"Globalisation: Lessons from History; Risks for Today"

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- **What caused Globalisation to fail in the 20th Century**
- **How can investors recognise political-economy regime change?**
- **US policy is at a fork in the road where it can seek to go unilateral or set out to improve the multilateral order in America's favour.**

On 16th May, we hosted a webinar with Professor Jeffry Frieden of Columbia University on 'Globalisation and Regime Change'

This is a lightly edited transcript of the conversation

Professor Frieden wrote a prescient paper back in 2006 where he looked at drivers of Globalisation in 20th Century

He examined 'why did the Globalisation of the early 20th Century fail?'

The obvious answer is because of World War One … but that does not explain why Globalisation was so hard to restart

To do that, one needs to understand the 'rules of the game' during the classical era … at that time your international commitments took priority over domestic considerations

On 16th May, we were delighted to host a webinar event with Professor Jeffry Frieden of Columbia University on "**Globalisation: Lessons from History; Risks for Today.**" Professor Frieden specializes in the politics of international economic relations. We could think of no one better to help investors navigate the seismic changes underway in America and put them into an historical context. Owing to the high level of investor interest in his comments, we have decided to publish a lightly edited transcript of the event.

David Bowers (DB): It's a great pleasure to have Jeffry with us this afternoon. Jeffry has published extensively, but I think there's one paper which stands out, which Jeffry wrote almost 20 years ago for the Bruegel Institute in Europe, and it was titled, "Will Global Capitalism Fall Again?". And I had the pleasure to reread it last night, and I thought how prophetic it was, because many of the issues that were live back then are even more vivid today. The new US Administration has prompted a lot of discussion among investors about globalization and where we are in that cycle. I think adding a historical perspective could be useful here, because people forget that we did have a period of intense globalization in the early part of the 20th century that was followed by an intense period of deglobalisation. Are there lessons that we can take from that to help frame some of the questions that investors are having to wrestle with today?

Jeffry Frieden (JF): You're right. Globalization, which lasted for many decades in the late 19th and early 20th century was seen, at the time and in retrospect, as a great success, delivering some of the most rapid rates of economic growth seen in history. In just 75 years, the world economy grew more than in the previous 1000 in an environment of general prosperity, macroeconomic stability, and even peace among the major powers. And so we must ask, why did it fail? Because it did. It collapsed when World War One started, because, of course, you don't maintain a global economic order during a world war. But when the war ended, there were continual attempts for over 10 years to try to restore that classical order, the gold standard, free trade, international capital movements, and they all failed. The question we want to ask is, what went wrong?

To understand that, you must understand a little bit about what that classical era was like. Most of us are familiar with free trade and the gold standard and that classical era when there were "rules of the game" that monetary authorities and governments were meant to follow in order to maintain their commitment to international economic integration and to the gold standard. The rules of the game were largely that you had to privilege the international connections of your economy over domestic economic considerations. If your economy was out of balance macroeconomically, you drove it back into balance to maintain your commitment to the gold standard, even if it meant imposing austerity on your national economy. And that was feasible at the time, largely because the people who were primarily bearing the burden of adjustment didn't have a political voice. There were virtually no real democracies in the world at the time, even among the countries that were the main actors in that economic order. So farmers, the middle classes, the working class, who were the principal people who bore the burden of adjustment in that era, didn't have the opportunity to object, and

The domestic economy bore the burden of adjustment … because there was no democracy

the elites who had benefited from "Globalization Mark I" were adamant about the necessity of maintaining those international economic ties, even at the expense of national economic austerity.

Labour unions and Socialist parties began to gain traction

But things started to change around 1900 and they changed very drastically during World War One. The period right before, during, and right after World War One saw a huge increase in democratization. Countries that had previously had little or no representation from the middle-class, farmers, and working-class voters suddenly had what we would regard today as working democracies. And you can see that in the position of labour unions and socialist parties. In the nineteenth century, Socialist parties were in many instances illegal, or certainly very suppressed - labour unions as well. But by the 1920s there were Socialist parties everywhere in Europe. They were in government in many parts of Europe, and in many instances, were the largest parties in Europe. This represented a profound change in the political environment.

The crunch came in 1929 when the elites tried to impose classical measures of adjustment, only to discover that they were politically unsustainable

The global economy had changed – and wages / prices were not as flexible as they were under the Victorian era

And what that meant was, once the crunch came in 1929, the pre-existing elites, if you will, tried to impose those old, classical measures of adjustment. But they were politically unsustainable. The farming community, the middle classes, the working class, would not accept the adjustment measures that had been so common under the gold standard. And this was something that Keynes had been pointing out, really since World War One. He constantly took policymakers, and many of his fellow economists, to task saying 'you are trying to impose the strictures of a Victorian-era economy on what is no longer a Victorian-era economy'. The Victorian economy was characterized by family firms, family farms and disorganized labour, whereas by the time of the interwar years, we have huge national companies and national corporations. We have mass production, we have big labour, we have big business. And suddenly wages and prices are not as flexible as they were in that previous era. The people who had to bear the burden were no longer willing to accept the flexibility that they had to endure under the classical gold standard.

"A revolution comes when the ruling class can no longer figure out how to rule in the old way, and the people can no longer accept to live in the old way"

There's an old line about revolutions, saying that 'a revolution comes when the ruling class can no longer figure out how to rule in the old way, and the people can no longer accept to live in the old way'. And that's <u>what happened in the interwar years. Governments could not figure out how to manage the economy in ways that they understood. And the ways that they tried to manage the economy were completely unacceptable to mass publics around the world. This is why so many of the mass publics turned towards fascism or towards communism</u>. Eventually there was a sort of middle-road established, with the New Deal and with social democracy in Northern Europe. But it took a long time, and in the interim, the world had to endure the greatest economic catastrophe in modern history, which contributed to trade wars, currency wars, and eventually shooting wars. Ideally, we want to try to avoid all of those things. It looks as though we haven't avoided a trade war, but the onus is on us to try to avoid generating something that looks even remotely like the 1930s.

Looking at parallels with today …

DB: Do you think there are parallels with today? Today, there's also a tension between the winners and losers from globalization. The rise in income inequality and wealth inequality is feeding the same kind of dissent. Is that what is fuelling - and it's not just an American story, it's a global story - growing discontent with the existing structure?

The rise of income inequality and wealth inequality is leading to regional inequality

JF: Going back to that earlier era – and while I'm an American, I like to think I know a little bit about British history - there was a lot of discussion in the interwar period about 'two Englands', and today we have 'two Americas'. In fact, we have two of whatever country you're talking about. Those who know the United States know that we have a prosperous Northeast and a prosperous West Coast, with prosperous big cities in between, characterized by knowledge industries, by biotechnology and fintech and other technologically oriented industries. More generally, a lot of college educated people tend to be very enthusiastic about globalization, both economic, political, and cultural. And then you've got the rest of the country, which, in some sense and to some extent, has been left behind by globalization. You can go through the old industrial belt in the Midwest and then the new industrial belt in the Upper South, and find town after town after town, small cities even, that have relied on a couple of factories, textile, garment, toy, furniture, auto parts that have been in distress for decades, not for a few years, not even since China joined WTO, but in many instances since the 1980s, that have been declining continually. The feeling in many of these areas - and I think there are analogues in the north of England, the north of France, eastern Germany and southern Italy - the feeling in these areas, is that we've been struggling for decades, and no one's been listening, and no one's been doing anything. All the emphasis, certainly in the US, has been on the big cities, on technologically intensive industries, on the knowledge industries, on college educated workers, on college educated people. And that's not us. Two thirds of Americans do not have a college education. Most Americans are not in knowledge intensive industries. Most Americans don't live in big cities. And so, if we can talk about two Englands in the interwar period, I think we can talk about two Americas today, and those two Americas, unfortunately, but realistically, closely resemble the two political parties that we see in the United States today. Often the backlash against globalization comes from those that feel that they have been hard done by, due to both globalization and the government's response to globalization.

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DB: That's a very nice segue to one of the issues that investors are wrestling with now, namely, to what extent is a regime change underway? Have we this reached the point where something is fundamentally going to shift? And do all the surprises of Trump's first 100 days signal that something much bigger is underway? As an academic, how does one gauge regime change? It's a phrase that's easy to use, but very hard to define. What would you be looking for, that might indicate that regime change is underway? How concerned should we be that this process has begun?

Thinking about regime change …

JF: I am an academic, so I'm going to give you what may sound like a very abstract definition of a regime, but it's one that we use, typically in thinking about regimes. A regime is a set of norms, rules and procedures around which actors' expectations converge. Now that sounds very abstract, because it's not talking about institutions, or buildings with addresses, or constitutions, or laws. Earlier I mentioned before the 'rules of the game' under the gold standard. We talk about the 'rules of the game', but there were no explicit rules, and there was no explicit game. These were informal norms that existed among governments. And that's a really important point to make about regimes, when we think about a regime being challenged, or we talk about a regime that is changing. Laws must be obeyed by people, and for people to obey laws, they must feel that others are also going to obey the laws. Likewise with norms: these are procedures around which expectations converge. I'm going to obey the law if I expect that others are going to obey the law. And countries are going to behave in line with expectations, if they think that other countries are going to behave in line with expectations. I wouldn't focus primarily on the institutions of the international economy, or the domestic economy. I would focus on the way in which countries behave – and what happens when those norms start to break down.

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Where it gets interesting is when those norms of behaviour start to break down

And I want to give you a couple of examples drawn from monetary history, for my area of expertise is international monetary relations. And there are two very revealing episodes in international monetary relations in recent history. The first is the collapse of Bretton Woods; and the second is the collapse of the European Monetary System. What was the Bretton Woods monetary system … not the Bretton Woods system more broadly, but the Bretton Woods monetary system? The Bretton Woods monetary system was quintessential multilateralism. What do we mean by multilateralism? Multilateralism in the post-World War Two era is where the United States is going to lead the world towards the establishment of a set of principles under which it's going to operate. Now these principles are going to be determined by the United States, which means they're going to favour America, but we're going to set up institutions that are going to ensure, explicitly or implicitly, that in running the system, the United States is going to take into account the concerns of other countries. So in the Bretton Woods monetary order, we're going to link our dollar to gold without question, and everybody else is going to link their currency to our dollar. And the implicit agreement here - the implicit commitment, if you will, on the part of the US government - is that we're going to run our monetary policy to maintain monetary stability. The reason the dollar is going to be anchor, is that we are going to commit to having a stable monetary order so that you can have a stable monetary order, which means we're taking your concerns into account. We're not just running the system for our own benefit. We're running it for everyone's benefit.

First example: the end of the multilateralism underpinning Bretton Woods monetary system

That starts to change in the mid-1960s, when the US begins running big deficits associated with the Vietnam war, and begins running a rate of inflation that is substantially above that in Europe. While it was not a high rate of inflation by contemporary standards, it was higher than Europe, and it led to a material divergence in the rate of inflation between the US and Europe. This meant that the dollars, in real terms, that people were being required to hold, were worth less and less. This was what led to the French, in particular, to complain about being asked to keep time with a clock that was constantly losing a few minutes every day.

Things came to a head in the early 1970s, when the US under the Nixon Administration was confronted with the challenge, and the challenge was brought to brought home to Richard Nixon at a meeting in August 1971, where the Treasury Secretary and the Fed said that the US needed macroeconomic adjustment to bring our macro economy into balance to restrain inflation and to maintain the dollar stability and solidity. And Nixon, remembering the 1960 presidential election, said, I know what macro adjustment means … in 1960 it meant we lost 15 senators and 60 congressmen, and I lost the presidential election. That's not happening again on my watch. What's the alternative? And the alternative was taking the dollar off gold, closing the gold window. What's the cost of that? He asked. And Arthur Burns said, well, it will anger the central bankers. And Nixon said, who cares about the gnomes of Zurich. At which point the US decided that it was no longer concerned with how its currency relations affected the rest of the world. And John Connolly, very famously, turned to the Europeans and said of the US dollar "it's our currency, but it's your problem". In a sense, the multilateral monetary order of the <u>Bretton Woods system, broke down because the US was unable, or unwilling, to maintain its commitment to monetary stability. It was unwilling, or unable, to maintain its commitment to the other members of the system</u>. That was a regime change.

Second example: The breakup of the European Monetary System

In 1979, in response to the collapse of Bretton Woods, many of the members of the European Union set up the European Monetary System. And this is my second anecdote. This was a regional multilateral system, which evolved into a Deutsche Mark link, so that the members of the EMS were linked to the Deutsche Mark on the understanding that the Bundesbank would do what was necessary to maintain macroeconomic stability in Germany and in the EMS member states. Countries that had been running high inflation said we're going to link to the Deutsche Mark because we trust the Bundesbank to run monetary policy in a way that will serve our interests, and the interests of the entire bloc that eventually becomes the Eurozone. <u>And that goes fine until 1991 with German unification, at which point the Bundesbank - being German and obsessed with the potential inflationary effects of unification - raises interest rates again and again, driving the other EMS members into a very deep recession.</u> Countries like Spain saw 20%+ unemployment rates for reasons that had nothing to do with conditions in Spain, or the rest of the of the EMS, and everything to do with domestic German conditions. <u>In this instance, the German central bank had violated the implicit commitment that it had made under that multilateral order, which was to take other countries' considerations into account.</u>

To what is extent the current regime under threat?

And so, if we want to think about a regime change, then we must first define the current regime. The current regime has been one in which the US is the 'primus inter pares' (the first among equals). But that still requires taking the concerns of other countries into account, especially when those concerns have to do with macroeconomic stability, financial stability, and macroeconomic policy coordination.

The question now is whether the current Administration is committed to multilateralism as it has been practiced by American Administrations for the past 75 years?

When the financial crisis hit in 2008/9, what surprised me was how effective the coordination was, led by the US and the UK, among the major macroeconomic authorities. There was the scope there for a collapse into anarchy. But it didn't happen. That was because the US sat down with its major financial partners, in a very responsible way, and said that we are now responsible for the stability not just of the US economy, but of the entire international financial system. That was multilateralism at work. And the question now is whether 'the current Administration is committed to multilateralism as it has been practiced by American Administrations for the past 75 years?' And I think the answer has to be, while it is too soon to tell, there are many indications that it is not.

DB: Jeffry, you make an interesting point that one of the things that makes it hard to understand what's going on is that there are different factions within the US Administration. There are those who think that multilateralism can be restored to work better for America, and there are those who think game over. It's time to move on. How do you see that balance? And secondly, do you think the current multilateral framework can survive the US stepping back from it? Do you think that it's possible for the global world order to work together without the US being the centrepiece – the so called 'Schelling Point of Global Finance' - as Scott Bessent described it?

What are the historical threads behind the US Administration's desire for change?

JF: Let me divert you back to an historical continuity with which we can identify. The position of the current Administration does not come out of nowhere. It is related to a very long strand in American foreign-policy thinking, going back to the 1890s. Remember that McKinley is Donald Trump's favourite president. McKinley was the architect of the 1890 McKinley tariff, and then the President in 1896. The McKinley view, which was reflected in the view of many other American foreign-policy thinkers at the time, was that America is unique. We don't have to worry about Europe. We don't want a hostile power taking over Europe, but we don't have to worry about it. Asia is a very important market, but we don't need to be too engaged in them. Politically, what we're really worried about is our backyard, which is the western hemisphere. And that view carries through to the isolationist period of the 1920s when the isolationists say, 'we tried getting involved in Europe, and look what happened to us'. Let's step back to the 1940s with the Taft Republicans, who were very hostile to Bretton Woods, the British Loan, and the Marshall Plan, but who are eventually defeated by Eisenhower and others in the Republican Party.

There is a strand that runs through American foreign-policy thinking that says multilateralism may not suit us as well as it suits other countries

There is a strand, a red thread that runs through American foreign-policy thinking that says multilateralism may not suit us as well as it suits other countries. And I think it's interesting to note that the early period, is a period in which the US is the rising power. What McKinley and others are saying is that the British are running the world. We're going to run our part of the world. And today, there are people in the Administration saying that we can no longer afford to be the global hegemon. Let someone else worry about other areas of the world. We're going to worry about our backyard, and our backyard is the Western Hemisphere, maybe East Asia, and maybe a few other areas. There is continuity there.

Almost everyone in the US Administration believes that multilateralism, as it has been exercised over the last 30 or 40 years, is not serving American interests.

One thing that almost everyone in the Administration agrees on, is that multilateralism, as it has been exercised and implemented by the US and the rest of the world over the last 30 or 40 years, is not serving American interests. Now this is the Administration's perspective; there are people outside the Administration who disagree. But inside the Administration, it is pretty much universally agreed that the multilateral institutions have strayed too far from American interests. What that implies is that the US can strike a better deal working bilaterally, or unilaterally, with countries around the world, rather than working through the WTO, which is far too dominated by other countries that don't have our interests at stake, and by a bureaucracy that has overstepped its grounds. Rather than working through the WTO, we can negotiate better trade deals with every country in the world. We're the 800-pound gorilla in the room. We can push our weight around. Why do we have to obey a WTO order on Costa Rica, when we can get a much better deal from Costa Rica, bilaterally or unilaterally?

But there are differences in the Administration: some want to shift to a more unilteralist position; others want to maintain the multilaterist approach but believe that it must be remade in America's favour

While this dissatisfaction with multilateralism is pretty much universal within the US Administration, there are differences. There are some who say multilateralism per se does not serve our interests. We need a different kind of order. The US needs to construct a more unilateral order in which we act alone. And there are others who say we can maintain many of the structures and expectations of a multilateral system, but it must be remade. And Scott Bessent's speeches at the World Bank and IMF meetings were pretty explicit in saying, we don't mind the IMF, but we want it to be our kind of IMF. And it has stopped being our kind of IMF; it has stopped becoming our World Bank. And so therefore, either you remake it as our kind of IMF, or World Bank, or we're going to have to have to reconsider our relationships with these institutions. Whether the Administration ends up jettisoning multilateralism, or arguing and pushing for a dramatic rethinking of what multilateralism means in the current era, there are some changes going to be made.

DB: And what if the US were to step back, or try to redefine multilateralism in a way that the rest of the world wouldn't accept? Do you think that there is a viable option for Europe and Asia to come to try and patch things up, not least, because they've done quite well under the WTO structures? Do you think they will try, or is it impossible given America's centrality to the current system?

Watch whether trade policy points towards 'Fortress America" …

… or whether the use of tariffs is a tool to extract more favourable terms from the existing multilateral order

JF: Let me go back one step. You mentioned factions within the US Administration, I think is useful for fixing ideas about the ways forward. We can think of one faction that sees the goal of current trade policy as 'Fortress America', as re-industrializing the United States, as bringing lots and lots of manufacturing back so that we don't have to worry about insecure global supply lines, whether for national security reasons, or for economic reasons. And those are folks who don't have much truck with the multilateral system. And so, if we want to see which way the wind is blowing, if we go in that direction, then I think we know which way the Administration is trending. But then there are people who want to use the tariffs as a way of extracting concessions, either economic or non-economic, from the rest of the world, and they're probably more sympathetic to maintaining some form of the multilateral order.

If the US continues to go in the direction of insisting on changes to the multilateral order that are unacceptable to others, what does the rest of the world do?

Let me answer your question, however, more directly. If the US continues to go in the direction of either insisting on changes to the multilateral order that are unacceptable to others, or that would take it far too far from its current status, or just decides that it's going to leave the WTO, the World Bank, the IMF, the system more broadly, then, what does the rest of the world do? I must start by saying that if the US does decide that it wants to abandon multilateralism, that doesn't suddenly make the rest of the world protectionist. It just means that the rest of the world needs to somehow figure out how to protect itself from the United States. And that's the question that you're asking: what does the rest of the world do if, in fact, the US does retreat into some kind of 'Fortress America' mentality?

Just because America has walked away from MFN status, does it mean that the rest of the world has to do likewise?

Let me give you an example from trade. The US has already violated what has, in some sense, been the most basic principle of international trade for the past 100 plus years, which is Most Favoured Nation (MFN) status. By negotiating individual deals with individual countries, or by imposing individual deals on individual countries, they're jettisoning any semblance of a commitment to MFN. So does that mean the rest of the world has to do likewise? No. It means that the rest of the world can say, OK, we will have one set of trade relations with the US, and we will have another set of trade relations, perhaps managed by a WTO, or a rump WTO, or a new WTO, because we like those rules … we like the way the WTO was working. We appreciate the existence of a dispute settlement system that seems to work reasonably well for most countries in the system. We can restart this system even if the US is out of the WTO and keep it going. And I think that is feasible now. It is also a lot more feasible in trade than it is in some other areas. The US is not dominant in world trade; arguably the Chinese are more dominant in world trade than the US. It is perfectly feasible to think of a trade bloc around the US, which would presumably include the US, northern Latin America, northern South America (but not Brazil or Argentina). You can imagine an American trade bloc of that type. Then Europe, with southern South America, Africa, Asia, or large parts of Asia, might make up another trading system. I think that's a reasonable conjecture - but note that I am not talking about next week - I'm talking about over the next 10 years.

Things become more complicated on the monetary and financial front

Talking about a longer-term perspective on where things might go on the monetary and financial front, it gets a lot more complicated, because the US is, and has been, absolutely central to the international financial, and monetary, system. One could imagine a movement away from the WTO in relatively short order, because the US has already sort of done it. It's harder to imagine what might lead to the world moving away from the dollar and the US as being the centrepiece of the international financial system. But it could happen, and we've seen some indications of how it might happen.

DB: The future of the dollar and the role of the dollar becomes critical. I wonder what you think about the role that that foreign investors now play? One thing which really stands out is that foreigners now own $31 trillion of US Securities. To what extent has the uncertainty of the last 100 days triggered a rethink? Do you think that one of the risks the US is playing with is that foreign investors start to reassess whether they have excessive exposure? And I guess this comes back to whether you start to question *whether the US is still committed to the rules of free movement of capital and fair treatment of capital? Are US assets still 'safe' assets?*

JF: Well, we got an inkling of this in the week after the tariffs were announced and Donald Trump talked about trying to displace Jerome Powell from the Fed. That's when we saw a 50 basis point rise in the yield on Treasuries over four days. That scared the Administration, and rightly so. But what we've seen, in a sense, has been in an environment of uncertainty, where we might normally have expected a flight to safety, which in the past might have meant to US assets and the USD, and instead we've seen a flight from the US, a flight away from the dollar, and a flight from American assets.

The Administration seems to want inconsistent things … it wants to retain dollar dominance of the Global Financial System, but doesn't want to pay the price of a loss of US manufacturing competitiveness

I think the problem is that the Administration seems to want inconsistent things. On the one hand, they say they want to maintain the central role of the dollar and the United States in the international monetary and financial affairs. On the other hand, they say, or at least some of them say, that they don't like the fact that the reserve currency role of the dollar, and the central role of the US in international finance, means that the dollar is too strong. And that puts competitive pressure on American manufacturers, and that the role of the US in international finance may put too many constraints on the financing of what are enormous American fiscal deficits of six to seven percent of GDP (and likely to rise to eight, nine, even ten percent of GDP). Well, you can't have it both ways, right?

And the attempt to have it both ways was represented by Stephen Miran's paper, where he suggested a series of measures, which, in my mind, raise real questions about America's commitment to some of its previous roles, monetarily and financially. One of those suggestions was that we can require - we can expect - countries to continue to hold dollars as their reserve currencies. But we're going to tell them, you can hold dollars, but not as traditional Treasury securities. We're going to convert all those treasury securities into century bonds, which essentially is expropriating the creditors of the US government. Inasmuch as that reflects an actual desire on the part of people in the Administration to exercise greater control over foreigners' investments in Treasury securities, or in the US market more generally, I think that's worrisome. I would be worried if I were a foreign investor in the US and had to wait and see what happens with CFIUS (the Committee on Foreign Investment in the United States), as it monitors foreign direct investment in the US. What happens with the SEC if it thinks about regulating foreign ownership of Treasury securities? What is the Administration going to do? If not, there is a non-trivial probability that a big increase in the fiscal deficit ends up blowing a hole in the US Treasury market, in the sense of raising yields well above 5%, or even raising questions about a treasury market via a failed auction.

It is worrisome that people in the Administration wish to exercise greater control of foreigners' investments in US markets

Ken Rogoff, my former colleague at Harvard, has been adamant about his expectation that this time may be different, namely that the Administration risks ruining the standing of the United States, and the standing of the US dollar in international finance and international monetary relations. Now that would take a lot, because the international monetary system and the international financial system are, to a very large extent, built around the breadth and depth and stability of the American financial markets and the confidence in the willingness and ability of the Fed to maintain monetary stability. But at this point, we've had four years of above inflation outcomes on the part of the central bank, some worrisome discussions about what's happening in the financial system, and about regulation in the financial system.

Some argue that the Administration risks ruining the standing of the United States and the standing of the US dollar in international finance and international monetary relations

I would be watching very carefully what the Administration does with respect both to the fiscal deficit, to financial regulation and to the Fed, because it can take 10 years to build up a reputation, but you can lose it in 10 minutes. And I think being a little bit more opinionated than I usually am, that this Administration has gone pretty far down the road of shaking international confidence in the United States. At this point, there still is hope. I believe that this current round of the trade war will settle down, that we will end up with something stable, a new equilibrium that is stable and predictable. But that's not a given, and once you've disrupted confidence in something as important as international trade relations, there's also a question about whether you might not also disrupt confidence in international financial and monetary relations as well.

Once you've disrupted something as important as international trade relations, there's also a question about whether you might not also disrupt confidence in international financial and monetary relations

DB: I think many investors are asking themselves questions that they didn't think they would ever have to ask. And that's a red flag in its own right. Most economists don't really think about this, but free trade is only optimal if you can arrange compensation *from the winners to the losers. The great thing about free trade is that it creates so many gains that this is possible. However, we've never arranged a good compensation system. So the question is, why not? And will we be able to return to a system of free trade and free global capital movement without one?*

Free trade is great for aggregate social welfare, but it does create winners and losers

JF: Absolutely, absolutely on target. I tell my students, anybody who tells you that there are no trade-offs in economic policy is either stupid, or lying, and free trade is a great example. Free trade is great for aggregate social welfare, but it does create winners and losers. Now the 'compensation hypothesis', as it's usually called, is the way you deal with that. If it's good for aggregate social welfare, you can tax the winners to compensate the losers, and everyone can still be better off. It's a Pareto improvement. The problem is that the winners don't like being taxed to compensate the losers, and that's what we have found politically, over and over and over again.

The compensation hypothesis is the way you deal with that

Now there are there are two questions here, that I think are important to raise. The first is, does compensation work? And there are questions about that. My good friend and former colleague, Dani Rodrik, really thinks compensation is not enough, because he thinks that it's not enough just to compensate people by giving them money. He thinks that people want meaningful jobs. And I think he's right there. But the first question is, does compensation work? And the I think the evidence is, on average, yes, the countries that have been more successful at creating a broad and deep social safety net face less of a populist anti-globalization reaction right now. That's a difficult case to make, because almost every country has had a populist reaction. But if you think of countries like Sweden, which has a higher share of foreign born than almost any country in Europe, and has been subjected to lots and lots of trade and related shocks, and yet they still have only a relatively small populist movement. The US, with a much less generous social safety net, has, of course, now had two populist governments in the last 10 years. There's a lot of statistical analysis that demonstrates that compensation works.

Countries that have been more successful at creating a broad and deep social safety net face less of a populist anti-globalization reaction right now

The second question is, why has it not been implemented more broadly? And I think there it's politics. It's very difficult to convince those who are doing well that they need to invest in those who are doing poorly. Now, you know, there are lots of wake-up calls out there. And this may be a wake-up call to the elites that maybe they should be paying a little bit more attention to the non-elites, and that people in New York, and Boston and Washington and Chicago need to be figuring out what's wrong in Erie, Pennsylvania and Syracuse, New York as well as western Pennsylvania and Eastern Michigan, and what needs to be done about it. I think that that there's a lot of discussion in the US today about the need for 'place-based policies', because this is not really about divisions among individuals. It is about divisions among regions in countries across the world. Populism is popular in this backlash against globalization, popular in particular regions … regions that have been de industrialized, regions that have been in distress for a long time: the north of England, the north of France, the eastern parts of Germany, Southern Italy. So it's not about giving aid to individuals. It's about giving aid to regions. I don't think we have figured out how to do that particularly well, but I think that we can.

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And I know that there are people, very smart people, Gordon Hanson at Harvard and others, trying to figure out how to make place-based policies work better. This is not about a government just showering a billion dollars in an area that's depressed. This is about how do you make an area that's depressed an attractive place for people to invest. How do you turn areas that have been depressed for 30 years, into attractive places for people to live, and attractive places for jobs to be created. How do you establish training systems, vocational training, community colleges, workforce development, infrastructure development, so that areas that have been declining can flourish again. That, I think, is the challenge. It has not been met by many governments. I know that there are attempts to figure out what has gone wrong, and what has gone right, both in Europe and in North America, but we've got a long way to go. You know, like anything else, political economies don't turn on a dime. We had a political economy that was working very well under a kind of consensus for 70 years, and all of a sudden it seems not to be working well, and we have to figure out how to create a new set of expectations, a new set of norms, a new set of institutions, a new set of policies that will make the political economy work better. So I think we need to

How do you turn regions that have been depressed for 30 years into attractive places for people to live, and attractive places for jobs to be created?

We need to focus on what to do about those who are not the direct beneficiaries of globalization, and who have legitimate concerns about being left out of the prosperity that many areas of our countries have experienced

focus on compensation, or more broadly, on what you do about those who are not the direct beneficiaries of globalization, who have legitimate concerns about being left out of the prosperity that many areas of our countries have realized. What do you do about those concerns, those demands that are legitimate? Dismissing them is not going to do anyone any good. We must figure out how to move forward rather than simply ignoring the complaints of those who have legitimate concerns about what's happened to them.

DB: Following on from that, if you frame the current tensions as being a reflection of regional disparities, of the emergence of the two Americas, what do you think would have to happen to see a reverse or this divergence? And is this realistic politically?

To be a great politician, you must have vision … You have to understand what the constraints are… You have to understand what the opportunities are

I can see the elements that could come together to make this realistic politically. But I must invoke professional privilege here, in some sense. I'm an academic, I'm not a policymaker, and I'm not a politician. And unlike many people, I think for politicians to be good politicians is really difficult. To be a great politician, you must have vision. You have to understand what the constraints are. You have to understand what the opportunities are. And I think back to the 1930s in America, a time of great despair, a time when many people thought the United States was heading down the road of fascism - and there were many fascist movements in America – and then Franklin Roosevelt came along and rebuilt American politics by creating a coalition that really had not been imagined before. Similar things happened in other countries, in Sweden, and maybe some of the other Western democracies. But it wasn't easy, and it took vision, and it took political creativity.

I think of times like these as a political crisis preceded by two economic crises (first the Great Financial Crisis and then COVID). We've had a series of serious economic disruptions which led to serious social disruptions, and which have now led to a serious political crisis. The party systems of almost every Western democracy are in crisis. I don't know what the way forward is, but I do think that there's room for creativity and thinking about how we meld the legitimate concerns of working class and middle-class citizens with the needs of an integrated economic order.

How do you build a political coalition that will support some variation of an integrated international economy, maybe not the hyper globalization that some people have protested against, but with due respect for the legitimate concerns of those who were hard done by the last 25 years?

I think we have plenty of instances in which that was done poorly. The US Democratic Party ended up ignoring working class voters and threw its lot in with the college educated in the big cities, who, in many instances, were very happy with globalization and pursued a set of cultural and non-material policies that were very alien to a lot of working class and middle-class voters. The latest round of elections showed that to be a big mistake. I know that there are people in the Democratic Party, just as I assume that there are people in parties around the around the world, thinking about new ways of building different kinds of coalitions. How do you rebuild an alliance, a coalition, that will support some variation of an integrated international economy, maybe not the hyper-globalization that some people have protested against, but some variant of an integrated international economy, with due respect for the legitimate concerns of those who were hard done by the last 25 years. That's the challenge that faces us. I have the great privilege of being an academic, so in a world of multiple equilibria, I can sit back and wait until some equilibrium emerges and then explain why that was inevitable. But real-world politicians, and people in the real world, have to figure out how we find our way to a better equilibrium - a better way forward that addresses legitimate concerns on both sides, both in terms of international economic integration and the costs of that integration.

DB: Do you think there an alternative to the US Dollar as the world's reserve currency?

The euro is the obvious alternative to the dollar, but is currently in no shape to take on that role

Not now, but eventually there can be. I think that the obvious alternative would be the euro. But the euro is in no shape to be an alternative reserve currency - for now. You don't have the depth, breadth, solidity of the American financial markets. The euro doesn't have sufficient safe assets available. It doesn't have the persistence, the long history the US dollar has, but those things can be built up over time. And you know, I hate to suggest that bad times may bring forward good outcomes, but Europe has been unsuccessful at moving forward on a whole variety of financial and monetary and economic fronts for the last 15 years or so. The banking union is not complete. Europe does not have a single financial market. The euro is a single currency without a single financial market. That's a big problem. Europe does not have a safe asset that foreigners can invest in. Now, much of that may be changing … changing with the

Europe still lacks a safe asset that foreigners can invest in

"It's always good to have an external enemy, and now we have two, Russia and the United States"

Maybe the current circumstances will push Europe to work together to build the kind of solid financial system and solid monetary order that could make the euro an alternative to the dollar

repeal of the debt brake in Germany, with concern about investing much of Europe's massive savings in reconstruction and rearmament, in rebuilding a European economy.

I was here in London for a meeting, and one of my friends from the eurozone said, "it's always good to have an external enemy, and now we have two, Russia and the United States." I hope that's not the case, but maybe the current circumstances will push the eurozone and the European Union and the UK to work together, to build the kind of solid financial system, and solid monetary order, and safe assets that could eventually, not next week, but maybe in five or seven or ten years, be a true alternative to the dollar. It doesn't exist now, but you know, a big mistake, both in political economy and in investing, is to assume that the future will always be like the past, when it rarely is so. I think that we should be thinking about the future, what the constraints and opportunities are, when thinking about the future, rather than what the last 25 years have looked like. And the future does hold out opportunities for Europe to explore, to consider a degree of independence from the United States that it has not had to contemplate up until now.

DB: Jeffry, thank you for a fascinating discussion.

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