Transcript of IMF podcast:

**Systemic Hazards and the Spheres of Well-Being**

Ann Florini:

There are three spheres that are fundamental to human wellbeing. And in all of them, we're seeing systemic fragility. The first you'd call the political realm, how we organize ourselves to manage our shared problems, where we're seeing breakdown of global order. And we're seeing rising tensions within many countries as well. The second, the economic and financial system, here we've seen a reduction in global poverty, but income and wealth inequality has soared within countries. And for a lot of people, the incoming increases are precarious at best. The third, human systems of are inherently embedded in the natural environment, but we're rapidly destroying it with some pretty dire consequences.

Bruce Edwards:

The global pandemic has put enormous pressure on society and exposed cracks in the systems that we all depend on. In this program, systemic hazards.

Sunil Sharma:

We try to manage problems in small pieces within each of these fears that Ann has described. But what we are learning is that this does not work even within each sphere. And of course, politics and economics and the environment constantly interact in complex and unpredictable ways. So we are constantly unprepared for large systemic shocks.

Sunil Sharma:

I'm Sunil Sharma. I'm a distinguished visiting scholar at the Elliott School of International Affairs at George Washington University. And I'm also associated with the council on economic policies in Zurich, Switzerland.

Ann Florini:

My name is Anne Florini and I am a clinical professor at the Thunderbird school of global management at Arizona State University. I run the Washington DC programs

Bruce Edwards:

And I'm Bruce Edwards. Welcome to this podcast produced by the International Monetary Fund. The pressures of the global pandemic are forcing a reckoning about the world's ability to manage systemic hazards, driven by increasing fragility in political social economic, and environmental

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*Note: The transcript includes a mix of direct quotes and summarization of the discussion points.*
systems. Ann Florini and Sunil Sharma say the 21st century is set to experience massive disruptions that pose serious, possibly existential threats to society. Their article, Systemic Hazards is published in the June, 2020 issue of finance and development magazine.

Bruce Edwards:

So you describe the interaction of these spheres, but can you give us an example of how they interact today?

Sunil Sharma:

So let me take the COVID-19 crisis as an example. So, so here we have a health emergency, which is causing tremendous labor market disruption. And the implication is that we are putting our economies into comas. In some sense, we are trying to freeze frame a private market economy. And while we do that, we have to support households and we have to support firms. And the governments have to bear the burden, as a system is selectively put to sleep. This is putting stress on the economic, the financial, the legal, the social, and the political systems simultaneously. And success here is going to depend upon state capacity, whether it has the administrative capacity and the fiscal capacity to actually bear the burden of this COVID-19 crisis. Social trust in governments and private institutions, will the citizens actually listen to what the government would like them to do. Leadership and norms of behavior. And since it is a global pandemic international cooperation for dealing with the pandemic and additional resources for many developing countries,

Ann Florini:

Just to drill down on this a bit more, you can look at the extended impacts that COVID is having. Take for example, food systems, local markets are physically affected. Can the buyers and sellers of food actually physically show up without contaminating each other. The income of millions of people is going down sharply. Can they afford food? Harvesters, who is actually going to go out and harvest food supplies over the coming months? Seasonal labor has been displaced all over the place. A lot of people are falling ill. What's going to happen to the harvest system. And this is happening in a context where food supply chains were already facing massive challenges, from climate impacts that we're already seeing. Remember last year's massive floods in the U.S grain belt. And now we're even seeing plagues of locusts in East Africa, which just seems like too much for right now.

Bruce Edwards:

Yeah. And so what is wrong with our system? And I mean, why have these systems become so fragile?

Ann Florini:

Part of it was deliberate choice over the last several decades. We've lost the balance between the state and the market. And so you had many governments that really weren't providing appropriate counterweights to private interests. And we had an ideology that was prioritizing efficiency above everything. Everything had to be as efficient as possible. We had to optimize for financial returns. So we have quite deliberately stripped resilience out of all of these systems. We've disparaged it as redundancy. And at the same time, we have become much larger and more complex societies, which were harder to manage anyhow.

Sunil Sharma:

There'll be implications for each of the spheres that we are dealing with. So let's take the economic and financial sphere. This is led to highly indebted corporations, households, and governments that are not able to get stand adverse shocks to income and expenditures. Government indebtedness has compromised the ability of governments to provide public goods and serve as a shock absorber to society. Weak government oversight and regulation and deficiencies and corporate governance, have led to income and wealth inequality that has
adversity affected the less fortunate segments of society. In the political sphere. We are seeing political systems that are reflecting the preferences of the elites and not necessarily of society at large.

Sunil Sharma:

This has led to political polarization and loss of trust in governments and institutions. In the environmental sphere, we have made energy choices. We're using production methods that have polluted the land, the oceans and the atmosphere leading to global warming and climate volatility. We also have deforestation, destruction of ecosystems and species extinction, which is affecting many natural cycles, the consequences of which we do not fully understand. So we're dealing with fragility in all three spheres and these fragilities interact producing a system, which is truly complex.

Bruce Edwards:

So in your article, that's published in finance and development magazine. You foresee the 21st century being particularly difficult, but things change and disruptions happen. And there have been many major disruptions in past centuries. What do you see coming up in the 21st century that will in fact make it so difficult?

Ann Florini:

I think this is a really important point that people tend to respond to looking at the state of the world and say, we've been through stuff before we can get through stuff again. I think that's a little unduly optimistic, because there's a few things that are fundamentally different than they have ever been before. The first is that we're reaching the planetary boundaries. This is a term that you hear a lot these days, that we're destabilizing the natural systems to such a degree that we're tipping ourselves out of the kind of natural environment in which our civilization has evolved. And it's not just the carbon cycle and climate change. You can look at a whole bunch of natural cycles that we're just massively, massively disrupting. This has never happened before. Things like artificial fertilizer means that we're introducing a huge amount of very reactive nitrogen into ecosystems that can't deal with them.

Ann Florini:

And you're ending up with these huge dead zones in the ocean as a result. So you have this major environmental destabilization that is far beyond anything that has ever happened before and it's happening globally. Some of this is because of our sheer in numbers. I mean, we've quadrupled our population in the last 150 years or so. That's a really short period of time to adjust to that kind of a massive change. And partly it's because of the lifestyles that we've chosen and our energy and production system choices. So we're having this huge environmental impact, this huge environmental footprint on a scale that has not happened before. That's one of the two big changes. The second is the technological one, the same technologies that have made it possible to have that environmental impact clearly are part of it. More recently, we've had the advent of the digital platforms that we see destabilizing democracies around the world. And those are again different from anything that we have seen before.

Sunil Sharma:

And, I think that these new developments are playing out in social and political structures that are already challenged. Remember what was going on before the COVID-19 crisis, protests all over the world that reflected a breakdown of social trust and problems with the social contract. So we are trying to rethink the social contract with the aim of providing more horizontal equity between groups and more vertical equity among income strata. And this is happening amid a changing global order that seems rudderless and lacking in leadership. And I think the need of the hour is more democracy rather than more technocracy, as the siren songs of demagogues temp the electorates.

Bruce Edwards:
So you were talking earlier about the pandemic and in the article, you describe how the medical and the scientific community came together to fight the pandemic, this great collaboration, but that did not really happen at the political level. So what does that say about the political economy right now? I mean, is there a disconnect between what political leaders want and what citizens want?

Sunil Sharma:

As we mentioned earlier, political systems have reflected the preferences of the elite and not at the broader public. And the golden rule seems to be that those that have the goals have the rules. And political democracy really is meaningless without some minimum economic democracy and individual agency for most of the population. So you can see the reason which we are getting pushback from, I would say in many societies for change.

Ann Florini:

And I think if you look at how the political systems around the world, the political economy systems around the world have responded to the pandemic. I think you're seeing the results of two things. One is we never really have fully developed the state capacity that is needed around the world to manage the kinds of complex problems that we're talking about. But you have also seen some deliberate undermining and destruction of existing capacity for cooperation and problem solving, particularly at the global level, the intergovernmental systems, the international systems. So both within the state, which has been in many starved of resources and in the international political economy, we never developed the kind of capacity we should have developed, and even what's already there has been reduced.

Bruce Edwards:

And so how does the rise of populism play into this story?

Sunil Sharma:

I mean, the rise of populism, I think has three broad reasons. Increasing economic insecurity and rising income inequality. Now we might say that this was due to globalization technological change, but I think it's also importantly, due to the redistribution of power in societies. The second is structural and cultural factors, the lack of access to health systems, education systems for many. Growing ethnic diversity, generational shifts, changing social values, identity politics, and immigration. And the third, the widespread perceptions that the political system is unresponsive to many segments of society. And what that tends to do is reduce trust in ruling leads and create a desire for changing the state of school.

Ann Florini:

And I think this point on trust is really important. The Edelman Trust Barometer that came out in January, 2020 demonstrated that there is no sector that actually is well trusted in most societies, not business, not government, not civil society. That is a frightening state of affairs, because when you have to take action and yet there is no locus of authority that is trusted, how are you possibly going to get societies to agree on action? So I think there might actually be a glimmer of hope in that populism and this distrust of expertise and et cetera. Well, in light of the pandemics, pretty compelling demonstration that societies actually do need and need to pay for a competent government institutions. And that there are things that we need business to do differently. We might begin to see the restoration of some attention to competent government and competent governance.

Bruce Edwards:

And you've been close to the Paris Agreement since it all started. And you use it in this article as a good example of how to go about changing complex systems. But many have argued that the Paris Agreement is too weak to actually influence real change. What do you see in the Paris Agreement that is so strong? What do you see are its strengths?
Agreement that is so strong? What do you see are its strengths?

Ann Florini:

The Paris Agreement I think only seems weak, if we think that the only way to get things done is to tell people what to do and punish them if they don't comply. It's this very command and control approach, which we had tried a bunch of times in the climate negotiations. The Kyoto protocol, the negotiations in Copenhagen in 2009, and it completely failed. The command and control approach just doesn't work for this issue. So let's think about what Paris actually calls for. The Paris agreement sets a goal. And that goal of not exceeding two degrees Celsius is really important, because it gives everybody a focal point around which everyone can organize their action. But then how do we do that? And parents takes advantage of the reality that many of the things that we need to do to address climate are also good for other reasons.

Ann Florini:

Maybe you want to adopt renewable energy because it solves massive problems of air pollution that kills millions of people every year, for example. The same kind of agricultural practices that could help remove carbon from the atmosphere, also restore soil productivity, which we desperately need for food production. So what the Paris Agreement does is ask each country to put forward, what is it prepared to do anyhow? And then all the countries come together and say, what does this add up to? And is it good enough? And then a very important point is they come back together every five years and say, what is the science telling us now about climate? How has the technology developed with all these incentives that we've put in place to take these steps that we have other benefits from? And how do we ratchet up?

Ann Florini:

That Paris agreement also takes advantage of the reality that global life isn't just about what countries do. It's organized into this massive number of global and regional and transnational networks, business, civil society, activists, all sorts, all of which can take action that serves their own causes plus helps with the climate problem. So Paris actively encourages and supports major action from the private sector, from civil society among cities and others of national units. That approach has actually helped the United States stay within shouting distance of achieving its Paris commitments, which of course were undertaken under the Obama administration. Even now under a central administration that is actively dismantling climate action at the federal level. There is so much that is going on in the non-governmental realm, in the private sector, in public private networks, around the world, among cities, among other kinds of actors that what Paris allows us to do is not be dependent on this rather problematic intergovernmental process.

Bruce Edwards:

So how do you take this approach and apply it to reforming those systems that have been compromised? And how do you reconcile these longterm objectives with the short term political motivations, as we touched upon earlier?

Sunil Sharma:

I mean, given what Anna has just said about the Paris Agreement, it's sort of clear that is centralized authority simply cannot have the information and the administrative capacity to respond to the differential impacts of climate change in different areas. That means they just cannot have enough knowledge about the local community to fully manage these problems. So we'll require a much more multilayered governance. And what we try and convey in the paper is that the reality of these systemic hazards is complex, it's uncertain and it's ambiguous. Ambiguous in the sense that there will be multiple perspectives on these problems and no one perspective is going to be right. And so this calls for decision criteria based on a new set of principles, if you want.

Sunil Sharma:
And so we call for saying that robustness, in some sense, has to be built into the systems. That means we can't just look at narrowly optimized choices, but have to build in buffers and redundancy as a matter of form. And that our choices have to be flexible enough to not in some sense constrain, what we may have to do in the future. That's precisely where the uncertainty comes in. Secondly, we need multilayer governance because we're going to require central governments. We're going to require regional governments. We're going to require cities. We're going to require communities to play appropriate roles. And self-governance talk about means that systemic fragilities can manifest in different ways in different places. And we need people at the lowest level to be able to respond as the needs demands, that we need to have appropriate bottom-up responses. Of course, the central governments have to play an important role in terms of informing, empowering and coordinating.

Sunil Sharma:

Communication is very, very important because we have to be able to convey complicated societal dynamics. And we're seeing that in the context of the COVID-19 crisis, that we are trying to coordinate systemic responses from the population at large, based on the best expertise we have to create some understanding of the problems we are facing. And understanding produces the trust and collective ownership of decisions. And the last point I think really is fundamental to all this, which is that we have to be preemptive when it comes to tackling systemic risks, right? When systemic risk becomes obvious, it's always too late. And given the unpredictability, we have to try and scan the horizon to look at emerging problems and deal with them. That means in some sense, we have to deal with the fires before the smoke becomes visible. And how we motivate societies to focus on prevention of these systemic risks, I think is a very, very important political challenge.

Bruce Edwards:

And so what do you think about what we've seen out on the streets and cities around the world in recent weeks? I mean demands for racial equality, a fundamental change to policing, et cetera. Is this how systemic change will happen, do you think?

Ann Florini:

I think this is exactly how systemic change happens. As you're thinking about how do you do empowered self-organization, what does it mean to have robust governance? Most of it really boils down to, to what extent are you changing mindsets so that people start choosing to do things differently? Basically it's about norm shifts. When you think about these complex systems, you can't possibly manage them solely by top-down control mechanisms, through laws and regulations, as we both been saying. What really brings about the lasting changes when all the agents, all the individual people change their minds about how they should behave. These are not things that just happen, although they can seem to come out of the blue. They're usually the overnight success that actually results from years or decades of organizing and effort on the part of many people.

Ann Florini:

The Black Lives Matter movement that we're seeing in the United States that has spread around the world is a perfect example of this. There has been an enormous amount of groundwork that has been laid, but it is now seizing a moment, a moment of opportunity that makes it fairly clear that things in the future are not going to be the same as they have been. It's really striking to look at what's happening in the public opinion, polls within the United States about attitudes toward police brutality, to what degree is this a widespread systemic problem? The attitudes have changed dramatically just in the last several weeks. We're seeing a norm shift unfold before our very eyes.

Sunil Sharma:

Let me just add to that by saying that, yes, what we're seeing on the streets is demand for racial equality and a change in policing norms and behavior. But also it's a demand for fairness.
Fairness in terms of access to health, education opportunities, greater inequality in income and wealth and greater agency for the average citizen. I think that's part and parcel of what's also going on in the streets.

Bruce Edwards:

Thanks so much to you both.

Ann Florini:

Thank you so much for having us. We've really enjoyed it.

Sunil Sharma:

Thank you very much Bruce.

Bruce Edwards:

That was-

Ann Florini:

Ann Florini.

Bruce Edwards:

And?

Sunil Sharma:

Sunil Sharma.

Bruce Edwards:

Talking about systemic hazards. Look for their article published in the June, 2020 issue of finance and development magazine. You can read the article online at imf.org/fnd or download the finance and development tab to read it on your mobile device. Look for other IMF podcasts, wherever you get your podcasts. Subscribe, if you like what you're hearing and follow us on Twitter @IMF_Podcast. Thanks for listening.