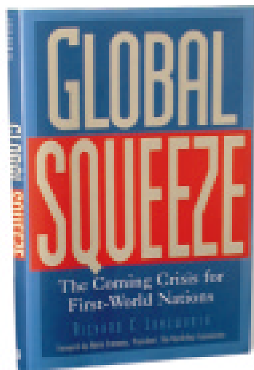
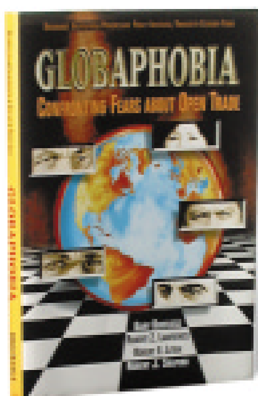


Richard C. Longworth

Global Squeeze

The Coming Crisis for First-World Nations

Contemporary Books, Chicago, 1998, x + 293 pp., $25.95 (cloth).



Gary Burtless, Robert Z. Lawrence, Robert E. Litan, and Robert J. Shapiro

Globaphobia

Confronting Fears About Open Trade

Brookings Institution/ Progressive Policy Institute/Twentieth Century Fund, Washington, 1998, xiii + 162 pp., $36.95 (cloth), $15.95 (paper).

THESE two books reflect an ongoing debate in the popular press and in policy circles about the effects of globalization on the U.S. economy. On one side, *Global Squeeze* is representative of a number of books about the dangers of the global economy—many of them journalistic accounts blaming the ailments of postmodern capitalist societies on the increasing internationalization of economic transactions. Other recent books in the same camp are William Greider's *One World, Ready or Not* and Robert Kuttner's *Everything for Sale: The Virtues and Limits of Markets*. All three of these books are written by journalists (Longworth writes for the *Chicago Tribune*, Greider for *Rolling Stone*, and Kuttner for *Business Week*) who apparently have little background in economics.

Globaphobia, on the other hand, represents a smaller group that tries to inject a note of realism, in the form of commonsense economic analysis, into the debate. This camp includes such books as Dani Rodrik's *Has Globalization Gone Too Far?* (reviewed in the December 1998 issue of *Finance & Development*) and Paul Krugman's *Pop Internationalism* (reviewed in the September 1996 issue). These books are not as sensational as their journalistic counterparts. The authors of *Globaphobia* worry about readers' equating reading their book with swallowing castor oil. But, for an audience of self-selected castor oil addicts, this will not be a problem—in fact, the book may be rather light reading. What may be less palatable to them is *Global Squeeze.*

Global Squeeze begins with the premise that "a new force called globalization" is sweeping across the landscape of the industrial countries, threatening the economic base of their civilizations. Although the integration of the world economy has progressed for over a century, the author argues that, in the United States, this "new force" is responsible for the stagnation of real wages, the widening of wage and income inequality, the splitting of the middle class, and growing job insecurity.

The book reviews the impact of globalization in a number of other industrial countries. In Germany, globalization is found to be responsible for the unraveling of the social market economy and the trimming of the welfare state. France and Japan have shielded themselves from globalization by maintaining a large economic role for the state (France) or by maintaining high barriers to trade and investment (Japan) and thus represent models for the United States to follow. A chapter on efficiency argues that there is a trade-off between market efficiency and social programs that promote the welfare of workers. A chapter on demographics argues that because of the aging of their populations, industrial countries are becoming even more vulnerable to the forces of globalization and competition from the younger, cheaper labor force in the developing world. These arguments sometimes sound persuasive if you are looking for a scapegoat for the ills of an otherwise booming U.S. economy, but they have little basis in fact or logic.

The credibility of *Global Squeeze* begins to erode rapidly in the second chapter, when the author states that the principle of comparative advantage "has very little to do with trade in the real world of the global economy," and that, while trade may at one time have been a positive-sum game, it becomes zero-sum if a trading partner (alternatively China or Japan) "makes up its own rules and plays by them." The final result of playing by its own rules is that China will become the next great competitor in the global economy, maintaining a trade surplus while at the same time sucking in huge flows of foreign capital to upgrade its productive capacity. Under this scheme, it will be able to compete with an unbeatable combination of advanced production technologies, high productivity, and low wages.

Globaphobia was written especially to set right this kind of wrongheaded thinking. It does not sugarcoat the problems in the U.S. economy: a lack of real wage growth, increasing wage and income inequality, and poor productivity growth. But it clearly demonstrates why they cannot be laid at the doorstep of globalization. It recognizes that international trade and investment create dislocations in the U.S. economy and addresses the need for some kind of policy to help those who are adversely affected.

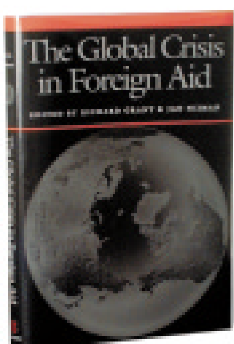
The first chapters present the classic case for the benefits of open trade and investment in refreshingly simple and direct terms. In subsequent chapters, the authors recreate the arguments against openness and trade and then answer them in a consistent and straightforward manner. First, about openness, jobs, and wages, the authors show how trade has little to do with the overall level of employment in an economy but may affect its industrial composition, eliminating less productive

jobs while creating more productive ones. Although the authors acknowledge that there is a good theoretical argument that U.S. trade with lower-wage countries depresses the relative wages of less-skilled workers in the United States, they counter that, in practice, there is little hard evidence that this has actually happened. Indeed, all available evidence suggests that growing wage inequality in the United States is mainly the result of technological change and (to a lesser extent) immigration.

Subsequent chapters treat the issues of fairness in trade (the leveling of the playing field), standards, and sovereignty. The authors note that the definition of unfair trade has changed over time as protectionist interests have used it to keep out foreign competition. They point out that the charge of unfairness that is made when American workers and companies must compete on an uneven playing field reflects a fundamental misunderstanding of the gains from trade, which come from country differences. There is a brief discussion of the arbitrary nature of U.S. antidumping practice, which the authors argue is unfair to foreign producers. Finally, they reject the claim that globalization has cost the United States its sovereignty and argue that the constraints that trade agreements impose pale in comparison with the benefits derived from freer trade.

Perhaps the best part of the book is the final chapter, in which the authors propose a mechanism for dealing with the dislocations caused by international trade. They begin by describing what already exists: Section 201 safeguards (which allow the U.S. government to protect against imports that threaten a domestic industry), voluntary restraints and antidumping legislation, and the Trade Adjustment Assistance Program (a U.S. program that assists workers who lose their jobs as a result of trade). They point out the shortcomings of the Trade Adjustment Assistance Program and describe how they would amend it by including time-limited wage insurance that would compensate workers if they earned lower wages after being displaced by trade. Though many readers will find something to object to in this proposal, its virtues are that it is relatively modest (hence realistic) and highly targeted and that it attempts to address the issues of adverse incentives that plague unemployment insurance in general. It thus provides a welcome contrast to the proposals made in *Global Squeeze* (a 100 percent tax on short-term speculative profits, a global currency, global tax arrangements, and a global equivalent of the U.S. Securities and Exchange Commission), which are ill conceived and totally impractical.

Geoffrey Bannister



Richard Grant and Jan Nijman (editors)

The Global Crisis in Foreign Aid

Syracuse University Press, New York, 1998, xxiv + 224 pp., $34.95 (cloth).

THIS COLLECTION of essays provides useful insights into the evolution of aid flows over the past 30–40 years. Its strength is in bringing together the views of academics as well as of policymakers, donors, and recipients. The contributions show how aid flows were largely dominated by strategic considerations during the cold war. With its end, the "transnational liberal order," which promotes liberalization and democracy around the globe, is essentially the only remaining development philosophy.

Nonetheless, the editors expect aid to continue to be an "expression of the structure of political relations and hegemony in the international system," as donors' strategic concerns override other priorities, such as supporting good governance, protecting human rights, or reducing poverty. The editors disregard the "21st Century Strategy" of 1996 in which all members of the Development Assistance Committee of the Organization for Economic Cooperation and Development (DAC/OECD) pledged to reorient their aid policies to achieve quantitative "core development indicators."

The book's analysis of U.S. and Japanese aid policies, their institutional setup, and their evolution is particularly helpful. The decline in U.S. aid to 0.08 percent of GNP in 1997, one of the lowest levels among OECD member countries, reflected the influence of political conservatives, a diminishing interest of the U.S. public in foreign affairs, and budget consolidation. Only Egypt and Israel, which receive the lion's share of U.S. aid, have been spared the large cuts that other countries have experienced in recent years. The new paradigm "trade not aid" has helped few countries although, as Boutros Boutros-Ghali points out in his section on Egypt, developing countries could benefit significantly if industrial countries abolished import barriers and eliminated agricultural subsidies.

In 1993, Japan surpassed the United States as the world's largest foreign aid donor, helped, at the margin, by the DAC/OECD methodology that uses a fixed 10 percent discount rate rather than market rates—which have been much lower in recent years, especially for the yen—to define aid (minimum grant element of 25 percent). In the contribution on Japan, Richard Grant shows that Japan's aid has supported the Asian development model, promoting government-guided investment strategies and emphasizing private sector involvement, particularly in infrastructure, transportation, and the environment. However, the current Asian

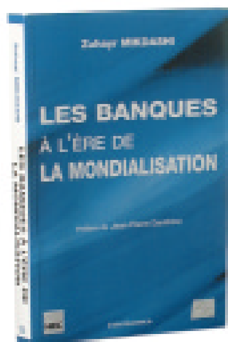
crisis has fueled doubts, held by many Western analysts, about the long-term effectiveness and sustainability of the Asian model.

The book discusses European aid mainly from the perspective of the central bodies of the European Union (EU), even though EU aid policy is a "complement [to], rather than a substitute for, national foreign aid policies." A more detailed discussion of the latter, including the emphasis in Dutch and Nordic aid policies on human development and poverty reduction, would have been helpful, as would a discussion of the trade-offs between debt relief and other forms of aid.

The discussion of aid to Africa could have focused more on the differences between (1) the aid-dependent low-income countries, mostly in sub-Saharan Africa, that receive virtually no resources other than bilateral aid and concessional multilateral lending; and (2) other aid recipients, including the transition countries, most of which have access to significant other foreign inflows.

In the concluding chapter, the editors note the shortcomings of the belief underlying most aid—namely, that developing countries need only temporary support to build up their economic potential, after which they would be able to participate in the global economy without further assistance. While they point out that this approach has not worked in practice, they do not offer alternative approaches on how to allocate aid more effectively. To fill this gap, the reader may want to turn to new research by the World Bank (*Assessing Aid: What Works, What Doesn't, and Why*, Oxford University Press for the World Bank, 1998) that shows that, for aid to be effective, the institutional and policy environment in the recipient countries must be right.

Doris Ross



Zuhayr Mikdashi

Les banques à l'ère de la mondialisation

Economica, Paris, 1998, xiii + 365 pp., F 275 (paper).

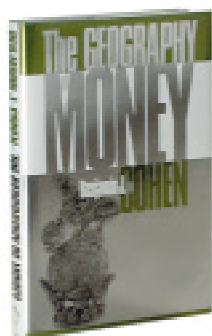
INTERNATIONAL banking has been much in the headlines recently, and most of the news has not been good. From the failure of Barings Bank in 1995 to the more recent episodes of banking sector fragilities in Japan and other Asian countries and the losses suffered by major European and U.S. banks in connection with the problems of the Long-Term Capital Management hedge fund—a well-known U.S.-based hedge fund—there have been numerous and pervasive signs of increased riskiness in banks' business. Yet not only the public but also policymakers and often even bank managers and supervisory authorities appear to have problems evaluating the sources of risk—both old and new—in international banking.

Against this background, the greatest contribution of Zuhayr Mikdashi's book is to provide a comprehensive summary of the issues at stake. In simple but adequately technical language, he summarizes the role of banks in the economy, their business behavior, the principal sources of risk, and financial institutions' main new approaches for balancing risk and return. Because most readers of this type of book will be familiar with the more traditional side of banking—evaluating liquidity and credit risks—Mikdashi rightly emphasizes newer concepts, such as the "value-at-risk" approach (a sophisticated statistical risk measure that tries to estimate potential losses based on a portfolio's historic performance) and individualized, bank-specific mathematical methods for risk evaluation. He underlines that such models can be better adapted to measuring risks of new financial instruments than the standard models that regulators generally apply. However, they also decrease transparency and comparability across institutions and therefore complicate prudential oversight.

Is improved supervision the answer to the increasing riskiness of banking? Not entirely, says the author, given remaining obstacles, especially to supervision in an international framework. Obstacles include, for example, the absence of a supranational supervisory agency, which is unlikely to be established in the foreseeable future. As a "second best" option, the book calls for effective cooperation among national authorities and for consolidated supervision of banks and other financial institutions operating in different countries. In addition, the book points to remaining differences in accounting standards and practices across even the Group of 10 industrial countries, as well as significant deviations between the supervisory rules set by the Basle Committee on Banking Supervision and those of the European Union. For improved regulatory action, such differences will have to be overcome, possibly in a discussion framework that includes the IMF.

The book concludes with a comprehensive discussion of deposit insurance. In this area, however—in contrast to a number of other controversial issues—the book avoids presenting a recommendation as to whether deposit insurance should be mandatory. A more definite recommendation on deposit insurance as well as a discussion of systemic issues—contagion and the fragility of entire banking systems—would have been two useful extensions of the book. These gaps notwithstanding, Mikdashi offers a topical work that should greatly enhance readers' appreciation for the growing complexities of domestic and international banking.

Anne-Marie Gulde



Benjamin J. Cohen

The Geography of Money

Cornell University Press, Ithaca, New York, 1998, xv + 272 pp., $25 (cloth).

IN *The Geography of Money*, Benjamin J. Cohen argues that governments typically want their currencies to have full authority within their territorial domain—what he calls the one nation/one money view. He considers this notion of currency space a *physical* one and also calls it a "Westphalian model" of monetary geography, which makes territory the central organizing principle for thinking of the legitimate domain of a money. He refers, of course, to the Peace of Westphalia of 1648, which ended the Thirty Years War and, as one outcome, affirmed a norm of sovereignty for each state within its own geographical frontiers. Cohen proposes, as more empirically meaningful, a *functional* approach to monetary space, according to which market forces constrain governments' control over the use of the moneys they supply.

Believers in the Westphalian model, Cohen admits, often see the advantages of monetary arrangements that are different from those that ensue from a strictly "one nation/one money" perspective. But even here governments want to be the ones determining the monetary geography of their moneys. Cohen discusses how countries voluntarily (and "rationally") subordinate monetary sovereignty—by creating currency boards, pegging their currency to other currencies, and joining monetary blocs—or share it, through currency or monetary unions.

Cohen argues not only that the Westphalian model, empirically, is a fiction but also that, as a doctrine, it has enjoyed only a short life. Sovereign coinage has existed since the dawn of modern civilization, but has not always been interpreted in exclusively territorial terms. Cross-border competition in currencies was the rule and not the exception. Some currencies did become genuinely international, the first being the silver drachma of Athens in the fifth century B.C. The Westphalian view did not take hold until well into the nineteenth century, as national governments sought to consolidate their power by asserting greater control over the creation and management of money. In fact, this task has not been easy in the face of market forces and centuries of tradition. Cohen contends that the Westphalian world view reached its apogee during the Great Depression and the years following World War II, when exchange and capital controls were widely used to reinforce the exclusive role of each state's currency within its own borders.

From the struggle between demand and supply forces, Cohen argues, emerges a hierarchy of currencies. A currency's place in this hierarchy reflects its national and cross-border popularity as a medium of exchange; store of value, including in foreign reserve portfolios and exchange market intervention; and unit of account. How does a money build trust, establish a wide authoritative domain, and attain a high ranking in the currency hierarchy? Cohen mentions three essential qualities:

- widespread confidence in a money's future value, which typically results from a track record of a relatively low level and variability of inflation backed by political stability;
- the twin qualities of "exchange convenience" and "capital certainty," which Cohen believes require well-developed financial markets that are sufficiently open to ensure full access to nonresidents; and
- the promise of a broad transactional network—the expectation of general acceptability by others.

In this Darwinian world, then, Cohen paints a picture of growing deterritorialization of money. He does not believe that this precludes an important role for public policy in the management of currency relations, but only that the task of governments has become more complicated. For, as he puts it, states, which once claimed the rights of monopoly, must now act like oligopolists, "vying endlessly for the favor of market agents."

In this book, the topics—such as choice of monetary arrangements and exchange regimes, as well as currency substitution—are all viewed, in economic geographic terms, as a struggle between government and the market over who will determine the authoritative domain of money. I found the book enjoyable and would recommend it to both general readers and economists, with the caveat to the former that its treatment of the topics is not the typical treatment of an economist.

Omotunde E.G. Johnson

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