

Approaches to Economics: Time for a revolution?

Symposium on the occasion of Professor Knut Anton Mork's 80th birthday

2nd Keynote: Macroeconomics Needs Foundations for a Fragmenting World

Opening

Thank you, Knut Anton. And Happy Birthday! Gratulerer med dagen!

I am deeply honored by your invitation to give this keynote on this very special occasion.

Frankly, I am a bit starstruck, too, at giving a keynote between those of such august figures as Norges Bank Governor Ida Wolden Bache and Professor Doyne Farmer of Oxford.

I had the pleasure during the last year and a half of working with Knut Anton on our initiative to push for higher Norwegian transfers to Ukraine's defense; which is, as we know, also our European and Norwegian defense.

Knut Anton has invited me to speak today on The Big Picture of macroeconomics. In particular, on how geopolitics changes the perspective in macroeconomics, which is what I will focus on.

So, let me see if I can provide some food for thought.

The framing problem

We tend to think of macroeconomics as resting on politically neutral models with firms, households and governments as rationally optimizing agents. Where the government is represented by a depersonalized "fiscal authority" and an independent central bank, and where both of these seek the same efficient solution.

Several of these concepts are now being challenged to an unusual degree by, among others, the behavior of the world's leading power: Neutrality. Independence. Efficiency. And even rationality, in the sense of stable and internally consistent policy objectives.

The issue is whether we are facing a structural shift towards higher volatility and deeper fragmentation, instead of intermittent and temporary disruptions. Economics Nobel prize

winner Michael Spence has argued that the global economy is indeed in a [period](#) of “more frequent and violent shocks”.

This goes beyond the realities of the current US administration. Macroeconomic modelling relies on aggregation of assumed government priorities in a “government objective function”. But geopolitics changes this objective function, with conflicting objectives as the result.

Instead, variables that were previously second-order constraints have now become first-order policy objectives: essential materials, technology and AI, energy, the defense industry, general security, and, for the most powerful states, the pursuit of dominance.

These issues began to emerge under the Biden administration. They were turbocharged by Russia’s invasion of Ukraine. And they have been radically extended under the second Trump administration. Covid, as we recall, turned resilience into a macro-objective.

For me, as a former World Bank economist, it is tempting to see these changes through the prism of the effective demise of the Washington Consensus, which was for long a cornerstone of World Bank and IMF operations.

Roadmap

So, let me set out where I want to go.

First, I want to say something about the Washington Consensus itself and the meaning of its demise.

Then I will move on to some characteristics of the new geopolitical environment that now shapes the context of macroeconomics. Notably, the channels of geoeconomic fragmentation: trade, capital flows, payment systems, and the use of sanctions and security measures. To a lesser extent, the spread of state capitalism.

Third, I will try to place all of this inside a longer historical arc: from Adam Smith’s argument against British mercantilism, through David Ricardo and the classical political economy of the nineteenth century, the Pax Britannica and the first wave of globalization, into the interwar interregnum that broke that order. Then out the other side into the Bretton Woods settlement that John Maynard Keynes and Harry Dexter White negotiated in 1944 in New Hampshire.

I want to use that arc to explore the following proposition with you:

*Are we now living through the beginnings of a first post-Keynesian interregnum of the global economic order? The second such period since 1776 when Adam Smith published *The Wealth of Nations*. If we are, what does that mean for the discipline?*

Fourth, I will turn to what all of this means for the discipline of macroeconomics, organized around three questions that Knut Anton has put on the table, and as seen through the proposition of the interregnum.

The Washington Consensus

Do we now even remember how dominant the Washington Consensus was? The notion that economic growth would follow from fiscal discipline, elimination of government subsidies, liberalization of trade and investment, independent central banks and market-determined interest and exchange rates, as well as privatization and deregulation?

The broader interpretation of the Washington Consensus, if we understand it as a sort of neoliberal tract, has been dead for at least a couple of decades. But the softer version has persisted until being effectively finished off by the second Trump administration.

It must be one of the great ironies of economic history that this approach has been brought to an end by the political right-wing, after having been for decades under attack by the political left.

A catalyst for its demise was probably that China, after its entry into the World Trade Organization in 2001, has enjoyed such enormous economic success by applying very selectively the criteria of economic liberalism. That involved restricting market access for foreign firms in China, while gaining extensive market access within the WTO countries. It meant repression of interest rates in China and of the exchange rate for the Renminbi, as well as massive subsidies and industrial policy - all anathema to the liberal economic agenda.

When China was admitted to the WTO, the assumption was that it would become more like the West: in terms of liberal economic governance, and even democracy. Instead, it is the West, including the US, that has become more like China in its use of industrial policy, subsidies, and strategic control over key sectors.

Background conditions: the hegemonic order

But to look for the background conditions that macroeconomics could afford not to model explicitly we need to go beyond the Washington Consensus, which emerged in the 1980s.

It is worth noting that the dominant paradigms of modern macroeconomics emerged during the post-war period. The US as the global hegemon provided international security in a bipolar Cold War global system. Within “the West”, geopolitics and security could be treated as exogenous. The US also provided the political underpinning for the Bretton Woods system of international financial institutions: the IMF, the World Bank, and later the WTO, as well as the global reserve currency.

So, what we had was a single hegemon at the central node of the payments, reserves, and security systems, and strong incentives to keep those systems open and rules-based. With a benign central node - benign, that is, at least for the West - networks behaved sufficiently like markets for standard economic analysis to work.

Even before that, the first period of globalization, roughly from 1870 to 1914, was made possible by the Pax Britannica, British leadership of the international system, and by the gold standard.

In fact, to find a period in which economic analysis had to operate without a functioning hegemon, and with fractured payment and security systems, we may have to look all the way back to the interwar period between 1918 and 1939.

The Kindleberger framing

A stable international economic order [depends](#) on the leading economy supplying a small number of public goods that no other actor has the incentive or capacity to provide: An open market for the rest of the world's exports. Stable long-term lending. A lender of last resort in financial crises. And a stable exchange-rate system.

Britain provided these goods, even if imperfectly, in the nineteenth century and until World War 1. After 1944, the United States has provided them more deliberately: through the Bretton Woods institutions, the GATT and later the World Trade Organization, and increasingly through the Federal Reserve's network of swap lines.

The most visible sign of the US withdrawing from this role is maybe President Trump's tariffs.

Smoot-Hawley and the gold-exchange standard

These have a direct parallel in the Smoot-Hawley tariffs that the US imposed in 1930. Those tariffs, together with retaliatory tariffs by other countries, deepened and prolonged the severe contraction in world trade and aggravated the Great Depression.

That Great Depression also had a monetary dimension: the leading powers' return to the gold-exchange standard. That was reconstructed in the mid-1920s after the gold standard collapsed in 1914. This arrangement transmitted deflation across borders. Then it collapsed in stages between 1931 and 1936, into a more fragmented and less anchored monetary reality, until the Bretton Woods system was established in 1944.

The Norman / Churchill anecdote

There is an [anecdote](#) from that period which is worth retelling.

Winston Churchill was then Chancellor of the Exchequer - Minister of Finance. He was advised in 1925 by Bank of England Governor Montagu Norman to return the pound sterling to gold, at pre-war parity. Churchill later told his physician that this had been "the biggest blunder of his

life". He was rumored to have said that he "should have had Montagu Norman hanged" rather than letting himself be convinced.

Montagu Norman himself, later in his life, reflected with regret on the work he had done together with his counterparts: Benjamin Strong as Governor of the Federal Reserve Bank of New York, Émile Moreau at the Banque de France, and Hjalmar Schacht at the Reichsbank, to strengthen international monetary stability through the return to gold. Instead, their policies had created deflation that brought devastation to the lives of millions.

"We worked so hard" Norman wrote, "and we achieved absolutely nothing". Their lives, he concluded, had been futile.

Hjalmar Schacht, for his part, went on later to become Hitler's central banker.

The contemporary parallel

The parallel of the interwar period with today is not direct. I will say more later about how trade, capital flows, and payment systems are fragmenting today as a result, partly, of geopolitics.

What we do have, however, is a hegemon that has begun to withdraw, as the United Kingdom did after World War 1. We have a monetary architecture under visible strain. And several other factors that I will describe in more detail.

No candidate has yet emerged willing and able to supply the core hegemonic public goods on a global scale. China is providing some of them in parts of the global South: through the Belt and Road Initiative, renminbi swap lines, and the Cross-Border Interbank Payment System, CIPS, a China-led parallel to SWIFT.

So, a question I would like to pose for your reflection is this: *to what extent has the Washington Consensus, globalization broadly, and US hegemony during the post-war period functioned as background conditions that modern macroeconomics could afford to take as given?*

The new environment: volatility

Let me now move on to say something about the characteristics of the new environment in which macroeconomics operates. Notably increased volatility and the growing geo-economic fragmentation in recent years: the weaponization of trade and finance, increasing neomercantilism by the world's two leading powers, the exploitation of trade choke points, the increasing importance of geopolitical blocs, and the breakdown of the rules-based international system.

As regards volatility, the past six years has seen three major global tail events: Covid in 2020. Russia's invasion of Ukraine in 2022. And the US-Israeli war with Iran this year.

Before 2020, we would need to go back to the global financial crisis in 2008. Before that, to Russia's default in 1998. And before that, to the oil shocks of 1973 and 1979.

Four of these seven episodes 1973, 1979, 2022, 2025 were primarily geopolitical events. Two of those four have come in the past four years. Is this just random clustering? Or is geopolitics indeed causing more volatility?

Fragmentation

Now, on to fragmentation.

Geo-economic fragmentation has recently become a topic of reports by organizations such as the IMF, the World Trade Organization, the OECD, and the EU.

This fragmentation is **driven** by several motives:

- National security.
- The desire for greater autonomy: here, the European goal of “strategic autonomy” is perhaps the clearest articulation.
- Rivalry between great powers.
- And domestic political goals such as protecting production and jobs.

In economic policy, we can think of this fragmentation as working through several distinct channels, each with its own macroeconomic transmission.

The most obvious one, and the easiest to measure, is evidently trade.

According to the IMF's latest [World Economic Outlook](#), and [previous IMF staff papers](#), this fragmentation has three main characteristics:

- First, trade is becoming more concentrated among “like-minded” countries; the so-called friend-shoring. Trade and capital clusters are increasingly organized along geopolitical lines.
- Second, it is increasingly common for governments and companies to think in geostrategic terms about their supply chains; for example, for minerals.
- Third, technological fragmentation is accelerating. There are growing trade restrictions on technologies linked to semiconductors, data infrastructure, artificial intelligence and biotechnology.

Capital and portfolio flows

But trade is not the only source of fragmentation. Fragmentation is also starting to show in capital and portfolio flows.

According to a recent Bank for International Settlements [Working Paper](#) (Pradhan and others, 2025) geopolitical tensions between countries reduce cross-border bank lending between them. Furthermore, there is an interaction between geopolitical tensions and monetary policy: elevated geopolitical tensions amplify the international transmission of monetary policies.

So, for example, a Federal Reserve tightening, transmitted to non-US banks lending in dollars to non-US borrowers, causes sharper contraction of dollar lending when the bank and the borrower are also geopolitically distant.

With regard to [portfolio flows](#), according to a recent IMF working paper, investment funds allocate smaller shares of their portfolios to recipient countries that are geopolitically more distant from their country of origin.

Foreign direct investment, on the other hand, [appears](#) to be holding up well against fragmentation, except in strategic sectors such as computer manufacturing and information and communications technology.

So, an important macroeconomic point here is that foreign direct investment flows are aligning along geopolitical lines precisely in the sectors that determine future productivity.

This fragmentation that I describe is still of limited magnitude. But could it be the early warning cracks that are starting to show in the global financial system? The IMF has warned that the world could fragment into ‘economic blocs’, creating obstacles to the cross-border flow of capital, goods, services, ideas, and technologies.

Payments fragmentation

Fragmentation is also increasingly [appearing](#) in the international payments system; the backbone of global trade, capital flows, and remittances.

Whereas payment systems used to be regarded as merely the “plumbing” of international capital flows, it has in recent years become increasingly evident that these systems are not geopolitically neutral infrastructures. Rather, they are important strategic assets.

What we are now seeing is the emergence of a parallel payments architecture, aligned with geopolitical blocs. Several governments are now pursuing alternative systems to reduce the risks posed by payment system weaponization. Such developments have accelerated after Russia was excluded from SWIFT and its reserve assets frozen, after its invasion of Ukraine.

This fragmentation is still at an early stage. But it represents a widely held view that new systems are an effective means of hedging against the risks posed by geopolitics.

Choke points

A more physical and visible aspect of geoeconomic fragmentation right now is of course Iran's weaponization of the Hormuz Strait as a choke point. China's control of critical minerals is another example of strategic use of choke points. As are the US export controls on advanced semiconductors and the equipment used to produce them.

Adam Smith and the historical arc

Now, we could go all the way back to Adam Smith, and his opposition to British mercantilism, to see why geopolitical fragmentation is a bad idea: gains from specialization and gains from exchange will both suffer, and the welfare cost of misallocation will increase.

The weaponization of trade is also nothing new, although the term is. In *The Wealth of Nations*, Book IV, Chapter III, Smith writes:

“Commerce, which ought naturally to be, among nations as among individuals, a bond of union and friendship, has become the most fertile source of discord and animosity.”

The two open orders

The intellectual victory of Smith's argument against mercantilism, carried forward by Ricardo and the classical liberal political economists, made possible the free-trade order of the nineteenth century. Britain's unilateral move to free trade in 1846. The Pax Britannica. The first wave of globalization.

After 1944, a second open international order was built on the same foundations. We got Bretton Woods. We got the GATT, and later the WTO. We got the gradual liberalization of capital accounts. And we got the network of multilateral institutions through which the United States provided the public goods of system stability.

Modern macroeconomics is the product of that second order. Macroeconomics as a discipline was developed inside an open trading system, an integrated capital market, a politically neutral payments architecture, and a stabilizing hegemon. Importantly, it took those background conditions as given rather than as objects of analysis.

Setting aside the interregnum between 1931 and 1944, macroeconomics - and the classical political economy that preceded it - has rested on a single set of open-economy assumptions. Assumptions that reach back to 1776. Or certainly to 1846.

This general point is not new. The late economic historian Robert Skidelsky has long argued that modern macroeconomics has neglected the historical and institutional conditions in which it

operates. As have others. What I want to do today is to point to the specific conditions of the post-1944 order that are now being reversed.

Gramsci and Keynes

The Italian political thinker Antonio Gramsci's framing is worth mentioning here. In 1930 he writes of interregnum as a period when "the old is dying and the new cannot be born; in this interregnum a great variety of morbid symptoms appear". I am not proposing that there will necessarily be a new "regnum". Rather that we are, at a minimum, observing serious cracks in the old one.

John Maynard Keynes' General Theory, published six years later, in 1936, was written precisely during the period of breakdown of the open international order. The Bretton Woods system, as set up from 1944, was the answer Keynes and Harry Dexter White negotiated to the question of how to rebuild that order on different foundations.

So, Keynes invented modern macroeconomics under conditions of disintegration, in some ways not unlike what we may now be returning to. As part of that, he and Dexter White designed the institutional architecture that is now dissolving, and which has provided the terms for macroeconomic thinking.

What the return of neo-mercantilism and geoeconomic fragmentation now confronts us with is the reversal of precisely those conditions: tariffs as a [routine](#) instrument of strategic competition, the weaponization of payments and reserves, capital flows that respond to security as well as to return, and a leading economy that has begun to withdraw from the system-stabilizing role.

State capitalism

In parallel with this geo-economic fragmentation, the practices of state capitalism are increasing. This changes the assumption that macroeconomics commonly makes about the state not being a market participant, or a market participant with strategic objectives.

The United States, in particular, has under both the Biden and Trump administrations, deployed large-scale industrial subsidies, export controls, and screening of strategic capital flows - to secure technological and strategic advantage.

The three questions

Now, back to the question Knut Anton asked me to address in this talk: How do these geopolitical, or geoeconomic, developments change the perspectives in macroeconomics?

Specifically, and here I am citing an email from Knut Anton:

- One. Can the Chinese economy be analyzed with the same instruments that have been used for Western economies?
- Two. Must macroeconomists now be explicit about what kind of political setting they are assuming?

And

- Three. Can economic analysis trump political differences, or will it be the other way around?

I will come to this from the perspective of a formerly Washington-based practitioner of development finance - with due respect for the macroeconomists in the room who are surely far more versed in macroeconomic theory than I am.

Question 1: China

So, to your first question Knut Anton: can the Chinese economy be analyzed with the same instruments used for Western economies?

This is, in fact, what the IMF and the [World Bank](#) tried to do for decades: to use standard macroeconomics instruments for analyzing the Chinese economy. China, for its part, engaged with these recommendations and did implement critical reforms. But on the macroeconomic framework the Chinese government largely did things its own way.

Instead, it is the IMF and the World Bank that have in many ways been dragged closer to China's way of doing things.

The People's Republic of China took its seat at the Bretton Woods institutions in May 1980, under Deng Xiaoping. My understanding is that the engagement was in the beginning genuinely two-way.

Then, in the 1980s, the Washington Consensus hardened. The Bank's and the Fund's advice converged along the typical line of the Consensus: market interest rates, exchange-rate flexibility, capital account opening, banking commercialization, state-enterprise reform, withdrawal of industrial policy.

Decades later, from the mid-1990s onwards, a sequence of Bank documents began, very slowly, to concede value to strategic state coordination and sequenced liberalization.

But the operational advice to Beijing was slower to move. The IMF's Article IV [reports](#) on China, through the 2000s continued the standard prescriptions: greater exchange rate flexibility, faster capital account opening, a smaller role for directed credit and industrial policy.

That language only began to soften in the 2010s. The position remains mixed: the Bank's 2026 [report](#) on industrial policy accepts it with caveats, while the Fund's most recent [Article IV](#) report on China still calls on Beijing to scale back "unwarranted industrial policy" and to give the renminbi more flexibility.

So, historically, China declined the core of the advice. Capital controls were kept as continuous infrastructure, not crisis instruments. The exchange rate remains managed. The Fund's most recent estimate is that the real effective rate is [undervalued](#) by 12 to 21 percent. Credit is still directed through state banks toward priority sectors. Industrial policy and state ownership remain.

It is worth being clear that this declination has had a price. Ruchir Sharma made an [important point](#) in the Financial Times this weekend.

China now accounts for some 17 percent of global GDP and 15 percent of global trade, but only about 2 percent of central bank reserves and 2 percent of trade invoicing is in renminbi. As a financial superpower, China will not rival the US anytime soon. This is the price the country is paying for retaining a managed capital account and exchange rate.

The Fund and Bank's diagnoses were nonetheless right about many things. Several of the now very visible weaknesses of the Chinese economy were flagged by the IMF long before. Property-sector and shadow-banking risks were flagged in [Article IV reports](#) from the mid-2010s, years before the Evergrande default. Local-government financing-vehicle debt was named and progressively quantified through the 2010s. And the rebalancing to consumption that the Fund's 2025 Article IV report now calls the overarching priority was named by [the Bank](#) as early as 1985.

But in terms of macroeconomic framework, it was the Bank and the Fund that moved toward the Chinese position, not the other way around. The Fund's 2012 Institutional View on Liberalization and Management of Capital Flows [accepted](#), and I cite, that "there is no presumption that full liberalization is an appropriate goal for all countries at all times."

The IMF's 2022 [revision](#) allowed pre-emptive controls. The Fund's Integrated Policy Framework formalizes joint use of monetary policy, FX intervention, capital flow management, and macroprudential tools: combinations the People's Bank had been deploying for two decades. And the Bank and the Fund's position on industrial policy have, as I said earlier, moved significantly towards acceptance.

So, to answer your question Knut Anton, I want to turn it on its head:

Can the Western economy be analyzed with the same instruments used for the Chinese economy?

Question 2: Political setting

Now to the second question: must macroeconomists now be explicit about what kind of political setting they are assuming?

Ok, so based on the review of the China - World Bank - IMF relationship that we just talked about, we might conclude that macroeconomics has been, at least in the format these institutions pitched to China, a somewhat Western format.

That, I think, in part answers your question. The traditional macroeconomic approach has left out elements that are key to the Chinese economy. Some of these elements are increasingly propagating outside China, including in the US and elsewhere in the West.

So, as I laid out earlier in the talk, the postwar Bretton Woods settlement let macroeconomics treat the political setting of the international system as exogenous. Within that, between roughly 1979 and 2008, a particular operational paradigm crystallized: the Washington Consensus as reflected in approaches to economic liberalization.

To be clear: the interregnum I am proposing is not the end of the inner paradigm, the Washington Consensus. That broke long ago, in 2008 if not before. What is breaking now is the outer framework. A stabilizing hegemon. An open trading system. Integrated capital markets. A politically neutral payments architecture.

What I think economists may increasingly need to make explicit is which configuration of these four conditions is being assumed, and what happens if such assumptions no longer hold.

So, an analyst would now need to specify, for each country under study: which bloc the country sits in. Which security guarantees it relies on. Which choke points it depends on remaining open. Which payments systems its trade and reserves run through. How open its capital account is. And how exposed its cross-border capital and portfolio flows are to the geopolitical alignment of its partners. And to what extent these conditions are assumed to hold, or change. For central banks, sovereign-wealth funds and finance ministries, such considerations will increasingly shape reserve composition, swap-line access and the geography of capital allocation.

Question 3: Europe and Draghi

On the third question: can economic analysis trump political differences, or the other way around?

I would point here to the Draghi report on European competitiveness, published by the European Commission in September 2024, authored by former Italian Prime Minister and President of the European Central Bank, Mario Draghi.

The report is clear that several elements enter the European objective function alongside conventional macro objectives. These include industrial sovereignty in clean technology, semiconductors, defense and AI.

And the report makes security an analytical variable: Europe is running a savings surplus, but European savings flow to the United States, financing American venture capital, American technology, and ultimately American competitive advantage over Europe. In the report's frame, that is a security problem, not just an efficiency problem.

Importantly, competitiveness is treated not as a residual outcome of well-functioning markets but as a strategic objective that the state must actively construct.

Closing

So: are we in fact in an interregnum with respect to the conditions that have set the terms for modern macroeconomics?

Much will of course depend on how the US-China relationship develops, which will determine much of the pace of fragmentation. As I noted earlier, the timing of any Chinese capital account opening will tell us a great deal about the rate of financial fragmentation in particular.

But the predictive power of the interregnum proposition does not rest entirely on the US-China relationship. Several other variables matter at least as much.

- One. Whether the second Trump administration's dismantling of US-supplied global public goods proves cyclical or structural.
- Two. Whether Europe completes the Draghi agenda, or remains captive to terms set by the two larger powers.
- Three. Whether the major middle powers: India, Brazil, the Gulf, Indonesia, Türkiye, continue to hedge successfully between Washington and Beijing, or are at some point forced to choose.
- Four. Whether the dollar system continues to be accepted by states that are not formally aligned with the United States.

My own view is that the possibility of an interregnum is non-negligible. Also, even if the existing framework holds, the concept of a possible interregnum gives us a sharper way to think about the limitations of current macroeconomic approaches.

Thank you, Knut Anton.

Thank you, All.