



Lawrence H. Summers

in conversation with
Ann Bernstein

Democracy | Markets | Development

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To mark 25 years since its establishment, in November 2020 CDE initiated a series of discussions with global experts and prominent individuals in South Africa on important questions on democracy, business, markets, and development. The series was relaunched in 2022 as CDE Conversations. This was the 22nd event in the series.

Ann Bernstein: It's my privilege to welcome Larry Summers to CDE Conversations. Larry is one of the leading global economists of his generation. He has been Treasury Secretary under Bill Clinton, director of the National Economic Council under Barack Obama, and he is President Emeritus of Harvard University.

I want to start with inflation. You are a supporter of the Democratic Party, yet a month after President Biden took office in 2021, you criticised both the scale and the direction of the administration's fiscal policy. You were correct, as we now sadly know. Why did you argue that the Biden administration's policies would set off inflationary pressures that America had not seen in a generation?

Prof Lawrence Summers: It is true. I am a Democrat and a strong supporter of President Biden. I was honoured to work for Presidents Clinton and Obama. My support for the Democratic Party has only been reinforced by some of the depravities we have seen from the Republicans. However, I am an economist, and when it comes to judging the consequences of economic policies, my obligation is to call them as I see them. I will not skew my analysis in favour of one political perspective, regardless of who is in power. I believe that those in charge will be best served by an accurate and rational economic debate.

In the winter of 2021, it was clear the United States had a GDP gap. We were perhaps 2, 3, 4 percent short of our potential. What then emerged was a policy providing 14 percent of GDP in fiscal stimulus, while at the same time holding interest rates at zero. I looked at the 2 percent GDP gap, and then at the 14 percent stimulus, and concluded that it was overwhelmingly likely that the bathtub would overflow. Once the policy was implemented, nominal GDP spending increased by 11 and a half percent. There was no way that an economy 2 percent short of potential was going to have 11 percent growth in real output. The inevitable result was inflation.

Inflation has had unfortunate consequences for many working people, and it has undermined confidence in government. The decision to concentrate heavily on transfer payments had the effect of using up fiscal capacity, thereby reducing investments in the future of our country.

Fortunately, we have since had very important legislation promoting investment in infrastructure, developing capacities in science and technology, and boosting the development of green technologies. That means the first two years of the Biden administration will be remembered as very successful. It is also worth pointing out that, while I was on this occasion correct in my economic forecast, mine was very much a minority voice among economists. Most did not see it coming and felt that that this kind of stimulus was appropriate. Rather than being politically irresponsible, Biden's stimulus went along with consensus economic analysis. Many experts who should have known better allowed their hopes to obscure realities they should have seen.

Ann Bernstein: Having given us part of the answer, why do you think no one wanted to really listen to you at the time? Was the economic consensus based on wishful thinking, and was it influenced by notions like 'modern monetary theory' (MMT)?

Prof Lawrence Summers: The most important factor was shortness of memory. It had been 40 years since we had inflation. People could not remember dealing with it and any statistical model covering 40 years of data or less had prices at a more or less constant level, leading to conclusions that inflation would not be a substantial issue, almost no matter what you did.

There was also a political dynamic. The big mistake in the response to the 2008 financial crisis had been insufficient stimulus, which was seen to have contributed to the rise of populism and inequality. There was a strong determination not to repeat that mistake.

MMT was an additional factor. Someone once said that politicians use economic theories the way drunks use lamp posts: for support rather than for illumination. MMT offered support to the politicians who wanted to spend and ignore budget constraints and certain arithmetic realities. and modern so-called MMT provided them with an intellectual rationalization. That is how MMT suddenly gained traction. Before that these theorists had not been influential at all, and most mainstream economists rightly rejected this theory as fundamentally wrong.

Ann Bernstein: Let me turn to unemployment. I know you have been concerned about unemployment for a long time, and that you agree with CDE that it is one of the great social evils and challenges of our time. There are many people in SA who think if we allow a little more inflation, we could lower our unemployment rate, and that means we should chose reducing unemployment over keeping inflation in check.

So why is inflation so dangerous and harmful for society in your view?

Prof Lawrence Summers: It is important to get to grips with the modern understanding of the relationship between inflation and unemployment. It is like the relationship between certain drugs and feeling better. It is never enough to just take one dose before you feel better and there is always the possibility that you become habituated and have to take ever larger doses to get the same buzz. The same is true of inflation. Only inflation that accelerates and surprises is associated with stimulating the economy and reducing unemployment. If the goal is to reduce unemployment permanently, the necessary path involves not just a higher inflation rate, but constantly accelerating inflation. That, unfortunately, will at some point cause the economy to break down.

The idea that there is some exploitable trade-off where you can accept slightly more inflation and then have lower unemployment fundamentally misunderstands how economies operate. That was the central intellectual lesson of the 1970s, when almost every major country experienced the phenomenon of stagflation. High inflation was accompanied by high unemployment, something the models of the time had not predicted.

The reason mainstream economists like myself believe in disciplined monetary policies is not because we think inflation is more important than unemployment. We do not see financial virtue as a worthy objective for its own sake, and we are totally concerned about the loss of output and, even more, the loss of human fulfilment that comes with unemployment. Rather our judgment is that if countries make mistakes like those made by the US in the 1970s and many times before and since in emerging markets, and allow inflation to accelerate, the cure causes far more unemployment than any initial, once-off reduction that higher inflation may have 'achieved'.

My argument for containing inflation is based on a desire to maximize the average level of employment through time. This is based on an awareness that when we had the most aggressive monetary policies, we also had, over time, the lowest average unemployment rate.

The other motivation for this view comes from the fact that people like you and me, and I suspect most who have joined this conversation, are able to insulate ourselves from inflation. Those who are less fortunate than us, by contrast, are often the biggest losers from inflation. They are more likely to have set incomes and are locked into buying necessities no matter what the price.

Ann Bernstein: You are sceptical about the prospects of the US avoiding a recession as inflation starts to decline. Why is it not possible to let the air out of the balloon more gently?

Prof Lawrence Summers: I start, as I think economists should always start, by looking at history. Based on that I believe the idea of a soft landing is similar to the way Samuel Johnson referred to second marriages: "the triumph of hope over experience". There are no examples of that. Every time inflation goes up and unemployment goes down, when inflation goes above four percent and unemployment goes below four percent, the economy goes into recession within two years. It is not obvious to me why things would be substantially different this time.

I agree that letting the air out of a balloon gently may theoretically be possible sometimes, but it seems very unlikely to me. Past disinflations have not worked out that way.

Ann Bernstein: If there is a hard landing in America, what will this mean for developing countries and can we do anything about it?

Prof Lawrence Summers: There are three major poles in the global economy: the United States, the European Union and China. While I am concerned about the short term prospects of the United States, I am actually more optimistic about the States than I am about Europe or China. Europe has similar challenges with post-Covid inflation but has also been hit by a major supply shock from the switching off of Russian natural gas, and the associated substantial increases in electricity prices. Europe is almost certain to go into a, potentially quite deep, recession in the next twelve months.

China is facing all kinds of challenges. Covid, financial strains, political instability, all in the very short run. In the longer term they are struggling to locate a new growth engine, having to deal with the negative effects of excessive state control, a shrinking population, etc.

2023 is likely to be a difficult year for the global economy, and challenging for many emerging markets.

Ann Bernstein: With all the impact that American economic policy has on emerging markets should they feature more in policy debates in the United States? Or is this issue thought about sufficiently?

Prof Lawrence Summers: It is probably appropriate that the United States primarily make its monetary and fiscal policies based on the interests of our own economic strength. The world has an enormous stake in our economic strength, given the way in which we are a market for imports, a source of ideas and entrepreneurship. I do wish that Americans would support a more outward looking international economic policy in which we were doing more to finance green transitions around the world and to support the substantial expansion of international financial institutions.

Ann Bernstein: Lets talk about an issue that is relevant to South Africa, and which you have written about: competition policy. You have been critical of what you have called "hipster anti-trust policies". You argued that it is very important to distinguish between protecting competition and protecting competitors. What do you mean by this and why do you think it is important?

Prof Lawrence Summers: Imagine a very successful firm, Walmart for example, which can very efficiently produce a large variety of goods and provide them at low cost to many consumers, in ways that small corner grocery stores cannot. Walmart is in no way morally superior to small corner grocery stores, it just has far superior technological capabilities.

Should we block Walmart, and not allow it to expand and provide those low cost goods to consumers because we want to protect corner grocery stores? Or should our criterion for regulation be doing what is best for consumers, and recognizing that the primary concern of the authorities should be to prevent Walmart from becoming a monopoly as a way to raise prices?

My argument is that the touchstone should be a thoughtful and careful evaluation of what is in consumers interests. What will be most upsetting to rivals in an industry is a new firm that does things in a new way that is more efficient, or an old firm that transforms itself into a way that makes it a more formidable competitor. That to me is the essence of competition, and I support vigorous competition that seeks to make consumers the winner.

When the argument for regulation becomes the importance of protecting existing firms I become very sceptical. I have been troubled by some statements made by US antitrust authorities suggesting that size per se is to be regarded as a major problem. This suggests an overturning of a 40-year bipartisan tradition emphasizing the importance of making goods available at the lowest possible cost, and with the greatest possible innovation for consumers.

Many people tend to feel that when a larger company buys a small company in a related area, that is bad because the small company has been eliminated as a competitor. Sometimes that will be right, but often the bigger company will be able to leverage technology much more rapidly and much more effectively than the smaller company, which will benefit consumers.

In addition, the possibility of being bought by a bigger company is an important way for smaller entrepreneurs to recoup their investment. Thus, if you remove the possibility of acquisition, you will also reduce the incentive to start small companies, and that will in turn also negatively affect the dynamism of an economy.

I am very much a believer in vigorous antitrust policy, and I think that the United States, over the last 40 years, has probably made more errors related to insufficiently vigorous enforcement than it has of overly vigorous anti-trust policies. However, I really believe that it is crucially important to practise this policy in an economically grounded way.

Ann Bernstein: A lot of people focus on big tech and demand that they be broken up. Are they a special case who need greater regulation?

Prof Lawrence Summers: In almost every area it is a mistake to dichotomize and say all big tech is good, or all breakups are good, and I think you really must judge the merits of individual cases. I am not sure what exactly the theory of harm is in some of these cases. After all, it is not that consumers pay anything to use Facebook or Google, or that the prices one gets on Amazon are higher than the prices that are otherwise available.

When I see, for example, the head of the Federal Trade Commission seeming to suggest that Amazon should not be permitted to sell Amazon branded products, because that is somehow unfair, I wonder why it is that when I go to the supermarket it is allowed to have branded products.

There are a range of social media platforms that compete, and we need to be careful of the argument that simply because they are large, they should be broken up. On the other hand, I think there are obvious concerns with untruthful content, invasions of privacy, and other concerns. It is hard to believe that these kinds of new technologies should not be regulated, and we need to have very thoughtful debates about how those regulations should be designed and implemented.

Ann Bernstein: You have talked about the importance of cooperation between the private sector and government for finding solutions to problems in the United States. You are opposed to what you call the vilification of profiteers. There are a lot of people in the US and elsewhere, including South Africa, who are critical of companies that make profits at times of great disruption, like the Russian invasion of Ukraine or Covid. Are large companies greedy and ready to exploit these kinds of situations?

Prof Lawrence Summers: A good example of this is when the price of oil goes up, and companies earn profits because of the shortage of oil. That may seem wrong, but there is another way of looking at it. I am reminded of an experience I had many years ago when I visited a resort town in America. I had failed to make a hotel reservation and it was a holiday weekend. We drove to 20 hotels and at the 20th, which was not very nice, we got a room and paid. The price of the room seemed unreasonably high for that kind of hotel, but I saw this as the market working.

That hotel could have rented out that room much earlier, but it chose to hold the room off the market. They banked on the possibility of it being a beautiful day with big crowds but had to factor in the possibility that it would be a terrible day weather wise and that they would then never rent out the room. Because they made that calculation we did not have to turn around and drive for three hours back to San Francisco. The incentive of getting a super high price meant there was a hotel that could provide room when we most needed it.

I think, as a society, we want to encourage people to have excess capacity that will be available when there is a crisis. Most of the time there will not be a crisis, but we want to provide an incentive for people to hold some supply off the market and to reassure them that there are profits available if they do so. I am not saying that every price that everyone wants to charge in every situation can be justified, but we do have to think carefully about incentives.

I am struck, particularly among some of my progressive friends, that on the one hand they put tremendous emphasis on the importance of resilience, while, on the other, they are enthusiastic about punishing those who are the most likely to deliver that resilience. By saying that whenever there is any kind of emergency or something becomes in very short supply then people who have it are not allowed to sell it at market price, ensures there will far less of it during the times of the greatest need. Reflections on resilience must become more balanced.

Ann Bernstein: Do you agree with Martin Wolf, who says that big companies have now got too much influence in American politics. The problem, as he sees it, is that for people who believe in competition, large companies play too big a role in writing the rules of the game. You have been in government. Do you agree with that perspective?

Prof Lawrence Summers: I think there are excesses. When I was in government and Dodd-Frank, the law overhauling financial regulation in the aftermath of the Great Recession, was being worked out, there were five registered financial industry lobbyists for every single member of Congress and Senate working on that. That is excessive and we should try in various ways to reform these practices.

However, the worst special interest excesses in the United States often do not involve very large corporations. For example, now that housing prices have on average doubled in 10 years you might have thought that the percentage

that the realtor got would have gone down. That has not happened, because a variety of laws allow realtors to collude. There are a lot of realtors in every congressional district, and they are able to exert substantial pressure to keep the situation working in their favour.

Another example is the quite extraordinary subsidies to farmers in the European Union and elsewhere. That is a very egregious distortion of the market, but it is not caused by big corporations. There are many examples where special interests are preventing efficient economic outcomes, and in many cases, instead of big corporations, it is large coalitions of voters doing the damage. The famous economist Mancur Olsen pointed to these dangers long ago in his books *The Logic of Collective Action* and *The Rise and Decline of Nations*.

Ann Bernstein: You have publicly started questioning the assumption that China will inevitably eclipse the US economy in size. You are in a minority on this issue. Why are you taking this viewpoint?

Prof Lawrence Summers: Would you want to bet on a country where capital and people are desperately trying to get in? Or a country where capital and people are trying hard to get out? The United States is the former kind of country. China is the latter kind. One of the best ways to judge when an emerging market will have difficulties ahead, is when its wealthiest citizens are seeking to move their capital out of the country. That has certainly been the case in China for the last several years, and it seems also to be true of your country.

China now has a substantially lower birth rate than it did when there was a law that said that women could only have one child. According to current forecasts, China's population will be substantially lower at the end of the 21st century than it was at the end of the twentieth century. China has to ask itself, "What is our growth engine from here?" For many years it was exports, but the world is losing its tolerance for Chinese exports and Chinese labour costs are rising fast. For many years it was also infrastructure, and China laid more concrete in five years in the 2010s than the United States did during the whole of the twentieth century. But that has lost momentum. It has also been housing, but China's housing stock now includes enough empty units to house the entire population of Germany.

What could be next? One natural possibility would be to shift from their traditional low share of consumer spending in GDP, towards empowering consumers. That would mean transferring resources from one hundred million Communist Party members to the 1,3 billion non-members. It remains to be seen whether that is something that Xi Jinping is willing to do.

The next years in China are not likely to be easy ones. I know that many people have counted out China before and been badly wrong, but I am reminded of the late 1950s when American students rushed to study Russian, and the late 1980s when American students rushed to study Japanese. When I see a rush to study Mandarin, I think that history is maybe repeating itself.

Ann Bernstein: Can the United States in cooperation with other leaders get us through this post-Covid period, deal with the challenges of climate change and return the world to prosperity? How optimistic are you?

Prof Lawrence Summers: I am struck that nine months ago there was a sense that democracy was failing, and that autocracy was on the rise. But today the governments of Iran, Russia and China are all looking unsuccessful, even a bit fragile. In contrast, while everyone was so alarmed after the events of January sixth that democracy would be overthrown in the US and elsewhere, many of the proteges of Donald Trump have subsequently been soundly defeated, while in Brazil the Latin American Trump was defeated and the transition appears to be quite smooth. Democracy persists.

Winston Churchill never actually said it, but the line is attributed to him: that the United States always does the right thing, but only after exhausting all the alternatives. That captures a truth about my country. I am old enough to remember when people thought the cold war was over and Japan had won; when Jimmy Carter gave his 'malaise speech' and people thought that we had a crisis of the national spirit; when there was a sense that the whole country was falling apart during the Vietnam War. There were riots on college campuses and the President of the United States could only publicly speak in the protected environment of a military base.

From history I know that the prospects for union were very much in doubt at the time of the Civil War and that founding father Patrick Henry had declared the American Revolution lost in 1792. It is the great strength of democracy in general and America in particular that it has resilience. The fact that people get agitated about the limits of democracy and panic about the future in an open society creates a dialogue and a search for solutions. That sets in motion restorative forces. That is what we are going to start to see going forward, I believe.

I look at the extraordinary things that technology is making possible, and it makes me optimistic about the future. Look at a reality that we often take for granted. The number of hours of work it takes a typical American worker to purchase an air conditioner in her house, has fallen by 97 percent since I was born. That is an immense difference in the way people are able to live. It is true. Real wages are stagnant, and the middle class is struggling, but 97 percent in the span of a single human lifetime is an immense improvement. Going forward we will struggle and there will be problematic governance, but, ultimately, I am a believer in progress.

Ann Bernstein: Larry Summers this has been a fantastic discussion, I have learnt a great deal and I am sure the audience has as well. We hope to make things turn in a better direction, both globally and in your country and in mine. Thank you very much for being with us.

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