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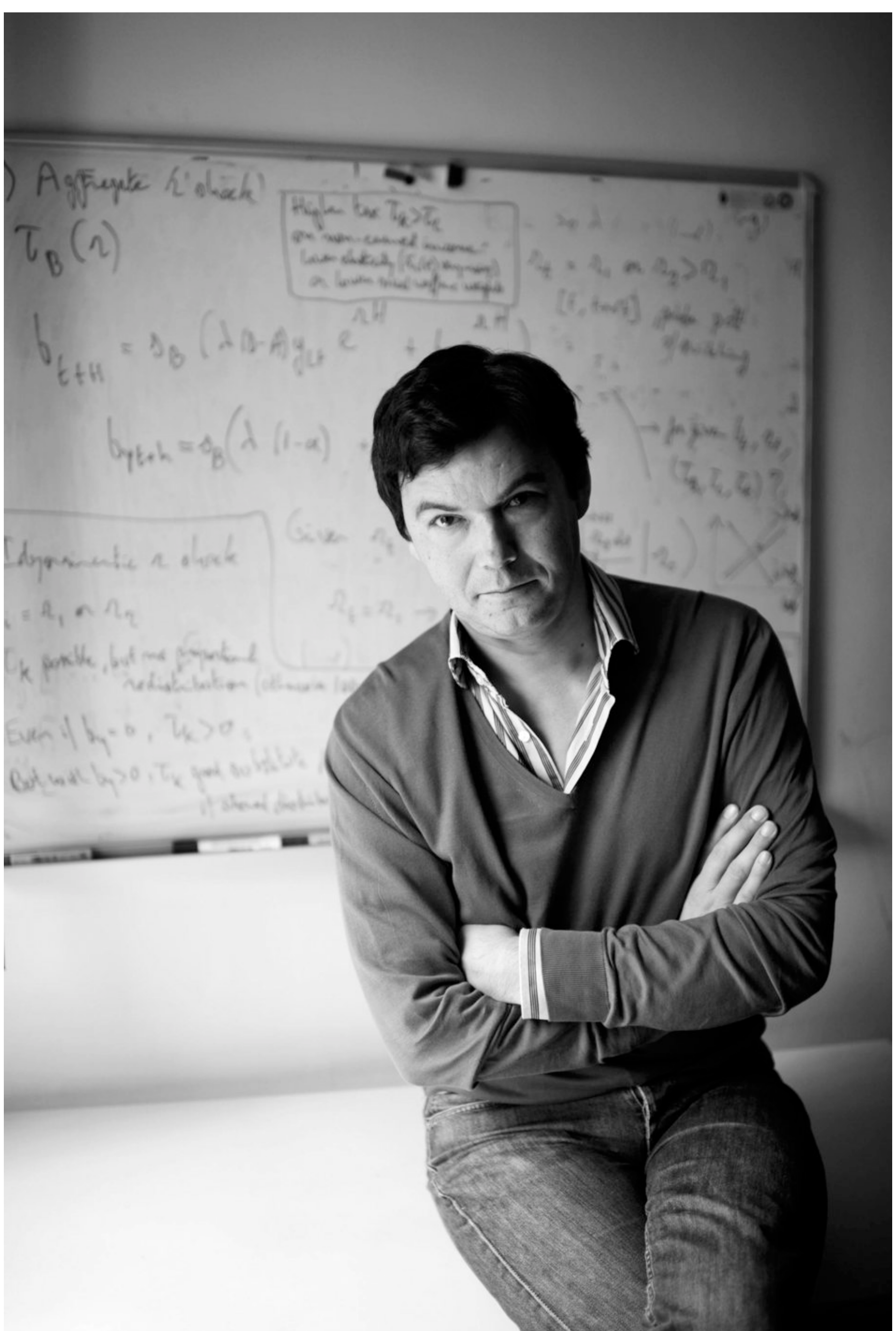
Why We're in a New Gilded Age

Paul Krugman, The New York Review of Books, May 8 2014 Issue

Thomas Piketty, professor at the Paris School of Economics, isn't a household name, although that may change with the English-language publication of his magnificent, sweeping meditation on inequality, Capital in the Twenty-First Century. Yet his influence runs deep. It has become a commonplace to say that we are living in a second Gilded Age—or, as Piketty likes to put it, a second Belle Époque—defined by the incredible rise of the "one percent." But it has only become a commonplace thanks to Piketty's work. In particular, he and a few colleagues (notably Anthony Atkinson at Oxford and Emmanuel Saez at Berkeley) have pioneered statistical techniques that make it possible to track the concentration of income and wealth deep into the past—back to the early twentieth century for America and Britain, and all the way to the late eighteenth century for France.



The result has been a revolution in our understanding of long-term trends in inequality. Before this revolution, most discussions of economic disparity more or less ignored the very rich. Some economists (not to mention politicians) tried to shout down any mention of inequality at all: "Of the tendencies that are harmful to sound economics, the most seductive, and in my opinion the most poisonous, is to focus on questions of distribution," declared Robert Lucas Jr. of the University of Chicago, the most influential macroeconomist of his generation, in 2004. But even those willing to discuss inequality generally focused on the gap between the poor or the working class and the merely well-off, not the truly rich—on college graduates whose wage gains outpaced those of less-educated workers, or on the comparative good fortune of the top fifth of the population compared with the bottom four fifths, not on the rapidly rising incomes of executives and bankers.

It therefore came as a revelation when Piketty and his colleagues showed that incomes of the now famous "one percent," and of even narrower groups, are actually the big story in rising inequality. And this discovery came with a second revelation: talk of a second Gilded Age, which might have seemed like hyperbole, was nothing of the kind. In America in particular the share of national income going to the top one percent has followed a great U-shaped arc. Before World War I the one percent received around a fifth of total income in both Britain and the United States. By 1950 that share had been cut by more than half. But since 1980 the one percent has seen its income share surge again—and in the United States it's back to what it was a century ago.

Still, today's economic elite is very different from that of the nineteenth century, isn't it? Back then, great wealth tended to be inherited; aren't today's economic elite people who earned their position? Well, Piketty tells us that this isn't as true as you think, and that in any case this state of affairs may prove no more durable than the middle-class society that flourished for a generation after World War II. The big idea of Capital in the Twenty-First Century is that we haven't just gone back to nineteenth-century levels of income inequality, we're also on a path back to "patrimonial capitalism," in which the commanding heights of the economy are controlled not by talented individuals but by family dynasties.

It's a remarkable claim—and precisely because it's so remarkable, it needs to be examined carefully and critically. Before I get into that, however, let me say right away that Piketty has written a truly superb book. It's a work that melds grand historical sweep—when was the last time you heard an economist invoke Jane Austen and Balzac?—with painstaking data analysis. And even though Piketty mocks the economics profession for its "childish passion for mathematics," underlying his discussion is a tour de force of economic modeling, an approach that integrates the analysis of economic growth with that of the distribution of income and wealth. This is a book that will change both the way we think about society and the way we do economics.

1.

What do we know about economic inequality, and about when do we know it? Until the Piketty revolution swept through the field, most of what we knew about income and wealth inequality came from surveys, in which randomly chosen households are asked to fill in a questionnaire, and their answers are tallied up to produce a statistical portrait of the whole. The international gold standard for such surveys is the annual survey conducted once a year by the Census Bureau. The Federal Reserve also conducts a triennial survey of the distribution of wealth.

These two surveys are an essential guide to the changing shape of American society. Among other things, they have long pointed to a dramatic shift in the process of US economic growth, one that started around 1980. Before then, families at all levels saw their incomes grow more or less in tandem with the growth of the economy as a whole. After 1980, however, the lion's share of gains went to the top end of the income distribution, with families in the bottom half lagging far behind.

Historically, other countries haven't been equally good at keeping track of who gets what; but this situation has improved over time, in large part thanks to the efforts of the Luxembourg Income Study (with which I will soon be affiliated). And the growing availability of survey data that can be compared across nations has led to further important insights. In particular, we now know both that the United States has a much more unequal distribution of income than other advanced countries and that much of this difference in outcomes can be attributed directly to government action. European nations in general have highly unequal incomes from market activity, just like the United States, although possibly not to the same extent. But they do far more redistribution through taxes and transfers than America does, leading to much less inequality in disposable incomes.

Yet for all their usefulness, survey data have important limitations. They tend to undercount or miss entirely the income that accrues to the handful of individuals at the very top of the income scale. They also have limited historical depth. Even US survey data only take us to 1947.

Enter Piketty and his colleagues, who have turned to an entirely different source of information: tax records. This isn't a new idea. Indeed, early analyses of income distribution relied on tax data because they had little else to go on. Piketty et al. have, however, found ways to merge tax data with other sources to produce information that crucially complements survey evidence. In particular, tax data tell us a great deal about the elite. And tax-based estimates can reach much further into the past: the United States has had an income tax since 1913, Britain since 1909. France, thanks to elaborate estate tax collection and record-keeping, has wealth data reaching back to the late eighteenth century.

Exploiting these data isn't simple. But by using all the tricks of the trade, plus some educated guesswork, Piketty is able to produce a summary of the fall and rise of extreme inequality over the course of the past century. It looks like Table 1 on this page.

Table 1

INCOME SHARES

	Low Inequality (Scandinavia 1970s/1980s)	*Medium Inequality (Europe 2010)*	*High Inequality (Europe 1910, US 2010)*
Top 1%	7%	10%	20%
Next 9%	18%	25%	30%
Next 40%	45%	40%	30%
Bottom 50%	30%	25%	20%

2.

Piketty throws down the intellectual gauntlet right away, with his book's very title: Capital in the Twenty-First Century. Are economists still allowed to talk like that?

It's not just the obvious allusion to Marx that makes this title so startling. By invoking capital right from the beginning, Piketty breaks ranks with most modern discussions of inequality, and hearkens back to an older tradition.

The general presumption of most inequality researchers has been that earned income, usually salaries, is where all the action is, and that income from capital is neither important nor interesting. Piketty shows, however, that even today income from capital, not earnings, predominates at the top of the income distribution. He also shows that in the past—during Europe's Belle Époque and, to a lesser extent, America's Gilded Age—unequal ownership of assets, not unequal pay, was the prime driver of income disparities. And he argues that we're on our way back to that kind of society. Nor is this casual speculation on his part. For all that Capital in the Twenty-First Century is a work of principled empiricism, it is very much driven by a theoretical frame that attempts to unify discussion of economic growth and the distribution of both income and wealth. Basically, Piketty sees economic history as the story of a race between capital accumulation and other factors driving growth, mainly population growth and technological progress.

To be sure, this is a race that can have no permanent victor: over the very long run, the stock of capital and total income must grow at roughly the same rate. But one side or the other can pull ahead for decades at a time. On the eve of World War I, Europe had accumulated capital worth six or seven times national income. Over the next four decades, however, a combination of physical destruction and the diversion of savings into war efforts cut that ratio in half. Capital accumulation resumed after World War II, but this was a period of spectacular economic growth—the Trente Glorieuses, or "Glorious Thirty" years; so the ratio of capital to income remained low. Since the 1970s, however, slowing growth has meant a rising capital ratio, so capital and wealth have been trending steadily back toward Belle Époque levels. And this accumulation of capital, says Piketty, will eventually recreate Belle Époque–style inequality unless opposed by progressive taxation.

Why? It's all about r versus g—the rate of return on capital versus the rate of economic growth.

Just about all economic models tell us that if g falls—which it has since 1970, a decline that is likely to continue due to slower growth in the working-age population and slower technological progress—r will fall too. But Piketty asserts that r will fall less than g. This doesn't have to be true. However, if it's sufficiently easy to replace workers with machines—if, to use the technical jargon, the elasticity of substitution between capital and labor is greater than one—slow growth, and the resulting rise in the ratio of capital to income, will indeed widen the gap between r and g. And Piketty argues that this is what the historical record shows will happen.

If he's right, one immediate consequence will be a redistribution of income away from labor and toward holders of capital. The conventional wisdom has long been that we needn't worry about that happening, that the shares of capital and labor respectively in total income are highly stable over time. Over the very long run, however, this hasn't been true. In Britain, for example, capital's share of income—whether in the form of corporate profits, dividends, rents, or sales of property, for example—fell from around 40 percent before World War I to barely 20 percent circa 1970, and has since bounced roughly halfway back. The historical arc is less clear-cut in the United States, but here, too, there is a redistribution in favor of capital underway. Notably, corporate profits have soared since the financial crisis began, while wages—including the wages of the highly educated—have stagnated.

A rising share of capital, in turn, directly increases inequality, because ownership of capital is always much more unequally distributed than labor income. But the effects don't stop there, because when the rate of return on capital greatly exceeds the rate of economic growth, "the past tends to devour the future": society inexorably tends toward dominance by inherited wealth.

Consider how this worked in Belle Époque Europe. At the time, owners of capital could expect to earn 4–5 percent on their investments, with minimal taxation; meanwhile economic growth was only around one percent. So wealthy individuals could easily reinvest enough of their income to ensure that their wealth and hence their incomes were growing faster than the economy, reinforcing their economic dominance, even while skimming enough off to live lives of great luxury.

And what happened when these wealthy individuals died? They passed their wealth on—again, with minimal taxation—to their heirs. Money passed on to the next generation accounted for 20 to 25 percent of annual income; the great bulk of wealth, around 90 percent, was inherited rather than saved out of earned income. And this inherited wealth was concentrated in the hands of a very small minority: in 1910 the richest one percent controlled 60 percent of the wealth in France; in Britain, 70 percent.

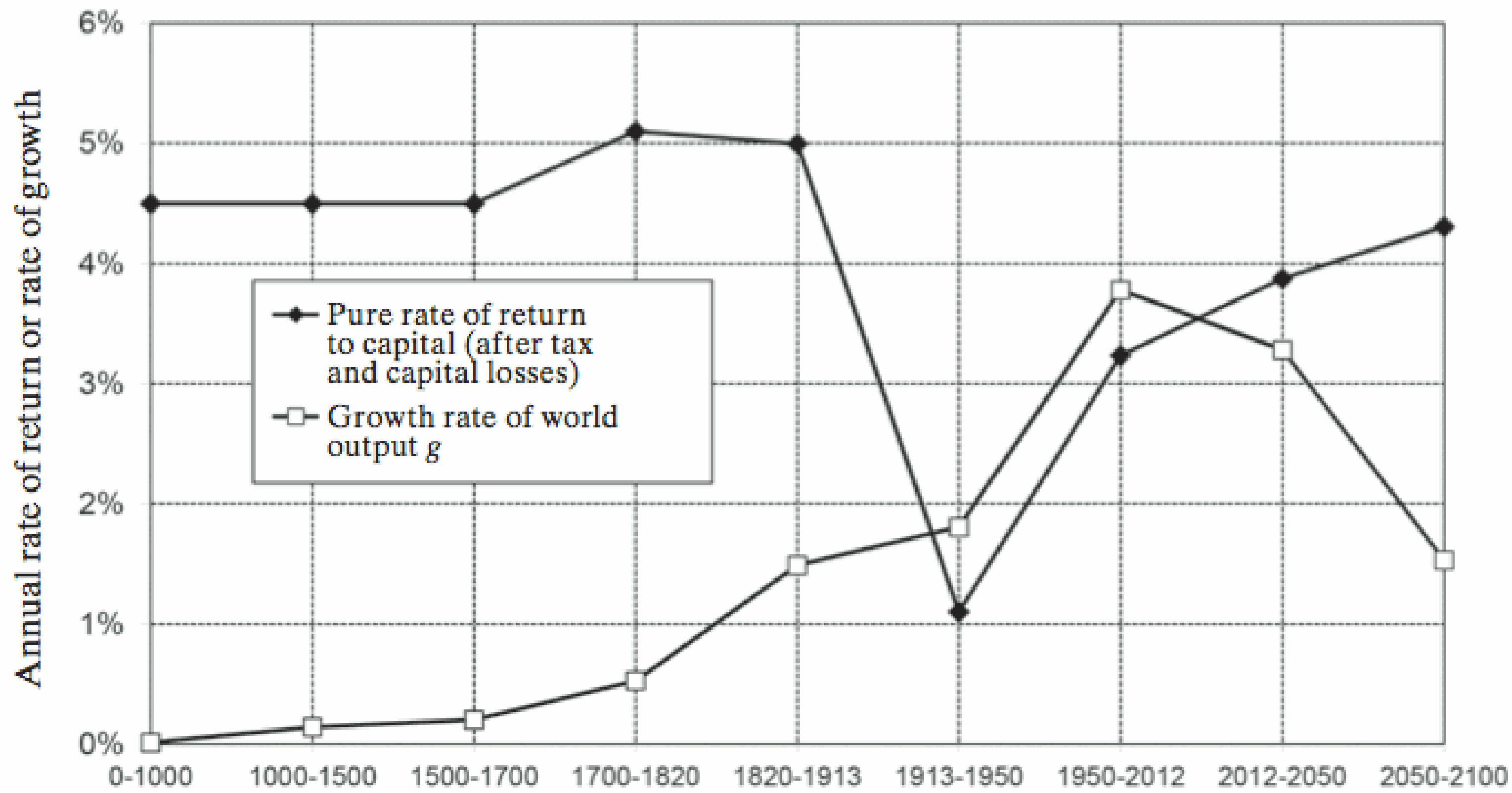
No wonder, then, that nineteenth-century novelists were obsessed with inheritance. Piketty discusses at length the lecture that the scoundrel Vautrin gives to Rastignac in Balzac's Père Goriot, whose gist is that a most successful career could not possibly deliver more than a fraction of the wealth Rastignac could acquire at a stroke by marrying a rich man's daughter. And it turns out that Vautrin was right: being in the top one percent of nineteenth-century heirs and simply living off your inherited wealth gave you around two and a half times the standard of living you could achieve by clawing your way into the top one percent of paid workers.

You might be tempted to say that modern society is nothing like that. In fact, however, both capital income and inherited wealth, though less important than they were in the Belle Époque, are still powerful drivers of inequality—and their importance is growing. In France, Piketty shows, the inherited share of total wealth dropped sharply during the era of wars and postwar fast growth; circa 1970 it was less than 50 percent. But it's now back up to 70 percent, and rising. Correspondingly, there has been a fall and then a rise in the importance of inheritance in conferring elite status: the living standard of the top one percent of heirs fell below that of the top one percent of earners between 1910 and 1950, but began rising again after 1970. It's not all the way back to Rasti-gnac levels, but once again it's generally more valuable to have the right parents (or to marry into having the right in-laws) than to have the right job.

And this may only be the beginning. Figure 1 on this page shows Piketty's estimates of global r and g over the long haul, suggesting that the era of equalization now lies behind us, and that the conditions are now ripe for the reestablishment of patrimonial capitalism.

Figure 1

AFTER-TAX RATE OF RETURN VS. GROWTH RATE AT THE WORLD LEVEL, FROM ANTIQUITY UNTIL 2100



The rate of return to capital (after tax and capital losses) fell below the growth rate during the twentieth century, and may again surpass it in the twenty-first century.

Sources and series: See piketty.pse.ens.fr/capital21c

Given this picture, why does inherited wealth play as small a part in today's public discourse as it does? Piketty suggests that the very size of inherited fortunes in a way makes them invisible: "Wealth is so concentrated that a large segment of society is virtually unaware of its existence, so that some people imagine that it belongs to surreal or mysterious entities." This is a very good point. But it's surely not the whole explanation. For the fact is that the most conspicuous example of soaring inequality in today's world—the rise of the very rich one percent in the Anglo-Saxon world, especially the United States—doesn't have all that much to do with capital accumulation, at least so far. It has more to do with remarkably high compensation and incomes.

3.

Capital in the Twenty-First Century is, as I hope I've made clear, an awesome work. At a time when the concentration of wealth and income in the hands of a few has resurfaced as a central political issue, Piketty doesn't just offer invaluable documentation of what is happening, with unmatched historical depth. He also offers what amounts to a unified field theory of inequality, one that integrates economic growth, the distribution of income between capital and labor, and the distribution of wealth and income among individuals into a single frame.

And yet there is one thing that slightly detracts from the achievement—a sort of intellectual sleight of hand, albeit one that doesn't actually involve any deception or malfeasance on Piketty's part. Still, here it is: the main reason there has been a hankering for a book like this is the rise, not just of the one percent, but specifically of the American one percent. Yet that rise, it turns out, has happened for reasons that lie beyond the scope of Piketty's grand thesis.

Piketty is, of course, too good and too honest an economist to try to gloss over inconvenient facts. "US inequality in 2010," he declares, "is quantitatively as extreme as in old Europe in the first decade of the twentieth century, but the structure of that inequality is rather clearly different." Indeed, what we have seen in America and are starting to see elsewhere is something "radically new"—the rise of "supersalaries."

Capital still matters; at the very highest reaches of society, income from capital still exceeds income from wages, salaries, and bonuses. Piketty estimates that the increased inequality of capital income accounts for about a third of the overall rise in US inequality. But wage income at the top has also surged. Real wages for most US workers have increased little if at all since the early 1970s, but wages for the top one percent of earners have risen 165 percent, and wages for the top 0.1 percent have risen 362 percent. If Rastignac were alive today, Vautrin might concede that he could in fact do as well by becoming a hedge fund manager as he could by marrying wealth.

What explains this dramatic rise in earnings inequality, with the lion's share of the gains going to people at the very top? Some US economists suggest that it's driven by changes in technology. In a famous 1981 paper titled "The Economics of Superstars," the Chicago economist Sherwin Rosen argued that modern communications technology, by extending the reach of talented individuals, was creating winner-take-all markets in which a handful of exceptional individuals reap huge rewards, even if they're only modestly better at what they do than far less well paid rivals.

Piketty is unconvinced. As he notes, conservative economists love to talk about the high pay of performers of one kind or another, such as movie and sports stars, as a way of suggesting that high incomes really are deserved. But such people actually make up only a tiny fraction of the earnings elite. What one finds instead is mainly executives of one sort or another—people whose performance is, in fact, quite hard to assess or give a monetary value to.

Who determines what a corporate CEO is worth? Well, there's normally a compensation committee, appointed by the CEO himself. In effect, Piketty argues, high-level executives set their own pay, constrained by social norms rather than any sort of market discipline. And he attributes skyrocketing pay at the top to an erosion of these norms. In effect, he attributes soaring wage incomes at the top to social and political rather than strictly economic forces.

Now, to be fair, he then advances a possible economic analysis of changing norms, arguing that falling tax rates for the rich have in effect emboldened the earnings elite. When a top manager could expect to keep only a small fraction of the income he might get by flouting social norms and extracting a very large salary, he might have decided that the opprobrium wasn't worth it. Cut his marginal tax rate drastically, and he may behave differently. And as more and more of the supersalaried flout the norms, the norms themselves will change.

There's a lot to be said for this diagnosis, but it clearly lacks the rigor and universality of Piketty's analysis of the distribution of and returns to wealth. Also, I don't think Capital in the Twenty-First Century adequately answers the most telling criticism of the executive power hypothesis: the concentration of very high incomes in finance, where performance actually can, after a fashion, be evaluated. I didn't mention hedge fund managers idly: such people are paid based on their ability to attract clients and achieve investment returns. You can question the social value of modern finance, but the Gordon Gekkos out there are clearly good at something, and their rise can't be attributed solely to power relations, although I guess you could argue that willingness to engage in morally dubious wheeling and dealing, like willingness to flout pay norms, is encouraged by low marginal tax rates.

Overall, I'm more or less persuaded by Piketty's explanation of the surge in wage inequality, though his failure to include deregulation is a significant disappointment. But as I said, his analysis here lacks the rigor of his capital analysis, not to mention its sheer, exhilarating intellectual elegance.

Yet we shouldn't overreact to this. Even if the surge in US inequality to date has been driven mainly by wage income, capital has nonetheless been significant too. And in any case, the story looking forward is likely to be quite different. The current generation of the very rich in America may consist largely of executives rather than rentiers, people who live off accumulated capital, but these executives have heirs. And America two decades from now could be a rentier-dominated society even more unequal than Belle Époque Europe.

But this doesn't have to happen.

4.

At times, Piketty almost seems to offer a deterministic view of history, in which everything flows from the rates of population growth and technological progress. In reality, however, Capital in the Twenty-First Century makes it clear that public policy can make an enormous difference, that even if the underlying economic conditions point toward extreme inequality, what Piketty calls "a drift toward oligarchy" can be halted and even reversed if the body politic so chooses.

The key point is that when we make the crucial comparison between the rate of return on wealth and the rate of economic growth, what matters is the after-tax return on wealth. So progressive taxation—in particular taxation of wealth and inheritance—can be a powerful force limiting inequality. Indeed, Piketty concludes his masterwork with a plea for just such a form of taxation. Unfortunately, the history covered in his own book does not encourage optimism.

It's true that during much of the twentieth century strongly progressive taxation did indeed help reduce the concentration of income and wealth, and you might imagine that high taxation at the top is the natural political outcome when democracy confronts high inequality. Piketty, however, rejects this conclusion; the triumph of progressive taxation during the twentieth century, he contends, was "an ephemeral product of chaos." Absent the wars and upheavals of Europe's modern Thirty Years' War, he suggests, nothing of the kind would have happened.

As evidence, he offers the example of France's Third Republic. The Republic's official ideology was highly egalitarian. Yet wealth and income were nearly as concentrated, economic privilege almost as dominated by inheritance, as they were in the aristocratic constitutional monarchy across the English Channel. And public policy did almost nothing to oppose the economic domination by rentiers: estate taxes, in particular, were almost laughably low.

Why didn't the universally enfranchised citizens of France vote in politicians who would take on the rentier class? Well, then as now great wealth purchased great influence—not just over policies, but over public discourse. Upton Sinclair famously declared that "it is difficult to get a man to understand something when his salary depends on his not understanding it." Piketty, looking at his own nation's history, arrives at a similar observation: "The experience of France in the Belle Époque proves, if proof were needed, that no hypocrisy is too great when economic and financial elites are obliged to defend their interest."

The same phenomenon is visible today. In fact, a curious aspect of the American scene is that the politics of inequality seem if anything to be running ahead of the reality. As we've seen, at this point the US economic elite owes its status mainly to wages rather than capital income. Nonetheless, conservative economic rhetoric already emphasizes and celebrates capital rather than labor—"job creators," not workers.

In 2012 Eric Cantor, the House majority leader, chose to mark Labor Day—Labor Day!—with a tweet honoring business owners:

> Today, we celebrate those who have taken a risk, worked hard, built a business and earned their own success.

Perhaps chastened by the reaction, he reportedly felt the need to remind his colleagues at a subsequent GOP retreat that most people don't own their own businesses—but this in itself shows how thoroughly the party identifies itself with capital to the virtual exclusion of labor.

Nor is this orientation toward capital just rhetorical. Tax burdens on high-income Americans have fallen across the board since the 1970s, but the biggest reductions have come on capital income—including a sharp fall in corporate taxes, which indirectly benefits stockholders—and inheritance. Sometimes it seems as if a substantial part of our political class is actively working to restore Piketty's patrimonial capitalism. And if you look at the sources of political donations, many of which come from wealthy families, this possibility is a lot less outlandish than it might seem.

Piketty ends Capital in the Twenty-First Century with a call to arms—a call, in particular, for wealth taxes, global if possible, to restrain the growing power of inherited wealth. It's easy to be cynical about the prospects for anything of the kind. But surely Piketty's masterly diagnosis of where we are and where we're heading makes such a thing considerably more likely. So Capital in the Twenty-First Century is an extremely important book on all fronts. Piketty has transformed our economic discourse; we'll never talk about wealth and inequality the same way we used to.

Lifting as We Climb: A Progressive Defense of Respectability Politics

Randall Kennedy, Harper's Magazine, October 2015 Issue

My parents inculcated in me and my two siblings a particular sense of racial kinship: in our dealings with the white world, we were encouraged to think of ourselves as ambassadors of blackness. Our achievements would advance the race, and our failures would hinder it. The fulfillment of our racial obligations required that we speak well, dress suitably, and mind our manners. In our household we felt tremendous pride in the attainments of blacks, and we took personally their disgrace. My father and mother loved to regale us with stories about the accomplishments of Jackie Robinson and Wilma Rudolph, Thurgood Marshall and Charles Drew, Paul Robeson and Mary McLeod Bethune. At the same time, when scandal ensnared a prominent black person, we all felt ashamed, diminished. We were also embarrassed when blacks with poor diction and sloppy comportment appeared on television. We were taught to look down on such people as "bad Negroes" whose antics further burdened "good Negroes" like us, and we suspected that whites in the news and entertainment industries preferred to publicize the former and ignore the latter.

My parents sternly ordered their children to be dignified in the presence of white people so that there would be no opportunity to put us in racist, stereotypical categories. "Don't act like a coon," they told us bluntly. "Don't act like a nigger." They also told us that racism made us more vulnerable than our white counterparts to certain risks, and that we would be judged by less forgiving standards. In competition for advancement, I would have to clearly outdistance my white peers. "Tie-tie, you lose," my father said repeatedly — meaning that as a black person I would always be deprived of the benefit of the doubt. Throughout my years at a predominantly white private high school, my parents warned me against attending boisterous parties; if something happened that called for the intervention of police, the blacks in attendance would be the ones singled out for punishment.

They never suggested that these circumstances were just; to the contrary, they resented them and abhorred the prejudice and discrimination that littered with dangerous booby traps the pathways trod by their beloved children. They believed, however, that one had to face reality with clear eyes in order to fashion responses with any hope of success. They were under no illusion that strict adherence to their protocols would immunize us completely against the ravages of negrophobia; they knew that racism targeted "good" blacks too. But they reasoned that their strictures would at least improve our chances of surviving and thriving.

Is it wrong for black parents to deliver to their children the sort of talks that my parents gave to me? The demand that young blacks pursue certain actions and avoid others in response to racism is sometimes understood to implicitly fault those young blacks who decline (or fail) to follow such recommendations. Just as complaining about the "suggestive" attire or demeanor of women who are raped is blaming the victim, many believe it is blaming the victim to complain about the "menacing" (or merely "too black") attire or demeanor of African-American men who are harassed, assaulted, or killed. The clothing a woman wears is irrelevant to the culpability of a rapist, and so, too, should the appearance of a young black man in a hoodie be irrelevant to the culpability of anyone who inflicts violence upon him.

This is true as far as it goes, but it misses the point. My parents' goal was not to apportion blame; it was to keep their children clear of danger — even as they recognized that the need to expend energy to avoid that danger was itself an unfair product of racism. The "parents' talk" is a prudential plea to take reasonable precautions. Following its advice is no guarantee, but it improves the odds. That so many black families feel the need to have such a talk illustrates their realistic belief that, even in a context of racial injustice in which African Americans are hemmed in by severely limited alternatives, there is still something that they can do to better the prospects for themselves and their communities.

The parents' talk has a larger social analogue within the black community: the politics of respectability. Its proponents advocate taking care in presenting oneself publicly and desire strongly to avoid saying or doing anything that will reflect badly on blacks, reinforce negative racial stereotypes, or needlessly alienate potential allies. They urge their activist colleagues to select as standard-bearers those who are free of seriously discrediting records. When choosing a focal point for the burgeoning movement against police brutality, for example, they counsel caution before embracing the cause of someone involved in a violent encounter in which an officer makes a plausible claim of self-defense. They preferred to rally attention around Tamir Rice, the black twelve-year-old who was playing with a toy gun in a park when he was precipitously shot dead by a policeman in Cleveland, rather than a figure like Michael Brown. Aggrieved as they were by Brown's death at the hands of a white police officer in Ferguson, Missouri, they were concerned that Brown's participation in a robbery before the shooting and the ambiguous circumstances surrounding his encounter with police would muddy the issue. Practitioners of the politics of respectability suggest focusing more on those whose victimization is clearest and likeliest to elicit the greatest sympathy from the general public.

This approach has recently become a target of much derision. It is denounced as a flight from blackness, an opportunistic gambit, a cowardly capitulation, a futile exercise, and an implicit concession that racist mistreatment is excusable unless committed upon a perfect black victim. Last fall, after a grand jury failed to indict the officer who shot Michael Brown, Michael Eric Dyson, a professor at Georgetown, wrote an op-ed for the New York Times that dismissively defined respectability politics as "the belief that good behavior and stern chiding will cure black ills and uplift black people and convince white people that we're human and worthy of respect." Such politics, he added, "don't work." Around the same time, Theodore Johnson asserted in The Atlantic that the politics of respectability "is really a coping mechanism. It affirms the inferiority and unattractiveness of black culture." Also last fall, writing for Salon, Mychal Denzel Smith suggested that "instead of asking why the options for black survival are so limited, the proselytizers of respectability politics would rather reify the theories of black inferiority that excite the white racist imagination." Ta-Nehisi Coates, perhaps the most influential young commentator on contemporary race relations, has called the appeal to respectability one of the "most disreputable traditions in American politics": "This is the black tradition that believed that 'brutes' were partially responsible for lynching in [the] 20th century, and believes that those same brutes are partially re sponsible for the 'achievement gap' in the 21st."

Defenders of a sensible black respectability politics — I am one of them — do face real challenges. "Respectability" has served at times as a harbor for bigotry or for the complacent acceptance of racism. Moreover, what should count as disreputable conduct has been subject to serious debate. Some leaders of the civil-rights movement kept Bayard Rustin and James Baldwin at a distance, out of a dislike of gays or a desire to prevent homosexuality from smearing the movement's reputation.

One critic of respectability politics, Jesse Taylor, has observed that "the saggy pants of today were the backward caps of yesterday, the Afros of the 70s, the jazz music of decades ago." He has a point. Some early-twentieth-century practitioners of respectability politics denounced jazz, perhaps America's greatest cultural invention. Today, some proponents of respectability politics similarly condemn rap, though it, too, is rightly celebrated as a great American innovation. Distinguishing prejudices that ought to be disregarded from biases that must be accommodated and judgments that ought to be acted on is a difficult endeavor.

More pressingly, the misapplication of the politics of respectability has occasionally inflicted deep wounds on the black community. Among the most ruthless enemies of civil-rights activists were the administrators of historically black public colleges who denounced black dissidents as disgraceful lawbreakers. These and other black adversaries of the black-liberation struggle failed to recognize that law and order is only presumptively legitimate — that under certain circumstances, like those that obtained in the Jim Crow South, "law and order" is undemocratic, oppressive, and evil, and thus a suitable target for revolt. In the context of the battle over segregation, lawbreakers such as Martin Luther King Jr. and John Lewis are heroes.

In seeking desperately to distinguish themselves from "bad Negroes," some putative "good Negroes" have tolerated racist misconduct. While most blacks condemned lynching unequivocally, a few endorsed a theory set forth by lynching's apologists. Commenting on the rising toll of lynchings in 1899, the Seventy-First Annual Conference of the African Methodist Episcopal Zion Church unanimously condemned "those worthless negroes whose shiftlessness leads them into the commission of heinous crimes." In an allusion to the lynching of a black man accused of rape, the Reverend George Alexander McGuire stressed the man's alleged crime rather than the lawless violence that took his life. In 1903, McGuire told an audience of African Americans at a high-school graduation that they must ruthlessly "ostracize such brutes in their own race."

This attitude persists in some circles today. In Please Stop Helping Us, Jason Riley, a black conservative, describes being stopped repeatedly by police officers who, he believes, have racially profiled him. But Riley refuses to chastise the police. Instead, he blames the blacks who commit a disproportionate share of crimes for accentuating the criminal image of the African-American male. In Riley's view, it is these "bad Negroes" — not the police — who have put a target on his back.

The attitude of McGuire and Riley tolerates what ought to be condemned: racist misbehavior perpetrated (or enabled) by police, who should be held to a higher standard than ordinary citizens. Police are agents of government, endowed with a quasi monopoly on the exercise of lawful violence. Failing to discipline wayward police will only exacerbate immoral lawlessness in distressed communities. By disgracing themselves, the guardians of law and order subvert what should be their greatest resource: the internalized allegiance of the citizenry.

But these misapplications of respectability politics should not obscure an essential fact: any marginalized group should be attentive to how it is perceived. The politics of respectability is a tactic of public relations that is, per se, neither necessarily good nor necessarily bad. A sound assessment of its deployment in a given instance depends on its goals, the manner in which it is practiced, and the context within which a given struggle is being waged. Its association with esteemed figures and episodes in African-American history suggests that the politics of respectability warrants a more re spectful hearing than it has recently received.

Consider Rosa Parks and the Montgomery Bus Boycott. Parks was not the first African American arrested in Montgomery, Alabama, for refusing to give up her seat to a white bus rider. But she was the person selected to be the face of black suffering and resistance. Listen to E. D. Nixon, a key organizer of the boycott, on why he refrained from rallying around the others who had been arrested before Parks:

> Okay, the case of Louise Smith. I found her daddy in front of his shack, barefoot, drunk. Always drunk. Couldn't use her. In that year's second case, the girl [Claudette Colvin], very brilliant but she'd had an illegitimate baby. Couldn't use her. . . . When Rosa Parks was arrested, I thought "This is it!" Because she's morally clean, she's reliable, nobody had nothing on her, she had the courage of her convictions.

Martin Luther King Jr. reiterated this point in his address announcing the boycott. "Mrs. Rosa Parks is a fine person," he declared. He was happy that she would be the community standard-bearer, for "nobody can doubt the height of her character." At the conclusion of the victorious boycott, after a lawsuit got rid of segregated seating, King again recognized the importance of maintaining an exemplary image and reputation. A flyer he and his colleagues in the Montgomery Improvement Association distributed stated that victory

> places upon us all a tremendous responsibility of maintaining, in the face of what could be some unpleasantness, a calm and loving dignity befitting good citizens and members of our race. . . . Remember that this is not a victory for Negroes alone, but for all Montgomery and the South. Do not boast! Do not brag! . . . If cursed, do not curse back. If pushed, do not push back. If struck, do not strike back, but evidence love and goodwill at all times.

Participants in the electrifying Freedom Rides and sit-ins of the early 1960s were given detailed instructions about what to wear (jackets for men and dresses for ladies) and how to act (be courteous and refrain from retaliating even if assaulted). Their leaders, including James Farmer of the Congress of Racial Equality and John Lewis of the Student Nonviolent Coordinating Committee, were doing what many leaders routinely do: packaging their campaigns in ways designed to blunt the opposition of their enemies, to elicit solidarity from supporters, and to induce acceptance from the uncommitted. Recall the dignified black teenagers who desegregated Central High School in Little Rock, Arkansas, while bands of snarling, foulmouthed white hooligans sought to torment them. Remember the determined activists who demanded service at segregated lunch counters while screaming white thugs doused them with ketchup and mustard. A vivid snapshot is provided by none other than James J. Kilpatrick, the racist journalist who fiercely opposed the civil-rights movement yet expressed grudging admiration for the youngsters who carried off the sit-ins with such splendid tact:

> Here were the colored students, in coats, white shirts, ties, and one of them was reading Goethe and one was taking notes from a biology text. And here, on the sidewalk outside, was a gang of white boys come to heckle, a ragtail rabble, slack-jawed, black-jacketed, grinning fit to kill. . . . Eheu! It gives one pause.

The attentiveness to image and reputation that was so central to the civil-rights movement in its most productive phase (1950–65) had been presaged by the efforts of groups like the Woman's Convention (W.C.) of the National Baptist Convention, an organization of black churchwomen that did important work at the turn of the twentieth century, following the dismantling of Reconstruction. The W.C. established kindergartens, orphanages, and old folks' homes; conducted training classes for new mothers; created a school to professionalize domestic service; offered counseling and comfort to prisoners; provided forums in which black women shared their impressions about their condition and how to elevate it; and served as the institutional sponsor for protests against all manner of social vices, including the racist mistreatment of African Americans through lynchings and other Jim Crow outrages.

"The politics of respectability" was coined by Evelyn Brooks Higginbotham in her 1993 history of the W.C. to describe the group's approach. According to Higginbotham, the W.C. "emphasized reform of individual behavior and attitudes both as a goal in itself and as a strategy for reform of the entire structural system of American race relations." To counteract the racist dogma that portrayed black women as dirty, dishonest, lazy, irresponsible, and lascivious, the group stressed that black women could be clean, honest, hardworking, frugal, responsible, and chaste. The W.C. protested against racist limitations imposed on blacks, but it also stressed blacks' own capacity to improve oppressive conditions even under those limitations. A 1915 statement by the W.C.'s executive board is characteristic: "Fight segregation through the courts as an unlawful act? Yes. But [also] fight it with soap and water, hoes, spades, shovels and paint to remove any reasonable excuse for it."

Stoicism suffused the W.C.'s preachings. The group demanded that blacks work to keep the cage of segregation from imprisoning their inner lives. "Men and women are not made on trains and on streetcars," declared Nannie Helen Burroughs, the W.C.'s most outstanding leader. "If in our homes there is implanted in the hearts of our children . . . the thought they are what they are, not by environment, but of themselves, this effort [by segregationists] to teach a lesson of inferiority will be futile." Higginbotham observes that "the Baptist women spoke as if ever-cognizant of the gaze of white America." Determined to avoid looking bad in front of white folks, the W.C. fielded "an army of black Baptist women [who] waged war against gum chewing, loud talking, gaudy colors, the nickelodeon, jazz, littered yards, and a host of other perceived improprieties." Their efforts were at times predicated on a belief that blacks needed to elevate themselves to reach parity with their Euro-American peers. Higginbotham notes, however, that sometimes "the Baptist women's emphasis on manners and morals served to reinforce their sense of moral superiority over whites." Urging blacks to display "proper conduct" on streetcars, the W.C. suggested in 1910 that

> a certain class of whites have set a poor example for the Negro . . . by making it a point to rush in and spread out, so that we cannot get seats. . . . We have seen our people provoked to act very rudely and to demand seats, or squeeze in, and almost sit in the laps of the "spreaders." Here is an opportunity for us to show our superiority by not squeezing in. . . . Let us at all times . . . remember that the quiet, dignified individual who is respectful to others is after all the superior individual, be he black or white.

Themes sounded by the W.C. were echoed time and again. Thurgood Marshall carefully screened potential clients before agreeing to represent them in the landmark cases that created the legal groundwork for the civil-rights revolution. "Mr. Civil Rights" withheld his services and the backing of the National Association for the Advancement of Colored People where he doubted that a person would be willing and able to present a good face to the public. He was similarly calculating in criminal cases. In his campaign for legal reform, Marshall did not proceed like conventional defense attorneys, who are generally indifferent to the culpability of their potential clients. To the contrary, he often declined to commit his scarce resources to the defense of those he believed to be guilty. He did not want the standing of the NAACP belittled by association with criminals. He viewed the reputation of his clients, his organization, and himself as important resources in the struggle to advance the fortunes of black America.

The effort to present the civil-rights movement in a fashion that would generate sympathy and admiration paid off. Segregationists attempted repeatedly to suppress the NAACP by making affiliation with the group a disqualification for public employment. They also tried to obtain NAACP membership lists so that members could be publicly identified and intimidated. Courts, however, thwarted those efforts with decisions that protected the NAACP, and thereby ratified Marshall's long-term cultivation of its reputation. Later, judges who could have plausibly ruled against demonstrators arrested for disorderly conduct and similarly amorphous offenses instead ruled in their favor, prompted to an important extent by sympathy and respect. On March 2, 1961, nearly two hundred protesters refused to leave the grounds of the South Carolina statehouse when ordered to do so. Taking care to avoid blocking vehicular or pedestrian traffic, the tightly organized demonstrators stood their ground, praying and singing religious and patriotic songs. In an opinion by Justice Potter Stewart, the Supreme Court quashed the prosecutions that resulted from the protest, concluding with admiration that the demonstrators were engaged in pro tected expression in its "most pristine and classic form."

I am not contending that a given strategy must be correct merely because it is propounded by esteemed figures. Great leaders make mistakes, too. Nor is a given strategy sound for all time. Many things that would have been imprudent to say in Mississippi in 1950 were, thank goodness, no longer so in 1970. One must be aware, moreover, that from the vantage of those in charge, virtually any effective protest is disreputable. Beyond that, one must be sensitive to the conditional virtues of outrageousness. In some circumstances it is effective and praiseworthy to scandalize the arbiters of established opinion, to give the finger to the powers that be. No movement in American history practiced a more honorable politics than the abolitionists, even though they often luxuriated in incivility. I am not defending observance of conventional propriety as a timeless principle. I am simply saying that there are occasions when deploying respectability can be useful and ought to be done.

Opponents of respectability politics often talk as though it has never been an effective tool for black activists. "Black folks have already tested out . . . respectability," Brittney Cooper, a professor at Rutgers, wrote recently. "We've been trying to save our lives by dressing right, talking right and never, ever fucking up since about 1877. That shit has not worked."

One wonders what Cooper has in mind. If she is complaining that blacks still confront racism, even after having ardently practiced respectability politics, then I fully concur. But if she is saying that the precautions undertaken and the cultivation of image pursued by countless blacks have not mattered, then I must object. By dint of intelligent, brave, persistent collective action, African Americans have helped tremendously to transform the United States in ways that offer grounds for encouragement and hope. Indeed, the tone of indignant futility struck by some opponents of black respectability politics is worrying. The politics of black respectability has not banished antiblack racism, but it has improved the racial situation dramatically and has kept alive some black people who might otherwise be dead.

Cooper writes that "we must stop believing that our lives only have value, that they are only worthy of protection, when we've done everything right." Certain denizens of the far right might embrace this odious notion, but intelligent proponents of black respectability politics certainly do not. Castigating journalist Jonathan Capehart and other "Respectables," Cooper claims that they believe that "if Black people would just 'act right' and 'do right,' we would be all right." But Capehart says no such thing. To the contrary, in the Washington Post column that provoked Cooper's ire, Capehart clearly rejected the idea that civilian misconduct is the overwhelming problem that ought to receive priority in Ferguson and other flashpoints of conflict between police and blacks. He condemned the "blatant trampling of the constitutional rights of people, mostly African Americans," by police in Ferguson and around the country. Capehart did recant his acceptance of an account of the Ferguson tragedy that put the onus of guilt squarely on the shoulders of the officer who killed Michael Brown once a Justice Department report largely corroborated the officer's version of the events. Perhaps that contributed to Cooper's outrage. But Capehart never suggested that criminality is the cause of or a justification for police malfeasance.

This is an oft-heard critique of the politics of respectability: that it wrongly shifts attention from illegitimate social conditions to the perceived deficiencies of those victimized by those conditions. We err, however, in forcing a Manichaean choice between outward-facing protest and inward-facing character building. The achievements of the civil-rights movement stemmed from and reinforced the reformation of white America, to be sure, but those achievements stemmed from and reinforced the reformation of black America as well. In demanding more of African Americans, most proponents of black respectability politics are not "letting the oppressor off the hook." They are being realistic in telling blacks that the support or at least the acceptance of many whites is necessary to enact policies that will bring about substantial positive change.

Jesse Taylor suggests that the proponents of respectability politics assume that "any bad outcome for black people is the fault of and can only be solved by black people." But most do no such thing. Rather, they acknowledge that overcoming oppression is hard work that will require effort from many parties, including those who have been grievously injured. Some observers may object that demanding anything at all of blacks is unfair because white-supremacist wrongs are behind blacks' predicaments. Whether or not the demand is fair, however, responding positively to it may be the fastest way for some blacks to attain a semblance of the lives they want. A person injured by a drunk driver has to take it upon herself to participate in the hard work of rehabilitation even if she played no role in her own victimization. Similarly, deprivations that are wholly attributable to white racism may still force blacks to work hard at personal and collective advancement if they are to have any chance of continued elevation.

Some claim that the politics of respectability is futile because racism is beyond the influence of putting our best foot forward. “Trading our sagging pants for suits and our sometimes foul language for a newly formed loquacity does nothing to address the systemic inequities and injustices that plague black bodies,” Jared Loggins declares. “Respectability did little to stop key provisions of the Voting Rights Act from being stricken and George Zimmerman from being acquitted of murder.” Loggins appears to believe that a strategy is of negligible value unless it always prevails. That is nonsense. The 2013 Supreme Court ruling in Shelby County v. Holder that weakened the Voting Rights Act was regrettable. But the decision might have been even worse absent the deserved halo that hovers over that act — a halo placed on it in large part by dedicated practitioners of the politics of respectability. Loggins’s despairing cry of futility flies in the face of evidence that, to an appreciable extent, racist attitudes can be, and are, amenable to change. Martin Luther King’s stress on touching the latent morality of white oppressors was not simply a gesture of Christian faith and Gandhian commitment; it was also good politics. The moral attractiveness of the civil-rights movement did convert some people, and negative perceptions of African Americans were altered by the dignified character of black protests.

One obvious problem for opponents of black respectability politics is the huge gulf separating what they say and how they behave. Well-known detractors of the politics of respectability typically dress to impress — as most adults do on a regular basis. Whenever people dress to impress they are engaging in a politics of respectability. They may be contemptuous of the conformism that demands certain attire for the purpose of securing a job, or satisfying the expectations of a television audience, or obtaining relief for a client in court. But they don the attire anyway, calculating that the cost of doing so is exceeded by the potential cost of failing to do so. Michael Eric Dyson does not wear casual street clothes when he appears on Meet the Press to do ideological battle with Rudy Giuliani. He dresses up because he is rightly attentive to his image. He practices the politics of respectability even as he disparages it.

We know intuitively that our appearance affects the treatment we receive. Image does not wholly dictate response, but often it makes a difference. This proposition is so obvious as to be banal. Yet some commentators dispute it, asserting that racism is no respecter of respectability. “No matter how angelic their acts,” Melissa Harris-Perry told the audience of her MSNBC show, “no matter how appropriate their attire, respectability has never been armor against violence toward black bodies." The politics of respectability is "erroneous," Myisha Carey wrote last year, "because history has shown that 'acting better' does not bring about being 'treated better.' We must remember that four girls were in Sunday school when their Birmingham church was bombed. Amadou Diallo did not commit any crime, obeyed the police, but yet was shot 41 times by the police."

No one with any sense claims that "acting better" ensures immunity against racist violence or any other lurking catastrophe. The argument is that prudent conduct and sensitivity to how we appear to others improve our chances for success in environments peppered with dangerous prejudices. It is unfortunate that safety might require such self-consciousness, and it is imperative to reform society such that self-defense of this sort is no longer needed. In the interim, however, blacks should do what they can to protect themselves against the burdens of a derogatory racial reputation that has been centuries in the making.

It is impossible to quantify with exactitude the extent to which the civil-rights movement caused or contributed to the evolution of white racist attitudes — an evolution, in some instances, from hard racism to softer racism, and in other instances from soft racism to a belief in racial equality. All one can say with confidence is that carefully organized protests were among the manifold influences that have dramatically transformed America. This transformation has been marked concretely by legislation, including the Civil Rights Act of 1964 and the Voting Rights Act of 1965, as well as its four reauthorizations, and by the exercise of power by blacks at the highest levels of government — chairman of the Joint Chiefs of Staff (Colin Powell), secretary of state (Colin Powell, Condoleezza Rice), Supreme Court justice (Thurgood Marshall, Clarence Thomas), attorney general (Eric Holder, Loretta Lynch), president (Barack Obama).

Obama is the exemplary recent practitioner of black respectability politics. He has assiduously cultivated a persona that is racially nonthreatening to many whites (though many others still find him "too black") by, among other things, distancing himself from African Americans who are perceived as unduly bitter or menacingly radical. He voices an updated version of the W.C.'s message. He criticizes the constraints that blacks encounter because of past and ongoing racism, and, to the extent that it is feasible, he supports policies that he believes will provide relief. But he also openly identifies failings by blacks — parental absence, negligent nutrition, destructive criminality, inadequate civic engagement. And he demands that African Americans, individually and collectively, do more for themselves.

A good illustration of Obama's approach is the address he delivered in May 2013 at the commencement ceremony of Morehouse College, the all-male, historically black college that educated Martin Luther King and other prominent civil-rights leaders. "Along with collective responsibilities," Obama told the graduating students, "we have individual responsibilities. . . . Too many young men in our community continue to make bad choices . . . there's no longer any room for excuses." Obama also observed with approval that "every one of you have a grandma or an uncle or a parent who's told you that at some point in life, as an African American, you have to work twice as hard as anyone else if you want to get by."

Critics of black respectability politics objected to this speech vociferously. Ta-Nehisi Coates wrote:

> Taking the full measure of the Obama presidency thus far, it is hard to avoid the conclusion that this White House has one way of addressing the social ills that afflict black people — and particularly black youth — and another way of addressing everyone else. I would have a hard time imagining the president telling the women of Barnard that "there's no longer room for any excuses" — as though they were in the business of making them. Barack Obama is, indeed, the president of "all America," but he is also singularly the scold of "black America."

Charging that the Morehouse graduation speech fit into a pattern of "convenient race-talk," Coates asserted that surely black Americans "have earned something more than targeted scorn."

This response is strikingly tendentious. It implies that any criticism of blacks by Obama nullified every other feature of the president's address. His speech was primarily celebratory, as one would expect and hope for at a graduation. Obama congratulated Morehouse for "the unique sense of purpose [it] has always infused — the conviction that [it] is a training ground not only for individual success but for leadership that can change the world." In a speech that Coates charged with "targeted scorn," one finds the following tribute to the Morehouse tradition:

> For black men in the Forties and the Fifties, the threat of violence, the constant humiliations . . . the uncertainty that you could support a family, the gnawing doubts born of the Jim Crow culture that told you every day that somehow you were inferior, the temptation to shrink from the world, to accept your place, to avoid risks, to be afraid — that temptation was necessarily strong. And yet, here, under the tutelage of men like Dr. Mays [former presi- dent of Morehouse], young Martin learned to be unafraid. And he, in turn, taught others to be unafraid. And, over time, he taught a nation to be unafraid.

It is true that Obama implored the men of Morehouse to be responsible, engaged, loving fathers. But he did so by praising Frederick Anderson, a member of the graduating class who had completed his education even as he went to great lengths to manfully shoulder the responsibilities of fatherhood: "Today, Frederick is a family man and a working man and a Morehouse man. And that's what I'm asking all of you to do: keep setting an example for what it means to be a man. Be the best husband to your wife, or your boyfriend, or your partner. Be the best father you can be to your children. Because nothing is more important."

Obama left unmentioned Anderson's marital status. While some proponents of respectability politics insist that men and women ought to be married before begetting children, Obama offers a more capacious view of what respectability entails. For him, being married is clearly subordinate to the day-to-day reality of a committed, loving relationship.

Elsewhere in his speech, Obama does explicitly criticize some young blacks. "We know," he remarked, "that too many young men in our community continue to make bad choices." But to whom did he refer to particularize his point? Himself. "I made quite a few [bad choices] myself," the president confessed. "Sometimes I wrote off my own failings as just another example of the world trying to keep a black man down. I had a tendency sometimes to make excuses for me not doing the right thing." In taking this tack, Obama reemphasized his own affiliation with "our" community — the black community. Moreover, he affiliated himself with a stigmatized section of that community: those who have made "bad choices." Speaking of the fallen, the disreputable, what some might call the "bad Negroes," Obama declared: "There but for the grace of God go I — I might have been in their shoes. I might have been in prison. I might have been unemployed. I might not have been able to support a family." Then, after having acknowledged the thin line between success and failure, Obama affirmed that those who make bad choices remain valuable and redeemable. After all, after having made his bad choices, Obama put himself on a different path and climbed to the White House.

In his Morehouse address, Obama stressed a theme that has been repeatedly sounded by other proponents of respectability politics — that part of being respectable is being socially conscious, public-spirited, and altruistic. Respectability entails giving back. As Obama put it:

> I know that some of you came to Morehouse from communities where life was about keeping your head down and looking out for yourself. Maybe you feel like you escaped, and now you can take your degree and get that fancy job and the nice house and the nice car — and never look back. And don't get me wrong — with all

those student loans you've had to take out, I know you've got to earn some money. With doors open to you that your parents and grandparents could not even imagine, no one expects you to take a vow of poverty. But I will say it betrays a poverty of ambition if all you think about is what goods you can buy instead of what good you can do.

Suffusing Obama's speech is the "lifting as we climb" ethos that animated the W.C. and many other practitioners of respectability politics. "Just as Morehouse has taught you to expect more of yourselves," he counseled, "inspire those who look up to you to expect more of themselves. . . . So be a good role model, set a good example for that young brother coming up. If you know somebody who's not on point, go back and bring that brother along. . . . You've got to be engaged in the barbershops, on the basketball court, at church, spend time and energy and presence to give people opportunities and a chance."

An underlying optimism animates respectability politics, a belief that even in the teeth of recalcitrant bigotry and cruel indifference, blacks can still wrest from this society more liberty and equality. Keenly aware of how far blacks have come over the past half-century, proponents of respectability politics have faith that shrewd, disciplined, and forceful action can help blacks, individually and collectively, continue to advance. The detractors of respectability politics, on the other hand, tend to eschew talk of progress and to dwell on the huge disadvantages that continue to burden African Americans.

Polls show that large numbers of Americans from all racial backgrounds are dejected about the racial situation today. The feelings of many people have soured considerably since Obama's election in 2008 gave rise briefly to racial triumphalism. I confess that I remain upbeat. I am aware that, to some, such a statement may seem odd, or grotesque, or even insulting in this moment of accumulating outrages, including the killings of Trayvon Martin, Michael Brown, Tamir Rice, Eric Garner, Walter Scott, Sandra Bland, and the nine parishioners at the Emanuel African Methodist Episcopal Church. As brutal and frustrating as our era can be, however, day by day it offers more racial decency than any previous era. At no point in American history has there been more overall freedom from antiblack racial impediments. At no point has there been more reason for young black men and women to be hopeful that investing in themselves will pay dividends in the future. At no point has a progressive black respectability politics made more sense.

Dominant and Dangerous

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Preface

IF HEGEMONS are good for anything, it is for conferring stability on the systems they dominate. For 70 years the dollar has been the superpower of the financial and monetary system. Despite talk of the yuan's rise, the primacy of the greenback is unchallenged. As a means of payment, a store of value and a reserve asset, nothing can touch it. Yet the dollar's rule has brittle foundations, and the system it underpins is unstable. Worse, the alternative reserve currencies are flawed. A transition to a more secure order will be devilishly hard.

When the buck stops

For decades, America's economic might legitimised the dollar's claims to reign supreme. But, as our special report this week explains, a faultline has opened between America's economic clout and its financial muscle. The United States accounts for 23% of global GDP and 12% of merchandise trade. Yet about 60% of the world's output, and a similar share of the planet's people, lie within a de facto dollar zone, in which currencies are pegged to the dollar or move in some sympathy with it. American firms' share of the stock of international corporate investment has fallen from 39% in 1999 to 24% today. But Wall Street sets the rhythm of markets globally more than it ever did. American fund managers run 55% of the world's assets under management, up from 44% a decade ago.

The widening gap between America's economic and financial power creates problems for other countries, in the dollar zone and beyond. That is because the costs of dollar dominance are starting to outweigh the benefits.

First, economies must endure wild gyrations. In recent months the prospect of even a tiny rate rise in America has sucked capital from emerging markets, battering currencies and share prices. Decisions of the Federal Reserve affect offshore dollar debts and deposits worth about $9 trillion. Because some countries link their currencies to the dollar, their central banks must react to the Fed. Foreigners own 20-50% of local-currency government bonds in places like Indonesia, Malaysia, Mexico, South Africa and Turkey: they are more likely to abandon emerging markets when American rates rise.

At one time the pain from capital outflows would have been mitigated by the stronger demand—including for imports—that prompted the Fed to raise rates in the first place. However, in the past decade America's share of global merchandise imports has dropped from 16% to 13%. America is the biggest export market for only 32 countries, down from 44 in 1994; the figure for China has risen from two to 43. A system in which the Fed dispenses and the world convulses is unstable.

A second problem is the lack of a backstop for the offshore dollar system if it faces a crisis. In 2008-09 the Fed reluctantly came to the rescue, acting as a lender of last resort by offering $1 trillion of dollar liquidity to foreign banks and central banks. The sums involved in a future crisis would be far higher. The offshore dollar world is almost twice as large as it was in 2007. By the 2020s it could be as big as America's banking industry. Since 2008-09, Congress has grown wary of the Fed's emergency lending. Come the next crisis, the Fed's plans to issue vast swaplines might meet regulatory or congressional resistance. For how long will countries be ready to tie their financial systems to America's fractious and dysfunctional politics?

That question is underscored by a third worry: America increasingly uses its financial clout as a political tool. Policymakers and prosecutors use the dollar payment system to assert control not just over wayward bankers and dodgy football officials, but also errant regimes like Russia and Iran. Rival powers bridle at this vulnerability to American foreign policy.

Americans may wonder why this matters to them. They did not force any country to link its currency to the dollar or encourage foreign firms to issue dollar debt. But the dollar's outsize role does affect Americans. It brings benefits, not least cheaper borrowing. Alongside the "exorbitant privilege" of owning the reserve currency, however, there are costs. If the Fed fails to act as lender of last resort in a dollar liquidity crisis, the ensuing collapse abroad will rebound on America's economy. And even without a crisis, the dollar's dominance will present American policymakers with a dilemma. If foreigners continue to accumulate reserves, they will dominate the Treasury market by the 2030s. To satisfy growing foreign demand for safe dollar-denominated assets, America's government could issue more Treasuries—adding to its debts. Or it could leave foreigners to buy up other securities—but that might lead to asset bubbles, just as in the mortgage boom of the 2000s.

It's all about the Benjamins

Ideally America would share the burden with other currencies. Yet if the hegemony of the dollar is unstable, its would-be successors are unsuitable. The baton of financial superpower has been passed before, when America overtook Britain in 1920-45. But Britain and America were allies, which made the transfer orderly. And America came with ready-made attributes: a dynamic economy and, like Britain, political cohesiveness and the rule of law (see article).

Compare that with today's contenders for reserve status. The euro is a currency whose very existence cannot be taken for granted. Only when the euro area has agreed on a full banking union and joint bond issuance will those doubts be fully laid to rest. As for the yuan, China's government has created the monetary equivalent of an eight-lane motorway—a vast network of currency swaps with foreign central banks—but there is no one on it. Until China opens its financial markets, the yuan will be only a bit-player. And until it embraces the rule of law, no investor will see its currency as truly safe.

All this suggests that the global monetary and financial system will not smoothly or quickly wean itself off the greenback. There are things America can do to shoulder more responsibility—for instance, by setting up bigger emergency-swaplines with more central banks. More likely is a splintering of the system, as other countries choose to insulate themselves from Fed decisions by embracing capital controls. The dollar has no peers. But the system that it anchors is cracking.

The Sticky Superpower

IN JUNE THIS year Jack Ma, the founder of Alibaba, a giant Chinese e-commerce firm, addressed the Economic Club of New York, whose members include many Manhattan luminaries and Wall Street chiefs. Mr Ma's message was that his company exists for the long-term good of society, a far cry from the creed of shareholder value followed by many in the room. He pledged to help America's struggling small firms export to China's 630m internet users, who between them now spend more online than Americans do. The venue for the event was the Waldorf Astoria hotel, which, when it opened in 1931, in the midst of the Depression, was hailed by President Herbert Hoover as "an exhibition of confidence and courage to the whole nation". Today the Waldorf is owned by a Chinese insurance firm run by Deng Xiaoping's grandson-in-law. The whole event seemed to symbolise a change in the world's economic order.

Yet as a parable of American decline that would be too neat. The lesson from Mr Ma's big day in the Big Apple is more subtle: that America remains the world's indispensable economy, dominating some of the brainiest and most complex parts of human endeavour. Alibaba is listed in New York, not on Shanghai's bourse, whose gyrations this year have alienated investors. Four of the six banks that underwrote Alibaba's flotation were American. Alibaba makes only 9% of its sales outside China (and has just hired a former Goldman Sachs executive to increase that share). The

Waldorf is run by an American firm, Hilton, that does well out of owning intellectual-property rights worldwide. Days after his speech Mr Ma spent $23m on a mansion in New York state's Adirondack mountains. No doubt he will enjoy the trout streams, but like many Chinese tycoons he may also want a bolthole in a country that embraces the rule of law. Two months later China devalued its currency, causing panic about its economy.

This special report will examine the paradox illustrated by Mr Ma's speech. It will argue that America is a sticky economic superpower whose capacity to influence the world economy will linger and even strengthen in some respects, even though its economic weight in the world is declining. For some, this is a welcome prospect. Hillary Clinton, a front-runner for the job of America's next president, wrote last year: "For anyone, anywhere, who wonders whether the United States still has what it takes to lead…for me the answer is a resounding 'yes'…everything that I have done and seen has convinced me that America remains the indispensable nation." But if handled badly, the growing gap between America's economic weight and its power will cause frustration and instability.

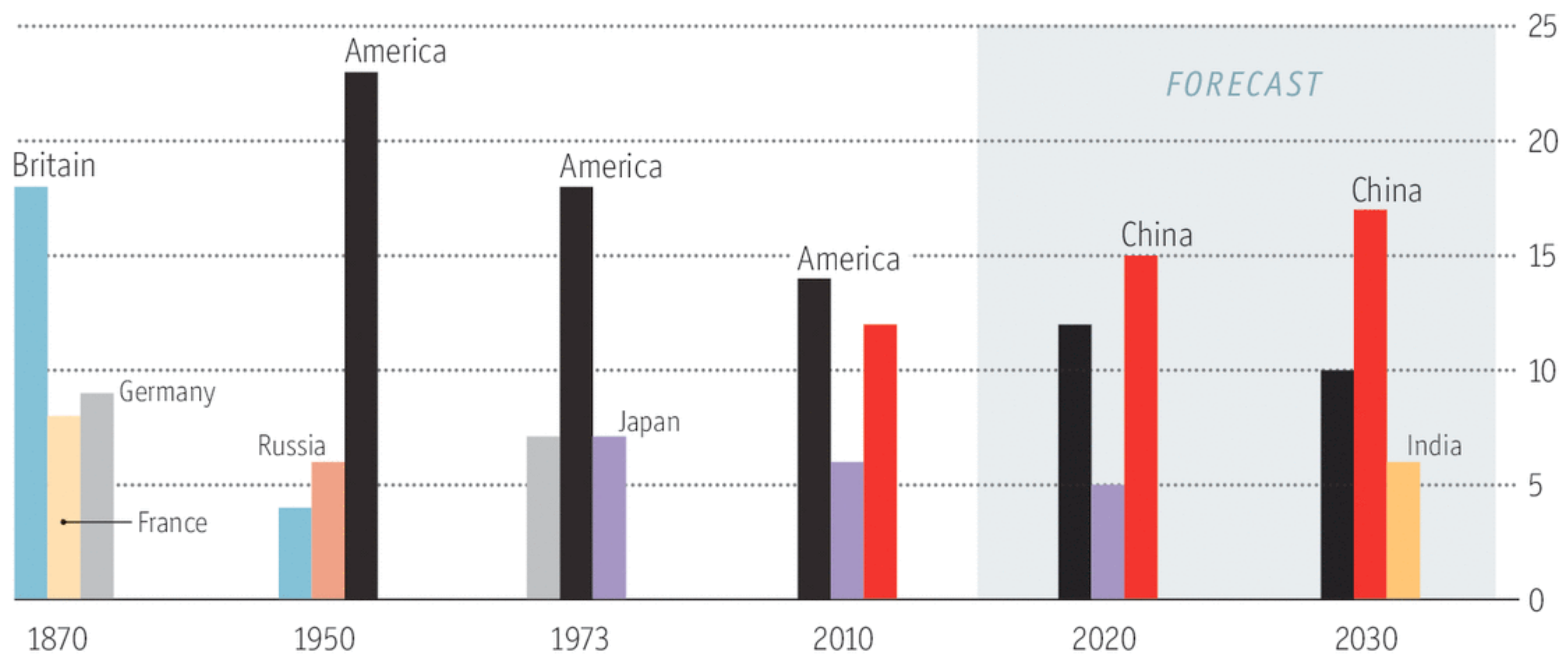
Power is the capacity to compel another to do what they otherwise would not. It can be exercised through coercion, by setting rules or by engendering expectations and loyalties. American power is sometimes defined so broadly that it includes both the flight decks of the USS Abraham Lincoln and the legs of Taylor Swift. This report will focus on a narrower point: how America's grip on the global economy helps, enriches, organises, bosses and annoys the rest of the world . This kind of power is often wielded inadvertently: for example, America has no desire to run India, yet India's economy is affected by the Federal Reserve's monetary policy; and two of the subcontinent's leading industries, technology and pharmaceuticals, are subject to American rules that are a de facto world standard.

American economic dominance has never been absolute. Between 1946 and 1991 the Soviet Union's empire of queues and rust aspired to be a rival model. From the 1970s onwards Europe pursued closer integration partly as a counterweight to America; the idea of a single European currency gained momentum as Europeans grumbled about the ascendancy of the dollar. Japan appeared to pose a threat in the 1980s and in its pomp tried to persuade Asia to join a yen zone. Even when the so-called Washington Consensus of American-inspired liberal economic policies was at its peak in the 1990s, many countries, most notably China, ignored it. But until recently one thing was clear: America had the biggest weight of any country in global GDP and trade.

In the first change in the world economic order since 1920-45, when America overtook Britain, that dominance is now being eroded. As a share of world GDP, America and China (including Hong Kong) are neck and neck at 16% and 17% respectively, measured at purchasing-power parity. At market exchange rates a fair gap remains, with America at 23% and China at 14%. By a composite measure of raw clout—share of world GDP, trade and cumulative net foreign investment—China has probably overtaken America already, according to Arvind Subramanian, an economist (see chart). Even if China's economy grows more slowly from now on, at 5-6% a year, its strength on such measures will increase.

The ebbs and flows of power

% share* of global economic power



Source: "Eclipse: Living in the Shadow of China's Economic Dominance", by Arvind Subramanian, 2011

*Weighted by share of world GDP, trade and net capital exports

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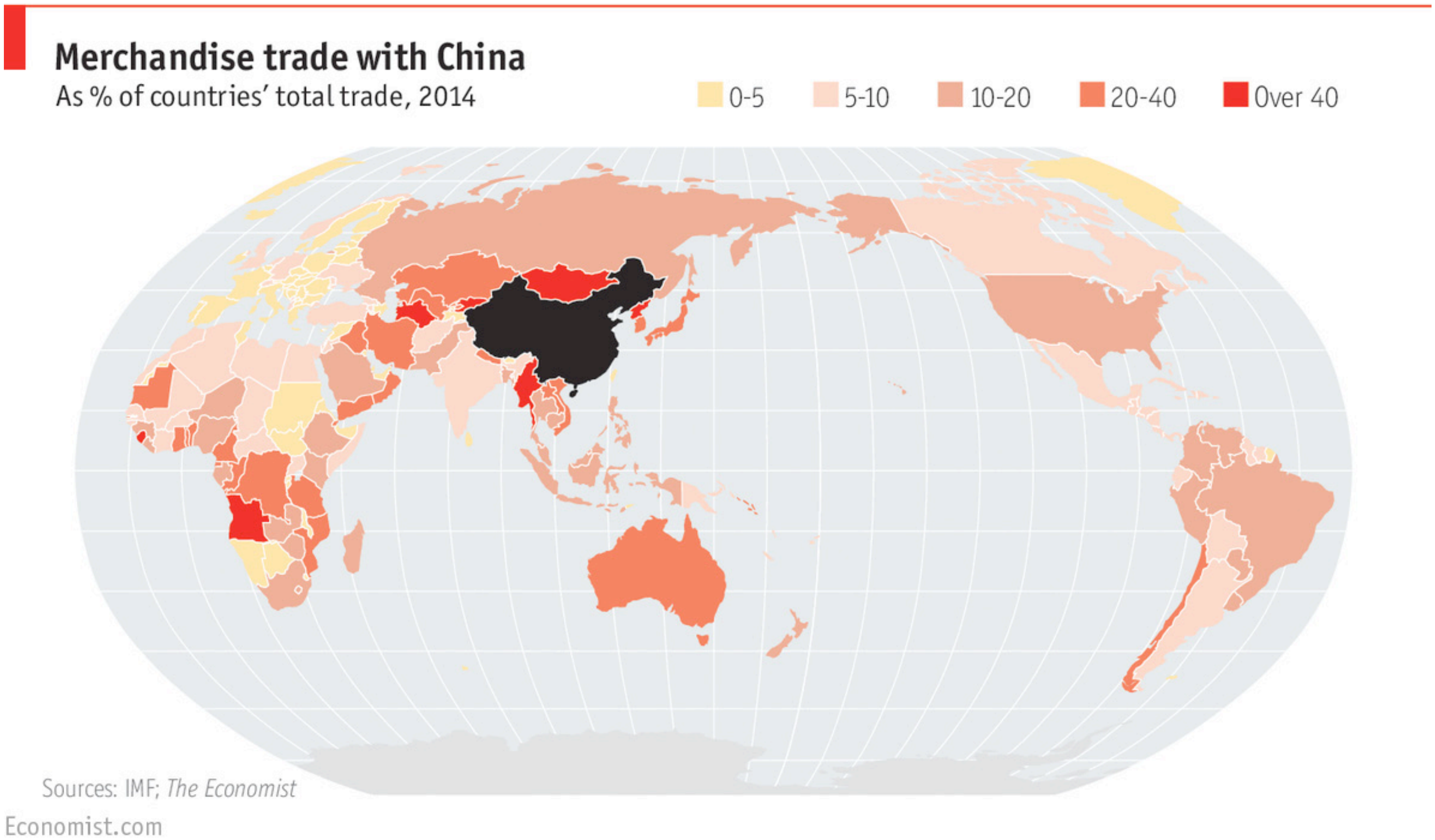
The experience of the 20th century suggests that such a transition can happen fast. In 1907 America lacked a central bank and suffered a banking collapse, but by the 1920s the dollar rivalled the pound sterling as the world's most widely used and trusted currency. If the past is a guide, China could surpass America in the blink of an eye, giving it the heft to issue the world's reserve currency and set the rules of trade and finance. A plurality of people polled by the Pew Research Centre around the world believe that China will become the world's leading economic power. Those aged under 30 are most likely to believe they will live in a Chinese epoch.

But any reordering of the world economy's architecture will not be as fast or decisive as it was last time. For one thing, the contest is more balanced. America is far stronger than Britain was at its moment of precipitous decline, and China is weaker today than America was when it took off. For all its efforts to promote its currency and its institutions, the Middle Kingdom is a middle-income country with immature financial markets and without the rule of law. The absence of democracy, too, may be a serious drawback.



Today's world also relies on a vastly bigger edifice of trade and financial contracts that require continuity. Trade levels and the stock of foreign assets and liabilities are five to ten times higher than they were in the 1970s and far larger than at their previous peak just before the first world war. The speed and complexity of capital flows surpass anything the world has ever seen before. Britain and America were allies, which made the transfer of power orderly, if often humiliating for the declining power. Having squashed Britain's global pretensions at the Bretton Woods conference on the international monetary and financial order in 1944, America helped cushion its financial collapse in 1945-49. China and America are not allies. The greater complexity and risk involved in remaking the global order today create a powerful incentive for current incumbents to keep things as they are.

Last, the nature of economic activity has changed, shifting towards intangible, globalised services (such as cloud computing and computerised financial trading) in a way that may allow America to exert dominance by remote control.

Economists, Tea-Partiers, trade unionists and Bruce Springsteen have chronicled America's slide on traditional measures of economic and institutional prowess. Judged by its share of world steel production, manufacturing, merchandise trade, transport and commodities production and consumption, the country is going to the dogs (see chart). The number of countries for which America is the biggest export market has dropped from 44 in 1994 to 32 now. Over the same period the equivalent figure for China has risen from two to 43.

America's lead in other areas, such as research-and-development spending, technology equipment and consumer brands, is no longer as comfortable as it was. Many of the world's most valuable firms are still American, but this overstates their clout abroad: their share of the stock of international corporate investment has fallen from 39% in 1999 to 24%.

America still shines in a number of fields. It has 15 of the world's 20 leading universities. Its Food and Drug Administration is the global benchmark for the efficacy of a new medicine. A patent registered in New York is far more credible than one booked in Shanghai. And Hollywood's domination of the world's box offices is as eternal as a Californian film star's youth.

What is less widely acknowledged is that in some domains America's clout is increasing. The country has demonstrated an astonishing capacity to dominate each new generation of technology. It is now presiding over a new era based on the cloud, e-commerce, social media and the sharing economy. These products go global faster and penetrate more deeply into people's minds and jobs than anything Silicon Valley has invented before, affecting everyone from cabbies to philanderers to despots.

Facebook and Google do a majority of their business abroad, and that share is rising. When Microsoft was at the height of its powers in 2000, it made less than a third of its sales overseas. American firms now host 61% of the world's social-media users, undertake 91% of its searches and invented the operating systems of 99% of its smartphone users. China's internet firms, including Mr Ma's, are both protected and trapped behind China's "Great Firewall".

America's dominance of the commanding heights of global finance and the world monetary system has risen. The global market share of Wall Street investment banks has increased to 50% as European firms have shrunk and Asian aspirants have trodden water. American fund managers run 55% of the world's assets under management, up from 44% a decade ago, reflecting the growth of shadow banking and new investment vehicles such as exchange-traded funds. Global capital flows, larger than at any time in history, move in rhythm with the VIX, a measure of volatility on America's stockmarkets.

Power through neglect

One of the oddities of globalisation is that although America's trade footprint has shrunk, its monetary footprint has not. The Federal Reserve is the reluctant master of this system, its position cemented by the policies put in place to fight the 2007-08 financial crisis. When the Fed changes course, trillions of dollars follow it around the world. America's indifference towards the IMF and World Bank, institutions it created to govern the system and over which it has vetoes, reflects power through neglect.

The position of the dollar, widely seen as a pillar of soft power, has strengthened. Foreign demand for dollars allows America's government to borrow more cheaply that it otherwise could, and the country earns seigniorage from issuing bank notes around the world. America's firms can trade abroad with less currency risk, and its people can spend more than they save with greater impunity than anyone else. Even when a global crisis starts in America it is the safe haven to which investors rush, and foreigners accumulate dollars as a safety buffer.

Since the attacks of September 11th 2001, America has emphatically asserted control over the dollar payment system at the heart of global trade and finance. Hostile states, companies or people can be cut off from it, as Iran, Burmese tycoons, Russian politicians and FIFA's football buffoons have found to their cost. The threat of this sanction has given America an enhanced extraterritorial reach.

Finance and technology are already a battleground for sovereignty, as Europe's pursuit of Google through antitrust cases has shown. So for America to lay a claim to running the world economy's central nervous system even though it is no longer its dominant economic power would be the ultimate expression of its exceptionalism. The country would need to show an extraordinarily deft touch. It would have to act, and to be seen as acting, in the collective interest.

America's political system has shown itself capable of great leadership in the past, not least during and after the second world war. Today it is falling short of these ideals. The global financial crisis proved that America always does the right thing in the end, but only after exhausting all the alternatives. The Federal Reserve provided liquidity to the world, and with a gun to its head Congress stumped up the cash to rescue American financial firms. But since then America's political system has flirted with sovereign default, refused to reform or fund the IMF, obstructed China's efforts to set up its own international institutions, imposed dramatic fines on foreign banks and excluded a growing list of foreigners from the dollar system.

The idea that America's political system does not feel obliged to meet what self-interested foreigners present as its global economic responsibilities is nothing new. When informed about a speculative attack against Italy's currency in 1972, Richard Nixon snapped: "I don't give a shit about the lira." But the country's current indifference may be more than a temporary lull. America's middle class is unhappy with globalisation and its politics are deeply polarised.

If America failed to live up to expectations, what would that mean for the rest of the world? For the moment it is easy for America's policymakers and politicians to be complacent: China's aura of competence has been damaged by its recent economic troubles, and America has the world's perkiest economy, admittedly in a sluggish field. But it is important to be clear-headed about the long-term choices. America cannot expect effortlessly to dominate global finance and technology even as its share of world trade and GDP declines and it becomes ever more inward-looking.

This special report will argue that the present trajectory is bound to cause a host of problems. The world's monetary system will become more prone to crises, and America will not be able to isolate itself from their potential costs. Other countries, led by China, will create their own defences, balkanising the rules of technology, trade and finance. The challenge is to create an architecture that can cope with America's status as a sticky superpower. The next article will explain why its internal politics have made this ever more difficult.

Neither Leading nor Ceding

AFTER THE HORRORS of the second world war most Americans just wanted to "go to the movies and drink Coke", observed Averell Harriman, who later became secretary of commerce. Instead their government built a world order centred around America. Its economic achievements were exemplified by the Marshall Plan to help rebuild war-ravaged Europe—"the most unsordid act in history", according to Winston Churchill. It revived the world economy and made America richer, too. By 1950 Coca-Cola was selling 50m bottles a day in Europe.

This was a golden era of American foreign-policymaking. What did it take to make the country act in such enlightened self-interest? According to "The Wise Men", a history by Walter Isaacson and Evan Thomas published in 1986, the magic ingredients included a rarefied East Coast foreign-policy elite who could easily glide between Wall Street and high office; responsible media; a thoughtful Congress capable of bipartisanship; a public that could be united against a common ideological enemy with which America had few economic links; and a president, Harry Truman, who was a war hero.

None of those conditions applies today. Viewed from outside, America's economic diplomacy since the financial crisis of 2007-08 has become cranky. Earlier this year America tried to discourage its allies from supporting China's new development bank, the Asian Infrastructure Investment Bank (AIIB), only to find that many of them joined the institution anyway. It was a diplomatic fiasco. Old-timers complain that links with Chinese policymakers, once carefully cultivated, have atrophied. A row with China over cyber-security is brewing.

Domestic constraints on economic policymaking have got worse. Political confrontations over the budget have pushed the country close to default, irritating the foreigners who own 60% of the Treasury market. Since 2010 Congress has refused to recapitalise or pass reforms of the IMF, keeping the world waiting.

Foreign banks have been subjected to fines and litigation costs totalling about $100 billion, some richly deserved, some little more than shakedowns by local officials looking for headlines and cash. Some banks from the emerging world and a few countries have been all but excluded from the dollar payments system by money-laundering rules whose cost, imprecision and extraterritorial reach are pushing the global banking system away from America. The Federal Reserve's extension of liquidity to foreign banks is under attack from the left and from the Tea Party, and at least a third of Congress wants to review or limit the Fed's powers. In July Congress stopped Exim Bank, a government body that finances exports, from writing new loans.

The grandest foreign-policy initiative has been the Trans-Pacific Partnership (TPP), a proposed trade deal between Asia-Pacific and America. (Another deal with Europe is coming up behind.) In June Congress agreed to hold a simple yes or no vote on any TPP deal that Mr Obama strikes. But TPP is a far cry from the trade pacts of the past. It excludes China and India. The hope is that both countries will eventually ask to join, but they could equally go into a huff and push their own trade pacts. TPP negotiations have dragged on and Congress may now be voting on it during next year, in the midst of a presidential election. Hillary Clinton, the Democratic front-runner, has declined to endorse the pact, even though she had supported it in broad outline in the past. Half the field of Republican candidates are hostile to TPP.

The campaign will also see tensions with China flare. Marco Rubio, a Republican contender, has called on America to stop appeasing China. Donald Trump, another Republican hopeful, said ahead of a visit to America by Xi Jinping, China's leader, that instead of a state banquet he would offer him a Big Mac.

One view is that all this is just a temporary blip. America has always harboured a strain of populism that dislikes elites and foreign engagements, sometimes called the Jacksonian tradition after Andrew Jackson, who served as president from 1829 to 1837. America declined to participate in the Genoa conference in 1922 that aimed to restore Europe's economy. In 1948-49 Congress vetoed American membership of a planned global trade body, the precursor of the World Trade Organisation (WTO). In 1953 Joseph McCarthy, a prominent anti-communist Republican senator, said the career of John McCloy as the second American head of the World Bank and a diplomat in Germany was an "unbelievable, inconceivable, unexplainable record of the deliberate, secret betrayal of the nation to its mortal enemy, the communist conspiracy". In the 1980s relations with Japan were prickly. In the 1990s China's rise and its currency peg to the dollar were the subject of bitter political debates.

Do the right thing

Optimists point out that America usually manages to overcome its Jacksonian impulses. At the Bretton Woods conference in 1944 it designed and pushed through the IMF and the World Bank, along with a system of fixed exchange rates that lasted until the 1970s. During the 2007-08 crisis American politicians agreed to bail out global banks headquartered in America. They did not stop the Fed from extending up to $500 billion of loans to foreign financial firms and at least the same again in dollar swap lines to foreign central banks.

Congress has always been tricky to handle. It delegates the power to negotiate treaties to the president but can investigate decisions, try to block funding for foreign-policy initiatives and pass laws that influence foreign policy. It also holds authority over the Fed. Even the policymakers of the post-war golden era found it troublesome. Robert Lovett, who as secretary of defence helped Harry Truman build up NATO, said dealing with Congress was like "getting a shave and having your appendix taken out at the same time". Paul Nitze, who helped draft the Marshall Plan, had to appear before Congress 43 times to defend it, losing 15lb (about 7kg) during the ordeal.

In the 1990s America was again ascendant abroad. Its economic ideas became a global, free-market orthodoxy known as the Washington Consensus. America led the response to the emerging-markets crises of 1995-99, prompting Time magazine to label a triumvirate of officials, Alan Greenspan, Robert Rubin and Larry Summers, as "the committee to save the world". America passed the NAFTA trade deal, joined the WTO and shepherded China into it, too. But all this was bitterly contested at home. To bail out Mexico in 1995, Mr Rubin, then Treasury secretary, had to use a kitty of money reserved for currency interventions that did not require congressional approval.

All this suggests that Congress and the American public have always been ambivalent about economic diplomacy, and that the current White House has not been good at managing that tension. But the pursuit of America's enlightened self-interest is also genuinely getting harder, for three reasons.

First, partisan politics have intensified, a fact attributed variously to gerrymandering, to a natural self-induced "sorting" of like-minded people into the same areas, and to the decline of the moderate wings of both parties. Congress has become gridlocked, a problem exacerbated by the 24-hour news cycle, lobbying and the huge sums spent on campaigning.

There is hostility to economic diplomacy on both sides of the political divide. The left wing of the Democratic Party, symbolised by Senator Elizabeth Warren, opposes free trade, perhaps more strongly that it did in the 1990s. The right wing of the Republican Party, the Tea Party, has an expeditionary wing that is willing to use force abroad and an isolationist one that wants to keep the world away from America. Both dislike anything that smacks of world government. Parts of the machinery of economic diplomacy are subject to an operating licence that must be renewed by Congress frequently, for example the president's right to pursue trade deals and try to get them through Congress with a simple yes or no vote, known as Trade Promotion Authority (TPA). These votes are now recurring triggers for ideological battles.

Stop the world, we want to get off

United States

Sources: Pew Research Centre; World Bank

Economist.com

Second, popular discontent with globalisation and worries about stagnant middle-class incomes and shrinking blue-collar jobs have become more prominent. In the abstract, a majority of Americans still support free trade and globalisation. But there are plenty of warning signs. Less than a fifth of them believe that trade creates jobs, and the poorer they are, the less they think it is a good thing. Americans are also suspicious of China, America's most important economic partner. In polls, a majority of them agree that their country should "mind its own business internationally and let other countries get along the best they can on their own" (see chart), and that America's influence is declining.

The third problem is the fallout from the financial crisis, which has exacerbated mistrust of globalisation. It has also made it harder for Wall Street types to work for the government, a staple of American economic diplomacy, thus reducing the quality of manpower available for such jobs. Of the 24 Treasury secretaries since 1945, 14 have worked on Wall Street at some point. America's economic relations with China after it opened up in the early 1990s were built up by an elite that moved just as seamlessly between the government, Goldman Sachs and Citigroup as their Chinese counterparts did between state-owned enterprises, party appointments and government posts.

The financial crisis has also led to a "populist creep" in which bits of the apparatus previously subject to technocratic control have become politicised. One example is the global dollar payments system, which used to be the responsibility of the Fed and the Treasury. Now lots of different official bodies are competing for authority over it and for the power to levy fines on global activity, which at their worst come with a storm of publicity and gagging orders and without judicial process.

Another example is the Federal Reserve itself, whose popularity with the public has fallen over the past decade. Several Republican bills currently passing through Congress are seeking to subject the Fed to more supervision by Congress and the Government Accountability Office. Elizabeth Warren has introduced legislation that would limit the Fed's emergency lending powers to American and foreign banks. These initiatives may not become law, but fear of confrontation with Congress will dull the Fed's appetite to take risks of the kind it did in 2007-08 when it was the world's lender of last resort.

The consequence of American ambivalence is that the three pillars of the world's economic architecture, the IMF, the World Bank and the WTO, are all in bad repair, though for different reasons.

Take the IMF first. It is meant to monitor the world economy and lend money to countries with balance-of-payments problems. Given the size of global imbalances and capital flows, it should have become more important. In practice it is hobbled. This is partly a question of legitimacy. Asian countries faced stringent conditions which the bank (guided by America) imposed on loans during the Asian crisis of 1997-98. Many emerging economies vowed that they would never borrow from it again. That is one reason why they have built up the huge foreign-currency reserves that have distorted American capital markets. The IMF has tried to make amends by allowing countries that it judges to be "very strong" performers to pre-qualify for loans, but so far only Mexico, Colombia and Poland have signed up.

Fund in a funk

In 2009-10 the Obama administration proposed a package of reforms to put the IMF's finances on a sounder footing and increase its legitimacy with emerging economies. European countries would cede votes and seats on the board to emerging economies, although America would retain a sufficient share of the IMF's capital and votes to have a veto. These proposals probably did not go far enough. Emerging economies would still have under half the votes and the capital, and in time the rest of the world might object to America's veto. Even if the reforms were implemented the IMF's permanent kitty would still be only about $1 trillion, nowhere near the $6 trillion of reserves that emerging economies consider necessary as an insurance policy.

All the same, Congress has failed to approve the reforms on four occasions since 2010. Part of its complaint is a nit-picking objection to the technicalities of the IMF's funding; the reform will replace a temporary arrangement with a permanent one. Another grumble is that the IMF has been disproportionately generous to the euro zone. Relative to the size of its GDP and its capital contribution, Greece has received at least five times more money from the IMF than the typical Asian country did in the crises of the 1990s. Congress has a point here, but its objections are perverse because the reform package would dilute Europe's influence within the IMF by cutting its votes and the number of people it can put onto the IMF's executive board. If the obstruction continues for another year or two, other countries may try to bypass America, for example by setting up a parallel fund. That might prompt America to exercise its veto, leading to a bigger spat.

If the IMF is partly beached, the World Bank and the WTO are drifting. The governance of the World Bank, where America has a veto and whose boss it traditionally appoints, has become cumbersome. Emerging economies complain that it is too bureaucratic and obsessed with fashionable campaigns. Its outstanding loans have shrunk from 3% of emerging-market output in 1994 to 1%, although it is now trying to increase them and to reorganise itself. The WTO is still good at enforcing existing trade agreements, but has not managed to bring in a comprehensive new deal for two decades. The so-called Doha round of talks, which began in 2001, has more or less fizzled out. Emerging economies refuse to agree to new trade deals, and America is no longer knocking heads together.

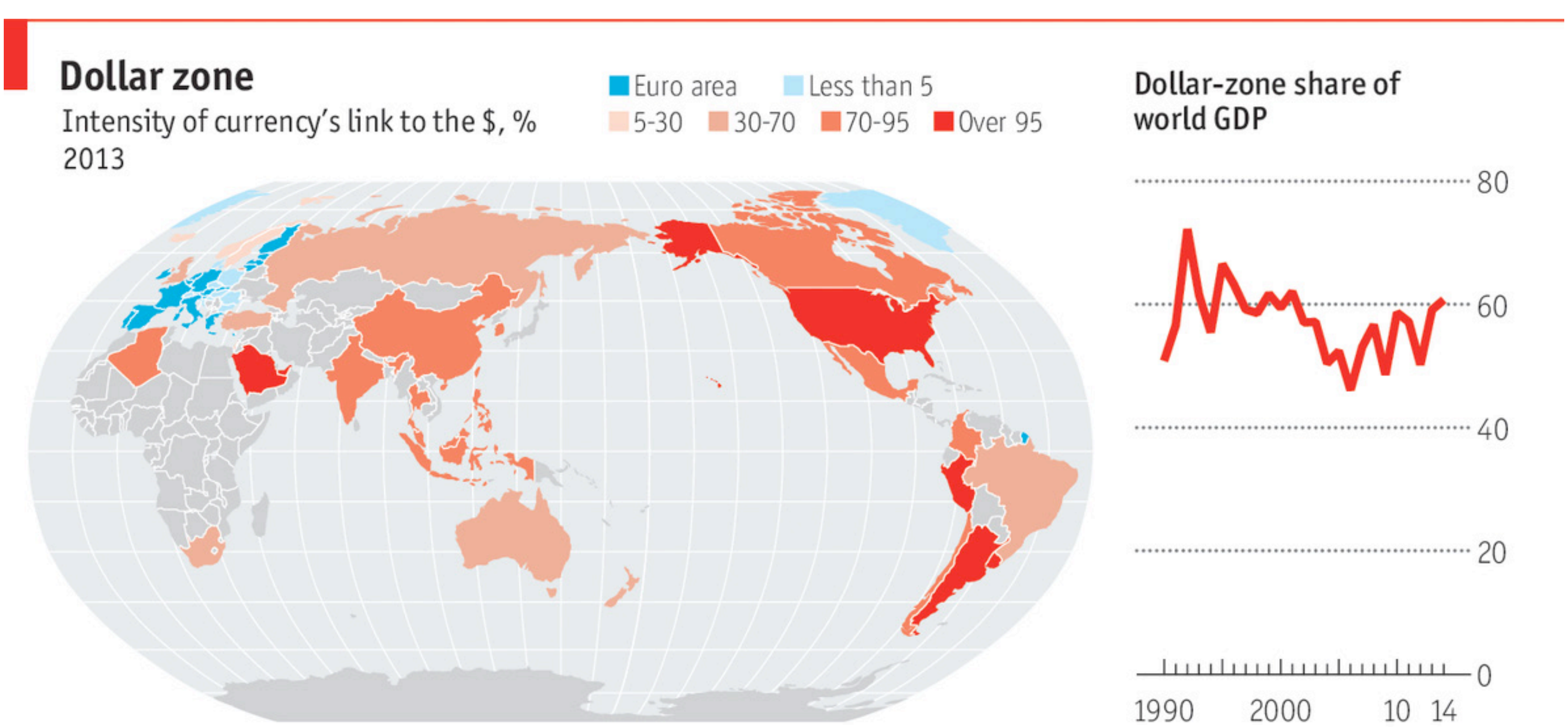
Should anyone care if the IMF, the World Bank and the WTO do not work well? There is no magic about these particular institutions, but a widely agreed international economic framework is worth having. The post-war system hinged on one country looking beyond its narrow self-interest to support a global set of rules. It is now less willing to do that. At the same time the world is becoming more volatile and complex. The best illustration of that is the global monetary and financial system.

Thrills and Spills

JOHN MAYNARD KEYNES observed that in the late 19th century London's influence on the global financial system was such that the Bank of England could be considered the world's orchestra conductor. Today America is like the dominant rapper in an anarchic transnational collective. Some politicians reckon that the global monetary system is a source of American soft power. This article will argue that it is unstable and, if unreformed, poses a threat to American interests.

The global monetary system has long been a headache. The gold standard of the 19th century dissolved into depression and chaos in the 1930s. The post-war Bretton Woods system of fixed exchange rates collapsed in the 1970s, to be replaced by a freewheeling system of floating currencies and mobile capital. Today it suffers from three related problems. First, the old collective-action one that Keynes grappled with: how to resolve the imbalances between countries (their current-account deficits and surpluses) in a way that does not hurt world economic growth. If deficit countries are forced to bear all the burden of adjustment by cutting back their imports, world output will be lower. This has haunted the euro zone, where tensions between northern countries with surpluses and southern ones with deficits were partly responsible for the crisis. Countries that try to cheapen their currency to boost their exports can set off tit-for-tat devaluations that benefit no one. China's devaluation in August has raised fears of such beggar-thy-neighbour policies.

The second problem is newer and more dangerous: the size of gross capital flows sloshing about the world. A country with a current-account surplus or deficit has to invest abroad, or attract, net funds of the same amount. In the 19th and 20th centuries economists tacitly assumed that the gross capital flows moving around the world would roughly reflect those amounts. But after two decades of financial globalisation, capital flows dwarf current-account imbalances. In 2007 they reached about 20% of world GDP. That year India's current-account deficit, for instance, was $16 billion, but the gross capital flows washing into the country were 28 times bigger, partly offset by outflows. Since the 2007-08 crisis very low interest rates have encouraged large-scale speculation, with capital flooding into emerging countries. The chaos in the currency markets this year has reflected the unwinding of these positions.



Source: "Currency movements drive reserve composition", by Robert McCauley and Tracy Chan, BIS Quarterly Review, December 2014
Economist.com

The third problem is the dollar and America's role in the system. The greenback reigns supreme by every yardstick for an international currency: as a medium of exchange, a unit of account, a store of value and a reserve asset held by central banks. The euro has lost ground, the yen has flopped and the yuan is still in nappies. By one estimate the de facto dollar zone accounts for perhaps 60% of the world's population as well as 60% of its GDP (see map). It is made up of America, the countries whose currencies float in sympathy with the dollar, and countries with dollar pegs such as China.

By law the Fed sets its policy to suit America alone, but a great archipelago of offshore dollar deposits and securities exists outside America. Dollar payments pass through banks that directly or indirectly deal with New York. Countries' trade flows and some of their debts are in dollars, so this is the currency they need. But there is no guaranteed lender of last resort. The Fed lends dollars to foreigners on ad hoc terms. The IMF has insufficient money and legitimacy to play this role. Instead, many countries have built up enormous safety buffers of dollar reserves in the form of Treasury bonds.

Those vast global capital flows tend to move to America's financial rhythm. Countries with currency pegs have to mimic Fed policy or risk excessive capital inflows if they keep rates too high, or outflows if they keep them too low. Global banks are financed in dollars and expand and contract to mirror conditions in America. Firms with dollar debts or deposits have no control over changes in their interest costs or income. Giant global investment funds, usually headquartered in America, often borrow in dollars, and their mood swings to the beat of Wall Street.

The Anna Karenina principle

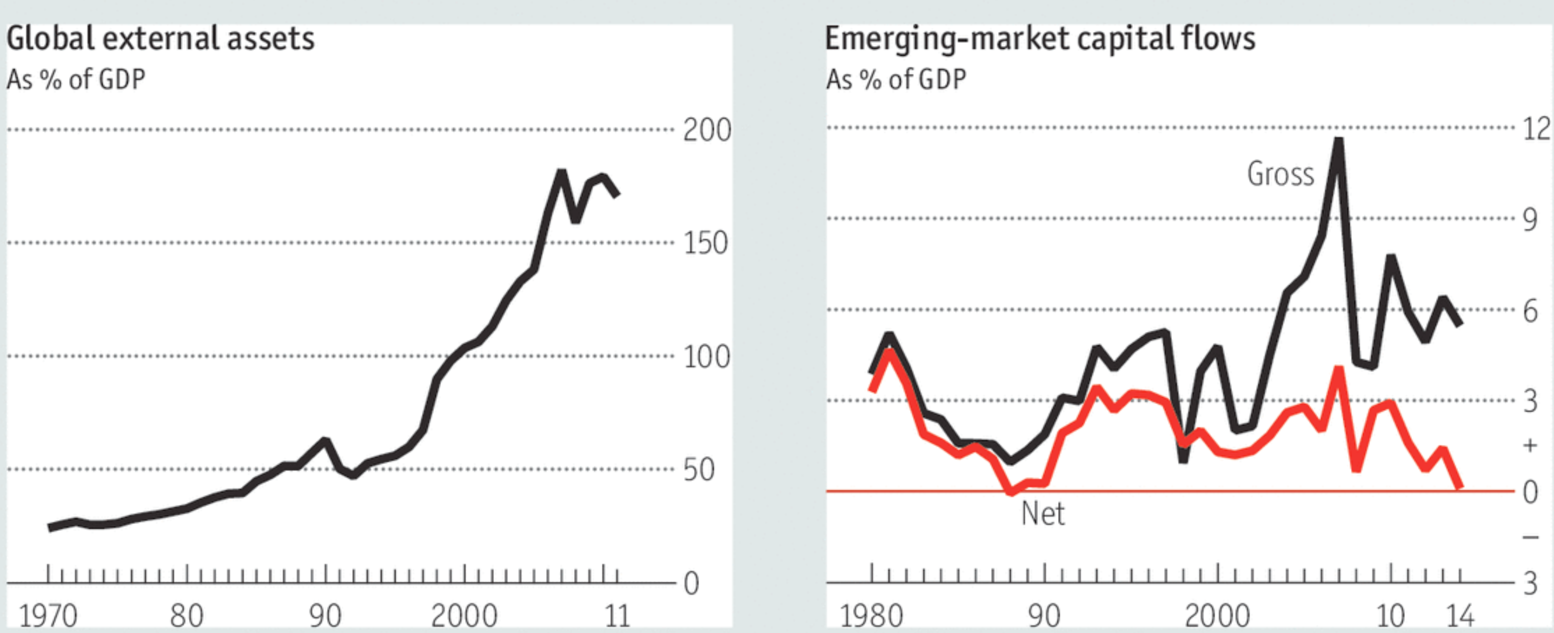
Just like Tolstoy's unhappy families, every country in the dollar system is unhappy in its own way. The three problems listed above—imbalances, capital flows and dollar dependence—are mixed into a giant omelette that is near-impossible to unscramble. At the heart of the problem is a piece of economic logic known as the "trilemma". It states that a country can have only two of three things it wants: a stable exchange rate, openness to global capital flows and the ability to set its interest rates freely to suit its own economy. Before the Asian crisis in 1997-98 many countries had fixed currencies and were open to money coming across their borders but had no independent monetary policy. The illusion of stability fostered by such pegs led to a build-up of dollar-denominated debts in emerging Asia. When capital inflows dried up, the pegs broke. Currencies plunged in value, pushing up the cost of dollar debts. A brutal recession followed.

The scars of the Asian crisis explain the emergence of a new consensus: countries should let their currency float so it would act as an adjustment mechanism. Their openness meant they would be buffeted by speculators, but that could be mitigated by keeping their house in order, controlling inflation, deepening local markets and avoiding borrowing in other currencies. For all emerging economies, median net foreign-currency debt (total debt less reserves) has fallen from 20% of GDP in 1995 to roughly zero today. Most countries built up immense dollar reserves and tried to minimise their current-account deficit or run a surplus. China had its own variation, pegging its currency but at a cheap rate to the dollar. That generated vast current-account surpluses which the government heaped into an ever-growing pile of American Treasury bonds.

None of this has worked as well as expected. Take the floaters first. Large capital flows can cause chaos even if your house is in order, roiling local-currency bond markets and interest rates. Just because you do not borrow in dollars does not mean you are immune to jittery foreigners' antics. Foreigners now own between 20% and 50% of local-currency government bonds in Turkey, South Africa, Indonesia, Malaysia and Mexico. Since 2013 the Fed has pondered tightening rates, and every time it gets close, money cascades out of emerging markets.

China and other countries with fixed pegs are fed up, too. When America raises interest rates, the dollar soars and so do their currencies, hurting exports. Moreover, the value of those huge reserves appears to be periodically at risk from a falling dollar, inflation or even default. During the 2007-08 crisis American officials made weekly calls to reassure their Chinese counterparts that it would not default.

Tempestuous



Sources: "External Wealth of Nations", by Philip Lane and Gian Maria Milesi-Ferretti, 2013; IMF; "Capital Flows are Fickle", by John Bluedorn *et al*, 2013, IMF working paper 13/183

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Even America has mixed feelings about the monetary regime it anchors. In theory its ability to trade and borrow cheaply and freely in its own currency is an "exorbitant privilege", in the words of a former French president, Valéry Giscard d'Estaing. The financial crisis caused many to reconsider that view. Artificial demand for "safe assets" in dollars may have pushed up the exchange rate, hurting manufacturing jobs. Indeed, it may have helped cause the crisis. Voracious bouts of foreign buying of Treasury bonds distorted the market, lowering interest rates and fuelling a debt binge by banks and homeowners.

One response is to assume that the global system heals itself naturally. The argument goes something like this. The imbalances between surplus countries in Asia and the Middle East and deficit countries, most notably America, will narrow now that oil exporters are earning less and China is trying to move away from its export-led model. Capital flows have gone over the top as central banks have tried to fend off a depression, but as the dollar rises, emerging economies will use their reserves to stabilise their currencies. The system will start to look more normal.

But that is wishful thinking. If the system unwinds and two decades of globalisation go into reverse, things could turn messy, with emerging markets rapidly selling down their reserves, perhaps disrupting the Treasury market, and capital rushing out. It seems just as likely that the system is self-perpetuating. Imbalances reflect long-term factors, such as a culture of precautionary saving in emerging Asia, which mostly lacks social-security safety nets. The sheer scale of the world's financial system will ensure that global capital flows remain big and violent. Governments still have a strong incentive to run current-account surpluses and to build up huge reserves if they can.

If this crisis-prone system were to stumble along for another decade, it would stretch everyone's nerves to breaking-point. For emerging economies, their relationship with America has become lopsided. Conventional wisdom has it that an American recovery is good for all. It raises global interest rates but also global exports, which in net terms benefits emerging economies. An IMF study concludes that a rise of one percentage point in American bond yields, if driven by hopes of better growth, will push up bond yields in emerging economies, but the resulting rise in American imports will boost emerging markets' industrial production by 2%.

The trouble is that American bond yields often rise for other reasons, which means the net effect may be bad for emerging economies. A dollar rally has been associated with emerging-market troubles in 1980-85, 1995-2001, 2008-09 and 2013-15. And whereas the effect of America exporting its financial conditions is as powerful as ever, its imports of goods from emerging economies have diminished in relative terms. America's share of global imports has fallen by a third since 2000, to 12%. The trade-off from being in Uncle Sam's orbit has become less favourable.

America may find that carrying on as before will become acutely uncomfortable for different reasons. One is the offshore dollar banking system and the risk that America may have to bail it out. The freewheeling Eurodollar market for banking in dollars outside America sprang up in the 1960s to get round red tape in America itself. It has been growing at a furious pace ever since. Foreign banks create dollar deposits and loans at the stroke of a pen: a bank lends a dollar to a foreign firm, which deposits it in a different foreign bank, which lends it out, and so on.

The Eurodollar market was at the heart of the 2007-08 crisis. Dollar depositors and bond investors in European banks panicked and refused to carry on funding them, piling into the safe haven of Treasuries instead and causing a run. Interbank rates in London soared relative to American interest rates. The Fed was forced to provide over $1 trillion of liquidity, by lending to foreign banks through their American subsidiaries and by extending swap lines to friendly central banks (in Europe, Mexico, Brazil, Japan South Korea and Singapore) which in turn made the dollars available to their banks. Even if these swap lines were not used in full, their mere existence calmed the panic.

Since then the offshore dollar system has become even bigger. It is now about half the size of America's domestic banking industry, compared with 10% in the 1970s. Offshore dollar credit (bonds and loans) has risen from 28% to 54% of American GDP over the past decade and from 11% to 16% of world GDP outside America. The Eurodollar is becoming the Asian dollar. A sample of a dozen of Asia's biggest banks (excluding Japan) have a total of $1 trillion of dollar assets, often financed by debt, with Chinese banks featuring prominently. Singapore now hosts $1.2 trillion of offshore dollar bank assets.

Some think that this is a cyclical boom, fuelled by low American interest rates. But it could just as easily be seen as reflecting the dollar's dominance as a global currency: as emerging economies get bigger and more finance-intensive, their use of the dollar will increase. Assuming that the relationship between offshore dollar borrowing and non-American GDP stays on its current trend, the offshore dollar market could reach $20 trillion-40 trillion by 2030.

Meanwhile the link between America and the offshore system has become weaker. An elite group of banks has always settled dollar payments with each other using CHIPs, a semi-official body in New York, and a mass of other banks deal through the elite. The hierarchy was shaped like a pyramid. But America slapped so many fines on foreign banks that many lenders now keep away from it, so the pyramid has changed shape. The top has got narrower, with almost all transactions funnelled through five or six global firms, including J.P. Morgan and HSBC. They deal with America on behalf of thousands of banks around the world. These big global banks, in turn, are cutting off direct dealings with some customers—Ukraine, some African countries, third-tier Chinese banks, small firms in the Middle East—because the cost of monitoring them has become uneconomic. Those customers have taken to using layers of smaller banks to act as intermediaries with the big global ones. More and more of the offshore dollar world is trying to avoid direct contact with America, making the middle and bottom of the pyramid wider.

The lesson of 2007-08 was that a run in the offshore dollar archipelago can bring down the entire financial system, including Wall Street, and that the system needs a lender of last resort.

An archipelago too far

Could the Fed save the day again? It would be a lot harder than last time. The offshore archipelago is almost twice as large as it was in 2007 and is growing fast, so any rescue would have to be on a much larger scale. The mix of countries involved is tilting away from America's allies. The banks in question are less likely to have subsidiaries in New York that can borrow directly from the Fed or are viewed as palatable by the American legal system. The consequences could be dire (for one possible scenario, see article).

The system's longer-term viability may also be tested by an inadequate supply of "safe assets" in the form of Treasury bonds. In the 1960s Robert Triffin, a Belgian-born economist, worried that foreign demand for dollars would jeopardise the Bretton Woods system in which the dollar was redeemable against a limited supply of gold at a fixed price. In today's freewheeling currency system the problem is different. Already foreigners own $6.2 trillion-worth of Treasuries, or 60% of the total available. If countries carry on building dollar reserves in line with the size of their economies, and America's debt-to-GDP ratio remains steady, Treasuries could be in short supply by 2035.

America could find sneaky ways to create safe assets, such as offering blanket guarantees of bank deposits and corporate bonds to make them as safe as government bonds. Or it could issue far more bonds that it needs and invest the surplus abroad, acting like a sovereign-wealth fund. But after the bail-outs of 2008 Congress wants to limit the scope of the Fed's safety net. Some believe the IMF could meet the demand for safe assets by creating more Special Drawing Rights (SDRs), a form of quasi-money based on a basket of major currencies. Yet if countries wanted to diversify their reserves they could easily do this directly, without a need for SDRs. They want dollars.

The global monetary system is unreformed, unstable and possibly unsustainable. What it needs is an engineer to design smart ways to tame capital flows, a policeman to stop beggar-thy-neighbour policies, a nurse to provide a safety net if things go wrong, and a judge to run the global payments system impartially. If America's political system makes it hard to fill those vacancies, can China do better?

We All Hang Together

BY 2023 THE global offshore dollar shadow banking system had grown larger than America's onshore domestic banking system. The euro's credibility had slipped further after Italy's partial default in 2018. The yuan's ambitions beyond its borders came to a standstill during the final days of Xi Jinping's rule in September 2019. In a last effort to placate conservative elements within the party, capital controls were temporarily reimposed, the head of the People's Bank of China arrested for "deviations" and yuan deposits in Hong Kong were frozen. The redback's use abroad never recovered.

That meant the dollar was more in demand than ever as the only reliable medium of payment for global trade. The dollar assets of China's largest bank, ICBC, overtook JPMorganChase's entire balance-sheet. Total offshore dollar credit reached $26 trillion, or about 100% of America's GDP. Emerging countries, with their trade still denominated in dollars, continued to build ever larger dollar reserves. Congress's failure to approve reform of the IMF and the subsequent withdrawal of China, India and Brazil meant there was no global lender of last resort.

In order to create a bigger supply of safe assets, Congress came close to approving the creation of the Invest America Fund, which sold Treasuries to foreigners and invested in shares overseas. But a bitter ideological row over how its surplus earnings would be distributed left the legislation stuck in the Senate. The imbalance between the supply of and demand for Treasuries led to a heavily distorted market.

The crisis, when it struck, came from an unexpected source. Indonesian and Malaysian firms had invested heavily in solar-energy projects, financed by Chinese and other Asian banks, using dollars and supposedly hedged and in some cases redistributed off the banks' balance-sheets, mainly to Asia's burgeoning pension funds. When shale-oil drilling began in earnest in the European Union, oil prices fell to $14, making the solar projects uneconomic. Depositors and bond funds fled from the

Asian dollar market into Treasuries, still the world's only safe haven. Analysts estimated the need for emergency liquidity at $5 trillion-6 trillion.

The Federal Reserve proved unable to help. The Fair Fed act of 2017 had prevented it from extending more than $300 billion of liquidity to other central banks. None of the big Asian commercial banks had branches in New York; most had shut them in protest after the New York Superintendent of Financial Services, in an election year, had attempted to fine Bank of China $12 billion and India's largest state banks $9 billion, alleging corruption in the banks' home countries. That meant they were not eligible to access the Fed's liquidity window.

In desperation, the central banks of China, India, Indonesia, Singapore and Malaysia agreed to pool their dollar reserves, totalling $8 trillion, and make massive liquidity injections into the Asian dollar banking system. At first it appeared they had stemmed the panic, with interbank rates falling. But as they sold down their holdings of American bonds, the price of Treasuries tumbled, pushing long-term American bond yields up by three percentage points and prompting talk of a housing crash rivalling that of 2007. In a settlement brokered by the Treasury secretary, Jamie Dimon, America agreed to allow the Fed to offer liquidity to Asian central banks in return for accepting their Treasury bonds as collateral. As the crisis eased, America, China and other Asian countries started talks to create a global lender of last resort and to promote the use of the yuan and rupee abroad. A new era of international co-operation had begun.

A Longer March

TO TEST CHINA'S chops as an economic hegemon, just walk across the border from mainland China into the special territory of Hong Kong, a global financial centre and a laboratory of sorts for China's ambitions. It lives on trade with the mainland and is a hub for yuan banking. Many shops and machines accept the redback. Yet even this place, on mainland China's border and as open as an economy can get, remains a long way from adopting China's financial habits.

Hong Kong has its own laws, institutions and currency, which has been pegged to the dollar for 32 years. Shares are mainly priced and paid for in Hong Kong dollars. They often trade at different prices to those listed on the Shanghai bourse, which is isolated and badly regulated, sometimes leading to distorted share prices. Only 11% of Hong Kong's bank deposits are in yuan, compared with 30% in American dollars. Most of the capital raised on its markets is in its own currency or the greenback. A global bank, HSBC, is considering shifting its headquarters from London to Hong Kong, but only if it is supervised by the special territory's impressive independent monetary authority, not the mainland's regulators. Hong Kong's richest man, Li Kashing, invests six times more in regulated businesses in the West than in his motherland of mainland China.

When China devalued its currency by 3% in early August, unnerving global markets, Hong Kong's officials and bankers were as perplexed as everyone else. Even China's central bank, which implemented the policy, seemed confused. It issued a statement promising nothing less than a system that would "keep the exchange rate basically stable at an adaptive and equilibrium level, enabling the market rate to play its role, and improving the managed floating exchange-rate regime based on market demand and supply". Rather than soothe nerves, this tortured prose prompted a big question. Does the pressure resulting from China's slowdown detract from its ambition to rival America on the world economic stage?

China's economy is open in some ways and closed in others, combining to form an incoherent whole. Foreigners can build factories but not buy bonds. China's firms are the world's second-biggest cross-border investors as measured by their stock of direct investment, but its private fund managers are an irrelevance; three streets in Edinburgh host more international assets. Mainland consumers can buy BMW cars and Gucci handbags, but not shares in the firms that make them. The People's Bank of China (along with related agencies) is probably the biggest investor in the world's most transparent bond market, but is itself as opaque as the Huangpu river. State banks lend like lions to Africa but are as timid as mice in Western capital markets. When China stumbles, the price of oil tumbles, but the oil-derivatives contracts that reflect this are traded elsewhere.

Ambition v stability

The Marxist books that China's leaders once studied suggest that such contradictions must lead to change, and there is something to this. For example, huge sums now drain out of China through cracks in its great edifice of rules, ending up in Manhattan property and Swiss bonds. Allowing foreigners to buy more Chinese shares and bonds would create a counterbalancing inflow. But China's potential to play an economic role in the world to rival America's rests mainly in the hands of its leaders, and they must weigh their vaulting ambitions against their deep fear of instability.

The ambition part of this is easy to understand. At a minimum China wants the natural privileges a vast economy might expect: a big say over global rules of finance and trade and a widely used currency. Gone are the days when its policymakers played little brother to America's. ("I understand," said Hu Jintao, China's president, in September 2006 when American officials privately requested that the yuan rise 3% by December to placate Congress. By the following May it was up 3.5%). During the financial crisis China realised that its reserves could be at risk from American devaluation or even default. By 2009 Zhou Xiaochuan, the boss of China's central bank, was calling for a new world reserve currency to replace the dollar.

It is not only China's pride that demands a bigger international role but economic logic too. Future trade deals covering new areas such as cybercrime and e-commerce could be tailored to fit China's needs, rather than China having to adopt someone else's rules, as it had to do in 2001 to qualify for WTO membership. With a bigger voice over development lending to poor countries, China could expand and protect its investments.

A more international China could escape its subordinate role in the dollar zone. Allowing the yuan to float might, in time, help the economy adjust better and bring down trade imbalances. Prising open the capital account would make it easier for foreigners to buy Chinese bonds and shares and help the yuan become a global currency. If Chinese firms can trade and borrow abroad in yuan and use fewer dollars, China will feel less inclined to hoard dollar reserves. There would be collateral benefits: China would be forced to reform its financial markets, which allocate capital sloppily.

The danger of instability is pressingly important. If growth slows down, China's reformers may face attacks from the vested interests that oppose change: state banks with guaranteed lending margins, state-owned firms that get subsidised loans, exporters that have borrowed in dollars assuming the yuan can only go up. The lesson from China's modern history is that deeper reforms do happen, though with a lag. In 1989-90 growth slowed to 4% after a botched attempt to quell inflation and the bloody events of Tiananmen Square. By 1992 Deng Xiaoping had reasserted his power through his famous "southern tour", in the course of which he pushed for market reforms and outwitted the party's conservatives.

Softly, softly

Growth has not got that low yet. Official figures suggest that it is currently 7%, and bearish private forecasters think 5% is plausible. So far the government has dithered. It has pursued membership of the SDR, the IMF's basket of elite currencies, a symbol of its international ambitions and its need for validation by American-designed institutions. But it has also made a clumsy attempt to prop up its stockmarkets. The devaluation of the yuan in August this year can be read either as a reform to make the redback more freely tradable or an act of panic to boost exports that tilts

China back towards the mercantilist policies of the past. It has been a rare misstep by Mr Zhou, the head of China's central bank, who is widely seen in America as the Chinese leader most committed to liberal reforms.

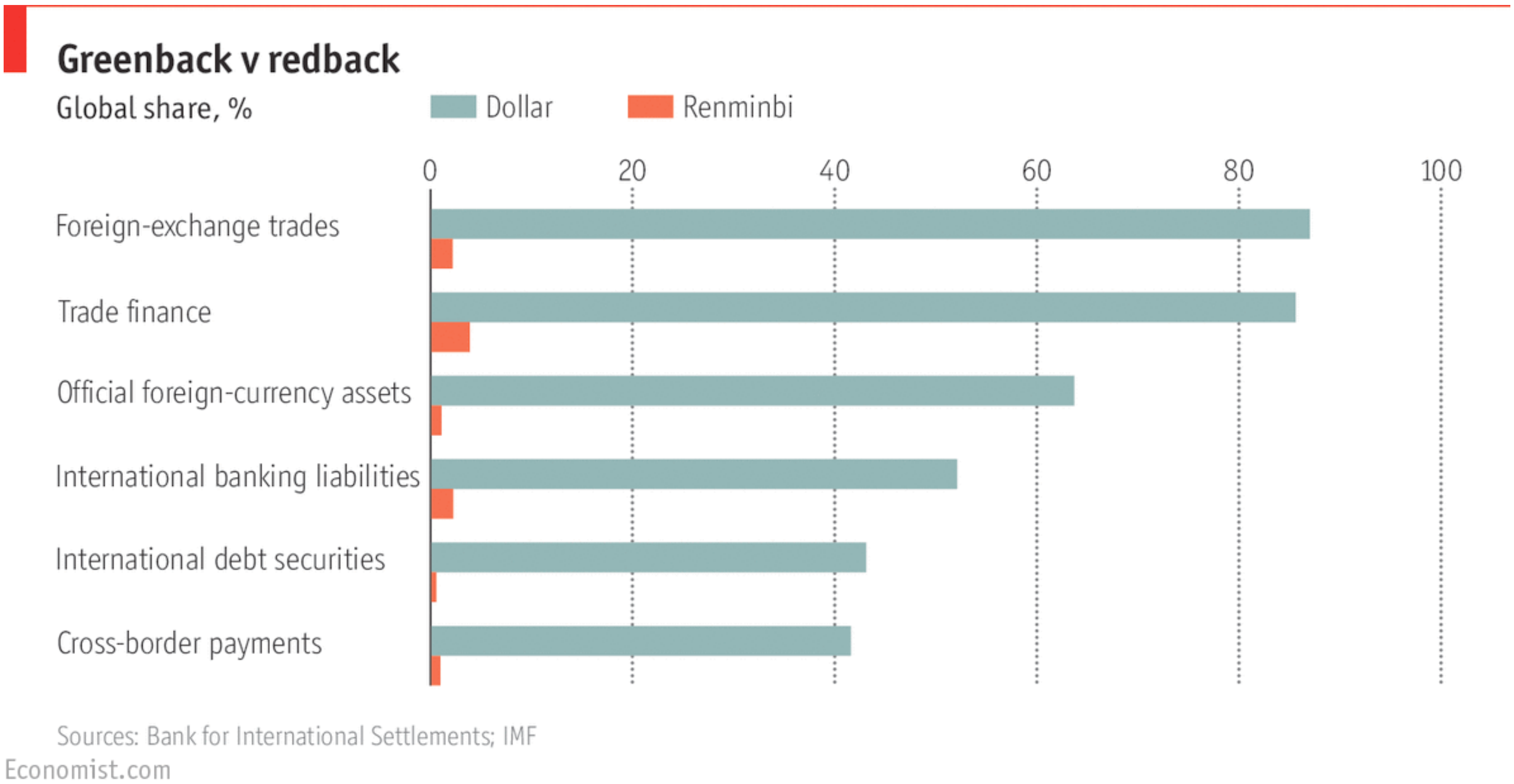
Fear of instability limits how far even the reformers are willing to go. China's repressed financial system leaks and strains in many places, but the government does not want to swap this for one that gets battered as waves of foreign capital from global markets wash in and out. The aim is to make China's capital account open, but not freely so, imposing fiddly rules on inflows and outflows to put off speculators.

China wants to be an economic superpower abroad, but on its own terms. It has built the international monetary equivalent of a ten-lane motorway with no cars on it, or a ghost city of skyscrapers. The government-built infrastructure is there, but so far the people have not come.

Stand and admire the yuan swap lines between China's central bank and 32 foreign ones, worth $500 billion (on a par with the Fed's dollar lines); 17 hubs trading around the world, including Doha and Toronto, where China's state banks clear yuan deals; quotas that let $146 billion of offshore yuan enter the country via the stockmarket (Hong Kong's stock exchange and Shanghai's also trade directly with each other to the tune of $4 billion a day); and a China-based yuan clearing system equivalent to the New York dollar one for foreign banks due to open this year.

Behold the skilfully drafted articles of the Asian Infrastructure Investment Bank (AIIB), signed in June at the Great Hall of the People in Beijing by 50 countries, including 13 members of NATO as well as such cosy bedfellows as Iran, Israel and Saudi Arabia (the main holdouts are America, Canada, Japan and Mexico). It will have $20 billion of paid-in capital and a further $80 billion of callable capital. China has 26% of the votes, giving it a veto over hiring and firing the bank's boss, big capital raisings, constitutional changes and booting out members. America may be uneasy about that, but China could point out that it is supplying 30% of the capital and that it is mimicking America's vetoes at the IMF and the World Bank. Jin Liqun, the AIIB's boss, sought advice in Washington about how to set it up.

Marvel at the China-anchored trade deals now in the works, not least a pact known as RCEP that takes in China, India and 14 other Asian countries which between them generate 30% of world GDP. It is due to be completed in 2016. China is discussing bilateral trade deals with India, the Gulf countries, including Saudi Arabia, and the ASEAN club of South-East Asian countries. President Xi Jinping's "One Belt, One Road" initiative envisages Chinese investment and transport links stretching as far as western Europe.



None of this government-directed infrastructure and diplomacy has yet had much impact on the ground. The surest measure of this is the still-puny stature of the yuan. As a means of payment, it appears at first sight to be making rapid progress. About a quarter of China's trade and foreign direct investment flows are now said to be in yuan.

But these figures are misleading, since they include mainland trade with Hong Kong, where about half of all payments are in yuan. If that is left out of account, the share of China's trade with the world conducted in yuan comes down to below 10%. The proportion of yuan payments over the SWIFT system used by global banks is only 1%. China's big trade partners barely use the yuan in their bilateral trade with the Middle Kingdom. The figure for Australia is 0.7% of bilateral payments with China. Of South Korea's exports to China, 94% are paid for in dollars and 2.9% in yuan.

As a reserve asset the yuan is peripheral. Other Asian central banks complain that it is hard to buy yuan government bonds; China's putative membership of the SDR basket does not solve this problem. As a store of value for the private sector it has yet to step up to the big league. Of international bonds issued in 2014, just 1.4% were in yuan. McDonald's, among others, has issued yuan bonds, but 96% of its debts are in dollars, euros, sterling or yen.

Some $400 billion-worth of yuan deposits sit offshore, mainly in Asia. But even in Hong Kong and Singapore, Asia's main financial centres, the value of offshore dollar deposits is four times larger than that of yuan ones. This ratio has changed only slightly over the past two years. Redback deposits are often speculative. Offshore banks that raise them are unable to lend them all out again, so they have to park the cash in mainland banks. Bankers in Hong Kong expect yuan deposits to decline as people worry about further Chinese devaluations.

Although the yuan has made only slight progress so far, it will gradually gain clout. An even bigger shove from the state could help. Foreign firms could be offered discounts or win brownie points if they buy from China using the redback. Samsung, a South Korean colossus, plans to settle flows between its Chinese subsidiaries and its headquarters in yuan.

China is the world's biggest commodity buyer, but oil is traded in dollars. Perhaps Saudi Arabia, which now sells as much oil to China as it does to America, could be persuaded to accept some yuan, despite its reliance on American fighter planes and missiles. In 2010, at the height of the commodities boom, global mining firms forced China to shift from long-term contracts to market-based pricing. Now that the miners are on their knees, China can bully them in turn. State-backed banks, too, could be prodded to do more. China's biggest bank, ICBC, has substantial operations in South-East Asia, only some of which involve yuan.

Eventually the offshore yuan world could become much bigger (although not as large as the dollar archipelago). The yuan has a sizeable lender of last resort, in the form of the swap lines the People's Bank of China extends to foreign central banks. Offshore deposits are governed by laws made in Hong Kong and elsewhere, so investors do not have to worry about China's legal system. China might well develop ways to protect its payments system from America's extraterritorial laws. It will be possible—if not easy—to use a yuan deposit in London to do business in China. The paperwork needed to use it to buy a security, asset, good or service on the mainland will be streamlined over time.

An open society

So why not go the whole way and open up China instead of walling it off from the world? It comes back to the question of stability. A fully open capital account could cause a shock as money from around the world floods in. There are not enough securities available. The freely traded bit of China's stockmarket is only the size of Switzerland's. The value of the central-government bond market is only a bit bigger than Britain's. And no one knows how much cash might flood out as Chinese people try to diversify their portfolios or put their assets somewhere safer. In the past 12 months the underlying capital outflows have reached a staggering $500 billion.

To make this process safer, China would need to consider a number of reforms. These include overhauling its stockmarket regulation; making its central bank more independent; selling the government's shares in state-run firms to increase the supply of tradable equity; preparing state-run banks for a possible deposit run as savers get more choice abroad; and allowing a large private-sector asset-management industry to flourish and sell foreign products. China would have to brace itself for global capital flows rushing in and out, changing asset prices in an instant.

Opening up China is a political question, and the party is not ready. Given the loss of power this would involve, it may never be. James Carville, an adviser to Bill Clinton, once said that he would like to be reincarnated as America's bond market, because it could intimidate anyone. Xi Jinping is not about to let China's bond market boss him.

China is on course to be a giant in trade and direct investment and a mid-sized power in finance, currencies and financial markets. That tempered ambition might be in its own interest, but it does not resolve the problems of the global financial and monetary system. China will not be a counterbalance to or a substitute for America soon. So what will fill the vacuum?

Glad Confident Mornings

THE DEBATE ABOUT America's special role in the world economy and China's troubled rise is haunted by the work of Charles Kindleberger, who studied the Depression of the 1930s. A lost decade of trade skirmishes, unemployment and devaluations eventually led to an arms race and a world war, the worst there had ever been. Kindleberger concluded that one country had to be in charge to keep the world safe in future. "The international economic system was rendered unstable by British inability and the United States' unwillingness to assume responsibility for stabilising it…When every country turned to protect its national private interest, the world public interest went down the drain, and with it the private interests of all."

Writing in 1973, Kindleberger worried that America was no longer able to play that role—although, oddly, in those days the challenger he saw emerging was Europe. In time it was replaced by another supposed rival, Japan, but by 1991 that had burned out. A reasonable person might conclude that gurus have been fretting about America's ability to hold on to its dominant economic position for decades. China, too, might crash and burn. The reasonable person might add that in the 2007-08 crisis America more or less did what Kindleberger said a hegemon should, maintaining an open market for goods and providing short-term liquidity (though it was less good at providing long-term loans, another thing he had demanded).

But false alarms do not preclude a real one. A lot has changed since the 1970s and 1980s. America's share of global output has fallen from 36% in 1970 to 22% today, measured at market prices. For all its flaws, China is a far more credible competitor than Japan. Its share of world output is close to where Japan's was at its peak, even though it is relatively still much poorer than Japan was then, so it has plenty of headroom. Global capital flows have vastly increased since the 1970s and 1980s, making the world's financial system more unstable, and the number of financial crises is rising.

A last hurrah?

America's response to the financial crisis of 2007-08 can also be seen as a last hurrah. Officials, as always, did all they could to bail out the banks and refloat the world, but at the cost of shattering the American public's trust in policymakers and causing a populist backlash that is still reverberating today. The way America saved the world in 2007-08 may make it impossible for it to do so again. All this points in a bitterly pessimistic direction. In Kindleberger's words: "Stalemate, and depression."

Yet just as circumstances have changed since the 1970s, so the world's response to a power vacuum need not be the same as in the 1930s. The 75% of the planet's population who do not live in either America or China may well come up with their own answers to some of these problems.

The need for rules to govern trade can be partly dealt with by a patchwork of regional trade deals, of which there are 450 in the works. If the dollar remains dominant but neither America nor the IMF is able to act as a lender of last resort to the system, there are other solutions. Just as English has transcended Britain to become a world language, the greenback could pass into global ownership. Foreign central banks could use their dollar reserves to guarantee liquidity to the offshore dollar system and club together to create a dollar payments system that bypasses America entirely. They could try to reform the IMF by excluding America from it or create new regional bodies to compete with it. In the past such attempts have not been successful—an Asian club called the Chiang Mai Initiative, for instance, has had little impact—but they could be cranked up. In response to the waves of capital gushing around the world, mainly to the rhythm of financial conditions in America, emerging economies could impose capital controls and restrictions on global banks and fund managers, and continue to build up dollar reserves.

A fiddly alternative

Such a world would have its downsides for participants. It would be fiddly. A patchwork of medium-sized trade deals is likely to be much harder to enforce than a few near-universal deals. It would be inefficient, too, as poor countries' hard-earned savings would be sitting idly as reserves invested in Treasury bonds. Attracting capital might become harder, too, although China's experience suggests that, given the right conditions on the ground, long-term investment might keep coming even when short-term portfolio flows are strictly ruled out. Restrictions on global banks might keep a lid on capital flows, too, and there would be no way to control competitive devaluations.

All this would still be safer than no organisation at all. But from an American perspective the cost of its neglect in recent years would end up being a world that looks a little less like America and rather more like China: less open, more guarded, keen to engage but on its own terms. It is far from clear that this would be in America's interest.

The world need not be a prisoner of the 1930s; but neither is it safe to assume that America's mood will always be as angry as it has been since the financial crisis, or that China will be paralysed by its many paradoxes. The Jacksonian tradition in American politics comes and goes. Perhaps if the economy continues to grow handsomely and more jobs are created, wages will rise at last and America's middle class will breathe a great sigh of relief that will be heard around the world. Americans' belief in their country's exceptional mission has already recovered a little from the depths of the 2009 crisis, opinion polls suggest. Perhaps it can recover a little more. A new president and House of Representatives in 2016 could clear the rancour in the air. Or the election after that might.

Imagine, for a moment, a fantasy American administration and Congress set to act in its own enlightened self-interest and to the benefit of the world. It would tackle the global paranoia about the lack of a lender of last resort. It would triple the funding available to the IMF, to $3 trillion, and prepare a plan to cede the American veto. It would allow the Federal Reserve to extend liquidity to foreign central banks without a cap and require it to start talks with big central banks with which it does not have swap arrangements, not least China and India.

A big and credible safety net should reduce the build-up of the vast dollar reserves that in aggregate may have a destabilising effect. But to meet long-term concerns about a shortage of safe assets, America would set up a sovereign-wealth fund that would be able to issue Treasury bonds and invest the proceeds abroad for a profit, leaving America's solvency enhanced.

To strengthen the link between America and the world's banking system, America would encourage big foreign banks in the emerging world to open or expand their presence in New York, transfer all powers of supervision from local governments to less politicised and more competent bodies, strictly limit extraterritorial judgments over their operations and take the resulting howls of protest in its stride.

Having revived and legitimised the IMF, America would resuscitate or replace the other two pillars of the global economic architecture, the World Bank and the World Trade Organisation. It could try to use its hoped-for regional trade deals, such as TPP, to create a new platform that takes in rival and duplicative trade deals, and get China and India to join.

This fantasy America would join China's institutions such as the AIIB. It would support China's ambitions to elevate the yuan as a reserve currency, by helping to get it into the IMF's SDR basket, and by establishing New York as a hub for yuan trading. For now the Big Apple is the only financial centre in the world that has no plans or arrangements to support the redback. A big effort would be made to raise Chinese investment in America. Today for every dollar of Chinese direct investment in America there are two dollars of Chinese investment in Europe and up to five dollars of American investment in China.

What would China have to do in return for that support? Most outsiders point to a long list of reforms that they believe to be important. There is no guarantee that any of them will happen. Even so, America seems to have nothing to lose by being more confident and composed. Making the world economy more stable will win it friends everywhere. It will also save it money in the long run.

Take a chance

If China's economy turns out to be a house of cards, the country's claim to global economic superpower status will soon be exposed as hollow. If it becomes ever more autocratic, it will need to become ever more closed to guard against capital flight and foreign influences, which will limit its capacity to affect the world economy beyond its borders. But if it manages to keep growing, to open up and reform, then America will have to reach an accommodation with it some day. Why not start now?

Transforming Turkey's Health System — Lessons for Universal Coverage

Rifat Atun, The New England Journal of Medicine Vol 373 No 14

In 2003, Turkey embarked on ambitious health system reform to overcome major inequities in health outcomes and to protect all citizens against financial risk. Within 10 years, it had achieved universal health coverage and notable improvements in outcomes and equity.

Health insurance was introduced in Turkey in 1945, at first covering blue-collar workers and later other groups. From 1960 onward, Turkey's 5-year development plans included universal health coverage as an objective; a new constitution in 1982 guaranteed rights to health insurance and health services; and a 1987 Basic Law on Health aimed to operationalize these rights. But the law wasn't implemented, universal coverage failed to materialize, and the poor and unemployed remained without effective coverage. Although the "Green Card" scheme was introduced in 1992 to cover low-income households, it wasn't integrated with existing insurance schemes and lacked a system for identifying potential beneficiaries; moreover, it provided limited financial assistance for inpatient care and none for outpatient consultations, diagnostic tests, or medicines; uptake was therefore low.

Battling economic instability, rampant inflation, rising unemployment, and a dissatisfied public, successive coalition governments between 1990 and 2002 did not prioritize health coverage and services. The Turkish health system faced insufficient and inequitable financing, a shortage and inequitable distribution of physical infrastructure and human resources, disparate health outcomes, and public dissatisfaction.

Then, in 2002, a new political party won a parliamentary majority and created a government committed to economic and social reforms. In 2003, it introduced a Health Transformation Program (HTP) that aimed to improve public health, provide health insurance for all citizens, expand access to care, and develop a patient-centered system that could address health inequities and improve outcomes, especially for women and children. The 2003 Directive on Patient Rights defined citizens' rights to health insurance and choice of health care providers. It codified providers' obligations regarding information provision, confidentiality, and patient consent for interventions and established systems for citizens to express their views about health services.

Health reforms introduced between 2003 and 2010 separated policymaking, regulatory, financing, and service-provision roles: the Ministry of Health would focus on policy and strategy development, while other agencies oversaw public health and delivery of personal health services. The Social Security Institution was established as a single payer, pooling both risk and funds from contributory health insurance and the government-financed Green Card scheme; it was responsible for strategic purchasing from providers, and its mandate was to improve service quality and efficiency.

The introduction of the HTP coincided with a period of sustained economic growth, which enabled the government to increase health expenditures at an average annual rate of 9.1%. Public-sector funding increased from 63.0% of total health expenditures in 2000 to 75.2% in 2010, the highest in the E7 group of countries with emerging economies — including Brazil (47.0%), China (53.6%), India (29.2%), Indonesia (49.1%), Mexico (48.9%), and Russia (62.1%) — while health expenditures rose from 4.1% of the gross domestic product in 2002 to 6.1% in 2010.

In 2004, Green Card benefits were expanded and new mechanisms introduced to identify potential beneficiaries. In 2006, the Social Insurance and General Health Insurance Law was ratified, though a court challenge by the Turkish Medical Association and medical professionals' unions resulted in amendments and delayed implementation. Between 2008 and 2012, Turkey's various insurance schemes were transferred to the newly established Social Security Institution and merged to establish general health insurance with a unified risk pool and a harmonized benefits package covering preventive health care and family medicine services (provided free at the point of delivery) plus targeted health promotion and prevention programs.

Between 2003 and 2011, the number of Green Card beneficiaries increased from 2.4 million to 10.2 million — 13.8% of the population, including more than 60% of those in the lowest income decile (a further 24% of the lowest-decile population was covered by contributory health insurance). Insurance coverage also improved in all other income deciles, and 85 to 96% of people in the top deciles were covered by contributory health insurance by 2011.

Simultaneously, health services expansion was made possible by increasing the size of the workforce; improving its distribution by means of compulsory service, higher remuneration, and contracting; scaling up primary care services; strengthening emergency medical services; and enabling insured people (other than Green Card holders) to choose private-sector providers.

Selected Characteristics of the Health Care System and Health Outcomes in Turkey.*	
Variable	**Value**
Health expenditures	
Per capita (U.S.$)	665
Percentage of GDP	6.3
Out-of-pocket (% of private health expenditures)	64.4
Public sources (% of total)	73.9
Health insurance	
Rate in population (%)	98
Source of funding	Employers (7.5%) and employees (5%), government contributions for Green Card beneficiaries
Annual physician income (U.S.$)	
Salaried general practitioners	37,900
Salaried specialists	65,300
Generalist–specialist balance (%)	
Generalists	31.9
Specialists	68.1
Access	
No. of hospital beds per 10,000 population in 2011	25
No. of physicians per 1000 population in 2011	1.7
Life and death	
Life expectancy at birth (yr)	75
Additional life expectancy at 60 yr of age (yr)	21
Annual no. of deaths per 1000 population	6
Annual no. of infant deaths per 1000 live births in 2013	17
Annual no. of deaths of children ≤5 yr of age per 1000 live births in 2013	19
Annual no. of maternal deaths per 100,000 live births in 2013	20
Fertility and childbirth	
Average no. of births per woman	2.1
Births attended by skilled health personnel in 2009 (%)	95
Pregnant women receiving any prenatal care in 2009 (%)	95
Preventive care	
General availability of colorectal-cancer screening at primary care level	Yes
Children 12–23 mo of age receiving measles immunization in 2013 (%)	98
Rates of chronic diseases	
Diabetes prevalence (% of 2013 population 20–79 yr of age)	14.9
HIV incidence (cases per 100,000 population)	0.12
Prevalence of risk factors (%)	
Obesity in adults ≥18 yr of age in 2014	29.5
Overweight in children <5 yr of age in 2004	9.1
Underweight in children <5 yr of age in 2008	1.7
Smoking in 2011	27

* Data are from the World Bank, the Organization for Economic Cooperation and Development, the World Health Organization, and the Turkish Ministry of Health Statistics Year Book and are for 2012, except as noted. GDP denotes gross domestic product, and HIV human immunodeficiency virus.

Family medicine–centered primary care was introduced in 2005. By 2011, the Ministry of Health had contracts with 20,000 new family medicine teams at 6250 centers, providing expanded primary care services including prevention, women's and pediatric health care, mobile health care for rural residents, and home care for the homebound (see table and case histories; to compare this country with others, see the interactive graphic). The number of primary care visits increased from 74.8 million in 2002 to 244.3 million in 2011.

Hospital capacity was expanded from fewer than 2.0 acute care beds per 1000 population in 2000 to 2.6 per 1000 in 2011. By 2010, the Social Security Institution had contracted with 421 private hospitals (90% of large hospitals) to provide diagnostic and curative care and complex emergency services such as burn care, intensive care, cardiovascular surgery, and neonatal care. Hospital visits, including inpatient admissions, increased from 124.3 million in 2002 to 337.8 million in 2011, even as active purchasing by the Social Security Institution drove efficiency gains by establishing tariffs for paying hospitals, reducing the average length of stay from 5.8 days in 2002 to 4.1 in 2010, and improving occupancy from 59.4% in 2002 to 65.6% in 2011.

Utilization of maternal and child health services and child mortality improved significantly between 2003 and 2008, especially among rural and socioeconomically disadvantaged populations. Meanwhile, provision of free health care services for costly interventions and reduced cost sharing lowered out-of-pocket and catastrophic expenditures. And satisfaction with health services grew from 39.5% in 2003 to 75.9% in 2011.

Several factors contributed to this transformation. Turkey's population was receptive to reforms that promised health rights and better, more accessible care, and such popular legitimacy helped to overcome the medical profession's resistance. Newfound political stability had invigorated Turkey after 20 years of ineffective governing coalitions, and the new government's absolute majority in the Grand National Assembly permitted swift development and implementation of legislation and policies. Economic growth and a broadened tax base provided Turkey's government with the means to expand its noncontributory insurance scheme, while rising employment levels helped increase coverage through contributory health insurance.

In addition, sustained support from the Council of Ministers helped to overcome opposition from medical professionals and the civil service. And a committed transformation team led by the health minister provided continuity and strategic direction for the HTP, mobilized provincial leadership, and addressed implementation challenges as they arose.

Turkey's experience offers five key lessons. First, universal health coverage may be best achieved through comprehensive improvements combining demand-side changes (health insurance) with supply-side changes (increased human resources and strong primary care). Second, reforms should be carefully sequenced, with flexible implementation informed by public receptivity to change. In Turkey, major policies were implemented when the sociocultural, economic, and political contexts were favorable, and tactical changes, such as reduced copayments and expanded choice of providers, were used to improve users' experience of the health system, increasing their satisfaction and support.

Third, implementation is facilitated when the transformation team works closely with field coordinators, who oversee day-to-day operations and gather real-time intelligence to rapidly address implementation bottlenecks by refining the scope, speed, and sequence of reforms. Turkey's transformation team drew on international experience and collaborated with agencies including the World Bank, the World Health Organization, and the Organization for Economic Cooperation and Development.

Fourth, it's important to focus on improving the system's responsiveness to citizens; public support provided legitimacy for Turkey's reforms and helped to overcome opposition. And fifth, swift policy formulation and decision making and carefully sequenced implementation can fend off organized opposition and bureaucratic resistance to reform.

But the sustained success of this new program faces hazards. Expectation of good government helped change the balance of power in Turkey in 2002. The transformations that advanced a right to health have increased expectations for an accountable, transparent, responsive executive. Citizens and opposition groups are better organized to scrutinize Turkey's health system, and the electorate has become more polarized. Problems in neighboring Iran, Iraq, Syria, Russia, and Ukraine threaten Turkey's political stability, and concerns regarding human rights, citizens' ability to voice grievances, and the growing democratic deficit exacerbate this fragility.

The continued global economic crisis and financial-market volatility threaten Turkey's strong economic growth, which is critical to sustaining investments in a health system facing increasing burdens of chronic illness and disability. To transition from a middle-income to a high-income country, Turkey needs to create a knowledge economy in which the health system plays a major part, but the life-sciences industry, universities, and the health system are not yet collaborating to generate meaningful research, development, and innovation.

Moreover, the reforms alienated many health care professionals. In designing and implementing reforms, the health ministry didn't always accommodate the views of such opponents, who have questioned the integrity of the ministry's data; more inclusive, broad-based reforms could foster a committed workforce and create an environment of shared values based on collaboration.

Turkey's experience shows that with committed leadership, middle-income countries can achieve universal health coverage and simultaneously improve population health, financial risk protection, and user satisfaction — health system goals to which all countries should aspire.

Myocardial Infarction

A 55-year-old man with no other serious health conditions has a moderately severe myocardial infarction.

Chest pain and breathlessness develop during the day in Mr. Öztürk, a civil servant who lives in a large city. His family calls an ambulance, which arrives within 10 minutes. He is assessed by the paramedical staff and stabilized with oxygen and painkillers. His electrocardiogram indicates a myocardial infarction. He is taken to the nearest public university hospital, which is able to administer 24/7 primary percutaneous coronary intervention (PCI) within 60 minutes after a patient with a heart attack arrives at the hospital. Mr. Öztürk is assessed in the emergency department and transferred to the cardiology unit for coronary angiography and PCI in two coronary arteries and a stent in one.

His recovery is uncomplicated, and the results demonstrated on echocardiography are not considered worrisome. Mr. Öztürk is discharged from the hospital after 2 days and is referred to a cardiac rehabilitation program at the hospital.

His hospital costs and the three new medications that he receives on discharge — an anticoagulant, a beta-blocker, and a statin — are covered fully by the Social Security Institution. He makes an appointment the following week to see his family physician and to receive a repeat prescription for the medicines, for which he pays 20% of the cost. He is seen in the university hospital outpatient clinic 6 weeks after his discharge, for which he incurs a small cost.

Pregnancy and Childbirth

A healthy 23-year-old woman is pregnant for the first time.

Ms. Kaya and her family have recently enrolled in the Green Card scheme and registered with the new family medicine center when she discovers that she is pregnant. At the center, Ms. Kaya meets a nurse and the family doctor and receives advice on family planning, healthy nutrition, exercise, and risks associated with tobacco and alcohol use. During this visit, her pregnancy is confirmed.

In her first antenatal consultation, Ms. Kaya has her history taken; a general physical check; measurements of height, weight, and blood pressure; abdominal examination to determine the size of the uterus; and a hand-held Doppler test to assess the fetal heart rate. She has a urine examination for bacteria and protein and blood tests for hemoglobin, ferritin, and hepatitis B. Ms. Kaya also receives tetanus toxoid booster and vitamin D supplements. She is provided with general advice on pregnancy and referred to the new “mother-friendly hospital” for an ultrasound, which proves to be normal. Ms. Kaya has three further antenatal clinic visits and receives iron supplements. Her delivery at the hospital is uneventful.

Ms. Kaya has postnatal checks for herself and the baby before being discharged home 24 hours after delivery. During the 6-week postnatal period, she receives four home visits by the family nurse; at the first visit, the baby is given a heel-prick test for phenylketonuria, congenital hypothyroidism, and biotinidase deficiency. Ms. Kaya receives continued support for breast-feeding and checks for postpartum depression. The baby is registered in the family health center and receives, according to schedule, immunizations for 11 conditions.

Predicting Future 2020

Liu Liu, September 27 2015

It has been 4 years since the last prediction for the year 2016. My original plan is to draft a prediction every 2 years, and scope for the next 4 years. Gates once said, we always overestimate the change that will occur in the next two years and underestimate the change that will occur in the next ten. A decade ago, having computing devices as small as a palm with Pentium 4 computational power was unimaginable. Even 8 years ago, it was a difficult fate for us to build an all-in-one TV with high-end PC capability.

Review the Prediction of the Past 4 Years

The prediction of the past 4 years has been accurate. The biggest promise of economic stability has been kept with all the unusual fiscal policies, otherwise such predictions can hardly be any believable if at all. Reviewing the prediction I made 4 years ago, Internet connection speed, the unfortunate market share of 3D TV, Television on demand, computational power, driving assistance (self-driving), and photography technology have matched the reality pretty well. However, for wireless power source, Pads and ultrabook merging, commercial supersonic flight, unemployment rate, and artificial intelligence has been off quite a bit. No predictions on unmanned aerial vehicles. Overall, some of these predictions are too optimistic, and some of these are simply ignorant.

The Economic / Social Outlook for the Next 4 Years

However, it is harder to predict the next 4 years on the same social / economic stability promise. Globally, the economy growth slowdown will be a given. On the contrary, the United States will be least affected due to the dominance of Dollar in Global economy. In Europe, it is unlikely the economic situation in Spain, Greece and other Mediterranean countries will get any better. As slow as politics go, the possibility of one or several countries exiting euro-zone becomes ever more real. However, under the gloomy environment, Japan's outlook improved marginally after several scheduled tax hikes. The tricky bits, is China. China would likely to take either two paths:

1). Its GDP will land at around 4.5% to 5.5% yoy growth in the next 4 years. This is after a controlled turbulence landing, with some finesse mix of fiscal / monetary stimulus. Overall, the fiscal sheet is more balanced, and as the world manufacturer, China integrates more efficiency in its system, and it is harder to compete on efficiency front even with much lower labor costs. This is a China as a newly-minted developed nation, seating comfortably among the rest of developed nations with GDP per capita between $9,000 and $10,000.

2). Its GDP will land at 4.5% or even below in the next 2 years and will be considered as fatal. Fiscal and monetary tools seem ineffective due to large amounts of capital outflow, as well as loosen control over capital in general after 2008. The social uprising turns out to be much easier than expected. The regional government would be hard to contain the unrest, and the central government would likely to have several rounds of negotiations with opposition leaders, it becomes impossible to predict what would happen afterwards.

For the sake of making any progress on this prediction, I will pick the China option 1 as the background for the next 4 years. If option 2 turns out to be closer to the reality, it nullifies all the predictions I am going to make below.

India, for the lack of systematic knowledge in that area, it is hard to predict the impact of India to the global technology and economy outlook. For Russian and Middle-East oil-producing countries, the assumption will be that oil per barrel will float around $40 to $100, and Russian's economy will struggle nevertheless due to the more volatility in the oil price.

The Basis of Any Predictions

The success of any prediction, if at all, looks at the past patterns. For the past 100 years or so, it has been the capturing and interpretation of exponential growth. It has been emphasized in enormous books and talks about the fascination of exponential growth. However,by applying exponential growth, without the underlying understanding of technological principles, we risk of hitting some fundamental laws of the physics, and makes no progress at all (and on the other hand, a premature prejudice of "understanding" the fundamental limits of physics, can be fatal too).

The exponential growth is made possible only with two key terms: standardization and the economy of the scale. The modern marvel of this kind, is the iPhone. Without the scale of the iPhone, modern high resolution screen with capacitive touch will cost thousands dollars to manufacture per square inch. But now, everyone gets a modern high resolution touchscreen with a few bucks.

These two key words, will manifest themselves in many forms, and will continue to play wonders in the next 4 years.

The Prediction

The smart hardware has been around for more than 10 years. But what makes sense as a "smart hardware"?

It makes the basic functionalities we assumed about that hardware a no-brainer. Smooth, one touch, perfect and care-free integration;

It extends beyond the basic functionalities, but operates under well-defined principles (good example, a router that caches cloud content and make the access instantaneous, bad example, a refrigerator that orders food for you);

It is unlikely to be something completely new.

Then, there is the un-PC era. In the next 4 years, homes rarely own any desktop computers, even though aggregated processing power in a single-family house can easily reach more than 10Tflops. There is a change of the interface too. People now interact with these devices by either touching or talk. The graphical interfaces now have a meaningful conversational re-touch.

Despite the potential conflicts and regional instability, the transportation will be more cost effective. In terms of the land transportation, self-driving or smarter driving assistant will be standard add-on in newly shipped vehicles. However, it is far from becoming the mandatory standard. The Abu Dhabi PRT was a failure in the Middle-East, but similar transportation services will run commercially in some cities. The next generation of long distance land-transportation is still in experimental phase in the United States. Not only that, some of the longest commercial flights are cancelled due to the cost. Commercial transportation is going to be more expensive, and slower.

Entertainment industry gets a big boost in time of recession. People still spend disproportionate time on big television, The movement of "cutting-the-cord" will happen much faster than expected. The United States 15 to 35 year viewership on cable will drop at the rate of 10% to 20% year over year and accelerating. Today's top TV show numbers (5m viewer at the premiere) will keep steady. But shows with 2m to 3m premiere viewership will see a drop to 1m or less. In the United States, online streaming players will ink deals with major sports and have exclusive rights to stream online. People will spend more than 3 hours a day on streaming services, either on television or on their mobile devices.

Shared economy is not going the way you would expect. At its core, shared economy moves the assets out of the company such as AirBnb or Uber's balance sheet and bumped up its profitability. At boom times, asset-light companies can move fast and quickly get rid of less profitable businesses painlessly. At down times, these companies will try to own more assets as the asset prices are all cheap. However, the most popular way for them to do so will not be out-right purchase. Instead, they will launch finance programs to help its share economy workers to own these assets, and leave the risk of asset depreciation to them.

The mobile messaging service will consolidate. Respectable players on messaging service will reach 300m daily active users, and have at least 2b message sent per day. Any player cannot reach that hallmark will be dead. There will be only 3 to 4 major players in that space, if not less. All the messaging services will have the ability to make audio and video calls, which will continue to marginalize the phone call service business for traditional phone service providers. In the United States at least, more than one online-based business will enter ISP business. The speed of the Internet will continue to improve. Home Internet speed globally will average to 100Mbps. Global mobile Internet speed will average to 10Mbps. Specifically, the mobile Internet service in Middle / South Africa will reach average 500Kbps. In the other word, as long as you can pay, with your cellphone, you can have semi-stable Internet connection and will be able to do video calls anywhere in the world except Antarctic.

Cost-effectiveness is penetrating medical equipments. With lower cost of processing power and general application of machine learning techniques in signal processing, popular and essential medical equipments will reach a point that are cheap and versatile enough to even be delivered to the most remote area on Earth. The profound impact will be a global lift in life expectancy.

Virtual reality gears will have tractions in many more homes. They are still struggling to find its killer applications. But on average, shipped units per year will be around 30m globally at the end of 2019. Industrial robots will replace more human labor, which is a good thing for China. Privatization of space technology continues. One or more private companies will accomplish at least one low-orbit manned mission.

Thus, it is not the worst time of humanity yet for the year of 2020.