1948-2018: FROM THE FREE-TRADE VISION TO PROTECTIONIST ATTITUDES

1. INTERNATIONAL ECONOMIC POLICIES: INSTITUTIONAL FOUNDATIONS

The institutions that have governed international and national economic policies after the II World War and still now govern them were initially devised before the end of the conflict. In fact, from the Bretton Woods (USA) agreements of 1944 the International Bank for Reconstruction and Development (IBRD), usually called World Bank, and the International Monetary Fund (IMF) were born, as institutions aimed at favouring international cooperation in the economic, social and political field.

At least until 1971, keeping fixed – but adjustable - exchange rates around a parity was required by the Fund until the early Seventies, even if some rules had to be obeyed tending to avoid frequent and diffuse changes in parities. These were admitted only to overcome deep and persistent imbalances of the balance of payments. To this end member countries could also implement some kind of capital movements control, since the Fund did not assist them to finance balance of payments imbalances due to capital exports. After the restoration of external convertibility in 1958, rapid shifts of capitals at an international level became possible and from the 1960s international capital movements increased. The IMF decided to finance them in order to protect the currencies that had been mostly hit, even if this was beyond its statutory obligations.

Also difficulties were faced in imposing re-equilibrating policies to both countries with persistent deficits and countries having persistent surpluses, even if the burden of adjustment was on both types of countries, as suggested by Keynes, who wanted to avoid a deflationary environment, which would have been the case if the burden had been imposed on deficit countries only.

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In addition to the borrowing facilities available from the IMF to face temporary balance of payments imbalances, also long-term financing was (and still is) available to fund specific investment projects from the World Bank, at the usual banking conditions. The country asking for funding must obey some conditions, including measures restricting demand, market liberalization, etc. We will say more on that below, when we deal with the *Washington Consensus*.

The World Bank has, in fact, the mission to promote public and private investment in less developed countries and regions, with the aim to ease their living conditions. This task is performed by financing this investment and providing technical assistance for projecting and executing them and, more generally, for programming public action.

The Bank’s guidelines in choosing the fields of investment to give priority to and financing conditions have changed over time. In the Nineties growth was favoured through free trade policies aiming at increasing the role of markets, as suggested by disputed interpretations of growth and development in some countries, as those of South-East Asia. The countries recipient of funds were induced to ‘adjust’ their economies, in particular:

- by removing alleged obstacles and ‘distorsions’ in goods, labour and financial markets;
- privatizing large shares of the public sector of their economies and drastically reducing public deficit;
- liberalising goods and capital movements;
- adopting flexible exchange rates.

Specific insistence was laid on adjustment of internal conditions of markets to the international ones, i.e., on the integration of the economic system in the international context.

These measures go under the name of *Washington Consensus*, a term indicating an identical stance of the US Treasury, the Word Bank and the IMF, institutions all located in Washington. According to many economists, the policies suggested or imposed by the World Bank and the IMF to some countries, such as Chile, Mexico, Turkey, East-European countries, South Korea, have often been too expensive, in terms not only of equity, but also of excessive and prolonged reduction in the growth rate of income and employment. Certainly, privatization and liberalization, often implemented in the absence of true markets (as in the case of East European countries), and the exposure, often abrupt, of economies not infrequently vulnerable to the
conditioning and shocks deriving from international markets, particularly the financial markets, have produced situations of crisis that in some cases were heavy, raising the costs of adjustment. The policies advocated by the World Bank – and, to some extent, also those of the IMF – tending to favour privatization and liberalization have recently been questioned by their managing bodies.

In addition to the IMF and the World Bank, the institutions devised at the end of the II WW at Bretton Woods to implement international economic cooperation included also the International Trade Organization. This Organization, which aimed at ensuring cooperation in the field of trade policies, should have been instituted as an UN Agency, but this was never done, due to the opposition of the USA and other countries to the 1948 international agreement from which it derived. It was substituted by an agreement signed in Geneve in 1947 that should have been provisional, but has instead lasted until January 1, 1995, the General Agreement on Tariffs and Trade (GATT). This has eliminated quantitative restrictions such as quotas and other measures having a protectionist flavor and trade discriminations implemented by a country, e.g., through preferential tariff agreements with a foreign country. In addition, it has stabilized and progressively reduced tariffs, through subsequent sessions of multilateral treaties, the last one having been the Uruguay Round, closed in 1993.

Since January 1, 1995 the World Trade Organization (WTO) has begun to operate. It should be the place where multilateral trade negotiation and discussion of the different positions (also with reference to the implementation of the trade agreements stipulated in the past) take place. Then, it takes on the role of the organization devised at Bretton Woods. The WTO maintains the principles and many rules of the GATT, but has a more pronounced institutional feature, as it has a stable structure and foresees the almost automatic resolution of conflicts over trade between the member countries, which is performed by one of its branches, the Dispute Settlement Body.

Other international organizations, as the FAO, the ILO, the BIS, the OECD, play an important role for international cooperation. In addition, a number of regional organizations of countries, such as the EU – and, within it, the EMU – operate.
2. INTERNATIONAL ECONOMIC POLICIES AND THE NEED FOR COORDINATION

2.1. The Inspiring Principles and Practical Applications

As to the principles inspiring the IMF, one can say that the institutions born at Bretton Woods were the expression of a tempered liberism, moderated by Keynesian thought.

The principle of free-trade was certainly the cornerstone that inspired the solutions adopted for the international setting. One can find it in the liberalization of exchanges of goods and in the multilateral approach we mentioned before. However, Keynesian thought implanted on this free-trade basis a series of public policies, which tended prevalingly to ensure maintenance of full employment and coordination of economic policies. This thought was behind the symmetry required for policies tending to redress the balance of payments imbalances by both deficit and surplus countries. The deflationary policies enacted by the former in order to reduce their deficit would be less heavy, if balanced by policies of an opposing sign implemented by surplus countries.

For the same reason limits were imposed of free capital movements, as we will see below. In fact, complete freedom could translate in a further root of asymmetry, difficult to cure. In addition, similar arguments could be referred not only to international financial markets, but also – more generally – to all short-term financial markets.

For them Keynes’s critique holds according to which speculation operates as in a beauty contest where wins he who designates not the prettiest faces, but who understands the prevailing preferences of the participants to the contest, thinking of their idea of beauty as to the face. Obviously, reasoning of a higher order of magnitude, of the kind ‘everyone thinks of others thinking that, etc.’, are possible, leading to indeterminate outcomes. More recently, the enormous size of international capital movements (with respect to the limited foreign exchange reserves of the various countries and the funds available through multilateral organisations), the high speed of their shifts, evidence of ‘herd behavior’ (which takes place when most agents behave like others that they think more informed) – which replicates the mechanisms acting in a beauty contest – increase the likelihood of self-fulfilling expectations having scarce or no relations with fundamentals, i.e., with the essential features of the economic systems in question.
As to the historical antecedents of Bretton Woods, confrontation between the results in terms of the GDP and international trade obtained as an effect of the liberalization in the period of the first globalization and those of the protectionist policies implemented in the interwar period was valuable. The former led to a remarkable increase in international exchanges, while the latter had the opposite effect.

2.2. The Need for International Coordination

For both the IMF and other international institutions (in particular, those dealing with the barriers that may be implemented by the various countries) the need for international coordination derives from the necessity to avoid ‘races to the bottom’ by the various countries. In a world where, on the one hand, the competitive pressure has increased as an effect of transportation and communication progress and, on the other, the action of international organisations has succeeded in lowering the classical tariff and non-tariff barriers, a country can still strengthen its competitive position by exploiting its more permissive policies in terms of environmental, antitrust and other policies vis-à-vis foreign direct investment and transnational enterprises, social protection and tax policies.

For instance, in order to attract foreign investment, it can lower taxes applying to foreign companies, inducing other countries to do the same. More generally, similar attitudes can be taken for any possible object of regulation, especially in the case when a country suffers from backward conditions. A country can thus try at least to gain benefits in the short-run, even if to the detriment of itself and other countries in the long-run. In fact, it is clear that the permissive policies enacted by some countries can be offset by similar policies of other countries, tending to re-establish the initial conditions. The race to the bottom between national governments, while not solving the problems of more backward countries, would risk to downgrade public policies to levels and modes that limit an effective control of markets or their substitution.

The need for international coordination is clear. However, we must notice right now the limits of an international coordination of national economic policies that neglects the equity aspects in the international distribution of income and wealth, not only as a source of ‘distortions’, but also as true distortions to remove.
Safeguard clauses and the exceptions granted to LDCs in the implementation of the rule agreed on in the international fora recognize this specific status of such countries, which is necessary, even certainly not sufficient to allow them to increase their production, which needs complementary projects to strengthen the exporting capacity of LDCs to which various international public institutions have cooperated.

There are then two reasons underlying the policy attitudes worth of specific attention by the international institutions entrusted with supervision of international trade: the competitive pressure (together with the joint need to avoid a race to the bottom) and the state of backwardness of the countries that often engage in the policies mentioned.

3. THE OUTCOMES OF EXISTING INSTITUTIONS

3.1. A General Picture

A general picture of the indicators relative to the various aspects of the second globalization that allows us to compare it with the first globalization is offered by the following Table 1, which, however, stops at 2007 and thus neglect the effects of the economic crisis.

<table>
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<tr>
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<tbody>
<tr>
<td>Population growth</td>
<td>0.8(^a)</td>
<td>1.7</td>
<td>1.9</td>
<td>1.6</td>
</tr>
<tr>
<td>Total (real) GDP growth</td>
<td>2.1(^a)</td>
<td>3.8</td>
<td>5.1</td>
<td>2.9</td>
</tr>
<tr>
<td>Per capita (real) GDP growth</td>
<td>1.3(^a)</td>
<td>2.0</td>
<td>3.1</td>
<td>1.2</td>
</tr>
<tr>
<td>Growth of trade (in real terms)</td>
<td>3.8</td>
<td>6.2</td>
<td>8.2</td>
<td>5.0</td>
</tr>
<tr>
<td>(Net cumulative) migration to US, Canada, Australia, NZ Millions</td>
<td>17.9(^a)</td>
<td>50.1</td>
<td>12.7</td>
<td>37.4</td>
</tr>
<tr>
<td>% annual rates of changes of migrations</td>
<td>0.42(^a)</td>
<td>0.90</td>
<td>0.55</td>
<td>1.17</td>
</tr>
<tr>
<td>Year</td>
<td></td>
<td></td>
<td>1982</td>
<td>2006</td>
</tr>
<tr>
<td>FDI stock, in % of world GDP</td>
<td>–</td>
<td>–</td>
<td>5.2</td>
<td>25.3</td>
</tr>
</tbody>
</table>

\(^a\): 1870-1913.
In 2015 and 2016, international trade has suffered the negative consequences of the crisis, more than the income produced in the various countries, as it happened in 2009, but already in 2018 it has come back to growth rates higher than those of income. Trade expansion in many cases leads to situations of imbalances: exports rise more than imports in some countries, determining a surplus in the current account of those countries, while the opposite happens in other countries. As to the sectors originating exports, there has been a strong growth of exports of services, whereas trade exports of both agricultural and, even if to an even more reduced rate, of manufacturing ones have risen less.

In the most recent years there has been a further shift towards international exchanges relative to the information industry, a term indicating all productive branches having a high informative content, e.g., those referring to the computer industry, a term referred to all the productive branches having a high informative content, such as those relative to information programming, telecommunications, design of systems. In this realm, the spillover effects deriving from these exchanges for the economic systems of emerging markets have a specific interest. China has been particularly able in exploiting purchases of the information industry products for its industrial development policies.

The rise of movements of people has been lower with respect to the high rates of growth of goods and capital exchanges. If we relate these exchanges of people to the world population, the ratio remains relatively constant over the years, even if it shows a low increases in the recent years. It is however true that even constancy of this ratio implies a substantial absolute increase, since the world population has significantly risen, even if at a lesser pace than in the early Sixties of the Twentieth century (around 1.1% now, against 2.2% of those years).

The population of developed countries has increased or remained stationary, due to immigration. For the world as a whole, it appears that the number of migrants has barely risen, but this can largely be attributed to the rapid growth of the population of the countries of origin of migrants, as shown by the following Table 2:
TABLE 2 - Stock of International Migrants as a Percentage of Local Population, 1990-2017

<table>
<thead>
<tr>
<th></th>
<th>1990</th>
<th>2017</th>
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<tbody>
<tr>
<td>WORLD</td>
<td>2.9</td>
<td>3.4</td>
</tr>
<tr>
<td>More developed Regions</td>
<td>7.2</td>
<td>11.6</td>
</tr>
<tr>
<td>Less developed Regions</td>
<td>1.7</td>
<td>1.8</td>
</tr>
<tr>
<td>Austria</td>
<td>10.3</td>
<td>19.0</td>
</tr>
<tr>
<td>France</td>
<td>10.4</td>
<td>12.2</td>
</tr>
<tr>
<td>Germany</td>
<td>7.5</td>
<td>14.8</td>
</tr>
<tr>
<td>Greece</td>
<td>6.0</td>
<td>10.9</td>
</tr>
<tr>
<td>Italy</td>
<td>2.5</td>
<td>10.0</td>
</tr>
<tr>
<td>Poland</td>
<td>3.0</td>
<td>1.7</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>6.4</td>
<td>13.4</td>
</tr>
<tr>
<td>Spain</td>
<td>2.1</td>
<td>12.8</td>
</tr>
<tr>
<td>Sweden</td>
<td>9.2</td>
<td>17.6</td>
</tr>
<tr>
<td>Hungary</td>
<td>3.3</td>
<td>5.2</td>
</tr>
<tr>
<td>Australia</td>
<td>23.2</td>
<td>28.8</td>
</tr>
<tr>
<td>United States of America</td>
<td>9.2</td>
<td>15.3</td>
</tr>
</tbody>
</table>


3.2. Specialisation Opportunities for some Countries in Segments of Chain Values

An important characteristic of international trade in the last decades has been the growth of the industrialization of various countries in different segments of the same sectors, which originates what is called intra-industry trade.

The underlying operation is the breakdown in value chains. For instance, the production of a vehicle can be broken down in that of motors, gears, wheels, doors, windows, etc. The production of each segments of the final product can be localized in a different country, on the basis of the characters of its production, on the one hand, and those of the various countries, in terms of industrial structure, labour skills and costs, on the other. For instance, door production can require a less specialized labour force than that of motors. In this case, the first can be localized in countries relatively less developed than the latter.
This is of specific importance, as it opens the way to produce the different component parts of a car in countries that in other cases could have never produced whole cars.

3.3. The Reduction in Inequalities between Countries, together with their Rise within some Developed Countries, mainly Anglo-Saxon Countries

Inequality is a multidimensional phenomenon, which can take different forms and can be measured by different ‘spaces’: consumption, income, wealth, utility, capability and opportunities of choice. The most common spaces are income or wealth. With respect to the first space, there are different dimensions of inequality: geographical, personal or factor distribution. Wealth inequality can refer to total wealth – net of debt – or to specific categories of wealth (financial assets or houses and land). For each dimension, different indicators can be used, as, e.g., the income pertaining to the richest (or poorest) 1% (or 10% or another share) of the population. Obviously, these indicators give information only for a share of the population. For example, if we know that the income share of the richest 1% of households rises, we ignore what happens to the remaining part of the population, i.e. whether the other 99% have a uniform loss of their share or it is the middle class that loses, with some possible increase of the share of the others. Synthetic measures of the distribution exist, such as the Gini index (or coefficient), but their complexity does not imply, also in this case, that their indication is completely truthful.

Measurement of inequality is in any case preliminary with respect to any other analysis and to the policy suggestions aiming at its reduction. Existence of many indicators should not discourage their use. In fact, by referring to multiple indicators one can enrich the analysis and better calibrate public intervention.

As to the indicators of geographic inequality, they can be referred to the different regions, or provinces, of a given country or to the whole world.

At the world level, inequality can be measured differently, since measurement is more complex than for a country, not only because it is difficult to have the wealth of information available at a national level. Only a few sources give information of the income of the richest or the poorest 1% (or 10% or any other share of the world population), who in this case can come from the different countries, or similar kinds of information. Usually, one can have a synthetic index of world
inequality taking for each country its average income, which can be weighted or not by its population, as this index is easier to calculate than the distribution of income for the whole world population calculated in a way similar to that of a single country. In fact, only a few sources offer such an index of world inequality. In the case we will show the index used is Gini coefficient.

The following Figure 1 gives an idea of the three different indicators, i.e., international inequality considering the average income of each country, weighted and unweighted for the population of each country, and world inequality.

*Figure 1 - International and Global Inequality, 1952–2011*

The different indexes of income concentration show different time trends. The first one, which considers the average income of each country, rises continually up to 2000 and then lowers until, approximately, 2008 (remember that a rise in the value of the Gini coefficient indicates a worsening of inequality.) The index calculated by weighting a country by its population practically declines over the whole period. This depends on the fact that the lower income of the LDCs appears as higher as an effect of the increase in the population of these countries. In other
terms, with this index poorer countries have a higher weight, which attenuates inequality and thus lowers the value of the coefficient.

The third index, i.e. global inequality, as measured by the global Gini coefficient, is available only for the two decades after 1988 and oscillates from one year to the next. This is much higher than inequality within specific countries, being almost twice as high as in the United States, which, in turn, is higher than in Sweden.

As to income inequality within specific countries, the findings of various studies, referring to different periods, countries and indicators, differ. From the end of the Civil War to the start of World War II, the United States show a profile of rising personal income inequality in terms of the Gini coefficient, mainly as an effect of rising industrialization. From 1976 to 2012 the share of the richest 1% of the population has increased from about 8-9% to 20%. It has also increased, but at a reduced rate in other Anglo-Saxon countries, whereas it has remained almost constant in Japan. The picture for Continental European countries is rather different from that of Anglo-Saxon countries. A general feature of Continental European countries is that after the II WW inequality has first lowered and then remained constant even after the Great Recession, mainly as an effect of the operation of the welfare state. Elsewhere, some reduction of inequality has taken place in the last two decades in some (not in all) South American countries, partly as an effect of lower interest rates and higher commodity prices, and in some cases due to a retreat in many places from the free-market policies enacted in the 1980s and 1990s. In China, India, Indonesia and South Africa, the share of the richest has increased in the last 3-4 decades.

Various factors have contributed to these trends. Globalization has certainly played a role: on the one hand, the increase in the goods movements has contributed to reduction of inequalities; on the other, liberalization of capital and financialisation have increased them, by raising the shares of income accruing to capital and giving rise also to financial crises. However, the differences between the various countries cannot be explained without referring also to their domestic policies, having to do with the different degree of liberalization for labour, goods and capital markets and to the income and wealth tax policies, e.g., inheritance taxes.
3.4. Financial Crises

The most relevant issue recently arisen is that of the financial and economic crisis begun in 2007, which has been named the Great Recession, due to its significance. In fact, in the last decade or so, most advanced countries have suffered the deepest economic crisis after 1929 (the Great Crisis), a phenomenon – the crisis – that seemed to be confined to history books, remaining outside reality. The Great Crisis lasted long, originating a kind of stagnation, which was exited at the end of the Thirties only as an effect of the strong increase in public expenditure tied to the impending war. After WW II there were various cases of crisis, which, however, have been limited to a few countries (often developing countries). In the USA the dot-com crisis arose in 2001 and still in 2018 crises have arisen in Turkey and Argentina. The crisis of 2007 has instead concerned mainly developed countries and has been by far the deepest crisis after WW II, recalling not only the intensity but also the sad episodes (like suicides, which have risen by 10,000 from 2008 to 2010, according to some estimations) of the Great Crisis.

It arose in the USA and transmitted immediately to Europe. Its proximate roots are in the accumulation of private capital and the improper forms it had taken as well as the speculative activities that preceded it. These recall to some extent the episodes of the recent and remote past.

In 2009 the crisis had begun to recede in the USA, but became deeper in Europe, transmitting itself to the sovereign debt, i.e., to public debt. The reason for that should be searched in the improper character of both the European institutions and policies. It is true that a similar problem arose also in the USA, where the crisis had been nourished by financial deregulation. However, the fiscal union existing in the USA has permitted to avoid there the indicated transmission, i.e., the transmission of the crisis from the private to the public sector, which has instead happened in the EMU, where there is no fiscal union. In 2009, the last common year of the crisis in the USA and Europe, the GDP has fallen by 3.1% in the USA and 4.4% in the Euro area.

To have an idea of the effects of the crisis, it is indicative that only in Italy 1 million jobs have been lost and 82,000 firms have gone bankrupt in the period 2008-2015. In the EMU the rate of unemployment has risen by almost 2.5 p.p. in the 8 years after 2007, reaching the value of about 1/7 of the activity rate (i.e., 1/7 of the total of employed and unemployed), but it has more than
doubled in Spain, reaching the value of 23%. On the whole, the effect on the unemployment rate of OECD countries has not been so high, reaching the highest value of 8.4% in 2009 and then lowering to 7.7% in 2013 and 6.4% in 2016. In the non-OECD countries the impact has been relatively lower: the NICs (newly industrializing countries), which include BRICS – i.e., Brazil, Russia, India, China and South Africa – and other lower-size countries) hit by a maximum rise in the unemployment rate of 4 p.p. in South Africa and of 2.4 p.p. in China. In some cases the rate of unemployment underestimates the negative effect of the crisis. In fact, ‘discouraged’ workers are induced not to offer themselves on the labour market, as they consider unlikely being hired. Among them there are the so-called NEET, acronym of Not (engaged) in Education, Employment or Training, whose number has risen significantly.

3.5. The Lessons that have Derived

The recent financial and exchange crises have offered a number of lessons that can be useful for domestic and international policy. They refer, in particular, to:

i) the need of adopting more effective policies to supervise domestic credit and financial markets, by a more extensive implementation of the standards indicated by the Basle Committee of the BIS for bank supervision referring to bank capital, prudential control for systemic risk and information requirements to customers;

ii) the cases when adoption of fixed exchange rates is not advisable; in fact, even if useful to acquire credibility in the initial phases after a period of high inflation, fixed exchange rates are sustainable with difficulties by countries characterized by real or financial weakness and, as for the EMU, without a fiscal union;

iii) the effects of international capital liberalisation in originating the crisis and the need of controlling them someway;

iv) the role of international organisations, in particular the IMF.

4. CRITIQUES TO INTERNATIONAL ORGANISATIONS

4.1. Critiques to the IMF. The Hegemony of the United States and the Indiscriminate Applications of Liberism

The IMF has largely intervened to sustain the countries experiencing exchange and financial crises and has provided hundreds of bn dollars. In order to have more funds available the Fund
has indebted to some countries and decided to rise quotas. For each of the countries in crisis the Fund has done programmes asking for undertaking of specific engagements (in particular, adoption of restrictive budget or monetary measures), in exchange for the credit granted (credit conditionality).

The conduct of international institutions, in particular of the IMF in exchange crises has been the object of numerous critiques by economists, politicians and other people in charge of public institutions. They refer to various aspects of this conduct.

1. Interventions of an international lender of last resort, as some think the IMF is, reduces the ability of self-assessment and discipline, accentuating the moral hazard of the various economic agents and countries, each of which engages in riskier actions, precisely as a result of its conviction that intervention by the Fund will avoid its bankrupt. As a matter of fact, one can notice that the likelihood of moral hazard is highly attenuated by the following circumstances:
   i) the intervention does not eliminate any damage for the borrowers; it certainly avoids its insolvency, but does not cancel the negative consequences, in terms of reputation, deriving from the inappropriate conduct that has made the intervention necessary;
   ii) in any case, the Fund’s intervention contains other penalties for the debtor whose insolvency is avoided; in particular, the interest rates applied by the Fund are higher than those of the market and, above all, as a rule the Fund does not bear all the losses of the debtor country.

Providing liquidity to it has the only purpose of avoiding propagation of the financial crisis, not to eliminate some ‘therapeutic’ effects of the crisis.

2. A second critique concerns the scarcity of the funds provided by the Fund. This critique is symmetric to the previous one. However, refusal of the argument according to which the role of lender of last resort reduces self-discipline of economic agents does not necessarily imply that one asks a rise in funds provided by the IMF. In fact, some paradoxical aspects in the behaviour of markets is that their reaction to the Fund’s intervention have been more negative the higher the size of the credit granted. A similar reaction has to be traced back once again to the circumstance of the high information asymmetry existing in financial markets, which makes any intervention of international authorities to be interpreted as a signal of crisis so much deeper the higher the size of the funds lent.
3. A third reason of critique has to do with the conditions imposed on the countries financed by the Fund, which can deepen the crisis. For instance, one such conditions is restriction of aggregate demand, which is often required to facilitate the adjustment of goods movements. This restriction limits the extent of the devaluation needed to rebalance them, but can cause recession and a rise in unemployment, aggravating in the short run financial problems, reducing solvability of banks and the service of public debt.

4. A fourth reason of critique to the action of the IMF has concerned the policies of liberalisation, privatisation and deregulation imposed together with deflationary measures within the Washington Consensus.

5. An aspect to discuss refers to full liberalization of capital movements. We have already said that it can play a negative role for the stability of the system. Similar considerations had inspired the IMF statute, which allowed countries’ control on capital movements. This should be left to national sovereignty, consistently with Keynes's indications at Bretton Woods. The rule has never been rejected and holds still now, even if it has fallen into disuse due to the implementation of the Washington Consensus. In fact, at the end of the Nineties the opportunity to change the statute – by introducing the obligation to capital movement liberalization was discussed – but the financial crises that had recently occurred, such as those of South-East Asian countries, and some studies within the Fund, led to an opposite decision. In addition, the Fund’s intervention to sustain the imbalances due to capital movements, rather than to the current account, shows the inadequacy of its action and violation of its statute.

In acceptance of some of the critiques addressed to it, after 1999 the IMF has devised plans in order:

i) to ensure higher transparency of the conditions and decisions of the various countries, in addition to the Fund’s orientations and decisions;

ii) to strengthen the financial sectors of the various countries through better rules and supervision and closer international coordination;

iii) to increase the activity of prevention of, and response to financial crises, in particular by introducing a new credit line to use for prevention;

iv) to limit the conditions imposed on the countries that are beneficiary of financial assistance only to the measures that are strictly necessary for macroeconomic stabilization and rebalance
of foreign accounts.

In addition, recently the Research Department of the IMF has recognized the opportunity to control capital movements in emerging and developing countries, having verified that the control has tended to induce a less risky and vulnerable structure of incoming capital.

With reference in particular to the action played by the United States in the realm of international payments, neglect by this country of the balance of its external payments has allowed to ensure the equilibrium of the whole system of international payments. One should think that the total of the balances of the foreign accounts of all countries cannot be but zero. In a two-country world, if country A has a surplus of 50, country B cannot but have a deficit of the same amount. Similarly, if – as it happened in reality – all the other n-1 countries wanted to have a surplus or a balance equal to zero, the United States should carry a deficit. This happened since WW II to the second half of the Fifties, but is only one aspect of the role of the USA in the international system of payments, which hides the fact that, by not caring for the balance of foreign accounts and suffering in practice a deficit, the United States enjoyed the condition of ‘living in excess of their possibilities’ or, more precisely, enjoyed imports higher than exports and freely exported capitals abroad in order to buy firms or to lend for economic and political purposes.

Ultimately, having continuous deficits in one’s balance of payments implies paying foreign exchange outflows in excess of inflows by its own currency. This explains why the dollar acquired a hegemonic role in the international monetary system. However, the establishment of the dollar’s supremacy was due – in addition to the continuous balance of payments of the USA – also to the low impulse given to the diffusion of the currency devised in the mid-Sixties, i.e., the Special Drawing Rights, a purely accounting currency, which should have complemented the dollar as an international currency.

The last aspect of the United States’ hegemony in the action of the Fund has to do with the influence of this country – also as a reflection of the positions and the interests of the financial environment – in the analyses and choices of this institution, as in the case of the report on the economic miracle of the South-East Asian countries, in which the IMF presented an enhanced pro-market interpretation of the determinants of their growth, whose validity has been questioned.
The United States have influenced not only the action of the IMF, but also that of the World Bank, as should be clear from what we said about the Washington Consensus.

### 4.2. Speculative Capital Movements and Foreign Exchange Crises

Numerous foreign exchange and financial crises have marked the events following WW II. In particular, they have been numerous after the Eighties, in relation with the restrictive monetary policy inaugurated by the United States in 1979, which caused marked increases in real interest rates, leading to the dollar appreciation that aggravated the service of debt for some Latin-American countries, thus requiring higher outflows of foreign exchange from them. Then, in the Nineties, a crisis of South-East Asian countries and Russia took place. The recent financial crisis, which has shaken the foundations of the European Monetary Union, with the possible exit of some countries, has not ended the series, which has continued in 2018, as said with the crises of Turkey and Argentina. Free movements of massive amounts of capital are a factor that undoubtedly eases and amplifies the diffusion of foreign exchange and financial crises.

All the countries involved in foreign exchange crises had previously liberalized international capital movements and actually a study of the Federal Reserve Board showed that already towards mid-Nineties the incidence of bank crises was highly correlated with the degree of capital market liberalization. One should also say that, after the inception of the crisis, various countries tried to re-introduce controls over capital movements, which however were ineffective. This does not demonstrates that controls are worthless, but, by contrast, reinforces the idea that a country should not prematurely liberalise capital movements. In fact, under asymmetric information in capital markets, a premature liberalization can lead to a considerable inflow of capital, which however rapidly flows out of the country, after reintroduction of controls, as this is interpreted as a signal of the heaviness of the crisis. In other terms, the issue of outflows of capital is strictly tied to the rules applying to incoming flows and foreign exchange crises cannot be avoided only by the introduction of a prohibition of capital outflows. If the issue is dealt with only from this point of view, it seems unsolvable, due to the indicated signaling effects. If, instead, rules introduce a selection of incoming capitals, the negative effects are absent or will be attenuated. Entry regulation, which can substitute Tobin’s tax, can tend to discourage short-term inflows, e.g., by introducing some additional reserve requirement for short-term deposits coming from abroad, as done in the past in Chile and Colombia.
The argument usually raised in favour of capital movement liberalization is that this generates efficiency. It is rightly noted that this liberalization can have efficient effects complementary to those deriving from international trade liberalization. In fact, while the latter allows exchange of a good on terms more advantageous than those offered in the domestic market, international capital liberalization allows outlets or provisions more advantageous than domestically, in an intertemporal setting, which is where capital transactions should be placed. Liberalization of capital movements should allow capital to move from the countries where it is abundant (and the rate of interest is low) – which are usually developed countries – to countries where it is scarce (and the rate of interest is high), usually LDCs. It is said, in particular, that capital movement liberalization benefits LDCs for three reasons, due, first, to the direct effects that capital inflows have on the possibility to carry out investment and, therefore, to raise their growth rate. In fact, the higher capital inflows that are thought to be related to the liberalization should allow higher net imports, without threatening the balance of payment equilibrium. LDCs should then have the possibility of investment exceeding the low level of domestic saving. In addition to these direct benefits, the international mobility of capital should offer indirect benefits, e.g., as they offer the possibility to share risks internationally. Finally, the international mobility of capital should allow, in particular, to redirect the destination of resources from countries having an ‘incorrect’ conduct and bad performance (e.g., having low growth, high inflation, balance of payment deficit) to those more ‘virtuous’ and with sound fundamentals (with fast growth, low inflation and balance of payments, net of short term capital, tending to equilibrium).

However, these arguments should be the object of a number of critiques, referred in particular to short-term capital movements (and then to short-term international financial markets) and, more generally to the working of short-term financial markets, also in a closed economy.

1. First, Keynes’s critique to the action of speculation (beauty contest) holds.
2. The enormous size of international capital movements (with respect to the limited foreign exchange reserves available by the various countries and the funds that can be obtained from multilateral organisations), the high speed of movements and the occurrence of herd behaviour raise the likelihood of self-realising expectations, having scarce or no relationship with fundamentals.
3. With reference to asymmetric information, financial liberalization, by leading at least in the short run to a rise in competition, reduces the profit margins of financial intermediaries, inducing them to raise their activity in completely new fields, possibly less known (with a possibility of a higher adverse selection) and riskier (moral hazard).

4. Capital movement liberalization has increased the volatility (i.e., the erratic variations of prices) and, therefore, the uncertainty of financial and foreign exchange markets. The higher volatility of financial markets has increased the search for short-term positions, which are less uncertain, but these positions are more affected by signals, news and contingent feelings, which can increase volatility.

5. Short-term capital movements imply an excessive variability of exchange rates that hinders international trade. In addition, they can generate misalignment of exchange rates, i.e., the tendency of these rates to remain at values that are continually above or below a value of them that ensures the ‘fundamental’ equilibrium of the balance of payments, with ensuing costs for the real economy.

6. With reference to the ability of international capital movements to determine a ‘virtuous’ conduct and outcomes for the various countries, one should notice that, for the reasons already indicated, financial markets tend to determine reactions that are excessive with respect to those that may be required to adjust the economic position of a country, worsening its position and, in case, raising its fragility.

5. National Policies

Until the end of the Sixties also national policies were inspired to a tempered liberism, similarly to international economic policies. Possibly, national policies were more sensitive to state intervention. In fact, Western countries enacted policies tending to favour employment and growth, controlling prices and incomes (in Anglo-Saxon countries, this was a continuation of policies implemented during WW II), redistributing incomes by taxes and public expenditures, and with a large sector of public enterprises and in some cases adopted national planning.

The theoretical foundations of these policies had been laid down by the Keynesian thought and Scandinavian programming theories. After all, planned economies of a Soviet type seemed to offer virtuous examples, thus pushing towards a more marked state orientation of the economic system.
After mid-Sixties, these orientations began to change, due to difficulty of controlling inflation. At the end of the Seventies, there was a radical change in the attitudes of two key countries, the United Kingdom and the United States, which found political expression in the election of Margaret Thatcher as Prime Minister, in the first country, and Ronald Reagan as President, in the second one. In practical terms, in these and other countries public intervention has drastically been reduced in both the allocative and distributive field. In some cases, intervention has taken different forms: e.g., attenuating tax progressivity, larger use of instruments imitating the market (such as assignment of trade permits for pollution control) or that, in any case, are based on its operation (such as money transfers) or, finally, reduce direct public involvement in the economy (by privatization and regulation of privatized firms).

To the root of these changes are also the liberist orientations that can be traced back to both the changes occurred in the working of the economy in the Sixties and some influential contributions in the economic doctrine, which, in some cases were inspired by those changes or took a cue from them. The main change in the economic attitudes that took place in the Sixties concerned the behaviour of economic agents, essentially as a consequence of a situation of full employment in all developed countries. The Phillips Curve augmented by expectations devised by Milton Friedman can be thought of as an expression of such behavioural changes.

Robert Lucas’ contribution, instead, can be traced back to an evolution of Friedman’s position aimed at substituting the rational expectations hypothesis – which implies according to Lucas that the private sector can always neutralize public intervention, by making it ineffective – to the adaptive expectations assumption.

6. The Recent Changes of Direction and the Dangers for the World Economic Equilibrium

6.1. The Growth of China and the Instability of a Multilateral Equilibrium

The strong growth of China in the last decades at rates of the order of 10% and more has slowed down in the most recent years, but only with respect to its former pace, since it is still much higher than that of the other countries. This has led China to the first places in the world in terms of total GDP and also of foreign exchange reserves, with ambitious plans of further progress. In this country the number of poor, in absolute terms (i.e., in terms of the number of people earning less than 1.90$ per day at the purchasing parity power), has reduced from 835
millions in 1981 to 0.7 millions in 2015, with an incidence on population that has reduced over the same period from 84.0% to 5.11%. However, also higher incomes have increased and therefore inequalities have not lowered, but risen. In some cases, also the wages paid in China are higher than those in some European countries, such as those of the East Europe.

In technological terms, China is now a leader in many sectors. In not a few cases, primacy has been obtained due to skillful imitation of the technologies adopted in more advanced countries, which partly derives from imposition of specific rules to be obeyed by foreign direct investors in the country. For instance, full ownership of shares of foreign subsidiaries by foreign investors is prohibited in some sectors and access to the Chinese market is still exchanged with technology transfer, in spite of prohibition deriving from the membership of the WTO. On the other hand, China has encouraged foreign transnationals to create R&D centres in China, which implies the creation of positive externalities for the country, in particular by training of highly-skilled staff.

The increased relevance of Chinese economy and the recent financial crisis have accentuated requests of reform of the Fund’s architecture. Following them, the G20 has decided in November 2010 to raise the Fund’s quotas reserved to emerging countries. Since November 2015 the yuan is one of the reserve currencies composing the Special Drawing Rights (SDRs), a notional currency that has been created for valuing the funds lent to countries, making international payments or making interventions in foreign exchange markets. The countries accepting these Rights, which are usually those with a surplus in their balance of payments, increase the availability of resources and can make use of the SDRs for possible future deficits, in any case earning an interest. The yuan is in the basket of the SDRs together with the US dollar, the euro, the yen and the pound sterling, with a 10% weight. The decision of the IMF will have no other practical effect than making the renminbi to weigh for determining the value of the notional currency, which is given by those of the currencies composing it.

The decision to admit the renminbi in the determination of the value of SDRs is a signal important from a political point of view, as it stops the ‘exorbitant privilege’ of the United States once denounced by General De Gaulle. Chinese people think similarly to De Gaulle: some countries, in the process of losing their economic primacy, hold on to the privilege of their currency. From an economic point of view, this recognition of the importance of China’s
currency implies that this country will ensure stability of the value of the yuan, avoiding recourse to devaluation as a way to compensate for the decline of growth.

Apart from this, in a longer perspective the fear can arise that the multipolar equilibrium is unstable, as it was for similar situations in the past. Differently from the past, however, there could not exist the cultural and political factors that allowed a(n almost) smooth transition from a multipolar equilibrium (having the pound sterling and the dollar at the centre of the system) to an equilibrium with only one dominant currency (the dollar).

6.2. Favourable and Unfavourable Conditions for the Chinese Growth

Progresses made in the protection of intellectual property rights by China are among the favourable conditions. In fact, many patents have been registered in the last years and now China holds 20% of international patents, following immediately the United States, which hold 23% of them. But what is more impressing is that China has had a two-figures rate of growth of registrations for several years.

On the other hand, one has to recognise that China still silently violates some international agreements, causing European actions brought to the WTO and American retaliations, which, in turn have been followed by Chinese counter-retaliations. In fact, for technology transfer from the EU China imposes specific rules on industrial property rights and other intellectual property rights, which are different with respect to those that it applies to technology transfers between Chinese firms. This has two outcomes: first, to discriminate foreign owners of property rights; second, to limit the ability of foreign operators to protect some intellectual property rights in China, thus violating WTO rules. Officially as a retaliation against the Chinese violation of international agreements – but really as a part of neo-protectionist policies – during 2018 the United States have introduced a 25% tariff on 818 industrial and technologic Chinese products, ranging from cars to electronic products, medical equipment and part components of aircrafts – for a value of 34 bn dollars of imports. Beijing’s reply has been to trigger similar sanctions on 545 American products, ranging from agricultural products to vehicles. In these conducts one can almost see the outbreak of a true trade war. In defense of China one can say that a country which is still emerging from a state of backwardness has more founded justifications than a country that is a leader in the world economy in adopting measures restrictive of foreign firms’
penetration. However, acceptance by China of international rules that should envisage also similar situations implies compliance to them.

6.3. The USA as Free Riders

Also the Trump Administration is implementing a policy that threatens respect of international and regional agreements and heavily undermines the existing equilibrium. In terms of the threats for the current international equilibrium, to the USA actions against China we have just mentioned one has to add the USA threat to Europe to raise tariffs against Europe and the threat of termination of the regional agreements stipulated by this country that has led to a new agreement of the NAFTA rules.

With respect to the WTO the Trump administrations seeks to justify what is really a violation of its rules, i.e., setting discriminatory tariffs on steel and aluminum, based on the argument that these are goods of relevance for national security, even if they are applied to imports from friendly countries such as Canada and Japan. To be true, Trump’s decision could backfire against the USA (and other countries), since these two products are part of value chains from which also goods produced in the USA are obtained, which will lead to the rise in the prices of those goods. Another action which is weakening WTO is Trump Administration’s attempt to block the activity of the Dispute Settlement Body of this Organisation, by non-renewal of its members.

7. What does the future hold?


A Turkish economist, Dani Rodrik, has highlighted mutual inconsistency of deep international integration, national sovereignty and democracy. This is the trilemma taking its name from the economist, which is illustrated in Fig. 2.

According to this trilemma two of these conditions optionally can be satisfied, but the third cannot at the same time. For instance, globalization and nation state imply renouncing to democracy, since national sovereignty would interfere with the consequences of international integration, which imposes following the indications of markets.

Accepting the couple democracy-nation state prevents full international economic integration, since that couple would lead to outcomes unwelcome for markets, due to the fact that the state
would direct the economy in a direction different from that of markets. It was so in the Bretton Woods world, where capital movements were limited in order to leave some degrees of freedom for nation states.

Finally, international integration and democracy at an international level would imply inexistence of the nation state, since the orientations of international organisations should be accepted.

*Figure 2 - The Political Trilemma of the World Economy*

THE POLITICAL TRILEMMA OF THE WORLD ECONOMY

Source: Rodrik (2002).

7.2. The Current Position and Perspectives

As we have said, the institutions born at the end of WW II were inspired to a well-tempered liberalism, but this principle has been disregarded, leaving instead room to an embittered liberalism, which found its highest expression in the Washington Consensus. Then, the initial principle has largely been disregarded in practice.

The Bretton Woods institutions, as they have evolved, have led to positive results in terms of international integration and rates of growth of GDP, but are also responsible for financial and exchange crises, some of which are strictly tied to the request to countries in need of being financed to liberalise capital movements. To the World Bank one has also to ascribe the policy
applied for some time to encourage growth of the country beneficiary of funds by prescribing lower taxes for the rich, with the idea that from this better life conditions would trickle down to the poor.

A number of critiques have been addressed to this embittered liberism, some of which have been accepted by international organisations.

If, until a few years ago the history of international economic relations after the war had offered a period indeed limited of tempered liberism followed by a longer period of almost complete liberalization, in the most recent years we have assisted to a new redirection of attitudes, with at least two countries, China and the United States, engaged in more or less open trade wars, in different ways.

On the other hand, the growth of China threatens the current equilibrium, which is largely based on the USA hegemony, and a multipolar equilibrium is looming, where this country is joined by China. The two facts together, i.e., the trade war between China and the United States and the bi-polar equilibrium, can generate instability and dangers for the world economic equilibrium.

Therefore, the solution that many people would prefer in order to avoid the instability highlighted by Rodrik's trilemma, i.e. the association of international economic integration and global democracy – which also today shows deep faults, due to the government of almost all international organisations being firmly in the hands of the USA and, to some extent, of Europe – could receive further blows in the future and risks of being unrealizable. Further obstacles could derive from the diffusion of qualms towards transfer of power to supra-national levels and wide waves of populism in many advanced countries, especially Europe, and from widespread episodes of protectionism, in primis by USA and China.

Thus the future is not rosy and there are high probabilities of a return to the situations of trade wars that were typical of the interwar period.

From the well-tempered liberism which found its expression in the international organisations established at the end of WW II we have moved to an exacerbate liberism and it may be that the diffusion of populism and protectionism is the product, certainly, excessive, of that exacerbate liberism. Political commentators and historians attribute the election of Donald Trump and his economic policy to the economic crisis begun in 2007-8, which was born rightly from such
exacerbate liberism. The populistic waves that afflict Europe, herald of similar closures, can have similar foundations.

If the world will stop in the path leading to commercial wars and closures of frontiers and will be able to reconstruct the season that led to the tempered liberism, is something desirable, but at present difficult to forecast.

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