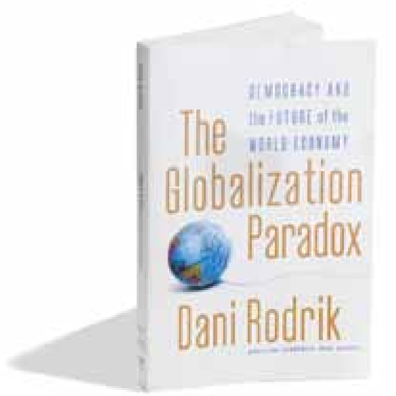
Globalization on a Diet



Dani Rodrik

The Globalization Paradox

Democracy and the Future of the World Economy

W.W. Norton & Company, New York and London, 2011, 288 pp., $26.95 (cloth).

Dani Rodrik is a long-standing critic of the existing international order. His excellent new book is a sequel to an earlier book about the often disruptive impact of international trade on national labor markets and social policies. The new book develops and extends this theme to include financial globalization. There is also a discussion about the democratic legitimacy of the existing international order. Rodrik concludes by considering how the world economy might be reformed.

The author's target is not globalization as such. He robustly defends both capitalism and globalization, because they have the potential to generate rapid economic development if properly harnessed. His target is "hyper-globalization," which involves the comprehensive elimination of barriers to trade and finance, together with severe constraints on the freedom of national governments to intervene in their domestic economies. This is the program promoted for several decades by "market fundamentalists" in the economics profession and within certain international institutions.

Rodrik objects to the fundamentalist approach on two levels. First, such a program rests on a crude version of economic theory that rarely applies in practice and runs counter to historical experience. During their take-off phase, the majority of today's developed economies actively promoted industrialization through the use of measures such as capital controls, subsidies, and restrictions on imports and foreign direct investment. The same is true of China and India in the recent past and even to some extent today. Such policies do not guarantee success, but few poor countries have taken off without them.

There is also national sovereignty to consider. Even if the program advocated by the fundamentalists is correct, there is no justification for imposing it on supposedly sovereign governments. Every country has the right to be wrong, so long as it does not cause serious harm to others. The international system needs rules, but these should be flexible and give national governments extensive freedom to experiment. This was the case under the old Bretton Woods system, which in its heyday was a stunning success in promoting economic growth and reconciling national autonomy with international order.

Market fundamentalism often accompanies the view that nation states are outmoded—that they are being undermined by global communications and market forces, and their role will be progressively supplanted by supranational institutions. The logical end of this process is world government. Rodrik is skeptical that world government is feasible. He is even more skeptical about its desirability:

"There is simply too much diversity in the world for nations to be shoehorned into common rules, even if those rules are somehow the product of democratic processes. Global standards and regulations are not just impractical; they are undesirable. The democratic legitimacy constraint ensures that global governance will result in the lowest common denominator, a regime of weak and ineffectual rules. We then face the big risk of too little governance all round, with national governments giving up on their responsibilities and no-one else picking up the slack."

Rodrik concludes that the alternative to world government is to strengthen the nation state. To this end he proposes seven principles for global reform that would restore much of the policy autonomy for individual countries that has been lost since the demise of Bretton Woods.

These principles are attractive, although they raise some tricky questions about implementation. For example, principle 7 states that "nondemocratic countries cannot count on the same rights and privileges in the international economic order as democracies." China is not conventionally classified as a democracy, since it is a one-party state without free elections. Yet the country has achieved miracles in terms of growth and poverty reduction. To penalize China because it is not a democracy might put this achievement in jeopardy. It would also be asking for trouble. China will quite soon have the largest economy in the world and would not take kindly to this kind of interference.

This raises a more general question. What is the political constituency for Rodrik's proposed reforms? The Bretton Woods system and the free market system that replaced it were both shaped by the United States and its richer allies in line with their priorities at the time. With Brazil, China, India, and other economic giants looming on the horizon, the world balance of power is shifting. Without the support of these future superpowers, no proposal for reform can succeed. It will be interesting to see what kind of reception Rodrik's ideas have in these countries.

Robert Rowthorn

Emeritus Professor,
University of Cambridge

Strength in Reserve

Barry Eichengreen

Exorbitant Privilege

The Decline of the Dollar and the Future of the International Monetary System

Oxford University Press, New York, 2011, 224 pp., $27.95 (cloth).

Barry Eichengreen's new book couldn't be more timely: on September 15, 2010—the second anniversary of financial services firm Lehman Brothers' collapse—the Bank of Japan's intervention to drive down the yen sparked a wave of reactions in Korea and Brazil and intensified the standoff between China and the United States over the value of the renminbi. A new round of currency wars broke out, and many fear that 1930s-style moves to push currencies down will lead to trade protectionism, economic nationalism, and increased international tension.

Eichengreen opens with an older question—not so much about the manipulation of weak currencies for trade advantages as the advantages of strength. How does the United States benefit from the dollar's role as the world's major reserve currency? What is the "exorbitant privilege" that French politicians have lambasted since the 1960s? Can there be only one major reserve currency?

Eichengreen's responses to these questions are elegant and pithy. He convincingly argues that it is not the status of a reserve currency that gives great power status; instead, the role of safe haven follows great power preeminence. Investors—whether private or official—are prepared to accept lower returns for investing in the United States simply because it is a secure country, with a well-understood and -enforced rule of law. As its great power preeminence fades and the catch-up effects of technical diffusion erode its economic superiority, a more multipolar currency system is likely to replace the dollar's hegemony.

Eichengreen explains how a specific policy initiative led to the dollar's quick rise as a major world currency. One of the purposes of the monetary reforms following the 1907 financial crisis was to enable U.S. merchants to use dollar acceptances instead of sterling bills via London to finance international trade. The Federal Reserve System was established to support the new financial center. By the 1920s, the dollar was a major reserve currency, and the immediate aftermath of World War I showed that a multicurrency system could work. Eichengreen also chronicles the rise of a new challenger, the euro.

New global currencies—first the dollar, then the euro—can emerge quickly, as did the deutsche mark in the late 1960s and 1970s. Eichengreen sees the renminbi as a possible major reserve currency, but argues that the Chinese leadership is not yet ready for financial liberalization. He considers China closer to late 1960s Japan (which struggled against moves that would lead to internationalization of the yen) than to the Federal Republic of Germany.

Could something besides existing currencies be an international medium of exchange? Eichengreen examines and dismisses the likelihood of a return to gold or the use of some other commodity standard. A more intriguing and currently fashionable idea is increased use of the IMF-created international reserve asset, the Special Drawing Right (SDR). Created in 1969 to supplement member countries' official reserves, its value is based on a basket of four key international currencies, and SDRs can be exchanged for freely usable currencies. But Eichengreen is skeptical about the feasibility of using the SDR as the common international medium of exchange. He describes the case for a global currency as "compelling in the abstract," but impossible in practice. "As long as there is no global government to hold it accountable for its actions, there will be no global central bank."

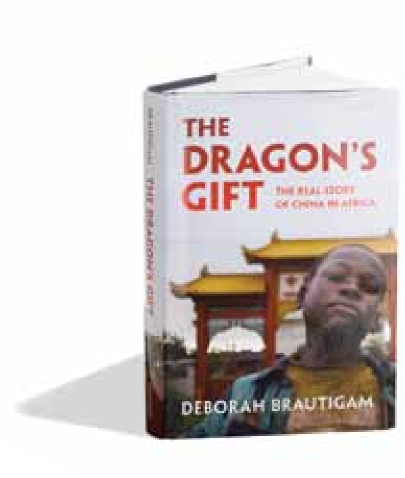
The section on a global currency seems at odds with the discussion of the emergence of the euro, which is after all issued by a central bank neither controlled by nor responsible to any government. The euro grew out of a sustained attempt at monetary cooperation in the face of unease about the global situation. Episodes of dollar weakness fueled creation of the euro: strains and then a breakup of the par value system in the early 1970s and U.S. currency mismanagement in the late 1970s and early 1990s. European cooperation was subject to the same problems that Eichengreen says confront a world basket currency. During the 1980s, the Europeans tried to promote private use of the European Currency Unit (ECU—a sort of precursor to the euro). Bonds and credits were issued in ECUs, but the market for a synthetic currency proved too shallow to survive the dramatic exchange rate crises of the early 1990s.

A final section examines the possibility of a swift dollar collapse, most plausibly, according to Eichengreen, as a result of an uncontrolled U.S. fiscal deficit. He argues that the 2010 euro crisis has already set euro area countries on a course of fiscal consolidation, whereas there is little political backing in the United States for similar reforms.

Harold James

Professor of History and International Affairs, Princeton University

The Misunderstood Dragon



Deborah Brautigam

The Dragon's Gift

The Real Story of China in Africa

Oxford University Press, Oxford, New York, 2009, 397 pp., $23.96 (cloth).

China is making a huge splash in Africa and in discussions about African economies, less because of the sheer size of China's aid, trade, and investment than because of the rapid increase in all three. African governments, civil society organizations, donors, and international organizations have reacted with a mix of enthusiasm, suspicion, and concern about the benefits and costs of Chinese economic engagement with Africa.

Deborah Brautigam's latest book is not the first to take on this topic, but it stands out in its efforts to convey the experience of China in Africa from a Chinese perspective, including both official and unofficial sources, on and off the record. Professor Brautigam is supremely qualified to write such a book: she has studied Chinese and worked extensively both in China and Africa for more than two decades, and much of her work has focused on Chinese-African economic relations.

The Dragon's Gift's strength is its extensive and varied array of interviews with Chinese government officials in Africa, Chinese factory managers, and other Chinese, African, and third-country participants and observers. Through these interviews, she conveys a rich sense of Chinese perceptions of how their own experience could benefit African countries. She also offers a snapshot of Chinese and African perceptions of Chinese aid and investment projects in Africa, including its successes, frustrations, and failures. Among the topics covered are cultural tensions between Chinese managers and African workers over work hours and wages, frustrations on the African side about the high number of Chinese managers and workers brought in for aid and investment projects compared with those of Western donors and investors (albeit at substantially lower cost for Chinese than Western expatriate staff), and mutual recriminations about who is responsible for failures in transfers of technical and managerial expertise.

Professor Brautigam repeatedly and convincingly makes the case that Chinese economic involvement in Africa is often misunderstood. In particular, she notes that there is often confusion between Chinese corporate investment through state-owned entities and foreign aid to Africa, that Chinese policy is explicitly focused on *mutually beneficial* opportunities for south-south cooperation. She also cites press reports and speeches that are often misunderstood (for example, as a result of errors in translating numbers or confusion between U.S. dollar amounts and renminbi figures).

The Dragon's Gift points out that reports of China's aid, trade, and investment flows to Africa are often overstated, sometimes in alarmist terms. It also explains that trade between China and Africa has been growing rapidly, albeit from a low base. She tries to address many other hot-button issues that dog China's economic engagement with Africa, including corruption (making the somewhat novel point that the direct transfer of aid from the Chinese state to the Chinese entities selected to carry out investment projects in Africa—often the funds never even leave China—limits opportunities for African officials to divert funds).

However, the book's strength is closely tied to its main weakness. Given that Professor Brautigam's focus is in large part on Chinese aid and the activities of state-owned enterprises, her book is very heavily and inevitably anecdotal. This stands in contrast to the more data-driven (but more trade- and investment-focused) approach taken by the 2007 study by Harry G. Broadman of the World Bank, *Africa's Silk Road*.

For example, the author is forced to adopt an anecdotal approach when she attempts to estimate 2007 Chinese aid flows to Africa. Her estimates include (1) a 2001 figure for China Eximbank's global concessional lending, (2) use of the annual growth rate of overall concessional foreign aid loans from a 2005 annual report to extrapolate the 2007 figure from 2001 numbers, and (3) a late-2003 report of discussions between a Chinese official and African ambassadors that mentions the share of aid to Africa over the preceding four years. Obtaining similar data for any other major donor would be a simple matter of looking up a published figure, but the author repeatedly notes that the Chinese government treats quantitative information on foreign aid, contract terms, and most other relevant data as state secrets.

Given these repeated difficulties, the author's criticisms of Chinese government transparency are surprisingly few and mostly implicit. She quotes the old academic saw "The plural of 'anecdote' is not 'data'" but proceeds to say that anecdotes will have to do until better information is available. Nevertheless, the reliance on press reports and interviews remains a frustration to readers.

Thomas Dorsey
Advisor, IMF Strategy, Policy, and Review Department