I'm Ezra Klein, this is the Ezra Klein Show.
How do you describe Adam Tews?
Adam Tews is an economic historian at Columbia University.
He's the author of the excellent Must Read Newsletter chart book.
And he's become, I think, a key interpreter and describer of the way the international finance system works.
He's become a historian of our financial present.
Also, I should note a repeat guest on the show.
But for the past few months, Tews has been taking the global view of this economic moment rather than the US-centric one that a lot of us are used to.
Right now, we are seeing around the world a convergence of forces.
We have high inflation.
We have central banks hiking interest rates.
We have governments cutting spending and raising taxes.
We have very high levels of dollar-denominated debt.
And we have droughts and floods that have been quite a bit worsened by climate change.
Some countries amidst all this have already tipped into ecological or political or economic crisis.
Many more are fragile.
It's easy to imagine them tipping there.
And what's happening now is that richer countries, most importantly the US, are tightening the economic screws.
We're doing it, we think, we intend on ourselves in order to curb inflation.
But the way we're doing it is putting tremendous stress on the global financial system and on these other countries that are highly exposed to us.
We are, in a sense, exporting our own economic pain and our own economic policy elsewhere.
And we're doing so with very little discussion, very little awareness of the consequences.
I will say, listening to two spin out the way the financial system works and the way everything feeds back into itself and connects to each other and how a problem here that nobody noticed can flap its butterfly wings and create a crisis over there, it is dizzying.
And that, to me, is very much the point.
The complexity and connectedness of the global economic system is dizzying and no one truly understands or holds the information to understand all of it.
We sometimes act as if our economic policy is a purely domestic matter.
But if that was ever true, it's not now.
As always, my email is reclinedshow at nytimes.com.
Adam Tews, welcome back to the show.
Great to be here.
For people who haven't been following this all that closely, tell me about just to start here.
What's been happening in the UK financial markets in the last few weeks?
Well, we saw the spasm, basically.
I mean, the UK has been a little bit on the suicide watch, you might say, for a while.
The fundamentals don't look too healthy.

The economy has a huge trade deficit.
There's Brexit in the background.
The Tory party is a little bit a while, we would say, and has been for a while, the Boris Johnson Prime Minister shit collapsed.
But then, in a kind of spasm of what appears to be really just downright, but rather naive ideological commitment, the neutral government with Liz Truss and Quasi Quarteng as a Chancellor of the Exchequer, so Treasury Secretary, announced that they were doing a mini-budget.
Now, in the UK, because it's parliamentary system, they've got the majority built in.
So when they decide to do this, it actually happens.
It isn't like they have to negotiate with anyone.
And this mini, what they call the fiscal event, they didn't want to call it a budget.
So they didn't have to go through the rigmarole of a proper budget, also evaded any kind of assessment by the Office of Budget Responsibility, which does the kind of assessment of British fiscal policy.
This decision to do a tax cut for principally better off people to the tune of about 45 billion pounds, which in modern money, given the exchange rate of the pound, is about 45 billion dollars.
On top of a decision before to do 150 billion pounds in energy price stabilization subsidy to deal with the energy crisis, which is rocking all of Europe, the combination of the two things together unleashed an almighty panic, kind of temper tantrum type thing in the British, well, currency markets first, the pounds sold off very hard, but then much more importantly in the bond market.
The British government bond market is the kind of granddaddy of government bond markets that originates in the late 1600s.
So at the time of the so-called Glorious Revolution, the parliamentary constitutional settlement that set Britain on its trajectory to being the permanent parliamentary power.
And so when the guilt market tremors, it's really quite big news, even though it's modest in size by global standards now.
And it went into full on spasm.
We didn't quite understand why, but Treasury bonds, especially the long dated ones, 30 year guilt, sold off spectacularly.
And that seems to have then unleashed some nasty derivative action, a little bit too familiar from 2008, this involved pension funds who'd hedged against interest rate movements.
They were then stuck, they then had to offload more portfolios of debt, which threatened to generate a fire sale, kind of run dynamic.
And before you know it, the Bank of England, which had previously was in the process of tightening, so selling debt it had on its portfolio, all of a sudden ended up having to buy a bunch.
Where we are now is the storm has stabilized, the pound is back to where it was before the crisis began.
And the Treasury yield as well, which is the inverse of the price for a bond.
So people don't want bonds, they sell them, the price goes down, the yield goes up.
So the yield is now back to where it was before the crisis as well, which means the Bank of England's buying has stabilized the guilt market as well.

But that we could have gotten as close as we did to a full on financial heart attack,
and this did have the feel of 2008 about it, shows you how fragile these systems are,
and in particular how precarious the situation in the UK is.
And the future really of the Tory government from here on in is very uncertain in the opinion polls, they now lag labor by 20 to 30 points.
So I think they're really, they're a flailing government at this point.
So there are two ways of reading this.
One is that you had some dumb policy mistakes, some weird economic idiosyncrasies, the way the pension funds were hedged, and that wasn't very well understood.
But it all worked out, as you say, that the pound is back to where it was, everything
is totally fine, no big deal here.
And then there's this other argument, which is more of the argument you've been making,
which is what we saw there is a signal of where we are, but more to the point what's
coming globally.
You write, quote, that we are reaching the point in the monetary tight eating cycle in
which things begin to break, end quote.
And so the idea is that we are now in this context of fragility, and we are changing
things and the changes are having knock on effects we don't anticipate.
Can you tell me more about that view that this is an example of something that is now
becoming our reality?
Yeah.
So there are two different risks in the current moment, which is worth distinguishing.
One is a recession risk, which you might think of as the more familiar, serious, almost
tragic trade-off, but nevertheless as it were one that you can contemplate with a degree
of calm in dealing with inflation.
So you raise interest rates, you take the pressure out of the labor market, you induce
some, quote, labor market slack, which is really a euphemism for unemployment.
I really hate the term labor market slack for the exact reason you put it.
It's very like, you know, Orwell politics in the English language kind of thing.
It is.
I mean, it creates this sort of image of a mechanism, right?
That is somehow we're going to add a little bit more play there.
Anyway, so yeah, so that's one vision.
What's implied by that is a sort of managerial sense, though, that we've got a clear choice
to make a trade-off that, you know, we are on the famous Phillips curve, we can pick
our point and then we steer towards it.
However you imagine the Phillips curve, whatever shape you think, you at least are positing
there that you have a degree of freedom.
That's one way of looking at our current situation.
And that's serious enough, right?
Because if you think globally, the destinies of tens, if not hundreds of millions of people
at stake and the generation that was hit by COVID now has to face the prospect of labor
markets closing on them as well, that, I mean, the young people whose education was so severely
disrupted.

So that's one side of this story.
And there's another side, which is, in a sense, even more alarming, but a little more obscure, which is that as we raise interest rates, what we're doing is putting pressure on every single joint in the financial system, because all of the contracts which were negotiated over debt and credit over the last decade or more were done on the basis of assumptions about inflation, namely that inflation was low and that interest rates would be low as well, that no longer obtain, right?
We're now in a world in which inflation across the developed economy will be the exception of Japan is around 10% and central banks are responding by hiking interest rates.
And so what we're doing is shaking this entire system, a system which also extends to the poorer countries of the world, the emerging markets, low income countries, which have also borrowed in dollars.
And so what we're doing is pressuring this entire system by raising interest rates.
And we honestly don't know.
We've never done as comprehensive an interest rate increases this before.
We've never done this with this level of dollar debt out there.
We hear creaking already in this system, right, with people who are already under strain.
What we saw in the UK guilt market last week in Time Warp because the pace of the increase in interest rates driven by the sell-off of bonds was savage.
But we saw there in Time Warp what is happening across the entire global economy slightly more slowly.
And if there are other mechanisms like that, one of the eerie things about this pension fund derivative hedging strategy is that it just wasn't top of stack for anyone in the financial stability community, apparently, in Britain.
It's really striking.
You would have given the scale relative to the size of the UK bond market.
This was a big event.
1.5 trillion pounds worth of debt were hanging on these derivatives contracts.
We have to worry at this point also about, as it were, the adequacy of the regulators, the central bankers, to the task of shepherding the system through this historic tightening that we're going through.
And when it breaks, then we're in a different world, and all of a sudden the pace of events speeds up.
We're in a situation of, it's a little bit more like the pandemic all of a sudden.
The chronology is not that of a rolling program of tightening over months, but all of a sudden hours and days begin to really count.
Ooh, there's a lot here.
So I want to put a pin, because we're going to come right back to this question of the adequacy of our knowledge of how the financial systems work, of what's happening in other countries.
But I want to hold for a minute on something you said, that we've never raised interest rates this comprehensively before.
We raised them, at least domestically, higher in the 70s.
So tell me what you mean by that.

And I'd also like to throw in this question that you've been attentive to, of there also being not just coordinated interest rate rises, but across the world coordinated tightening of government budgets, where you're saying spending cuts, tax increases.
So can you talk a bit about how that plays into it as well?
Yeah.
So the epic historical benchmark of monetary policy tightening is Paul Volcker's tightening after 1979, when interest rates went above 15%.
And we're not in that zone, but the change is considerable.
So the change that's been initiated since the beginning of the year.
And what's even more impressive is that it's so comprehensive.
So the World Bank, the IMF, have been collecting data on this.
And really, at no point in the history of the modern international financial system, which we could say dates to the early 1970s.
And we use that marker, because that's the moment at which the dollar was unhitched from gold in 71 by Nixon.
And so we enter our modern regime of money, which is a fiat money regime.
So money anchored only really by the authority of the state and the monetary actors associated with the state.
So in that modern period, which is half a century old, we have never seen as comprehensive a tightening as this.
This process did not start, remember, with the US.
The Fed was relatively late to the party.
The ECB is even later to the party.
The Bank of Japan still isn't tightening.
The tightening this time around actually began in the emerging markets.
I mean, it will be, I think, misleading to call them the periphery.
I mean, it began with Brazil, which began tightening quite hard last summer, the summer of 2021, and has swept from there across many of the emerging markets and eventually enrolled the Fed from the beginning of this year.
And when the Fed moves, because the dollar is so much the dominant currency, everyone else has to follow.
So we're really talking about a global bandwagon, which at this point leaves only the Bank of Japan and the People's Bank of China as central banks, which are loosening policy.
If you exempt the British emergency action, which really had nothing to do with macroeconomic policy, it was about keeping the financial markets afloat.
And the effect of this tightening, which is unprecedented in its breadth, is compounded by the fact that, yes, at the same time, fiscal policy is tightening.
Now it's important not to misread this.
There is some which is deliberate, like the Inflation Reduction Act negotiated over this summer between Congress and the Biden administration.
That actually sets out to tighten the deficit by raising taxes more than it spends.
From a macroeconomic point of view, you don't need to have deliberate policy decisions to produce a tightening of fiscal policy.
You just run off the stimulus programs of 2020 and 2021.

And unless you replace them with new stimulus, which is an implausible idea at this point,
you end up with a negative net effect, a so-called fiscal shock.
And that's very large in the US.
So in the second quarter of this year, it was as large as 4.5% of GDP.
And the third quarter, it's down to about 3.5% of GDP.
This isn't a deliberate policy decision, or rather, it's a decision not to pile in on
the stimulus of 2021.
Another way of thinking about it is this is what happens when you're built back better,
$3 trillion program stalls and you end up with Inflation Reduction Act instead.
Under the circumstances, massive fiscal stimulus is no longer called for in America.
Investment, perhaps, but not fiscal stimulus.
But overall, this produces a very negative drag.
And this fiscal effect is not confined to the United States.
So again, we're seeing a de facto tightening across the world at this moment.
So when you add monetary and fiscal policy together, this produces an enhanced effect.
The sum is greater than the parts when you do this combined pressure.
A further effect, which is rather important, is the adjustment in exchange rates.
So as the Fed tightens monetary policy in the United States, what we've seen is that
the dollar is surged.
And the effect of that is to produce a contractionary effect on everyone who's borrowed in dollars
was effectively their debts are increased in value in local currency terms.
And that effect then ripples throughout the world economy, because it's about $22 trillion
plus in dollar-denominated credit to non-Americans outstanding.
So these three different mechanisms, the contraction of monetary policy, the hit to fiscal policy
and the exchange rate adjustment, are very negative, you might say, euphemistically for
the economic outlook.
Let's get to that third one, because I think the first two are more familiar to people.
When the central bank's tightened, they're making it harder to borrow money, so economies
slow down.
When the fiscal authorities, the government's cutback, they were taking the amount of support
or stimulus they're putting into the economy and turning it negative instead of putting
as many dollars in, they're taking dollars out from wherever they were, or pounds or
whatever it might be.
But this idea that interest rates have this other international effect, that they create
currency dynamics and they create races for other countries to tighten, you've been focusing
a lot on this, and I don't think this is very well understood, honestly, from talking to
people.
I don't even think it's that well understood by policymakers, not to mention by me.
So can you talk more about that intersection between interest rate increases and their
international spillovers?
Yeah, I mean, I think it's fair to say that this is something of a puzzle, because we're
supposed to live in a world that's emerged bit by bit since the 1970s in which exchange
rates were flexible, and one of the effects of that is it's supposed to render the economic
development of the individual countries relatively autonomous of each other in the sense that

the exchange rate adjusts in between them.
What we see is that in fact, the dollar functions as something like a currency for the entire world to the extent that if the US tightens monetary policy, it's as though everyone else did tighten too, and it slows the global economy down.
Now in practice, because if you do not tighten along with the Fed, your domestic monetary policy, your exchange rate depreciates very dramatically, everyone does tend to track the Fed.
Essentially, what these statistical correlations are capturing is the reality of a world which is not just interdependent, but more hierarchically dependent on the United States than the cover of the magazine would suggest.
The cover of the magazine says new global monetary systems since the 1970s, independent exchange rates, degrees of national autonomy they didn't have before, de facto what we see is a system which tracks the dollar very closely.
One mechanism for this is that central banks actually track the Fed's policy because otherwise you tend to get depreciation.
If your currency devalues against the dollar, then you tend to get import inflation because the goods that you buy from abroad, many of which are denominated in dollars, become more expensive.
The other reason you'd be leery about doing this, especially if you're an emerging market or low income country, is that many of your businesses, big businesses, will have borrowed in dollars.
Why?
Because your local capital markets aren't big, deep, or sophisticated enough.
The US market is there, and hitherto, borrowing on US markets has been cheap, relatively speaking.
What big corporates in the emerging market will do is issue debt with the help of investment banks in New York and in Europe, onto global dollar markets and borrow there.
If your currency severely depreciates against the dollar, and this is a big company which is earning revenue locally, its problem all of a sudden is that it has liabilities in dollars which are worth more, and assets or a stream of income which is in a depreciated local currency.
That's a recipe for financial crisis in big corporations.
Those effects between them, there's also an effect by way of major commodities.
Oil, for instance, is denominated in dollars.
The price of oil tends, however, to vary inversely with the value of the dollars.
If the dollar goes strong, oil tends to sell off.
That helps to a degree, but overall, a strengthening of the dollar will often put pretty severe pressure on commodity importers in the short run because they then say Pakistan this year or Bangladesh or India, the entire South Asian continent, which is heavily dependent on imported energy, has been facing a double whammy or even a triple whammy where interest rates have gone up.
The price of commodities has gone up, and they're paying for those commodities in an American currency which also has gone up.
That triple effect exerts a very painful squeeze on the bits of the world economy which are integrated enough to actually be entangled with the dollar system, but not sufficiently

strong and resilient to be able to ride this out.
This crash test that we're applying here, this very severe shaking of the system, is in a sense going to reveal who is on what side of that crucial divide, who can handle the stress and who can't.
So I want to sit down on one part of this, which is sort of implicit here.
Why when the US raises interest rates, does it cause the currencies of countries that have not raised interest rates to depreciate?
Why should making it more expensive to borrow in America create a problem in the currencies of Brazil or Bangladesh or Chile?
Yes, so this is a crucial point, and it acts on the difference between the trade element of the balance of payments and the capital account element.
Because as America increases interest rates, it becomes more expensive to borrow, as you say, in the United States, but it becomes extremely interesting to lend in the United States because when you lend, you're going to get a better interest rate for lending.
The way you lend in big markets is not with a bank loan, but by buying or selling bonds.
So when you sell a bond as a business, you're borrowing, and the person buying the bond is lending you the money, the face value of the bond or whatever you actually buy and sell it for.
And so as interest rates go up, in the United States, it becomes more attractive for foreign investors to own American assets because they attract this higher interest rate.
And so as people buy those assets, essentially America is exporting assets, if you like, and is buying them, and that produces an appreciation of the dollar.
The flip side of that is a depreciation of everyone else's currencies, because if you're a global investor and you've got a portfolio, you've got a giant trillion dollar portfolio and you've got to put that money somewhere, you spread it across the entire world, and as interest rates adjust, you reallocate your portfolio away from the now relatively low interest countries and towards the relatively high interest countries, and that in this case would now suddenly be the United States.
So you see these big reallocations in portfolios which drive exchange rate movements.
And I want to go back to something you had said a few minutes ago, which is that there were these dynamics in UK financial markets that were just not the top of anybody's mind, not something that a lot of people understood very well, and to connect that to something more broadly, certainly my read from covering 2008 and the financial crisis then and doing more research into past financial crises is that the really dangerous thing in financial markets is when one of two things happens.
Information, everybody took as settled and known and made decisions about, like housing prices are going up and these bonds are safe.
If that information changes all at once, and as such, everybody now has to live in a new informational world where their old assumptions don't hold, that often can create a financial crisis.
But the other piece of it is that when something like that happens, when there is a rapid effort to respond to new information or changes, it turns out there's a lot of parts of the financial markets that we don't understand, dependencies, vulnerabilities, exposures, counterparty risk.

And so you were saying a few minutes ago that you wonder if our central banks and our regulators have what they need to track all this.
And it seems to me the answers, of course, no.
This really comes through in your work, oftentimes to me, that the complexity of international even domestic markets is now so far beyond the capacity of any individual or even any agency or any kind of informational structure that any kind of rapid change is going to expose things nobody was prepared for.
And so that creates just an underlying vulnerability to big explosions.
Is that a fair way of talking through the risk now?
Certainly, I would wholeheartedly agree on the first point, which is that indeed we build institutions to deal with and we make strategic choices of a large size to deal with scenarios and futures as we within reasonable boundaries think are reasonable and are likely to emerge.
And the scenario which British pensions were hedging against is a scenario in which interest rates went down, and that was a historically warranted assumption to make.
And so the irony of the current situation is that the strategies that blew up were strategies that were needed in a world which we no longer currently inhabit, where we're suddenly seeing huge interest rate increases, and that is what they were not prepared for.
I don't think you can really blame them for having adopted these strategies in the first place because they were highly exposed, largely private pension funds with large commitments in the future.
I think the question has got to be in the UK case why the bank, the Treasury, the financial regulators, knowing that we were heading into an interest rate increase cycle were not more attendant to this risk.
And it's a reasonable question to ask because we know how anguished the communication between the financial sector and the bank was on Monday and Tuesday before they had to make the decision on Wednesday.
And by all accounts, the bank took a long time to really get it for the penny to drop.
And that's not what you would really want in this situation.
You would have wanted the central bankers to be on this risk in the very beginning, carefully monitoring it before things got as toxic as they were by the end of Tuesday and as dangerous as they were at that point.
To your point about whether or not this stuff can be foreseen, I think I'm less, I mean, I would characterize your description there as sort of conservative liberal.
There's a kind of almost a shade of hayek about it, right?
The world is too complex for us fundamentally to grasp.
We have therefore to face in a kind of rather resigned way, the prospect that we are going to be overwhelmed by things that we can't see coming.
And so then presumably we either adopt a very conservative stance, which says that we should prudentially avoid certain risks as far as possible, or I don't know, I think we sort of have to shrug and say, well, bad things are going to happen and we just have to roll with that.
I'm not sure I'm willing to settle for that.
I think especially with regard to the global financial system, there is persistent evidence recurring examples of cases where the bank and the British regulators were in fact warned

year in, year out for several years by people who were knowledgeable about the pension system
of how dangerous this strategy was.
It's not rocket science to look at the major holders of UK treasuries of guilt and figure
out where the risks are to work your way down the tree.
My take would be more kind of left progressive radical take, which is to say, there are systematic
reasons as to why we're blindsided by these kind of events.
People are actually not trying hard enough or the folks that are in these positions are
not competent and for good reason not competent.
In other words, folks who are making money don't want competent, aggressive regulators
in those jobs and make damn well sure that they're not in those jobs.
Information is deliberately not shared.
That would be my approach until we saw somewhere that had made a very concerted effort to crack
down on this kind of behavior.
I wouldn't be willing to concede that modernity is just too complex for us.
I think on balance right now, my guess is simply that this is exactly the kind of crisis
you'd expect in the system shot through with conflicts of interest as it is, and it's the
conflicts of interest which are the driver here.
I mean, in part of the contrast here, and it's a disconcerting comparison, but it's
one we've talked about before, but so it's on the table already.
The contrast is a place like China, which this year and last year is going through what is
unprecedented in global financial history, the deliberate efforts to deflate the bubble
to end all bubbles, which is the Chinese real estate bubble.
Now, that is being deflated with complete deliberateness.
They don't know exactly how all of the things, you know, how the Jenga Tower is going to
fall that they're having a hard time containing Evergrande.
They've got problems at the local level, but they brought that thing down deliberately
because they thought there was too much risk in that system.
Until we see a determined effort by a Western regulator to do something like that, I wouldn't
be, I think, willing to concede that this is a problem which surpasses us on grounds
of complexity per se.
I think it's more likely to be that there just isn't the will out there, and there aren't
the interests, in other words, that would drive us towards really firm-handed, intelligent,
aggressive regulation of these sectors.
Well, I'm going to cop to half of that.
I think I do have some of the view that these systems are now more complicated than human
minds can fully grasp, although I don't think I'm as fatalistic as where you would take
that.
But I want to be clear here that I'm talking not so much about the specific thing we just
saw in the UK, but of what we saw in the UK is more of a metaphor for the other side
of what we're talking about, which is this now global system of pressure coming from
global inflation, coming from US interest rate increases, and now spreading out into
a lot of economies that we don't understand that well, that we don't watch that closely,
that have uncertain relationships to their own political systems or the political systems
of their neighbors.

As such, that, to me, is where this gets a little bit frightening, that we are playing
with systems.
I don't even think that we truly pretend to understand, which is maybe a good bridge
into what you've been calling the South Asian polycrisis.
Do you want to talk a bit about what you've been tracking there?
Yeah.
So this polycrisis is this notion which I picked up when I wrote this book, shut down
about the 2020 crisis, and it's a term originally used, well, coined and put into somewhat wider
circulation by Jean-Claude Juncker, the president of the European Commission at the time of
Europe's
Troubles between 2014 and 2016, and the term, it turns out, has an interesting genealogy
which goes back to 1970s complexity theory.
Basically, it's the idea that you can have a crisis, and then you can have a polycrisis,
and a polycrisis is when you have a whole series of interconnected fires which then
turn into a general, a firestorm, a conflagration, which is larger than the sum of its parts.
So the situation is worse even than the diagnosis of each individual one of its components would
suggest because those components are powerfully interacting with each other, moving fast as
well, which makes it difficult to track.
And so at that level, yes, complexity theory, you know, you're right, Ezra, would point
towards the kind of idea which says there are constraints to what we're able to do and
understand more importantly about the world.
I guess my invocation of the term is trying to at least point to the fog we need to be
navigating through, even if we can't necessarily clear all the fog away.
And I find this a useful way of thinking about interactions of crisis.
So deciphering the polycrisis a little bit, one way is to understand the regional connections
between crises.
Maybe this comes out of my background thinking about the EU and the Eurozone, which you could
describe as sort of a classic regional polycrisis.
So you can see interactions like that between Turkey, Syria, Lebanon, that entire complex
of regional issues, you know, you could refer to that as the West Asian polycrisis.
But there was and there is ongoing, I think, a question about the stability of several
of the states within what you might broadly think of as the shatter zone of the British
Indian Empire, which took in at its height, Burma, Bangladesh, India, Pakistan, Sri Lanka
and much of the border region to Afghanistan, which in modern parlance is South Asia.
And out of that emerged a series of more or less successful post-colonial states, of
course, building on long, long historical lineages.
And as of this summer, we had a manifest total crisis in Sri Lanka, an ongoing disaster now
compounded by this gigantic climate shock in Pakistan, and very severe pressure on Bangladesh.
And that's strategic because Bangladesh, you know, in the global development narrative,
Bangladesh is one of the truly bright spots, right?
So this is a model student, if I may use that language, in the development game, coming
under very severe pressure.
And what connected all of those, they all have very distinct political histories, interacting,
of course, through a geopolitical force field that connects Pakistan, India and Bangladesh,

for instance, or, you know, India and China around Sri Lanka, but all of them were under
the pressure of this triple whammy of rising interest rates, accelerating commodity prices,
which early in the year were very dramatic and in energy persist, and also the strong dollar.
And those three forces were acting on this cluster of states, and we're talking about
a huge slice of humanity in a rather concerted way and had just to say about a quarter of humanity.
Yeah, this South Asia, I mean, South Asia and East Asia between them, you know, if you monitor
those two regions, you're covering close to half of humanity's experience at any given moment.
Of course, it's hugely asymmetric because India entirely dominates this, but Pakistan and
Bangladesh
are very, very big countries by any standards. Pakistan, I think, is number five in terms of
population, Bangladesh, number eight. So these are hugely significant pieces of the global jigsaw
puzzle, and they were all simultaneously being rocked, even India, by this triple shock.
And the energy component is particularly dramatic because Bangladesh and Pakistan had been
tempted
in the gloved days of global energy when, you know, LNG in particular was dirt cheap because
there was an over supply. Liquid natural gas. Yeah, liquid natural gas. In global parlance right
now, that's a key variable. I know it doesn't figure very much in American politics right now,
because America has an abundance of gas. But LNG is crucial because it's shippable, right? You
don't have to have a pipeline. You can put it in a very, very sophisticated tanker. And Bangladesh
and Pakistan, in Bangladesh's case, at least rapidly developing low income countries, had
fixed onto LNG as a cheap source of relatively clean energy as well, because the alternative
is either burning diesel or burning coal. And they were therefore blindsided. I mean,
hit really hard by this spasm that we've seen in the global LNG market, shippable, transportable gas,
as East Asia, the giants to the East and Europe to the West compete for these cargoes,
which literally will just turn course in the middle of the Indian Ocean. If the Europeans
outbid Bangladesh, and that's not hard for the Europeans to do, the tanker just turns around
and it goes to Spain rather than going to Bangladesh. So Bangladesh, this extraordinary
example of rapid economic development under the sign of globalization in the last 20 years,
because they have this incredible boom in their garment sector. This state, which was for the
first time really also offering its citizens regular electricity supply, that keeping the
lights on all the time. So there was an emerging IT sector as well, suddenly faced rolling blackouts,
and all the symptoms of dysfunctional emerging market and low income countries.
And then looking down the Indian Ocean to Sri Lanka, there is this terrifying
prospect of complete state failure, which would be obviously a great disaster.
Anyway, so this is one way of trying to think of this region as being shaken by this global
tension. How do you think about the strength or vulnerability of the Indian economy right now?
One of the things that India has going for it is that it's a relatively closed economy.
So it is not as exposed to global dynamics as Thailand, for instance, or Malaysia, which are
true workshop economies in the current global economy. India is huge, poor, and relatively
less exposed. It doesn't borrow very much. It doesn't have a bond market to speak of.
So there isn't much international involvement in Indian debt. It's now rich enough to be able to
afford what is its crucial import, which is energy. It's heavily dependent on imported oil,
increasingly also on coal. But it also has a currency reserve, much of it borrowed,
but nevertheless on stable terms of over $500 billion. So India can ride out any of the shocks.

The last time that India was in really manifest crisis, financial crisis was in the early 1990s.
So India has moved itself well out of what you might think of as the danger zone for low-income countries. But it is nevertheless subject to buffeting from the outside. And what I think is more important is the question of how dynamic its growth engine really is, because India is sustained right now by a dramatic story of rapid economic growth that came out of the 1990s and really hit its stride in the early 2000s. Growth was up seven, eight, nine percent at various points recently as well. India is outpaced China. But I think there are deep concerns at the structural level about the adequacy of India's infrastructure, the adequacy of its education system to providing the skills that hundreds and millions of young India needs. India has a huge youth bulge coming in its way and increasing signs of what you might call a kind of crony capitalism where Prime Minister Modi and the BJPs collect around them pivotal players in the Indian oligarchy in a sense almost as a substitute for the absent states. So those oligarchs and their giant business empires will do the job of building the infrastructure that India needs rather than working away over the long run at building the state capacity. This is the term you hear again and again in India that would allow it to emulate the sort of things that China has done. The big questions are all about the longer run in India and whether or not there is a growth model that can be sustained over the next two generations, which is what India would need
to rise comfortably into the zone of higher middle income countries.
We've talked about the role that interest rate increases and economic policy in the US might be playing in adding tension here. You've touched on the weather events to use a very bloodless term in South Asia recently. Obviously, we are a main driver of climate change over the century. These weather events are related. Can you talk a bit more about the role, the floods and the rains have been playing in the problems in South Asia and also what that perhaps implies for US or Western responsibility?
Yeah. We're seeing it around the world, but South Asia is perhaps the most vulnerable. Certainly, when you put it in proportion to population that's exposed, South Asia really is at the absolute crosshairs of climate change. It works in a double way there. On the one hand, you have terrible heatwaves and drought, which have been affecting crops in northern India.
Then on the other hand, you have the appalling epic flooding in Pakistan, which is undated a third of the country. This isn't the first time this kind of mega flood has happened in Pakistan. For the entire northern region of India that's in the Ganges and the runoff from the Himalayas, one really has to fear for the possibility of this kind of mega flooding. Those are, as it were, the two types of exposure, extreme heat on the one hand and drought. The prospect of inundation through the monsoon, if the monsoon is even more extreme than normal, the immediate effect on Pakistan is devastating. I don't think there's any real doubt that Pakistan is going to have to fundamentally renegotiate its international debt. There's no way I think that it can continue in what was already a very fragile IMF program. There is there an immediate linkage to financial crisis. I think more broadly what this does is to put India in particular in a really severe dilemma with regard to its climate policy in the upcoming COP in Egypt. Then it's caught in something of a cleft stick, because on the one hand, with its developmental ambitions, India could try and do a China and run up a huge fossil fuel intensive industrialization program. If it could get the infrastructure sorted, that would be an option for India. The problem is that by doing so, it would exacerbate a problem to which it is

more vulnerable than practically any other really large state in the world. On the other hand,
it also alienates the most vulnerable small island nations, which could be India's allies.
Add that to the list of challenges which India has facing it in this current moment. Not just as it
were the issues of political economy and the huge backlog of infrastructure investment and human
capital education, in other words, that needs to be delivered, but also the fact that going forward,
its 20 to 30 year time horizon is shaped by this climate crisis. Stand back far enough from this
and you really begin to get a sense of the tragic dilemmas facing the large emerging and low income
countries in the world. India is perhaps the most dramatic in the sense that much of Africa,
particularly sub-Saharan Africa, has not really embarked on rapid economic growth at all in
patches in individual countries, but not for the continent as a whole. India really has,
and it sees the door to the classic development path slamming in its face. It's like one of those
action movies where the bad guys hurtling towards some sort of door which the heroes are trying to
shut before the villain can get their fingernails around the edge of the door and they're desperately
trying to keep this door closed. And India finds itself a little bit in that position, but reverse,
right, where the door to the development future is swinging closed in front of it and it now has to
conceive of an entirely different strategy to go forward because the path to fossil development,
even if it embarked on it, A, it would be disastrous for the planet and B, it would find
itself most likely outflanked by the supercharged green development that China's now embarked on.
So it comes into its own, and the Indians speak a lot about this being India's moment,
it comes into its own at a moment where we're at some sort of a fork in the road or in this
poly crisis in which the way forward is completely opaque. And you and I can argue back and forth
about whether complexity is the issue. But what is certainly clear is that the path forward from
here in most respects, political, scientific, economic is unclear. That's precisely the moment
in which Delhi feels that history has arrived. So it's really a tragic, I don't think it's too
strong a word for this situation. And it demands huge creativity. And that is another question
certainly liberals that you meet in Delhi put to, is that can you really imagine
Modi and the BJP rising to this challenge? Because it's as big as if you like the non-aligned
movement
in the 50s and 60s that was trying to shape an alternative for humanity beyond the Cold War.
In terms of climate, nothing less than that is what's on India's play.
Then let me add another dimension of vulnerability here, which has been,
I think something we're talking about less here in the West, which is the amount of
indebtedness, particularly in emerging markets.
Yes, I mean, the amount of indebtedness is in and of itself not that huge, because you know,
almost the definition of being poor is that you can't borrow as much as you would like.
So the total quantities are not that impressive in many cases. And I think the worry is that the
debt levels were goes back to your diagnosis of the parameters changing, the debt levels were
contracted in a world for low interest rates. And the question is whether any of them are
sustainable as interest rates become significantly positive. And you know, maybe we're talking
about long run interest rate in the United States of three to 4%, which means that an
emerging market and low income borrower is paying 8, 9, 10%. Generally, you know, whereas right
now
those are the kind of rates paid by true frontier market borrowers. So in that kind of world,
what kind of debt is sustainable? And this is indeed a huge question for a whole list of countries.

The question is whether any of them are big enough to cause a systemic crisis. You know, if you think of the Indias, the Brazils, the Indonesias of this world, all of them are robust enough at this point to handle the shock that's coming their way, right? So they have done an enormous amount of work in terms of building institutions, accumulating foreign exchange reserves, have just been developmental success stories over the last generation such that they're robust to this kind of shock. The real question is about the Angolas, the Sri Lankans, the Pakistan's, which are in a much, much more fragile position. The question, however, from their point of view is also, are they too big to fail? And in the case of Sri Lanka or Angola, they're almost certainly not too big to fail, right? These are states which would be regional crises, perhaps certainly local disasters. But it's very unclear whether the, you know, this thing we euphemistically call the global community or the international financial institutions would really muster the wherewithal to mount major support actions in their favor. I mean, one of the things that complicates the current debt situation is not just the level and the poverty of some of the borrowers, but the structure of the debt as well, which has undergone a really dramatic shift in the last 15 years. So the early 2000s began with the debt jubilee, which meant that the lowest income countries had their debts cut. And that debt was largely owed to a group of governments known as the Paris Club, which is basically Europe, the United States and Japan, who used to do government to government development lending. Almost all of that debt was written off. So what the developing and emerging market countries now do to access funds is they borrow from things like the World Bank, which is a major source of development funding. They borrow from bilateral lending by new lenders, notably the Chinese, who emerged in the One Belt, One Road period in the last 10 years as a lender on a scale of the World Bank. And then they borrow from private markets. And so part of the problem in dealing with a current debt overhang will be that if things do break, in other words, if a state becomes unable to continue with paying its debts, the question of renegotiating those debts is complicated in a way it's not been before because there's more private debt and because the Chinese have a much bigger stake and because the classic Paris Club lenders, the Europeans, the Americans, the Japanese, have precious little influence over the situation. And this complicates the situation because the Chinese have a bunch of public, private policy banks, which they insist are simply banks and everyone else insists they're extended arms of the Chinese government, which the Chinese will or will not, depending on the circumstances, allow to be incorporated into government to government negotiations. In any case, this is a situation of complexity. It's not inherent, you know, this is like a four-body problem. This is not immensely overwhelmingly complex, but it's just that interests on the part of the private lenders and the Chinese and everyone else mean that it's very difficult to assemble a clear-cut structure for restructuring all of this debt. So this gives us further reason to be anxious about a world in which interest rates are going up.

One of the things I think about sometimes when I read descriptions of poly crises or I look at some of these numbers is that there's this interesting shadow side to it or light side to it. And I'm almost nervous making this argument because it can sound like you're downplaying or could become what will become a lot of human suffering. But I want to at least open up this question of poly bulwarks because by the same token that we have a lot of financial and governmental
and economic interconnection that creates a lot of vulnerability and climate interconnection

and communication interconnection and political interconnection,
some of that ends up being a force in the other direction. I mean, you've talked a bunch of different times here for a bunch of these big countries about the support they might be able to get from the international community, which might buffer shocks it at another time would have overwhelmed the country. We've talked a lot about how much richer India and China and for that matter Bangladesh have gotten and that among other things has also helped them a lot when dealing with things like very rough weather. We're seeing unbelievably bad disasters now, but the death tolls
of them, thankfully for now from what we can tell compared to what we've seen from not even quite as
bad weather shocks in the past, it's better than it once was. I mean, it's a really big deal that Bangladesh has something near or it says actually 100% electricity. And so one of the things I sometimes read when I read your descriptions of poly crises is a sort of narrative of vulnerability. There is so much more now that every country in the world, including us for that matter, feels vulnerable to. But there's also more support, more technology, more money, more kind of possible multilateral coalitions, you can get help from China now, which really wasn't on the table 20 years ago. Is there something to be said not just for a rise in invulnerability and exposure, but particularly when you're speaking outside of the climate context to a rise in reinforcement that comes from some of these same dynamics having a positive side?
I wouldn't disagree with you at all. I mean, I think that was very visible in 2020. I mean, in two different dimensions. One is that we in early 2020, many of us were on the war path, you know, warning in a sense already then of the sort of crisis that we're warning again about now. In other words, interest rates were going up. Many, many low income countries were shut out of global financial markets. It seemed the prospect of a kind of rolling disaster.
And it didn't happen, nor did debt restructuring, however, but the mega crisis that we anticipated did not arise. And many of the emerging market countries actually showed considerable resilience in coping with the crisis. And if you go from the 30,000 feet, you know, discussion of government debt to situation on the ground in India, I mean, many people will remember the extraordinary images of the tens of millions of Indian migrant workers driven out of the cities, you know, where they live in informal housing, desperately seeking refuge in their home villages as the lockdown was put in. You know, it was a movement of people that India and the subcontinent hasn't seen since the partition after independence when Pakistan and India violently separated.
But the astonishing thing and talking to experts in India recently, the astonishing thing that even critics of the Modi regime admit, even critics of his lockdown policy admit, is that very few people starved, if any, that there was malnutrition, there was misery. But in the end, the government and the local authorities and the villages along the way were sufficiently competent, sufficiently capable. And in the case of the villages sufficiently rich to be able to feed people.
So there was not a humanitarian catastrophe. And this has to do with overall higher levels of income. And it also has to do with technologies, which a state like India in a pioneering way has put in place for personal identification, electronic identification, direct delivery of benefits. And the Indian state has a higher degree of capacity by way of electronic accounts to deliver income, of course, small amounts to its citizens than the United States does, or most European states do. And this was the deliberate effort through a leapfrogging, if you like, of the development of various administrative stages of the state to enable Delhi and provincial

government in India, the state at the state level, because India is a federation, to target
benefits at very low income people by means of electronic tagging and biometric identification.
Now, this is problematic in all sorts of ways, data protection and so on. But it does provide
a resilient capacity for the delivery of support that hasn't been there before. And Bangladesh
does far better in typhoons now because it has, you know, world-class typhoon forecasting.
So yes, there is that resilience there. The question that smart folks in India ask themselves is,
is this the platform for a progressive narrative of development from here on in, you know, which,
of course, is the side the boosters take that once you equip people with these kinds of means
of identification and means of payment and so on, you enable a program of, you know, bottom-up
led development. And we've seen some elements of that in East Africa as well, in Tanzania and
Kenya,
where cell phone-based payment systems are much more common than they are in the West.
The question is whether that's the future, which would be a full-blown progressivist kind of reading
of the situation, or whether it could be something rather grimmer, which would be the avoidance of
existential disaster. It would be a kind of adaptation, if you like, to a world of greater
danger, a successful adaptation up to a certain point. But we'd also leave you trapped in a kind
of technopopulist equilibrium, which my friends in India describe as cheap rice and cell phones.
You know, you basically have an endless stream of electronic entertainment on your cell phone.
You know you're not going to starve. But beyond that, neither the national or the personal level
is the much prospect of development in a society with hundreds of millions of poorly educated
young men and women entering the labour market without really the prospect of dramatic economic
growth. So we could be in a kind of warehousing bread and circuses kind of model of stabilisation.
I mean, I think one way of looking at India is that it is precisely the most grand, I mean,
the most dramatic spectacular world historic in scale, you know, project of social stabilisation
first and foremost in the current moment, which may offer growth prospects, but that's yet to
be tested as a proposition. But I want to think about this more on the side of vulnerability,
because this goes to where I was saying earlier, I copped a half of the Hayekian description,
which is, I have this experience, first as somebody who's covered now, I mean, I feel like my whole
life as a journalist is just one crisis after another. And now I look back and I think of the
90s as this very anomalous period, not of no crises. I mean, there are obviously
debt crises in Asian markets and Latin America, but is more relative stability than I have
experienced
in my political adulthood. But nevertheless, I do often have this sense that I read on any given
week about five things that could plausibly become a gigantic international financial,
economic or humanitarian crisis. And most of them don't. And that's not to say none of them do.
I mean, we've lived through 2008. Obviously, the pandemic was and is like a catastrophic scenario,
but that our tools for response do seem somewhat more effective than they have been at other times.
Our ability to blunt things that could, through complexity, overwhelm the whole world also seems
somehow to be matched by an ability to form coalitions. And even with the very, very weak
methods of international governance we have, take on coordinated actions that keep a lot of
things from rising as far as they do. And I'm asking this of you very particularly, because
your work very much focuses on these questions of poly crisis and the ways in which these crises
could build on each other, interconnect to each other and become more than the sum of their parts.
And when I read it, there's such a sense of deep vulnerability. And then I sometimes step back and

I wonder, well, is it actually matched? Is it potentially at this point more than matched, looking historically by somehow the opposite? Like the, I don't want exactly want to call it coordination, but that I wonder if our tools have not become somewhat better than we often appreciate. I do think the system is too complex for people to understand.
And yet by the same token, it seems to mostly be working not morally, not as well as it could be, not the utopia. But as you say, India is a lot better off than it used to be. China is a lot better off than it used to be. We're seeing, we didn't see 2020 become the kind of crisis we worried it would become in financial markets. Is there maybe more room for optimism here than an average reader of the news would assume? I think this is a very valid point. And if you go back to the 20th century reference points, you could say, we've avoided another great depression and we could have had one in 2008 and arguably in 2020 as well. We've avoided another World War One, World War Two style total war. And we've avoided revolution in the catastrophic overwhelming sense of the wave of revolutions after 1917, and notably the Russian revolution, for better or worse, some people would say. We've also avoided outright modern versions of fascism, which have an apocalyptic politics about the do or die, you know, genocidal violence of that type has remained rare. If you know, there hasn't really been a straightforward repetition of that kind of politics, it comes out of, you know, massive economic and dislocation and the logic of total war. So at that level, yes, those nightmares, I think we have to a degree learned to contain more or less effectively, and especially on the macroeconomic side. Yes, I think we've gotten pretty good at avoiding great depressions. That doesn't mean, however, that the risks won't repeatedly arise so that our efforts to contain them becomes larger and larger. And this is, you know, the lesson of 2020, as opposed to 2008, the stuff we had to do in 2020 to contain the fallout from the lockdown shock was not an order of magnitude, but several times larger than what we had to do in 2008. So I think the reasonable question to ask is, you know, are we at a moment at which the culmination and accumulation of a series of challenges, which are not unprecedented
individually, and which we have some track record of managing in the past, whether those could be accumulating in a way that becomes increasingly difficult to cope with. And I think tensions over Taiwan and Ukraine in the last six months should give us serious pause. I think people who study, you know, the logic of nuclear deterrence, which was well established a really formalistic and expert system in the Cold War feel that the current situation with regard to US-China-Russia relations is much, much more precarious. And also, I think we have to reckon with the possibility that the climate crisis, let's use that as a cipher for environmental stress more generally, may be reaching a point, may be reaching a whole series of tipping points indeed, where it poses challenges to us of a type which our societies have never faced, right? Because that relative success in managing crises, which you quite rightly alluded to, the worry is surely that it took place within an environmental envelope not yet so stressed that it became impossible for us to cope. But we have never lived on a planet as stressed as the one currently and as stressed as it will become in the next decades as population, shall we say, crests and global growth continues and the accumulation of CO2 and other greenhouse gases in the atmosphere continues and the attrition of ecotopes and pollution piles up. We simply don't know how that system works. But I think, as it were, that is the question whether or not these coping techniques of the 20th century will continue to work. A, in a genuinely multipolar world in which we have many more empowered regional

actors of which China is just one, but there are a whole series of regional systems which are all nuclear capable push-come-to-shove, which could escalate into global catastrophes because a medium-sized exchange of nuclear weapons we'll have, we should be clear about this, would have devastating impacts environmentally. I mean, at least all our science tells us that. And on top of that then, as it were, this issue of the environment. But stepping even one step further back than that,
let's grant that we do live in a world that's continuously excitable. You know, part of the price we pay for this higher crisis management is continuous crisis awareness. So I wouldn't, I take your point that the news is continuously full of crisis talk and there's a famous historian of political thought, Esthan Haunt, who thought that crisis was, as it were, the idiom in which modernity expresses itself all the way back to the 18th century. But you know, that doesn't mean that in some sense it's not necessary. You know, sometimes the fact that I'm paranoid doesn't mean that they aren't out to get me. In this case, the fact that we are continuously haunted by crisis doesn't mean that some of those risks aren't at this point on a reasonable assessment accumulating to the point at which we should become extremely concerned about our ability to go on winning as often as we are right now. I think that's the wager of our generations.
I think the idea there that there is also a dynamic relationship that the very fact of worrying about things is sometimes what puts us in a position to do enough that the worries and later seem hyped up. It is a very, very important one. I think sometimes that if we ultimately are relatively successful on climate change, we will learn almost exactly the wrong lesson of it, that people will look back and say, oh, the worst did and happened. All those environmentalists were overstating things. But a lot of the reason the worst may not happen if you look at current trends is because enough alarm was put into the system that our technological forces change direction, our policy change direction, our cultures change direction. There is, on some level, like an almost all of the planet effort. It is not the only thing happening, but it is a very real thing happening to change our climatic direction and, on some level, too, it's working. And if it works, I think people will not realize sometimes that it worked. They will instead say, oh, look, the things that people worried about at four and a half degrees didn't happen. And so we don't need to take these kinds of warnings seriously in the future.
But that also brings up a place where I want to look at another historical analogy that we are using quite a lot right now and the way maybe there's another side to it. So in America, the dominant historical analogy of this economic moment is the 70s and 80s. Is the stagflation period, is the Paul Volcker disinflation, where he jacks up interest rates incredibly high, he causes 10% even more unemployment that does do enough to break inflation.
And central bankers, including Jerome Powell, look back on Volcker as the central banker, and Powell has been referencing him quite explicitly. But an overlooked dimension of that era is what Volcker's interest rate increases did to emerging economies. And I want to quote here, the Harvard historian, Jamie Martin, who writes,
in developing countries, the debt crisis had followed the so-called Volcker shock was profoundly traumatic. Across Latin America, it led to a collapse in GDP, rising unemployment, and skyrocketing levels of poverty from which the region made a slow and imperfect recovery over the last decade that followed. Even those who claim Mr. Volcker made the right decision admit that he precipitated what may have been the worst financial disaster the world had ever seen in Latin America, the consequences of which were even worse than those of the Great Depression.

Elsewhere, Volcker himself later said, Africa was not even on my radar screen.
I don't think the Fed right now, somewhat understandably, is thinking too much about its effect on emerging economies. It is obsessed with what its statutory mandate is, which is managing employment and inflation in the American economy. But if there is reason to fear that big interest rate increases could trigger the kinds of crisis that the Fed triggered in the 1970s elsewhere, how do you think they should take that into account? How do they balance their responsibility to the United States and our moral responsibility not to throw the rest of the world into or many countries elsewhere in the world into depression-like conditions?
I think right now on the broader system and the broader concerns of the Fed, I mean, the Fed has a mandate for the American economy. It does not have a mandate as a global hegemon. And you can scratch a Fed person as deep as you like. And all you'll ever see is fundamentally a concern for the stability and health of the US economy. And that's their job. And I don't think that's merely a legal technicality. That's their main concern. When and where the Fed acts globally, it does so because it believes that there is a serious possibility of blowback to the US economy from global events. This goes back to the point I was making about which crises in the emerging and low-income market world will matter to the system and which not. And the Pakistan crisis matters to the State Department, to the NSC, to Pentagon, right? A financial crisis in Pakistan does not matter to the Fed. It does not matter to the Treasury. It does not matter to Wall Street. Even a major financial crisis in India probably doesn't. And when India's Central Banker Rajan, who was at the helm in India in 2013, made this case to Ben Ben Anki against Ben Ben Anki's proposition of tightening American interest rates at the time, which unleashed a so-called taper tantrum. Again, the American Central Bankers shrug. The countries that enter into their calculus are ones which threaten global financial stability. And you can tell the ones which they take seriously in this respect from the degrees of support they'll extend to them. And the critical indicator here is the so-called swap line system. And the swap line network, which extends to Singapore's health career, to Brazil, to Mexico, is there because those are members of the financial system about which the Fed is concerned in a crisis because potentially the scale of a disaster there could have ramifications for systemic players in the American financial system. Those support actions tend to support the stability of the local banking system, notably in Europe, for instance, after 2008, is a side effect, which is welcome, but it's not the ultimate justification for the Fed's actions. And there is here a systemic issue. There is a huge tension between the de facto role of the Fed and its constitutional, indeed, its sociology, its entire purpose. I mean, there is a tension. The overlap is created by the de facto vulnerability of the American financial system. So the more vulnerable the American financial system is to these kind of shocks, the more those other bits of the global system become too big to fail. And to that extent, they become extended and incorporated into the system. Again, to take your point about resilience, though, these networks have spread, right? So the Bank of Japan has a swap line network with a whole bunch of other economies in Asia, which de facto, therefore indirectly become part of the US system. Though the United States was not willing to extend a swap line to Indonesia, for instance, it did create a facility, a standing repo facility, which is a facility where you can essentially trade good assets for cash to take account of China and Indonesia. So there is, as it were, tacitly and in quite a quite a deliberately, I think, low key below the radar kind of way, the construction of a series of networks which give resilience to this system, which helped to bridge the gap somewhat, if you like, between the almost

logical contradiction between a globalized economy running on the national currency of the United States. Let me then bring things to the Fed and what it believes it needs to do here, because we've been talking about vulnerability elsewhere. But particularly if we're going to be talking about the 1970s in Volcker, the question there that seems to dominate thinking is this question of credibility. And when the Fed has credibility and people believe prices are not going to rise, they act as if prices don't rise and so prices don't rise. And when Fed loses credibility, they need not only to change the demand curve in the economy, they need to not only slow the economy down so people aren't buying as much, but they need or they believe they need to do it with
such violence. They also change people's beliefs about the economy. I mean, it's an act of not just economic policy making, but economic psychological intimidation. They're trying to cow people into acting with different beliefs about the future. The view at the Fed, the view of quite a few quite loud economic observers right now, is that they're really dangerous saying is the Fed losing credibility and that they need to act with a lot of force, because if they do, they're going to have to do everything even worse in the future. Say what you will about how bad it is if interest rates go up to 5%, but it'll be even worse if they go up to 10% or 15% as they did under Volcker. How do you understand the task here? How do you understand what it takes for the Fed
to maintain and not just bring inflation under control, but maintain that slightly ineffable quality that seems to be so crucial to economic action of credibility?
Yeah. I mean, I think the idea in and of itself is fairly intuitive. Anyone who's been involved in the difficult business of parenting or received parenting will be aware of threats and sanctions regimes and the credibility of such regimes. There's a big difference between your parents saying, do this or else, and them saying it and doing it in a way which means you know that the punishment will be forthcoming. And once that credibility is established, then they really only have to start counting to three or something, and that by itself will already induce the adjustment in the child's behavior that the parent is looking for. That's the kind of logic that we're talking about here. And with regard to big financial markets, there is a way in which psychology does seem to be the most apt way of talking about it. In a sense, because you're dealing with a relatively small number of actors who are all relatively similar to each other. And so we are really talking about a sort of social psychological phenomenon where mediated by news outlets and news sources, and you can do these sort of quantitative studies of nice sounding, optimistic sounding words and pessimistic sounding words as they ripple through the chatter of the financial markets. At that level, this sort of talk makes sense, it seems to me. And if you're dealing with bond traders, what you want to convince them of is that, you know, if you raise interest rates a little bit, you mean to move them a lot. And so then the markets will adjust in a way which means that you don't need to move
them too much. You can rapidly get caught up in a whole series of really opaque psychological dynamics in doing this, right? Because once you've said you're going to do it and they believe you and then they anticipate you, then you never actually have to do it. And so, you know, is it really a credible threat? And so on and so forth. When it comes to broader society, I think this entire social psychological talk about credibility and confidence and expectations and so on actually is quite misleading. Because when we talk about the willingness and capacity of, you know, market actors, in other words, employers and, well, workers, and maybe in some cases, historically,

their representatives, trade unions, to set wages and prices, when we ask, you know, how credible is the Fed and if the Fed is credible, then people will not raise wages and prices. The question you have to ask is, who sets wages and prices? What empowers them to do so? And what are the uncertainties under which they make those choices? And in the 1970s, you know, it wasn't so much a matter of psychology as so much bargaining power between capital on the one hand and organized labor on the other. And what you were really trying to do was adjust the behavior of distinctly identifiable groups of major trade unions and employers, both in the United States and Europe and in Japan, so as to get buy-in on an adjustment path that would lead to lower inflation. And originally, those conversations took place behind closed doors or sometimes, in fact, in public between the government and the key decision makers in the economy. And it was in a sense when that structure, what was called liberal corporatism, was abandoned in the course of the neoliberal market revolution that we ended up in this world in which the Fed acts on some nebulous thing called
psychology and expectations to establish its credibility. Whereas previously, what it was about was Jimmy Carter trying to negotiate a deal with the AFL-CIO on all the United Auto workers on what they expected and expected as reasonable in terms of a wage adjustment in relation to price changes. And they would literally bargain over whether or not they could anchor a wage increase if and only if the government agreed to fix gas prices in a way which was acceptable to the members of the United Auto workers. This was part of the negotiation over whether or not to liberalize gas prices in the United States. So it's the shredding of that world, the destruction of that world, which really pushes us into this new era of very kind of vague psychologic talk. And that for me is also the fundamental element of implausibility about the extension of the 1970s analogy to the present moment. Because what it ignores is the fact that not the psychological dynamics, sort of human nature, sort of eternal factors like that, but the concrete political institutions, the historically given circumstances under which decisions about pricing are made have fundamentally changed. I mean, we are seeing in the United States wage adjustment in line with
prices. And that's what really freaks the Fed out because that tells you that the inflationary pressure is broadening. But that isn't because of the empowerment of the organized working class in the United States, though, of course, there have been these dramatic breakthroughs in terms of the organization of high profile employees like Starbucks or whatever. But that does not make a wage push. The wage push in the United States has been on an entirely atomistic individual basis driven by the surge out of the labor market of workers during COVID and then back into the labor market. Of course, many people just lost their jobs and had to shuffle back in to new jobs. And that sorting process generates a tumultuous adjustment in wages in the United States, ultimately. In Europe, where we've also had very high levels of inflation hit by recent standards, 10% or so, we're seeing systematic attrition of real wages. The same was true in the United States early on in the inflationary push. And that just shows that even in the Europe where you have higher levels of unionization, there isn't that dynamic push that so-called wage price spiral, which is the real nightmare that lurks behind all of this talk about expectations.
We are, in a sense, shadow boxing here around the actual question of what the political economy of price and wage setting is. And until we engage with that seriously, to my mind, we're really not actually grasping the nature of this inflationary situation, which is quite different from that in its underlying logic from the 1970s. Well, let's end by trying to grapple with that seriously,

but I want to do it less as a philosophical question and more as a policy one.
What would you tell Jerome Powell to do differently than he is currently doing? What is your sense of how the situation has changed since the 70s imply for how he should treat the situation differently than the analogy to the 70s, which is that the interest rate pain will continue until morale declines? How would that advice change? I mean, I like the power of the beginning of 2021 who came flat out and said, you know, we don't think basically that the inflations of my youth will return. It is on record of saying we can bury the 1970s. And he's right. He was right that time round. I think he's been bullied into the sort of hawkishness that he's adopted more recently by the just relentless drumbeat of the inflation hawks, by the fact that inflation has remained relatively high, by the fact that it's spread to a wider range of sectors, that it's now quite deeply entrenched above all in the cost of housing, which is the big driver most recently.
It's spread from energy and supply bottlenecks to a much wider circumference. Broadly speaking, I'm not a critic of the Fed and the way it's handled this situation. I think that the argument that they should have hiked sooner is misplaced. I think they erred on the right side in being slow I don't think we should regard this inflation shock as a disaster. It's a reasonable tradeoff.
That isn't to say that we should downplay the distributional consequences. It's been very tough for the real living standards of certain parts of the American population. And there's a need for policy to adjust to that fiscal policy should be doing that work. I don't actually think that the Fed is wildly off beam here. I think the questions are going forward. How long do they tighten for and what are the costs? And the solution for emerging market in low-income countries is not necessarily for the Fed to stop its movement, but for other agency, notably the international financial institutions, to step in to provide the support that they need. So the questions about the Fed are really how long are they going to continue this tightening cycle for? They've been slow enough to get there. The interest rate increases so far have been large in historic terms because they're doing 75 basis points at a time. But nevertheless, we're still quite a long way away from having positive real interest rates. So this is not a savage tightening cycle in those terms. The question really is whether the current system with the huge levels of leverage we've got in it and the global ramifications can manage that. And if the Fed needs to do interest rate increases, it may not need to do very more because I think the American economy, the steam is rapidly
coming out of the system. And at that point, they should be flexible enough and brave enough to take their foot off the break as soon as possible. But if there are wider problems in the global economy, you need other instruments to deal with that, right? You cannot target multiple problems with one instrument. If you do, you'll end up in horrible trade-off situations. So what we need to do is multiply the means with which we fight this crisis. There could be another issuance of SDRs or there could be a more generous policy in reallocating the synthetic currency that was created within the balance sheets of the IMF. That's what SDRs are to face the crisis. We should ensure that the World Bank and the IMF can move rapidly to address country crises. The United States and other Western states should be proactive in pushing for debt restructuring options at this point. So that would be the range of policies that I would advocate that they should be moving also towards cooperation with other central banks and should do so publicly. It's not that they're going to make a major adjustment to American interest rate policy, but they need to signal that the central banks of the world are cognizant of the blowback, the interaction between the policies that they're adopting on a national basis. Because otherwise, we really are going to be

dealing with the first truly global inflationary shock of the new era of globalization since the 1990s on a nation by nation basis. And that, I think, is behind the curve of what the current moment demands. What is your explanation then for why the month-on-month and now year-on-year inflation data has been so defiant to the projections of those, including me, I should say, who felt, you know, this is different than the 70s. It's localized. The way the inflation has kept spreading, spreading out of localized sectors into a general dynamic, the way you're beginning to see wage adjustment, the way it has been persistent in the face of the stimulus running out of the economy, the way it has been persistent in the face of the economy sort of coming out of the pandemic, the way it just keeps going beyond what I think people who are a little bit more dovish said was the cause and ending up kind of somewhere else or somewhere more broad. You know, I think there is something where Powell would say, hey, look, my rhetoric certainly has changed because the facts changed. You still seem a little bit more bullish on the view that this would wring out of the system, that we're looking at an adjustment, not a problem of expectations. But I think you also would have expected it to end earlier. So what if anything has the sort of ongoing persistence of the inflation done to your model of the situation? Well, I think the situation is more complicated and dangerous than I thought. I mean, particularly thinking about the European side, the persistence of the energy price shock, you know, linked to Pugin's war is, you know, it was a huge aggregation of the problem. You could say the same about global food markets, which were also shocked earlier in the year. Then I think it's very interesting to see the recovery dynamics in the US that notably the labor market recovery dynamics. So the fact that there was such a wave of unemployment that people made redundant and lost their jobs during COVID did shift labor market dynamics in a way which I don't think we quite anticipated. Why? Because as people got back into work individually, they had a degree of bargaining power and were more choosy about the sort of jobs that they went back into for good reason and furthermore demanded adjustment in relation to prices and got it largely from employers who thought they could probably afford to pay those wages. And so that's why we've seen those adjustments. I think the element of this, which is probably most troubling, is the housing sector. And I don't think there's much reason to doubt that in quite a number of the major real estate markets of the United States, there were some pretty serious structural issues, which mean that they are sensitive to, you know, price pushes like this. I'm thinking notably of the, you know, the discrepancy between the coast and the other parts of the United States where we don't see the same level of escalation in real estate and rental prices, which is now one of the key elements driving this. So as that real estate boom, I think grinds to a halt and goes into reverse, I still expect the transitory hypothesis to be confirmed. Of course, at this point, you could say, well, this has been, I mean, this is a semantic argument, but in any case, I expect a downturn in the real estate market to become quite a big driver of a slowdown over, you know, the course of the rest of this year and into next year, by which point I think many people expect the US housing market to be going into a quite serious recessionary phase. I mean, it would be astonishing if that were not the case given how rapidly mortgage rates have moved up to 6%. So this is a huge shock to the cost of buying houses. That too may be something that ripples around the world to Canada or Australia where there's very, very overheated real estate markets. So I think that's the, you know, the broad logic is there was the energy and commodity price shock that was then a widening of that to labor and to the service sector. And now the inflation is to a considerable extent in the real estate sector. And I expect that to ebb away in the next

six to 12 months so that by next year, most forecasts still see inflation coming down very dramatically, which again is a reason why on the whole, I don't think that we are going to see anything even remotely like Volcker style, you know, interest rate shocks that we know what Powell and his colleagues are doing aren't going to add up to that. But there's a way in which they need to, you know, summon the ghosts, the spirit of Volcker to refight the 1970s, apart from nothing else to demonstrate that they're serious. I mean, amongst central bankers and in finance want finance
Twitter world, invoking those kind of analogies are what you do when you want to signal purpose.
I mean, in the speech that Volcker gave at Jackson Hole, the gathering of central bankers and economists this summer, that the whole speech was an exercise in kind of retro chic, if you like, a kind of invocation of the stylistics of the 1970s and 80s, just to kind of reassure everyone that they were now wide awake had smelled the coffee and were ready to do what was necessary.
In practice, I don't think they're going to have to do anything even remotely as dramatic as what Volcker did, because the underlying dynamics are different, right, because you do not have that sociology of distributional struggle working its way through the American system and expressing itself in prices and wages in the way that it did, you know, 40 years ago.
I think that is a good place to end. So always our final question. What are three books that have been on your mind of late that you'd recommend to the audience? So I've been reading the Elena Ferranti Neapolitan Quartet series, which are stunning. Another book that I read recently that rocked my world was Edward Pace's But Youth Quake, Why African Demography Should Matter to the World.
And then I read it and reviewed it quite critically. I think if you want to follow the conversation right now on global economic history, you should check out Brad DeLong's Slouching Towards Utopia, which came out recently and has been very widely reviewed and make up your own mind. Adam Tooze, thank you very much. Great pleasure to be here.
The Ezra Clancho is produced by Andy Galvin, Jeff Geld and Margea Karma.
Fact-checking by Michelle Harris, Roland Hue, Mary-Marge Loughra and Kate Sinclair.
Original music by Isaac Jones, mixing by Jeff Geld, audience strategy by Shannon Busta.
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