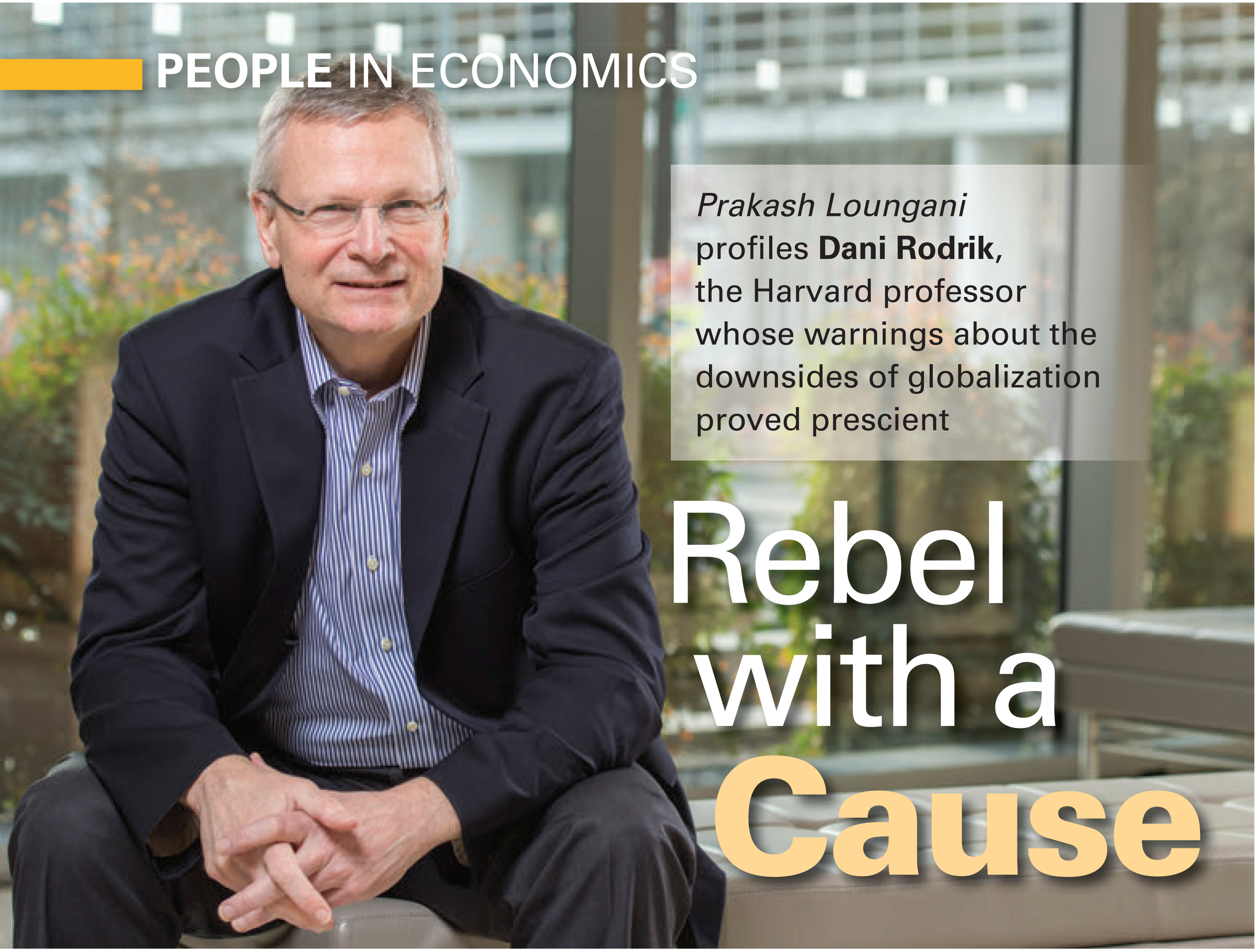

Prakash Loungani profiles **Dani Rodrik**, the Harvard professor whose warnings about the downsides of globalization proved prescient

Rebel with a Cause

THE triumph of markets over the state appeared almost complete in the early 1990s. The collapse of the Soviet Union and the fall of the Berlin Wall had discredited the role of the state in commanding the economic and political life of citizens. The political scientist Frank Fukuyama proclaimed in 1992 that the spread of democracy and capitalism around the globe would henceforth make history somewhat "boring." Among economists, markets—already held in fairly high regard—gained further esteem. Prominent left-leaning economists like Larry Summers admitted to a "grudging admiration" for such champions of the global spread of free markets as Milton Friedman.

But Harvard economist Dani Rodrik refused to join the party. Instead, he warned that globalization—the process of economic integration of nations through trade and finance—may have gone too far. In a 1997 monograph, he said there was a "yawning gap" between the rosy view of globalization held by economists and "the gut instincts of many laypeople" to resist it. In the United States, he noted, "a prominent Republican," Pat Buchanan, had just run "a vigorous campaign for the presidency on a plank of economic nationalism, promising to erect trade barriers and tougher restrictions on immigration" (themes pushed two decades later by Republican Donald Trump in his campaign for the 2016 presidential nomination).

Rodrik's warnings that the benefits of free trade were more apparent to economists than to others were prescient. His skepticism about the benefits of unfettered flows of capital across national boundaries is now conventional wisdom. His successful attack on the so-called Washington Consensus of policies to generate economic growth has made governments and international organizations like the IMF and the World Bank admit that there are many policy recipes that can generate growth. That the phrase

“one size does not fit all” has become a cliché is due in no small part to the influence of Rodrik’s work. “We didn’t understand how right he was,” says David Wessel, a former *Wall Street Journal* economics writer now at the Brookings Institution’s Hutchins Center.

Inside the ivy tower

Rodrik has spent most of his professional life at Ivy League institutions. He has a bachelor’s degree from Harvard and master’s and PhD degrees from Princeton, followed by a teaching career at Harvard and Columbia.

He was able to go from his native Turkey to Harvard because of his father’s success as a businessman. Like many countries in the 1970s, Turkey followed a policy of import substitution—imposing tariffs to keep out imports and substitute domestic products. Protected by these tariffs, his father’s ballpoint pen company was successful enough that Rodrik could contemplate studying in the United States. “I am the product of import substitution,” Rodrik has said.

On his application to Harvard, he wrote that he wished to major in electrical engineering, unaware that the school then did not offer it as a major. Nevertheless, he has since written, he was admitted because one member of the admissions committee “somehow saw a flicker of hope” in his application and pushed his case “over the strenuous objections of others on the committee.”

Shortly after arriving at Harvard in 1975, he decided to major in political science—and take a minor in economics due to his “father’s prodding.” His father, he says, “still had hopes that I would go to business school and do something useful in life.” In his senior year at Harvard, still “confused about his career goals,” he applied to six different graduate programs—some in economics and business, others in political science and international relations. He chose a master’s in public policy at the Woodrow Wilson School at Princeton and “had a great time,” but realized that he had “simply put off the decision” of whether to pursue a career in economics or political science.

He remembers “well what settled it.” One day in the library he picked up copies of the flagship publications of the two disciplines, the *American Political Science Review* and the *American Economic Review*. The former was “written in English, the other in Greek”—that is, liberally sprinkled with the mathematical equations favored by economists. He says he realized that “if I did a PhD in economics, I would be able to read both journals, but that if I did a PhD in political science, it would be goodbye economics. That was my epiphany.”

He was admitted to the economics department at Princeton in 1982, a year after his initial application, “more out of compassion than conviction,” he has written. A member of Princeton’s faculty, Peter Kenen, “was single-handedly responsible for my admission.” Some members on the admissions committee had concerns about Rodrik’s math skills but Kenen, with whom Rodrik had taken a course as a master’s student, prevailed on them to give him a chance.

At Princeton, he wrote his dissertation under the noted economist Avinash Dixit (see “Fun and Games,” in the December 2010 *F&D*). “I’ve never seen anybody who’s a clearer thinker than him,” Rodrik has said. “There’s never been a paper that I’ve written that I haven’t thought, ‘What will Dixit think about this?’”

Rodrik’s first job was at Harvard’s Kennedy School of Government in 1985. Except for stints at Columbia from 1992 to 1996 and, more recently, at the Institute for Advanced Study in Princeton, New Jersey, he has been at Harvard for the past three decades. It is from within the confines of this ivy tower that Rodrik has launched the attacks that have changed the profession’s views and made his name.

Taking on trade

That there are gains from free trade is a core belief of economists. Trade theory shows that if countries specialize in making some products, and then exchange some of those products through imports and exports, they end up richer than if each country were to go it alone. But there is a catch. When the United States decides to specialize in producing Hollywood movies rather than textiles, its textile workers stand to lose. Not to worry, trade theorists respond, our analysis shows that the gains to the Hollywood producers will be sufficient to make up for the losses of the textile workers.

Rodrik also emphasized that trade “fundamentally transforms the employment relationship.”

In practice, though, losers seldom share in the winners’ gains (redistribution in economic parlance). Rodrik says that “to this day, there is a tendency in the profession to overstate” the gains from trade while paying lip service to the need for redistribution. But trade theory shows that “the larger the net gains, the larger the redistribution [that is needed]. It is nonsensical to argue that the gains are large while the amount of redistribution is small.”

In his 1997 monograph, “Has Globalization Gone Too Far?” Rodrik pointed to the failure to push redistribution seriously as one reason for the gap between economists and laypeople in their attitude toward trade.

And he outlined several other tensions created by trade. Rodrik wrote that trade “is exposing a deep fault line between groups who have the skills and ability to flourish in global markets” and those who lack them. Without retraining or education, the latter would understandably be opposed to free trade. Rodrik also emphasized that trade “fundamentally transforms the employment relationship.” If workers can be more easily substituted for each other across national boundaries, “they have to incur greater instability in their earnings [and] their bargaining power erodes.” Trade could also “undermine the norms implicit” in domestic production, for instance, if child labor in a foreign producer displaced U.S. workers.

Rodrik concluded that the cumulative consequences of these tensions could end up “solidifying a new set of class divisions" between those who stood to gain from trade and those who lost out.

The monograph was published by the Institute for International Economics—now the Peterson Institute—and has become one of the think tank's bestsellers. The institute's founding director, C. Fred Bergsten (see "An American Globalist," in the March 2012 *F&D*), says that he suggested the title "instead of the long and technical one that Dani had." But Bergsten did more than suggest the title. He also persuaded his advisory board that the monograph was worth publishing; several members of the board were opposed to associating the Institute's name with an attack on free trade.

Rodrik says that Bergsten deserves credit for backing his cause when many others were reluctant. But he also credits a seemingly unlikely institution, the IMF. "Over the years I have been quite surprised by the assistance I have received from the IMF," where he wrote part of the monograph while a visiting scholar in 1995–96. The Fund is "not exactly the place you would think the ideas in that book would have necessarily originated."

Controls on capital

In October 1997, at its annual meetings in Hong Kong SAR, the IMF put forward its arguments why countries should not only *lower restrictions on trade* but should also move to *relax restrictions on the movement of capital across national boundaries*. Economists refer to the former as current account liberalization (or convertibility) and the latter as capital account liberalization or financial globalization. The IMF asked its member countries to amend the institution's charter to give it authority to monitor progress toward capital account convertibility.

At this time, several Asian economies were engulfed in a financial crisis that many attributed to the decision to open up to foreign capital flows. Though this made the timing of the IMF request awkward, then–First Deputy Managing Director Stanley Fischer gamely went ahead. He called capital account liberalization "an inevitable step on the path of development, which cannot be avoided and should be embraced." Fischer noted that this liberalization ensures that "residents and governments are able to borrow and lend on favorable terms, and domestic financial markets become more efficient as a result of the introduction of advanced financial technologies, leading to better allocation of both saving and investment."

Along with Jagdish Bhagwati, a champion of free trade, and Nobel Prize–winner Joseph Stiglitz, Rodrik spoke up against this financial globalization. Rodrik argued that the benefits that Fischer mentioned paled in comparison to the risks of increased volatility from the entry and exit of foreign capital. "Boom-and-bust cycles are hardly a sideshow or a minor blemish in international capital flows; they are the main story," he said.

Rodrik also was skeptical of any benefits of long-term capital moving to the countries where it was most needed. He argued against IMF insistence that capital accounts could be liberalized in "an orderly fashion and buttressed by enhanced prudential regulation of financial practices," which he said happened more in textbooks than in the real world. "Enshrining capital account convertibility in the IMF's articles of agreement is an idea whose time has not yet come," he concluded. "We have no evidence that it will solve any of our problems, and some reason to think that it may make them worse."

Two decades later, the time for capital account liberalization has still not come.

Indeed, two decades later, the time for capital account liberalization has still not come. Evidence has accumulated that its benefits are difficult to establish, while the costs have been undeniable. In 2006, a major study coauthored by the IMF's then–chief economist Kenneth Rogoff found little evidence of improved economic performance after a country opens up to capital flows. Another study found that foreign capital increases volatility in developing economies. The chief economist who followed Rogoff, Raghuram Rajan, showed that countries that grew rapidly relied less, not more, on foreign capital. In 2009, Rodrik himself wrote in *IMF Staff Papers*, an academic journal published by the institution, that "more is not necessarily better" when it comes to foreign capital flows; "depending on context and country, the appropriate role of policy will be as often to stem the tide of capital inflows as to encourage them" (see Box 1).

Killing the Consensus

In 1989, John Williamson of the Institute for International Economics put together a list of 10 policy actions he felt summarized the consensus among major international organizations on what countries had to do to trigger growth. The

Box 1

Global financial regulation: less is more

The recent global financial crisis turned a harsh spotlight on the effects of international flows of capital and triggered calls for a better system of global financial regulation. Predictably, Dani Rodrik is a lone voice in opposition, writing that "global financial regulation is neither feasible, nor prudent, nor desirable" (*The Economist*, March 12, 2009). He argues that desirable forms of financial regulation differ across countries and depend in part on how countries value financial stability versus financial innovation. The responsibility for regulating leverage, setting capital standards, and supervising financial markets should "rest squarely at the national level." Global financial firms should have to comply with these national requirements, just as global manufacturers comply with product-safety rules that differ across countries. "The world economy will be far more stable and prosperous with a thin veneer of international cooperation superimposed on strong national regulations than with attempts to construct a bold global regulatory and supervisory framework."

term “Washington Consensus”—sometimes also “neoliberal agenda”—has come to represent a general orientation toward market-based solutions for growth.

Rodrik has said that “when I first began to criticize the Washington Consensus, I thought I was doing the obvious.” In a series of papers and books written during the 1990s and 2000s, he made three points against the Consensus. First, growth often happened as a result of “eclectic solutions” that combined the roles of the market and government. Second, growth was often triggered by one or a few changes and did not require a “long checklist” of reforms. Third, there were many pathways to growth, not a unique set of institutions and reforms.

Rodrik provided many examples of successful industries in many countries that relied on a combination of market and state support. “Costa Rica is not a natural place to manufacture semiconductors,” he noted, but the government “got Intel to come in and do just that.” He argued that the historical record did not support assertions that the government cannot pick winners: “when economists say [this] they are really, for the most part, doing amateur political science.” What was more important, he said, was “to design institutions that … give the government the capacity to let go of the losers.”

Relying on detailed case studies by other scholars, Rodrik also provided examples of “how little it takes for countries to suddenly experience a rapid growth spurt.” In Mauritius, it was the establishment of an export processing zone; in China, it was the introduction of the household responsibility system and a two-track price regime; in India it was a change in the government’s attitude from extreme hostility to being supportive of entrepreneurship. Hence, transitions to higher growth did not require a long checklist of actions. Countries could boost growth by identifying “the binding constraints” to growth and overcoming them through “well-designed but relatively minor interventions” (see Box 2).

The case studies also showed there was “very little in common across [the] policy changes” that triggered growth, according to Rodrik. This suggested that there were many ways to grow. Moreover, a look at countries that were already rich—many in Europe, Japan, and the United States—showed that “you can end up being wealthy” despite differences in institutions and policies. Countries that had gotten richer more recently—those of east Asia in large part—had “marched to their own drummers and are hardly poster children for neoliberalism. East Asian countries would have been far worse off had they encountered something like the Washington Consensus. China would have been worse off if it had had no choice but to start the growth process through a structural adjustment loan from the World Bank.”

Today, “the Washington Consensus is essentially dead,” Rodrik says, “replaced by a much more humble approach” that recognizes “we need a lot less consensus and a lot more experimentation.”

The revolution is over

Andrei Shleifer, a Harvard colleague of Rodrik’s, often used to greet him in the corridors by asking, “How is the revolution going?” While there may have been some doubt about the answer when Rodrik started his Harvard career in 1985, it is clear three decades later that the revolution has succeeded.

His warnings about the downsides of trade and its potential to create class divisions have become widely accepted. Harvard professor and former U.S. Treasury Secretary Larry Summers wrote in the *Financial Times* in April 2016 that “the core of the revolt against global integration … is not ignorance. It is a sense, not wholly unwarranted, that it is a project carried out by elites for elites with little consideration for the interests of ordinary people.”

Rodrik’s caution about financial globalization is now widely shared, including at the IMF. Jonathan Ostry, an IMF deputy director who led the institution’s recent research on capital flows, says: “That Dani and the IMF can now have useful conversations about the design of capital controls is tribute both to his persistence and the institution’s flexibility.”

The attacks on the Washington Consensus have led to greater humility in the advice international organizations offer countries on growth strategies. Rodrik noted that the IMF’s 2013 paper on growth strategies made a “plea for contextual analysis and recipes that sounds, to this set of ears at least, quite pleasing.”

Rodrik himself seems to have acquired a deeper love of the profession he has often attacked. After two years at the Institute of Advanced Study, where his colleagues were drawn from various social sciences, he decided to return to the fold. His new book, *Economics Rules*—short-listed for the *Financial Times*’ best book award—tells noneconomists that “there is much to criticize in economics but there is also much to appreciate.” ■

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Box 2

Getting the diagnosis right

With economists Ricardo Hausmann and Andrés Velasco, Dani Rodrik proposed a framework—called Growth Diagnostics—to help countries decide which reforms to pursue for growth. As the trio wrote in a March 2006 *F&D* article, countries should figure out a small number of binding constraints on growth and focus on overcoming those, rather than tackle a “laundry list of needed reforms.” Applying their method to El Salvador, they concluded that the binding constraint on growth was not a shortage of savings but a “dearth of ideas”: the country’s traditional sectors (such as cotton, coffee, and sugar) had declined, but no new ideas had sprung up for other potential investment sectors. They advised that encouraging more entrepreneurship and new business opportunities should be “at the center of [El Salvador’s] development strategy.” The Growth Diagnostics framework has been used by both the World Bank and the IMF as a complement to devising growth strategies. For instance, as applied by the IMF staff to Tunisia in 2016, the framework suggests that lack of “access to finance” was the binding constraint rather than infrastructure bottlenecks or a shortage of human capital.