

Policy options for the euro Heterodoxy ahead

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Learning from the Great Depression



Euro periphery (still) overvalued

Heterodoxy is coming

Learning from the Great Depression

The unmentionable

Heterodoxy is coming



Learning from the Great Depression

The unmentionable

Heterodoxy ahead



**JOBLESS MEN
KEEP GOING
WE CAN'T TAKE CARE OF OUR OWN
CHAMBERS OF COMMERCE**



Why compare to Great Depression?

- Extreme prohibition on exit
 - * unlike 1990s crises
- Conventional wisdom misguided
 - * *Golden Fetters* (Eichengreen 1992)
- Creditor perspective favours deflation
 - * then: France now: Germany

Why compare to Great Depression?

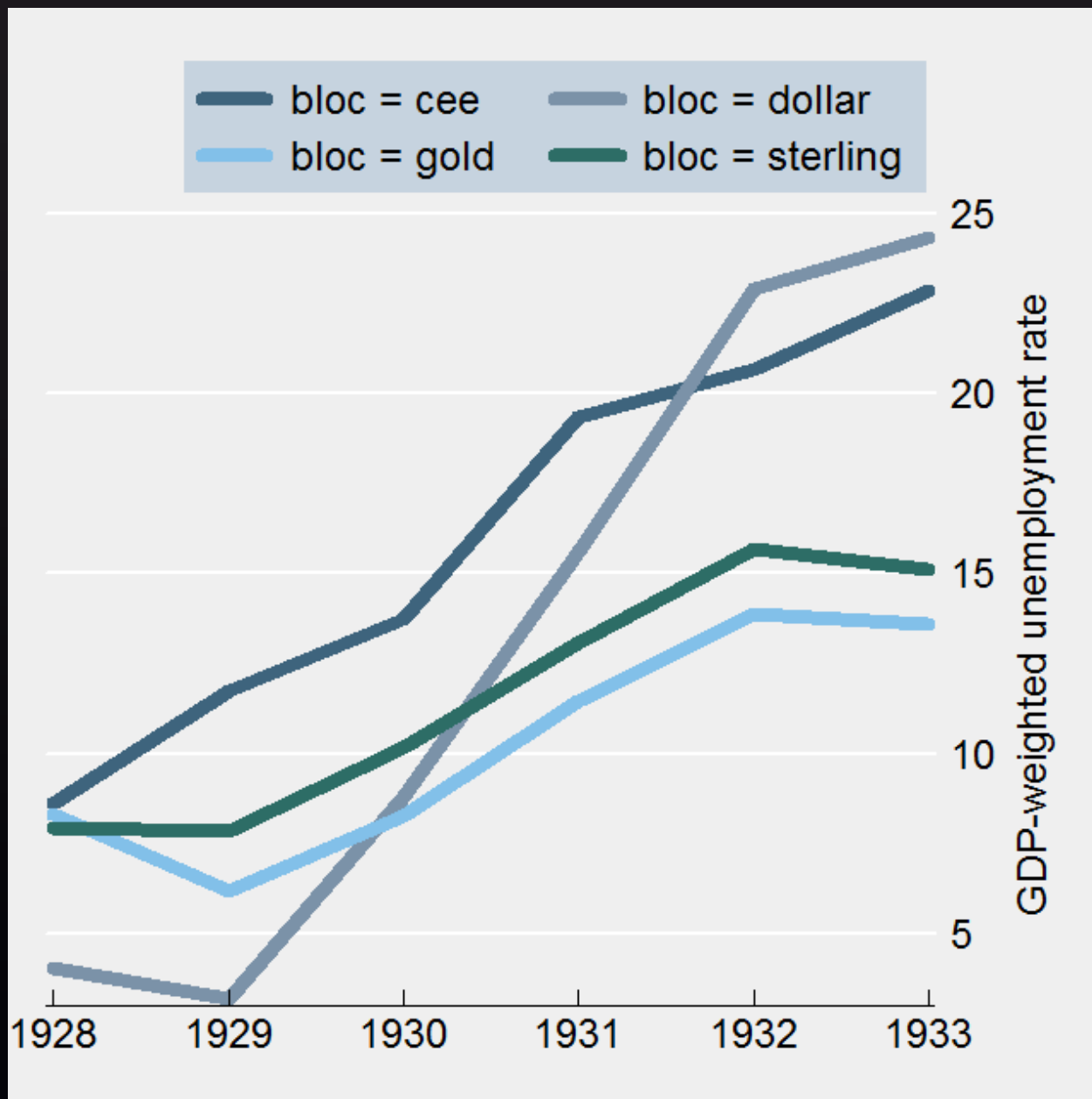
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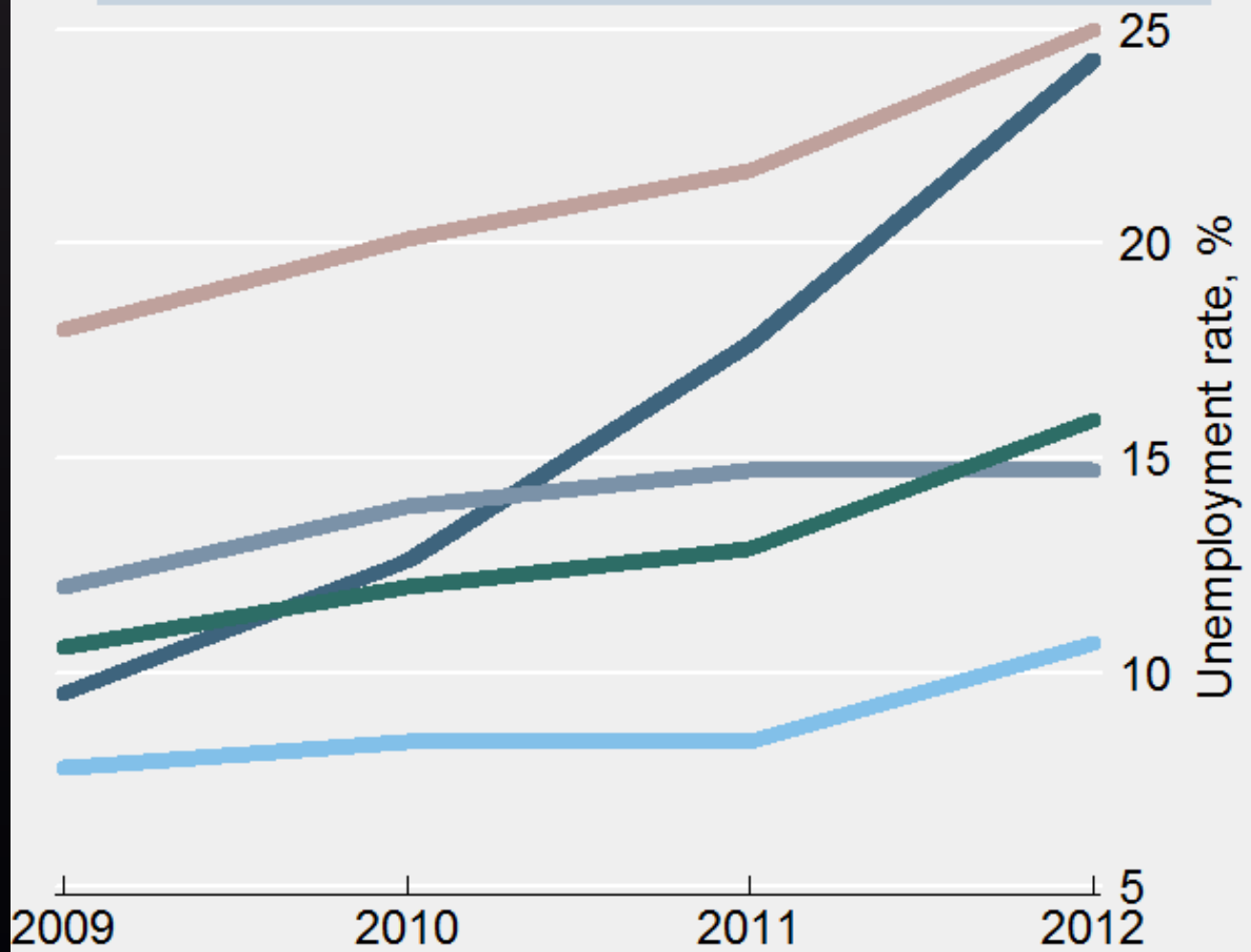
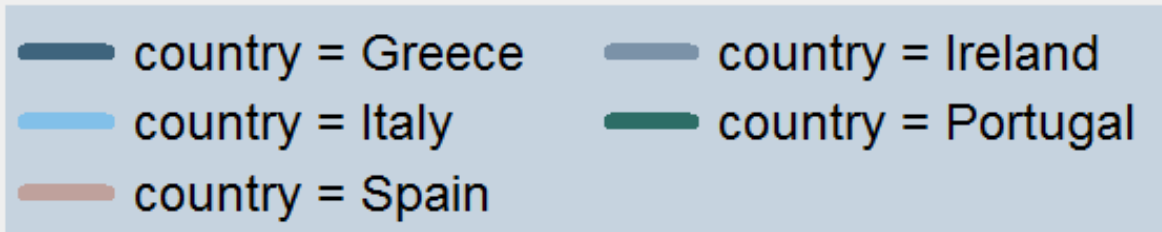
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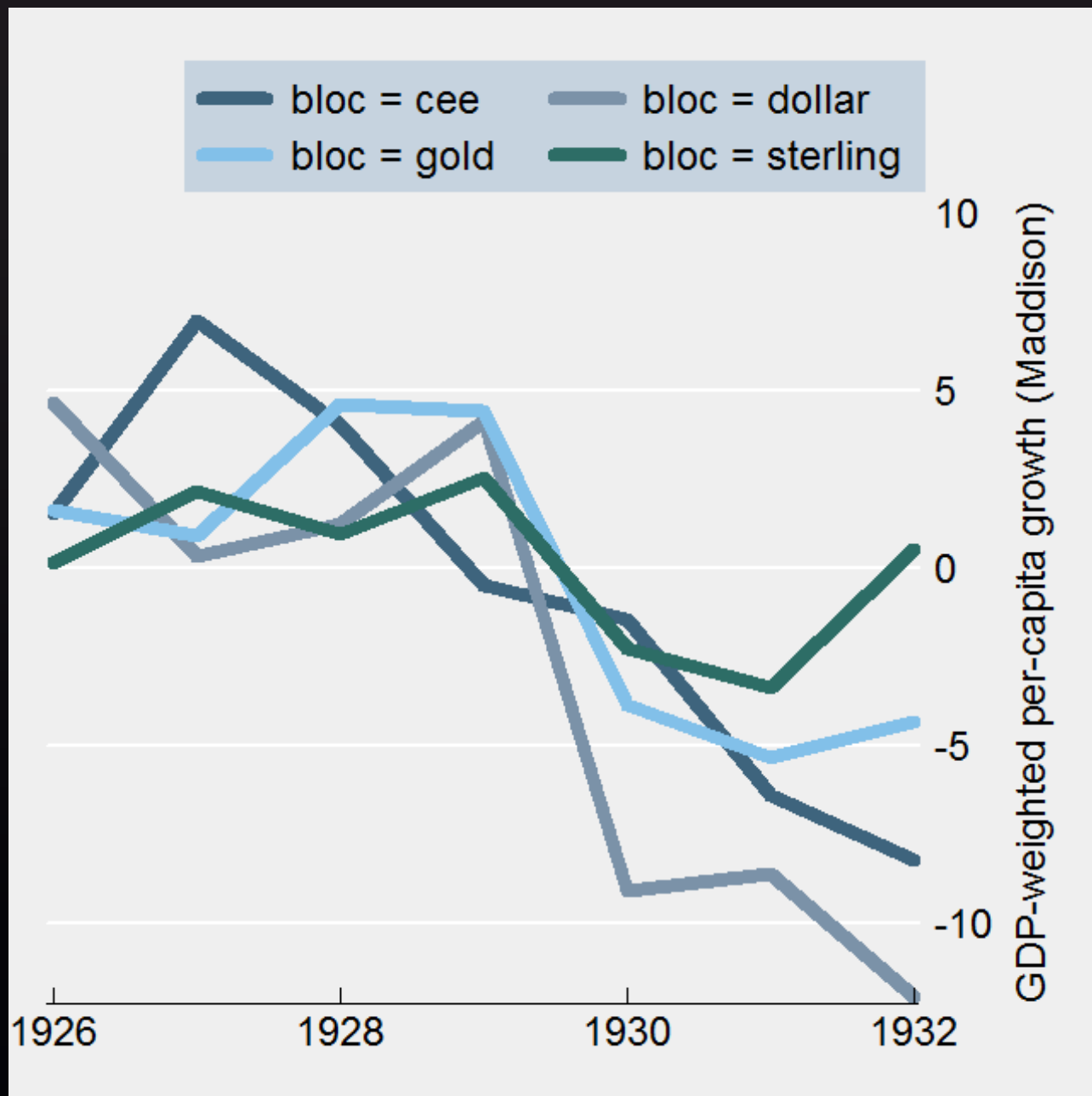
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"The simple formula of increasing productivity by wage reductions and yet further wage reductions offers no solution. The purchasing power of the population would be more and more contracted by such a process, and productivity most seriously damaged..."

Dr Heinrich Brüning, quoted in *The Economist* (1931 July 01)

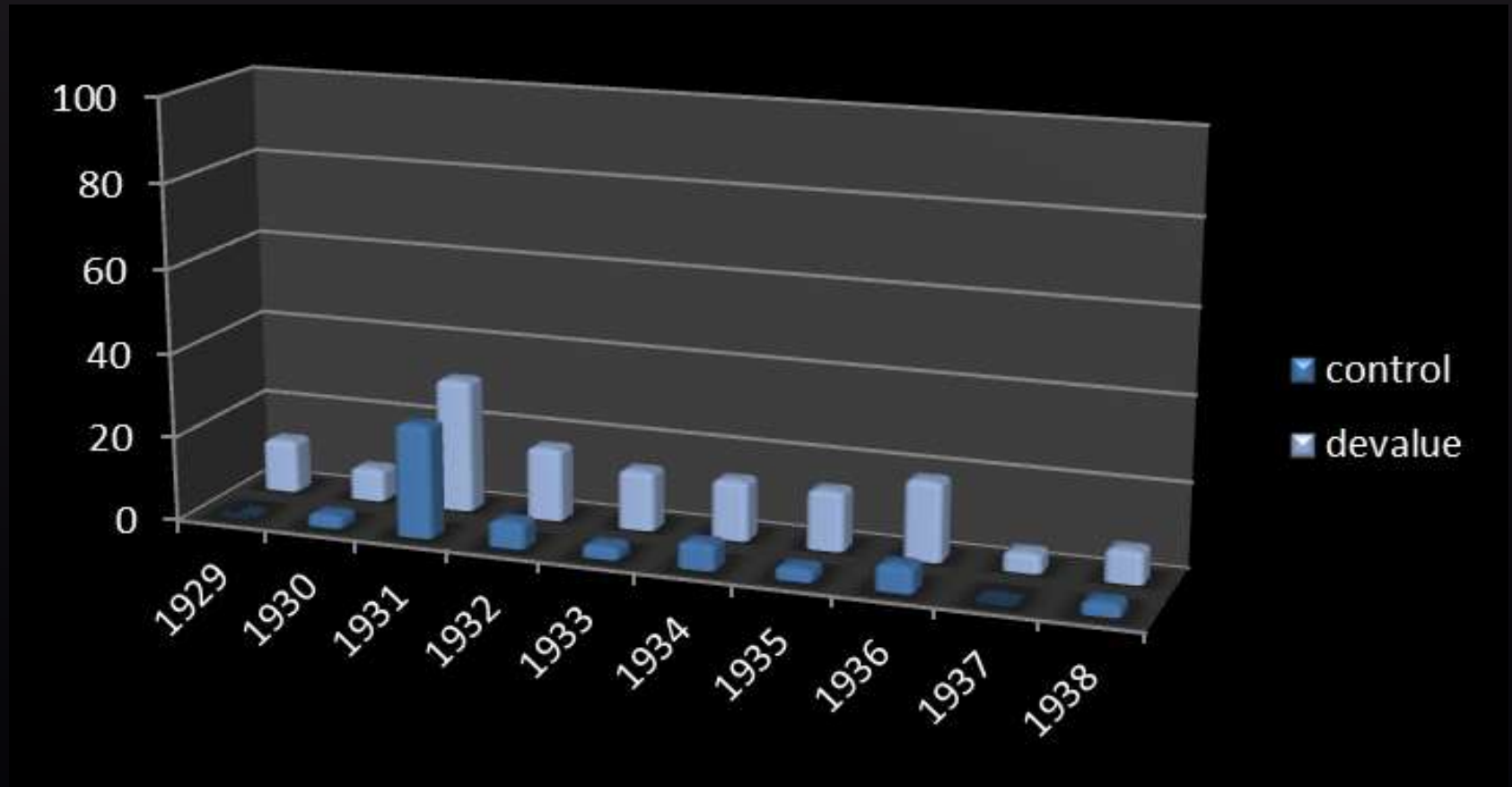
Policy paths in Great Depression

Policy paths in Great Depression



Exchange control vs devaluation – year of incidence

% of 63 countries reported in League of Nations 1938/1939*

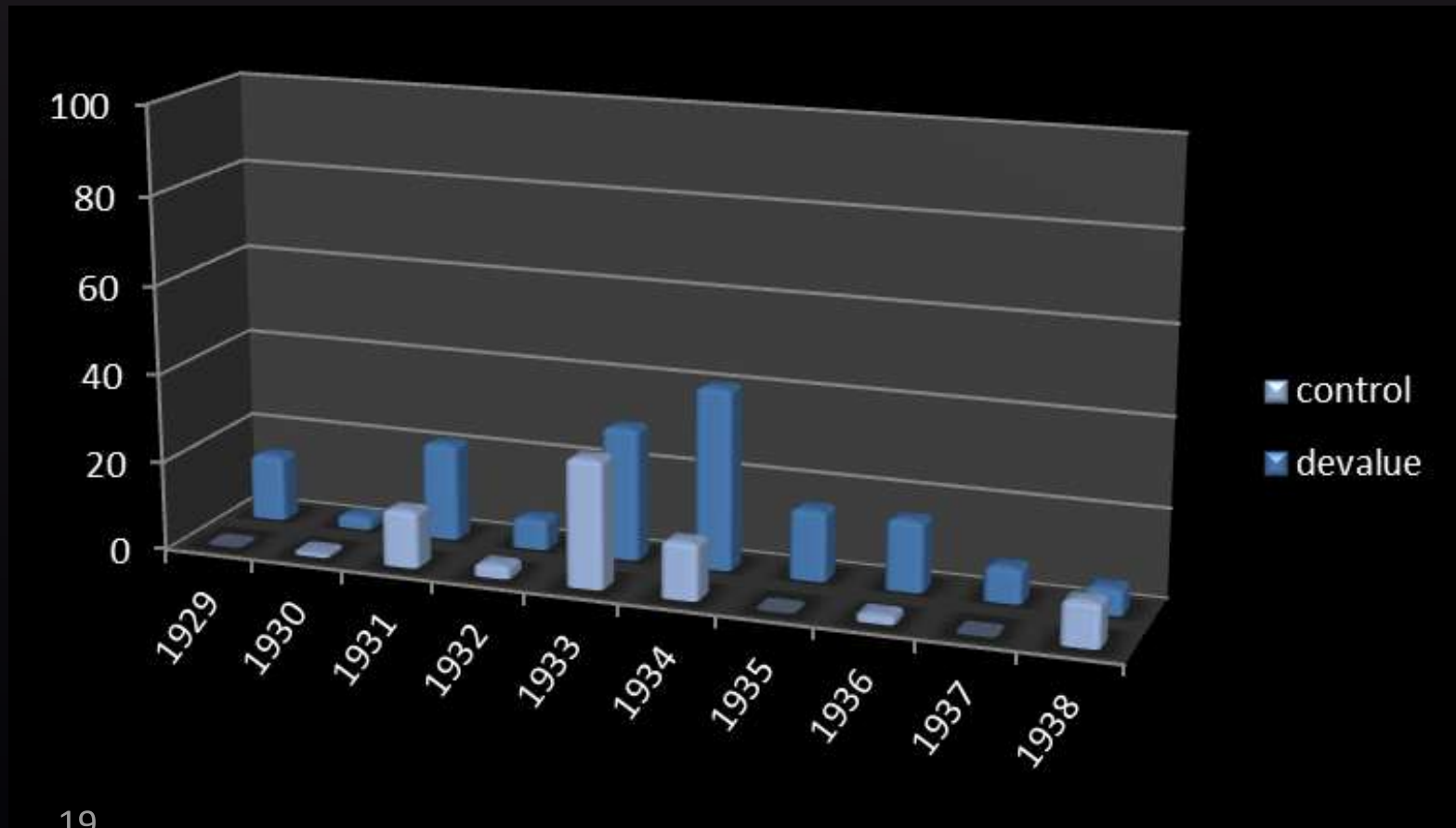


18

* control =1 if impose exchange controls and no devaluation;
devalue =1 if gold std official suspension and/or depreciation and/or gold parity change

Exchange control vs devaluation – year of incidence

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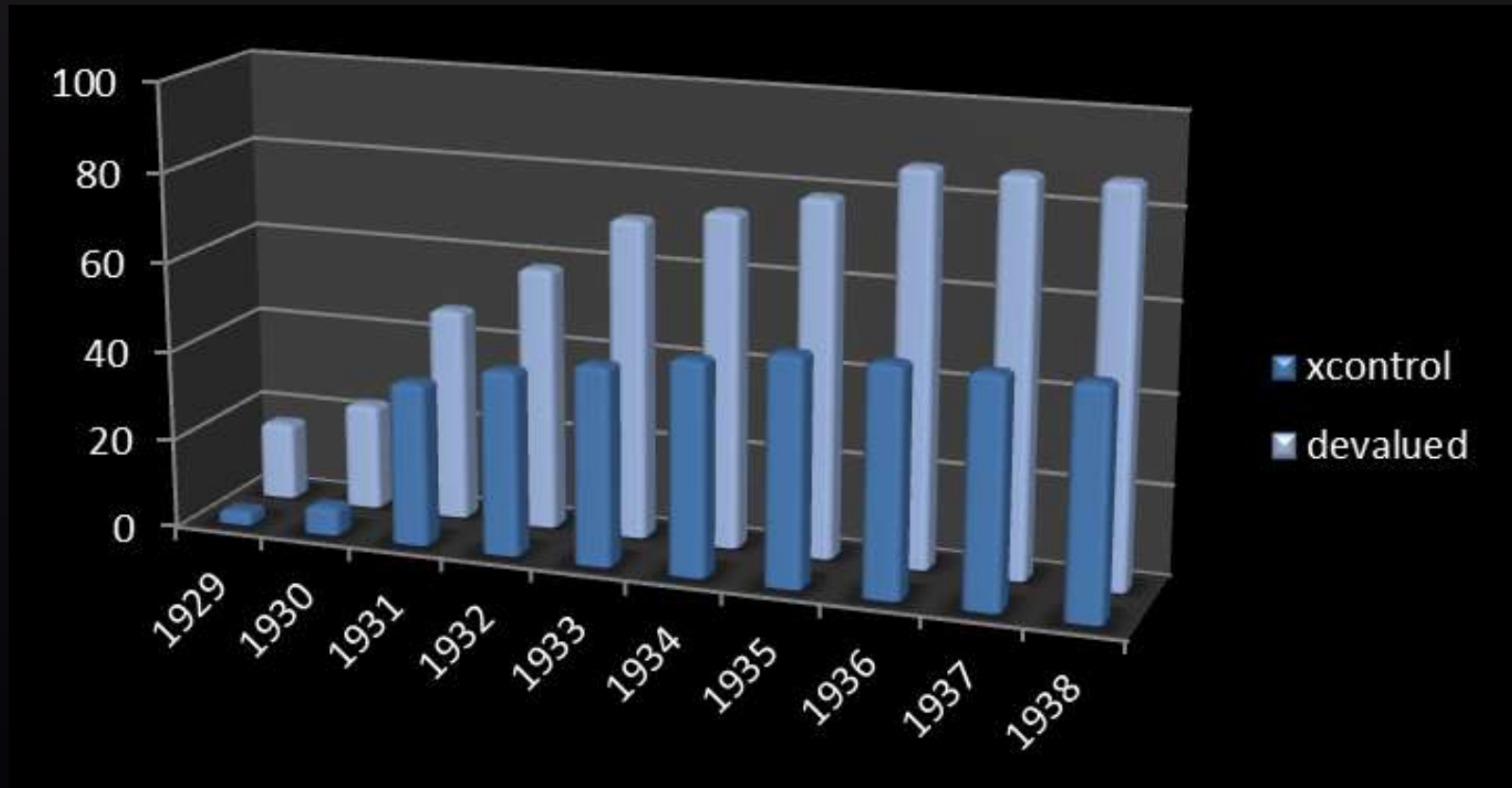


19

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Exchange control vs devaluation – cumulative

% of 63 countries reported in League of Nations 1938/1939*

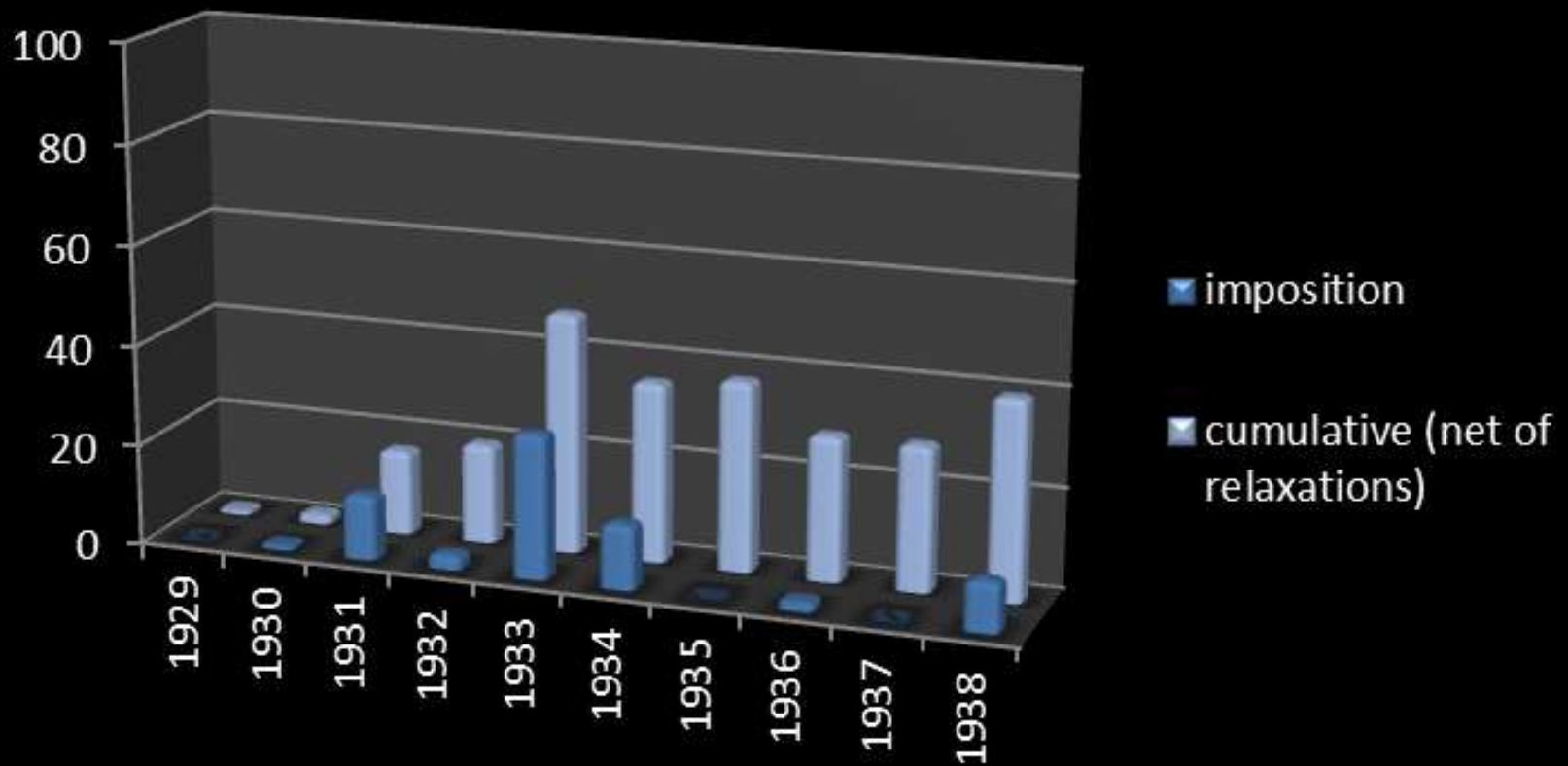


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* xcontrol and devalued are accumulations of 'control' and 'devalue' variables on previous slide

Exchange control – cumulative vs incidence

% of GDP of 63 countries reported in League of Nations 1938/1939



... in 1935 ... the outside world would have generally welcomed a certain measure of devaluation in France and Germany in preference to the alternative policies of deflation and import quotas in France and drastic exchange controls in Germany.

Nurkse 1944, 224

Under these conditions many approaches to the problem aimed at immediate restoration of the international gold standard and removal of trade restrictions and discrimination were more concerned with the outward manifestations than with the basic causes of disorder.

Lary 1943, 182



$$q = E \frac{P}{P^*}$$

q is the real exchange rate

E is nominal exchange rate (e.g. 1.55 \$/£)

P is the domestic price level

P^* is the foreign price level

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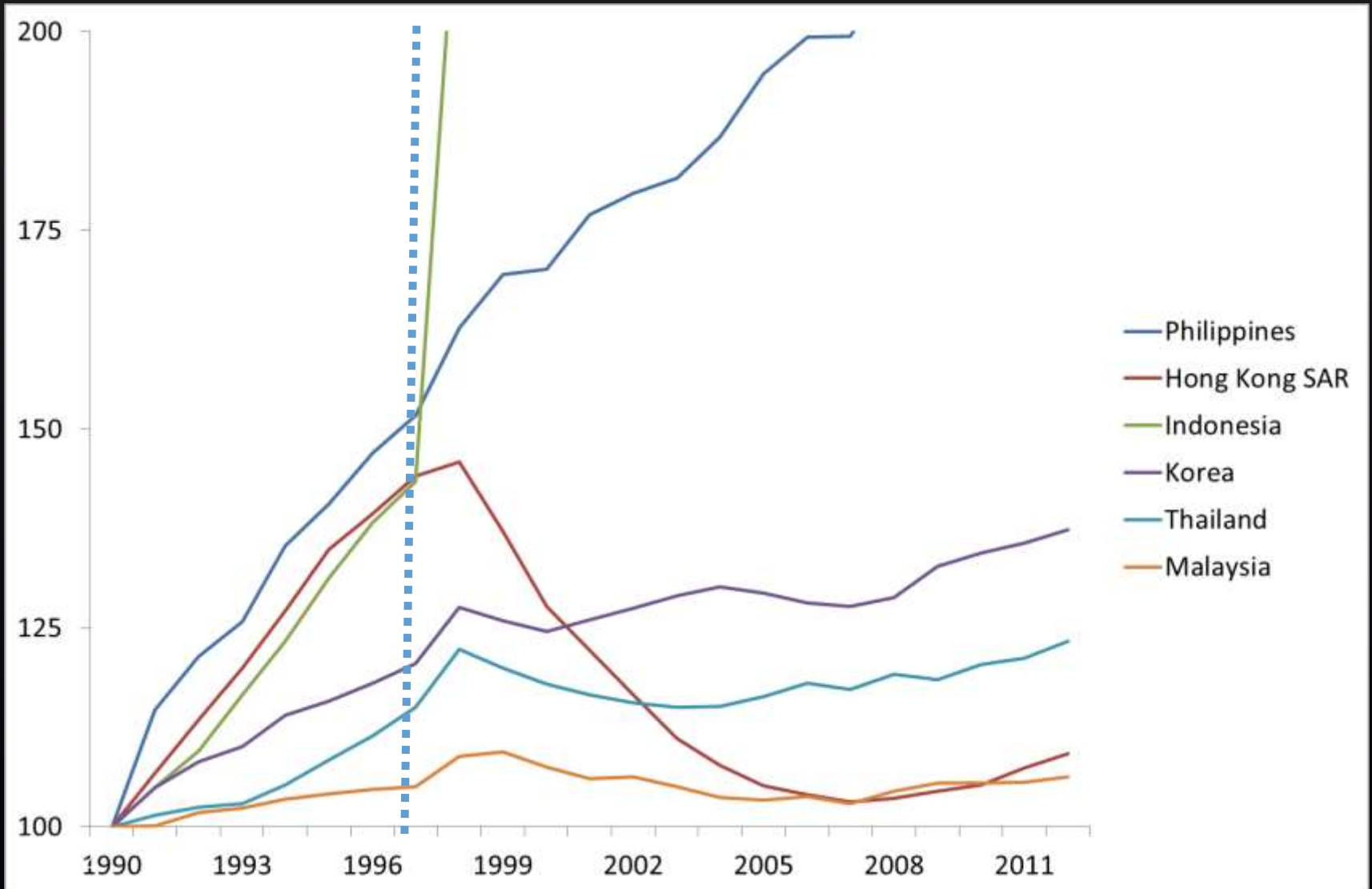
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real-effective exchange rate, 2000=100

	May 2013
Ireland	120
Greece	117
Spain	115
Portugal	108
Italy	108
UK	80

CPI relative to USA



Country Rankings

Tweet 661 +1 102



#1 Hong Kong

Hong Kong's economic freedom score is 89.9, making its economy the freest in the 2012 Index. Its overall score is 0.2 point higher than last year, with improvements in freedom from corruption and the control of government spending partially offset by a small decline in monetary freedom. Hong Kong is ranked 1st out of 41 countries in the Asia-Pacific region.

READ MORE ABOUT THIS COUNTRY

RULE OF LAW		LIMITED GOVERNMENT		REGULATORY EFFICIENCY		OPEN MARKETS	
Property Rights	90.0 —	Government Spending	91.0 ^	Business Freedom	98.9 ^	Trade Freedom	90.0 —
Freedom From Corruption	84.0 ^	Fiscal Freedom	93.1 v	Labor Freedom	86.5 ^	Investment Freedom	90.0 —
				Monetary Freedom	85.8 v	Financial Freedom	90.0 —



Embed This Slideshow

FREE (100-80)

WORLD RANK	COUNTRY	OVERALL SCORE	CHANGE FROM PREVIOUS
1	Hong Kong	89.9	+0.2 ^
2	Singapore	87.5	+0.3 ^
3	Australia	83.1	+0.6 ^

WORLD RANK	COUNTRY	OVERALL SCORE	CHANGE FROM PREVIOUS
4	New Zealand	82.1	-0.2 v
5	Switzerland	81.1	-0.8 v

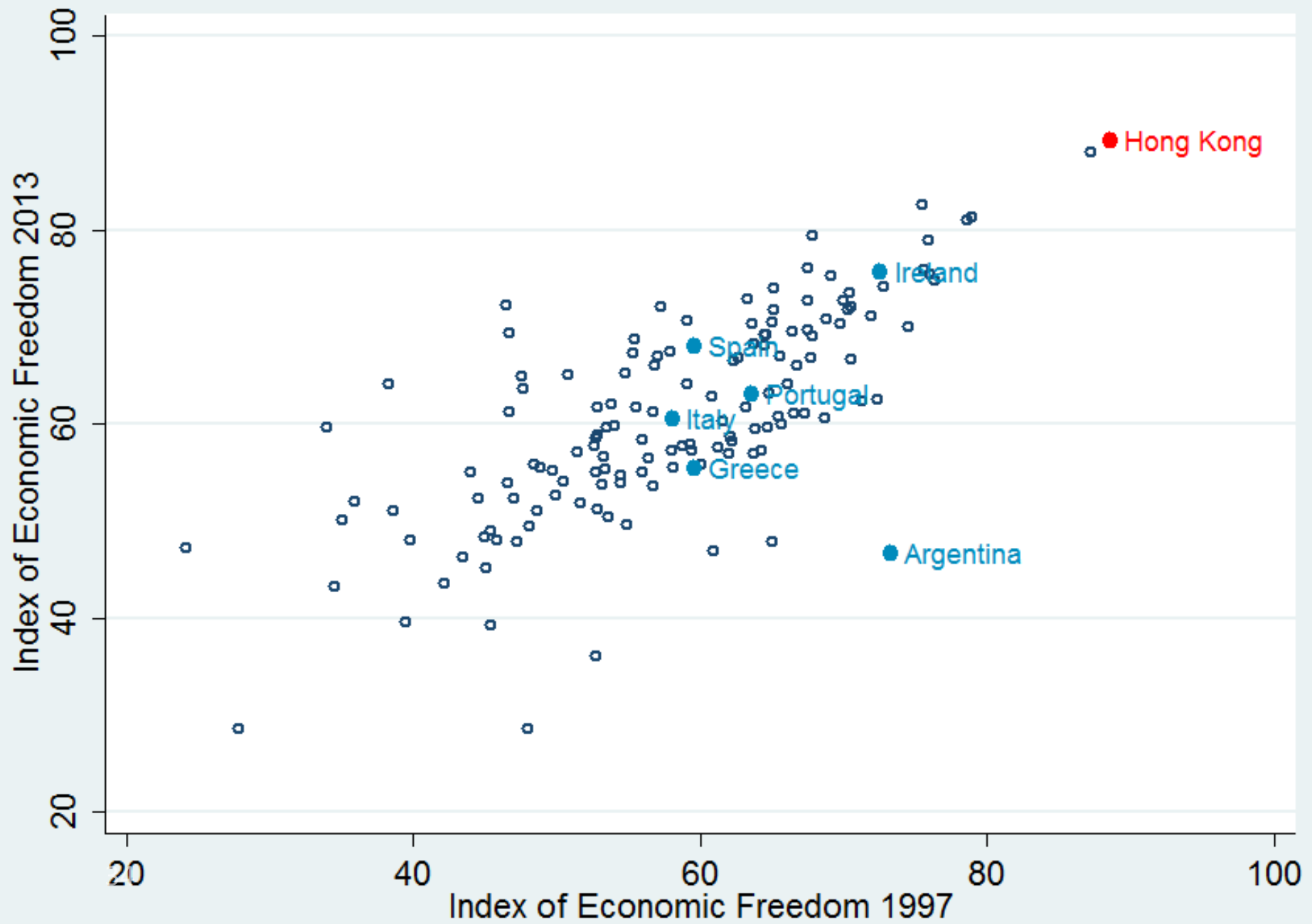
Create a Comparison Chart

Compare two countries using any of the measures in the Index.

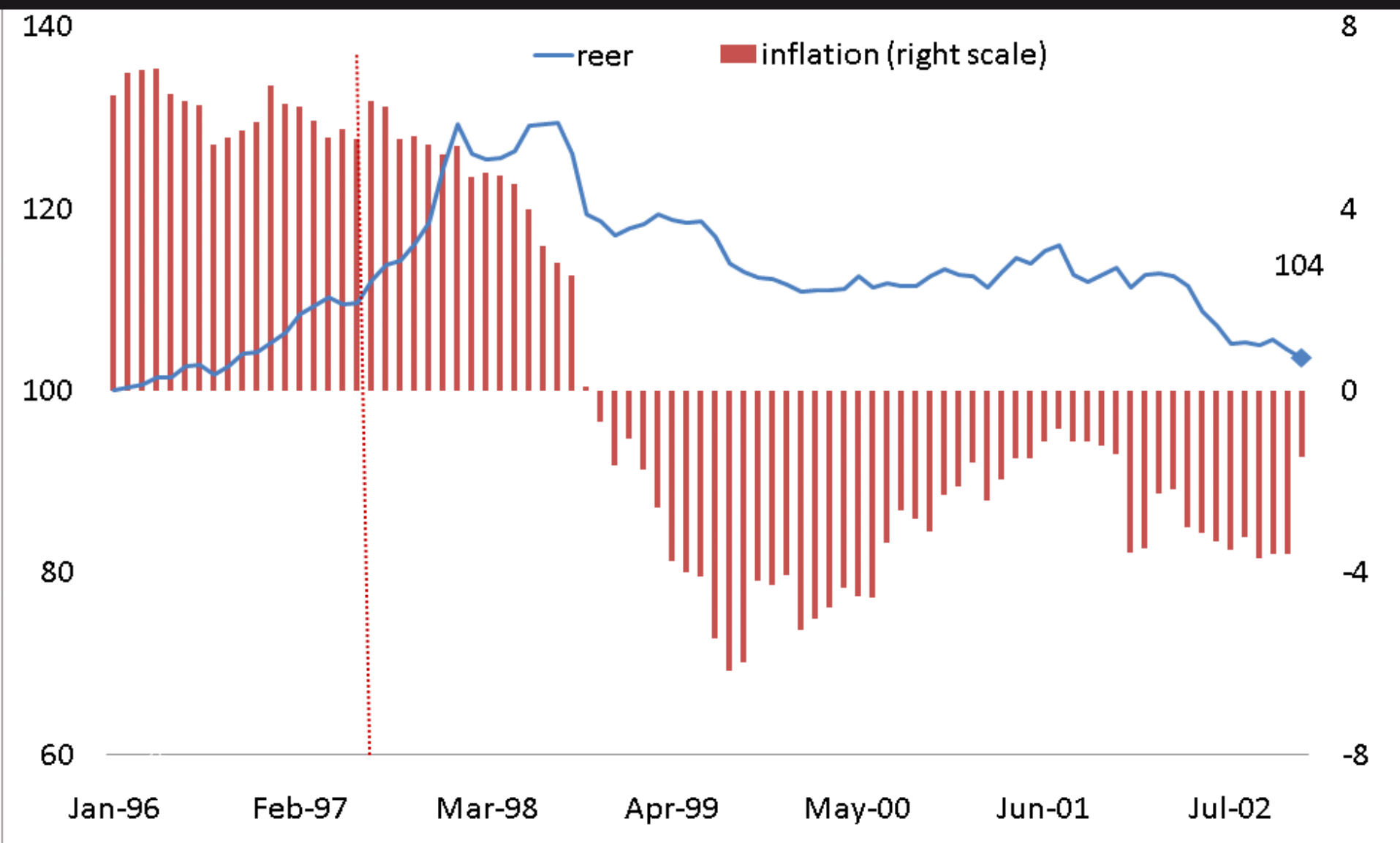
Hong Kong

vs

United States



Hong Kong



$$q = E \frac{P}{P^*}$$

← troika

← Krugman

q is the real exchange rate

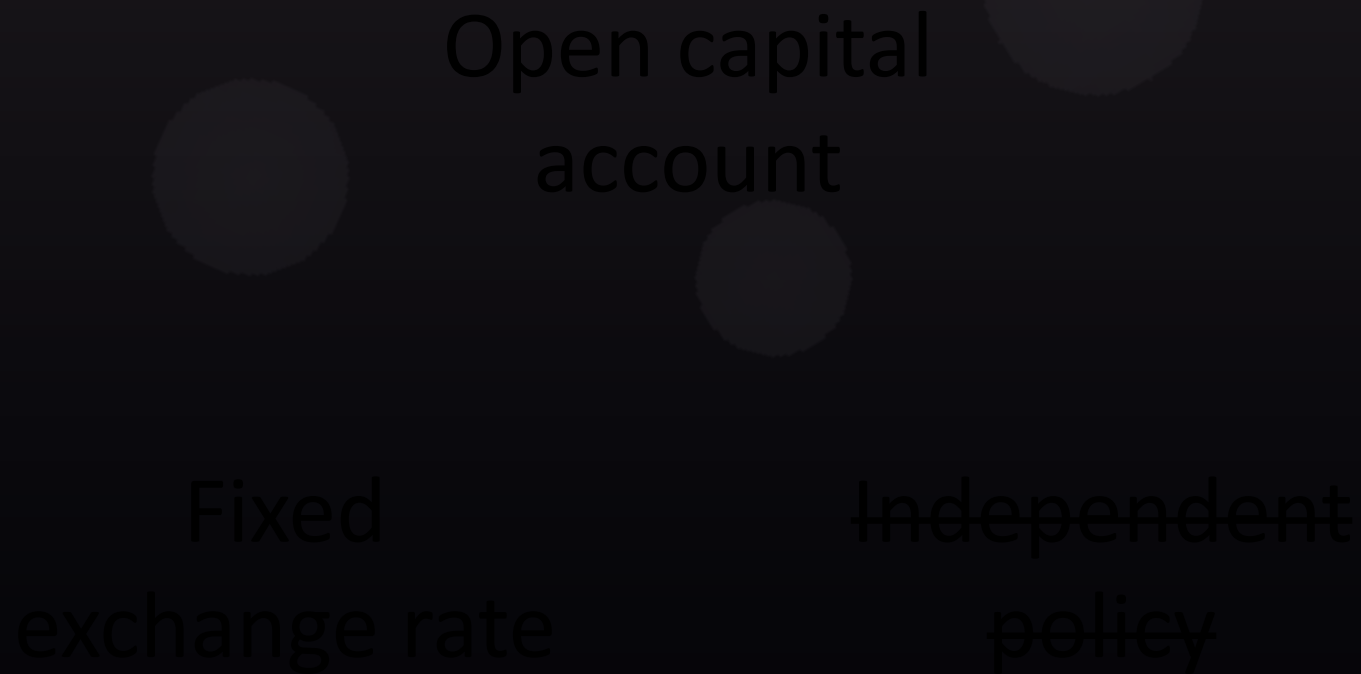
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Policy trilemma



Policy trilemma

Open capital
account

Fixed
exchange rate

Independent
policy

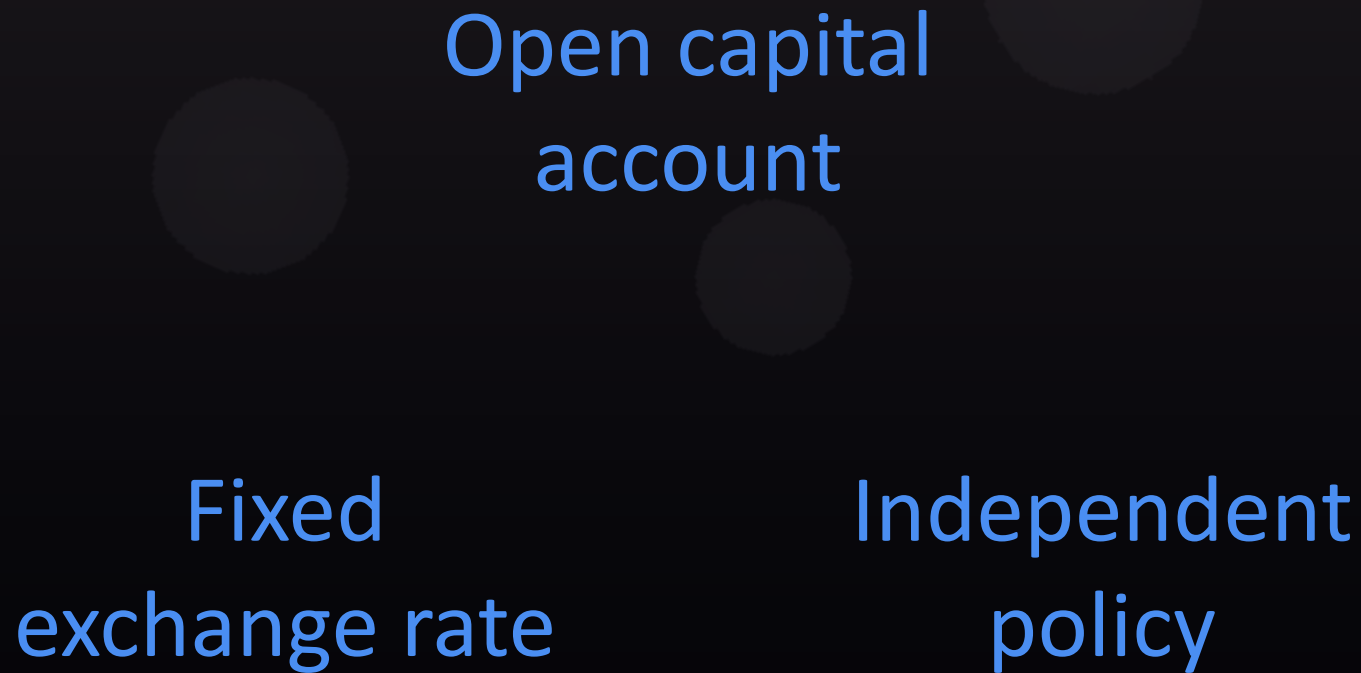
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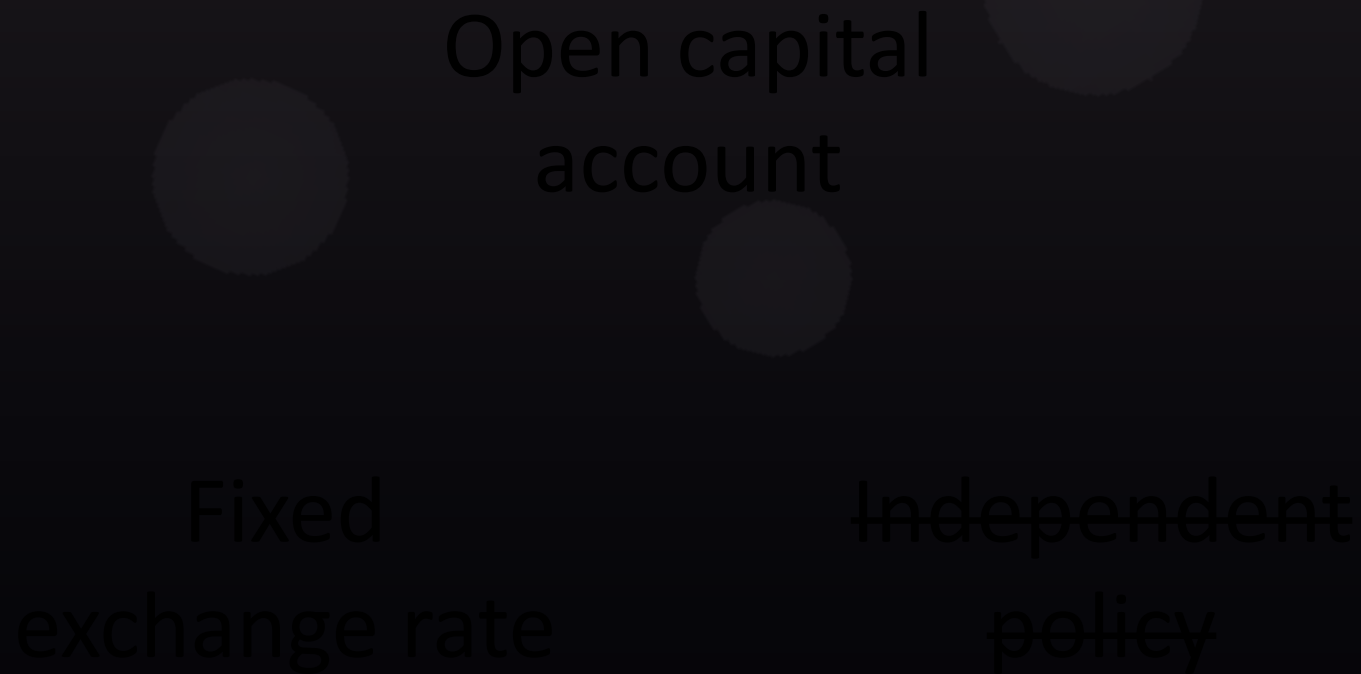
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Policy trilemma



Policy trilemma: EMU today



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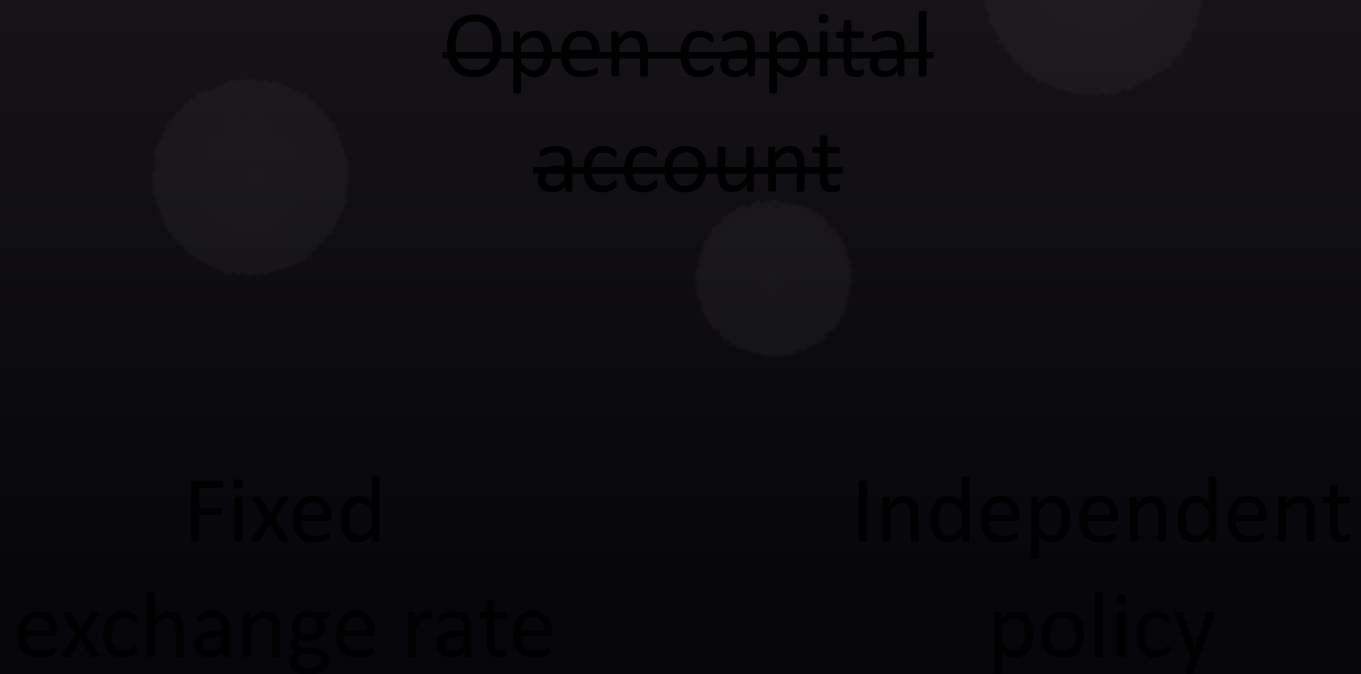
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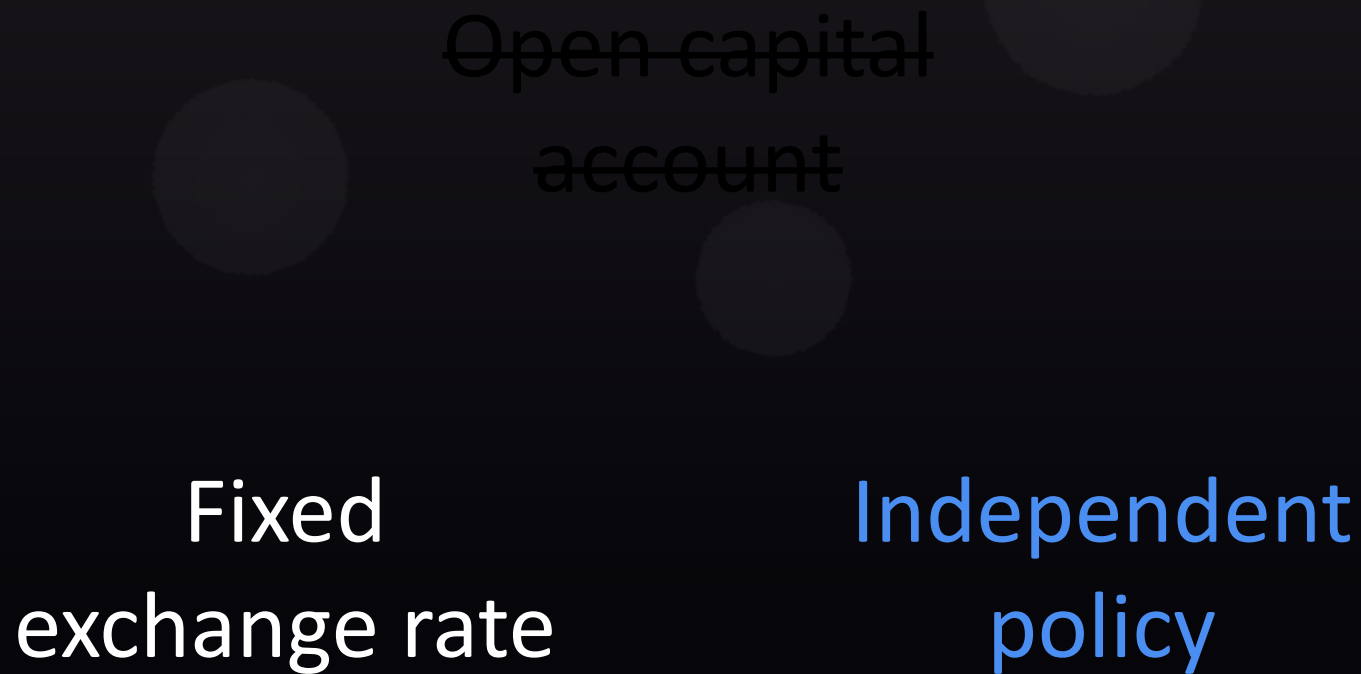
Policy trilemma: EMU tomorrow



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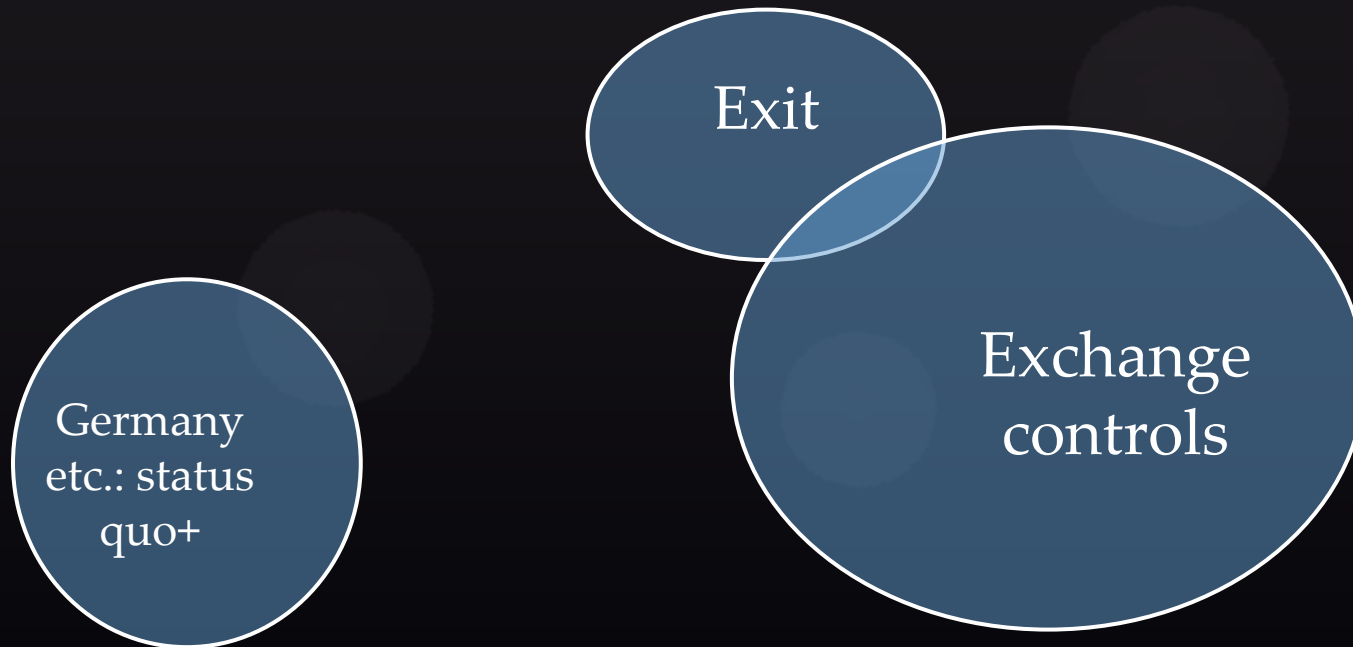
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Heterodoxy ahead

Policy paths for euro-area

Heterodoxy ahead



Heterodoxy ahead

- Friendly *cf* Bretton Woods?
- Unilateral *cf* 1930s?

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Is breaking up so bad?

— GDP in PPP — REER

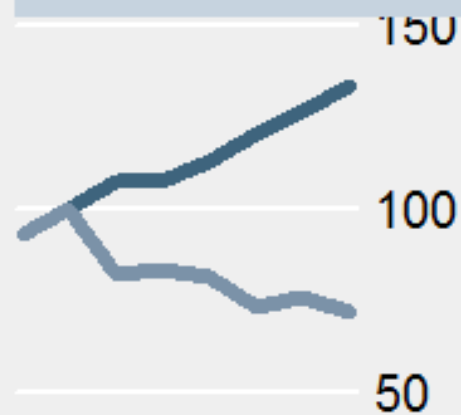
Indonesia



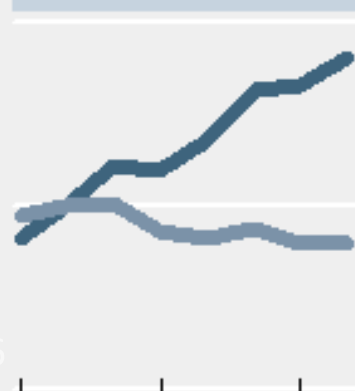
Malaysia



Philippines



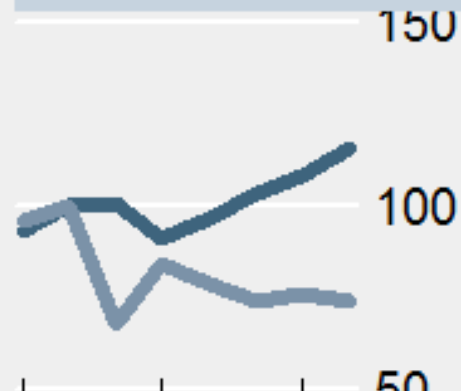
Singapore



South Korea



Thailand



— GDP in PPP — REER

Cyprus

Greece

Ireland

150

100

50

Italy

Portugal

Spain

150

100

50

57

2006 2009 2012

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East Asia crisis (1997-98)

- Extreme fear of floating
- Balance-sheet crisis and deep recession
- Recovery with depreciated real exchange rate
- Euro-breakup: cleaner?

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- Great Depression suggests “first best” policy is devaluation
- If “first best” not attainable, then heterodoxy is coming
- We (e.g. UK, other EU) can play a role in encouraging Brussels to create a “safe space” for exit/heterodoxy

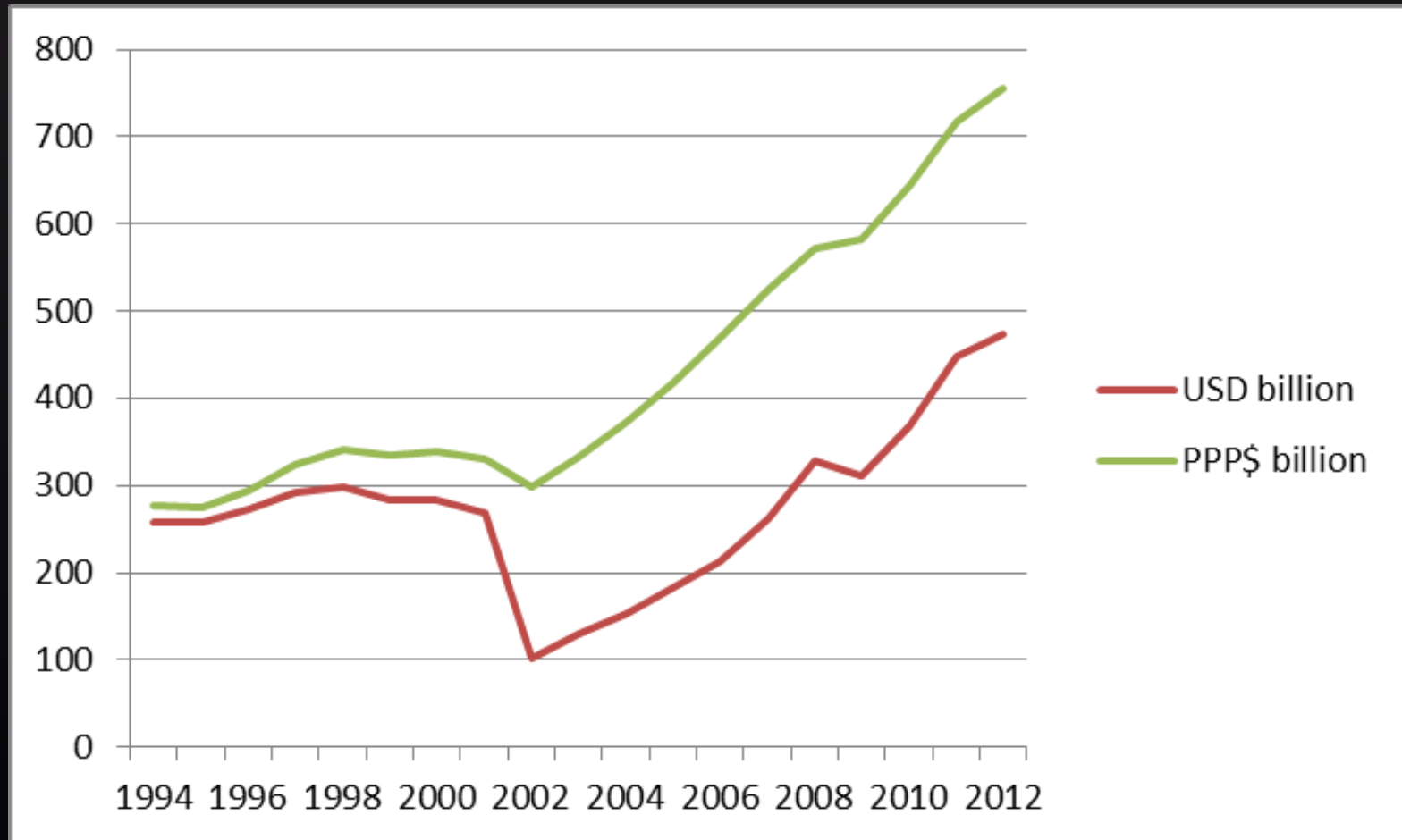
The world economy did not begin to recover when [elites] changed their minds; rather, recovery began when mass politics ... removed them from office.

Eichengreen and Temin 2000, 185

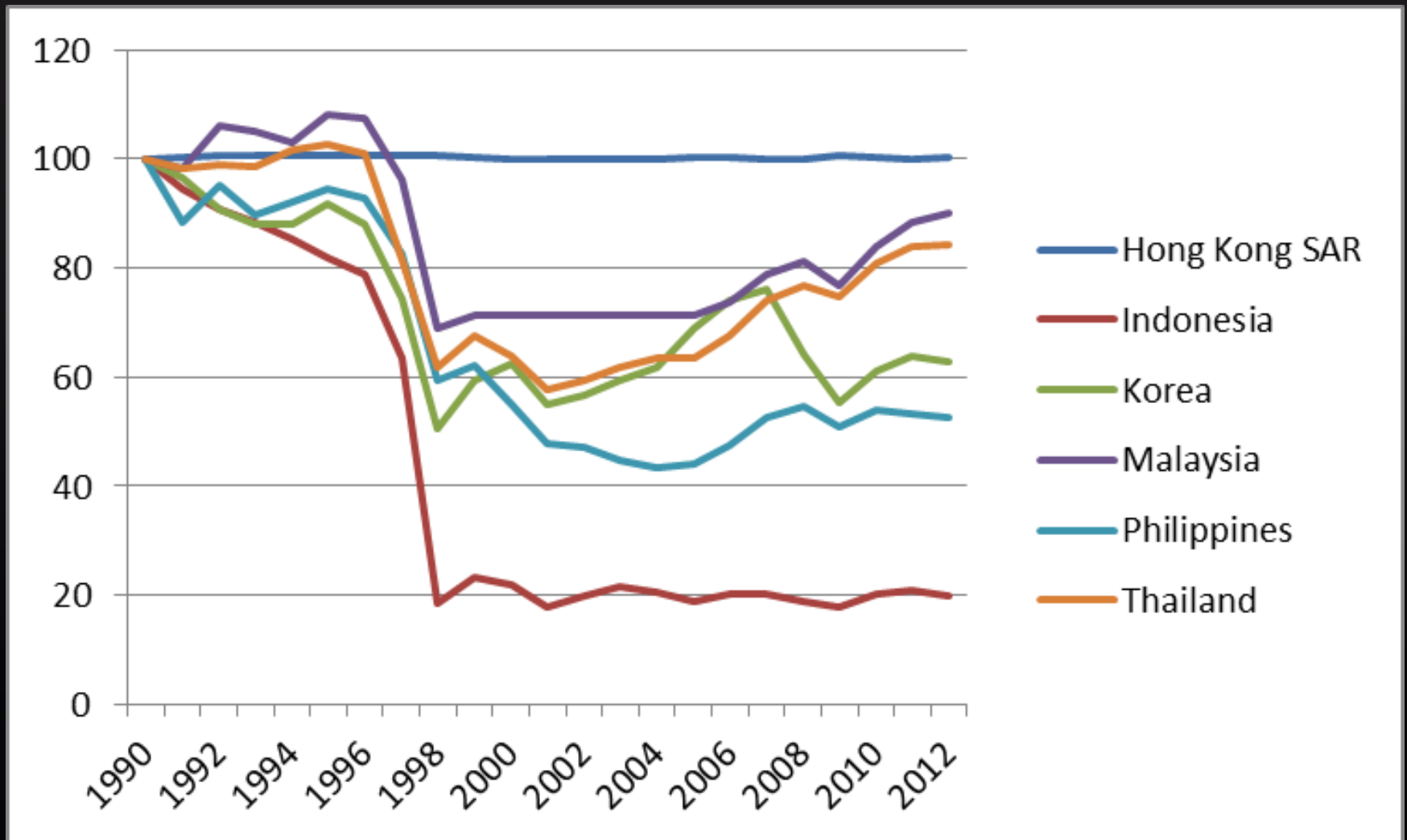


extra info

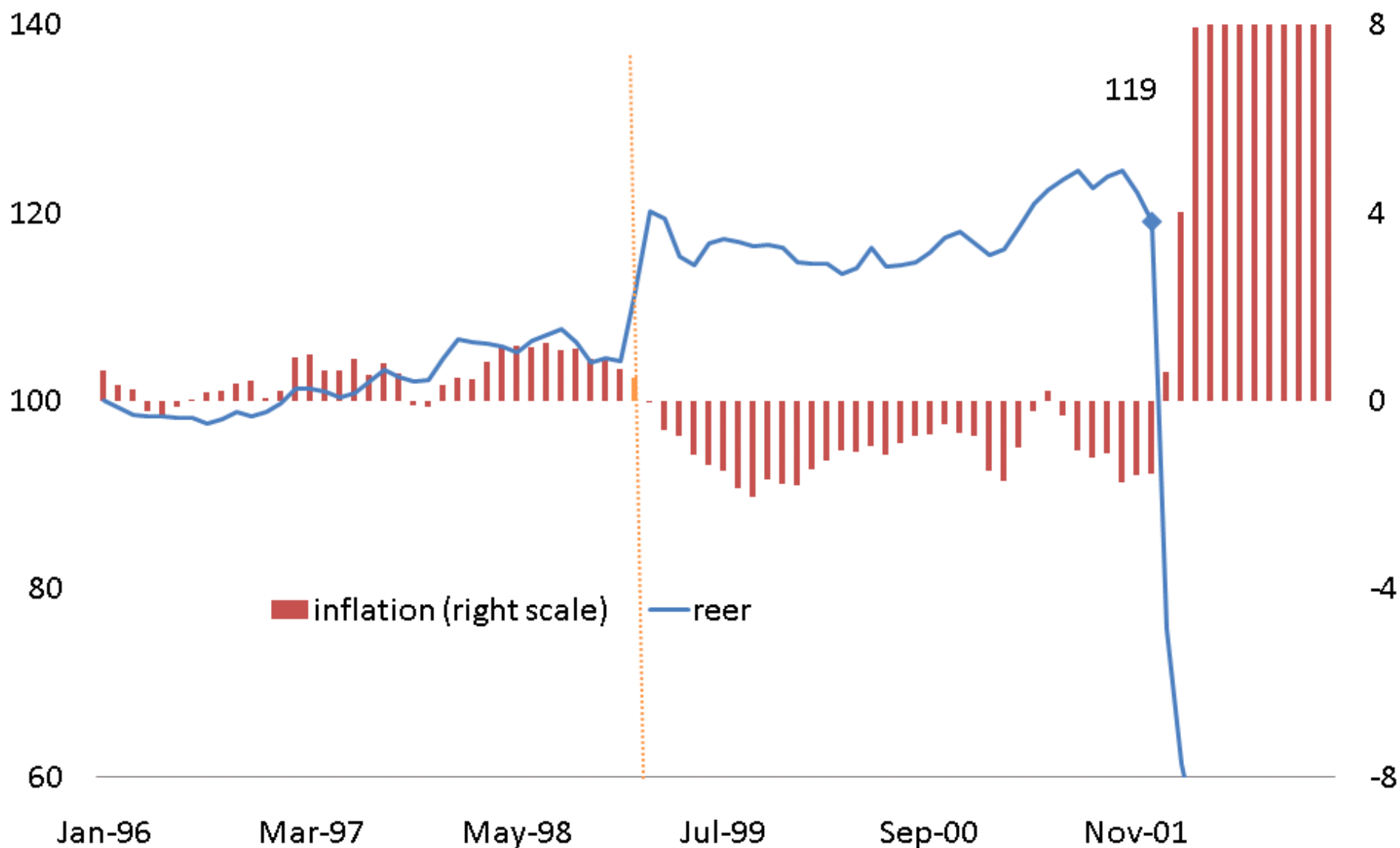
Argentina: GDP



Nominal exchange rate (vs USD)



Argentina



"In practice, apart from its inherent disadvantages, income deflation and unemployment as a means of adjusting the balances of payments is liable to encounter insuperable social resistances. In these circumstances the only remaining alternative to exchange adjustment in cases of chronic overvaluation is a policy of import restrictions."

Nurkse 1944, 224

"The failure of economic activity to stabilize reflected not the rise of trade barriers but the tendency of supplies of money and credit to fall more rapidly in gold standard countries than they rose in countries with depreciated currencies."

Eichengreen 1992, 290

"The strength of the French situation, it is universally recognised here, is that France possesses an abundance of capital available with which to help Germany, that her present commitments in Germany are enormously less important than those of Great Britain or the United States, and that she stands less risk of direct loss than any other Power from another German collapse."

The Economist's Paris correspondent, 27/7/31