It is time for the 2014 Globie—a (somewhat fictitious) prize I award once a year to a book that deserves recognition for its treatment of the consequences of globalization. (Previous winners can be found here.) The financial turmoil of the last week makes this year’s award-winner particularly appropriate: Martin Wolf for *The Shifts and the Shocks: What We’ve Learned—and Have Still to Learn—from the Financial Crisis* (http://www.amazon.com/Shifts-Shocks-Learned%2C2%2797-Learn%2C2%2797-Financial/dp/1594205442/ref=sr_1_1?s=books&ie=UTF8&qid=1413660172&sr=1-1&keywords=the+shifts+and+the+shocks). Wolf, a distinguished writer for the *Financial Times* (http://www.ft.com/intl/comment/columnists/martin-wolf), once viewed globalization as a positive force that enhanced welfare (http://www.amazon.com/Globalization-Works-Yale-Nota-Bene/dp/0300107773). But the events of the last few years have changed his views of financial markets and institutions. He now views financial flows as inherently susceptible to the occurrence of crises. And Wolf’s intellectual evolution leaves him deeply concerned about the consequences of financial globalization.

Part I of the book deals with the “shocks” to the global economy. Wolf begins in the U.S. with the crisis of 2008-09 and the relatively weak recovery. He shares the view of Richard Koo of Nomura Research (http://www.paecon.net/PAEReview/issue58/Koo58.pdf) that this was a “balance sheet recession,” with the private sector seeking to shed the debt it had built up during the pre-crisis period. The cutback in private sector spending was initially matched by an increase in the government’s fiscal deficit, which arose as expenditures on unemployment benefits and other programs grew and revenues fell. The rise in the fiscal deficit was particularly appropriate as the “liquidity trap” limited the downward fall of interest rates and the expansionary effects of monetary policy. However, the political acceptance of deficits and debts ended prematurely in 2010, and the recovery has not been as robust as it needs to be.

Wolf then turns to the Eurozone, which experienced its shift towards fiscal austerity after the crisis in Greece erupted. Wolf views the monetary union as “incomplete and imperfect.” On the one hand, its members have sovereign powers that include issuing debt; on the other hand, they do not have the risk-sharing mechanisms that a federal union possesses. When the capital flows that had fed housing bubbles in Spain and Ireland and financed fiscal deficits in Greece and Portugal ended, the borrowing countries were encumbered with the debt they had accumulated either directly through fiscal borrowing or indirectly as they bailed out their domestic banks. Those increases in public debt were seen by Germany and others as proof that the crises were due to fiscal excess, which had to be met by fiscal austerity. But Wolf claims that the German view “...was an effort at self-exculpation: as the Eurozone’s largest supplier of surplus capital, its private sector bore substantial responsibility for the excesses that led to the crisis.”

After surveying the relatively more benign experience of the emerging and developing countries during the crisis, Wolf turns to the “shifts” that led to the breakdown of the financial system. These include the liberalization of market forces, particularly finance; technological change, which sped up the integration of markets and financial markets; and ageing, which transformed the savings-investment balance in high-income countries. These led to an increase in financial fragility that made financial markets unstable and crises endemic. The changes took place in a global economy where global savings where channeled from oil-exporters and Asian economies, particularly China, to the U.S., thus reinforcing the credit boom.
The last section of the book deals with solutions to the crises. Wolf is ready to consider “radical reform,” which includes higher capital ratios for the banks and macroprudential policies that seek to achieve both asset market and macroeconomic stability. Policies to rebalance the global economy include encouraging less risky forms of finance, increasing insurance against external shocks, and moving towards a global reserve asset. The steps needed to assure the continued existence of the euro start with a mechanism to assure symmetrical adjustment across the Eurozone, debt restructuring, and a banking union.

None of these measures will be easy to implement. But Wolf’s willingness to discuss them is a sign of how much the crisis has unsettled those who thought they understood the risks of financial globalization. Wolf attributes the responsibility for the crisis to “Western elites,” who misunderstood the consequences of financial liberalization, allowed democracy to be weakened, and in the case of the Eurozone, imposed a system without accountability. The loss in public confidence, he writes, reduces trust in domestic legitimacy.

The title of the last chapter, “Fire Next Time,” is taken from James Baldwin’s book of the same name, which in turn borrowed from an African-American spiritual: “God gave Noah the rainbow sign, no more water but fire next time.” Wolf warns that the next global economic crisis “could end in the fire.” While he does not explicitly explain what this fire will be, he mentions in the preface that his father was a Jewish refugee from Austria in the 1930s, and the historical reference is clear. At a time when right-wing parties are ascendant in Europe (http://www.bbc.com/news/world/europe-27559714), Wolf’s warning is a sober reminder that unsettled economic circumstances can lead to political extremism and instability.

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