



Shades of Green

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Green can be a moral color, a political color, or an economic color. Join William Blair’s Hugo Scott-Gall for a conversation with Adam Tooze, history professor at Columbia University and author of “Crashed: How a Decade of Financial Crises Changed the World,” for a multidisciplinary discussion of how the decade is shaping up from an economic historian’s perspective—including climate change, inequality, geopolitics, and fragile financial markets.

Adam’s comments are edited excerpts from our podcast, which you can listen to in full below.

https://media.blubrry.com/the_active_share/b/content.blubrry.com/the_active_share/The_Active_Share_Adam_Tooze_E

Because you’re very good at pattern recognition and multidisciplinary thinking, I want to ask how you think the decade is shaping up through the lens of geopolitics, economics, and the financial system. But let’s start with politics. What are the big political problems?

Adam: Entrenched problems of inequality have reached a crisis point in the United States, and we’ve seen something similar in Europe regarding the immediate social impact of the coronavirus crisis. The climate problem is one for humanity as a whole. Solving migration is going to be a huge chore of the 21st century.

And a fourth problem is democracies being increasingly overshadowed by the geo-authoritarian regime in China. That’s a problem we thought we’d passed. We’d won the Cold War; we could move on. And that is not where we are.

Let's start with the first problem you mentioned. If we were having this discussion in 2030, would you say inequality was on its way to being solved?

Adam: You're asking a historian to read a crystal ball. But I'd be surprised if there were any fundamental shift in the underlying distribution of wealth. That's very rarely happened, and the wealth taxes that have been discussed are nowhere near large enough to offset the gigantic disparities in wealth between the fraction of the 1% that owns the bulk of assets and the rest of the population.

But what has happened in successful welfare states as a result of deliberate policy (as opposed to a catastrophe like a world war or hyperinflation) is shifts in income distribution. Affluent societies could tackle the problem of, say, child poverty, in a sustained way, not in the form that we're doing it in the United States right now, which is hurling a few thousand dollars at people for a couple of months.

But it depends very much on the nature of the political parties in charge.

What does your crystal ball say about climate change?

Adam: On the climate issue, it's make or break. We've created this somewhat artificial deadline of 2030, and to achieve the kind of reductions we've been talking about by then, we need to see change by the end of this year.

I don't expect us to hit those deadlines. But I do expect the pressure of urgent action to continue. And then we will need radical action.

Whether we have a constructive blueprint for that is unclear. Even the Biden administration, which is very willing to push, is still trying to figure out its key strategies.

As a historian, have you ever seen the world come together to fix something like this? My guess is there's not a lot from history to make one optimistic.

Adam: No, there isn't. We haven't seen a challenge like this before. But one thing that inspires optimism is that global climate politics is a bandwagon. It has gathered momentum, and I think we're at a critical turning point, with the double commitment by the European Union and China. My personal hope is at some point technology takes over, because then it becomes very unpolitical.

We're also seeing a huge shift in capital. There is growing awareness among large capital allocators that this is a strategic issue. That, I think, is the best hope at this point.

Green can be a moral color, a political color, or an economic color. Do you think that democracies can find inner strength from rallying around the cause of solving climate change? Is there redemption via this common purpose?

Adam: Senior European Union (EU) figures would say that climate is the salvation of European politics. I'm not sure that works quite yet in the United States, because of the polarization of the culture wars. But even in the post-Brexit United Kingdom, the Tories are making a fist of a rather dramatic green energy policy.

You talked about a cold war between China and the United States. Is that how you see the world? And do you think the extent of that is underestimated?

Adam: As a historian, I'm tempted to say that we were always kidding ourselves. When we built collaborative relationships with Beijing, we overlooked the fact that we were doing it with a regime that in 1989 sent a very clear signal that what was happening in the Soviet Union would not happen in China, even if that meant the violent repression of a large part of its population. That was an uncomfortable reality we chose to ignore.

So, we had a cold war. Then we had a cold peace. And now, in a sense, we're heading back in the cold war direction. Microchips are a red line China simply can't accept.

Do we choose *détente*, warts and all? Because *détente* was always a warts-and-all policy. You have to reckon with the fact that your counterpart has a very different conception of human rights, of law, of politics. Nevertheless, you collaborate on key issues of mutual interest, particularly those that concern the survival of humanity. In other words, the nuclear threat was so real we had to look past other things.

Alternately, do you head down the route the Trump administration was taking, for better or worse?

I don't see the haste I expected from the Biden administration to reevaluate some of the choices that were made. From Beijing's point of view, that means the status quo, which is a kind of economic warfare. The most fundamental aspiration of China's regime is the restoration of Chinese sovereignty and assertion of China as one of, if not the, great powers of the world.

Your answer is very much about resources versus ideology. Once China and the United States have access to the resources they feel they need to continue their economic growth, does the cold war stop escalating?

Adam: I'm pessimistic on that score because I don't think the United States is arguing over microchips. America is the incumbent superpower, and it faces a historic decision as to when and how and on what terms it cedes space to China. That's not something that is addressed by this issue of resource access.

What does this period—with one superpower and another rising power—feel like? Thucydides, Germany, turn of the 20th century? Or something else?

Adam: As a historian that's a question you see coming a couple of thousand years away. One response I have is, "Let's put this in proportion."

Sparta, Athens, Imperial Germany, the British Empire—I think China is in a different league. With 1.4 billion people, China is a huge slice of humanity that has achieved middle-income status. And this implies fundamental shifts in the balance of power.

Beijing has to decide how to play this, but the difficult questions are all for the incumbents. Everyone you talk to about this issue knows the Thucydides trap—the risk that an incumbent power will strike at a rising power before it becomes too powerful. Xi Jinping is even willing to say it out loud. We're making a wager on our collective intelligence in our ability to steer away from the inevitability of that clash.

When you have something like a cold war, innovation has historically been a healthy byproduct. Are we on the cusp on something great?

Adam: I think there are reasons for optimism on that score. The vaccine race in 2020 was an extraordinary demonstration.

Four percent of total science output in 2020 was devoted to COVID. That's a staggering amount of brainpower devoted to a single question. There is huge potential there, enormous capacity for innovation within the science system.

There's no reason to think that that isn't possible. We haven't tried. We spend less in the United States right now, faced with a climate crisis, than we do on pet food. I want more molecular biologists funded through the education system. I want more med techs. I want more nurses. We should be lavishing money on these careers.

You wrote a weighty book called *Crashed*, which is a forensic analysis of the pipes of the financial system. How do you look at the financial system today? It's difficult to find a global asset price that isn't close to an all-time high, which is unusual. When that happens, there's usually an increase in leverage, and that increase in leverage leads to something bad happening.

Adam: I agree with that diagnosis. But 2020 revealed that banks aren't the concern they were in 2008 or 2009. On the other hand, we had a profound market failure in the most important market of all—the \$20 trillion U.S. Treasury market.

The key actors were fund managers that needed liquidity and dumped U.S. Treasuries—the market where you're always supposed to find a price close to what you paid. So, hugely liquid markets suddenly turned illiquid.

That was a massively alarming symptom of instability—in some ways, worse than what we saw in 2008. When the panic was on in the banking sector, people ran to Treasuries. This time, it wasn't clear that Treasuries were a safe last resort for liquidity. And that suggests that there are still some pretty serious plumbing issues in the system. The Treasury market should not experience those kinds of dysfunctions.

Your argument, I think, is that the fragility rises almost in tandem with asset prices. Does that mean you see the system becoming more and more fragile?

Adam: It does. I think the question is, where would we start tweaking? We need to look at market structure, at the incentives of the key actors involved.

Big banks will say their regulations should be lifted, which increases their balance-sheet capacity. I'm skeptical about that argument as long as we have a repo-based system in place, which is running into multiple trillions of dollars of liquidity that in the end all comes back to the central bank.

If we don't want that to be the case, we need to think about much tighter regulation on the entire nonbanking area of global finance that repeatedly squeezes liquidity, or credit, out of the system. But you would want to carefully pick your moment in the business cycle to do that. And that's not where we are right now. We're in taps-full-open mode.

Let's talk about the threat of inflation. But it's not always seen as a threat. Quite a few commentators actually say, "What we need is a nice burst of inflation." Do you ever get nice bursts of inflation? Doesn't inflation usually end badly?

Adam: Well, usually, but our track record with inflation is a small data set. What I think people mean when they say that—and I would definitely be in that camp—is that if we could have inflation tick up to 3%, trending toward 4%, and the Fed has to pull back hard on the levers, this would be a success.

In fact, that's what the Fed's adjusted policy is trying to bring about. It wants to achieve an average inflation rate of 2%. To hit that target, the Fed needs to go toward 3% or slightly higher. And it does that confident that it has the levers to address it.

Milton Friedman was right. Inflation is always a monetary phenomenon, but not all monetary phenomena are inflationary. You can blow the money supply up and not get inflation, as we've seen since 2008. To actually turn it into inflation, you need real economy bottlenecks of some kind.

We are going to see some bottlenecks this year because we're disentangling a world economy that was just gunged up last year. It's going to be a variety of different things, like lumber in the United States.

But what we don't have are the flywheels of inflation that we had in the 1970s, tight labor markets in the West. And labor markets, even when they are tight, do not have organized labor, a workforce with bargaining power that can rapidly drive up the nominal wage.

If that remains the case—and there's no reason to think it will change—the mechanics of inflation control look relatively straightforward. So yes, I think a little bit of inflation would be a great thing.

I understand you are currently working on a book. Will it define the age we're in?

Adam: It's called *Shutdown*, and it's out in September. It's about the shock of smart people struggling to make sense of the world and finding themselves blindsided, confronted with realities they didn't anticipate, then scrambling to make up solutions.

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