Keynote Address (July 2020)

Pandemic Crisis: Bump in the Road or Threat of Great Collapse?

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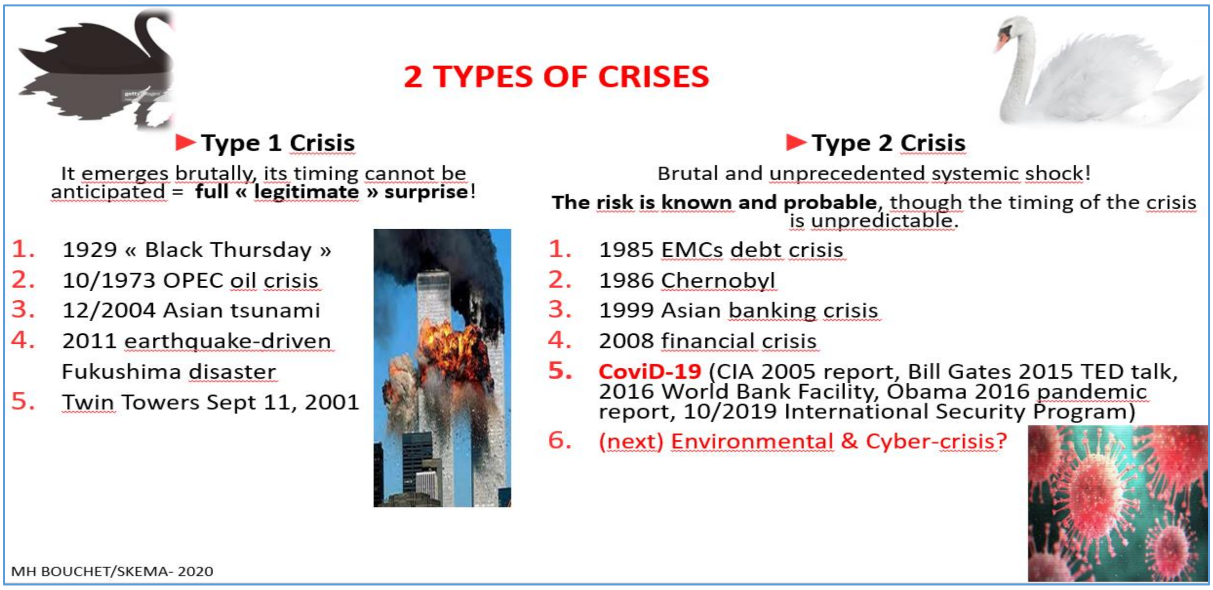
Very challenging to try to make sense of the current pandemic and its impact on what I call a risk of Great Collapse. Making sense does not mean in 15 minutes giving you a blueprint for re-designing a more equal and sustainable socio-economic system. It's hard enough to predict the present. So, why should we be so adventurous to look at the future? Well, it's our job in a business school to stick our neck out and to look beyond the headlines. In the academic world, the name of the game is preparing students and young professionals to navigate through radical uncertainty and to be agile and mobile. To be ahead of the game. My own challenge is to focus on global risk management to give you keys to understanding that uncertainty can be tackled by transforming information into economic intelligence. Today, I propose two modest objectives: let's try to see where the global economy came from when the crisis hit in early 2020, but also what might be the ramifications of the global shock, in the aftermath of the pandemic.

1. **So let's look first beyond the headlines. Where are we now?** Make no mistake**: this time, this crisis is different. A North-Korean missile or the blockade of the Straits of Ormuz c**ould have triggered the long-expected crisis, but a global virus ended up causing it. The overall socio-economic impact is already much greater than the 2008 financial crisis, with truly global reach on both developed and developing countries. Today, the pandemic is widely seen as the outpost of an unprecedented structural shock that will unfold for years. This shock knows no boundaries! Globalization, a sort of echo chamber, makes that there is no place to hide!

Look at the numbers. The IMF now forecasts global income no longer to grow 3% but to fall 3 % in 2020. Global trade might drop 15 to 20%. Negative per capita income growth this year might bring back nominal GDP to 2015 levels, the worst reading on record for African countries! The pandemic will politicize travel and migration. Self-reliance will become a strategic objective. Geopolitical instability will worsen. And let's look also behind the numbers: stories of people without jobs, factories closed, planes grounded, central banks acting as firefighters, radical uncertainty mounting…. The world has been transformed by the COVID-19 crisis. It's a game changer.

Just a few months ago, the pandemic has caught everyone off guard, like a missile. The VIX index, the so-called volatility or fear index, shot up abruptly in mid-March 2020.

A brutal surprise. However, we just emerge from a decade-long myopia of analysts, managers and governments who ignored repeated warnings. The wakeup call is brutal, but look: in fact, there are two types of crises.

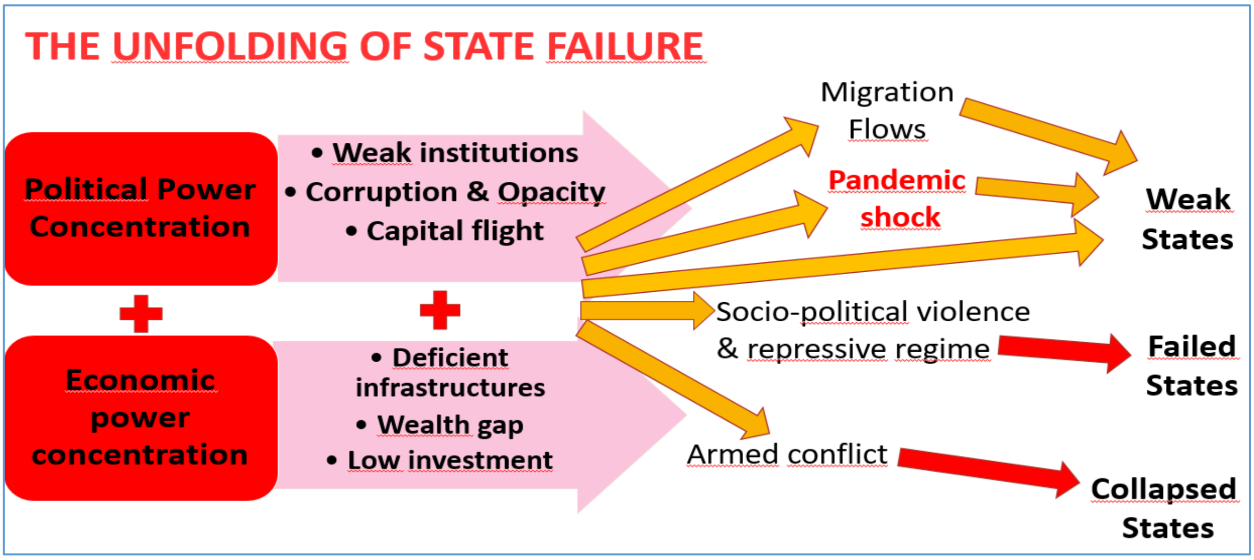


A so-called black swan is a brutal shock whose timing is unpredictable. Think of the twin towers in NY. But this is not the case of the covid-19, that belongs to a second category of crises, brutal, unprecedented, but with a number of warning shots as early as 2005 or Bill Gates' 2015 TED talk or the World Bank 2016 Pandemic Facility. It was predictable though the timing could not be anticipated**.**

2. **Now, we need to understand what happened**: Why is this crisis different? Is the covid-19 accelerating a systemic shock? You know, chemical precipitation is the change in form of materials dissolved in water into solid particles. **Well, the question is: could the covid-19 crisis create a « precipitation » of accumulated institutional and structural weaknesses to trigger a systemic shock, a sort of dreadful crystallization, in a nutshell a Great Collapse?** And this is not only a threat for poor, developing countries. The crisis has revealed deeply-rooted fragilities in many developed countries, you know the 37 members of the OECD. So, we probably need to **redefine our understanding of what a weak or even a failed state means**, because these developed countries have "failed" somewhere. **And that will help us pinpointing which of the weakest countries are prone to fail in the next couple of years.** We need definitions, we need indicators, but we surely need to shelve comfortable categories, such as developed/emerging, industrialized/developing, or North/South… As I will suggest, we better focus on institutional strength and the quality of governance. This is the cornerstone of resilience!

Let's see how to best describe a "weak state"?

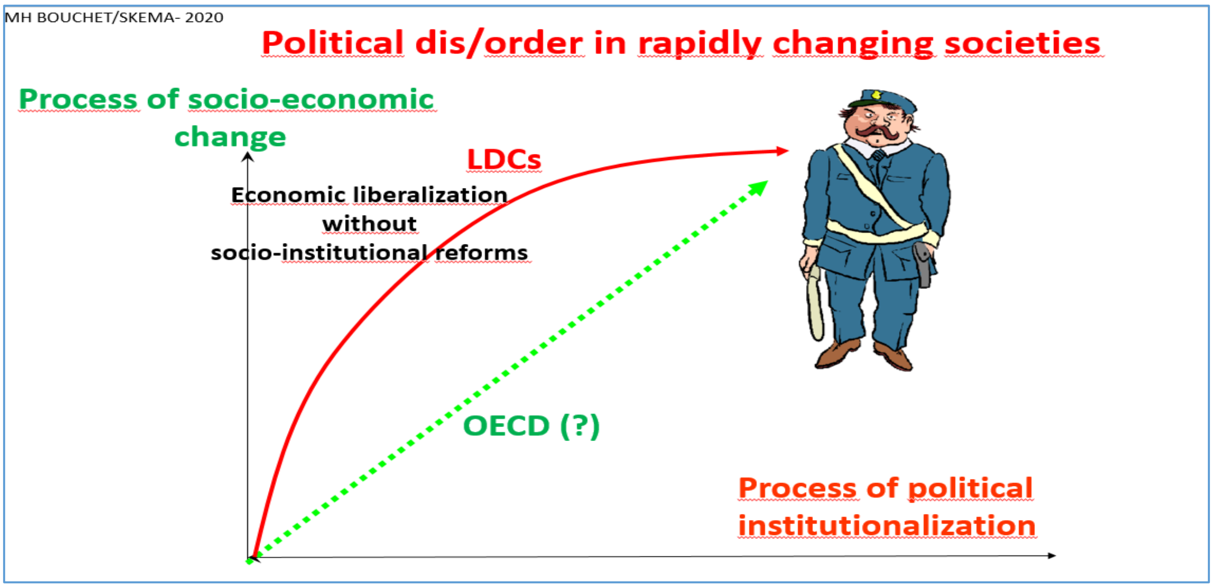
A state is expected to deliver common goods necessary to sustain social cohesion in the process of socio-economic development. For instance security, social welfare, healthcare, political stability, education, and so on. Well, a "weak state » is unable or unwilling to provide these public goods due to institutional flaws. But these common goods are precisely crucial to transform economic growth into equal development opportunities.



One of the root causes of state failure is a two-fold economic and political power concentration. Then wealth gaps and low human capital will worsen the social situation. Weak states are unable to manage an efficient state bureaucracy, nor to respond effectively to challenges and crises, including sanitary!. Then growing social tensions will result from the flawed policy response to internal or external shocks. Finally, think about what happens where institutions like political parties, associations, unions, are not allowed to do their job of channeling the citizens' demands? Well, they go the streets and violence will start!

Three or four thinktanks develop composite indices which use a large number of parameters to provide you with groups of weak and failed states. There are all struggling with a toxic brew of corruption, low public trust, and repressive regimes. The most obvious examples are Syria, Libya, Venezuela, Zimbabwe, Congo, Sudan, Angola, Gabon, Equatorial Guinea… and many others.

But an index, whatever the quality of the underlying research, does no tell you why states fail? Well, modernization is a bumpy road! And as societies modernize, they become more complex, and much of the social tensions stem from faster economic change than political reforms. Think of China, Turkey, Morocco, Brazil! Perfect equilibrium would produce smooth and inclusive change, with socio-political stability. Not even Norway or Switzerland! So, if the process of socio-economic modernization is not matched by flexible institutions capable of managing the stress of change—the result is turbulences!

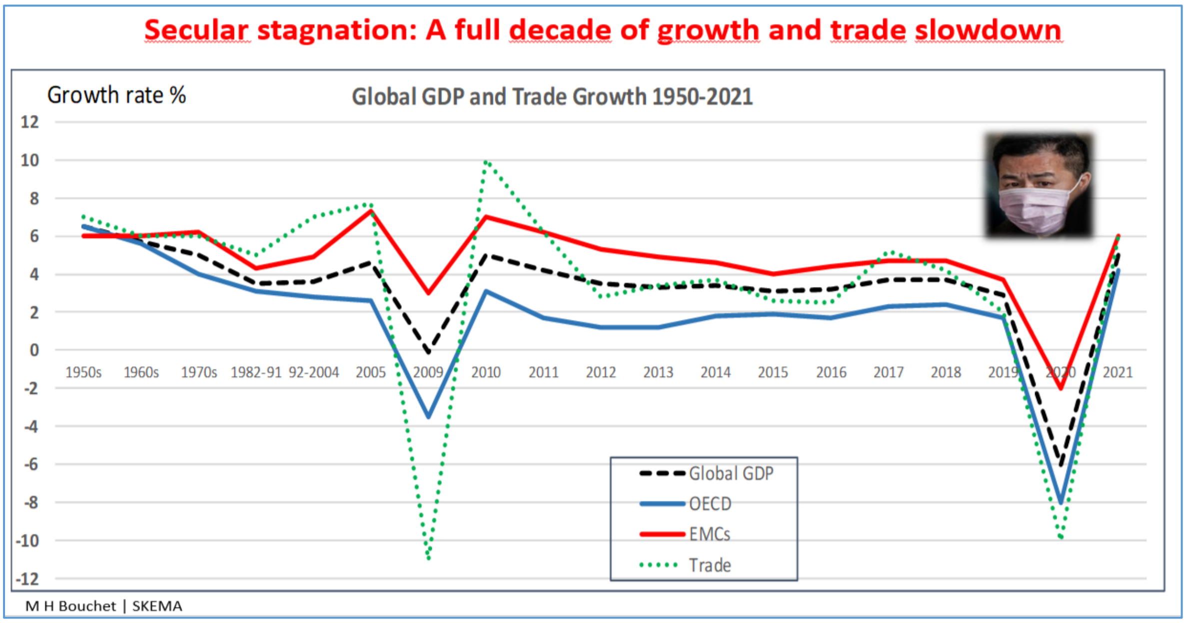


Institutional weaknesses generate **a crisis of social mediations**: parties, unions, local elites lose credibility and trust for addressing social frustration and demands, hence rising tensions. And once again, upheaval is not the monopoly of poor developing countries. Think of the yellow vests in France, regional fragmentation in Spain, repression in Turkey and in Hong Kong, riots in Algeria, red shirts in Thailand, anti-establishment parties in Italy and Greece, hunger protests in Chile and all over Latin America…

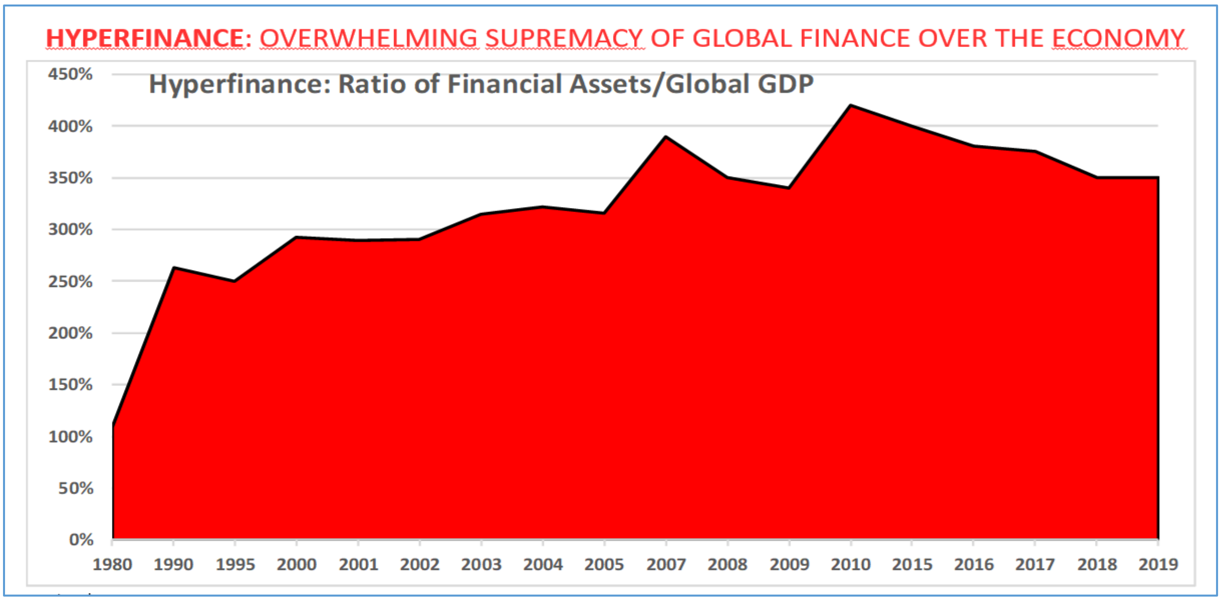
So the question is: How could the covid-19 destabilize social systems that seemed apparently robust the night before? How would accumulated weaknesses in each country **create a spill-over effect?** A brutal systemic crisis always involves catalysis: An incremental aggravation in one fragility (economic, financial, sanitary, environmental, or socio-political) can trigger a chain-reaction process that precipitates multiple breaks and failures, hence destabilizing an entire social system. This is due to snowballed fragilities from the last 50 years or so: each of them, independently, cannot capsize a country. But these fragilities can crystalize, and they can precipitate a Great Collapse.

From my standpoint, there are three drivers that today can precipitate a structural crisis in weak states: **Declining growth, large wealth gaps, and bad governance.**

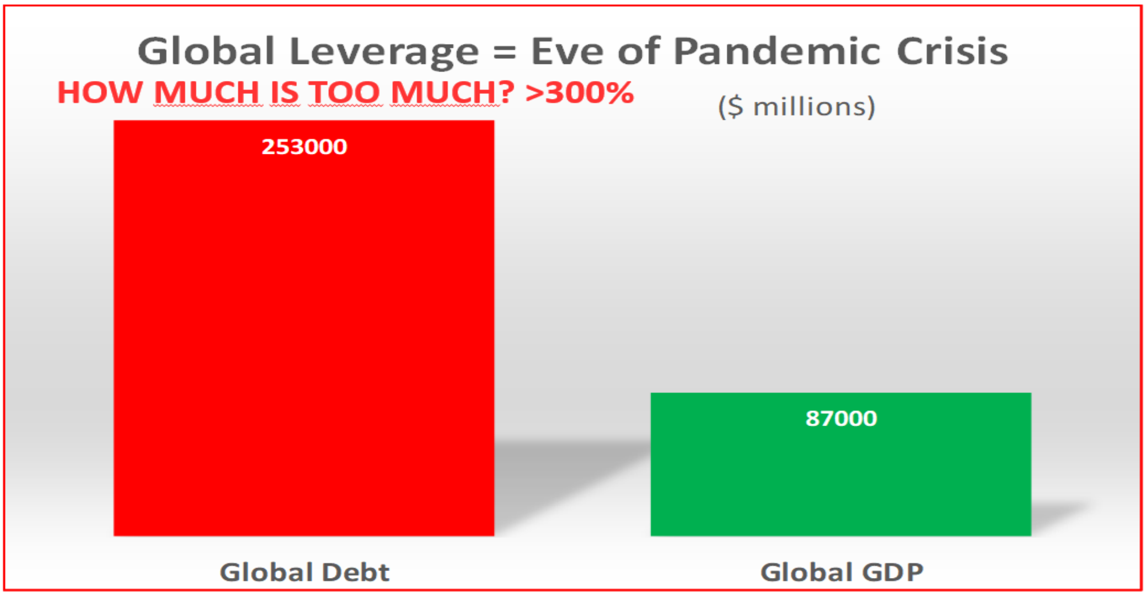
1. First, the sanitary shock emerges in a long-term trend of weak growth, what Hansen, Gordon, and Summers call **secular stagnation**.



These headwinds stem from structural factors, including demography slowdown, technological innovations, larger savings, and rising debt. The pandemic will accelerate that trend of sluggish growth. Let's remember that both Germany and Italy were tipping into recession in the end of 2019, on the eve of the crisis. What I have called **Hyperfinance, that is globalized and unregulated financial networks**, amplifies the risk of recession due to large volatility in capital flows.



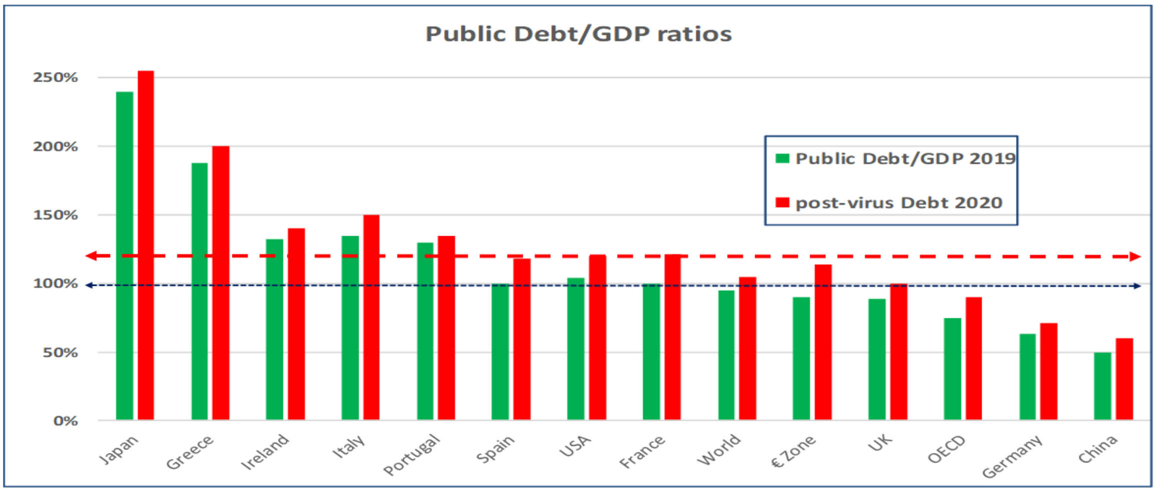
Financial markets behave almost independently, in total disconnect with the underlying real economy. The toothpaste got outside the tube. Economic growth slowdown is also amplified by rising public and private debt since the 1990s. Global leverage has been unabated, in fact rising since the financial crisis. Total debt reaches more than three times global GDP.



Source: IMF & IIF 2020 MH BOUCHET/SKEMA- 2020

For most developed and more vulnerable developing countries, their public debt burden is larger than their total GDP! To fight the sanitary crisis, large budget deficits will make public debt much worse, at a time of meager growth.

THE BUDGETARY AND DEBT IMPACT OF THE CORONA VIRUS CRISIS



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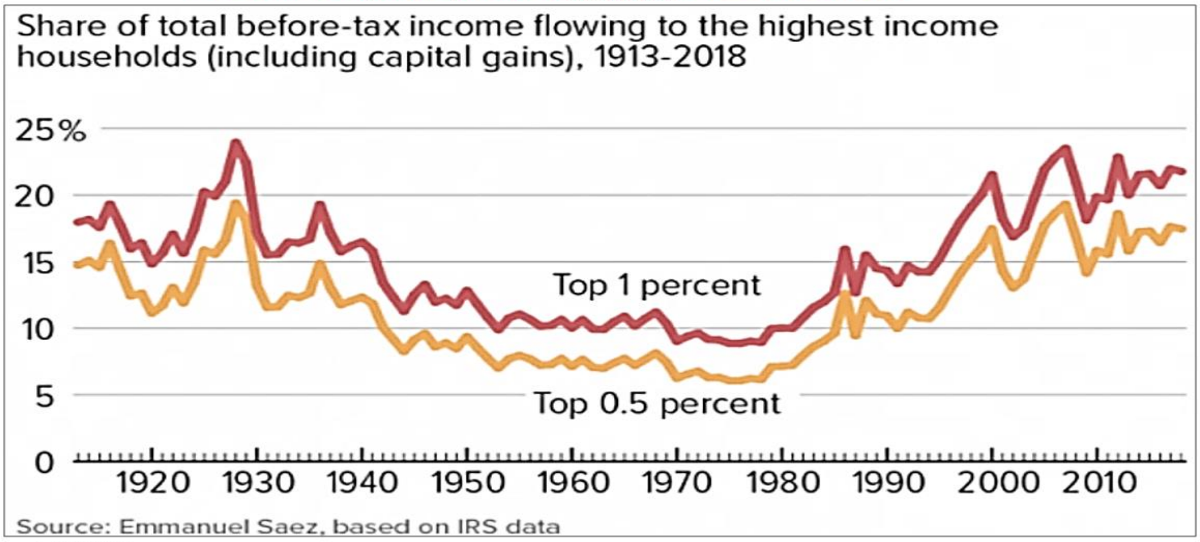
Weaker countries, such as Italy, Spain, and Greece, maybe France, will face tough financing challenges, given that investors become risk averse and will prefer buying German, Japanese and US bonds. Sooner or later, central bank financing will face limits, and interest rates will not fall more.

2. **The second driver of a Great Collapse is wealth gaps**: Socio-economic convergence is a myth. Actually, it stalled since the 1980s, contrary to the promises of the magic hand of the market that will help the poor to catch up with the rich.

THE WINNER TAKES ALL: US WEALTH ACCUMULATION



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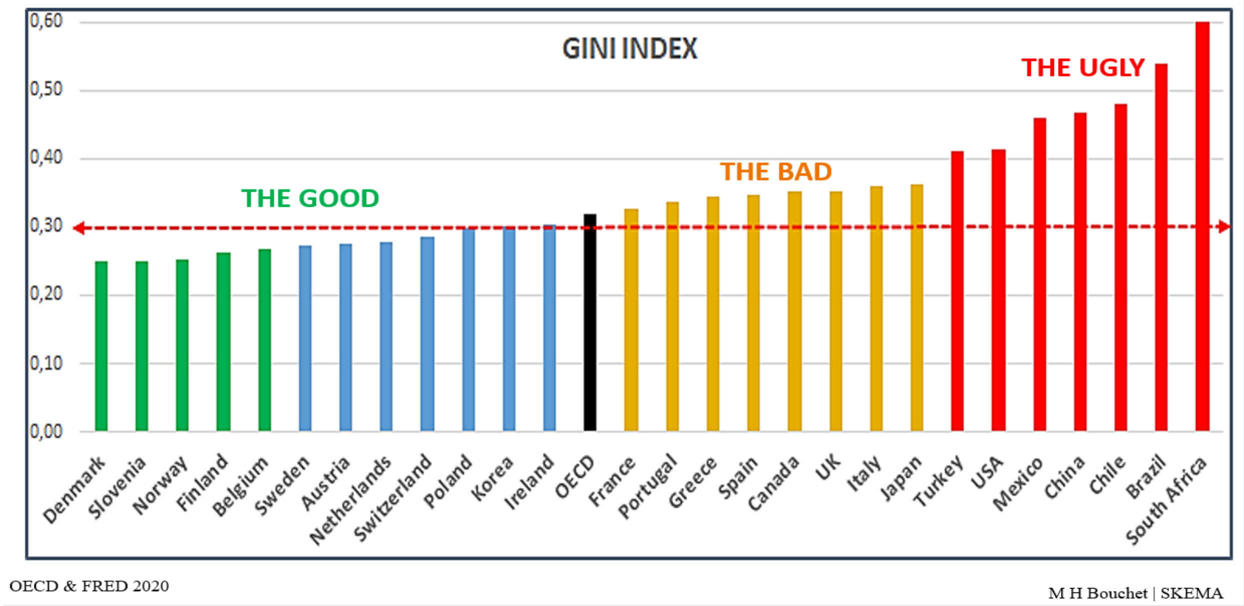
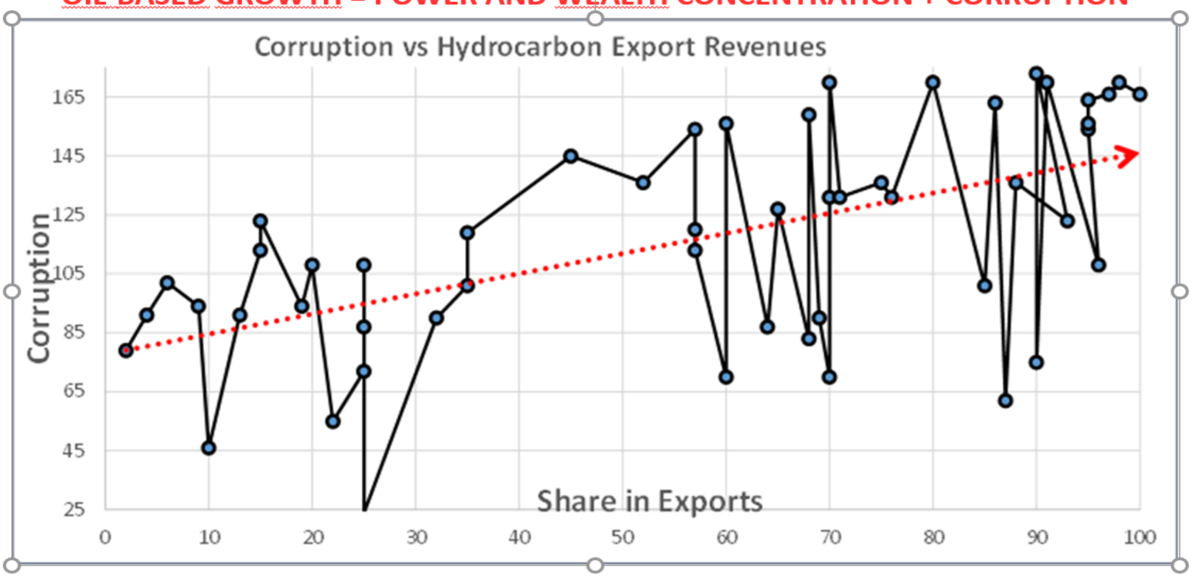
Wealth gaps have increased between and within countries. Income inequality is driven by financial globalization, technological change, and unemployment, and not only in the US! One way to measure income equality is the GINI index, the higher the worse: In the OECD, a dozen countries have a GINI index below the average, but the vast majority is much higher. If past pandemics are any guide, the toll on poorer and vulnerable folks will be much worse.



This is due to the disproportionate impact of the pandemic on low-skilled workers! This is contrary to what historians tell us regarding epidemics, plagues and catastrophes since the Middle Age that reduced inequalities. Today, folks on the frontline, as well as migrants and minorities are less resilient and they will suffer more.

3. **And the third driver of Great Collapse is deeply-rooted bad governance**. The covic-19 has exposed the underlying anarchy of global governance. Multilateral institutions have become arenas for geopolitical competition between great powers, namely US, China and Russia! Look: At the country level, dynamic economic growth and bad governance can be combined, you just need tight social control! There are many poor people in rich countries! Corruption prevents transforming economic growth into sustainable and inclusive development. GDP growth is a necessary but not sufficient condition. Prerequisites include sanitary systems, environmental responsibility, education, social peace, and good governance. The deficit in governance is striking in oil-driven countries.

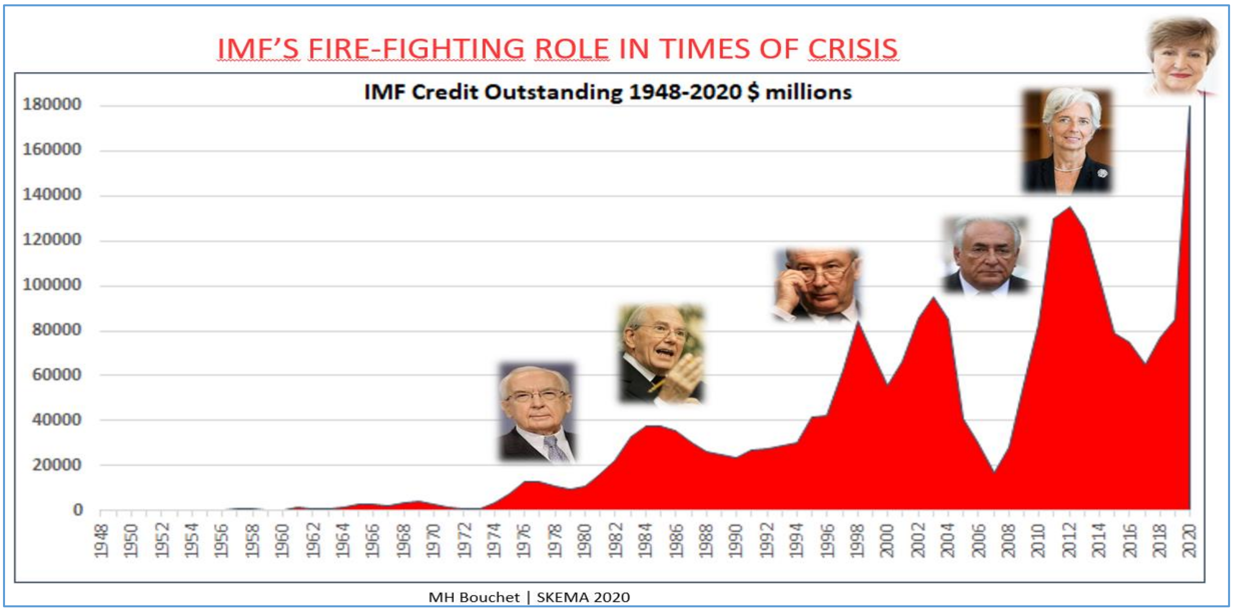
OIL-BASED GROWTH = POWER AND WEALTH CONCENTRATION + CORRUPTION



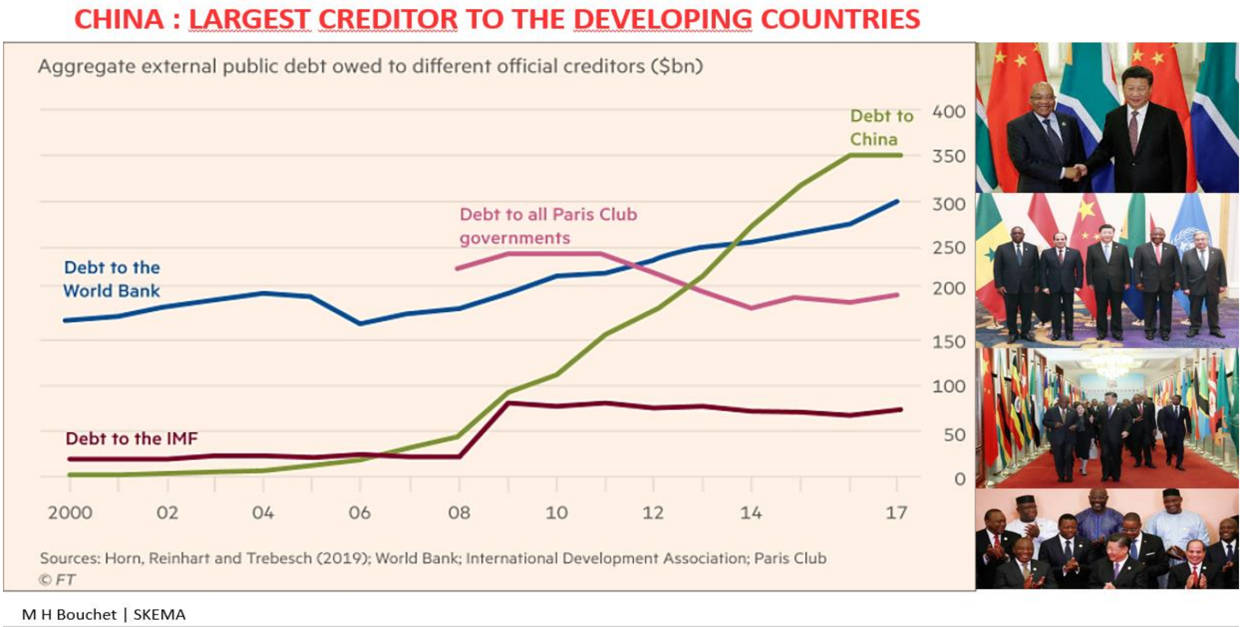
One can observe a clear correlation between large corruption, measured by Transparency International, and oil-based growth. Why is it so? Because hydrocarbons and raw materials lead to economic and political power concentration, and to bad governance. This is true everywhere in the world… excepted in Norway!

To sum up, many countries will fall in deep economic and social distress during 2020 and beyond: In the frontline, those which suffer from a massive commodity shock, coupled with informal economies, capital flight, and large debt burden. But also those more developed countries which show less resilience, and weaker social mediations, including those countries that can borrow in their own currencies, in a nutshell, in the EU!

All in all, the most visible impact of the pandemic will be a **number of debt crises** in the next few months. A toxic combination of limited fiscal space, depreciating currencies, and large deficits, will drag down fragile countries. The IMF's involvement will be indispensable to help restructure public debts. The IMF has already committed nearly $100 billion, but eventually, the IMF will tighten the lending conditions, hence mounting social tensions.

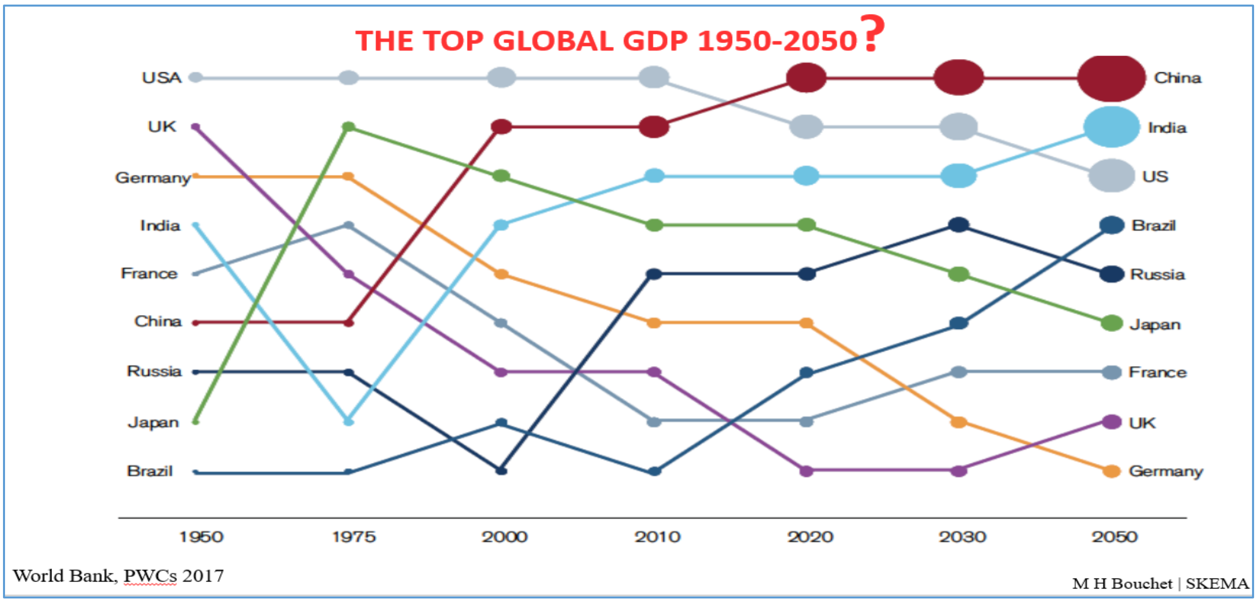


However, resolving the coming debt crises may be tougher than in the past. Why? Well, banks and governments were in the frontline in the debt crises in the 1980s and 1990s — but creditors are nowadays a multitude of private bond funds. They are very tricky to co-ordinate. They don't respond to phone calls! In addition, China has become one of the largest official lenders, much larger than the WB, the IMF, and the Paris Club. Will China join debt relief negotiations? Not sure. What is obvious is a cycle of tough and protracted debt restructuring!



So, to conclude: Just a bump in the road or the threat of a Great Collapse? When people are confined and fear for their lives, their jobs or their assets, it is tough to grasp the chain reaction between various interconnected systems, that is, sanitary, economic and financial, environmental, and socio-political. But today, it's timely to raise our heads and turn our minds toward the "new" future. The climate crisis has not gone away. Economic inequalities are soaring. A number of countries will sink into sovereign bankruptcy. All in all, I would propose a couple of takeaways:

1. **First, systemic risk requires systemic resilience, and it's going to be tough because countries will need to combine economic growth, social protection, and higher taxes.** Massive transfers are required eventually, and capital flight is a risk if there is no concerted fiscal policy across countries. For countries with weaker institutions and unsteady social resilience, rising unemployment coupled with corporate bankruptcies will lead to state destabilization. And whatever GDP per capita! For those countries that can afford it, economic self-reliance will become a strategic objective. In the US, probably. In plain English, a fractured world means subsidies, trade protectionism, tighter rules on foreign investment, and closed doors to migration. This is a trap. Populism and nationalist hysteria such as "take back control" and "make our country great again" won't protect from the rise in unemployment and inequality. Counter-intuitively, the pandemic opens a window of opportunity to exit from **the trap of short-termism**, which has been the cornerstone of the globalized market. Only a concerted "new deal", which means a renewed social contract, could shift the focus toward long-term and more equal development… Between you and me, this is unlikely at the global level, unfeasible at the national level, but possible at the regional level. Europe can and should move toward greener and more inclusive growth. Otherwise, the European story will be over after only 70 years of chaotic efforts.
2. Second, the covid-19 crisis is a **game changer, and it should be a game changer**. Who will be the key players in 2050? Who knows!



Keynes, in the 1930s, stressed that the future is no longer what it used to be, not linear, not a simple projection of the past. This sort of graph, for instance, with a 30 year projection, should be taken with a grain of salt. Development is more than fast GDP growth. After a war, the name of the game is reconstruction of the industrial and human capital. However, in 2020, what should be reconstructed is not factories or bridges, but more importantly social trust, in cities, in companies, between citizens and governments, in the whole social fabric, and that's a formidable but a very exciting challenge. And it's up to you to meet the challenge!

One last word: **The global job market is about to be deeply affected**, and so what can be expected from a business school in this environment of radical uncertainty? For sure, not just a tool box for a quick fix! But certainly a compass to navigate in uncharted waters, hence a combination of technological skills, strong analytical capacities, I mean knowledge and not only information, an entrepreneurship mindset, the active network of your professors with their academic and operational background, and a set of values because ethics will be a powerful force to transform promising students into skilled and mobile young professionals, and into global citizens. *MHB 07-2020*