Some lateral thinking on post-pandemic economics

ECONOMIC SYSTEMS WERE CONVERGING

Pity it stopped…

By Bart Le Blanc

- *So, no surprise: the new IMF update expects economies to continue to struggle under the COVID pandemic. This slows consumption and investment, while inflation and supply disruptions knock recovery hopes off course.*
- *There are many opposing ideological views on how to run an economy. It is therefore remarkable that countries all over the world followed similar policy paths to tackle the social and economic devastation caused by the pandemic.*
- *The Atlantic Council has recently published an important study (Pathfinder: China, September 2021) which concludes that - although differences remain - China's 'socialist market' system has moved closer to the principles of open market economics (the 'Washington Consensus').*
- *Would the pandemic have further narrowed the gap between the economics of the major world powers??*
  That would be good news for post-pandemic economics and could bring huge benefits for all!
- *Unfortunately, the answer seems to be NO…*
  Western politicians and media have blamed China for the lack of progress. And YES, Chinese market reforms may have stalled somewhat. But the ***main culprits are the Western economies****, which have been retreating from their own free market beliefs.*
- *The consequences are not pretty: a darkening outlook of slower growth, higher inflation, higher interest rates for households and businesses, greater inequalities, new trade disputes, plenty of old and new geo-political tensions, and thus more volatility in (financial) markets. Not good news for people, businesses, governments, and investors (including your personal pension funds!).*
- *But maybe I worry too much…*
  Maybe Western economies will rediscover their beliefs in free trade.
  Maybe China will speed up opening its economy.
  And maybe there will be agreement that benchmarking economic progress must go beyond the 'Washington Consensus' and needs to include key objectives on social fairness and common prosperity as in China's economic system beliefs.
  That would be great news: Convergence 2.1

1. 'Rising Caseloads, a Disruptive Recovery and Higher Inflation'

It had been on the cards. Continuing COVID-19 uncertainty is still migrating around the world creating havoc in public health systems and threating economies and societies. The consequences are well captured in the title of IMFs recent World Economic Outlook Update (see above).

The two biggest economies of the world are struggling: the US particularly under rampant energy prices, higher than expected inflation and supply disruptions, and systemic sectoral crises (real estate, finance) and lagging private consumption in China.
The IMF key data table below illustrates how this affects global economic growth with a cautionary note that it could be worse if vaccination rates would not improve worldwide, and restrictions continue to hinder the long hoped for economic recovery.

Table 1. Overview of the *World Economic Outlook* Projections
(Percent change, unless noted otherwise)

	Year over Year						Q4 over Q4 2/		
		Estimate	Projections		Difference from October 2021 WEO Projections 1/		Estimate	Projections	
	2020	2021	2022	2023	2022	2023	2021	2022	2023
World Output	**–3.1**	**5.9**	**4.4**	**3.8**	**–0.5**	**0.2**	**4.2**	**3.9**	**3.4**
Advanced Economies	**–4.5**	**5.0**	**3.9**	**2.6**	**–0.6**	**0.4**	**4.4**	**3.5**	**1.8**
United States	–3.4	5.6	4.0	2.6	–1.2	0.4	5.3	3.5	2.0
Euro Area	–6.4	5.2	3.9	2.5	–0.4	0.5	4.8	3.2	1.8
Germany	–4.6	2.7	3.8	2.5	–0.8	0.9	1.9	4.2	1.6
France	–8.0	6.7	3.5	1.8	–0.4	0.0	5.0	1.9	1.7
Italy	–8.9	6.2	3.8	2.2	–0.4	0.6	6.2	2.5	1.7
Spain	–10.8	4.9	5.8	3.8	–0.6	1.2	4.9	5.0	2.5
Japan	–4.5	1.6	3.3	1.8	0.1	0.4	0.4	3.6	1.1
United Kingdom	–9.4	7.2	4.7	2.3	–0.3	0.4	6.3	3.8	0.5
Canada	–5.2	4.7	4.1	2.8	–0.8	0.2	3.5	3.9	1.9
Other Advanced Economies 3/	–1.9	4.7	3.6	2.9	–0.1	0.0	3.8	3.4	2.5
Emerging Market and Developing Economies	**–2.0**	**6.5**	**4.8**	**4.7**	**–0.3**	**0.1**	**4.0**	**4.3**	**4.8**
Emerging and Developing Asia	–0.9	7.2	5.9	5.8	–0.4	0.1	3.7	5.4	5.7
China	2.3	8.1	4.8	5.2	–0.8	–0.1	3.5	5.1	5.0
India 4/	–7.3	9.0	9.0	7.1	0.5	0.5	4.3	5.8	7.5
ASEAN-5 5/	–3.4	3.1	5.6	6.0	–0.2	0.0	3.5	5.6	5.9
Emerging and Developing Europe	–1.8	6.5	3.5	2.9	–0.1	0.0	5.8	2.2	3.0
Russia	–2.7	4.5	2.8	2.1	–0.1	0.1	4.2	2.1	1.8
Latin America and the Caribbean	–6.9	6.8	2.4	2.6	–0.6	0.1	3.7	1.8	2.6
Brazil	–3.9	4.7	0.3	1.6	–1.2	–0.4	0.6	1.5	1.4
Mexico	–8.2	5.3	2.8	2.7	–1.2	0.5	2.9	3.4	1.9
Middle East and Central Asia	–2.8	4.2	4.3	3.6	0.2	–0.2	. . .	. . .	. . .
Saudi Arabia	–4.1	2.9	4.8	2.8	0.0	0.0	5.2	5.3	2.8
Sub-Saharan Africa	–1.7	4.0	3.7	4.0	–0.1	–0.1	. . .	. . .	. . .
Nigeria	–1.8	3.0	2.7	2.7	0.0	0.1	2.4	2.1	2.3
South Africa	–6.4	4.6	1.9	1.4	–0.3	0.0	1.3	2.6	0.9
Memorandum									
World Growth Based on Market Exchange Rates	–3.5	5.6	4.2	3.4	–0.5	0.3	4.2	3.9	2.8
European Union	–5.9	5.2	4.0	2.8	–0.4	0.5	4.9	3.5	1.9
Middle East and North Africa	–3.2	4.1	4.4	3.4	0.3	–0.1	. . .	. . .	. . .
Emerging Market and Middle-Income Economies	–2.2	6.8	4.8	4.6	–0.3	0.0	4.0	4.3	4.8
Low-Income Developing Countries	0.1	3.1	5.3	5.5	0.0	0.0	. . .	. . .	. . .

As to be expected, the unequal access to vaccination, test and treatments penalises the emerging and low-income countries more. This will lead to further indebtedness of poorer nations whilst the international financial markets, already struggling with inflation control through monetary tightening, may not be very accommodating.

In this context it is worthwhile reading the recent article by IMF's Ruchir Agarwal and Gita Gopinath titled "*Pandemic Economics"* (see *IMF Finance and Development, December 2021*).
They argue that the slow vaccination roll-out in the emerging markets and developing countries is resulting in a growing gap of economic prospects between rich and poor countries. This in turn will create major roadblocks for a balanced global recovery: '*There is no durable end to the economic crisis without an end to the health crisis'* and thus the authors conclude: '*Pandemic Policy is Economic Policy'.*

In addition, the IMF WEO Update highlights other global risks which "… *may crystallize as geopolitical tensions remain high, and the ongoing climate emergency means that the probability of major natural disasters remains elevated."*

There are thus major issues to address beyond national politics.
Has the experience of the pandemic made us all wiser, more open, and compassionate…?

2. The BIG question: Has the pandemic changed economics as we knew it?

The pandemic changed the way we live, work, educate, travel.
It has made governments/central banks intervene in daily life on an unprecedented scale both on national and coordinated international level.
It is fair to assume that as a result, certain traditional economic relationships between consumers, businesses, governments, and environment have changed for good.
So, the answer to the above question must be YES!

In today's context, a first interesting observation is that - regardless the significant ideological differences between the major global powers - all countries have followed similar policy paths in fighting the COVID 19 pandemic. For example, there was remarkedly little policy divergence between countries adhering to liberal markets economies or the more dirigiste (centrally) planned economies.
The fabulously insightful OECD COVID policy tracker illustrates the US pandemic policy responses were in essence much like China's COVID policies.
All over the world we have seen policies testing very basic and widely accepted personal freedoms through lockdowns, and work from home regulations.

We have witnessed massive programmes for income support through furlough schemes and social welfare extensions (some even with untested distribution methods for example in the form of 'helicopter money').
We have experienced across the world central banks supporting financial markets and continuing to keep the cost of borrowing down.
And finally, as a life changer, we have noticed that climate change and energy transition has become a core policy for all nations whether they are big or small, rich or poor, liberal or dirigiste.

The BIG question is therefore: has the pandemic accelerated the convergence towards a globally shared understanding of the benefits of market economics?
And could such new post-pandemic economics support the recovery, create huge benefits for stable global growth?
The answer to these questions is of more importance than just to satisfy this commentator's curiosity.
They could provide a new perspective for policy makers and central bankers, for company executives and investors (including those who manage your pension fund!).

3. On the catwalk: Economic models and Ideologies

Political economics have always been rooted in ideology; one's beliefs shape the way of how to solve a problem.
Let's start at the beginning.

The current Nr.1 the US, is a long time advanced developed and rich country.
Its strong runner-up is China, a country which is a middle-income country and still in its economic development phase. Logically this means different economic horizon and the paths toward it.
But there is more. The US and China have a very different view on the basic philosophic issues of community and socio- economics.
They commence their economic journeys from sometimes opposite ideological viewpoints.

It is easier to have a casual conversation about such a big topic as many will more or less understand your point.

But the moment that you start trying to write it down in a not too fragmented and predisposed way, you will find yourself hesitating about the use of words and expressions. So, any short-hand description of current dominant economic models easily becomes a caricature.
However, let's still try to capture the different economic systems in a sketchy summary fashion.

The American free markets model: the 'Washington Consensus'
Trying to capture the quintessence of the American economic model is like endeavouring to summarise the key messages in the Bible.
In the Western world, everyone has grown up with the stories of the virtues (and sins) of free markets economics. The Hollywood film industry has ensured that we have been able to vividly picture them (from Orson Welles' '*Citizen Kane*' of 1941 to the more recent *'Wolf of Wall Street'* of Martin Scorsese).

Trailing through my old economic textbooks and after consulting a few of my American economist friends, I came up with the following oversimplified characteristics for the American free market economic model (apologies for the '*cartoonisation'* of such important economics phenomenon):

- It is rooted in Judaeo-Christian values of personal and individual responsibility and shared societal goals including protecting the poorest/weakest
- A dynamic private sector delivers economic growth and securing prosperity for citizens
- It values free enterprise which is based on entrepreneurship, risk-taking and innovation
- Freedom of choice and consumer sovereignty are vital elements
- It demands free trade through free, open, and competitive markets (incl. labour and capital markets)
- Enforceable property rights are indispensable
- Governments need to be rule setter but non-interventionist and support people, enterprise, and markets.
- In brief, the model is conceptually the example of *demand side economics*.

This model formed the living doctrine for much of the post-World War II Western economic policies and assumed to be the basis for economic success.

'*America's brand of capitalism - the version that has been in pace for the past half-century or so – has delivered unmatched economic growth and prosperity. GDP per capita has more than doubled over the past 50 years, while personal consumption expenditure has almost tripled, and there have been significant improvements in longevity and leisure.' (McKinsey: 'Rethinking the future of capitalism in America' November 12, 2021).*

It is no surprise that for many decades since their inception, these guiding principles have been used by the Washington based IMF and World Bank as the basis for economic reform agenda for crisis-hit countries. This so called '*Washington Consensus'* includes policy recommendations in the areas of trade liberalisation, deregulation of markets and promotion of foreign direct investment, privatisation of state-owned enterprises, secure property rights, fiscal policy discipline and tax reform.
This recipe was used for all countries regardless their development stage or political ideological context.
Understandably such standardised policy stance has not been without criticism.

China's socialist markets economic model
In my search to understand the quintessence the China economic model, I have tried to ignore the many studies from Western academics, and focussed my research on more authentic Chinese inside-out views.

My friend and UN colleague *Nan Li Collins* has provided invaluable advice and helped me finding my way through several studies from Chinese economists on the key issues of the China economic model as well as understanding the (political) thinking behind some of the new development paradigms.
With her help I have gained a better appreciation of the meaning of some (longwinded) texts in the current Five-Year Economic Plan called (its official title: *The 14th Five-Year Plan for National Economic and Social Development of the People's Republic of China and Outline of the Vision for 2035*").
I have enjoyed the further additional guidance from a number of insightful publications by *Justin Yifu Lin* (*dean of Institute of New Structural Economics and the National School of Development, Peking University, and former chief economist at the World Bank).*

In a similar vein as before, please accept my sincere apologies for my simple sketchy summary of key elements of the complex world of an economic model officially labelled *"Socialist Markets Economic Model":*

- It is based on Socialist (historically Confucian?) values of social fairness, harmony, and justice aimed at the common prosperity of all people
- The centralized and unified leadership of the Chinese Communist Party Central Committee is charged with the pursuit of this mission
- It balances central planning and state-ownership of key sector enterprises with controlled market forces and private sector business and finance
- The Party/Government coordinates with companies and markets to direct production growth and development of people
- It promotes economic *'circulation'* delivering output growth supported by green and innovation-driven investment allocations
- In a new development paradigm called '*Dual Circulation',* the former emphasis on international markets is now re-balanced to include enhanced focus on domestic consumption for the emerging Chinese middle classes.
- In summary, the model is predominantly driven by *supply side economics*.

Different ideologies, different economies?
The fact that the US *and* China have reached the top of the world GDP ladder does not mean that they follow comparable economic models. As said the difference in economic development and in ideological foundation have resulted in very different economic systems.

One glance at a set of key data proves that this leads to very different outcomes. China and the US show differences in international trade and external balance (see persistent US negative trade balance versus positive Chinese current account), different in sectoral structure (services versus manufacturing), different levels of state involvement in the economy, different capital markets, etc.
The gap in development level is also clear: GDP per Capita in China is currently less than half of the US level.
However, with a workforce that is five times bigger than the US and the commitment to further economic growth, China is expected to overtake the US as Nr 1 in GDP very soon … you see numbers count!

Table 1. Selected key economic indicators of the US and Chinese economies

	UNITED STATES	***CHINA***
Population	*331million*	*1,440million*
Labour Force	*157million*	*783million*
GDP (2021) ***GDP per Capita (2020)***	*$21 trillion* *$63,416*	*$15 trillion* *$ 17,192*
Current Account Balance (% of GDP 2021)	*-3.5%*	*+1.5%*
Agriculture-Manufacturing-Services ***(Sector contribution in % GDP 2021)***	*6%-15%-79%*	*7%-36%-57%*
Stock Market Capitalisation (2021 in $)	*$53 trillion*	*$13 trillion*
State Owned/Controlled Enterprises in top 100 (2020) ***GDP contribution SOEs (% of GDP 2021)***	*0%* *N.A.*	*77%* *30%*

What can we learn from this by looking behind the numbers?
Is it all ideologically determined? Or is the difference in economic development stage the important factor?
Could these economic models evolve and become more alike? And are the differences more transitional and temporary than structural?
Let's explore this a little further.

4. Converging economic models??

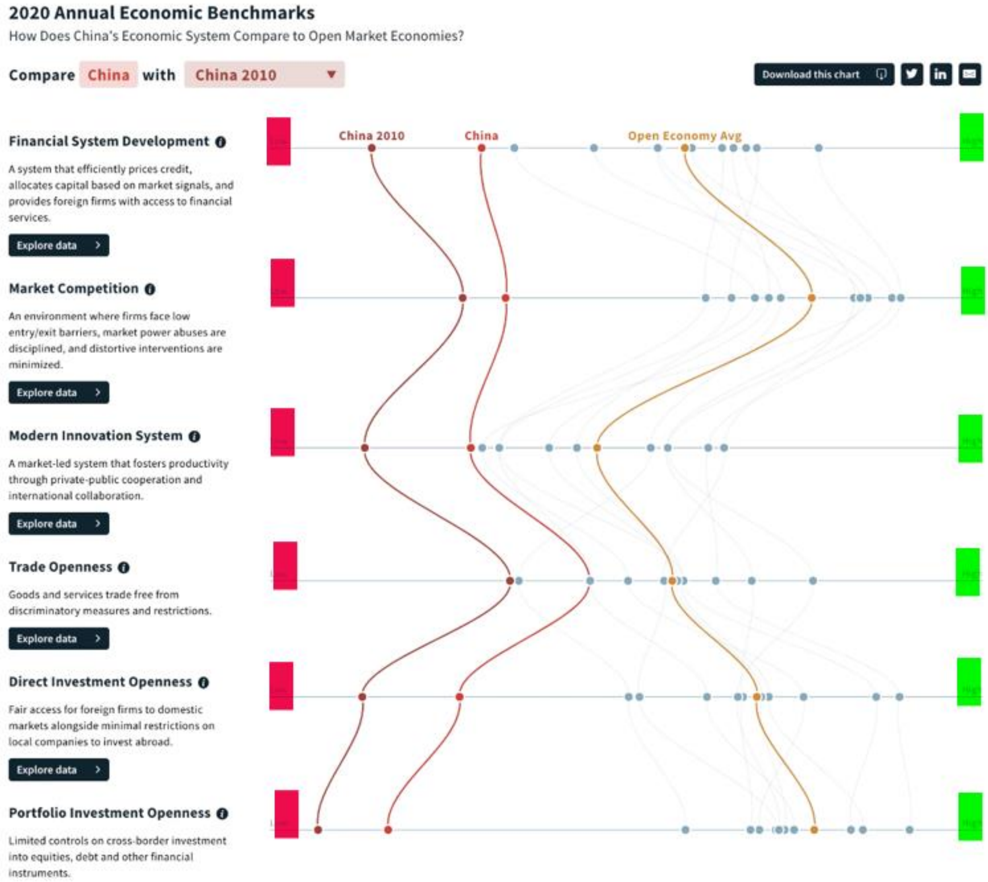
The evolution of different economic models has been a topic of scrupulous analysis by political economists for many decades. This is particularly the case for the Chinese economic model, fuelled by its economic success over many decades and now reaching the top of the world's economic powers.
China's economic system has undergone a remarkable journey over the last decades from a dogmatic communist command economy under Mao Zedong (CCP leader from 1949 to 1976) to the introduction of market economic reforms under Mao's successor Deng Xiaoping (CCP leader from 1978 to 1989). Deng was well known for his on-dogmatic trial-and-error approach of introducing market principles in the Chinese socialist system.

In the last decade, the emergence of China as a global economic powerhouse meant active participation in global trade. This has forced China to transform its manufacturing and trading practices and to comply with the generally accepted processes and procedures set by the World Trade Organisation (WTO). They require every trading nation to live by the rules of free and fair competition, trade without discrimination and barriers, predictable and transparent terms and tariffs and encouraging development. This has over many years proved to be a source of international dispute and tension.

In recent years however under President Xi Jinping, some slowdown of economic reform has been observed, which is sometimes interpreted as less market orientation and more state-interventionist.
In a recent publication the Atlantic Council presented a major international study on the ascendence of China as a top economic power: ***China Pathfinder*** *(Atlantic Council, September 2021).*

The *Pathfinder* report analyses China's economic model and provides a fact-based assessment of the Chines model benchmarked against the key characteristics of free market economies (very much based on the 'Washington Consensus').
The Atlantic Council Board states: "*By stripping some of the politics out of the debate over economic systems, we hope to maximize the room for cooperation … on matters of shared concern".*
A laudable intention but are they really stripping out politics once the comparator benchmarks are exclusively taken from the Western market economics??

The first annual report was presented in the Autumn of 2021 with annual updates promised. It is an important piece of work and is highly recommended for (critical) review.
The conclusions of this first annual benchmarking exercise are very enlightening.
Across six cluster areas ranging from Market Competition to Portfolio Investments, the Atlantic Council's team has mapped out the progress China has been making over the last decade and compared this with the current state of play of an average free market economy in the West.
A graphical illustration of their findings is copied below.



Source: Atlantic Council, China Pathfinder: 2021 Annual Scorecard, September 2021

As the graph shows, over the period 2010-2020 China has made significant progress towards identified high level of market economy benchmarks, (the right-hand side of the graph).
In some areas the gap remains important (*for example for nr.2 market competition and nr.6 investment openness*).

5. Impact of the pandemic: acceleration of system convergence?

The COVID 19 pandemic has forced governments all over the world to re-assess the role of government and the social economic policy focus.
It was remarkable to see that the gist of the policy approach across the globe was very similar. Hardly any ideological difference has been detected.
The expectation was that some of the lessons learnt from the pandemic would have a lasting impact on the future of economic policy making and thus on the future shape of the dominant economic systems.
Digesting the above major shifts in policy emphasis, one could imagine that the trend towards converging (market) economics would continue and bring the different economic ideologies closer together.

What sort of economic benefits would such greater system convergence potentially bring? Using the Pathfinder six benchmarks (see above) a number of potentially beneficiary effects could be identified:

- Financial system convergence would remove obstacles and improve market terms for international investment finance, and enhance accessibility for borrowers from all sectors and countries
- More market competition could provide effective ways to control inflation and satisfy consumer demand across the world
- Innovation would enhance productivity and the quality of people's work
- Trade openness would provide access to new markets and products and help the developing world
- Direct investment openness would support international trade and support growth
- Portfolio Investment openness would support international financial markets and access to these markets by business and investors

In general, convergence towards more market-oriented economics could allow for a balanced post-pandemic recovery with more growth, less cyclicality (no more boom-and-bust), reduce inequalities, focus on green recovery and innovation, etc.
In short, growing policy convergence could lead the way to a better future.

But has the pandemic accelerated this process of system convergence?
My answer is: *Unfortunately, at this moment NO …*

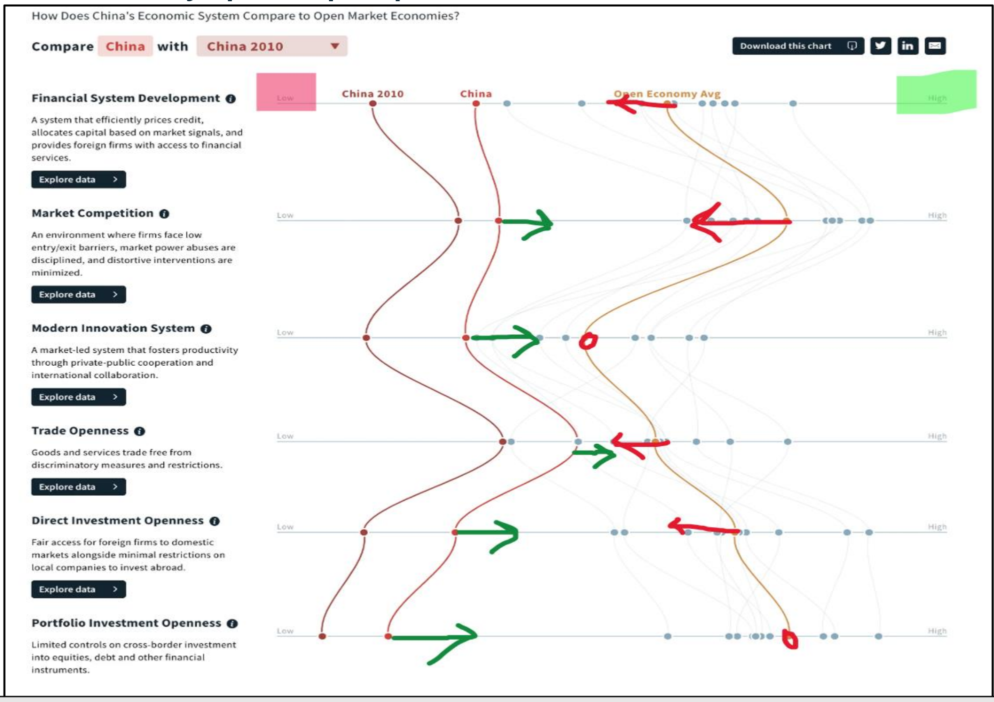
During the pandemic and recent post-pandemic years (from late 2019 to early 2022) we have detected, particularly on the Western Atlantic front, a certain retreat in areas which were previously regarded as sacred for free market economists.
For example: Trade was always core to the West's economic model.
However, in recent times we have seen the West (US and allies) retreating from its forward liberalisation stance in important areas, including and most worrisome the traditional free trade approach (remember Trump's mantra: *"America First"?).*
Under President Biden a slightly less aggressive policy tone towards China has been heard, but the current US policy stance remains defensive and far from an open to trade-attitude in the spirit of its free market model.

We have also experienced many agitated reactions on recent international supply chain problems. When the Western economies emerged after stuttering reopenings following multiple lockdowns, a new wave of critical voices emerged regarding unlimited free international trade.

Economic and political commentators were quick to advocate the break-up of previously established international supply chains and repatriation of manufacturing even accepting lesser quality and higher costs….
As if!

In the schedule below I have tried to identify some of the recent movements on key economic benchmarks since the 2020 assessment of the Atlantic Council's Pathfinder analysis.

My updated post-pandemic Pathfinder assessment



NB Please keep in mind that moving to the righthand side is progress towards market economics. The green arrows indicate a move in the right direction, the red arrows signify retreat.

This picture is not very uplifting!
It does not need a lot of economic analysis to detect some of a wrong direction of travel in some areas in recent years.
In my view, several of the pandemic experiences have not been in the right direction. The Chinese policy reform has stalled on key issues; only in a few areas minor progress has been achieved.

However, the BIG disappointment during pandemic years, the impact of Western backtracking from its own beliefs has been very tangible particularly in areas such as trade openness and market competition. This has had a devastating impact on the policy gap, away from the previously growing convergence towards common identified goals of high market economics (right hand scale of the graph).
The net overall impact on the world economy is at best mixed but tends to be negative, regardless Western politicians and media continuing to point accusing fingers at China.
In addition, the never-questioning attitude to the use of the open market economy benchmarks is also surprising given the decade long policy debate around the "Washington Consensus' in the IMF and World Bank circles.

In an attempt to give an academic twist to the current US defensive attitude towards China, the US Secretary of the Treasury, *Janet Yellen* (a former economics professor and Fed Chair) gave a lecture at the January World Economic Forum redefining the traditional typology of the US free market and demand driven economic model and rebranding the Biden economic agenda as *'the new supply side economics'.*
"*Rather than tax cuts and deregulation* [*from Reagan's supply side economics textbook] this new supply side economics seeks to increase labour supply and improve infrastructure, education and research to boost potential US growth and ease inflationary pressures." (WEF, 21 January 2022)*
Interesting enough as Yellen's speech on the new US innovation and green infrastructure investment push, uses vocabulary that much resembles wording in the China Five-Year Economic Plan.

Maybe the next Atlantic Council's Pathfinder report needs to introduce a more balanced set of benchmarks, one that is not exclusively focussed on the Western interpretation of "Open Market Economies" (see definition Atlantic Council in its Pathfinder study and much in line with the so called 'Washington Consensus').
In the spirit of the new Yellen approach (see above) some of the Chinese economic principles may need to find their way into a broader mix of benchmarks for example on the social fairness, harmony and common prosperity front and a pro-active government stance on innovation and green infrastructure investment.

6. *And thus: Outlook not very nice … UNLESS*

My hypothesis of increased policy convergence and its benefits was probably too much wishful thinking.
Under the pandemic we have seen life-changing impacts of policy choices across the globe unfortunately not all of them beneficial for a better economic outlook.
Let me try to summarise a few:

- The pandemic has questioned the value of integrated supply chains*: new 'safer' but more fragmented supply processes may increase security of supplies but will lead to cost inflation and we have seen new potential trade hurdles emerging.*
- Work from Home for large groups have been extensively tried and tested: *increased productivity has probably been delivered, but the impact was uneven and biased towards better paid, higher educated, service sector workers while for all social interaction has significantly declined (attention point: mental health) and maybe innovation as well.*
- New patterns of work/life balance and internet shopping have become the 'new normal': *inner-city retail economies have been severely hit and as well as the commercial real estate sector (except logistics property). The restructuring/transition will demand significant investments and government support (sometimes with a protectionist whiff).*
- Climate change is integral part of any post-pandemic recovery plan: *the transition process to green energy in all aspects of life will demand huge investments and pro-active government policies. Active government intervention is to be expected.*
- In general, a more pro-active role of government has emerged with a bigger policy function in areas of health, education, infrastructure, energy, and welfare: *the funding of bigger government will be partly through increased debt (for the well rated) as well as higher (green) taxes. Weaker governments particularly in the developing world will struggle to rise to these challenges*
- New inequalities have emerged on a global level as locally: *some governments have used the pandemic public debt increases as an alibi to reduce development aid and assistance (e.g. the United Kingdom)* and the lack of international cooperation in the area of vaccine roll out is shameful *(see earlier referenced article by Agarwal and Gopinath, December 2021). Without a new international cooperation effort, inequality will further rise.*

This could all bring a sombre message for the outlook: slower growth, higher inflation, higher interest rate expenses for households and businesses, greater inequalities, new trade disputes, plenty of old and new geo-political tensions, and thus more volatility in (financial) markets.
That is bad news for businesses, investors and many households who worry about the future.

But maybe I worry too much…
Maybe the decades long convergence trend will re-start.
The Western economies might rediscover their longstanding beliefs in free trade and open borders.
And maybe China will commit to more openness, transparency, and market reform.

And benchmarking of economic 'progress' should not be exclusively done based on the 'Washington Consensus" (or the Atlantic Council's definition of 'best market economy').
Let me stick my neck out: the development of the new post-pandemic economics needs to incorporate some of the social economic principles of the Chinese model such as the values of the public good (already somewhat re-found in the west under the pandemic) and renewed appreciation of the issues of social fairness and common prosperity.
Convergence 2.1.

Bart Le Blanc, February 2022.