

The eurozone, the world economy, and the international trading system

Kevin H. O'Rourke

All Souls College, Oxford

Dublin Castle, September 25, 2011

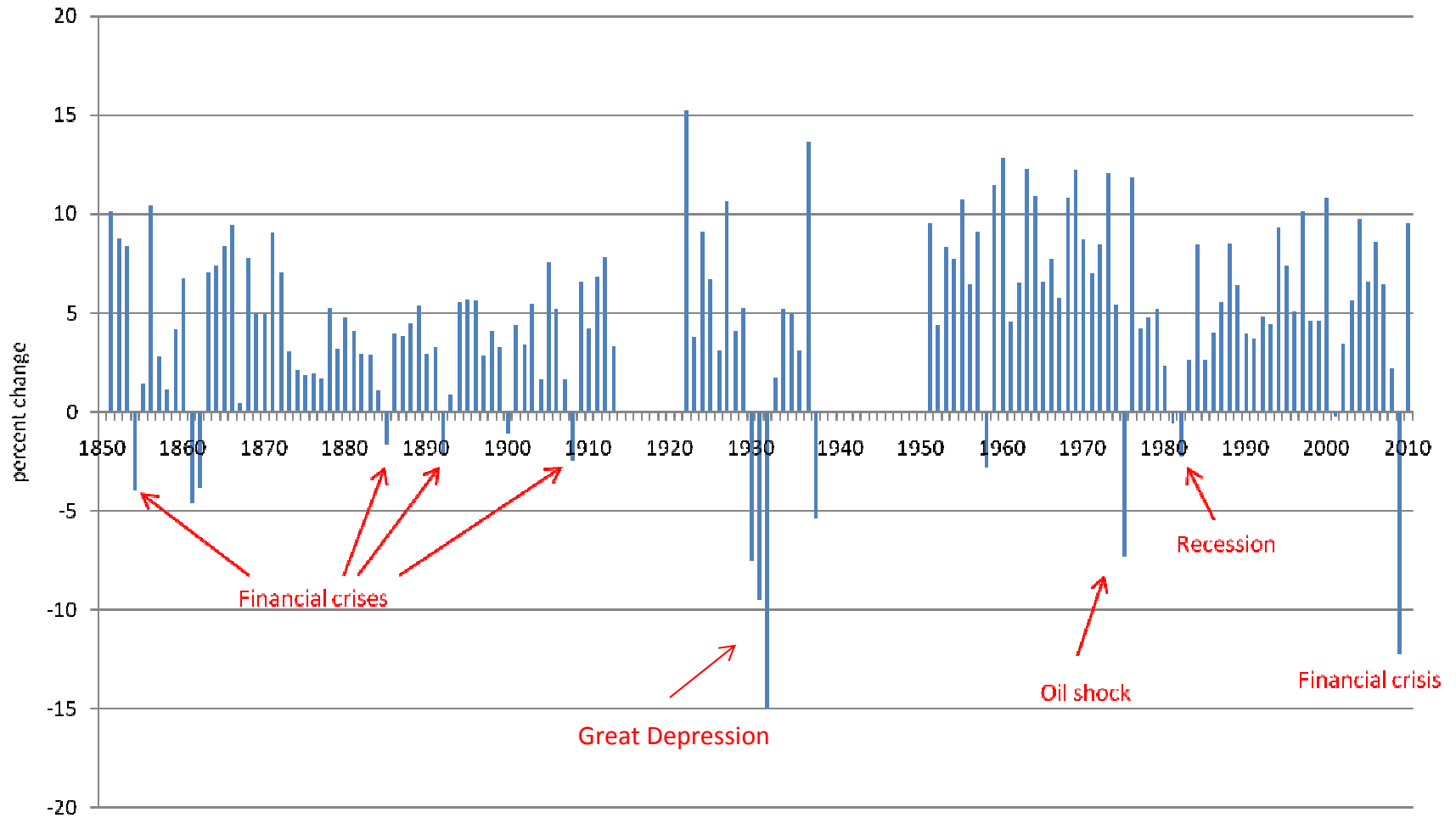
Today's international trading regime historically unique

- Trade openness
 - Low trade barriers
 - Stability and certainty
- Regime openness
 - Nondiscrimination (MFN)
 - Inclusive of all countries
- Investment encouraged as well as trade
- International institutional underpinning
- If it is unique, perhaps we shouldn't take it for granted? Not just technological, but political and geopolitical underpinnings

Challenges to the trading system

- Shocks
 - Wars
 - Financial crises/recessions
- Shifts
 - In comparative advantage
 - In geopolitical power

Shocks are rare



Shocks

- Wars
 - Regional: bad for trade, no effect on trade policy
 - Global: bad for trade, bad for trade policy
- Economic crises
 - Few recessions or financial crises have major systemic implications
 - *Drawn out* shocks (1929-33, 1979-82) do
- Shocks can be particularly harmful if superimposed upon shifts
- What features of international systems help them cope with shocks and shifts?

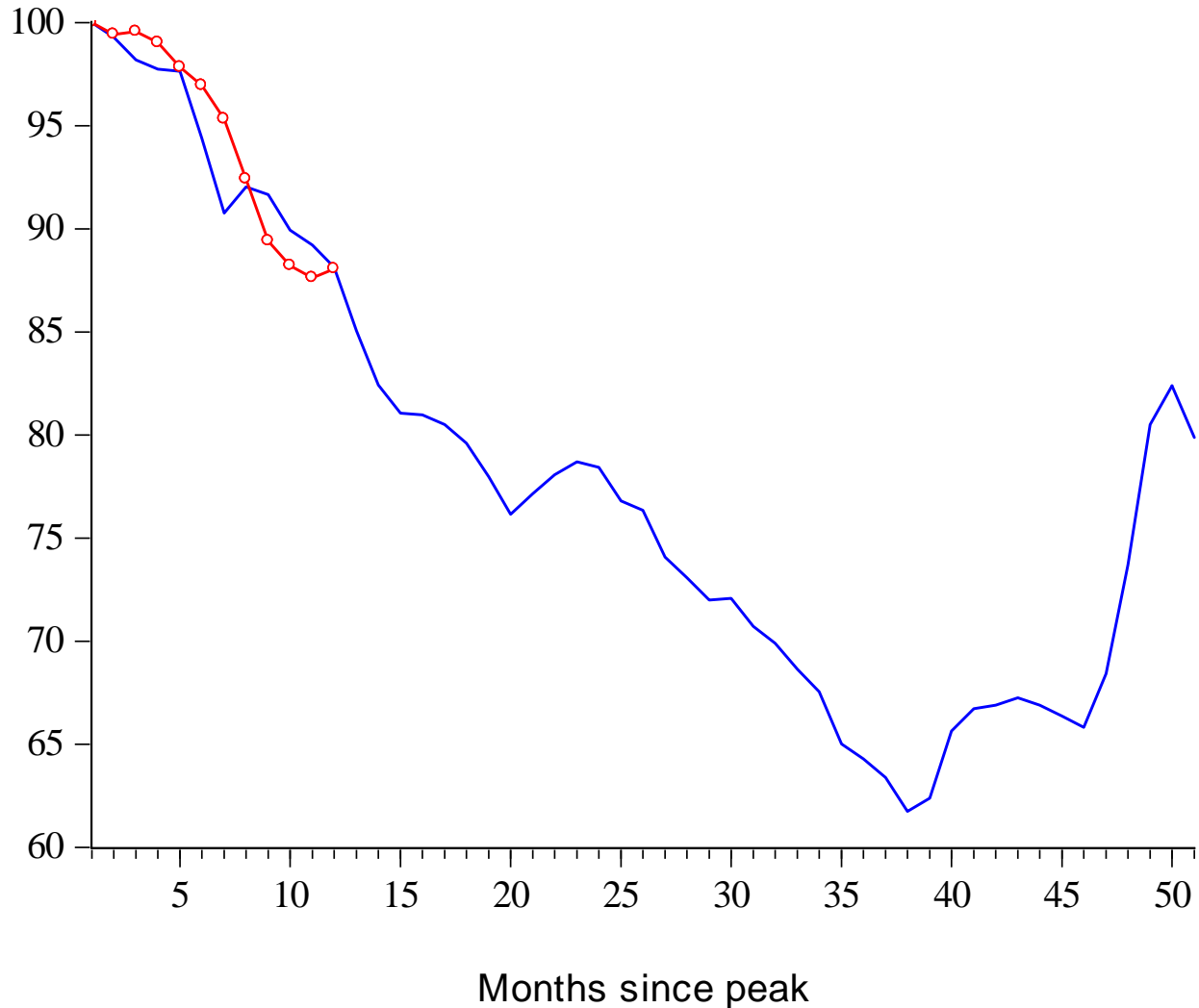
Aesop's fable



Which are we?

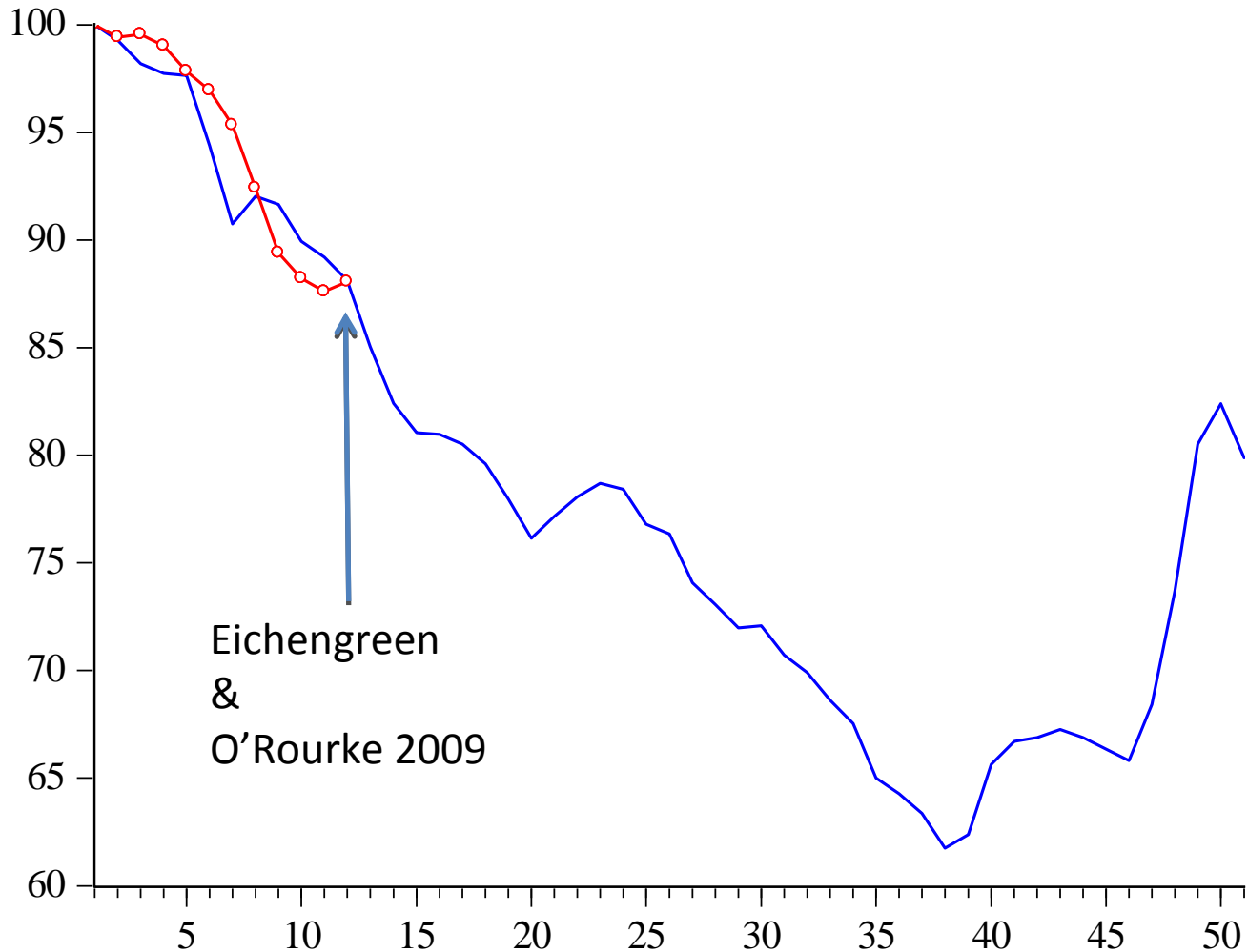
- We have seen a shock (the largest financial crisis since the Great Depression) superimposed upon a major economic and geopolitical shift (the rise of China and the developing world more generally)
- Thus far, remarkably little protection, although there has been some
- Why?
 - Superior shock absorbers

The length of crises matters



— June 1929=100 —○— April 2008=100

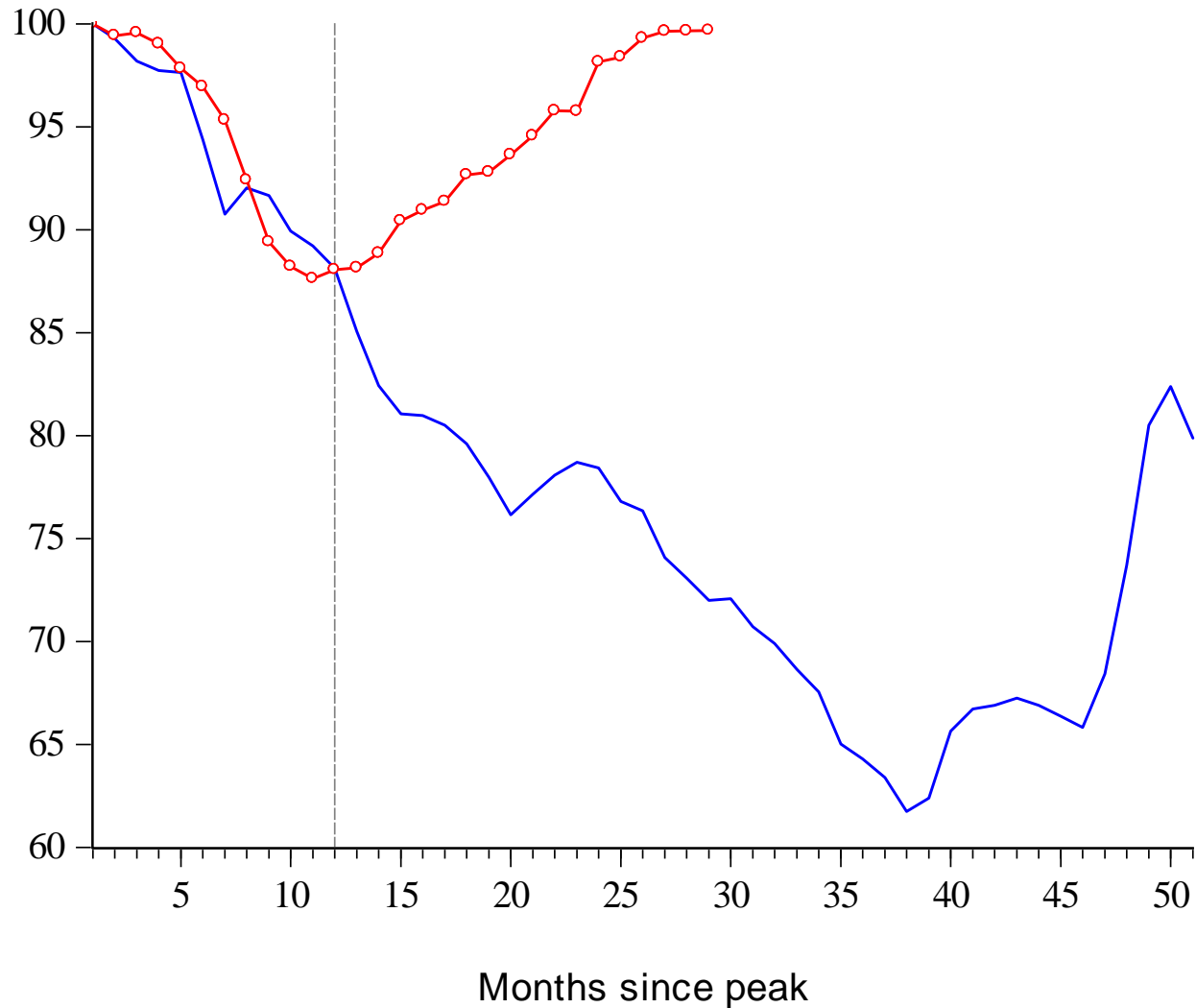
And a leading indicator



Eichengreen
&
O'Rourke 2009

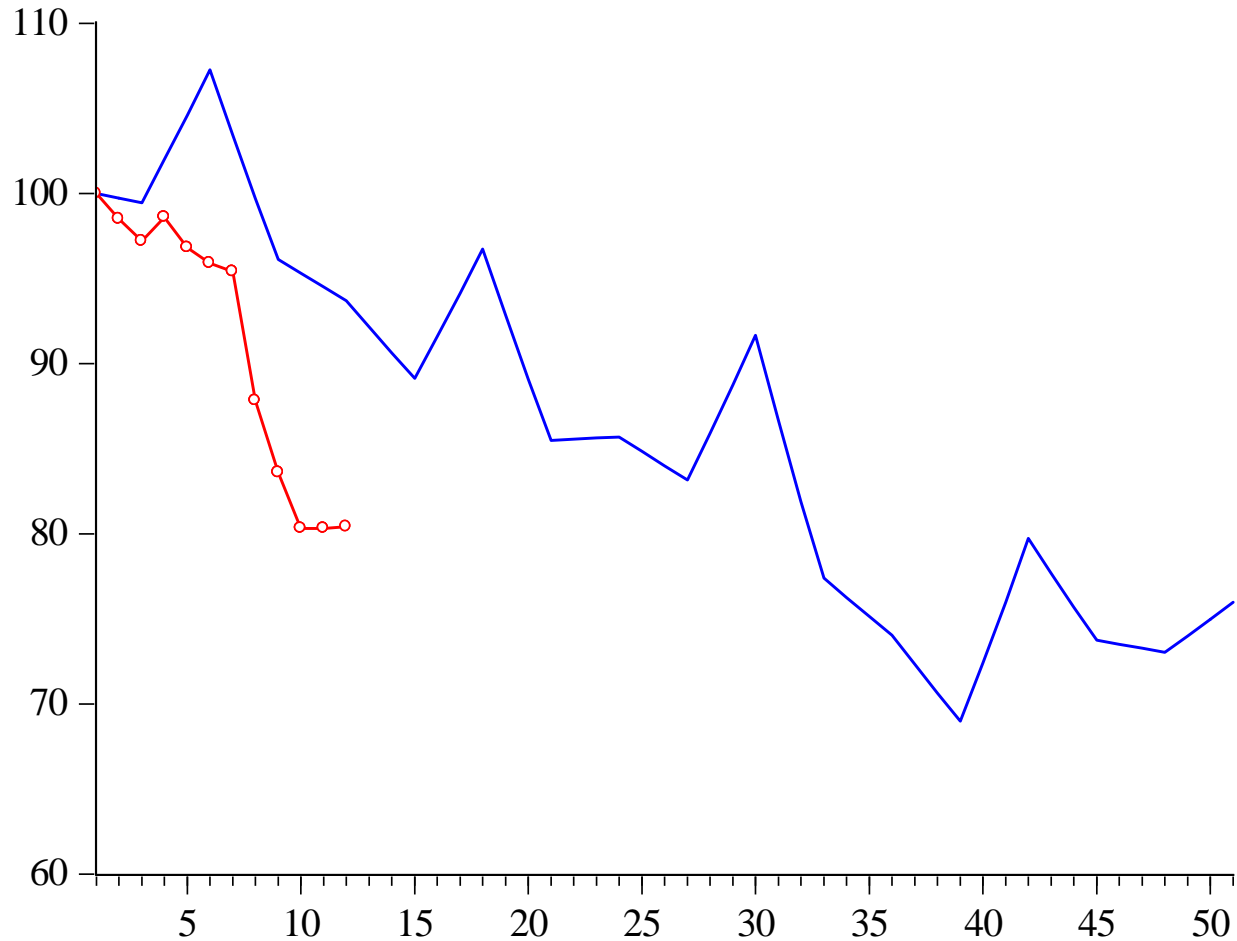
— June 1929=100 —○— April 2008=100

And the inevitable consequence



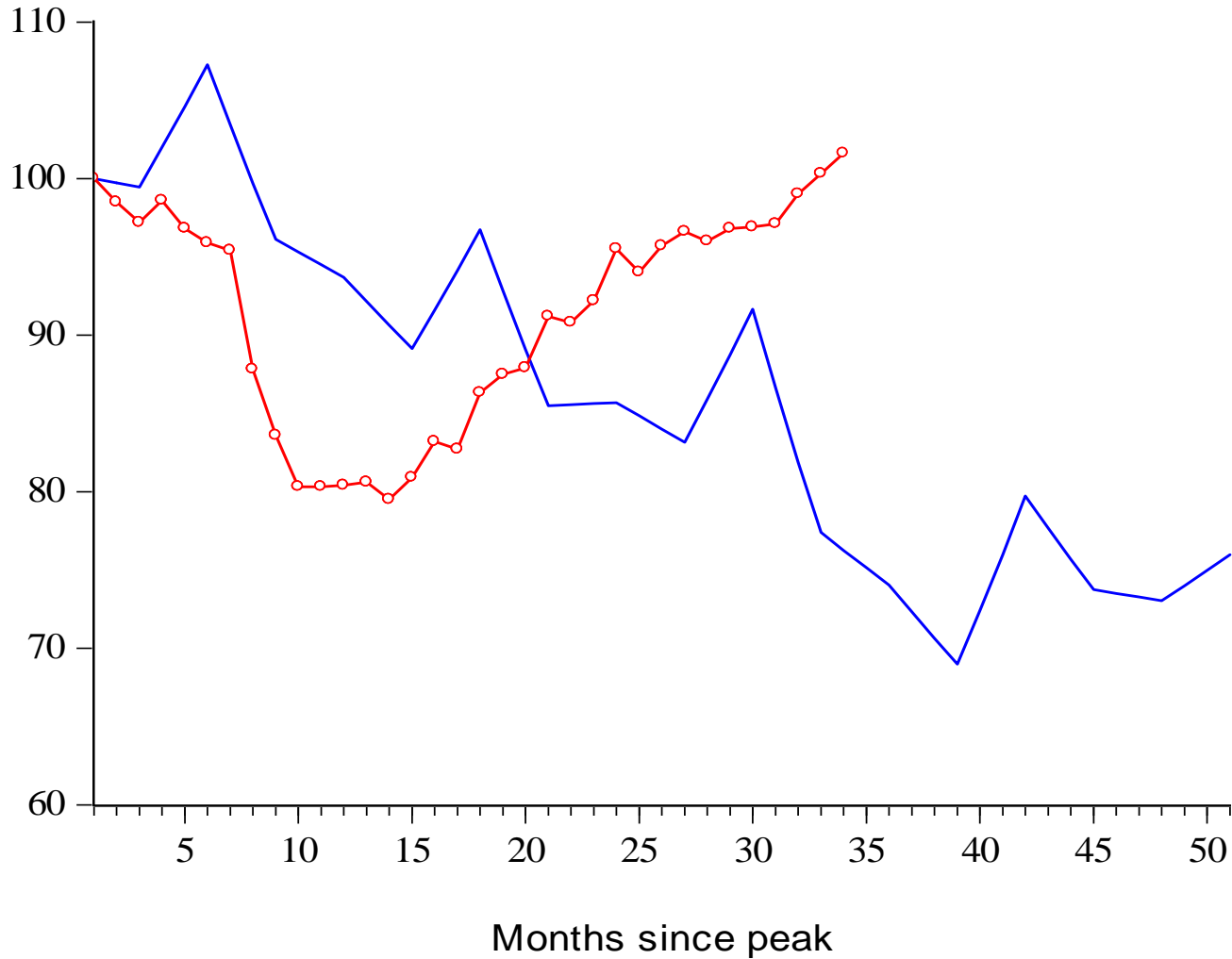
— June 1929=100 —○— April 2008=100

World trade in two crises



— June 1929=100 —○— April 2008=100

World trade in two crises

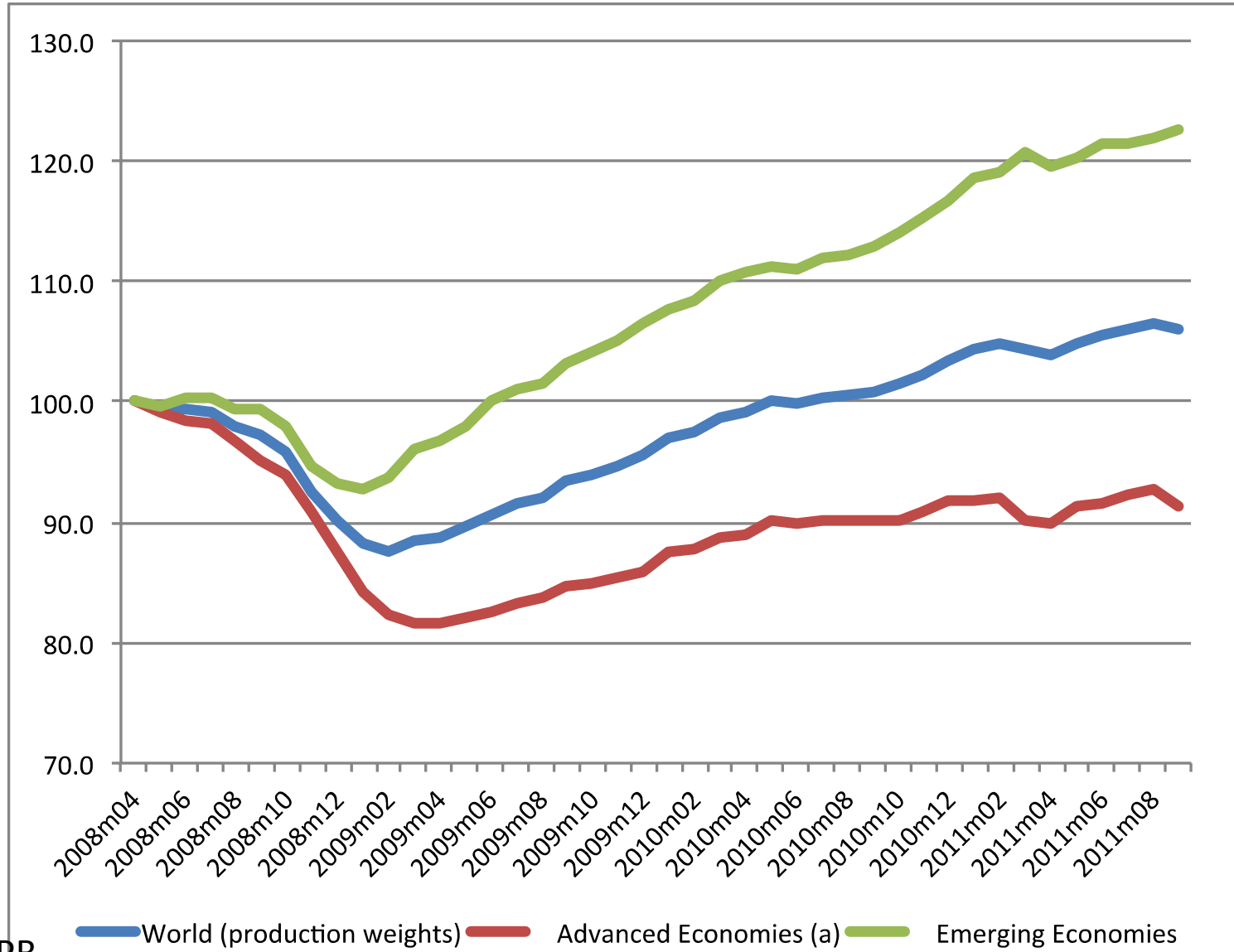


— June 1929=100 —○— April 2008=100

Sharper but shorter decline in world trade

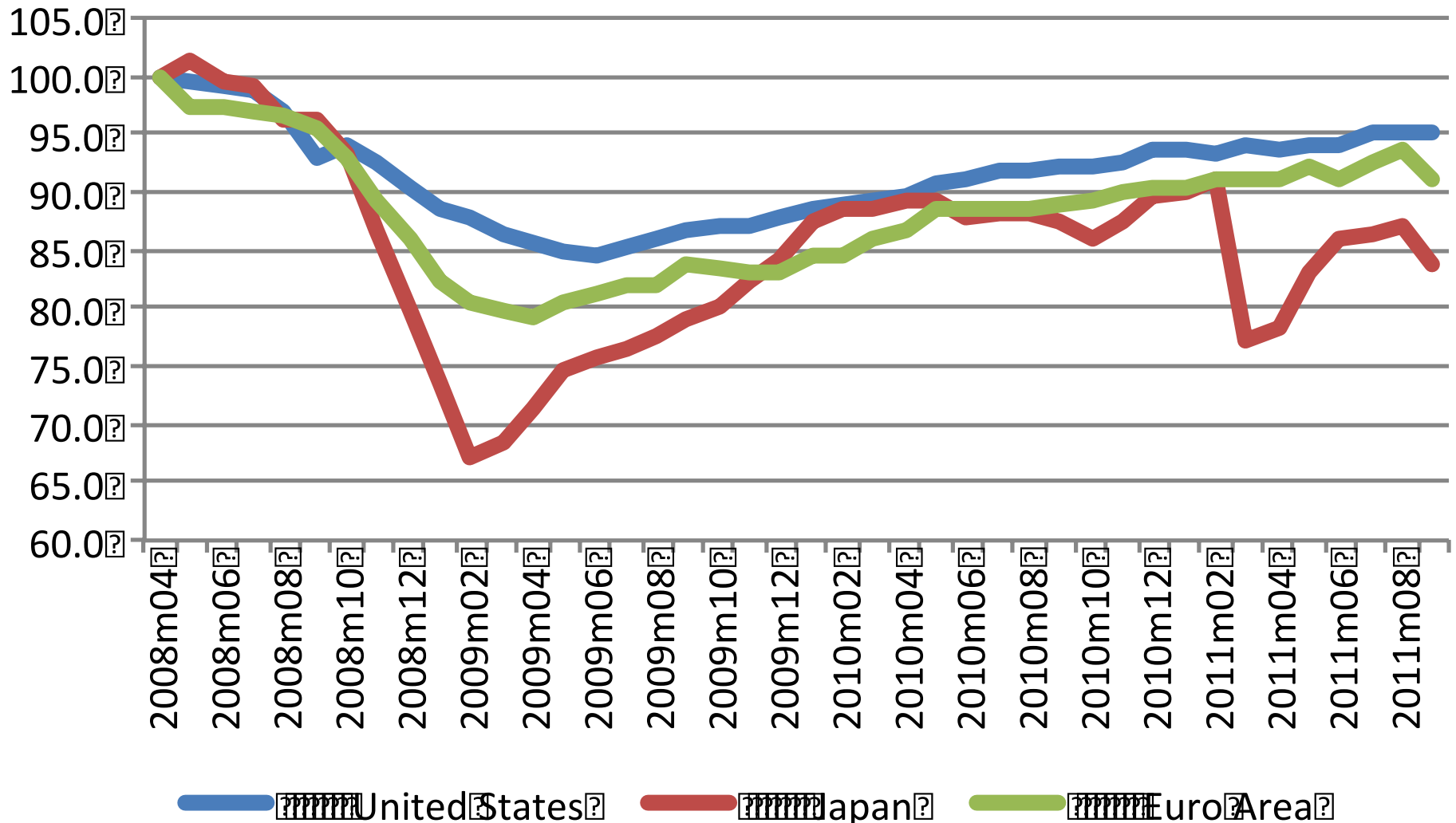
- Why was resort to protection so much less dramatic?
 - The world economy declined for one year, not three or four
- Superior shock absorbers
 - Macroeconomic
 - Flexible exchange rates, aggressive monetary policy, automatic stabilizers
 - Political
 - Welfare states
 - Multilateral organizations...
- But recovery was weak, and is now faltering

Recovery driven by emerging economies

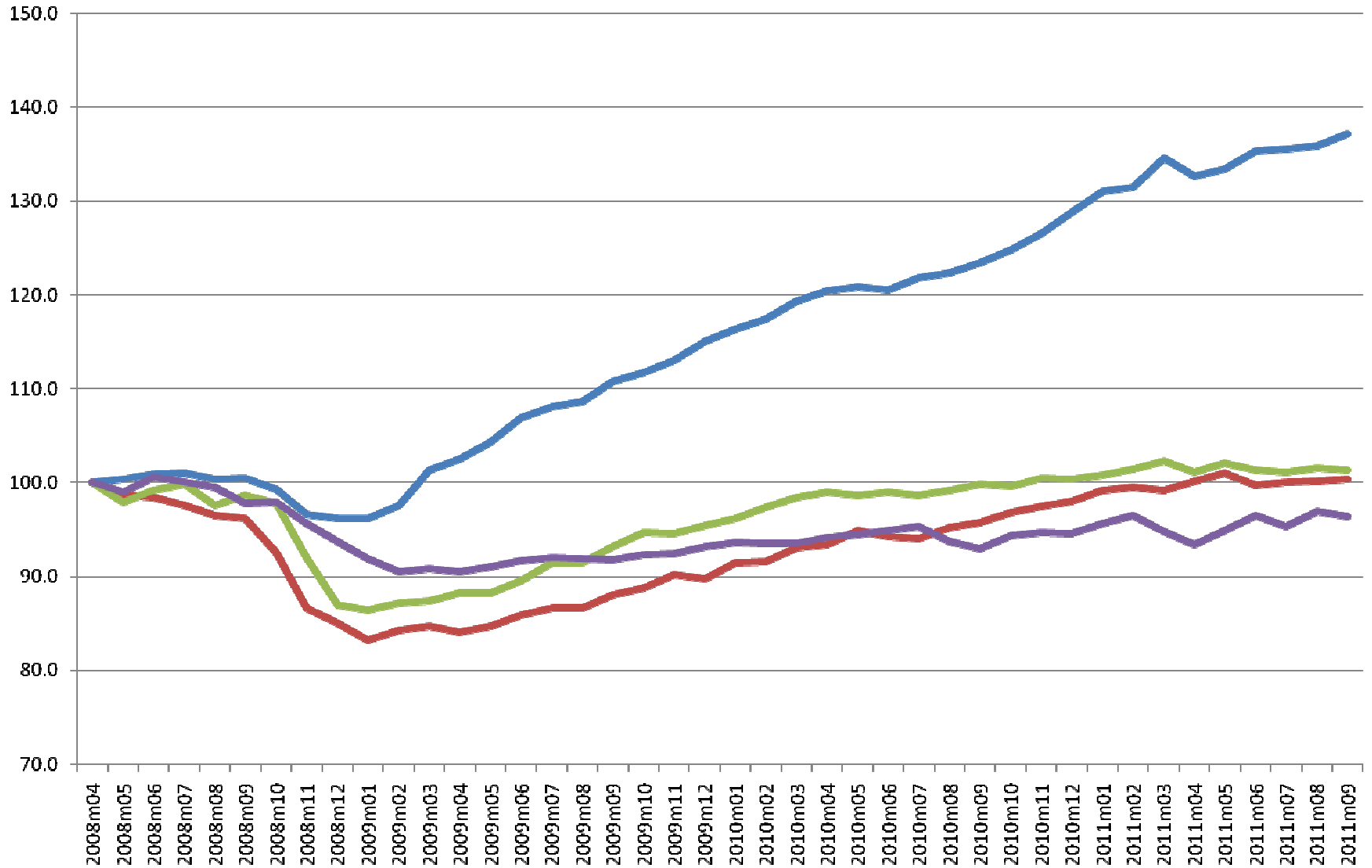


Source: CPB

USA: best of a bad lot



Recovery is Asian

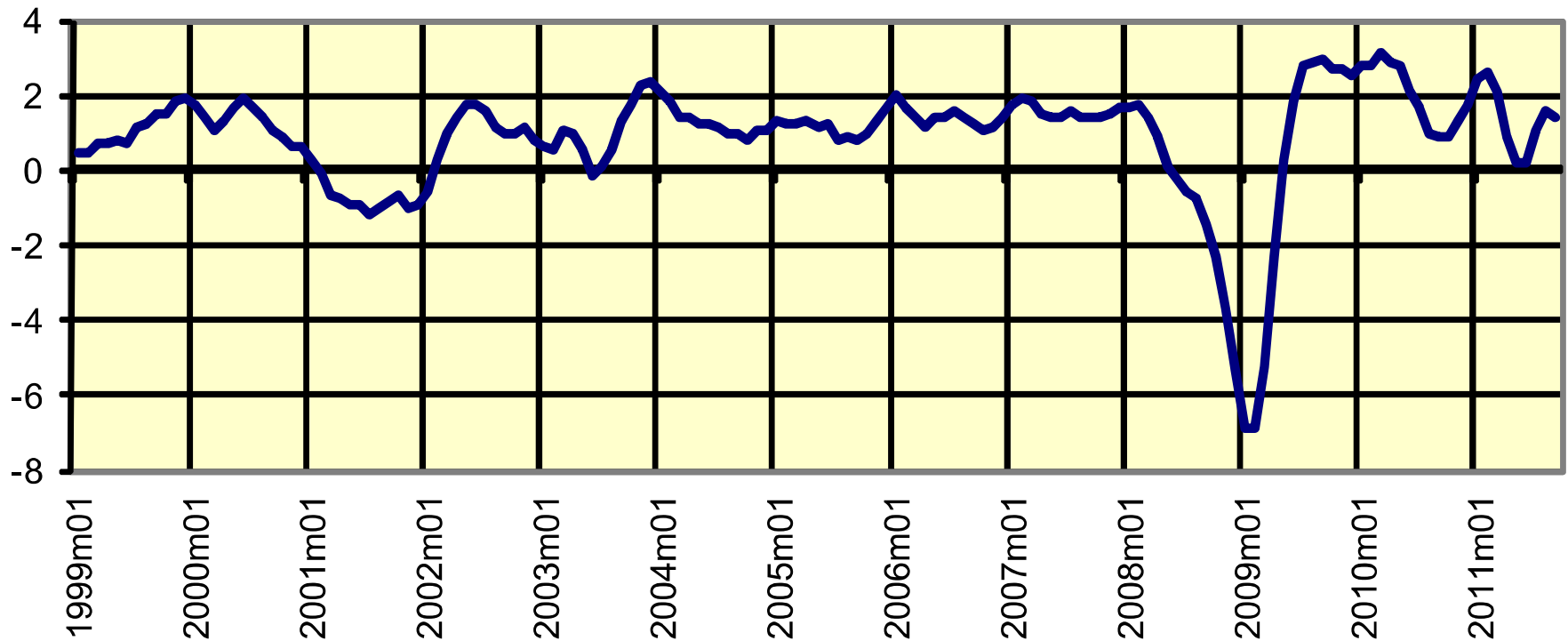


Source: CPB

Asia Central and Eastern Europe Latin America Africa and Middle East

World IP momentum slowing

Past three months over previous three months, percentage change



To state the obvious: Eurozone a big risk

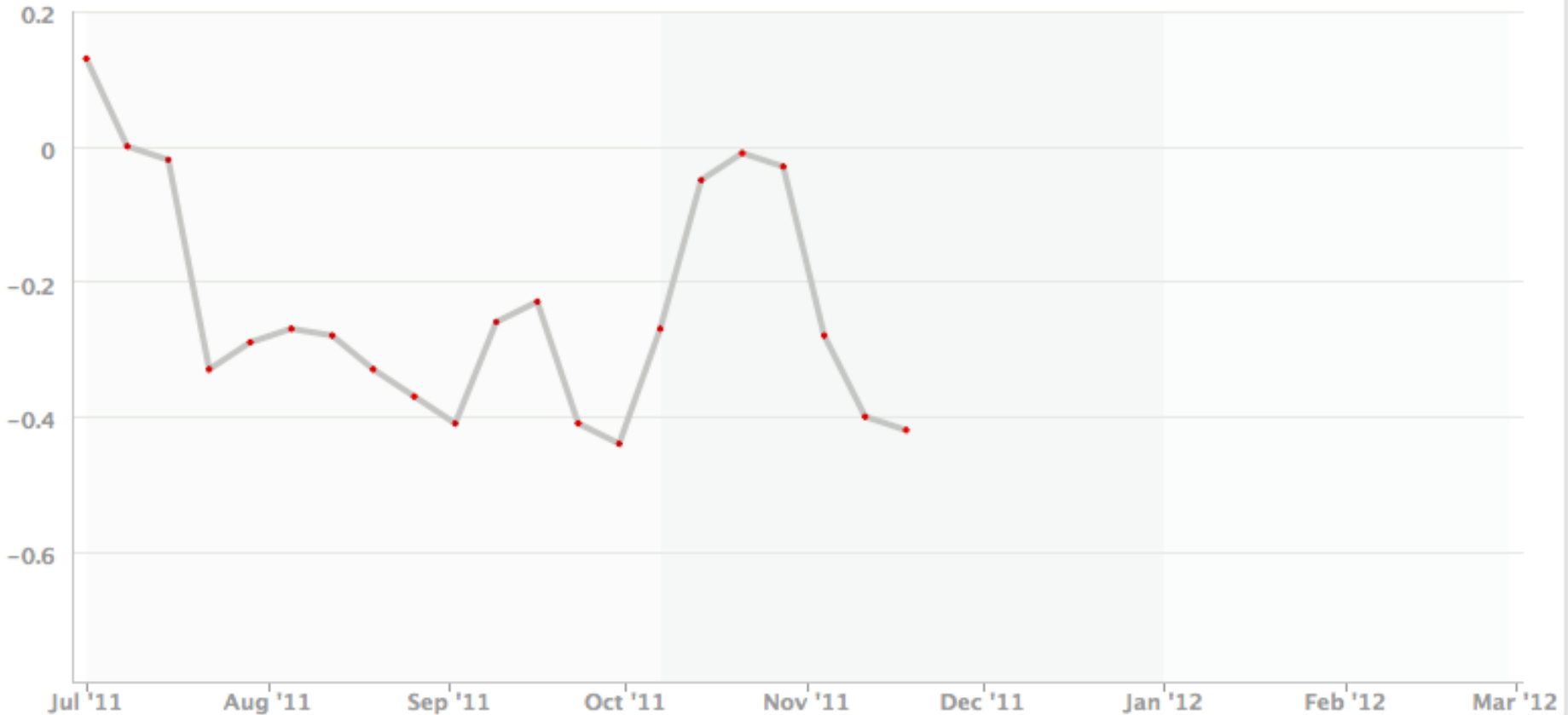
Euro-Area GDP - Weekly (%)

Q3 2011

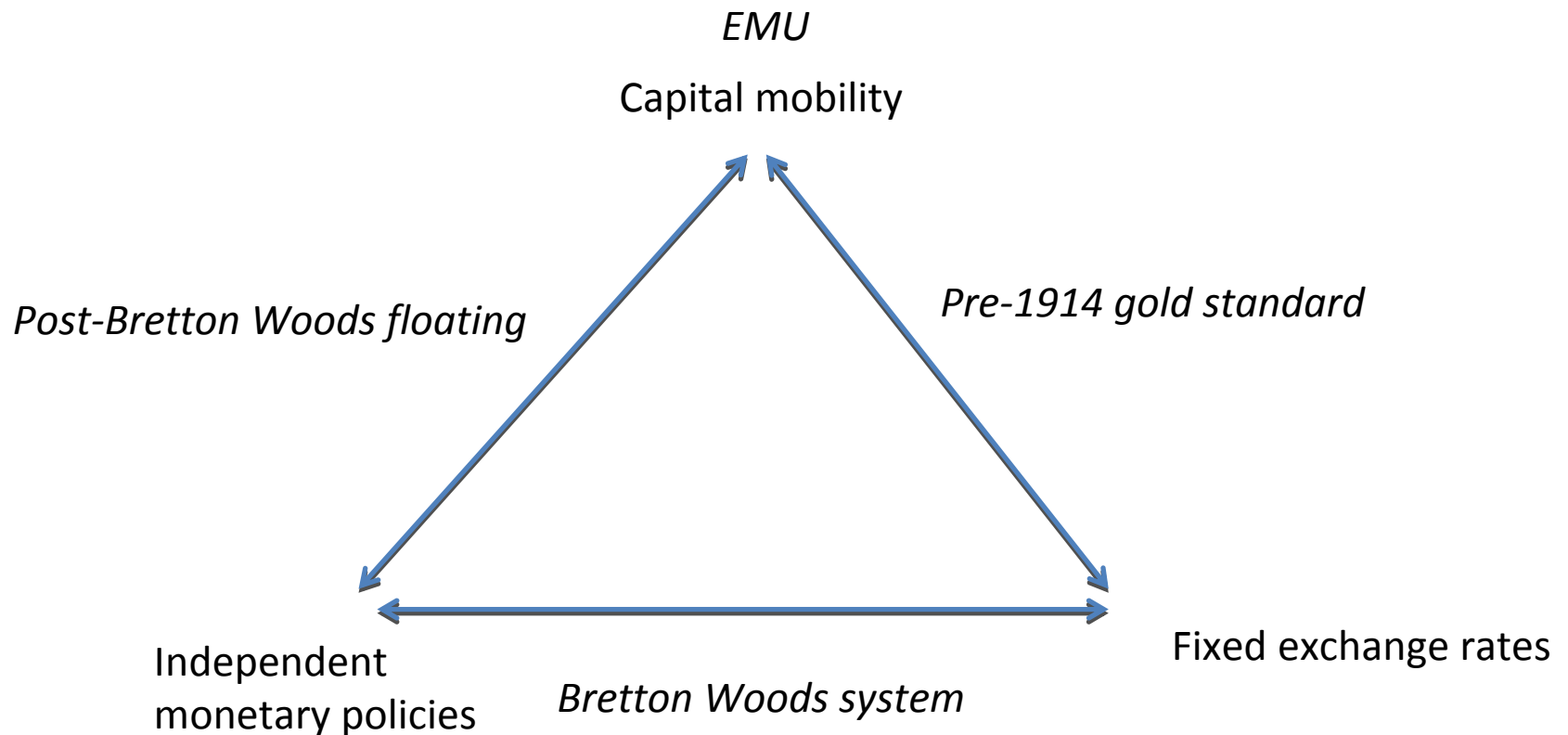
Q4 2011

Q1 2012

Euro-Area - % QoQ GDP growth rate - weekly plot



EMU as a solution to the monetary policy trilemma



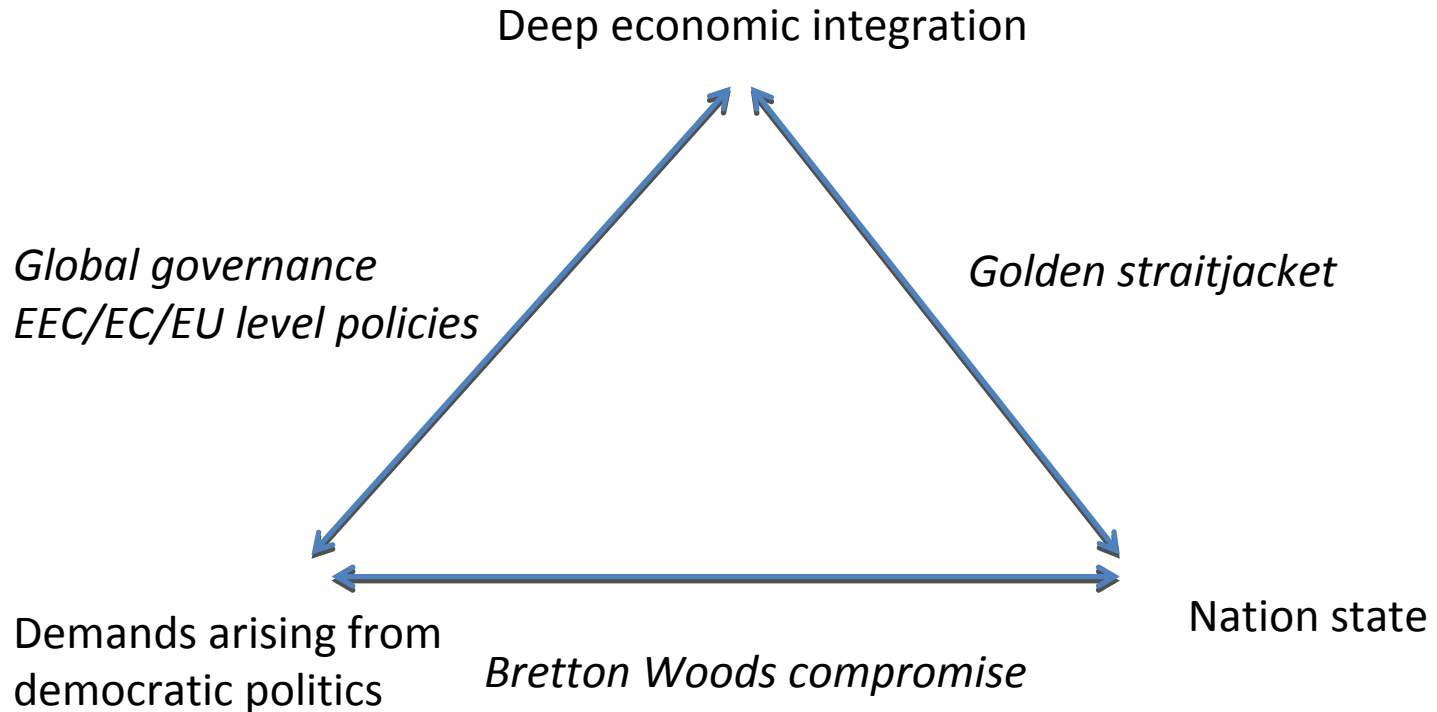
Euro's design flaws

- Lots of economists said that an inability to devalue could be risky, or an inability to set your own interest rates
- Lots of economists said that a common currency without a fiscal union was risky
 - In the US the federal tax and transfer system important in smoothing out regional shocks
- What was missed in the 1990s was the role of cross-border capital flows, channelled through financial intermediaries
 - Curious, since the Thai crisis happened in 1997
 - Lack of common financial regulations or banking resolution system
- Why do we have this flawed architecture, and what happens now?

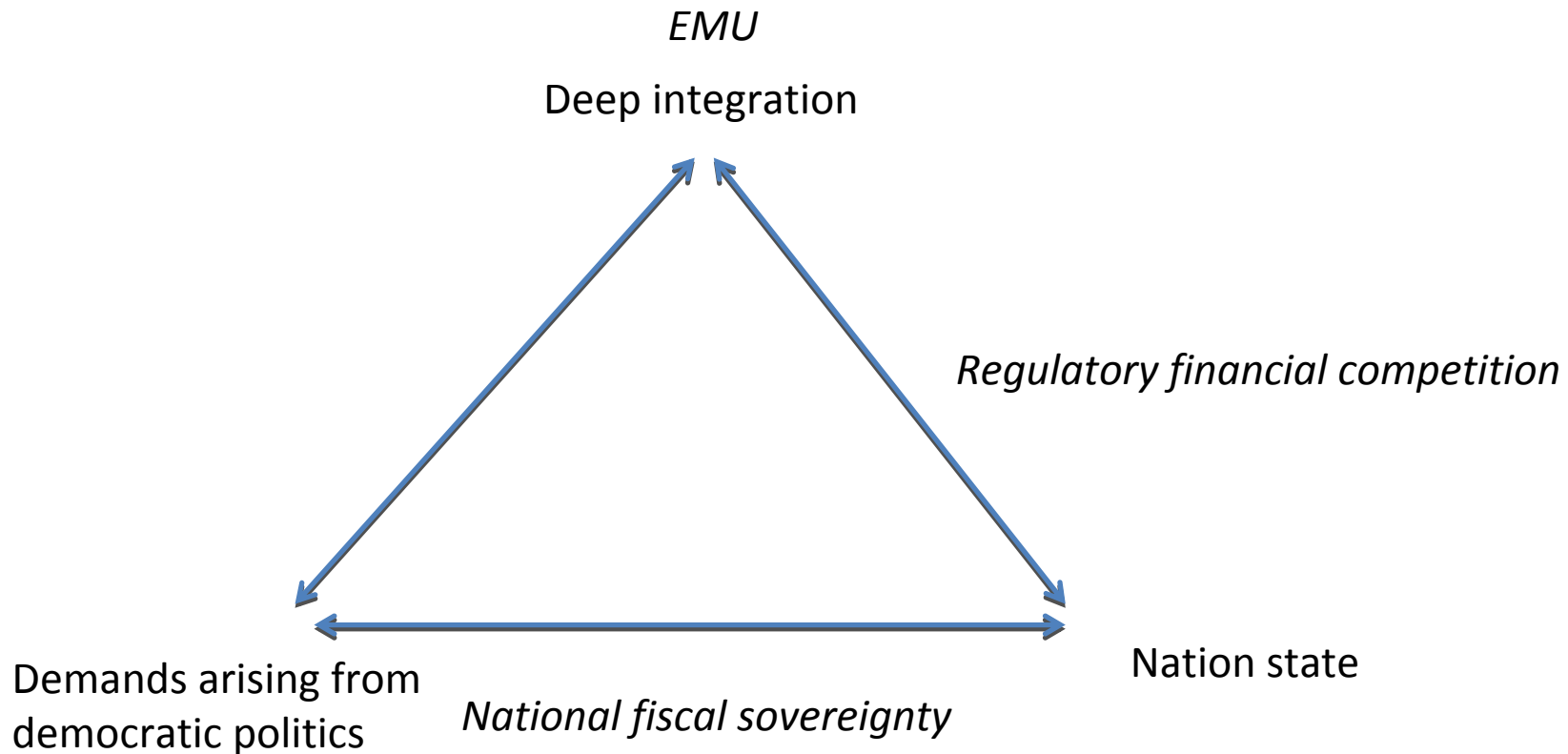
Rodrik: “the fundamental political trilemma of the world economy”

- “we cannot simultaneously pursue democracy, national determination, and economic globalization. If we want to push globalization further, we have to give up the nation state or democratic politics. If we want to maintain and deepen democracy, we have to choose between the nation state and international economic integration. And if we want to keep the nation state and self-determination, we have to choose between deepening democracy and deepening globalization”
- Sufficiently deep integration places constraints on governments’ ability to regulate and tax in the way their constituents want: the solutions are to do these things at the supra-national level (the traditional EU route), or to ignore popular opinion

The political trilemma



The political trilemma and EMU

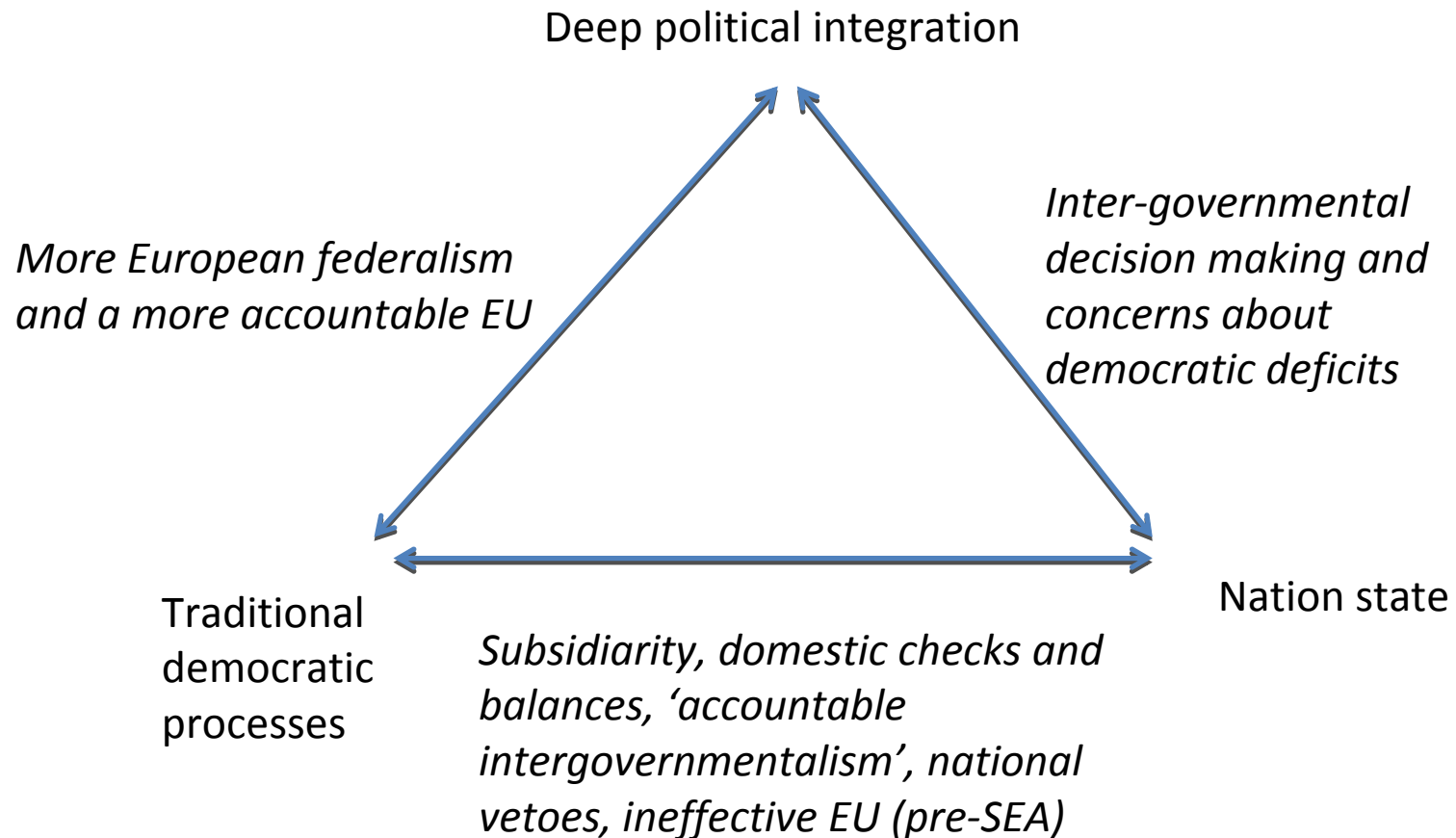


EMU: stuck between trilemmas

Where do we go from here?

What is politically feasible?

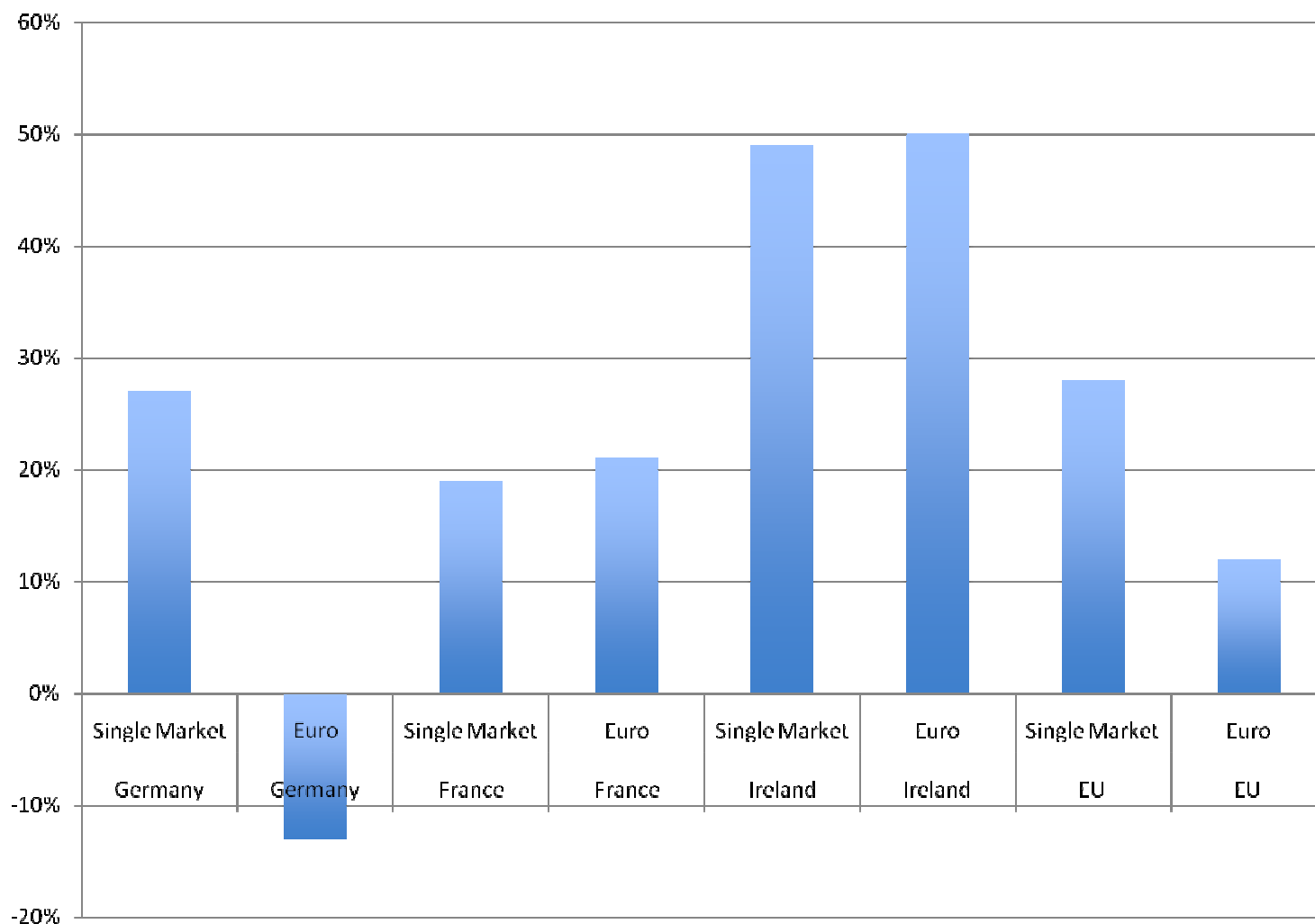
The political trilemma, the quality of EU democracy, and euroscepticism



Initial conditions

Attitudes towards Single Market & Euro in 1992 & 1997

Net response: %(favourable)-%(unfavourable)



Initial conditions: class divides and the EU France 2005

- Clearly many factors explain the No vote
- But in part a rejection of market/globalization
- Blue collar workers voted No, white collar workers voted Yes
- Similar in Ireland

Table 1
The Sociopolitical Support for the “No” in the Last Two European Referenda

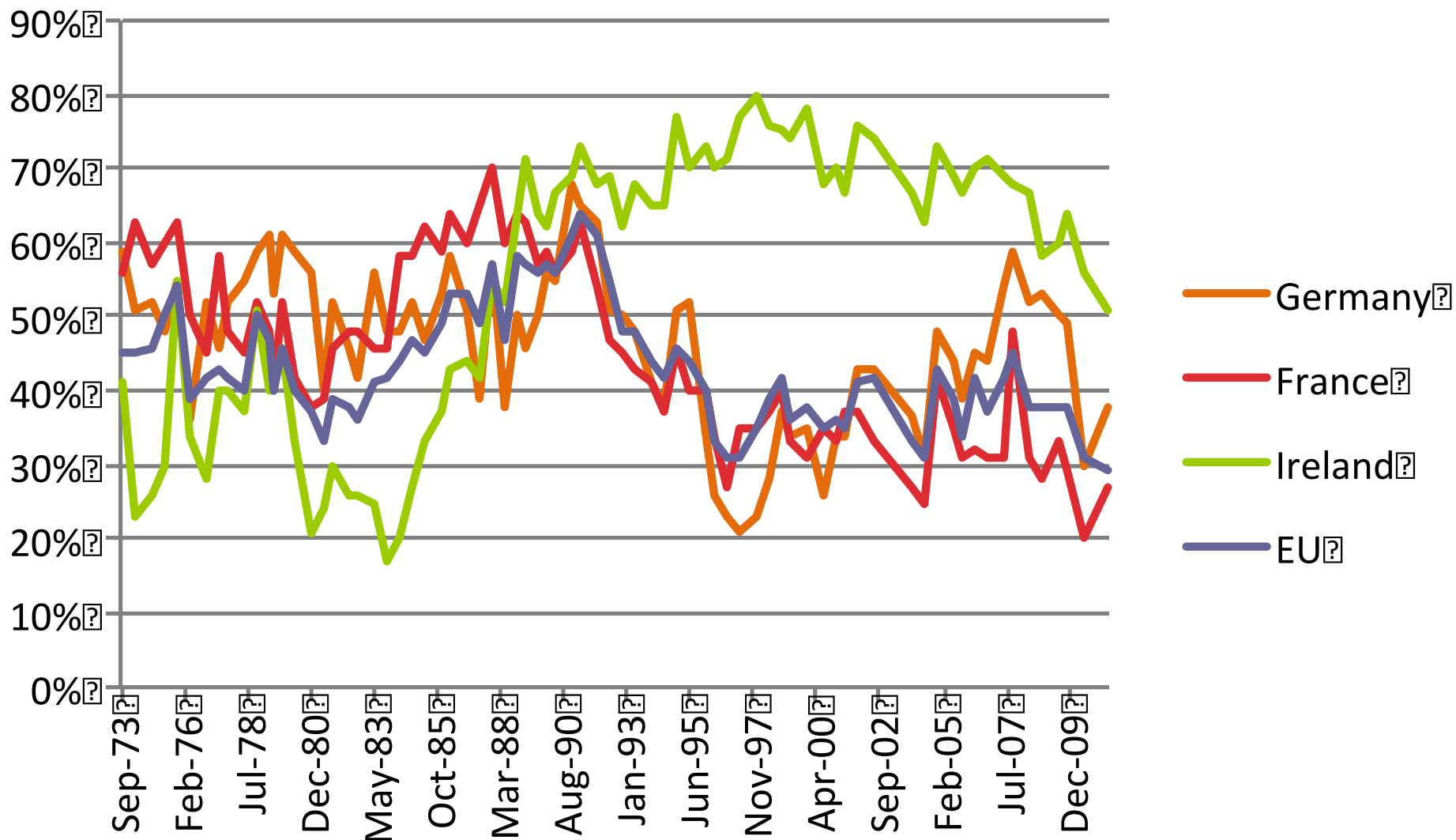
% of No	Maastricht Treaty (1992)	European Constitution Treaty (2005)
Whole sample	49	55
Gender		
Men	48	57
Women	50	53
Profession		
Farmers	62	70
Shopkeepers, Craftsmen	49	51
Professionals	33	35
Middle management and assimilated	38	53
Clerical workers	53	67
Blue-collar workers	61	79
Retired	46	44
Age		
18–24 years old	49	56
25–34 years old	52	55
35–44 years old	49	61
45–59 years old	47	62
60–69 years old	45	44
70 years old and more	**	42
Sector of activity		
Private sector	50	56
Public sector	49	64
Independent	56	58
Unemployed	59	71
Students	41	46
Partisan proximity		
Extreme Left	70	94
Communist Party	81	98
Socialist Party	22	56
Greens	43	60
UDF	39	24
RPR/UMP	59	20
National Front	92	93

Source: IPSOS, exit polls

Since the crisis started..

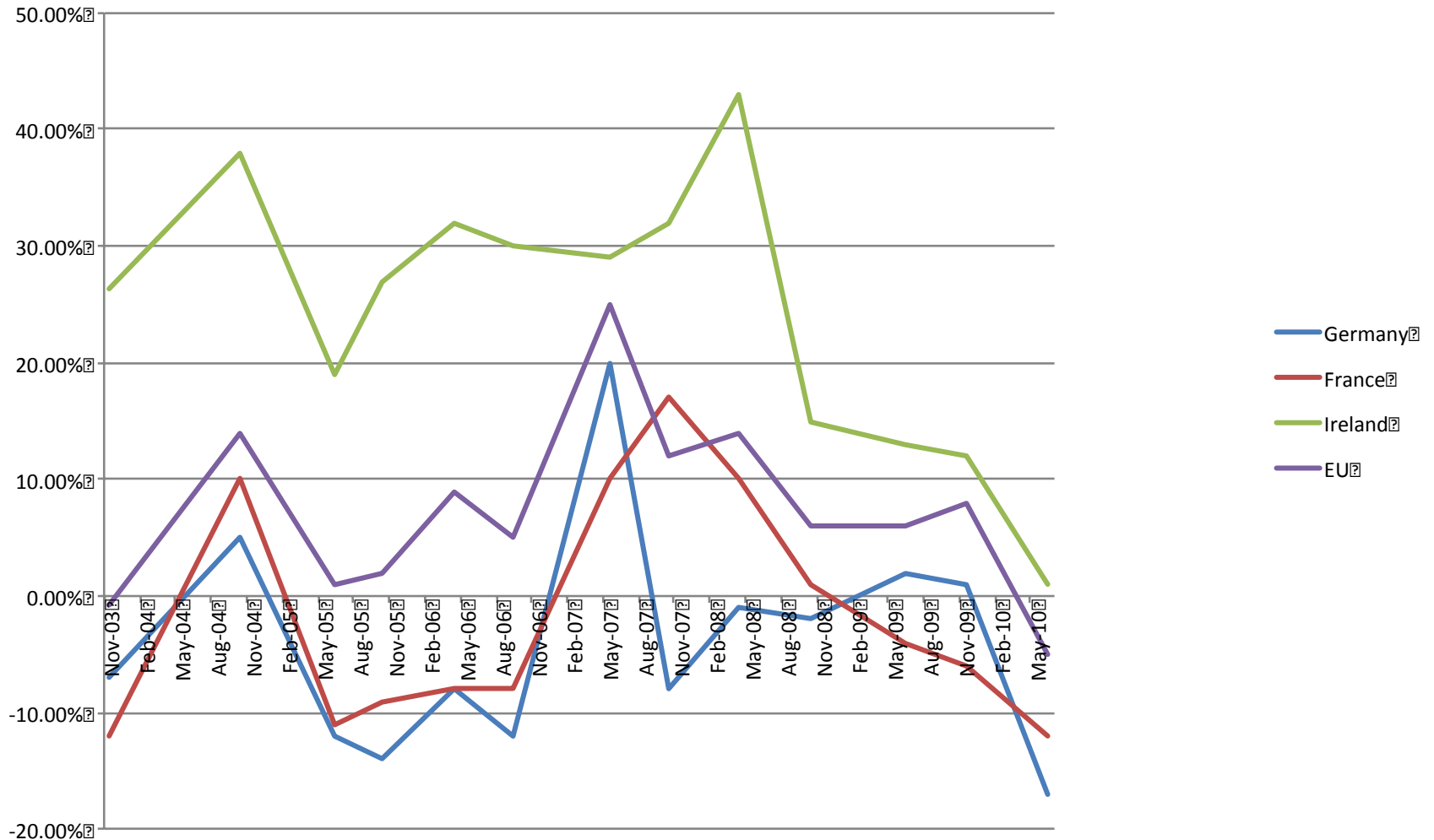
Generally speaking, do you think that (your country's) membership of the European Community (Common Market) is ...?

Net response: %(a good thing) - %(a bad thing)



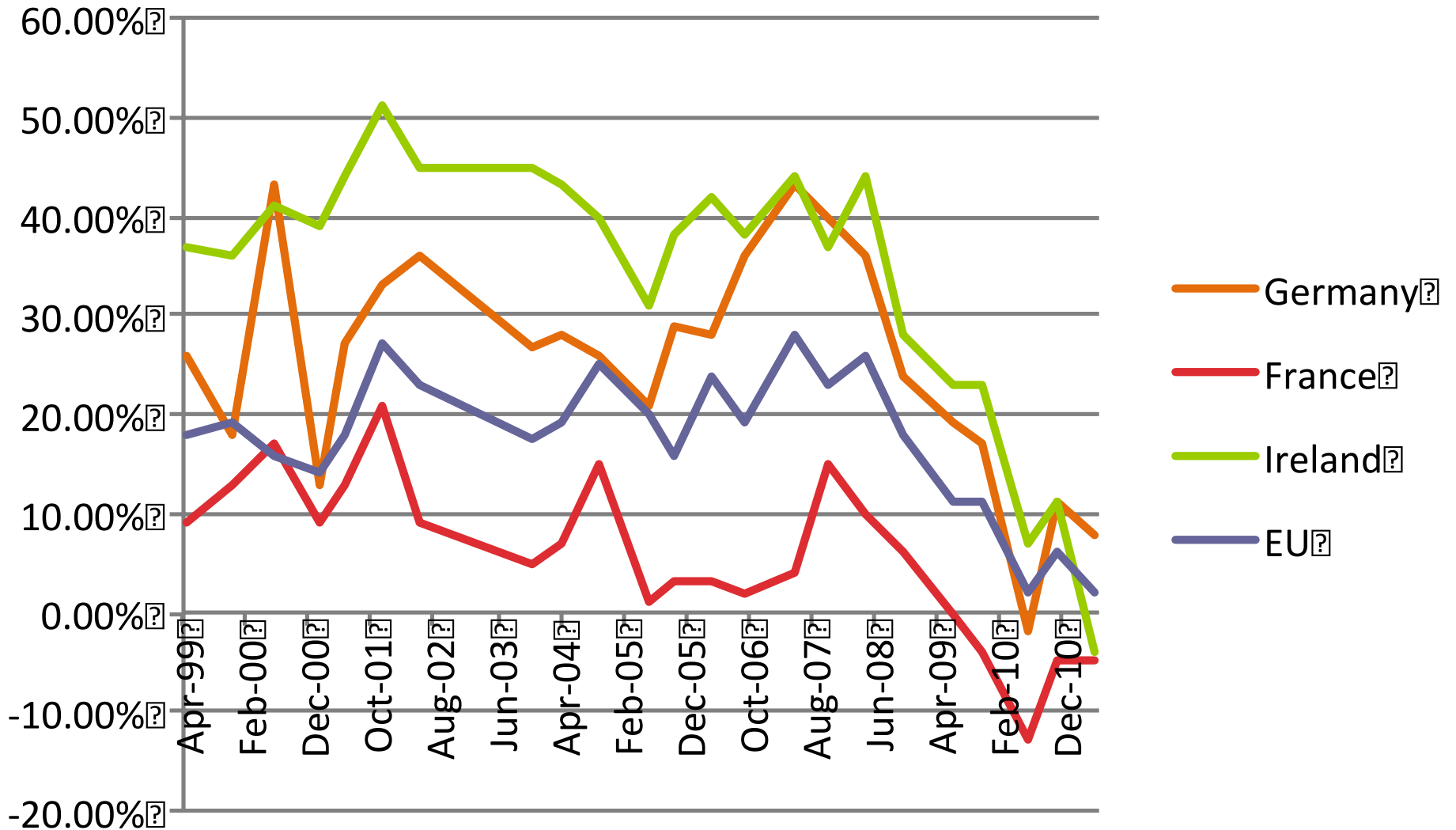
Trust in the European Union.

Net response %(trust) - %(not trust)



Trust in the European Central Bank

Net response: %(trust)-%(not trust)



Which is EMU?

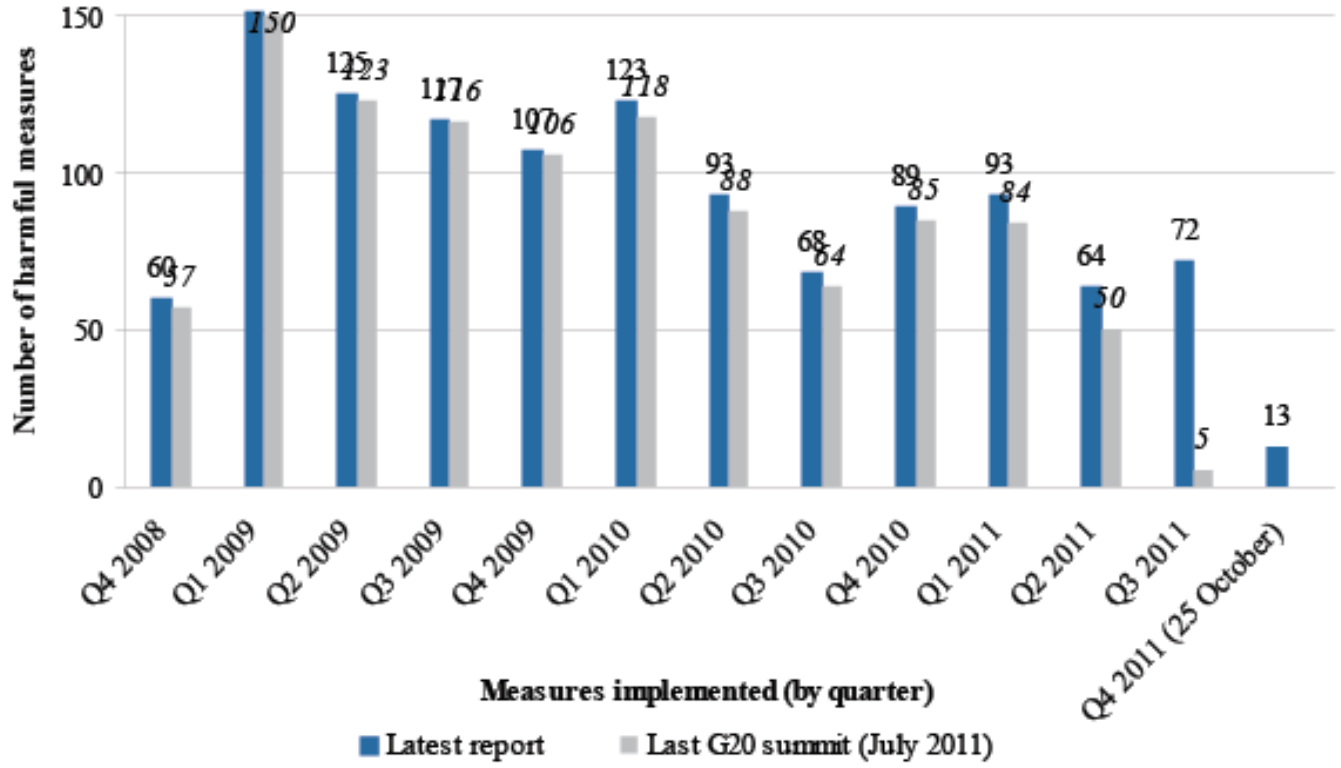


Whither EMU?

- Need a banking regulation and resolution framework
 - Almost forgotten amid the focus on state finances
- Need a move towards fiscal union
 - One that will promote counter-cyclical adjustment in depressed regions
 - We are being offered surveillance guaranteeing pro-cyclical adjustment
- In the short run need the ECB to step in
- If EMU survives, it will be because something happens we currently believe is impossible
 - Legal, political, intellectual rigidities
 - This is not primarily a fiscal crisis; wages are sticky...

Why this matters in the longer run: the world economy & signs of rising protection

Figure 1. Deteriorating prospects for the world economy since Q4 2010 coincided with an increased resort to discrimination



Note 1: The total quarterly number of harmful measures for Q1-Q3 2011 are converging quickly to the 100-120 range seen in 2009. Q3 2010 seems more anomalous as time goes by. *Note 2:* A harmful measure is taken to be one which has been implemented since November 2008 and is almost certainly discriminatory (coded red) or likely to be discriminatory (coded amber).

Why the eurocrisis really matters

- “ just as important to future generations that we deliver them an intact democratic system and liberal world economy, as to consider the commonly spoken debt-burden concerns”
(Posen 2010)
 - Domestic politics
 - European politics
 - International trade relations

QUESTIONS?