was confident in 2006 that 'The management of market risk and credit risk has become

increasingly sophisticated… Banking organizations of all sizes have made substantial strides over the past two decades in their ability to measure and manage risks'. He was complacent.

After the crash, regulation remained weaker than in the great depression – a result of capture by financial interests. Simon Johnson complained that the response to the crisis was 'an unwillingness to upset the financial sector …. or to question the basic outlines of the system that got us here'. The outcome was preservation of the existing system rather than fundamental reform.

Europe: Extend and Pretend

While China, the United States, and Britain acted, the eurozone dithered and delayed. The Bundesbank and Merkel limited action by the European Central Bank.

Initially, the eurozone seemed to escape the financial crisis – though in large part because of Fed support. Then crisis hit.

Before the Global Financial Crisis, the PIIGS – Portugal, Ireland, Italy, Greece and Spain – had been able to borrow at low interest rates because of the implicit guarantee of membership of the euro. Indeed, in 2007 the Irish government could borrow at a lower rate than Germany – a situation that defied logic. By 2010, a sovereign debt crisis hit these countries.

Borrowers were in difficulties:

- As members of the euro, it was not possible to devalue to reduce interest payments. Although Germans contemplated Greece leaving the euro, there was no easy way to exit.
- Other countries refused to mutualise the debt (that is, make the debts of individual countries a responsibility of the EU). The Maastricht treaty rested on intergovernmentalism, that is each state was responsible for its own obligations. There was also reluctance to reschedule.
- The president of the ECB, Jean-Claude Trichet opposed Quantitative Easing and even increased interest rates to force countries to take responsibility – one of the most misguided decisions in the history of monetary policy.

Finally, in July 2012 Mario Draghi, the new head of the ECB, said he was 'ready to do whatever it takes to preserve the euro' and offered to buy bonds from countries in difficulties; in 2015 the ECB at last adopted QE. Merkel gave in and overruled the Bundesbank – though there were still problems with the German constitutional court which questioned its legality and referred the matter to the European Court of Justice.

Resentment continued on both sides:

- Greece resisted austerity imposed by the IMF and Commission.
- The northern European states blamed the PIIGS for imprudence. The Dutch president of the European finance ministers commented that the north had helped the south, but 'You cannot spend all the money on drinks and women and then ask for help'.

The outcome was widening disparities in the EU: in 2007, German GDP was 10.4 times that of Greece; in 2015, 15 times. And the euro remained flawed: a monetary union without a banking union or fiscal union.

Consequences

The action of the Fed and China prevented a second Great Depression. There were shortcomings:

- Austerity hit those who were already losing from globalisation and deindustrialisation with a rise of precarious or lousy jobs.
- Monetary policy led to an increase in the value of assets.
- Piketty's data showing the gains of the top 1 percent fuelled protests. It was the graph that occupied Wall Street – and also led to populism.
- Support for the financial sector and large banks meant they became still larger and made the 'too big to fail' problem still greater.

- Did not take action on financial regulation or mortgage foreclosures – some reform of Obamacare but the US social safety net remained weak.
- Flaws in the eurozone were not removed – a monetary union without a fiscal union or mutualisation of debt.
- The responses of the Fed and China was not coordinated – what would happen if their interests did not coincide in future?
- Inequality not only led to tensions within countries but also to macro-economic imbalances between countries: weak domestic demand in China and Germany because of their high savings ratio meant they exported; the goods were bought by the US which covered its deficit by producing dollars. How stable was this system?

The response to the global financial crisis did not resolve the fundamental problems that had led to the crisis in the first place. Neo-liberalism had survived the crisis that it had created.

Then covid hit. What would be done in response – was this the point at which a new order would emerge? And what will be the consequences of the crisis in Ukraine for the global economic order?

Building a Fairer Capitalism or a Return to the Status Quo?

In 1933, Keynes remarked that

> *The decadent international but individualistic capitalism in the hands on which we found ourselves after the [First World] war, is not a success. It is not intelligent, it is not beautiful, it is not just, it is not virtuous – and it doesn't deliver the goods. In short, we dislike it and we are beginning to despise it. But when we wonder what to put in its place, we are extremely perplexed.*

We are in much the same position now – with geopolitical tensions just as serious as in 1933 when Hitler had come to power, and Stalin embarked on collectivisation of agriculture and forced industrialisation that led to famine – not least in Ukraine.

When I proposed this lecture series a year ago, I thought it would be difficult to analyse the impact of the pandemic – and now we are in the middle of the worst geopolitical crisis since the Second World War which will have profound consequences for the global economy.

We are at a stage when the basis of the capitalist economy might – I think should – change. Just as embedded liberalism arose in response to the Great Depression, and neoliberalism in response to the crisis of the 1970s, so we might now create a fairer, more inclusive capitalism. The shift did not occur after the Global Financial Crisis which left us vulnerable to the pandemic. Now is the time for change that will create greater resilience and political, economic and social stability. The question is whether there will be a backlash because of the costs of the pandemic and the impact of war in Ukraine, with a return to austerity and rejection of the green transition.

A new social contract is needed. I will suggest what I think is need, not signs of change, but also suggest the difficulties that lie ahead.

Reform Economics

John Kay, a leading British economist, complained that 'University economists of the sort gathered at Bretton Woods are now under relentless pressure to conform to a narrow, established paradigm. Inexplicably, most supporters of that paradigm also feel that the crisis confirmed its validity'. There are signs of change away from assumptions of individualistic, economically rational decision – but also the firmly entrenched professional norms.

Rents And Unearned Increments

In the New Deal, corporate power was viewed as a threat to democracy and economic dynamism. In the 1970s, it was assumed that large firms benefitted the consumer and corporate success was best measured by shareholder value. Now, 'shareholder value' is criticised as short-sighted and destructive; instead, they

call for 'stakeholder value' to cover workers, customers, suppliers, public interest.

To Joseph Stiglitz, dominance by large firms is 'ersatz capitalism' – genuine capitalism needs free competition. Returns often do not rest on efficiency but on barriers to entry so that much of the gain is an unearned rent.

The IMF found that an increase in the market power of firms in advanced economies led to an increase in the mark-up over marginal costs of 8 per cent 2000-2015; the share of labour income in value added fell by 5 per centage points. One result was a reduced incentive to invest for productivity growth. It has produced 'crocodile capitalism' – the opening jaw between labour and capital.

The Peterson Institute for International Economics – a free-market think tank - pointed out that during the Bretton Woods era from 1948 to 1973, real median family incomes in the United States rose by 3.0 per cent a year with a 96 per cent chance that the next generation would be better off. Since 1973, the median family income has grown by only 0.4 per cent a year and 28 per cent of children have lower incomes than their parents.

Hence the survival of free-market capitalism requires a response to growing disillusion in a way that is more creative than populism. Restoring competition through anti-trust policy is a start – but it is also necessary to transform corporate behaviour from shareholder value to wider social purposes.

In 2018, Senator Elizabeth Warren proposed an Accountable Capitalism Bill. Many business leaders saw that reform was needed for self-preservation. In 2020, 181 leading corporations issued a 'Statement on the Purpose of a Corporation', and Jamie Dimon of JP Morgan Chase called for action on the 'fraying' of the American dream by spending on education and infrastructure, even if it meant more taxes. Ray Dalio of Bridgewater Associates, the world's largest hedge fund, said that capitalism must evolve or die – 'I'm a capitalist and even I think capitalism is broken'.

There is some sign of change: in US, 36 states allow public benefit corporations. There is push back – and it can be argued that earning a profit is necessary for pension funds that own shares which is itself a wider social purpose.

Lousy and Lovely Jobs

Deindustrialisation meant the loss of well-paid, secure jobs for workers without formal qualifications. Instead, there has been a growth of employment in precarious – lousy – jobs with low pay which stand in stark contrast with jobs for those with formal qualifications. There is a need for levelling up to revitalise declining cities by place-based policies. A firm is unlikely to relocate to a decaying city without a wider cluster of enterprises and physical and social infrastructure – it is vital to assist pioneers with government support for development banks, business zones, investment promotion agencies, better education and retraining. Initiatives cannot come just from the centre – needs powerful local government. The process is difficult and will take time. The solution is not that advocated by Dominic Raab, Priti Patel, Liz Truss and Kwasi Kwarteng of removing employment protection, blame idle workers for poor productivity: rather, productivity rises if there is an incentive to use more expensive labour more efficiently.

Regulation of Banks and Finance

In 2015, the Bank of International Settlements – the central banks bank – worried that 'the level of financial development is good only up to a point, after which it becomes a drag on growth'. Gita Gopinath, the chief economist of the IMF, agreed. There was a mismatch between global finance and national regulation:

> *Countries can engage in a race to the bottom with lax regulations so as to win the favor of the financial services industry, while imposing large costs on the rest of the world. The lessons of the financial crisis if anything should highlight the costs of weak financial regulation and the virtues of international coordination of regulatory standards.*

Better and stricter regulation is needed at the national level, coordinated by an international body. Business dependence on debt leverage could be reduced by ending deductions of interest payment for tax purposes; changes could be introduced to tighten up on credit cards and second mortgages used for equity release to fund consumption. The question is whether the entrenched power of finance can be overcome.

Related to this – capital controls. In the 1970s, the IMF encouraged financial liberalisation and capital flows. In 2020, the IMF's Integrated Policy Framework accepted that cross-border capital flows could produce shocks as well as benefits, and that policy makers drew on an eclectic mix of tools that varied over time and between countries. The IMF suggested a framework to help policy makers decide on the best solution – a turn from dogmatism to pragmatism.

But there are problems in handling debt created by covid.

- It was easier to strike a deal to reschedule debt when creditors were bankers issuing bonds with interest and repayment; less so when many loans are refinanced and in hands of hedge funds that were more inclined to hold out.
- Role of China: it is the largest official lender to the developing world, and outside the 'Paris club' of official creditors that coordinated debt rescheduling. Chinese loans are secured by assets such as ports – seen by the US as strategic incursion. If others agreed to reschedule loans, would mean that borrowers used relief to pay China.
- Covid meant that indebted countries borrowed more with a risk of default if loans are not rescheduled. The response has been inadequate. The Debt Service Suspension Initiative covered only the poorest countries, and private loans only if creditors joined voluntarily, and none did. Proposals to over-rule creditors who were holding out were rejected. The result was, in Adam Tooze's view, a 'mockery'.
- Now we face Russian default, as in August 1998. What could the result be? It is possible that the fall out in the financial system will be contained – more likely risk is from commodity prices.

A large part of foreign direct investment was 'phantom' – tax avoidance by shifting profits to low tax regimes. This creates unfairness between mobile and less mobile capital, between companies that can and cannot shift profit. The response is a call to reform the international tax regime.

Tax Regimes

The global average of corporate tax fell from 40 per cent in 1990 to around 25 per cent in 2017; and companies avoided tax by booking profits in low tax jurisdictions – what is called 'bas erosion and profit shifting'. There has been progress in 2021 with action by the G20, IMF and OECD – not yet gone as far as it might with a minimum rate of 15 per cent. There is still an incentive for companies to shift their profits to the lower tax regimes.

Tax havens and profit shifting attract attention with exposures such as the Panama papers, and glaring anomalies of how little tax is paid.

The injustice is stark but could also be a distraction, for corporate tax is not a large part of total revenue. We need to go further by reversing the shift to less progressive taxation and rebalance taxation of earned income and income from capital.

The Patriotic Millionaires called for inheritance taxes to break up passive wealth; and there is call for a wealth tax – something that is not easy and can be achieved by adjusting existing taxes.

The Institute of Fiscal Studies points to 'a large, unjustified and problematic bias against employment and labour incomes and in favour of business ownership and capital incomes' – something exacerbated by the use of National Insurance contributions to fund social and health care.

As we have seen, QE led to an increase in value of assets as austerity hit poorer families – and this trend continued in the pandemic with rising asset prices. Despite furlough in the UK, the discrepancy continued, and was more striking in the US with its weaker social safety net. Pandemic wealth rose rapidly, in stark contrast to the limited 'hazard pay' to workers. In April 2021, the IMF called for increased spending and taxation of the wealth to avoid social and economic instability, to increase resilience and build trust in government. It suggested a 'solidarity tax' paid by high earners and corporations. Morris Pearl, a former director of Blackrock: 'given the choice between pitchforks and taxes, I'm choosing taxes'. But in 2021, the modest proposal of Democrats to tax the wealthiest households earning more than $100m a year or with assets of $1bn failed.

Tax reform is a high priority for domestic stability, especially as the cost-of-living increases: earnings are not rising in line with inflation, pensions are index linked; and there are calls for a windfall tax on energy companies. Shifting attitudes on taxation to return to a more progressive regime will be a fundamental shift

in social attitudes.

Reform is also needed to deal with imbalances within the global economy.

Global Imbalances

There is an imbalance between China's low level of domestic consumption and high level of savings which means a high dependence on exports; and the United States' high level of domestic consumption and low level of savings permitted by issuing dollars to cover deficits. Can this imbalance be rectified? Even before the invasion of Ukraine, there were problems which are now still more serious.

United States

The political system is dysfunctional and polarised. The one effective part of the state is the Federal Reserve which stepped in during the pandemic on a scale that surpassed 2008 – it bought Treasury bonds which monetised debt and allowed a deficit without raising interest rates. This 'fiscal QE' funded the government.

The Coronavirus Aid, Relief and Economic Security Act (CARES), 2020 increased spending by 10 per cent of GDP – more than after 2008. It gave a supplement to unemployment benefit and 'stimulus cheques'. Was it a rejection of neoliberalism? Rather, it covered the past failures of neo-liberalism (weak social security net and inequality) in order to preserve the existing social order. A second stimulus in December 2020 arose from political contingencies – the Republicans wished to show generosity to win Georgia. They failed and returned to blocking.

Biden had three plans: the short-term American Rescue Plan which exceeded Obama's stimulus; and longer-term American Jobs Plan and American Families Plan to invest in the infrastructure/green transition and to rebuild the middle class and invest in the future. The Fed accepted it – Jerome Powell said 'we welcome slightly higher inflation …. The kind of troubling inflation that people like me grew up with seems …. unlikely in both domestic and global context that we've been in for some time'. The weakness of organised labour meant that the risk of inflation was less than in the 1970s.

Not everyone was convinced: the economy might overheat, with higher inflation and interest rates that would hit foreign borrowers of dollars; and the surge in oil prices in 2022 threatened a return to the stagflation of the 1970s. In March 2022 Powell assured Congress that he would follow Paul Volcker in restoring price stability at all costs – though he still seemed to think he could squeeze inflation out of the system without a recession.

The *Financial Times* thought Biden's plans might be a shift in cultural attitudes on the scale of the New Deal – but this is not likely if the Republicans regain control of Congress in the mid-term elections. The US political system gives disproportionate voice to conservative rural states and blocks majority opinion. A return to austerity and failure to redress inequality could have alarming consequences. The prospects are not hopeful.

China

China was central to the recovery of the world economy in the Global Financial Crisis. Since then, geopolitical tensions have risen. Obama's pivot to the east in 2011 was taken further in Trump's United States Strategic Approach to the People's Republic of China which went beyond concessions on trade to attack on China's move into high-tech. Similarly, the American Jobs Plan aimed to respond to climate change and also to 'the ambitions of an autocratic China'.

China's fiscal stimulus has been less than during the Global Financial Crisis, and there are potentially problems:

- Shift to state companies which are less profitable and borrow to service their debt, with reliance on subsidies and overpriced contracts.
- Local government-controlled banks led to under-performing companies and there are fewer profitable infrastructure projects.
- Can the economy restructure to domestic consumption? Failed in 2007 and constrained by powerful local elites, weak unions. Much will depend on reform of the social welfare system to encourage a shift from savings.

During the cold war, the Soviet Union was not an integral part of global supply chains; China is. The outcome is tension between geopolitical conflict – especially with the alliance of Russia and China - and economic

interdependence.

Eurozone

The response to the global financial crisis was slow and modest. Has the pandemic made a difference?

The design flaws of the euro remained with the lack of a fiscal union or mutualisation of debt. When the pandemic struck, the ECB launched the Pandemic Emergency Purchase Fund. The German constitutional court continued to resist joint responsibility – but Olaf Scholz, the finance minister and Merkel's successor, agreed to a eurozone package, the NextGen recovery fund.

There was talk of a 'Hamiltonian moment'. In 1790, Alexander Hamilton mutualised the debt of the 13 states. The analogy is exaggerated: Hamilton had tax revenues from the federal customs service, the EU does not, and the 'frugal four' of Austria, Denmark, Sweden and the Netherlands oppose a larger budget. The EU's response was less than the US.

Will Ukraine now mark a real Hamiltonian moment? It is possible, but not a high probability given continued disagreement over the size of an EU budget.

Reforming each of these three major economic and political systems will be difficult. The question is whether the result might be an end of globalisation, much as happened in the early twentieth century? The talk in the later twentieth century was of ever-closer integration of supply chains, just-in-time delivery, out-sourcing, global flows of finance. Now, there are claims that this model is no longer feasible, and we will see a turn to national self-sufficiency – the title of Keynes's lecture in 1933 – or regional blocs as in the 1930s. The case for decoupling of the world economy is:

- Shock of covid to supply chains.
- Tensions with China over trade and technology, and closer ties with Russia in energy, finance.
- China's creation of the Asian Infrastructure Development Bank as an alternative to the World Bank.

I think the case for decoupling and the end of globalisation is exaggerated, and what we are more likely to see is a different form of globalisation rather than a reversal. This outcome is more likely if politicians and international organisations adopt sensible policies – admittedly a high bar.

My argument is:

Export markets: China has drawn closer to Russia, but its economy is small. China needs markets in the United States and EU, at least until it can shift its economy to domestic consumption which will take time. China and the United States are also closely tied through purchases of US Treasury bonds.

Future of international currencies: Neither the Global financial Crisis nor the pandemic displaced the dollar. Instead, it was a safe haven and the Fed sustained global finance. The renminbi has challenged the dollar as a reserve currency: in 2018, the renminbi accounted for 2.5 per cent of non-Chinese reserves compared with 62 per cent for the dollar. There is resentment of the exorbitant privilege of the dollar and Russia and China might look for a currency that is not linked to a rival sovereign power. One banker commented that sanctions against Russia might be similar to Nixon's closing of the gold window in 1971 – the end of the post-Bretton Woods era. The outcome is likely to be a multipolar system, with a number of currencies existing side by side. It has worked in the past – it is not self-evidence it leads to uncoupling into blocs.

A new social contract: The global economic order after 1945 rested on lower inequality, and a social contract between labour, capital and the state that provided decent wages and social security in return for high investment and growth. Finance was subordinated rather than dominant. The strategy was to maintain domestic welfare and a fair degree of freedom for national policy, alongside a return to open markets. It was 'shallow multilateralism'. I have been arguing for a new social contract – and this also means rejecting the pursuit of ever greater economic integration through hyper-globalisation.

Future of global institutions: In the later twentieth century, multilateral institutions embarked on a particular normative approach to the global economy that departed from the intentions of their founders: rather than maintaining a balance of national and international concerns, and accepting national distinctiveness, there was a one-size-fits-all approach. There are now signs of greater pragmatism, and a focus on specific issues where progress can be made, such as international taxation. Dani Rodrik, a leading commentator on this issue, calls for the replacement of 'globalisation enhancing deals' of the era of market liberalisation with

democracy enhancing global agreements'. 'A thin layer of international rules that leaves substantial room for maneuver by national governments is a *better* globalization'. This means avoiding Trump's extreme view that the future lies with patriots who put their country first rather than globalists. Instead, what is needed is a sense of whether action is needed, working at different levels and through different bodies at national, regional and global level. It is what Elinor Ostrom has called a 'polycentric' approach. We need to think which bodies and functions need to be strengthened.

- World Health Organisation: poorly funded, global initiative od Access to Covid-19 Tools Accelerator was slight: despite vaccinating the world paying for itself in 36 hours, little was done. Tooze: 'a staggering demonstration of the collective inability of the global elite to grasp what it would actually mean to govern the deeply globalized and interconnected world they have created'.
- Food and Agricultural Organisation: this was set up at the end of the war to create food security. Clearly, the current crisis in Ukraine and impact on energy and food prices will have a major global impact.
- World Trade Organisation: could coordinate responses to climate change through border taxes on carbon.
- IMF could build on monitoring of cross-border financial flows.

Conclusion

Keynes admitted he was perplexed in 1933 and there is no shame in admitting to the same feeling in 2022. We also know what was to follow within a few years of 1933 – we do not know what will come in the next few years. We are in a period of radical uncertainty.

- My wish is that we can turn back from neo-liberalism that led to the Global Financial Crisis and survived. The pandemic might be the opportunity for change – but that means creating a powerful intellectual and rhetorical case.
- I would like a fairer, more inclusive capitalism – a view shared by many major capitalists. Capitalism has survived because it has reformed. Continuing on the same lines as before the Global Financial Crisis and pandemic will be a recipe for further crises and unrest.
- Rather than decoupling and deglobalisation, the outcome is likely to be a rebalancing of national and international interests – a turn from hyper-globalisation. China needs markets in the EU and United States – but we do need a correction of macroeconomic imbalances through internal reform to boost domestic consumption in China and reduce American dependence on deficits funded by the dollar.
- And international agreements are needed to deal with specific, pragmatic issues on health or climate, rather than to pursue an agenda of market liberalisation.

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