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Conference Note

A Profound Economic Crisis: finding a way through to a better future

19-20 January 2023

DITCHLEY

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EXECUTIVE SUMMARY

This Ditchley conference set out to examine the causes and consequences of recent shocks to local and global economies. Our aim was to consider both the ongoing economic disruption caused by Covid, the energy crisis (and war in Ukraine) and the deeper structural workings of global capitalism, a system now challenged by an overdue necessity to transition to a sustainable economy and by increasing geopolitical competition and fragmentation. The manifestations of crises – shortages in food and energy supply, low wages, high living costs but falls in living standards, low productivity, migration, and demographic and climate impacts – appear connected, with crises feeding one another. Can these crises precipitate changes in our economic course, or will we continue until, like the metaphorical frog in ever hotter water, we are simply boiled? The frog metaphor or course doesn't hold – unlike the boiling frog, we have noticed the change in temperature but so far, we've failed to jump.

The conference began with a shared desire to move beyond what was described as a 'frozen economic orthodoxy' no longer adequate to serve either as an analytical frame to understand current economic complexities or the moves toward a sustainable economy. Existing measures for GDP were described as too limiting, masking our understanding of economic change, and diverting attention from an analysis of root causes. If measured differently, it was argued, GDP could grow while the material output of the economy (and associated pressure on the natural environment) decreased. Material goods would be circularised. Changes in accounting methods to value intangible resources such as intellectual and reputational assets or positive environmental outcomes, could create incentives to drive sustainable market systems. In other words, changes in measures for GDP, circularised economies and valuation of intangibles could support forms of growth that do not exceed planetary boundaries.

The call was for more experimentation, more pragmatism and an increased capacity to adapt and learn from economic experiments. Could we become a more adaptive society capable of rapid learning and collective action, able to work with more common purpose towards solutions? Whilst there was consensus over the need for more experimentation and a greater capacity to adapt, political ideology inevitably colours approaches to policy solutions. One view prioritised constraint, a necessity to reduce borrowing and spending, squeezing greater productivity from the workforce, with control of inflation as the priority: whilst another highlighted failures in the distribution of financial resources and in systemic inequities. On both sides though, there was agreement that we had reached an impasse over globalisation – it is not working as expected and that there is now a crisis of inequality. There was nervousness over the extent and consequences of the economic turmoil now at work and uncertainty over routes out but agreement on ideas about being 'adaptive' and more experimental in the search for pragmatic solutions.

Context and why this was important

This conference was planned mid 2022 as the issues in energy supply, cost of living, inequality, slow growth, inflation, strikes and an urgent need for climate action were becoming clear for the UK. A global recession was also expected. The aim was to better understand, define and describe these intersecting economic and energy issues and their compound impact. It also asked what the opportunities are for political and policy change and for routes out of crises in a context of far-reaching decarbonisation. Would this provoke a change in the direction of global and national economies?

People

This conference brought together politicians (across political divides), think-tankers, economic and political advisers, academics from the UK, Sweden, the US and Canada as well as representatives from energy companies, businesses and business and labour organisations from the UK, Germany and Japan, and UK journalists.

FULL REPORT

For UK participants, the impact of the previous September's mini budget still reverberated. It highlighted both the limits of ideological dogmatism and the fragility of the economy. There was unease about economic instability, whether caused by the unpredictability of market response to government policy or the effects of increased pressure on the cost of living for those facing mortgage and energy bill increases and severe hardships.

There were four broad areas of agreement. The first, that globalisation was somehow now misfiring and that disfunction is evident across the world. The second, that inequality is now potentially destabilising for democracies. Thirdly, a sense that the economic orthodoxies of the last 40 years are finally running out of steam and are being challenged from both the political right and left. Lastly, the recognition that energy transitions and structural decarbonisation will bring about fundamental change to economic thinking and policies.

Alongside these areas of agreement, there was some refreshing admission of uncertainty. After decades of centralised top-down planning followed by market-based models and globalisation, it was suggested that we've reached the end of the road, and no-one knows what comes next. Is there now a recognition that economics is more evolutionary - a complex system? Top-down planning has not worked. There are flaws in the current model of globalisation that we are not sure how to address and yet we're in a world of intensifying geopolitical rivalry. A core question framed the discussion: what is new about the current economic situation? If this is not new, why has nothing changed? Is it down to political resistance or are solutions far more complex than we want to admit? Do we need to dig deeper to alter our current model to one in which the whole of society contributes, or change the model entirely – what is that model?

Changing definitions of economic success

The extent of inequality in the UK was laid bare. Life chances were described as a dynamic measure of social mobility, and Britain was said to have the most unequal life chances in the OECD. The average American was said to be 50% richer than the average Brit. Social mobility within poorer regions within the UK has declined and this change has taken place over the last 40 years. Centralisation of power in Whitehall was identified as a problem.

A decade of austerity and stagnated incomes have led to a concentration of wealth and these national inequalities are also at work globally. There has been a build-up of debt in the global South and a syphoning of resources from the global South to the global North. The question asked was: to what extent is inequality a cause or the consequence or economic malfunction? Globalisation was said to have been successful at bringing people out of poverty but has also frayed social capital and damaged natural capital.

Part of the problem attributed to 'conventional economics' is that it assigns a price only to some aspects of work and excludes others that are critical for society, such as caring. It also externalises negative impacts, most obviously carbon emissions, so that there is no cost or consequence to them. Climate impacts are classed as externalities and investments into the transition treated as costs. GDP then is only a part of the bigger picture. Accounting for healthcare for example has become a significant challenge for conventional economics and for western democracies.

Demographic change has also brought challenges for the existing model of western labour markets. The ageing of western countries implies a falling labour force participation rate, and therefore a need to increase productivity. From the political right, solutions lie in efforts to retain older workers, for example, by stopping subsidising early exit from the labour force (through public pensions). For the left, the problem is not a deficient supply but constrained distribution. A world of overproduction is a world of debt and asset inflation. Borrowing to invest was put forward as a positive, justifiable, and credible, whereas borrowing to consume is not. Rent-seeking was an obvious example of a profitable, low-risk way of making money and a product of the financial system developed over the last 40 years.

The disruption of supply chains that began with Covid and further damaged by war in Ukraine and geopolitical tensions had also changed the economic picture, with localisation and ideas of 'ally-shoring' informing trading relationships. There has been a growing case made for strengthened trade and coproduction relationships between countries that share values. Integrating supply chains and resources in this manner, it was argued, would likely strengthen economies and alliances. Central banks too could collaborate internationally and governments across democracies could cooperate to prevent fragmentation among allies. Although it was pointed out that despite sanctions, large private sector companies have been slow to divest from Russia, trade with China has increased in recent years and that there are deep dependencies that cannot be wished away, especially in the case for economies like Japan and India. Japanese supply chain dependency was particularly noted in medicines and battery technologies despite likely market growth from IT and financial trading.

Even so, localisation has contributed to a change in the definition of economic success. There has been an inward turn as countries seek to protect their economic resources and adopt forms of protectionism. The Inflation Reduction Act has come under scrutiny for that reason. A revision of three broad areas was called for: a better balance between free trade and protectionism; a rethink of the balance between central controls and devolution (with a determination of what should be devolved and what services governments are well equipped to deliver) and a better delivery of equality of opportunity for individuals.

New economic forces

In the UK, there is some political consensus on aspirations for more manufacturing and an ambition to close regional productivity gaps but the detail on how to deliver such aspirations was said to be absent. It was not clear where the economic force, power or energy would come from for this next period of economic change. The merchant class was said to have provided the agency and energy for the economic change in the 18th century. Who will create the agency and force today? Can money and power be orchestrated to create a force for change?

The answer for the UK was suggested in part to be in greater investment in small regionally-based firms. The ambition within SMEs is not matched by investment. Finance tends to be centralised in London and HM Treasury does not support regional investment sufficiently. On the question of agency, it was argued that a suppression of motivation and aspiration for the young was dampening ambition. More than the high costs of housing, flagging impetus was said to reflect an under investment in human capital. There is a generational divide at work in the lack of assets for those under forty and little wealth transference (except for the few) despite an aging population. Ambition must be stimulated for economic growth to happen. What can be done to open and level up opportunities for youth and subsequently society as a whole? Investment in education and social mobility is key. A framework that extracts from younger producers to support the older economically inactive is not sustainable. In Denmark, it was suggested that the top 40% of earners know that their children or grandchildren may not automatically remain in that top 40% bracket (given greater equality of opportunity) and therefore they are more likely to support a distributed system to reduce risk. Countries that accept greater inequality of opportunity risk rising poverty and potential challenges to democracy.

Calls for better, more courageous political leadership although frequently made are futile. Better politicians cannot be summoned like genies. In their absence people will, can and do create their own agency to deal with the problems they face. Hence the current set of strikes in Britain. There is a humility in recognising that people will use their own agency to solve the problems they face.

The agency of a green transition

A series of points were made from the perspective of the green transition that also challenge economic orthodoxy. Firstly, what does a transition to clean sources of energy do to our economic models and is it an opportunity to rethink what is meant by economic growth? Most economists assume societies must want increased growth and that it is correlated with prosperity and better living standards. Arguments against further growth highlight environmental costs and the exclusion of factors associated with well-being and quality of life. GDP as a proxy for people becoming better off was said to be a weaker claim than it once was. Comments from Japan, for example, reiterated that the two most significant factors associated with long life are social integration and close human relationships. An assumption that investment in technology is a route to increased economic growth is also not a given. More consideration of what kinds of investment in which technologies to deliver what kinds of growth, is required. Secondly, investment in the green transition, although much increased, is not yet close to the investment levels required. Capital flows need to be scaled up and the investment is needed mainly outside the OECD. There is a huge challenge in directing the capital needed and in defining the path for transition – whilst targets are clear, the routes to achieving them are not. There was a perceived risk of the United States' Inflation Reduction Act blocking technology flows to the developing world. Even though there has been growth in venture capital in green tech, not nearly enough is being directed to the global South and with long-term investment in mind.

In the UK, the practical elements of the green transition are also not being acted upon quickly enough. The need is for better energy grids so that the power can get to where it needs to be. Costs have already decreased significantly, but size and scale should now be increased. There is a case for allowing larger wind turbines to drive efficiencies and costs down further. The planning and other regulations must be updated to support expansion.

Also, with reference to the UK, the incentives to prompt individuals to act in areas of energy efficiency, insulation or heat pumps are largely absent. The consumer experience in trying to make these changes is poor and unsupported. The government dropped for example, the 2012 zero carbon homes initiative which has cost a decade of inaction and a missed opportunity for savings.

There was said to be an observable difference now between the US and Europe. Europe was described as still in the discussion phase of the green transition, whereas the US is in the implementation phase. The US is working on an incentive-based system, compared to the regulatory system of Europe. Within Europe, however, there is pragmatism and a consensus that the green transition needs to take place, while in Japan investment in renewables is not yet seen as a profitable step.

Rare earth metals are critical for the renewable infrastructure and part of the energy independence and security calculation. The geopolitical challenges in securing these, for all countries, are looming. To avoid new or further dependencies, diversification in supply chains of critical minerals is also needed. Technology driven growth will also inevitably run into resource constraints. A shortage of semi-conductors and the link to national security and resilience also added to efforts to onshore their production, even if at the expense of increased costs.

Despite all, the events of the last year have changed International Energy Agency projections. In 2021, the IEA was predicting a 20% growth in global gas demand over the next three decades. Now, they don't expect growth in gas over the next 30 years at all. For solar, the outlook was said to have changed from a projected increase to 2000 GW of capacity by 2030, to 3000 GW.

Comments from Japan noted the longer-term economic impacts of the pandemic with for example changed behaviour of both consumers and office workers. Hybrid working has led to surplus office space and impacts on the real estate market. More broadly, the slowdown in the Chinese economy has affected the region. Japanese companies have also been directly affected by the disruption to energy markets. Some high-profile company collapses, despite joint ventures with the state, have created a more risk averse environment for investment.

Comments from India highlighted the constraints on India's role in the world. Despite a position in the G20, India is being held back by poverty and inequality. Expectations that India will follow the economic path of China in lifting millions out of poverty were said to be misplaced. The Indian economy was said to lack serious capital investment, and more was needed particularly in areas of education and innovation. It was argued that those already educated are not innovating effectively. The focus of start-ups tends to be on app creation to meet the needs of the already wealthy. There isn't anywhere near sufficient levelling up across society, which is needed to compete with China. Labour mobility is not leading to greater social mobility as labour integration is not happening.

Workers move from but then return to poorer areas and there is little investment in those poorer parts of the country. Despite its resources and a culture that has integrated twenty-four languages within one fiscal policy regime over seventy years, the lack of investment, poverty and inequalities held back opportunities for India to be an export-led country.

Ideas and actions

This conference was warned against an overly narrow definition of the climate crisis and responses. The climate crisis is part of a wider ecological crisis which includes current catastrophic biodiversity loss. A tight definition of the climate crisis and the response to it in terms of technology-based decarbonisation ignores a wider context of resource use constraint. This is a mistake. The supply chain and all the materials required for a technology-based decarbonisation and the associated resource constraints present a range of significant second-order considerations which cannot be wished away. Similarly, an emphasis on energy production risks losing attention to the changes necessary in consumption. The question of private finance and how governments and political actors interact with financial markets was a prominent feature of this conference with the sense that although government does not have all the levers – there has to be more capital investment. The relationship between state powers and private finance appears opaque, a system barely understood, let alone controllable. The constraints and costs of achieving defined goals requires much greater shared understanding. while the continued use of inappropriate theories and metrics presents an obstacle to progress.

The call was made for greater willingness in domestic economic policy to try different approaches by running experiments (in parallel) and to learn from the actions and policies of other countries. Experiments over devolution, education, investments in technology and changed approaches to taxation were at the heart of the change deemed necessary but require collaboration from states, markets, civil society and institutions.

There was agreement that long-term under-investment in both social and natural capital has coincided with an intense period of pressure on democracies. Bold leadership is required to take calculated risks and renew our economies for all. In short, what do democratic societies now want to achieve?

Topics and issues to be carried forward in the Ditchley programme

Trade relationships as a basis for strengthened relationships between countries who share values will be explored as part of a series of smaller discussion groups planned for late spring ’23.

The role of the private sector in contributing towards digital security and economic resilience within democracies is a current theme and was the subject of Ditchley’s November 2022 conference on Digital security for democratic, social and economic prosperity.

The role of geographic regions in economic security will form the basis of an event on devolution planned for June 2023. The purpose of this event is to to explore the role regions play in creating economic security. These discussions will conclude in a further conference on Economic Security in September.

On 3rd and 4th March this year Ditchley held a summit on critical minerals as part ongoing work for the *Responding to the Critical Minerals Challenge* priority area of the *Climate and Energy* programme.

Questions related to the delivery of climate policies are central to Ditchley's Climate Programme.

This Note reflects the Director's personal impressions of the conference. No participant is in any way committed to its content or expression.

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