



International Economic Cooperation in the Post-Brexit-Post Trump Era

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1 A time of opportunity

1.1 Background

- A hundred years ago, that first great era of globalisation collapsed into World War I.
- This was soon followed by the Great Depression and World War II.
 - But at the end of that global crisis an enlightened generation of policymakers in the US and Britain led the world in creating an open international order.
 - A remarkable period of economic growth then ensued, lasting for sixty years. But the second era of global prosperity ended with the global financial crisis of 2008.
- The initial response by policymakers to the second great global crisis in 2008 was also an enlightened one.
- But this has ceased to be the case.
 - Many observers attribute Brexit, the wider European crisis, and the rise of Trump to the mistakes which policymakers committed.

1.2 What happened in 1945

- The world was emerging from War with a memory of chaos: the Great Depression
- Many foresaw a return to closed economies and authoritarianism, but the best looked back to the pre-World War I era
- Leaders in the US East Coast reached out – in collaboration with leaders in Britain - to create a liberal International order.
- There were challenges
 - The end of the British empire
 - The emergence of the Cold War with Russia
- The task: to transfer prosperity from the US to war-torn Europe and Japan
 - Needed to ensure global macroeconomic stability
 - Needed to provide resources: the Marshall plan was critical
 - Needed liberalisation of trade: GATT and moves towards European Common Mkt.

1.3 This time in 2017

- The world has emerged from the GFC with a memory of chaos: this time financial
- Many – like in 1945 - look to closed economies and authoritarianism, whereas best leaders know that, as earlier, outward-looking growth is possible and beneficial
- The task: to continue the process of development, begun in 1945 in Europe and Japan, continued during the Asian miracle of the 1980s and 1990s
 - bringing prosperity to the poorer regions of Asia, Latin America and Africa
- But there is an absence of leadership
 - A contrast with 1945
 - Many observers link Brexit, the wider European crisis, & Trump to this lack of leadership

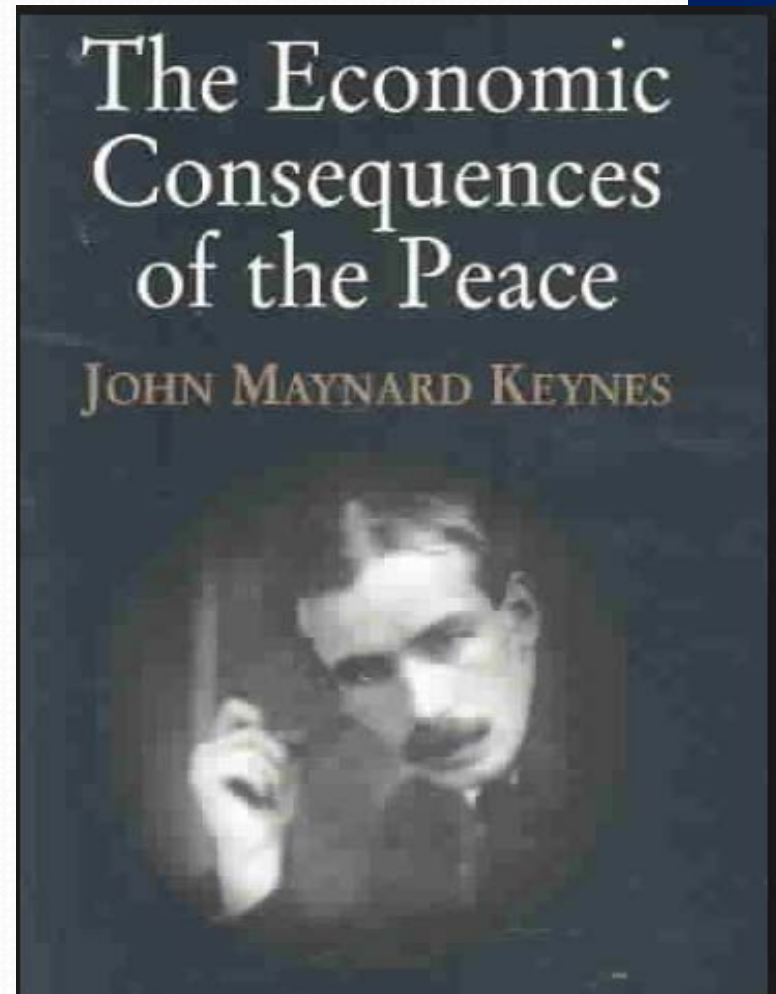
1.4 A memory of the Globalised World of the 1890s

In 1919 Keynes had written about the first great era of globalisation era in his *Economic Consequences of the Peace*

“The inhabitant of London 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; or he could decide to couple the security of his fortunes with the good faith of the townspeople of any substantial municipality in any continent that fancy or information might recommend.”

Keynes asked: how to bring back such a world in 1945, which had been missing since 1914?

We must ask: how to bring back such a world, which we now appear to be sliding away from?



1.5 How to do it?Keynes went back to basics...



John Maynard Keynes,
"National Self-
Sufficiency," *The Yale
Review*, Vol. 22, no. 4 (June
1933), pp. 755-769

- We would not agree now with all of what Keynes said:
“I sympathizewith those who would minimize, rather than with those who would maximize, economic entanglement among nations. Ideas, knowledge, science, hospitality, travel--these are the things which should of their nature be international. But let goods be homespun whenever it is reasonably and conveniently possible, and, above all, let finance be primarily national.
“Yet, at the same time, those who seek to disembarrass a country of its entanglements should be very slow and wary. It should not be a matter of tearing up roots but of slowly training a plant to grow in a different direction.”
- But we have similar choices to make.
- Note: the complete absence of any discussion by Keynes of the labour-mobility issue!

1.6 Plan of this lecture

- In this lecture, I will describe what led us into this position, and will consider possible responses.
- I will ask first whether there is a viable solution to the crisis in Europe that Brexit has brought into sharp relief.
- I will then describe how the effects of protectionist policies in the US might be countered, focusing on the crucial role of the Regional Comprehensive Economic Partnership process in Asia.
- Finally, I will ask what kind of global leadership we might hope and expect that China will provide.

2 Britain's Position – and the Global Position – in 1945

2.1 The end of empire issue

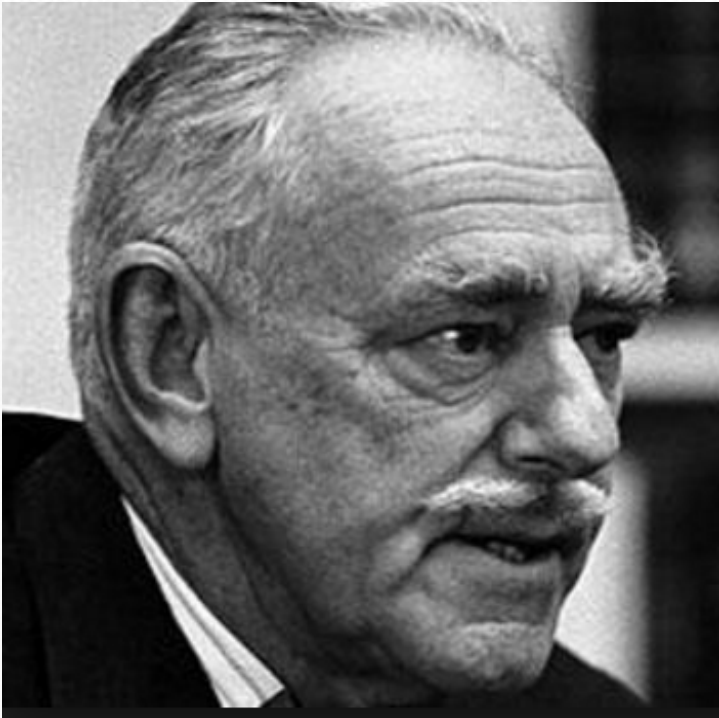
- I said above that: “At the end of that global crisis [which began in 1914] an enlightened generation of policymakers in the US and Britain led the world in creating an open international order.”
- I should actually have said that the discussion began with Article VII of the Lend-Lease Treaty: the price for US support for the UK during the World War II.

“The terms and conditions upon which the United Kingdom receives defense aid from the United States of America and the benefits to be received by the United States of America in return therefor, as finally determined, shall be such as not to burden commerce between the two countries but to promote mutually advantageous economic relations between them and the betterment of worldwide economic relations; *they shall provide against discrimination in the United States of America or the United Kingdom against the importation of any product originating in the other country*; and they shall provide for the formulation of measures for the achievement of these ends”.

[Italics added]

- When Keynes read this, he asked Dean Acheson (Under-Secretary of State) whether the article referred to Imperial Preference and to the sterling payments system. Acheson said that it did, upon which Keynes

“burst into a speech such as only he could make. The British could not ‘make such a commitment in good faith’; ‘it would require an imperial conference’: ‘it settled upon the future an iron-clad formula from the 19th century’; ‘it contemplated the hopeless task of returning to the gold standard’ and so on”. (Acheson, *Present at the Creation*, 1969, pp 19 - 20)



This discussion between Keynes and Acheson reveals a profound difference of view .

- To the British the Imperial preference and the Imperial Payments system involved the management of what was viewed as the British economic system.
 - James Meade anecdote: a conversation with Acheson in which he pointed out that New Zealand was part of the British economic system
- By contrast
 - non-discrimination was a part of the American heritage: *protection* of the home market, for the benefits of home producers, was seen as an expression of nationalism (and permitted) , but *preference* in trade relations was regarded an expression of modern imperialism (and to be stamped out)*
 - Roosevelt himself was also passionately determined to dismember the British Empire, as was Cordell Hull, the Secretary of State.
 - It became a war aim of the US State Department that Imperial Preference should be dismantled.
 - But catastrophically, it also became a war aim of the US Treasury that Britain would be denied the use of an Imperial Payments System (or indeed of any serious balance of payments restrictions) which the competition for its imperial markets might make necessary.
 - The penultimate chapter of Part One the Third Volume of Skidelsky's biography of Keynes concludes (on p. 133) with a succinct statement of this contradiction

* This was 10 years before Viner and Meade defined “trade creation” and “trade diversion”.

How might the UK deal with these American demands?

- Keynes came to see that, since the war against Germany was inescapable, there was no way to escape from the sting in the tail of Lend Lease.
- Nevertheless he saw, at first dimly and then in the end with great clarity, that perhaps there was a way out of the impossible contradiction into which the US was pushing his country. This escape route required him to remake the whole world.
 - Suppose that free trade (including the unwinding of specific imperial preference against the US) were to be imposed on Britain along with open international finance including the absence of general balance of trade restrictions)
 - Then the position of the UK could only be maintained as a good one if the trade were freer on a global basis, and international finance were managed, also on a global basis.
- Could a multilateral world of global free trade and open international finance really be made to work, to replace the imperial system(s) And the gold standard of the late nineteenth century?
 - Could Britain be given an important and prosperous place in such a brave new world?

Keynes' initial response



Keynes initial response was to begin with the money problem, producing in late summer of 1941 the first draft of his proposal for a Clearing Union.

As Lionel Robins said: “it would be difficult to exaggerate the electrifying effect on food throughout the whole relevant apparatus of government of the production of this document ... nothing so imaginative and ambitious than ever before been discussed as a possibility of responsible government policy. It became as it were a banner of hope; an inspiration to the daily grind of wartime duties.

Keynes' initial response (continued)

After much discussion, the two-targets-two instruments idea emerged: internal and external balance to be achieved by domestic demand management and exchange rate adjustment. Many remaining disagreements were papered over with legalistic text and the IMF was established at Bretton Woods in 1944

These ideas were not written down until Meade's book *The Balance of Payments* (published in 1952) and not understood until Trevor Swan produced the Swan diagram at ANZAAS in 1955



- Negotiations were then able to turn to the trade questions raised by Article VII
- These led eventually, to the ITO proposals (vetoed by the US Congress) and to the GATT (& ultimately to the WTO)
 - The gradual dismembering of Empire was one issue (and was to be very gradual)
 - The creation of a “European Community” was another issue (and was also to be very gradual)
- Crucial Role of Article 24 in these negotiations and the discussion of the desirability, and allowability, of regional preference in trade

Post-mortem on the process which led to Bretton Woods and to the GATT:

- Keynes said, in a letter written to a colleague in 1946:
“There was a logical reason for dealing with the monetary proposals first . It is extraordinarily difficult to frame any proposals about tariffs if countries are free to alter the value of their currencies without agreement and at short notice . Tariffs and currency depreciation are in many cases alternatives. Without currency arrangements you have no ground on which to discuss tariffs..... It is very difficult when you have monetary chaos have order of any kind in other directions It is perhaps an accident that the monetary proposals got started first.... but I am not sure that it was not a fortunate accident”
- Our first question: is international cooperation on macroeconomics necessary for us? Should we start on that first?
 - The French thought yes when they chaired the G20 in 2010
 - The outcome was a fiasco, due to lack of clear thinking
 - Such clear thinking shows that the answer is - it all depends.

3 Should international cooperation in macroeconomic policymaking still be first on the agenda? as for Keynes thought it should be in 1941?

3.1 Is monetary cooperation necessary internationally?

- Answer for Eurozone: in a monetary union the answer is yes
 - Banking union, liquidity provision and sovereign debt write downs all necessary within a monetary union when subject to asymmetric shocks.
- Answer for Bretton Woods II countries – i.e. China – the position is also yes
 - But note v. important adjustment of Chinese real exchange rate and move away from export-led growth which we can think of as cooperative
- Answer for countries with poorly hedged international market access the answer is also yes – c.f. the world wide taper tantrum
 - Problems for India, Indonesia and Korea and other EMEs
 - The importance of Barry Sterland's project at Brookings on international financial safety nets
 - Crucial role of AMRO regionally
 - Crucial role of the IMF and the Fed globally
 - Crucial role for regional/global cooperation (Europe has set v. bad example!)

Is monetary cooperation necessary (continued)

- Answer for other countries, with floating exchange rates, and hedged foreign exchange markets, the answer is probably no
 - Australian example: growth maintained after negative external shock by currency devaluation (1984-6, 1997-8, 2008-9, 2014-15) *
 - Similar outlook for the UK – stabilising role of exchange rate movements
 - This was true in 2008
 - Is likely to be true going forward, providing policy credibility is sustained (*n.b.* – large real depreciation of sterling still to be expected - see below)
- For these countries, floating rates may obviate need for cooperation
 - See Ostry, J. and A Ghosh (2013) “Obstacles to International Policy Coordination, and How to Overcome Them” IMF Staff Discussion Note
- But see paper by Helene Rey given at the annual ECB meeting at Sintra in June 2017 and Comment by David Vines

3.2 Is fiscal cooperation necessary internationally?

- In normal times – no
 - Fiscal consolidation requires monetary loosening
 - Interest rates fall and currency depreciates: demand maintained both by increased domestic spending and increase net exports
 - Improved fiscal position possible without damaging domestic economy
 - Nash equilibrium if all countries do the same: demand maintained by increased spending in response to lower world interest rates
 - Improved fiscal position still possible without damaging economies
- In presence of zero bound – yes
 - Fiscal austerity cannot lead to lower interest rates, just to QE
 - Instead leads to exchange rate warfare.
 - No fall in interest rates currency depreciates: demand maintained by beggar thy neighbour devaluation and an increase in net exports
 - Improved fiscal position possible without damaging domestic economy but only at expense of other countries
 - Nash equilibrium if all countries do the same: demand cannot be maintained by increased spending in response to lower world interest rates
 - Outcome is reduced output everywhere and little improvement in fiscal position anywhere

3.3 We now turn to trade issues

- What kind of international engagement will the UK choose to adapt and/or be forced to adopt?
- How will Europe position itself?
- How will the liberal international order survive without US leadership?

4 The World post Brexit

4.1 The Origins of Brexit

How should the UK respond when confronted with demands for an international order which are inconsistent with its perceived objectives?



- In 1940 it was the US demand to dismember the British Empire.
- In 2016 it has been
 - the implementation, within the EU, of the four freedoms for goods, services, capital and labour
 - the perceived loss of democratic accountability as the ECJ interprets the implications of these freedoms
- In my view this has involved just as serious an attack on the nature of the State
- In my view the UK should have fought to fix this issue within the EU.....

4.2 Background I: Churchill's vision of Europe as complement to the British Empire, not an alternative

- Churchill's "United States of Europe" speech in 1946 called on European countries, including Germany, to form a regional organization for security and cooperation on the continent.
- The following sentence is familiar
 - "We must build a kind of United States of Europe. In this way only will hundreds of millions of toilers be able to regain the simple joys and hopes which make life worth living."
- But the following statements were also important.
 - There is no reason why a regional organisation of Europe should in any way conflict with the world organisation of the United Nations. ... I believe that [the UN] can only survive if it is founded upon broad natural groupings. There is already a natural grouping in the Western Hemisphere. We British have our own Commonwealth of Nations. And why should there not be a European group which could give a sense of enlarged patriotism and common citizenship to the distracted peoples of this mighty continent?

4.3 Background II: The Changing British Model

- But by the time of the 1975 Referendum Britain was “with Europe” and had abandoned its special relationships with Empire, both trading and financial
 - Was it a result of the US pressure applied 30 years earlier?
 - Was it the [potential] attraction of trade creation within Europe?



4.4 The “reinvention” of Europe: Thatcher the Single Market and the Four Freedoms

- Soon after UK joined Europe it had run out of steam
- Margaret Thatcher launched the European Single Market
 - This has been immensely successful
- The UK thought that it was getting a single market in goods – and eventually in services
 - The UK worked for enlargement of the EU to expand this open market vision
- The other members of what was then the European Community thought that the aim was the “four freedoms” – goods, services, capital and labour
 - In the end this became an ambition for a quasi-federal state
- These two conceptions have clashed
 - Particularly in relation to Turkey



4.5 And increasingly the Four Freedoms have clashed with the British idea of a nation state

- Ideas of these freedoms have helped lead to the fiasco of monetary union
- Ideas ignore the need for control of immigration at national level
- These four freedoms have been interpreted in a necessarily political manner by the European Court of justice
- This process has become inconsistent with the British conception of a parliamentary democracy

4.6 The Four Freedoms may not have been essential to the UK's relations with the EU

- “This approach is all wrong. While it is undoubtedly regrettable that the UK is leaving, the truth is that free trade with the EU does not have to be accompanied by free movement of people. As pure trade theory shows, the economic effects and welfare gains resulting from free trade are substituted, not enhanced, by those of free movement of labour.”

(Hans Werner Sinn, *The Guardian*, 1 February 2017)

- But the referendum has now put aside the option of working from within to reform the EU
- See a highly constructive approach to the forthcoming negotiations by Andre Sapir and Jean Pisani Ferri: See <http://bruegel.org/2016/08/europe-after-brexit-a-proposal-for-a-continental-partnership/>

4.7 The Three Alternative Choices for the UK

- (i) Should the UK bargain to control labour migration whilst remaining in the Single Market (i.e. aim to break down the four freedoms)
- Without such membership what will happen to the City – is “regulatory equivalence a feasible outcome” . If not, what then?
 - Without such membership what will happen to the academic research in the UK and in Europe.
 - Without such membership how is British participation in European supply chains possible
 - For a lucid discussion of the issues see speech in London on 16 March by Pascal Lamy, posted on the website of the Institute of Government in London
But solutions to these problems are at present impeded the four freedoms:
- (ii) Or should the UK attempt to go it alone and begin the long and slow (spaghetti) process of bloc formation with other parts of the world?
- (iii) Or is unilateral trade liberalisation the way forward
- The “Australian model”
 - Note the crucial importance of good macro management
 - The choices made will determine how much more the pound needs to depreciate; good macro management will deliver what is needed

4.8 Trade Creation and Trade Diversion – in reverse!

- A discussion of these three potential outcomes for the UK requires one to carry out - in reverse - the trade-creation-versus-trade-diversion arguments about the formation of regional FTAs which were carried in relation to open regionalism in East Asia.
 - See Vines, D. (1994) "Unfinished business: Australian protectionism, Australian trade liberalisation and APEC" Shann Lecture published in the *Melbourne Institute Review*,
 - Also see Garnaut, R. and D Vines (2007) "Regional Free-Trade Areas: Sorting Out the Tangled Spaghetti", *Oxford Review of Economic Policy*,
- It is not yet clear how to carry forward these discussions into thinking about the extent to which the UK should seek to remain within the Single European Market.
- If the UK is able to remain with the European Single Market, more or less, then this will impose restrictions on the ability of the UK to liberalise its trade with other third-party players, including, especially, ASEAN.

4.9 The Two Crucial Choices for the rest of the EU

- The way in which the EU 27 faces the UK will partly determine the outcomes for what we have been discussing up to now.
- The way in which the EU 27 faces the Rest of the World is important for what follows.

5 The World Post Trump and Post TPP

- Up until now the world has looked to continuing US leadership
 - But this outward-looking leadership now no longer available
 - I will not discuss here the circumstances which have led to this position in the US.
 - There is a very good book on this by Peter Temin at MIT, with whom I have worked: Temin, P. (2017) *The Vanishing Middle Class: Prejudice and Power in a Dual Economy*, MIT Press
- Europe will be looking inwards: continuing crises about the Eurozone, migration and Brexit, are encouraging the anti-globalisation agenda
- The leadership task falls to Asia
 - It is the world's rapidly growing region where growth promoting reforms are possible
 - The world needs Asia to do accept this challenge
- The task: policymakers in Asia know how enormous the development agenda is
 - The task as described above: to continue the process of development, begun in 1945 in Europe and Japan, continued during the Asian miracle of the 1980s and 1990s, to bring prosperity to poorer regions of Asia, Latin America and Africa

5.1 The Asian Way: Collaborative Autonomy

- The actions of different countries best be brought together?
 - A forum is needed in which information is exchanged, preferences are articulated, discussions take place, compromises are reached, and then countries act autonomously
 - The leading countries will share the costs of collective action
 - They will need to mobilise second-tier supporters – Australia and India
 - Other countries will then be able to act of their own free will
 - This form of leadership enables countries to pursue their own self interest
- Leadership can be sustained in many ways
 - Global hegemonic country (e.g. US in the past)
 - international institution (e.g. IMF, WTO)
 - policy process (G20, APEC)
 - Regional cooperation (RCEP)

5.2 Trade liberalisation in East Asia in 1980s & 1990s

- Outstanding example of collaborative autonomy
- Name given was 'open regionalism'
- International environment supported objectives at home
 - Liberalisation by other countries was used as leverage by trade policy officials and politicians when they embarked on liberalisation at home
 - The sense of opportunities throughout Asia fed influenced reforms at home
 - Foreign actions were important in contests with protectionists at home.
 - Especially important when foreigners were important regional trading partners,
 - This process was important during the original 'East Asian Miracle' period, from the mid-1980s to the eve of the Asian financial crisis in 1997
 - Nearly all Western Pacific economies embarked on far-reaching *unilateral* liberalisation during period of internationally oriented growth in East Asia.
 - Process was led by the Asia Pacific Economic Cooperation (APEC) process
 - Leadership of APEC was collectively shared

5.3 This form of liberalisation was MFN

Liberalisation on a “most favoured nation” basis

- Leads to trade creation
 - opportunities for others who liberalise
 - benefits for others who do not liberalise – free riding a possibility
- Outward-looking reform process Asia supported global negotiations
 - Completion of ‘Uruguay round’ of negotiations at WTO in 1994
- Contrast with the FTA approach discussed below
 - Lead to trade creation
 - opportunities for others within the FTA
 - No benefits for others who are not members– free riding a not possibility
 - Also lead to trade diversion
 - Diverts trade away from those who are not members benefits

5.4 The TPP and subsequent 'leadership' of trade liberalisation in the Asia Pacific region

- Things have changed since 1990s
 - Move towards bilateral 'free trade areas' (FTAs) and towards regional trading areas (RTAs) – most recent has been the negotiation of the (TPP)
- The TPP (Trans Pacific Partnership) has been 'led' by top-down bilateral agreements between the US other members
 - Those joining the TPP would have experienced gains:
 - increased market access for exports to other member countries – 'trade creation'
 - Those joining the TPP have also lost:
 - Market access benefits have been selective and discriminatory, esp. in US
 - Discriminatory, non-MFN, tariff concessions lead to 'trade diversion'
 - Enforcement of in some ways damaging 'rules of origin'
 - Establishment of preferential investment access and provision for investor-state dispute-settlement provisions (investors will be able to sue governments)
 - Provision for improper protection of intellectual property (IP)
- Very different environment from APEC's 'open regionalism'
- Certainly not collaborative autonomy
 - Nevertheless, there is some support at this meeting for the external discipline which TPP has imposed
 - Question: how to obtain external discipline without authoritarianism?

5.5 Importance of One Belt-One Road

- Focuses attention on need for new regional trade forum
 - Chinese leadership needs to aim for collaborative autonomy
 - Aim could be a more transparent, less distortionary, and more open forms of regional trade integration
 - integration which supports and sustains unilateral trade liberalisation
 - RCEP might encourage moves in this desirable direction.
 - Is being managed by Indonesia in 2016 but future leadership is open
 - One-Belt one road already falling into place
 - China has already born fixed costs of leadership – especially transport network costs
 - A possible ambition is for a collaborative multinational forum
 - Will enable countries to liberalise in ways which would not have been able to do
- Focuses attention on need to strengthen WTO – or replace it
 - What will Chinese leadership do?
 - One-Belt One Road provides possible platform

5.6 The interests – and responses - of other players

- The objectives of the US, post Trump, and its response to the global game, may become critical
 - How will this declining hegemon come to behave?
 - Protectionism plus fiscal expansion will have what implications for the global trading system?
- It does not appear that the European Union will play a valuable role
- Britain's objectives post Brexit, and its response to the global game, may become critical as a mid-level facilitator
 - What kind of behaviour will the UK display
 - The UK's position is may become critical in relation to Asia and to one-bet one road
- Australia's response to the global game may also become critical as a mid-level facilitator
 - This was true in the 1940s – *c.f.* actions of Giblin, Coombs, Melville and Crawford
 - It was also true on the 1990s's *c.f.* actions of Hawke, Keating, Garnaut and Drysdale
 - Could Australia play a crucial role again?