Many things have happened on the financial scene over the past year, but all these things have paled into insignificance in the wake of the Brexit vote on June 23. The referendum, which Cameron rashly called on the basis of a weak hand but apparently favourable opinion polls, revealed the Brexiteers to be firmly in the majority in the country, if not in parliament. This creates a democratic dilemma for parliament which now has little choice but to implement the people’s verdict. What remains in question is the nature of the divorce from Europe, and that depends as much on what Europe (a many headed hydra) aims to achieve from these discussions (punishment or cooperation?) as on what Britain wants. Some may dismiss this event as a parochial matter in the scheme of things, of interest only to those living in Britain and/or those whose fortunes depend on London remaining the world’s pre-eminent financial centre. Others might see this as presaging a more profound tectonic shift in the global economic and political order, with the possibility of new alliances and new enmities and a prolonged period of unwelcome uncertainty in the meantime. Building on the successful two-day conference on the Future of Europe at the end of April, PEFM intends to take an active part in the debate on how Britain and the world should deal with the Britain’s epochal decision to leave the EU.

Adam Bennett and David Vines

PEFM’s vision

The purpose of the Political Economy of Financial Markets programme (PEFM) is to help improve the institutional design of policy frameworks affecting financial markets, toward supporting sustainable and crisis-free growth. The programme is devoted to the interaction between official policies and financial market behaviour. It explores how incentives affecting the financial sector could be better coordinated in the future. The scope of the ‘official policies’ reviewed under the programme, however, goes well beyond the design of regulatory frameworks and of financial supervision. The purview of PEFM is moreover evolving, and in light of recent events will be paying special attention in the coming year to the implications of Brexit for the political economy of financial markets.

The programme has focussed on two themes. The first is on the role of macroeconomic frameworks in setting the stage for sustainable financial flows, in light of ongoing global political and economic developments. The second is on the changes in ethical and cultural frameworks which might help the financial system resume a constructive role within the economy in the wake of the great financial crisis of 2008.

The goal of PEFM is not to compile a cookbook of static policy recipes. In a world of adaptive and interactive financial markets, that would not be realistic. Rather, the aim is to bring together a community of experts from different academic disciplines, and from official and private market institutions, so that their complementary research efforts and discussions can help develop and promulgate new policy insights. Our aim is that, over time, we can build PEFM into an internationally recognized go-to place in Oxford for policy-related work on the financial system.
People at PEFM

In 2016, Charles Enoch and Gordon Menzies joined the PEFM team; Charles as a Visiting Academic, and Gordon as an Associate.

Charles Enoch

Charles Enoch accrued a total of 26 years of experience in the International Monetary Fund (from up to his retirement in 2016). Following 12 years at the Bank of England, he served first as Alternate Executive Director for the UK, and then joined the IMF staff, concluding his career as Deputy Director of the Western Hemisphere Department. While on the staff, he worked on more than 60 countries, mostly in the Monetary and Capital Markets Department and its antecedents. He co-edited “From Fragmentation to Financial Integration in Europe” in 2013 and “Rapid credit growth in Central and Eastern Europe: Endless Boom or Early Warning?” in 2007. Charles has an M.A. from Cambridge University and a PhD from Princeton.

Gordon Menzies

Gordon Menzies is Associate Professor with the University of Technology Sydney. After an undergraduate degree in econometrics, he had over a decade experience with the Australian central bank. He was sponsored by the bank to complete a masters at the Australian National University, where he won a prize for the best student. ANU subsequently nominated him for a Commonwealth scholarship to Oxford, where he studied under David Vines and Donald Hay on the Asian Financial Crisis. He holds numerous teaching awards and the 2009 Arrow Senior Prize for the best economics paper in the Berkeley Electronic Press. He is a visitor to the PEFM group at St Antony’s college and the Oxford Martin School. In Australia he is the deputy director of the Paul Woolley Centre for the Study of Capital Market Dysfunctionality.

A tale of three cities: Commemorating Max Watson

In October 2015, St Antony’s College paid a tribute to the late Max Watson (PEFM’s founder), with a celebration of his life in a “Tale of Three Cities” at the Nissan Lecture Theatre, an event chaired by David Vines (Acting Director of PEFM), Jonathon Scheele (former EC official), and David Madden (former UK Ambassador to Greece), who orchestrated contributions from the many friends and colleagues who had worked with him in Washington, Brussels and Oxford respectively.
Highlights of PEFM events in 2015-16

The programme on the Political Economy of Financial Markets (PEFM) had another busy year during 2015/16, beginning with a tribute to the late Max Watson (PEFM’s founder), with a celebration of his life in a “Tale of Three Cities” at the Nissan Lecture Theatre (see previous page).

PEFM’s regular weekly seminars at the European Studies Centre continued to focus on financial market reform.

Malcolm Knight (former General Manager of the BIS) criticized the distinction between (supposedly risky) Originate to Distribute model of banking versus the (supposedly safe) Originate to Hold model on the grounds that the latter can still result in unsafe balance sheets. Despite this, the main emphasis of recent regulatory reform has been on the former model. Both models remain vulnerable to excessive leverage, on which better data is needed. Ian Plenderleith (Morgan Stanley) surveyed developments in regulation, and suggested that the pendulum of regulatory oversight was swinging back towards a more highly constrained and less innovative financial system, such as existed before the bonfire of regulations in the 1980s. It was important to get the regulatory balance right. David Wright (Secretary General of IOSCO) focussed on unfinished business in the reform in non-banking financial market regulation.

Lorenzo Codogno (Visiting Professor, LSE and former Chief Economist of the Italian Treasury) provided a rare insight into the Italian elephant in the Eurozone room, while Jeffrey Franks (Director, IMF Office in Europe) gave an IMF perspective.

Anatole Kaletsky (Co-Chairman, Gavekal Consultancy) argued (as in his recent book) that the world was evolving a new phase of financial development which he called Capitalism 4, which was essentially a less liberal model than the globalized deregulated model (Capitalism 3) that preceded it. Russell Kincaid (consultant for IMF’s Independent Evaluation Office) gave an early heads-up of some of the findings of the IMF’s external review of its role in the Eurozone crisis.

Collaborative work with SEESOX was featured in a book launch on Remaking the Balkan Economy, its authors represented by Adam Bennett (Deputy Director of PEFM) and Peter Sanfey (European Bank for Reconstruction and Development), and also by a joint presentation by Adam Bennett and Robin McConnachie (Oxford Analytica) on the record of IMF program work and technical assistance in the Balkans. Gazi Erçel (former Governor, Central Bank of Turkey) reviewed the history of IMF relations with Turkey during his tenure as Governor, and Boris Vujčić (Governor, Croatian National Bank) discussed recent global market trends from the perspective of Croatia.

Issues of Ethics in financial markets were debated in seminars by David Pitt-Watson (London Business School), who examined the purpose of the financial system in society, Robert Mass (Head of Compliance at Goldman Sachs) who is developing an ethics code for bankers, Nick Morris (Balliol College, Oxford) who drew lessons from Chinese law, and by David Vines (acting Director of PEFM) and Nick Morris who discussed the findings of their recent book Capital Failure.
What did you want to be when you were a child?
When I first applied to go to university, I signed up to train as an architect. I was quite a good draughtsman. Indeed, I think I was born into the wrong century. If I had been born in the 16th century in Rome, I think I would have cleaned up as an artist. However, I wasn’t born in the 16th Century. So I became an economist instead.

How did you become an economist?
It was clear that what I really liked designing were buildings in the style of John Vanbrugh and Inigo Jones—for which of course there was no market any more. What was on offer was training to build tower blocks. We were prompted to read Le Corbusier’s works as encouragement. I liked Corbusier’s idea that designs should have philosophical principles. Realizing that I probably didn’t have a future as an architect, I decided not to study architecture after all, but read philosophy. I was interviewed by Bernard Williams, who deemed me up to snuff (though I think I slipped up on the Law of Excluded Middle), and I was enrolled to study Part I philosophy at Kings College in Cambridge. My initial interest in philosophy at the time was in ethics, but I soon concluded that ethical principles could not be derived solely from Kantian laws of logic, any more than they could be discovered on stone tablets. They had to have empirical context—in other words the purpose of ethics was to serve society, not the other way around. My interest turned to the philosophy of science and of language, and I became engrossed in the works of Ayer, Feyerabend, Kuhn and Quine. I also made friends with two young fellow students, Anthony Appiah and Jeremy Butterfield, who were so much more brilliant than me (and both became professors in their field) that I decided I had better leave pure philosophy to them and follow up on my idea that ethics required empirical content—in particular an understanding of economics. So I switched to economics for my Part II.

What happened next?
Kings College was rather left wing in those days. My tutor was a Marxist called Mario Nuti. He taught me Neo-classical economics in much the same way as one might teach ancient Greek. There was no shortage of interesting characters floating about, including Nicholas Kaldor, Bob Rowthorn, and an unlikely person who actually believed in the usefulness of Neo-classical economics—Frank Hahn. But it was Wynne Godley who was to determine my future, because it was he who opened my eyes to empirical economics and applying this to policy formulation. After Cambridge, I went to LSE which, despite its reputation for being left-wing was actually quite mainstream when it came to economics. This was fortunate, because it was the LSE which cemented my career as an economist. From there I applied to join the Government Economic Service and then went to the Treasury.

My years at the Treasury were among the most exciting of my life. I joined just as the Thatcher revolution was unfolding. With Joe Grice (now head of the CSO), I published research (in the Manchester School) linking £M3 to gross financial wealth, producing an equation that was to be the foundation of £M3 targeting in the early 1980s. Talk about experimenting to destruction! Riding £M3 was like the rodeo, and this monetary animal bucked us fairly quickly. I also worked on the infamous 1981 budget (with Peter Spencer — now a professor at York), which was derided by the 364 economists in the Times. It was actually—in my view—the foundation of Britain’s economic recovery in 1982 and the real reason for Thatcher’s re-election in 1983 (the Falklands was merely the icing on the cake). The Treasury in those days was definitely the place to be. I shared rooms with Charlie Bean, and worked with Gus O’Donnell. They both pursued their careers in the UK, and I don’t need to explain where they ended up. But I decided to go to the one place that was even better than the Treasury for an applied macroeconomist wanting to make a difference in the world—the IMF in Washington DC.

What was it like working at the IMF?
The IMF is a unique institution. It is a bit like the Starship Enterprise, where the crew are recruited from across the Galaxy, but all (very helpfully) speak English! More importantly it is the only place—for an economist—where you can wield unfettered power and influence over economically wayward nations. The IMF does many things, including surveillance and technical assistance, but it is its program work that makes it an almost intoxicating place to work as an economist. As a small but slowly growing cog in the IMF machine, I was involved in
the late stages of the 1980s Latin American debt crisis, the Mexican tequila crisis in 1995, the Asian crisis in 1997, the Russian default in 1998, and the beginning of the Argentine and Brazilian meltdowns in 1999. After this, I spent nine years in the Middle East & Central Asia Department, starting with a two-year stint in Cairo, where I learnt (some) Arabic and spent most of my time in the desert. From there I emerged to become a “post-conflict” macro-stabilization and reform expert—in a region where my services were (sadly) constantly in demand.

Was it dangerous working in post-conflict environments?
It always looked more dangerous in the news on TV than it actually was on the ground. Of course, the term “post-conflict” was a misnomer. The conflict was usually ongoing. And I was in danger periodically—being shot at (by mistake) in the West Bank of Palestine, rocket bombed (intentionally) in Afghanistan, and accosted by Kalashnikov wielding “assassins” (who turned out to be police in disguise) in Kabul. Usually these things happened so fast, I was scarcely aware of being at risk of harm until after the event has passed. I had some near misses: the first IMF mission to Baghdad (which I did not join) was hit by the blast that killed UN Special Representative de Mello, the resident representative compound in Kabul (where we would normally stay) was hit by a car bomb, and the resident representative himself (who I had recruited) was later shot dead in a local restaurant.

What were your most notable successes and failures?
Most of the pivotal programs that stick in my mind stood or fell on exchange rate policy. My first ever program (as a very junior economist) was the disastrous 1988 program with Yugoslavia—which gave me a lifelong aversion to real exchange rate rules. I nevertheless subsequently became something of a guru on currency boards, a powerful nominal exchange rate rule which I helped to design for Estonia in 1992 and for Bulgaria in 1997. In both cases they proved extremely effective arrangements in containing inflation and providing the right environment for investment and growth. I also used a neat exchange rate trick (revaluation and small upward crawl) to kill nascent hyperinflation in Iraq in 2006 and reverse dollarization—a very satisfying example of economic theory delivering the desired results right on cue.

What brought you to Oxford?
This question is easy to answer—Max Watson. I knew Max at the IMF, but only on a personal basis. I didn’t become professionally involved with him until after he left Washington for Oxford, in my final years at the IMF (which I spent in the European Department). Following my own retirement, he encouraged me to join St. Antony’s College and help with SEESOX and then with the launch of PEFM. I was very fortunate that Max’s successor as Director of PEFM—following Max’s most untimely death in 2014—should have been David Vines. Very early in my career, I had published an article (in Economic Modelling) giving empirical support to a theoretical critique that David (who was also at Cambridge when I was there but I didn’t know at the time) had made of Wynne Godley’s then famous 1976 private expenditure equation. Having referred to David’s work approvingly in my article, I had always wanted to meet him. It seemed very fitting that I should do this near the end of my career! I am also glad that David has injected into the PEFM programme the extra dimension of Ethics and Finance, which brings me back to my initial interest in philosophy. Now if we could only justify a third leg for PEFM on the importance of 18th Century architecture …
Europe at the crossroads

Two conferences on the Future of Europe

The approach of the Brexit referendum on June 23, 2016 prompted PEFM to spearhead two high-level back-to-back conferences on the Future of Europe on April 27-28, in cooperation with the Oxford Martin School (OMS), the European Studies Centre, the Oxford Centre for Global History, and the Center on Capitalism and Society (Columbia University, USA).

Two connected conferences on 27 and 28 April brought in distinguished speakers from across the globe, and most especially from key European countries, to debate the future of Europe and the prospect of the integration – or disintegration – of the European Union (EU). Key note speakers included Edmund Phelps (Professor of Economics at Columbia University and Nobel Prize winner), Lord Patten (Chancellor of Oxford University), and Willem Buiter (Chief Economist of Citi). The conferences were convened in the context of a number of increasingly evident adverse long term trends (demographic, geo-political and economic) in Europe. The timing of these conferences was meanwhile prompted by the immediacy of several acute and potentially fatal stresses for the European Union—the Eurozone meltdown, the surge in refugees, and the approach of the Brexit referendum. With the European Union’s intensifying existential crisis the subject of the conference on the second day at St. Antony’s College, the conference on the first day at the OMS was tasked with the broader questions bearing on Europe’s long term future.

The first conference (held at OMS) on The Future of Europe: the Drivers of Change, explored the tension between the concept of the independent “Westphalian” nation state and the rise in border-defying flows of capital, labour and governance that resulted from globalization. Europe had become the most integrated collection of nation states in the world, but resistance was growing to further integration (fuelled in part by the Eurozone crisis). Europe’s position in the globalized world was also changing. As Ian Goldin (Director of the OMS) put it “Europe can no longer tell the world what to do. New Powers have risen and the world economy is much more balanced than it’s ever been. The problem is that when we think about risks the past isn’t a good guide. Our lifetime is unlike anything we’ve experienced in recent centuries”. The conference examined Europe’s pension crisis—the result of many factors including aging populations and rising dependency ratios as well falling returns in capital markets (exacerbated by quantitative easing and zero interest rates) and regulatory constraints. Professor Phelps contrasted Europe’s declining productivity performance with that of the USA and other more dynamic economies. If there was one single note of optimism, it was to be reminded by a delegate of John Maynard’s Keynes’ response (in Essays in Persuasion) to the prevailing pessimism of...
1931 when he said: “We are suffering, not from the rheumatics of old age, but from the growing-pains of over-rapid changes, from the painfulness of readjustment between one economic period and another.”

The second conference (held at St Antony’s College) on Integration or Disintegration: Europe at the Crossroads sought to analyse the EU’s developing existential crisis from the perspective of four countries: Germany, Greece, Poland and the United Kingdom, and centred on three key questions.

(i) What were the original ambitions of these four countries in joining the EU, to what extent had these been met, and what were their current concerns?
(ii) What were we to make of the economic and financial architecture of the EU—was it doomed or would it work?
(iii) How strongly did these four countries feel “European”, and was this European identity sufficient to meld the EU into “ever closer union”—or not?

It is not possible to provide an overall summary of this second conference, since speakers seemed to be pointing in so many different directions. The only common feature which in fact emerged from the remarks was a prescient sense of unease and pessimism. The announcement of the referendum result two months later was a profound shock to the liberal Establishment of Great Britain, as well as to the many European leaders who assumed that Britain would vote for the risk-averse option of staying in the EU. The political drama that followed in Westminster was meanwhile worthy of an episode (or two) from I Claudius. For better or worse, Britain is now being led out of the EU and must find a new role for itself in the world, much as it did in the aftermath of World War II with the end of Empire.

The process (as yet unclear) of Brexit has raised a host of questions regarding the future economic, financial, and political structures of Britain, Europe, and indeed the rest of the world. PEFM will be exploring these issues in the months and years ahead.
### Michaelmas Term 2015

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<td>12 October</td>
<td>Capital Failure: Next steps in restoring trust in the financial system</td>
<td>Nicholas Morris (Balliol College; Director of TUSK Advisory); David Vines (Balliol College, Oxford) Chair: Adam Bennett (St Antony’s College, Oxford)</td>
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<td>16 October</td>
<td>A Tale of Three Cities: Commemorating Max Watson</td>
<td>In association with SEESOX</td>
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<td>19 October</td>
<td>The Troika–Past and Future? A view from Washington</td>
<td>Russell Kincaid (Associate of PEFM; former senior IMF official); Chair: David Vines (Balliol College, Oxford)</td>
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<td>23 October</td>
<td>Rebuilding trust in the global economy: Lessons from Chinese law</td>
<td>Nicholas Morris (Balliol College, Oxford; Director of TUSK Advisory); In association with the Institute of New Economic Thinking at the Oxford Martin School and the Global Economic Governance (GEG) Programme</td>
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<td>26 October</td>
<td>Europe’s Economic crisis and the missing financial recovery</td>
<td>Jeffrey Franks (Director, IMF Europe; IMF’s Senior Resident Representative to the EU); Conference in Tirana hosted by the Bank of Albania In association with SEESOX</td>
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<td>30 October</td>
<td>Do crises change economic fundamentals?</td>
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<td>23 November</td>
<td>The Eurozone government debt crisis: Stylised facts, root causes, and policy lessons</td>
<td>Lorenzo Codogno (Visiting Professor, LSE; former Chief Economist at Italian Treasury); Chair: Adam Bennett (St Antony’s College, Oxford)</td>
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<td>24 November</td>
<td>European competitiveness challenges: The EU, Croatia and beyond</td>
<td>Boris Vujčić (Governor, National Bank of Croatia); Chair: Gillian Edgeworth (Wellington Management; St Antony’s College, Oxford) In association with SEESOX</td>
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<td>30 November</td>
<td>IMF programs and technical assistance in the Balkans -what has been achieved?</td>
<td>Adam Bennett (St. Antony’s College, Oxford); Robin McConnachie (Oxford Analytica; former Bank of England) Chair: Stewart Fleming (St Antony’s College, Oxford) In association with SEESOX</td>
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### Hilary Term 2016

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<td>25 January</td>
<td>Was the global financial crisis really a “debt crisis”?</td>
<td>Anatole Kaletsky (Founder and Co-Chairman, Gavekal Consultancy); Chair: Adam Bennett (St Antony’s College, Oxford)</td>
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<tr>
<td>27 January</td>
<td>The Eurozone crisis and Southern Europe: Recovery or illusion?</td>
<td>Adam Bennett (St Antony’s College, Oxford); Peter Sanfey (European Bank for Reconstruction and Development EDRD) Chair: Jonathan Scheele (St Antony’s College, Oxford) In association with SEESOX</td>
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<td>15 February</td>
<td>An ethics code for bankers?</td>
<td>Robert Mass (Head of International Compliance, Goldman Sachs); Chair: David Vines (Balliol College, Oxford)</td>
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<td>29 February</td>
<td>David Wright (Secretary General, International Organization of Securities Commissions (IOSCO))</td>
<td>Chair: David Vines (Balliol College, Oxford)</td>
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### Trinity Term 2016

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<tr>
<td>27-28 April</td>
<td>Two conferences on The future of Europe</td>
<td>In association with the Oxford Martin School and The History Faculty. Sponsored by Citi</td>
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<td>2 May</td>
<td>Financial reform in South East Europe: Turkey’s response to the past and current crises</td>
<td>Gazi Ercel (Former Governor of the Bank of Turkey); Chair: Nicholas Morris (St Antony’s College, Oxford) In association with SEESOX</td>
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<td>9 May</td>
<td>What they do with your money: Does the finance industry do its job well?</td>
<td>David Pitt-Watson (London Business School); Chair: David Vines (Balliol College, Oxford)</td>
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<tr>
<td>23 May</td>
<td>Banking reform: The limits of prudence</td>
<td>Ian Plenderleith (Former Bank of England); Chair: Robin McConnachie (Oxford Analytica)</td>
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<tr>
<td>6 June</td>
<td>The G20 reform of bank regulation and the next financial crisis</td>
<td>Malcolm Knight (London School of Economics); Chair: Adam Bennett (St Antony’s College, Oxford)</td>
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**Political Economy of Financial Markets**

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