Repairing Liberalism

Embedded Liberalism and Hegemony
Today’s agenda

• Review causes of “Great” Depression
• Saving Liberalism: Domestic Modifications
• Saving Liberalism: International Modifications
  – The Tendency Toward Economic Nationalism and the logic of Protectionism
  – Does the International Economy need a Leader?
  – The logic of Hegemonic Leadership
  – The logic of international institutions
From Liberalism to Economic Nationalism to War

Classical Liberalism at work
Britain is The World’s Creditor

Growth Stops
Trade Stops

Great Depression
Dropping the Gold Standard. Smoot-Hawley Protectionism
Depression and War

They’ve got more important places to go than you!...

Save Rubber
STAY AT HOME AND PLAY
WORLD WAR II: TITANS
Marxist explanations

• Exploit others
• Grow or Die
• Overproduction
• Underconsumption
Liberal Explanations: Depression as low point in the Business Cycle

Adjustment Required

But People lost their nerve and called on Govt. to intervene

Protectionism

If prices are low enough, demand will increase
Economic Nationalism at Work: Beggar-thy-Neighbor
Market solution: “purge rottenness out of the system”

- After the 1929 crash, Treasury Secretary Andrew Mellon advised the government to cut spending to balance the budget, and leave desperate banks, businesses, and families to fend for themselves because the market alone would "purge the rottenness out of the system."
But there are weaknesses of a liberal political economy

• Market imperatives
  – The business cycle
  – Free Trade creates losers and requires “adjustment”
    – Losers are free to fail

• Political Imperatives
  • Nations and states need political and social stability—losers must have a safety net because they are citizens of the “nation”
  • The political need for stability and the requirements of the market are contradictory under the above conditions

• Governments must intervene in markets
  • to protect the “nation”
  • They can topple when society is unstable
The Domestic Solution was a Keynesian Solution

• Modified Liberalism: Create a climate for a tamed liberal economy to thrive
The International Solution: Find a way to prevent economic nationalism
Why did States close their economies in the “trough”

- Balance-of-Payments Deficits
- When credit dries up, stop importing
Economic Nationalist Explanations

International Anarchy + Market Anarchy

States seek security

- Close markets
- Protect domestic industry
The Tendency toward Economic Nationalism

• The Logic of Protectionism
The tendency is acute under the gold standard.
Tendency toward economic nationalism: explaining protectionism as a PD Game

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<th>Cooperate (free trade)</th>
<th>Defect (protectionism)</th>
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<tr>
<td>Cooperate</td>
<td>5, 5</td>
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<td>Comparative advantage</td>
<td>I keep my market open but you close yours; I lose so eventually I will retaliate</td>
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Contradictions between needs of the domestic political economy and the International economy
Can the contradiction be resolved to overcome economic nationalism?

• Stable politics AND free trade require:
  – Credits for payment deficits
  – Markets for exports in downturns
  – Lender of last resort when exports can’t pay for imports

• Stable markets need currency stability

• This will stimulate free trade and maintain stability of the domestic political economy
The Resolution: Embedded Liberalism
Getting embedded liberalism is a collective action problem

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Collective Action requires that the strong help the weak cooperate
So Hegemonic Power is required for cooperation to create a system of embedded liberalism

• This is Kindelberger’s argument
• Many argue that a central source of the Great Depression in the 1930s was a lack of British leadership and the unwillingness of the U.S. to provide leadership in the world economy.
• Leadership is needed to stabilize the world economy because resources for stabilization are required
  – Open markets even with a trade deficit
  – Extend credits to countries with payments deficits
  – Provide countercyclical lending and be a lender of last resort in the “trough”
Hypothetical Recovery with Hegemonic leadership

But People lost their nerve and called on Govt. to intervene → Protectionism
It takes power to be a hegemon

• 1. Control over raw materials
• 2. control over sources of capital
• 3. control over markets
• 4. competitive advantages in the production of highly valued goods—technology
• 5. Military power
Britain had provided hegemonic leadership to the international economy before the Depression.
Before the Great Depression, The U.S. had the capability to “lead”

• It had the capability to
  – Extend credits for payment deficits
  – Offer a market for others’ goods
  – Be a lender of last resort
• But lacked the willingness to lead
• Why?
We will answer that question next week
Hegemonic Leadership

• What does “leadership” mean
• It means assisting others in the world economy
Institutions: Bretton Woods

• Resolving the “dilemma between internal and external stability.”
• Intergovernmental collaboration to facilitate balance-of-payments equilibrium
• Multilateralism based on domestic intervention