

Lessons from history



Barry Eichengreen

Global Imbalances and the Lessons of Bretton Woods

MIT Press, Cambridge, Massachusetts, 2006, 200 pp., \$26 (£16.95) (cloth).

For almost a decade, a major concern about the international economy at the IMF and among many economists elsewhere has been the sustainability of large global payments imbalances: the U.S. current account deficit and the corresponding surpluses of an evolving group of other countries.

But some economists have taken a more relaxed view. A well-known version of this view appeared five years ago, when Michael Dooley and coauthors argued that the imbalances were sustainable for a decade or longer. The situation, they suggested, was like the Bretton Woods (BW) exchange rate system of 1946–71. Again, the United States served as the “core” of a system in which countries at the “periphery”—formerly Europe and Japan, and now mainly emerging market countries in Asia, particularly China—pursued export-led growth by managing their exchange rates at undervalued levels that generated current account surpluses. Those countries were content to lend their surpluses, through reserve accumulation, to the core, even at low returns, to subsidize the development of their export sectors and take advantage of the core’s deep and liquid financial markets. The authors referred to this as Bretton Woods II (BWII).

Grist for the mill

This argument is grist for the mill of Barry Eichengreen, a leader in the field of international monetary history and its application to current policy analysis. The theme of this compact and engrossing book is that history suggests that, contrary to BWII, the current situation is unlikely to last for long.

The book has four chapters. The first has the same title as the book and compares BW with the current situation. Now, as then, members of the periphery see a collective interest in supporting the U.S. dollar to maintain the value of their reserves and their international competitiveness, but each member has an incentive to reduce its dollar holdings to avoid capital losses threatened by potential dollar depreciation.

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However, Eichengreen notes several differences. Members of the periphery are now more numerous and heterogeneous and less constrained by their collective interest. The euro offers a more attractive alternative reserve asset than existed in the earlier period. And then, the United States registered current account surpluses that made the dollar fundamentally stronger than it is now. (Its overall payments deficit then reflected large long-term capital outflows.)

Moreover, the U.S. authorities are now less committed to maintaining the dollar’s external value. For these reasons, the periphery’s central banks

are less likely to continue holding dollars. And the periphery’s members are also becoming increasingly aware of the costs of their strategy—increasing difficulties in sterilizing growing reserves and containing inflation—and of the need for more diversified growth.

In the remaining three chapters, Eichengreen digs deeper for historical lessons. He recalls the Gold Pool, created in 1961 by the United States and a group of European countries to share responsibility for holding the dollar price of gold in the private market close to the official price that was a lynchpin of the BW system. When tested by market pressure, beginning in 1966, the Gold Pool never functioned as intended and it collapsed in 1968. Eichengreen views the arrangement’s difficulties as indicative of the problems of collective action likely to be encountered sooner rather than later in BWII.

Eichengreen also considers the lessons of Japan’s currency moves in 1971–73—revaluation of the yen, followed by floating—for China’s potential shift to a more appreciated and flexible renminbi. Japan’s revaluation, he finds, was neither destabilizing nor followed by a sharp slowdown in the growth of exports or output. But this was partly due to unusually strong global growth in 1972–73 and fiscal support. One of his lessons, disconcerting in early 2008, is that steeper appreciation of the renminbi would best be undertaken when global growth is strong.

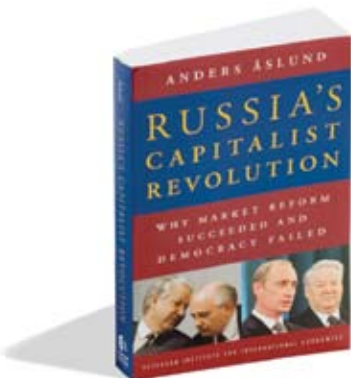
Finally, Eichengreen recalls the decline of the role of sterling in the 20th century and asks if the dollar is likely to continue as the world’s main reserve currency, as the BWII view suggests. He observes that the dollar’s share in global reserves has been rising in recent years—although, in fact, it has declined significantly from a peak reached at the beginning of this decade—but argues that the answer depends, above all, on U.S. policies, particularly on their success in reducing the current account deficit and preventing the associated further accumulation of net external liabilities.

ties. In any event, he sees the dollar as likely to lose ground to the euro.

For those who ponder global economic prospects, as well as for students of the international monetary system, this book should be high-priority reading. One could question some of the historical parallels, and, despite some progress in international adjustment, significant features of the global economy still, in early 2008, seem consistent with the BWII model. But the book's arguments are broadly convincing and reinforce concerns about the risks that the imbalances pose.

Graham Hacche
Deputy Director, IMF External
Relations Department

Longer view is better



Anders Åslund

Russia's Capitalist Revolution

Why Market Reform Succeeded and Democracy Failed

Peterson Institute for International Economics, Washington, D.C., 2007, 356 pp., \$26.95 (paper).

The transformation of the Soviet Union into 15 independent countries that have market economies and democratic, or at least noncommunist, political systems is, inevitably, a process stretching over many years. An assessment of progress at one point in time may differ from that made at another time. Thus, the despair about Russia that

many Russians and others felt during the chaotic 1990s has given way to greater optimism in the current decade. As Vladimir Putin's presidency ends, it is timely to look back over the entire period of Russia's transition.

Russia's long transition

The first great virtue of Anders Åslund's book is that he reviews all 22 years since Mikhail Gorbachev's early reforms in 1985. The first seven of his eight chapters are arranged chronologically, with two on the Gorbachev period, three-plus on Boris Yeltsin, and a little less than two on the Putin period.

This arrangement enables him to trace the consequences of the reforms over many years. For example, Gorbachev's economic reforms created a rent-seeking machine that enabled savvy businessmen to buy oil and other raw materials at controlled prices and sell them abroad at world prices.

These and similar practices became entrenched and compromised subsequent steps toward genuine market mechanisms. Åslund's longer view contrasts with the shorter perspective of those who came to Russia in the 1990s and wanted to attribute adverse outcomes to Yeltsin's reforms rather than to the deeper transformation taking place.

The second great virtue of the book is that Åslund is enormously knowledgeable about Russia. Not only does he know the literature (the bibliography contains more than 400 references), but he also knows many of the Russian actors and has spent much time in Russia. His account of developments and policies throughout the 22-year period reflects this knowledge as well as his analytical skills. Moreover, he writes in a clear and interesting way that keeps the reader engaged.

Åslund has a more positive view of Russia's economic transition than many writers, both Russian and foreign. He is right to dismiss the view that Russia could have followed a more gradual and less disruptive path to a market economy. Indeed, he

argues convincingly that many problems arose from insufficiently decisive early reforms, citing the prolongation of the ruble area, inadequate fiscal consolidation and hence macroeconomic stabilization, and the slow deregulation of energy prices.

But Åslund is perhaps too dismissive of the inequalities of wealth and income distribution that resulted from the way assets were transferred to private hands. Nevertheless, even those who do not agree with him on every point will learn much from his comprehensive presentation.

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The eighth and final chapter addresses the question in the book's subtitle: why market reform succeeded and democracy failed in Russia. His answer is that, in the early 1990s, Russia achieved a critical mass of economic reforms but nothing comparable on the democracy side. There was no vision about the democratic reforms that were required, and the opportunity to have an early election was missed.

Later, Putin's presidency coincided with the phase of postrevolutionary stabilization, and there were insufficient checks on his authoritarian tendencies. Looking ahead, Åslund asserts that the contradiction between fast economic modernization and reactionary politics will be resolved by a second wave of democratization. One hopes he is right, for the sake of Russia and the world, but contradictions can persist for a very long time.

John Odling-Smee
Former Director, IMF European II
Department