According to a folk saying, a single fool can confuse a thousand wise men. Paul Krugman has set himself the heroic task of being the single wise man to confound a thousand fools. Paul Krugman has, as evidenced by this collection of reprinted articles, decided to debate today’s popular writers on international economics—Lester Thurow, James Fallows, and others.

On the field of logical debate, Krugman triumphs. He exposes the inepitude of the “pop internationalists” in grasping both concepts and data. The favorite pop shibboleth that Krugman demolishes again and again is “competitiveness.” Competitiveness is the idea that the leading industrial nations are going head to head in the “decisive war of the century,” in Lester Thurow’s words. Krugman patiently explains over and over again that nations can mutually benefit from international trade. He explains why a productivity gain in one nation is not necessarily another nation’s loss and could well be its gain.

The pop internationalists even have trouble handling simple accounting, according to Krugman. In one hilarious section, he describes how pop internationalists warn simultaneously that (1) US capital investment is being diverted to the low-wage developing nations, and (2) those low-wage nations are running huge trade surpluses that are destroying US industry. Apparently, such pop internationalists don’t understand that it’s impossible for a low-wage nation, or any other nation, to have a trade surplus and a net capital inflow at the same time (domestic savings = domestic investment = exports – imports).

Krugman shows that pop analysts also have trouble handling the numbers, even when they do understand the concepts. The concept that capital could flow to low-wage countries is certainly respectable. But how important quantitatively are such capital flows to today’s industrial nations? The great emerging markets boom of 1993, with record capital inflows from the First World to the low-wage Third World, reduced the growth of the First World’s capital stock by at most 0.2 percentage points. Not exactly the stuff of First World nightmares.

Krugman points out how amazingly little interest pop internationalists display in the accumulated intellectual work on economic policy issues. This is not just Krugman complaining about his own work not being cited. The pop internationalists apparently lack interest in any previous thinking about economic issues by anyone, behaving as if they actually had to invent ideas from scratch. James Fallows finds little value in anything that has been written about economic issues since Friedrich List, a (justly) forgotten nineteenth-century German economist. Just to do a quick check on Krugman’s complaint, I glanced at the index of Lester Thurow’s new book, The Future of Capitalism. The ideas from economics that are cited in the index (two: factor price equalization and the “liquidity trap”) are outnumbered by the ideas from the natural sciences (three: evolution, punctuated equilibrium, and plate tectonics). This weakens my confidence in Thurow’s survey of economics in the late twentieth century. Whether it’s a good survey of the natural sciences in the late twentieth century, I can’t say.

What’s sad about all of this is how hard it’s going to be for Krugman to win the media war with the pop internationalists. The media hordes show little interest in either logical debate or hard numbers. They show a lot of interest, however, in Krugman’s alleged grudge because he didn’t get Laura Tyson’s job in the Clinton administration. (Paul Krugman does review a book by Laura Tyson in this volume. Contrary to legend, the review is favorable.)

Reading Krugman’s book raises larger questions about the nature of intellectual debate about economic policy in industrial nations. Why do the media—and too often policymakers as well—prefer warmongering metaphors to sober analysis, hysterical predictions of doom to constructive policy ideas, and Big Hair to Big Scholarship? How can we criticize developing countries for choosing bad economic policies when the economic policy discussion in the rich countries is so sophomoric? These questions remain unanswered. The optimist can only hope that Krugman’s valiant attempt to interject sense into pop policy debates will help matters. More economists should imitate Krugman and join the fray.

William Easterly
ness of transaction costs and the role of the organizations and organizational innovations in reducing them.” This notion has been imaginatively reinterpreted by Haggard and Lee and applied to the development of the financial system. Operationally, this implies that, in a given institutional setting, which may even happen to be a capitalist market economy, if the costs involved in carrying out certain financial transactions are higher than the benefits, new organizations, including private companies, emerge that tend to reduce these costs.

In its broad contours, this core idea is a clone of Ronald Coase’s famous proposition that it is not easy for a country to move on to a different public policy because of the presence of market failures, unless that policy entails decidedly greater benefits than costs. The editors put this issue very succinctly: “Just as the existence of market failures does not necessarily warrant government intervention, so the existence of government failures does not necessarily mean that intervention is detrimental to economic growth.”

The theoretical underpinnings the editors have formulated do not contradict the conventional wisdom that a country must have an adequate institutional infrastructure if a highly competitive, market-oriented financial system is to work efficiently. This infrastructure must satisfy an array of preconditions, ranging from a system of laws and regulations to an effective information system, to adoption of techniques designed to minimize costs of financial intermediation and to reduce uncertainty. But the principal question is how this infrastructure can be established. And here Haggard and Lee have something novel to say. They argue, mainly on the basis of their understanding of the Korean and Taiwanese experiences, that “It is possible for an internal organization such as an internal capital market to perform the tasks required of the needed institutional infrastructure more efficiently.” In other words, nonmarket institutions could be built up to nudge the financial system toward the market. In such a quasi-internal capital market, the government, financial institutions, and borrowing enterprises become partners. The efficient allocation of funds in such an organization is ensured by the dependence of its clients on the markets (often the foreign markets), which act as a check on the governments.

Will quasi-internal capital markets continue to be permanent financial features of the economies that have already benefited from them? Viewed in the light of what Korea has done since 1993, this question certainly appears to be a fundamental one. Korea is committed to completely dismantling its interventionist regime by 1997–98 and to taking the classical path of liberalization in vogue all over the world. The editors, however, are alert enough to deal with this emerging phenomenon. “Economic development may,” they argue, “itself affect the efficiency of the quasi-internal organizations. As the economy becomes larger and more complex, graduating from producing simple goods to more sophisticated products, organizational failures are likely to become more burdensome than the market failures.” This means that the editors view their theoretical framework as a transitional arrangement that is useful in the initial stages rather than a permanent architecture of the financial system.

Financial Systems and Economic Policy in Developing Countries is certainly one of the best books of its genre, with its main theses well articulated, its empirical evidence ingeniously marshaled, and the political dimensions of financial liberalization clearly and relevantly defined.

Deena Khathkate

Privatization and Capital Market Development
Strategies to Promote Economic Growth

By Michael P. McLindon
Foreword by Ceslav Ciobanu, Minister, Ministry of Privatization, Moldova

This is the first book to discuss comprehensively the linkages between privatization and capital market development, and how they support and reinforce each other to promote economic growth. It examines four types of privatization, including mass privatization, that are critical to developing capital markets and promoting growth, and analyzes the experiences of 14 countries that have adopted these strategies. It is intended for policy makers in developing countries and in the international donor agencies, for academics and practitioners working in development, and for the internationally minded private sector.

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The World Bank and nongovernmental organizations (NGOs) share the same overarching goal—poverty reduction in the zones of turmoil and development where 85 percent of the world's people live. Nearly 5,000 NGOs based in developed countries are active in the developing world. They provide support to some twenty thousand indigenous voluntary organizations. Together, they make up a mosaic of bewildering diversity.

The resources and skills at the command of voluntary organizations complement those available in public sector agencies. Thus, retrenching governments have become frequent sponsors and purchasers of nonprofit organizations' services and, increasingly, cooperative relationships are being forged between the government sector, the private sector, and the voluntary sector. As a consequence, NGOs have become frequent partners in the design and execution of World Bank-financed development projects.

Unfortunately, due to poor communications and policy differences, some important advocacy NGOs have opposed World Bank programs. Paul Nelson's book, characteristic of this branch of the NGO movement, questions the relevance and significance of NGO–World Bank cooperation.

Noting that World Bank finance and advice are used to connect developing countries to the global economy, Nelson portrays this role as inimical to the poor, biased in its choice of instruments, and unresponsive to local needs. Acknowledging that the World Bank has initiated important changes in its approach to poverty reduction programs, he suggests that such initiatives have not induced basic shifts in focus away from orthodox economic principles. Faced with an upward statistical trend in the number of NGO interventions in Bank-financed projects, he finds fault with the quality and scope of Bank–NGO interaction. Confronted with the advent of a World Bank participation learning group, he charges that top-down, capital-driven development models still dominate the organization.

The book presents an internally consistent view of the author's belief system. Its empirical basis is a set of interviews with Bank staff and NGO informants conducted in 1989 and 1990, supplementary conversations with staff, and a review of project documents produced during 1990–93. Paradoxically, the book relies heavily on internal Bank reviews and on the highly selective use of the World Bank's independent Operations Evaluation Department's findings.

A full chapter is devoted to the dilemmas faced by NGOs in defining accountability for their own actions and in preserving their independence while depending on official resources for a growing share of their activities. This reflects an awareness of the limits of voluntary action and hints at the potential benefits of a genuine dialogue between advocacy NGOs and official aid agencies.

Robert Picciotto
with a virtual exemption from several of GATT’s disciplines and norms. Most notable among these was a provision under the GATT agreement’s Article XVIII, which authorized any developing country to use import restrictions, provided GATT concluded that these were needed to correct a balance of payments problem—an approach that, in effect, went against the spirit of the IMF’s Articles of Agreement.

As policymakers globally came to acknowledge the importance of sound macroeconomic and appropriate exchange rate policies for balance of payments adjustment, and as economic development strategies came to emphasize outward orientation rather than import substitution, S&D was no longer considered a useful tool for developing countries generally, except perhaps for a few extremely poor countries.

Referring to the North American Free Trade Agreement (NAFTA) negotiations, Bhagwati worries that we may be entering a new era of “reverse” S&D, attributable to a fear that trade with the developing countries may hurt the real wages of low-skilled workers in the industrial countries. This fear led to attempts in the United States-Mexico negotiations on NAFTA to enforce minimum wage increases and higher environmental standards in Mexico that had no parallel in the earlier United States-Canada negotiations. Is this asymmetry the beginning of a pattern in which the industrial countries, in effect, seek greater concessions from developing countries than from each other?

Indeed, there is little doubt that the “fair trade” versus “free trade” controversy is being argued most vigorously in the area of labor standards. In their highly readable chapter on international labor standards and trade, which provides a valuable historical perspective, Drusilla Brown, Alan Deardorff, and Robert Stern ask readers to look beyond the impressionistic (and perhaps impressionistic) political rhetoric. Using a variety of trade models, they analyze the economic case for international harmonization of labor standards and find it is rather weak. They suggest that, in fact, a country’s position in international trade, as either a net exporter or a net importer of those goods most affected by labor standards, will determine whether it should favor international standards that are high or low.

The authors note that the objective of labor standards in high-income countries may not, in fact, be to raise national welfare, but rather to protect their scarce production factor—that is, low-skilled labor. Scaling up labor standards in low-income countries will support this protectionist objective, but only by lowering the welfare of both the high-income countries and the world as a whole.

This volume makes clear that the “one size fits all” approach to harmonization is inappropriate. It is “must” reading for all those interested in getting to the bottom of the “fair trade” debate. Professors Bhagwati and Hudec have brought together a set of papers that provides a penetrating analysis that cuts through the fog of intuitive half-truths obscuring the current debate.

S.J. Anjaria

Legal Analysis

Volume 2 examines the relationships between trade and environmental policy, labor policy, and competition (or antitrust) policy. Increasing tensions among trading partners have been created by differences in their domestic policies that, they believe, create unfair advantages and distortions in trade. Likewise, calls for using trade restrictions as inducements for countries with less rigorous standards in these areas to raise them (or as penalties for not doing so) have created increasing friction. Although environment, labor, and competition policy objectives are no doubt extremely important, the use of trade restrictions to enforce them is not compatible with the present WTO framework. Consequently, there is considerable debate about whether that framework should be changed to facilitate attainment of these objectives.

The papers are interesting and fruitful additions to the current debate and will certainly help influence the future design of policy. The legal analysis complements the economic analysis of Volume 1. But one does not need to be a lawyer to enjoy and benefit from Volume 2. It does not aim to present either a single comprehensive view or an overall policy prescription, but rather a variety of perspectives. Nonetheless, the general thrust of most of the book is to question the validity of a radical revision of the WTO framework to cater to domestic and social objectives. Some flexibility in institutional procedures is advocated, together with critical cost-benefit analyses of the issues.

In the opening, general chapter, Frieder Leary presents an interesting history of attempts to link trade with workers’ rights and urges that future discussions stress the common ground for both parties to the debate. But she also warns against the use of social clauses as an excuse for protectionism, which has become a matter of serious and vocal concern to most developing, and some industrial, countries. She recommends that primary emphasis be put on moral suasion through the International Labor Organization (ILO), with WTO-authorized sanctions reserved for the most serious violations and used only as a last resort.

Brian Langille takes a contrary view, noting the influence of government policies on competition and arguing that trade negotiations must explicitly establish basic labor rights. He points out that labor laws (such as those covering collective bargaining and specific conditions of employment) already modify market-determined outcomes in the light of political imperatives based on concepts of justice and individual autonomy.

Regarding harmonization of divergent competition laws, Daniel Gifford and Mitsu Matsumita assert that difficulties in this area—particularly as regards recent disputes between the United States and Japan—arise from failure of communication. They suggest that efficiency consider-
The restructuring of Japan’s textile industry over the past 30 years has been phenomenal. Total production of natural fibers dropped 50 percent between 1961 and 1990. Zensen, the Japanese federation of textile and other unions, reports that since 1975, employment has declined 55 percent in the spinning industry and 59 percent in the man-made fiber industry. The value of imported textiles tripled from $5.5 billion in 1980 to $15.4 billion in 1990 and is now more than double the value of Japanese textile exports. By following a process of “adjustment,” the Japanese textile industry has tried to moderate this decline and redirect itself into more profitable products and sectors. Japan is, for example, one of the world’s largest exporters of synthetic textiles.

Textiles and Industrial Transition in Japan winds its way through the Japanese textile industry’s adjustment experience, providing a cogent explanation of how the “collective interests” of individual companies and specific sectors have sustained a common commitment to the industry’s survival. The Japanese textile adjustment “story,” as McNamara modestly calls it, is a study in Japanese corporate philosophy. The story’s cast of characters spans the full range of Japanese industrial society, including textile “moguls” (the industry’s leading spinners and synthetic-fiber producers), “mavericks” (opportunistic upstarts), sogo sōsha (general trading companies), and fashion houses, as well as the state, the Ministry of Trade and Industry, owners’ associations, and labor.

The story line is that growing pressures from within Japan (rising costs of labor and energy, a more discerning consumer) and from without (competition from lower-cost Association of Southeast Asian Nations (ASEAN) and other offshore producers, many of whom the moguls themselves helped spawn) threatened jobs and the survival of highly leveraged textile companies and forced the three principal parties involved—capital, state, and
labor—to pursue a common course of adjustment. The sharp rise of the yen accentuated the pressure to adjust. While the general perception has been that cooperation and mediation have prevailed across the industry, there are numerous examples of dissent and deviation. For instance, efforts by the moguls to balance supply and demand by scrapping spindles have been countered by maverick spinners seeking to expand and modernize spindle in order to gain market share. At different times, the state tried to coordinate adjustment through incentives and promotional programs, but its effectiveness is debatable.

Some moguls opted out of the fray by using their technological know-how and financial clout to diversify into related industries (such as chemicals and plastics). For example, Kanebo, Japan's largest spinner, oversaw a decline of textiles as a percentage of total sales from about 75 percent in 1971 to 32 percent in 1992. Textile producers similarly invested offshore, often allied with their traditional sogo sosha partners, in search of lower-cost production bases, generous government investment incentives, and new markets.

Strategies of product specialization were likewise embraced and driven by efforts to optimize value addition in an industry characterized by slim profit margins. The textile companies' clarion call was to mobilize their superior technology and efficiencies to make value-added textile products for which proximity to market and consistent quality were worthy of a price premium. Japan's producers of man-made fiber leapfrogged traditional cotton-based mills by building much larger plants to take advantage of economies of scale, procurement clout, and ready access to feedstocks traded at international prices.

Labor has had a history of going along with owners' restructuring programs out of loyalty to the firms (although this may be changing). Workers' overriding concerns have been for company survival, job security, and the terms of corporate and government severance and re-employment packages.

McNamara describes the sogo sosha as the “integrator” of the industry that helped keep adjustment on course. Indeed, the histories of the Japanese textile industry and the sogo sosha are intertwined.

This well-written book is a storehouse of useful references. It makes for compelling reading for those interested in industrial transition and, especially, for practitioners and students of the Japanese and global textile industries. While the success of the adaptation of the Japanese textile industry may not be clear-cut, McNamara suggests, its experience could offer insights into similar challenges faced by other countries' textile industries or by various other “sunset” industries in Japan and worldwide.

McNamara asserts that corporatist theory helps to explain patterns of collective action among competing interests—as have been observed in Japan's textile industry—when such action could determine whether a declining industry survives or not.

Peter B. White

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Alberto Giovannini has been a prolific and influential contributor to the debate on money in Europe. His book on the European Monetary System (EMS), Limiting Exchange-Rate Flexibility, co-authored with Francesco Giavazzi and published in 1989, is still required reading for anyone interested in the economics of the EMS. This new book brings together his other writings on European monetary matters, including several well-known papers on Economic and Monetary Union (EMU). The earliest paper was written in 1985, the most recent in 1992. Reading these papers together, some years after they were written, one can appreciate more fully how Giovannini's work both reflected and affected the European debate.

In his 1990 paper on the transition to monetary union, written just after the publication of the Delors Report, Giovannini emphasized the risks of the long and open-ended transition to EMU endorsed by the report. The longer the transition, he argued, the greater the probability of exchange rate realignments, and these, he said, would prolong the transition because they would widen inflation rate differences between the strong- and weak-currency countries and thus prevent the convergence of inflation rates that is the only rationale for a long transition. The same point is made in other papers, most of which were written at a time when many European economists believed that devaluations could not affect real exchange rates because they would merely validate expectations of continuing inflation. (There is still an antipathy to exchange rate changes, but for the opposite reason; as recent episodes have shown decisively that devaluations can in fact influence real exchange rates, they are now viewed as a threat to the single market!)

In his 1990 paper on fiscal rules for a monetary union, co-authored with Luigi Spaventa, Giovannini provided the best analytical case for using limits on deficits and debts as entry conditions for EMU. The paper is notable for emphasizing debt; the Delors Report had recommended strict limits on budget deficits but had paid less attention to debt. I do not know how strongly this particular paper affected official thinking, but it was, without question, one of the first to focus on debt levels and thus to recommend entry conditions resembling the conditions actually embodied in the Maastricht Treaty.

The distinguishing feature of this book, however, is Giovannini's use of quantitative methods to answer basic questions raised by the debate on money in Europe. The questions actually answered are not always the same as those posed initially. Nevertheless, they deserve close attention, partly because they raise new questions.

Three of these empirical papers appear in the first part of the book, which deals with the functioning of fixed exchange rates. The first paper asks whether fixed-rate regimes are always asymmetric even when they are based formally on seemingly symmetric rules, and the paper goes on to examine actual experience under the gold standard, the Bretton Woods system, and the EMS. Giovannini finds evidence of asymmetry under the gold standard and the EMS but, somewhat surprisingly, much less evidence of asymmetry under the Bretton Woods system. The second paper is concerned with the relative importance of rules and discretion under various fixed-rate regimes, but the empirical work deals more narrowly with the credibility of exchange rate bands under the gold standard and Bretton Woods system. The third paper, co-authored with Zhaohui Chen, asks...
whether economic fundamentals have influenced expectations of exchange rate realignments in the EMS and finds little evidence to that effect. Expectations were influenced mainly by the position of the actual exchange rate within the exchange rate band and by the length of time since the previous realignment.

The second part of the book contains two short papers published originally in *A European Central Bank*, a volume that Giovannini edited in collaboration with Marcello de Cecco. The third part contains four papers on the Delors Report and its aftermath, including two already mentioned—the paper on the transition to EMU and the joint paper with Spaventa. It also contains a wide-ranging paper on European monetary reform. The paper develops in greater detail Giovannini’s critique of the gradualist approach to EMU, and it contains empirical work on interest rates, exchange rates, and the ex post profitability of speculation under the EMS.

There are two short papers at the end of this part, with paradoxical titles and dates. The first one, written early in 1991, several months before the Maastricht Summit, asks “Is EMU Falling Apart?” The second one, written late in 1992, months after the first EMS crisis, has as its title “Economic and Monetary Union: What Happened?” but it says nothing at all about the crisis itself—the most dramatic happening of 1992. It is instead an exercise in political economy that asks which groups and countries stand to gain or lose from EMU and concludes that this sort of analysis is not very useful. (There is no discussion of the EMS crises in this entire collection, not even in the introduction, although it was written in August 1993, just after the second crisis.)

The fourth part of the book contains two forward-looking papers—on the intricacies of introducing a single currency and on central banking in a monetary union. The first subject has attracted a great deal of attention, partly because of the odd restrictions imposed by the Maastricht Treaty (for example, the rule that the locking of exchange rates must not affect the external value of the ecu) and partly because of questions about the enforceability of existing contracts denominated in the old national currencies. But the paper does not shed much light on those issues. Instead, it concentrates on a strange case—one in which the conversion rates between the national currencies and the new single currency are chosen without paying attention to the effects on the cross-rates between the national currencies or the effects on existing exchange rate expectations. The second paper deals with two controversial questions raised by the provisions of the Maastricht Treaty—whether the treaty strikes the right balance between central bank independence and accountability (Giovannini is not sure) and whether the European Central Bank should be given a bigger role in the prudential supervision of financial institutions (Giovannini says yes, and I agree).

Although this book does not address the issues now being debated in Europe, it is a useful addition to the literature. Most of the papers are well worth reading, even by those who have already read much of Giovannini’s work.}

Peter B. Kenen

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**ECONOMIST PROGRAM**

Each year the International Monetary Fund seeks men and women economists below age 33 from its member countries to fill 30–35 positions in its ECONOMIST PROGRAM. This two-year program enables those interested in a career in the IMF to undertake one-year assignments in two different departments and thus to take part in a variety of Fund work, including missions to at least two member countries. While practical training in a number of areas is provided to participants, it is not a “trainee program” in the usual sense, as participants are expected to contribute to the Fund’s work from the outset. Most participants are offered a position on the permanent staff at the end of this initial two-year appointment.

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The starting salary in the Economist Program for a Ph.D. with no major work experience is around $60,000 net of tax. There are two intakes into the Economist Program in 1997, on June 1 and October 1. Applicants for both groups should send their resumes, preferably by mid-October, but no later than November 30, 1996, to:

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