60 MINUTES WITH PROFESSOR JOSEPH STIGLITZ

A discussion with economist Joseph Stiglitz, winner of the Nobel Prize for Economics and public policy analyst and professor at Columbia University and Christophe Donay, Chief Strategist, Head of Asset Allocation & Macro Research, PWM

We live in an increasingly complex world, in the midst of a fantastic innovation wave that has many consequences across multiple dimensions. These impacts go beyond technology, reverberating through the economy via disinflation and magnifying society's inequalities that have ultimately paved the way for the rise of populism around the world.

PART I: DEFINING AND CHARACTERISING THE CURRENT ECONOMIC REGIME

CD: Innovation is one of the most appropriate lenses to use in discussing increased inequality and the potential for future inflation. In this context, how would you define the current economic environment and what role do you think innovation plays in it?

JS: Innovation is very much alive and the current pandemic underscores this in a hugely tangible way. If covid had arrived 20 or 40 years ago, we would not have been able to so swiftly identify and develop a means of testing, nor develop a vaccine – let alone multiple vaccines – at such a rapid speed. In this way, we have been protected by innovation. Global GDP would have plummeted far worse and for longer without these biology innovations.

Climate change is another major issue we face today. But I feel confident that innovation will provide us with the means of combating climate change and allow us to achieve net carbon neutrality by 2050. The cost of renewables has plummeted to a degree that no one anticipated, and this will allow us to leave the fossil-fuel-based economy behind, all because of innovation. By its very nature, we cannot anticipate what direction innovation will take or where it will show up and how it will help us in one way or another. But we can envisage a brighter future – from health to climate change.

CD: Do you think the current covid crisis is changing the innovation dynamics at work (slowing, speeding, altering the direction)?

JS: I think the pandemic is stimulating innovation and having some effect on the direction of it. One of the big insights that the pandemic shed light on is how important science is. If it hadn't been for science, where would we be today? Science will deliver us from this pandemic and is the reason why we have such a high standard of living compared to 200 years ago, before the Industrial Revolution.

The pandemic is impacting the direction of innovation. Afterall, robots don't have to socially distance and are not susceptible to covid. This has provided an enormous impetus for robotics and AI (artificial intelligence), the drive behind which was already huge before. This has serious implications for society because robots and AI are particularly good at replacing routine work. This disproportionately affects unskilled workers and feeds into one of the other crises we face - inequality, which feeds into the political. The pandemic will stimulate innovation that helps the more skilled and hurts the unskilled. We are already seeing this in the K-shaped economic recovery taking place in the US and many other advanced economies around the world.

CD: Innovation means higher economic growth in real terms. However, we are in an innovation wave that has not created economic growth, which is subdued in Europe and to some extent in the US, compared to historical standards.

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JS: This is exactly the same question asked at the beginning of the computer era, when Robort Solow, a great economist of the 20th century, said you see innovation everywhere except in GDP statistics. Back then it actually did come through in GDP a few years later. It took a long time for the innovation of computers to get translated more broadly into GDP growth, but it eventually did. Likewise, some of the innovation we are in the midst of today will show up later, but some is of a different nature and may not. Rather, it may show up in how well off people feel. For instance, social media makes people feel more connected, but also makes some feel more anxious, potentially creates shorter attention spans and can be used to incite, like we saw in the January 6th insurrection in the US and with other hate crimes. These are negative aspects of innovation. Innovation is something new; it can be positive but it can also be negative. And when it is negative, the regulatory and legal frameworks must adapt to ensure that these innovations will actually serve the wellbeing of society.

CD: We have been in a disinflationary environment since the 1980s. Can we expect innovation to be a driver that determines the direction of inflation one way or the other in the near future?

JS: Innovation reduces costs: it lowers the cost of production and is generally disinflationary. On the other hand, we are now experiencing very strong fiscal support from governments in response to the pandemic. In the US, these packages altogether total nearly 25% of GDP and some people are worried that this, on top of the Federal Reserve's USD 3tn expansion of its balance sheet, will be inflationary.
I understand those concerns.

My view is that the risks of doing too much are overshadowed by the risks of doing too little. Doing too little risks long-term effects: when a company goes bankrupt due to weak demand, it does not go un-bankrupt when demand returns. A weak economy erodes the balance sheets of firms, households and even public bodies. So when evaluating the risks of doing too little versus too much, it is very clear to me that a strong response is what is necessary now.

But when balancing risks, we must also ask what if the response is too much? If this turns out to be the case, we have tools at our disposal: we can raise interest rates. I think it would be good to move to a higher rate environment. Since 2008, ultra low rates at 0 or 1% have distorted capital markets. The cost of capital should be greater than zero because it is a scarce resource and in economics, scarce resources should never be priced at zero. If the price of risk is too low, it is distortive. The other tool is to raise taxes, which are also abnormally low. We can raise wealth, windfall and environmental taxes. The bottom line is that if the fiscal response does prove to be overdone, we have a set of tools at our disposal to mitigate the inflation effects.

CD: How do you raise interest rates without crashing the stock markets and creating financial instability?

JS: Central banks are closely monitoring what is happening within the economy. Today they have access not only to the official data but also data in real time – from the internet – which provides a much more fine-tuned assessment of what is going on in the economy. They get daily data on credit card sales, for example. Today we can monitor economic dynamics on a daily basis and that is something we could not have done five or 10 years ago. Central banks will change rates very gradually as a result, and markets know this. So I am not worried that there will be a market crash. An adjustment is nearly inevitable, but interest rate changes will likely be done in a smooth way.

PART II: THE INTERNATIONAL LANDSCAPE: THE RISE OF ASIA AND GLOBAL RISKS

CD: Broadening our scope , let us look at China; we cannot discuss innovation without China. The US has been the global tech leader since WW2, but now China is presenting itself as a serious challenger, especially in AI and robotics. How do you see the trade war and innovation confrontation between the US and China?

JS: Most economists see the world as positive sum, rather than a zero-sum game. If another country grows more, it can buy more of our goods, and we can all expand and grow together. But there are areas of concern. Obviously one wants a level playing field. Difficult issues arise because differences in economic systems imply greater difficulty in agreeing to common rules that work fairly for both systems. One area – AI – illustrates this point. Data is a huge input into AI and in Europe, you have a great respect for privacy compared to China. This gives China a huge competitive advantage in data.

The pandemic and climate change remind us that we have to cooperate on a range of global issues. This will be the big challenge going forward. How do we devise an international rule of law that both allows us to uphold our values and provides a framework for cooperating in areas essential for doing so.

CD: Cooperation is also needed to manage risks. Debt is rising in Europe, the US and China, with the debt-to-GDP ratio standing at roughly 300% everywhere today and continuing to drift upward. Is this sustainable?

JS: Because of such low interest rates, today's outstanding debt is broadly manageable. Indeed, so long as the growth rate exceeds interest rates, the debt should be sustainable. But the critical issue is risk. It may be that inflation and interest rates will rise in future; I'm not worried, but it could happen.

Governments should change the maturity structure of their debt to longer term, 20-year issuance. If interest rates start to rise, the budget will only slowly be affected as those bonds come through. While they may have to pay a price for insurance, it is worth it to manage the volatility of the overall budget. In my view, the debt is sustainable, but must be managed and the risk in particular must be managed.

CD: What about the role of central banks? Will we see a monetary policy regime change to something like Modern Monetary Theory (MMT)?

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JS: Despite the massive monetary expansion following the 2008 crisis, inflation did not transpire. This is because much of that expansion stayed within the banks; they didn't lend it on so it did not end up in the pockets of businesses and households. It did not increase aggregate demand.

One of the outcomes is that the balance sheets of those at the top are doing very well; at the bottom they are terrible. This raises the question of whether inflationary pressure down the line is possible. It is possible, but I'm not worried. MMT nearly denies this possibility, given there are underutilised resources in the economy. The real unemployment rate in the US is likely over 10% and strong aggregate demand would draw a lot of these workers back into the labour force. We don't yet know the limits and it is good for economists to push against these limits. But we must be ready to raise interest rates once these limits are reached, and I think this would be a good thing.

PART III: THE UBIQUITY OF CONCENTRATION AND ITS AFTERMATH

CD: Today there is a ubiquity of concentration, from profit growth and margin contribution to technology and inequalities. Does innovation play a key role in the rise of inequality?

JS: Yes; it is not the only driving factor but it plays a key role. We have witnessed the growth of wealth at the very top, among the tech giants. It relates to why we have seen the rise of enormous fortunes without very large increases in GDP. Innovation hasn't provided the impetus for GDP that one would have hoped, nor has it helped the tax base to the same degree, due to big tech's aptitude for tax avoidance. Throughout our discussion, I have made reference to the positive and negative types of innovation and one of the latter includes that around avoiding taxes. The big tech players have also been extremely innovative at extending their market power and exploitation, which is of course a real concern. This comes back to the matter of rules and the enforcement of rules. Europe has historically done this better than the US, but there are many antitrust actions now underway in the US.

CD: Coming back to climate change, how can innovation play a key role in combating this issue and how should it be done – through monetary or fiscal policy?

JS: Climate change is an existential issue for all of us and we must use every tool at our disposal in addressing it – including both monetary and fiscal. Central banks the world over are worried about stranded assets and climate risks. Regulatory bodies and central banks are moving very quickly to require disclosure of carbon risk. These are all critical to the transition away from fossil-fuel assets.

We have already discovered more fossil fuels than we can possibly use if we achieve carbon neutrality by 2050 or even 2060. That means there will be a lot of stranded assets – assets priced positive today that will go to close to zero in the next 30 years. Bearing in mind the mortgage price readjustment crisis – we know that markets can sometimes adjust prices suddenly, rather than smoothly over time, leading to sudden price collapses. This could lead to a systemic crisis greater in magnitude than in 2008. So it is essential that institutions like the central banks review the systemic carbon risks.

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There is critical impetus for financial institutions and nonfinancial enterprises to move away from fossil fuels and this is a key accompaniment to the investments that the fiscal authorities must make and governments must provide in pricing carbon and setting regulation.

CD: We cannot omit cryptocurrencies in a discussion on innovation in a financial context. Do you consider them a part of the innovation wave and are they an unavoidable future replacement of sovereign money?

JS: I again return to the concept of good and bad innovation. I have worked over many years in a range of capacities to make the financial system more transparent and ensure that everyone pays their fair share of taxes. Why do we need cryptocurrencies? They are secret. We have a very stable currency in the US dollar. We can conduct transactions with it and there has been extensive innovation in mediums of exchange using platforms to execute transactions efficiently. In India, this can be done at nearly zero cost. We’ve had a lot of good innovation. But crypto seeks to undermine all of these efforts over the last quarter century in order to circumscribe regulation. The only reason it hasn’t yet been shut down is it remains small. If it grows, I think national governments around the world will respond and will respond forcefully. Furthermore, we are all concerned about energy intensity – mining crypto-currency uses more energy than Argentina. That’s an enormous social cost for negative social value.●

YOUR QUESTIONS TO PROFESSOR STIGLITZ ANSWERED

1. Prof Stiglitz made the point about how the rise of robotics will widen the gap between skilled and unskilled workers. Do you think there are policies being implemented in the US to help educate individuals and incentivise them to become skilled workers?

JS: Unfortunately, not so far. The education system is mostly run by local school boards, and in the very places where this upskilling is most needed, there are limited resources and sometimes even a limited commitment to upskilling. Under the Trump administration, there was even an attempt to downgrade the importance of college education. Hopefully, this will change.

2. What is the biggest risk to the current economic recovery (except for COVID), and to the current bull markets in your opinion?

JS: The biggest risk to the recovery (besides a mutation of COVID 19) is that Europe doesn’t do enough to reignite its economy and the world doesn’t do enough to help the afflicted emerging markets and developing countries that don’t have enough resources on their own.

The bull market could be brought down by higher interest rates (a real possibility if we get a strong recovery) and by stronger competition policies that might curb the high profits of the technology giants that have played such a large role in the bull market.

3. Do you perceive a risk of loss of confidence in the current financial system and its potential collapse as a result?

JS: No, I don’t. There are many problems, but I think that these will be addressed gradually over time.

4. What is your opinion about the dilemma of advancing exponential innovation and the difference between countries, which can create a very large social problem?

JS: I am very worried that the convergence between the rich countries and the rest that we have seen in the last fifty years will be reversed. This will increase political tensions, but also set off waves of migration.

5. Technology changes and innovation have always in the past brought Technocracy at the forefront, to the detriment of politics. Will the Technocratic society be the role model for this century and humanity for the foreseeable future?

JS: We've seen a wave of anti-elite, anti-science, anti-technocratic political movements in the last decade meeting with considerable success in a large number of countries, including the US. Unless the technocrats can show that they can "deliver" for a larger swath of society, and can somehow bridge the gap that separates them from the less educated, these movements are likely to continue to have some success, threatening both economic and social progress.

6. I understand the use of sanctions as just another competitive tool, but surely it's only when one power has the upper hand that it can bully the other into playing by its rules. In a 'free market' situation isn't it natural and OK that both (all) countries will use all the resources they have to promote their advantage and from that perspective the demarcation between government or corporate assets is irrelevant?

JS: As you remark, defining what a level playing field means is difficult, especially in a context where different countries have different economic systems. Europe has tried to do so by prohibiting various forms of state aid, but of course governments have research and education programmes that help their economies—and can even help particular sectors within the economy. There have been massive bailouts of banks, which also affect the private sector, which would have had problems getting access to credit without these bailouts. Globally, massive agriculture subsidies have grossly distorted that market. Still, firms in one country rightly feel that it is fundamentally unfair to have to compete against firms in another country receiving massive subsidies. Unless we have some rules curtailing at least the worst abuses, it will be hard to garner support for an open economy.

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