Professor Craig Calhoun
What threatens global capitalism now?
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Well, hello everyone, and thanks to Brendan for that introduction and for the work that he does here in China to strengthen LSE and its profile.

I think you probably all know that we have a range of programmes in China: we have joint degrees, we have research relationships, we have short courses that are offered, we have an annual conference, and other sorts of events, including the alumni activities which keep growing.

Because Chinese students are now the largest international student group at LSE, with almost a thousand Chinese students, we expect the alumni group to keep getting bigger and bigger; so expect to see me coming back on a regular basis to visit with you.

The alumni activities are an important part of the school. Before starting the proper lecture, I wanted to stress that. LSE is your school; it will always be your school. Take care of it, but also give us advice. If you have thoughts of ways in which LSE can improve, things in the LSE that you want to make sure we never change – I'm told that it's very important that we never change Wright's Bar, and we have no plan of changing Wright's Bar – but if you also have ideas of ways in which returning alumni can be helped as they return to China after degrees or other thoughts, please feel welcome and encouraged to share those thoughts with us. We would like to learn from you, and make LSE work even better for students in the future. My task tonight isn't to speak about LSE, though; however, in the questions, if you want to ask anything about what is happening at LSE, feel free.

What I want to talk about, or assigned to talk about, is what threatens capitalism now. The financial crisis has obviously captured a great deal of news in the West, and there are obviously a variety of changes. Capitalism has been threatened recurrently. Not just threatened with the Russian revolution and the Chinese revolution; it's been threatened by a number of sorts of direct action challenging it, and it's been threatened by crises internally. But capitalism seems unlikely to collapse next week, or next year, or anytime soon. This, however, doesn't mean that there aren't threats and challenges to the capitalist system, and this what I'm to talk about.

Capitalism is, at the moment, surviving the worst financial and economic crisis since the Great Depression. The crisis has lingered much longer than expected; already, three years ago people began to speak of recovery, and the question was how rapid would the recovery be in the United States, in Europe, and globally. By now, people began to change the language, and to talk about the extent to which a very long recession is changing some of the basic institutions, and that is what I want to talk about.

This crisis is deep, it's lingering, and it comes on the heels of a damaging era of lopsided financialisation and neoliberal weakening of social institutions. It accelerates also a shift of momentum away from the longstanding core economies in North America and in Europe and towards other parts of the world, including China. The crisis didn't create this shift but it accelerated it, the shift of momentum – of proportionate energy, if you will – in the global economy, which has moved to some extent from West to East and from North to South in the global affairs. That's not an overnight change.

No, US is not going to go away tomorrow, and China is not going to be the global hegemonic power tomorrow. But there is an important change underway. I will suggest briefly it's really been underway for at least 30 or 40 years. It was brought to the forefront of attention by the crisis and accelerated in many ways the proportionate shifts. So at the very least, capitalism as we know it is likely to be transformed.

Arguably, it may only be possible for global capitalist growth to be renewed and extended if it is transformed; and arguably, it may only be possible for global capitalist growth to be renewed and extended if it is transformed. Significant changes may be required. To think well about how capitalism may be renewed and whether it may be transformed, we need to recognise, though, that it is not a perfectly self-contained system, and that the challenges it faces are not only economic.

It's a habit…it's actually a product of the capitalist modern era to speak about the economy, the state or politics, society, as though they are completely separate phenomena. You know; we have economics, and we have the study of government, and we have sociology, and they're different disciplines and different subjects. But the world itself doesn't divide up quite so neatly as our academic boundaries; these flow into each other.

One of the things I'm sure you all learned at LSE was about the social context of the economy, the social issues that are influenced by economic life, and the kinds of debates that go on about this. This is something that's very current in China because in many ways, China's very rapid economic development has outpaced social development, development of certain social institutions, and other sectors in society.

Very rapid economic growth, increase in wealth, has not yet been accompanied by as much renewal and transformation of healthcare by building new institutions to care for older people in society, by finding replacements for the kind of organisations that used to be provided by the local work unit in many people's lives, housing markets have changed all of this….

So there's lots of change. Success in capitalism can produce social challenges just as much as crisis in capitalism. So there are certain kinds of social challenges that come in the UK, for example, where growth is very slow and the economy is really hovering on the edge of a triple-dip recession – for the third time falling into recession in rapid succession. And there are social consequences to no growth. But there are also social consequences to rapid growth, and partially similar, partly different issues that face other parts of the world.

What we need is not simply a theory of capitalism, but an appreciation of how capitalism depends on relationships between economic and political organisations, economic action and the rest of social life. One of the questions that I will ask, implicit in this is, to what extent should we think of the rapidly developing economic sectors in China as capitalist, or as socialist but with a partial capitalist side, or as simply capitalism with Chinese characteristics, right? How do we think of this?

But the point is not just the name; it's to recognise that a key feature is the interconnections of the different economies globally, and the fact that there is no simple boundary anymore to say, oh, this is a socialist society completely self-contained; this is capitalist self-contained. The economy doesn't remain self-contained.

Capitalism has flourished and economic growth in China, whether we call it capitalist or not, since the 1980s and especially since 1992, has flourished and secured widespread social legitimacy only on the basis of institutions and social relations, many of which in the West were damaged in the recent decades.

The contrast that I'm going to draw is between large parts of the West, North America and Europe in particular, where since the 1970s there were a set of changes that in many ways either undercut or removed or privatised social institutions that provided welfare systems that provided support for individuals.

We can see this even in LSE, where the proportion of funding from the UK government went from the large majority of funding – most of the costs of LSE – to 18%. So a dramatic difference. Now, LSE thrives, but it thrives because it receives a variety of kinds of private support, starting with student fees and continuing to philanthropy.

Well, in China, and in varying degrees in other rapidly developing economies, there's not exactly the same situation, but not completely different either. The need for new sorts of social institutions is considerable, and this includes questions about what is the role of philanthropy in Chinese society. What are the role of charities? Is the state the only source of support and welfare, or do organisations of various kinds created outside the state also play this role: either private businesses for their members and employees, or charitable organisations doing this for others? Sometimes for groups that are related, like a clanship organisation, sometimes for people who are strangers – a pure charitable organisation. How do the institutions develop that are needed in this sense?

This is crucial because in either system, or either setting – in the UK, in China, or for that matter, Brazil, and Russia, and the US, a lot of other places around the world – it's important because the global economic growth is vulnerable not only to market upheavals, the excessive risk-taking, or poorly-managed banks. It's vulnerable to wars, environment degradation and climate change, crises of social solidarity and welfare, and to social changes if we don't adapt adequately to those changes.

The recent financial crisis reveals the main internal vulnerability of capitalism. Inside the economic system, there's one big vulnerability that the financial crisis makes clear: this is systemic risk. That is, risks embedded in the complex web of internal connections that make up the modern financial system. So the modern financial system gets described from outside, and some of you who are specialists on finance will have much more detailed descriptions.

From outside, people say, oh, it's globalisation and it's highly interconnected and so forth. These are true. It's global, it's highly interconnected…very unevenly interconnected, but also interconnected in ways that create a system that is potentially supportive of economic enterprise, including not just financial enterprise, but all of economic enterprise that provides for credit, that provides for leveraging of assets into development, whether it's property development or startup businesses, new technologies and so forth.

Finance plays a crucial role in all of this. But it creates a risk, and the risk, in its very systematicity. This sort of systemic risk is critical to see, and it's shaped the nature of the crisis. This wasn't a capitalist crisis, between 2008 to the present day, in the old sense, the sense described by both neoclassical economics and Marxism, a crisis of overproduction and underconsumption. It was a crisis much more specifically centred in finance, and it was multiplied in its effect, made much more powerful, by a growth in finance, by what we might call financialisation.

Starting at about the 1974-75 recession and then continuing up until the 2008 crisis in the Western markets, there was a dramatic increase in the amount of the world's total wealth that was held in the form of financial assets. It went approximately from 25% to 75%, to the extent this can be measured. The measurement qualification is important because the measurements are skewed in the direction of OECD economies.

It's very hard to measure the proportion of wealth held outside the OECD and outside formal asset structures. But nonetheless, notice how dramatic that shift is. Financial assets, credit instruments, and so forth, bonds, all of these kinds of assets, accounted for 25% of global wealth in the 1970s; 75% of global wealth by the time of the current crisis. So when the crisis hit, it had much more impact because finance mattered so much more.

There is a complicated story I won't try to rehearse, about why that happened, or what happened at the 1970s, but a couple of elements are important to see because they remind us about the fact that the economy is not completely sealed off in just the economic realm, but is connected to other things. So a variety of things were going on. One that played a central role was the Vietnam War. You ask, what does that have to do with finance? What it had to do with finance is that as the Vietnam War became unpopular in America, as Americans my age – I was a university student in those days; in fact I was drafted in this period of time, though I worked in a hospital, not in the army – at the time of the Vietnam War, the government under Richard Nixon determined it was not possible to pass tax increases to pay for the cost of the Vietnam War. The last several years of the Vietnam War were financed mainly on credit, and this started a long-term pattern of US borrowing, continued on into the present era.

It wasn't yet borrowing from China, but the pattern would continue so that by the late 1980s, this would be a pattern, especially from 1990s, of increased borrowing from China and from developing countries; an unusual credit pattern – the richer country borrowing from the poorer countries. But it played a crucial role at this.

So the Vietnam War played a role in this financialisation, in that it brought a massive increase in the amount of debt around. The particular debt of the US government remains a problem, but also the more general phenomenon just of debt in the world, because debt then becomes something that is tradeable. It can be securitised, it can be bought and sold in various ways as a sort of asset.

Well, other things happened in the 1970s as well. The Yom Kippur War, a war between Arab states and Israel over issues of Palestine and organisation, led among other things to an OPEC boycott and a dramatic increase in the price of petroleum on a world scale. By "dramatic," I mean from approximately $3 per barrel to over $100 per barrel. Dramatic increase. We get worried now when there's a 10% or 20% increase. Think of that.

That was, again, a political phenomenon, but also a cultural clash between Arabs and Israelis that had, as a byproduct, an impact on global commodities markets, and helped to produce a recession: the 1974-75 recession was the most severe between the Great Depression and the one we're in now in the West – and it reshaped, again, a lot of things, one of them being a finance. In this case, it led to things like the establishment of sovereign wealth funds.

So the world's largest sovereign wealth funds operating today, that of the United Arab Emirates, is founded at exactly this moment in this context to make use of the petroleum wealth which becomes so much larger in the context of that new deployment of OPEC's power after the Yom Kippur War. It not only means that there's, again, financialisation, because what happens to the oil money? It can't be absorbed immediately into the Saudi Arabian or the Emirati, or other economies in the region which are rather unpopulous societies with relatively low levels of development.

It gets invested internationally. It becomes another source of credit to the US, sometimes equity investments as well, and to Europe. It also is invested gradually in economic transformation in the home countries, in the Arab states. But without spending a long time on that, you'll get the idea that in Europe now there's more debt, there's more finance in the world, that finance is significant in the finance industry which grows dramatically during this period and begins to do work like investing in new technologies. Some of the inventions, these laptop computers and iPads and iPods and all these sorts of things, are shaped by this global availability of finance that can be directed at these different sorts of investments by smart LSE graduates of the Finance Department and others. This begins to, continues to, reshape.

I'll make the story of the '70s short, because I want to get to the present day, but there are a lot more components. The beginning of a very long asset bubble globally, which takes the shape of changing asset prices for private commodity raw materials but particularly for US real estate and English real estate. The real estate gets tied up with mortgage markets. The amount of money that people owe on their homes goes up, so the leveraging of what had previously been a relatively nonfinancial asset – a house or a flat – becomes enormous. People sometimes owe 100% of the value of the property. There's a lot of gambling on this.

This will not be lost on you as a phenomenon, anyone who lives in Beijing: the idea of investors who buy property simply to sell the property, not to live in it. They buy five apartments if they can. The government potentially steps in to regulate and say, no, you can't have so many apartments; it either succeeds or it doesn't succeed in this, there's a highly speculative market. It creates a problem, so that even a slowdown in Chinese growth, from 10% or 12% to 5%, creates a problem in that market because people have been betting, in effect, on the faster growth. So you would think, oh, 5% growth! This is great! But it's actually a bit more of a problem. If growth fell further below 5%, it's a more serious problem. Well, this in the over-30-year period in the West transforms the economy.

There's lots and lots of effects, and I won't try to go on in it. But you get the idea. The stage is set for 2008 in many ways because the trigger for much of 2008 was mortgage-backed securities in the North American market. The continuation, the ripple effect, was banks and investment firms – sometimes hedge funds and others – that were over-leveraged or were taking excessive risks. Perhaps above all, heavily using a variety of new kinds of financial technology – credit defaults, swaps, and derivatives, and so forth – had become far more interconnected than ever before.

So the point that I started with is crucial. The interconnectivity of the financial capitalist system is much greater, much more global. There is interconnectivity in manufacturing. German auto companies are manufacturing in China and selling globally, and this is interconnected. Finance multiplied the levels of these interconnections and can do it much faster. We had a foretaste of the issues in the 1997 currency crisis in Southeast Asia; other bubbles burst.

But what we had in effect was a very long bubble. You might call it a megabubble, a boom in the West. Huge increases in house prices, huge increases in the cost of universities, huge increases in all kinds of prices, which made many people rich – huge increases in the number of millionaires – but which was produced largely on paper, in financial assets, rather than by transformations of output.

There's one big exception to that, which also shows some of the role of finance in this, and that is the high-tech industries. The high-tech industries are an interesting combination of things. They are produced when finance capital comes to back innovations and new technologies. The innovations and new technologies were not all new, however. They were largely produced by the government, particularly the US government, during the period after World War II; starting in the war when the US was heavily involved in technology developments in the war, and continuing with healthcare and military spending from the US government, doing the basic work in the technology.

The internet rose out of what was called the ARPANET, the Advanced Research Projects Administration Net. The ARPA was part of the Defense Department of the United States. The biggest part of the early communications and information technology revolution was financed by government funding, not intended as an economic investment but part of a defence expenditure linked to the arms race and the Cold War. But then it created technologies that entrepreneurs could put to new use in the 1970s and after.

In the 1970s, we got Apple founded, Microsoft founded, a range of these sorts of businesses and increasingly others in biotechnologies and other areas. Now, the entrepreneurs are a crucial ingredient, the technology is a crucial ingredient, and the finance – that is, the existence of a lot of money in a form that can be redeployed to back new companies and startups that can take a new public offering to a valuation of $100 million off the bat and so forth – reshapes this.

So we get much of the world that we inhabit. Finance makes possible huge advantages, gains; the new technologies being the preeminent example of this. But there's a vulnerability, and the vulnerability, as I suggested, is in the systemic risk. Overleveraging in a bank doesn't just hurt that bank; it now creates a variety of risks for counterparties; that is, for other people who either put their money in the bank or owe money to the bank, or in some relationship with it. Much of the fanciest of the new financial technologies were attempts to minimise or mitigate this risk. There were actually developed many of the derivative instruments, things like credit default swaps, in order to manage risk. They were all meant to reduce the risk in certain ways. Some of them function as insurance, some of them as hedges, and so forth. But the effect was to multiply the interconnections.

In 2008 and 2009, when there were crises like the failure of the Lehman Brothers in New York, and other precipitating events of this financial crisis, there was a phrase that was often used: "too big to fail." Everyone said, oh, the government had to bail out Lehman Brothers…or didn't bail out Lehman Brothers; they had to bail out other firms. And eventually this continued. At first Europeans…people will be all somewhat, ha, that's only Americans. This is all about excessive risk-taking and bad regulatory management in America.

But of course, it's spread. And it's spread to Europe, and it encountered in Europe a banking system that was extremely vulnerable. The problem is that the banking system had grown extremely rapidly during this whole era of financialisation. And so the banking system is hugely vulnerable.

Britain experienced bank failures; it had to step in and nationalise banks, like the Royal Bank of Scotland, which owned by then National Westminster and other banks, was in negotiation of a merger with Santander…there had been this huge consolidation and merger mania, largely driven again by financing, not just by being in the financial industry but by the leveraged money that went into these firms.

The effect on the European economy was huge, it very nearly brought down the euro, and it continues to this day, in the news like the bailout of Cyprus in which you have to ask yourself: what's going on with the fact that a bailout of Europe's smallest economy accounts for one half of one percent - not quite one half of one percent - of devaluations in the eurozone, could be creating such a crisis as it seems to be doing now? Back to moment of that. The main thing I want to say is that it wasn't just too big to fail; it was too connected to fail.

This was the problem in the economy. It was so connected that when any one firm failed, if you just said, "Well, look, they made stupid mistakes. Let them fail," then it also affected lots and lots and lots of other firms. It affected ordinary people who then became politically upset with their governments, and it affected the governments themselves which began to run in deficit and have to borrow more money in their financial policies. So the connectedness of the financial system created the set of vulnerabilities in which even business managers who were not making the crucial mistakes were highly vulnerable to some of those issues in the larger system. And that remains the case today.

By and large, as the economies of the OECD countries, or the richer countries in the world, have worked out of the crisis, they have maintained this. There's been a retreat in global financial connection; it's less than it was five years ago, but just a little bit less. We still have much of this in place. There's not been a structural reform. At the same time, there's not very much additional financial regulation.

One of the other features of the period when this happened was that there was a widespread reduction in the amount of financial regulation governing all of this complex system. That was partly because of deregulation under the Thatcher government and afterwards in Britain; after Reagan and afterwards, and especially under Bush, in the US. But it was even more because much of the finance moved into new areas that had never been regulated. So almost the definition of the hedge fund industry is not what hedging is; it is operating outside of the conventional regulatory and transparency regimes of other kinds of investment structures…outside the rules that apply, for example, to banks. Now, all of this created vulnerability, created the crisis.

This is somewhat different in China, and for that matter, in India and Brazil and so forth. But they're connected. They don't escape completely. It's connected in interesting ways because it speeds up Chinese development. One of the things that brought China's rapid development after 1992 was an increase in the availability of credit to business in China, and by the Chinese government, which made intentional policies to try to spur economic development. There are various theories of why it came to this decision – I'm not going to comment on that now; we could take it up in questions.

But starting around 1992, there's a much more open credit regime. This is made possible in part by this global financialisation and China's role in it, and China's financial assets that it has to be able to deploy at this point. But other things are also crucial. The rise of joint-venture companies which played a pivotal role in the transition in China, although they are in a way less and less important as indigenous Chinese companies are more and more important, was largely finance-based, and the West deindustrialised to a very large extent.

This process in which the West moved from 25% finance to 75% finance in the holdings of wealth was also a period in which industrial production was shipped overseas to a large extent for most western countries. One of the reasons why Germany is in better shape than most other European countries today is that Germany did not cut its industrial production as much as others. The UK, for example, basically moved out of manufacturing industry to a large extent.

By various estimates, 50% and upward of its total manufacturing productivity. This has various effects, including a relatively large problem of generating employment for people who don't have high skills. LSE graduates all get jobs. LSE has the highest average earnings of its graduates of any university in Britain. That's not the problem. Where are LSE graduates going to work? In government or in finance or in law. The issue is that there are now many fewer jobs for people who are not university graduates, or not elite-university graduates in this changed economy, and that the economy is not balanced.

The financial downturn hits much harder because of the role of finance in the economy and so forth. The development in China, however, and in Malaysia, and in India, and in South Korea, and in several other economies; changes capitalism because now we have a number of new entries into the global markets which are playing bigger and bigger roles, initially in manufacturing, but increasingly in other areas, and increasingly, with financial capacity to effectively buy out some of their early joint-venture partners. For example, you've got the Lenovo takeover of the IBM personal computer business.

There's a whole series of these kinds of moves. The same effects that are producing the stagnation in the North American and European economies are producing proportionate gains in many other economies in the world. So there's a huge issue here.

Now, I'm going to leave this behind for the moment, and just frame this by saying the risk didn't go away. Who is benefiting from the booms changed. This is more benefit in China, and more benefit in other emerging markets, developing countries. I think this is a permanent change in capitalism, and one of the things to come back to at the end is to say, well, how does it matter?

I asked at the beginning, what's the system? Do we call economic growth in China that looks a lot like capitalism, capitalist? Or do we call it socialist, or what? I'm going to say, it's not just an academic question; it's a question of what China will make of its future growth, how it will organise it, and how this will change the global situation.

Capitalism has always been in part a relationship between politics and economics. It has never been pure economics except in textbooks, because the pure economic system is always a sort of abstraction from the messier and more complicated reality in which governments were creating currencies and managing monetary systems. In which governments were securing the internal market and organising it in relation to an external market with or without protectionist regimes. In which governments were stabilising credit systems, creating bankruptcy laws and in other ways always involved; and among other things, making possible in the West, the development of the very large multinational corporations that helped to globalise what had been the European and North American model of capitalism. But also making possible in China the growth of very large corporations that depend not only on their market power but on their relationship to the state for successful operation.

This is not an exception; it's not as though that's true in China and it's some sort of problem. It was true in the US. Don't think that General Motors or IBM didn't also depend on their relationship to the state. So we have to change a bit of our thinking of that. What it means is that upheavals and transformations in politics actually matter a lot in economics. Consider the social context: the question of welfare systems and whether ordinary people think the growth is legitimate. Do ordinary people think that the rich people that they see have earned their money, or just gotten lucky? Or, are criminals? And I think they think some mix of this, here and elsewhere. I think there are resentments of the rich when people don't see how that has been a productive investment for society, whether it has created jobs. There's resentment of corruption.

Corruption remains, in China, a huge issue to be dealt with, and I'm sure it will be one of the new issues, one of the big issues for the new government. Speculation fuels this. When people see lots of rampant speculation, what it looks like, and I think to some extent is, is an unproductive investment that pays off a lot. It's not an investment that creates jobs or creates new products for people as much as it is something that seems to make money out of money without benefiting people on the way. So there's a question about how the economy is connected to other social institutions in a way that makes it all seem to work for the whole society and generates legitimacy for it.

With that in mind, let me turn more quickly to my concluding comments and say there are some big, big threats, some of which I haven't even mentioned, and it's significant. I started with the core systemic issues in the economy. I would sum up by saying, by themselves, those will not spell doom for capitalism. Capitalism can recover from those things, but the recoveries often involve government action, as in the New Deal in the United States with the Great Depression, but in various crises sense, including the bailouts and the government actions in North America and in Europe that addressed the problems of 2008-2009.

So this doesn't have to spell an end to the fantastic growth that has been brought about by this economic system, but we have to recognise that it always is entwined by politics and ask how that works. I'm going to say there are other sorts of threats in connections: that it is the outside of capitalism; that it is capitalism's connections to the rest of life that hold the biggest threats in various ways, what we might call in economic terms the externalities.

Capitalism operates as a system which, left by itself will externalise lots of the costs. The costs will not show up on the balance sheet of any capitalist corporation. So the question is, where do they go? Does the government bear them, or do ordinary citizens have to bear them? And if it's ordinary citizens, do they become resentful, and then threatened the system? So what are these kinds of externalities? Well, today was a beautiful sunny day with a blue sky after the snow. But, you know, I'm told the air quality isn't always this good in Beijing. (Laughter) This is an externality. This is a product in several levels; not just of capitalism but of a growth in consumerism in Chinese society. The cars, the high-energy use system, and of a – so far – a failure to adequately manage this from the government point of view.

Now, I'm not proposing any particular policy or intervening into Chinese politics, but I'm just suggesting this is going to be on the agenda now. The government is going to be pushed to it, because the premier volunteered in his speech that he's going to deal with this. But he also volunteered, you can hold me accountable if I don't, and that's because there will be Chinese citizens complaining. There are already environmental movements, there are already green movements in China, but there are also just already a lot of people who are annoyed to have to wear purifiers and masks and still breathe in the air. It's an externality to the business of any one company that contributes to this, but it's an issue for the larger system. And there are more. So let me just comment briefly.

There are a whole set of issues that are threats to capitalism that we might call the failure of states to provide the necessary conditions for continuing capitalism, for capitalist reproduction. What are those conditions? Those conditions from the health of the population to education of future generations. China is investing enormously in both. My reading is that China is going to work very hard to provide the conditions for the continued expansion of its economy. That's high on the agenda. But my reading of the situation in Europe is that this is much less clear. In the US, this is sort of deadlocked in an extreme split in Congress that is making it very hard to get legislation through and reach compromises in effective ways. So the low growth, or even negative growth, in Europe and the US has largely to do with governments being not up to their role in sustaining the economy.

The core financial issues in Europe are that the political system behind the European Central Bank and behind the euro was way too weak. I'm actually proud to note that Ralf Dahrendorf, one of my predecessors at LSE, late in his career wrote a trenchant essay in which he said, nobody is more in favour of the EU than I am. Nobody is more European than I am. Look at me: both somebody who's very active in Germany, very active in Britain, globally, a leader of the LSE. But he said, Europe has not created the institutions to actually sustain what it is setting in motion. And I think we saw that over the last five years. We saw that the institutions weren't up. It's not whether the euro was a good or bad idea in itself; it's that it required a new set of institutions, and Europe didn't move enough to get these.

Well, the US Congress is now an institution that begins to look sadly inadequate to the economic tasks that are before it. Short-term political debates and sort of ideological divisions stand in the way of needed political actions. We get things like the so-called fiscal cliff debates earlier this year, about whether the US would run into a massive collapse in spending with a fairly good new spending bill. That actually shouldn't even have been an issue. That wasn't an issue of deep disagreements; that was an issue of each side being unwilling to compromise in order to get something sensible done, but it had potentially huge impacts.

So I think we face a risk if states fail. What that means is we have to look at states, governments, politics, as much more centrally connected to the economic future than we often do. It means for the West that we have to stop looking at Asian economies and say, isn't it strange? In China, in Korea, in these other countries, the state seems to play a very large role. And sometimes they say it's not even really capitalism. But we have to notice, states have been crucial in the West. The state is intrinsic to this. What we have to ask is, what are the good policies for the state? What should the state be doing? Is it doing that?

We have to recognise the dangers of high state involvement, that some kinds of state involvements will be economically problematic, even calamitous, that states aren't good at picking champions in certain sorts of things, and that it increases the risk of corruption. So it's not that this is all good; it's that it's inevitable and necessary. Another kind of risk, we might call informalisation, where states don't provide effectively. And the economies, the private-market economies, don't provide effectively, how do people live?

Well, there's another side to corruption. The corruption that we get upset about is when a general is using his power and influence to basically siphon money off from the economy in various kinds of illegitimate deals. We don't think that it's the same thing when everybody in the society is just using guanxi to get through life. But they're not totally unrelated, because they're both dysfunctions of this larger system. We have systems in which people's only way of surviving is an informal sector in the economy. So there's a big informal sector and a small informal sector.

Let me take it away from the Chinese example. How are people surviving in Barcelona or in Lisbon during this financial crisis with unemployment rates of young people that are 30%, 40%, 50%, with an absence of credit, with huge collapses in the economy? They're surviving by informal systems of mutual trade. In many cases they've even created local currencies that are not official state currencies to measure that relations.

There's a huge informal sector of this kind in the world. It's historically been associated with developing countries. The word, the phrase "informal sector" was invented by an economic anthropologist studying in Ghana in the 1970s, and the way in which countries with low economic development managed to keep things going. But now, the biggest growth of this kind of informal sector is in Europe and North America, in the previous core-rich capitalist countries, for the parts of the society that have been somewhat left out of the benefits of the market system, and that the government isn't taking care of as much because of the destruction of the welfare state. That's the small-scale version. The large-scale versions are significant, and it's not just corruption of individuals; it's what we could call off-shore capitalism. It's almost impossible to measure, but many trillions of pounds' worth of global capitalism is never formally recorded.

I mentioned Cyprus earlier, and the issue of the bailout of Cyprus and its impact. Part of the story of the bailout of Cyprus is Russian money. Cyprus appears, if you consult statistics, World Bank statistics, on global foreign direct investment, Cyprus is the largest source of foreign direct investment in Russia. Larger than the EU, or the rest of the EU combined. Now, this is not because Cypriots just have so much capital to invest and they specialise in Russian investments. This is money laundering. This is Russian money that has been taken out of Russia, using Cypriot banks to either keep it or invest it back in Russia. This is a global version of capitalism, outside the legal system: not paying taxes, not formally registered, and not regulated by any state, and it's many trillions of pounds' worth.

Not just Russia either. This is going on globally. This is in the background to the stories of minerals in Africa and the wars over minerals in Africa. This is in the background of global drug issues and arms trade, and a whole range of different sorts of issues. But some of it is just business, in which the businessmen make more money by avoiding taxes and regulatory systems. That informalisation is also the risk to capitalism. This money can threaten states and topple the system.

One of the reasons this informalisation is going on is the failure to rebuild the damaged social institutions in the West, or new institutions elsewhere. The small scale of corruption in China is an adaptation to the absence of formal systems and formal institutions that would handle all the necessary things. In the West, it's a response to the decline of many of the formal institutions that used to do a better job handling all of these sorts of basic human needs. Caring for people, care economies are a big part of this. So there's a threat from having weak social institutions; either not building new ones enough in China to take care of people, or losing the ones in the west. And that's linked to a feature of this whole era of financialisation, which is radically increased inequality.

That's a slightly different story in every country. In China, of course it has to do with the dismantling of part of the institutional structure of an older Chinese economy. But inequality grew dramatically. The gap between the richest and the poorest just grew enormously. But it grew enormously in the US, and it grew enormously in Britain, it grew enormously everywhere that experienced this, and it almost always grows faster in an era of financialisation. That financialisation allows an almost indefinite accumulation of assets. They don't spoil or deteriorate in the same way that material, physical assets do. Physical assets tend to get recycled much more in the economy in various ways. They get turned into jobs for people, in workers, maintenance, whatever.

So we've had a huge increase in inequality. Governments have chosen not to do very much about the inequality. That threatens legitimacy; that leaves a lot of unhappy people and it leaves a lot of people relying on the informal sector in various ways.

Now, another externality is the one I alluded to before: environment, climate change, water resources, air pollution – a threat to the system. I think it's much more likely, if we see a huge social upheaval, that it will come from environmental crises than from a collapse of capitalism as such. But it will have huge impacts on capitalism if it can't get the energy resources it needs, or the materials and raw materials it needs, or this producing so much externalities in terms of the environment that it loses legitimacy with the people.

Finally, there's war. We shouldn't rule it out. Local wars, the risk of things getting out of hand in relatively local conflicts, island with Japan, South Seas, South Pacific, Korea, and this region. But in other regions, other conflicts and the potential for larger conflicts, which would also be huge threats to capitalism. So far, our progress is relatively mixed on building a multilateral world order.

That is, building a new system that doesn't depend on American hegemony, doesn't depend entirely on the old institutions that were build at the end of World War II, to balance power among what had been the most powerful countries in that complex. Remember, the UN, the Bretton Woods institutions, all of these, were built at the end of World War II to prevent that war, and to balance and unify the countries mainly of North America and Europe, secondarily Australia and some others.

Those institutions have adapted; they brought in new countries, China finally was recognised, Taiwan; there's been change. But these are old institutions, and we live in a new world. We don't live in a world where America is going to be the hegemonic power forever, bearing lots of extra cost. American taxpayers object to carrying the extra cost; the American economy isn't growing fast enough for it to play all of this role of leader in these different organisations. Americans haven't fully woken up to this, of course. We still think we are the unquestioned global leader, but sort of deep down, we're nervous because we know that we can't afford this and it's not entirely true.

But we haven't developed a really new system, a system that would bring the so-called BRICS – Brazil and Russia and India and China, maybe South Africa and some others – into a more cooperative order. That could even include countries like Iran, that at the moment are isolated from international politics, but that are big, significant countries with major resources.

Somehow, if we're to avoid war, if we're to deal with environmental crises, we're going to need to evolve a different structure for global politics as well as to keep improving in domestic politics. So what really threatens capitalism now is only partly inside capitalism. And maybe that's the easiest part to deal with. The big threats are external. They're serious, and we should all work on them. LSE is certainly working on them. Thank you.