Opinion

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Putin and Xi Exposed the Great Illusion of Capitalism

Unless the U.S. and its allies mobilize to save it, the second great age of globalization is coming to a catastrophic close.



Goodbye globalization? Photos via Getty Images; Illustration by Jessica Karl/Bloomberg

By John Micklethwait and Adrian Wooldridge March 23, 2022, 9:01 PM PDT

A book published in 1919 on "The Economic Consequences of the Peace" isn't the obvious starting place for understanding the economic consequences of the current war in Ukraine. But it's worth taking a little time to read John Maynard Keynes's famous description of the leisurely life of an upper-middle-class Londoner in 1913 – just before the Great War changed everything:

The inhabitant of London [in 1913] could order by telephone, sipping his morning tea in bed, the various products of the whole earth, in such quantity as he might see fit, and reasonably expect their early delivery upon his doorstep; he could at the same moment and by the same means adventure his wealth in the natural resources and new enterprises of any quarter of the world, and share, without exertion or even trouble, in their prospective fruits and advantages.

Keynes then describes how this Londoner could speculate on the markets and travel wherever he wanted without a passport or the bother of changing currency (the gold standard meant that his money was good everywhere). And then the famous economist delivers his coup de grace by going inside the privileged Londoner's head:

[The Londoner] regarded this state of affairs as normal, certain and permanent, except in the direction of further improvement, and any deviation from it as aberrant, scandalous and avoidable. The projects and politics of militarism and imperialism, of racial and cultural rivalries, of monopolies, restrictions and exclusion, which were to play the serpent to this paradise, were little more than the amusements of his daily newspaper, and appeared to exercise almost no influence at all on the ordinary course of social and economic life, the internationalization of which was nearly complete in practice.

Keynes's cosmopolitan Briton, completely unaware that the first great age of globalization was about to be shot to pieces at the Somme, is the urban equivalent of the cavorting toffs in "Gosford Park," Robert Altman's movie about a weekend in a grand country house just before the outbreak of war. One of us possesses a photograph of the Bullingdon, Oxford's poshest dining club, in 1913: The future rulers of the world stare out at us with frozen arrogance. Within a year most of them were in the trenches.

Foppish aristocrats weren't the only ones who were complacent. Intellectuals agreed. Norman Angell's "The Great Illusion," the Edwardian bestseller published in 1909, argued that war was impossible given the interconnectedness of the world. The great businesses of Europe and the U.S. operated on the same assumption. The first great age of globalization, which started in the 1860s and was underpinned by British power and coordinated by British statecraft, had left the commercial classes free to make money – businesspeople then faced far fewer barriers than their modern equivalents when it came to moving money, goods or people around the world.

It's easy to mock the shortsightedness of the West's ruling class in 1913 – for not seeing how the rise of Germany and the complex web of alliances between the Great Powers could turn an assassination in Sarajevo into a global conflict. Clio, the muse of history, is always wise after the event, but future generations could well ask the same question about us: How could they not know?

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Keynes's Londoner, lounging in his bed, had at least this excuse: The end of his age of globalization came with little warning. In our case, globalization has been under sustained attack for two decades, with serious assaults in 2001 (when two planes, hitherto symbols of modernity, slammed into the World Trade Center); 2008 (when Lehman Brothers collapsed and the global financial system went into cardiac arrest); and 2016 (when the British voted to leave the world's largest free-trade zone and Americans elected a nativist TV personality as president). The "decoupling" of the global economy into Chinese and Western portions has been gathering pace for some time. And the biggest drama before Ukraine was a virus that froze supply chains and forced the world into hibernation.

And yet, at the beginning of 2022, many of us shared the assumptions of Keynes's Londoner. We ordered exotic goods in the confident expectation that Amazon would deliver them to our doors the next day. We invested in emerging-market stocks, purchased Bitcoin, and chatted with people on the other side of the world via Zoom. Many of us dismissed Covid-19 as a temporary suspension of our global lifestyle. Vladimir Putin's "projects and politics of militarism" seemed like diversions in the loonier regions of the Twittersphere.

Now that we have been shaken awake, most of our attention is on the bloodshed in Ukraine, and rightly so. But just as World War I mattered for reasons beyond the slaughter of millions of human beings, this conflict could mark a lasting change in the way the world economy works – and the way we all live our lives, however far we are from the carnage in Eastern Europe. The "inevitable" integration of the world economy has slowed, and the various serpents in our paradise – from ethnic rivalries to angry autocracies to a generalized fury with the rich – are slithering where they will.

That doesn't mean that globalization is an unalloyed good. By its nature, economic liberalism exaggerates the downsides of capitalism as well as the upsides: Inequality increases, companies sever their local roots, losers fall further behind, and – without global regulations – environmental

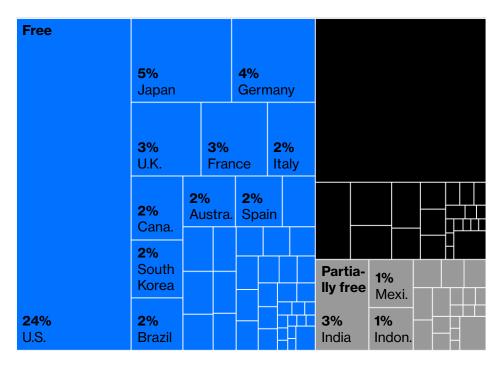
problems multiply. Yet liberalism has also dragged more than a billion people out of poverty in the past three decades and, in many cases, promoted political freedom along with economic freedom. The alternatives, historically speaking, have been wretched. Right now, the outcome that we have been sliding toward seems one in which an autocratic East gradually divides from – and then potentially accelerates past – a democratic but divided West.

From this perspective, the answer to globalization's woes isn't to abandon economic liberalism, but to redesign it. And the coming weeks offer a golden opportunity to redesign the global economic order.

By any economic measure the West is <u>significantly more powerful</u> than the East, using the terms "West" and "East" to mean political alliances rather than just geographical regions. The U.S. and its allies account for 60% of global gross domestic product at current exchange rates; China, Russia and the autocracies amount to barely a third of that. And for the first time in years, the West is coming together rather than falling apart. This week, Joe Biden is traveling to Europe as the leader of the newly united and reinvigorated free world.

Free World

Share of global GDP by country and level of freedom based on political rights and civil liberties



Sources: IMF; Freedom House

Note: GDP figures are the latest available.

So far, for all his talk of uniting democracies, Biden has done little to highlight, let alone advance, the economic dimension of freedom. The question for Biden and the European leaders he will meet this week is simple: What sort of world do they want to build in the future? Ukraine could well

mark the end of one great episode in human history. It could also be the time that the free world comes together and creates another, more united, more interconnected and more sustainable one than ever before. Seizing that opportunity will require an understanding of both economics and history.

The Way We Were

The end of the last global age was particularly brutal. Even once the slaughter had begun in Flanders, British shopkeepers, with stoic good humor, displayed signs as the war started that read "Business as usual during alterations to the map of Europe." But it was not to be. The conflagration quickly halted trade, capital flows and migration. Governments interfered in the economy more deeply than ever before. When the guns finally fell silent in 1918 and peace was forced on Germany at Versailles (in the Carthaginian terms that Keynes decried so eloquently), the Bidens, Johnsons and Macrons of the time tried to restore the old world order of free trade and liberal harmony – and comprehensively failed.

The new superpower, America, refused to become the defender of the faith that Great Britain had protected with such skill until 1913. A beggar-thy-neighbor policy of tariffs slowed the world economy and eventually produced the Great Depression, with global trade shrinking by more than half in 1928-1933. The serpents continued to slither: Lenin, Mussolini and Hitler exploited defeat and poverty to create aggressively anti-liberal regimes, the Soviet version of which lasted for seven decades. The situation for liberal economics was so dismal that, by the mid-1930s, Keynes himself had abandoned free-market liberalism as a lost cause and was campaigning for national self-sufficiency.

Only after the Second World War did economic integration resume its advance – and then only on the Western half of the map. What most of us today think of as globalization only began in the 1980s, with the arrival of Thatcherism and Reaganism, the fall of the Berlin Wall, the reintegration of China into the world economy, and, in 1992, the creation of the European single market.





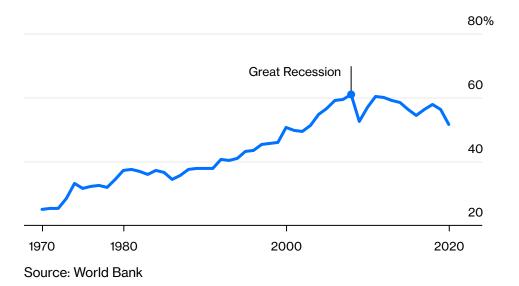
1992: Beijing experiences its first Big Mac attack Photographer: Mike Fiala/AFP via Getty Images

Yet once politicians got out of the way, globalization sped up, driven by technology and commerce. Young technology companies such as Microsoft Corp. and Apple Inc. took off while old technology companies such as Nokia Oyj, a Finnish rubber-boot and electronics maker that by 2010 was the world's largest manufacturer of mobile phones, got a new lease on life. McDonald's Corp. opened restaurants in Moscow's Pushkin Square in January 1990 and just off Beijing's Tiananmen Square in April 1992. As the new century dawned and an unknown "pro-Western" bureaucrat called Vladimir Putin came to power in Russia, the daily volume of foreign-exchange transactions reached \$15 trillion.

More recently, as the attacks on globalization have mounted, economic integration has slowed and in some cases gone into reverse.

Shrinking Share

Trade's share of global GDP peaked in 2008



But Russia's invasion of Ukraine marks a bigger and more definitive assault than the previous ones.

That's partly because the immediate rupture is so savage. The supply of basic commodities, from wheat to nickel to titanium to oil, has been disrupted. The West is doing everything it can to "cancel" Russia from the global economic system – sanctioning oligarchs, expelling Russian banks from the global financial plumbing, and preventing Russia's central bank from accessing its reserves. There's talk of throwing Russia out of the World Trade Organization.

Even when they haven't been forced to do so by law, Western companies are boycotting Russia and closing down their Russian operations. Russian consumers can no longer use Visa, MasterCard and American Express. The McDonald's in Pushkin Square is closed – along with 850 other branches. Photos have appeared on social media of Russians standing in interminable queues for sugar and other basic foods or else fighting over remaining scraps, just as they did in the Soviet days. For its part, the Kremlin has hit back by blocking access to Facebook and threatening to imprison or fine anyone suspected of spreading "fake" news, thereby essentially closing down Western news organizations inside the country.

We Didn't Mean It

The Western policymakers meeting this week will say they have no intention of closing down the global order. All this economic savagery is to punish Putin's aggression precisely in order to restore the rules-based system that he is bent on destroying – and with it, the free flow of commerce and finance. In an ideal world, Putin would be toppled – the victim of his own delusions and paranoia – and the Russian people would sweep away the kleptocracy in the Kremlin.

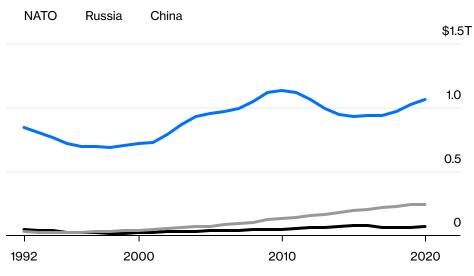
In this optimistic scenario, Putin's humiliation would do more than bring Russia back to its senses. It would bring the West back as well. The U.S. would abandon its Trumpian isolationism while Europe would start taking its own defense seriously. The culture warriors on both sides of the Atlantic would simmer down, and the woke and unwoke alike would celebrate their collective belief in freedom and democracy. McDonald's would be open again in Pushkin Square – and Keynes's various serpents would slither out of the garden.

There's a chance this could happen. Putin wouldn't be the first czar to fall because of a misjudged and mishandled war. Many of Russia's most powerful people are seeing their mansions, yachts and private planes confiscated, all for an invasion they weren't consulted about. Younger Russians, particularly in the big cities, are more liberal than their parents. Russian shoppers don't want to return to the Soviet era.

Meanwhile in the West, Ukraine has already prompted a great rethink. As German Chancellor Olaf Scholz has proclaimed, we are at a *Zeitenwende* – a turning point. Under his leadership, pacifist Germany has already proposed a defense budget that's larger than Russia's. Meanwhile, Ukrainian immigrants are being welcomed by nations that only a few months ago were shunning foreigners, and, after a decade of slumber in Brussels, the momentum for integration is increasing.

The Power of Alliances

Military expenditure in 2019 U.S. dollars



Source: SIPRI

Note: Figures for China and Russia (1992-2012) are SIPRI estimates.

But this turning point can still lead in several directions. The chances of a regime change in the Kremlin remain slim, given Putin's popularity and terror machine. Western Europe has heard pious words about integration and immigration before. And look at the West's leaders! Joe Biden hardly conveys an image of world-changing dynamism; after his initial heroics, Olaf Scholz greeted Volodymyr Zelenskiy's speech to the German parliament with pudding-like inertia; Emmanuel Macron is bent on winning an election while trying to look like Zelenskiy, in hoodie and stubble; while Boris Johnson has dared to compare the Ukrainian resistance to Brexit.

As we wait for these giants to act, the facts on the ground are changing in economics as well as politics. In particular, the invasion of Ukraine is accelerating changes in both geopolitics and the capitalist mindset that are deeply inimical to globalization.

The changes in geopolitics come down to one word: China, whose rapid and seemingly inexorable rise is the central geopolitical fact of our time.

The immediate question with China is how far it will support Putin in Ukraine. On the sidelines of the Winter Olympics in February, Xi and Putin signed a statement rejecting NATO expansion in Europe and American alliance-building in Asia and agreed that the promotion of democracy was a Western plot. China has still notably failed to participate in Western sanctions. But now that Putin's triumph looks less assured, China's support for him looks more conditional. A week ago, the mere rumor that Russia had asked for military assistance — a rumor that Beijing immediately denied — sparked the biggest drop in China's stock market since 2008. On the same day, a Chinese think tanker, Hu Wei, posted a fascinating memorandum warning his country that the invasion of Ukraine is revitalizing the West, and that China needs to dump the burden that is Russia.

Regardless of whether China's leader decides to ditch Putin, the invasion has surely sped up Xi's medium-term imperative of "decoupling" – insulating his country from dependence on the West. Xi has spent much of his rule building a Sinocentric economic order through the Belt and Road Initiative. China has joined the 15-member Regional Comprehensive Economic Partnership (RCEP) and applied to join the 11-member Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), a free-trade bloc that the U.S. first invented, then foolishly abandoned.

For the "wolf pack" of young Chinese nationalists around Xi, the reaction to Ukraine is another powerful argument for self-sufficiency. China's vast holdings of dollar assets now look like a liability given America's willingness to confiscate Russia's assets, especially if the regime were to think about invading Taiwan (where its claim that the island is culturally and legally part of China is frighteningly like Russia's claims about the Ukraine).

Some Americans are equally keen on decoupling, a sentiment that bridged Republicans and Democrats before Putin's invasion of Ukraine. Biden may have dropped Trump's Sinophobic rhetoric – there's no more talk of "the China virus" – but he has kept in place most of the tariffs, export controls and investment regulations that he inherited, and added a few of his own. For many Americans, too, Ukraine has been a pre-Taiwan test case: They don't want to end up relying on Taiwanese components that might suddenly disappear in a puff of smoke.

So, absent any decisive action by the West, geopolitics is definitively moving against globalization — toward a world dominated by two or three great trading blocs: an Asian one with China at its heart and perhaps Russia as its energy supplier; an American-led bloc; and perhaps a third centered on the European Union, with the Europeans broadly sympathetic to the U.S. but nervous about the possible return of an America-First isolationist to the White House and irked by America's approach to digital and media regulation. Other powers will vacillate between these two (or three) great blocs, much as they did during the Cold War. India may do what it has done so well over Ukraine and play both sides. Pakistan will lean toward China but not fully commit while India is in play. Saudi Arabia will exploit uncertainty over energy supplies to pursue brutality at home and Islamist policies abroad. And so on.

The Bonfire of the Certainties

Just as important as this geopolitical shift is the change in the capitalist mindset. If the current age of globalization was facilitated by politicians, it has been driven by businesspeople. Ronald Reagan and Margaret Thatcher didn't decide that the components of an iPhone should come from 40 countries. Facebook wasn't created by senior politicians – not even by Al Gore. Uber wasn't an arm of the Department of Transportation.

From a CEO's viewpoint, Putin's invasion of Ukraine has done more than unleash Western embargoes and boost inflation. It is burying most of the basic assumptions that have underlain

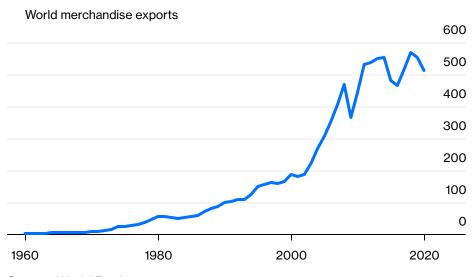
business thinking about the world for the past 40 years.

In the great intellectual battle of the 1990s between Francis Fukuyama, who wrote "The End of History and the Last Man" (1992), and his Harvard teacher Samuel Huntington, who wrote "The Clash of Civilizations" (1996), CEOs have generally sided with Fukuyama. The view from the boardroom has been straightforward: Democracy won't always win (China taught capitalists that quickly), but sensible economics usually will. Businesses could rely on a world in which countries would specialize in their comparative advantage. Commerce and free trade would bring people closer, as Fukuyama argued, rather than divide them, as Huntington warned – and businesses that ran themselves globally and wove the most cost-effective supply chains would prosper.

Commercially speaking, this bet paid off spectacularly. Over the past 50 years multinationals have turned themselves from federations of national companies into truly integrated organizations that could take full advantage of global economies of scale and scope (and, of course, global loopholes in taxes and regulations). World trade in manufactured goods doubled in the 1990s and doubled again in the 2000s. Inflationary pressures have been kept low despite loose monetary policies. Even with a barrage of political disruptions – Trump's tariffs, Brexit and so on – profits have remained high, as the cost of inputs (such as energy and labor) have been kept low.

Booming Trade

Merchandise exports doubled in the 1990s and again in the 2000s



Source: World Bank

Note: Indexed data, 1990 = 100

Now what might be called the Capitalist Grand Illusion is under assault in Kyiv – just as Norman Angell's version was machine-gunned on the Western Front. All the dangers that used to appear at the bottom of a CEO's morning briefing are slithering to the top. Militarism and cultural rivalries keep trumping economic logic. Putin invading Ukraine is merely one in a long list of economically self-harming decisions that vary from dynastic thuggishness (Saudi Arabia bombing Yemen and

murdering journalists) to knee-jerk isolationism (Brexit). And these stupidities reinforce each other: Thus, the French are responding to Britain's act of self-harm in leaving the EU by cutting their companies off from the continent's main source of cheap capital in the City of London.

Against such persistent irrationalism, CEOs who used to build empires based on just-in-time production are now looking at just-in-case: adding inefficient production closer to home in case their foreign plants are cut off. The head of one of the world's most powerful investment firms, with shares in almost every significant Western company, talked privately about "a tsunami of recalculations" on the weekend after Putin invaded Ukraine. The CEO of one of America's most iconic multinationals admits that he is reexamining production across China. Every Western company is now wondering how exposed it is to political risk. Capitalists are all Huntingtonians now.

Nor is just fear changing the capitalist mindset. Greed is also acquiring an anti-global tint. CEOs are rationally asking how they can profit from what Keynes called "monopolies, restrictions and exclusions." Now that governments are using national security as an excuse for national champions, businesspeople can choose from a *plateau de fruits de mer* of opportunities for rent-seeking and competition-crushing in industries like energy, pharmaceuticals and semiconductors. That erstwhile Thatcherite Narendra Modi now echoes Mahatma Gandhi's calls for self-sufficiency and imposes tariffs for local industries. Japan's new prime minister, Fumio Kishida, has created the job of economic-security minister with a mandate to intervene in cybersecurity, chipmaking and much else besides. Macron has <u>declared</u> that "The state will need to take in hand several aspects of the energy sector." Biden used his State of the Union speech on March 1 to promise that "Everything from the deck of an aircraft carrier to the steel on highway guardrails is made in America from beginning to end. All of it." Both sides of Congress applauded.

So the second age of globalization is fading fast. Unless something is done quickly and decisively, the world will divide into hostile camps, regardless of what happens in Ukraine. And this divided world will not suit the West. Look at the resolution <u>passed</u> by the United Nations General Assembly to condemn Russia's invasion of Ukraine. The most trumpeted figure is that only 40 countries did not vote for this (35 abstained, and five voted against it), compared with 141 countries who voted in favor. But those 40 countries, which include India and China, account for the majority of the world's population.

These deeper changes in capitalism and geopolitics increase the stakes this week. Joe Biden and his European interlocutors have a lot on their plate with Putin's escalating terror and nuclear-tinged threats, but they also need to address the wider economic ramifications of the war sooner rather than later. Do nothing and the drift toward protectionism will inevitably accelerate. The Chinese, for one, seem pretty sure that the West lacks the collective character to keep up its current stance as energy prices soar and compassion fatigue sets in. But we still have time to shape a very different

future: one in which global wealth is increased and the Western alliance bolstered.

Despite his less-than-stellar presidency thus far, Biden comes to Europe with several big advantages. The first is that the West is more united and determined than it has been for decades. The sense of unity behind liberal values is no longer confined to the metropolitan elite. One of the great problems with modern liberalism for the past few decades has been its lack of a gripping narrative and a compelling cast of heroes and villains. Globalists have talked a bloodless language of "comparative advantage" and "non-tariff barriers," while populists have talked about sneering elites and hidden conspiracies. Now Putin has inadvertently reversed all that. Freedom is the creed of heroes such as Zelenskiy; anti-liberalism is the creed of monsters who drop bombs on children.

The second is Biden's long experience. George H. W. Bush, another long-serving vice president who stumbled into the big job, was much mocked for his lack of "the vision thing." Yet his handling of the last days of the Soviet Empire in 1989 was exemplary: He provided Mikhail Gorbachev with gentle encouragement, resisted premature triumphalism, and worked with allies to lay the foundations of a new global order. So far, Biden's handling of the Ukraine invasion has been similarly nuanced. He has drawn a line between supplying the resistance and becoming involved in the war (or giving others an excuse to claim the U.S. is involved). And he has put firm pressure on China to stay out of the conflict.

Biden needs to go further in the coming weeks. He needs to reinforce the Western alliance so that it can withstand the potential storms to come. The American president has spent his first year in office talking about reengaging America with the world after Trump's isolationism, and forming an alliance of democracies, but so far he has failed to give his allies the economic cement to bind together these alliances – especially free-trade pacts. His commerce secretary, Gina Raimondo, was dispatched to Asia last year to talk about inviting countries like Singapore and Malaysia into vague things like "frameworks," when all America's Asian allies really want is a solid trade deal – in fact, one like the CPTPP deal that Trump jettisoned.

Biden needs to recognize that expanding economic interdependence among his allies is a geostrategic imperative. He should offer Europe a comprehensive free-trade deal to bind the West together; it could be a slightly remolded version of the rejected Transatlantic Trade and Investment Partnership, based on regulatory convergence (under which a product safe to sell in the EU is safe to sell in the U.S., and vice versa). He should also join CPTPP.

It is not difficult to imagine Europe or democratic Asia signing up for these sorts of pacts, given the shock of Putin's aggression and their fear of China. Biden's problem is at home. Why should the Democratic left accept this? Because, Biden should say, Ukraine, China and America's security matter more than union votes. The U.S. president's first job is to protect his country. Biden is old enough to remember that the United States won the last Cold War peacefully because it united the

free world behind it. This is the way to win the next one peacefully as well. Put together the free world's economic potential – the EU, North America, Latin America's biggest economies and the democracies of Asia – and it can do more than see off the autocracies; it can pull them toward freedom.

Biden should pursue a two-stage strategy: First, deepen economic integration among like-minded nations; but leave the door open to autocracies if they become more flexible. China could be wooed toward freedom. But nothing will improve unless Biden first glues together the free world. That means freer trade – and the sooner he tells his party that, the better.

Biden can soften that message at home by adding a political dimension to his trade agenda. "Build back better" applies to globalization, too. A global new deal should certainly include a focus on making multinational companies pay their taxes, and the environment should be to the fore. But Biden should also talk about the true cost of protectionism in terms of higher prices, worse products and less innovation. Spreading economic freedom remains the best guarantor of both global and American prosperity: global prosperity because, for all its travails, the last 50 years of globalization have enriched most of the world; and American prosperity because his country's prosperity depends on his country's security.

Constructing such a "new world order" will be laborious work. But the alternative is a division of the world into hostile economic and political blocs that comes straight out of the 1930s. Biden, Johnson, Scholz and Macron should think hard about how history will judge them. Do they want to be compared to the policymakers in the aftermath of World War I, who stood by impassively as the world fragmented and monsters seized the reins of power? Or would they rather be compared to their peers after World War II, policymakers who built a much more stable and interconnected world?

Nobody would understand the significance of that choice better than Keynes. He first came to prominence as a decrier of the Treaty of Versailles – and the know-nothing statesmen of the time. But at the end of World War II he participated in something that was much more constructive.

In 1944, with the defeat of Hitler seemingly inevitable, President Franklin Roosevelt invited the Allied powers to a conference to design the postwar order – under the aegis of Keynes and, on the American side, the economist Harry Dexter White.

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The elderly Keynes had heart problems and a strong dislike for American summers – "one sweats all day and the dirt sticks to one's face" – so he was delighted that the conference was held in New Hampshire rather than the infernal federal capital. The Mount Washington Hotel in the White Mountains was selected partly for the climate, but also because it had all the amenities of civilized life – its own power plant, post office, golf course, church, beauty parlor, barber shop, bowling alley and cinema.



Keynes at Bretton Woods, July 1944 Photographer: Hulton Archive/Getty Images

This was the setting for the most consequential conference since the disastrous Paris Peace Conference in 1919. Keynes, no longer a protectionist, played a leading role in designing the International Monetary Fund, the World Bank, and the infrastructure of the postwar Western order

of stable exchange rates. He helped persuade the U.S. to lead the world rather than retreating into itself. He helped create the America of the Marshall Plan. This Bretton Woods settlement created the regime that eventually won the Cold War and laid the foundations for the second age of globalization.

At the closing banquet on July 22, the great man was greeted with a standing ovation. Within two years he was dead – but the world that he did so much to create lived on. That world does not need to die in the streets of Kyiv. But it is on course to do so, unless the leaders meeting this week seize the moment to create something better.

– With assistance by Lara Williams

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