Playing Catch-up

Michael Spence

The Next Convergence

The Future of Economic Growth in a Multispeed World

Farrar, Straus & Giroux, New York, May 2011, 320 pp., $27.00 (paper).

We may be standing on the hinges of economic history. If so, we will be witnesses to an extraordinary event, one that has happened only twice since the beginning of mankind. For thousands of years, living standards displayed no truly long-term trends, nor any great variation from country to country. Then, in the 1700s, came the first sudden swing in the course of economic history. The Industrial Revolution propelled a remarkable and sustained rise in living standards, first in Britain, then elsewhere. But this transformation occurred only in a few places, essentially in Europe, nations of European descent, and Japan. The rest of the world, more than four-fifths of humanity, remained mired in the agricultural past. By 1950, the world was a profoundly unequal place.

Then the course of history suddenly swung again. After 1950, some countries, mainly in Asia, that had been lagging behind started growing at unprecedented rates, about 7 percent per year, enabling them to start closing the gap with the advanced economies.

More recently, the two most populous countries—China and India—began to grow at rates close to 10 percent. If these trends continue, we will witness, in our lifetimes, a third historical swing: a renewed convergence of living standards. What was once the privilege of a favored few will become commonplace for many. This potentially epochal process is the subject of Michael Spence's remarkable new book, *The Next Convergence*.

The basic arithmetic behind convergence is simple. It is known as the rule of 72. This rule says that you can calculate the number of years it will take to double living standards by dividing 72 by the average growth rate. So if a country is growing at 10 percent, its standard of living will double in about 7 years. This means that if a country starts off with per capita income of $500, and grows by about 10 percent a year, incomes can reach $16,000 in just about 35 years. A few years after that, incomes will be at advanced economy levels. Provided, of course, the country continues to grow at the same pace.

In fact, that proviso is a big one. For growth is a mysterious process. Only 13 countries have managed to grow at even 7 percent on average for a 25-year period. And of those lucky 13, only half have continued on to advanced economy levels. In other words, catch-up is far from inevitable.

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For that reason, Spence eschews speculation about what a converged world would look like. Instead, he focuses on a more practical matter: what countries need to do to get there.

What are the keys to success? No one truly knows. But economists have some ideas—particularly, Spence. Not only is he a Nobel laureate, but he has thought long and hard about these issues in his capacity as Chairman of the Commission on Growth and Development, launched in part by the World Bank. The current book is the fruit of those years of research and thinking.

Spence argues that poor countries grow through two primary mechanisms. First, they acquire knowledge from rich countries. Second, they specialize in producing goods that are demanded by other countries, so that they can sidestep limited domestic purchasing power and the divergence between what locals demand and what the country is good at producing. Put simply, success requires that countries educate their populations and integrate into the global economy.

Spence makes one further key point. Too many countries, he points out, find a successful formula, such as labor-intensive exports, and then try to stick with it, most notably by preventing their exchange rates from appreciating. But sustained growth requires structural change, with labor-intensive manufacturing giving way to advanced manufacturing and services as skills and income rise.

The Next Convergence considers a range of such issues, including the structural problems of China and India and doubts about appropriate economic models in the wake of the 2008 global crisis. In all of these cases, Spence explains complex issues in remarkably clear and concise language. His concision and range occasionally come at the expense of the richness and variety of growth experiences. But you will not find a better introduction to today's most critical global economic debates.

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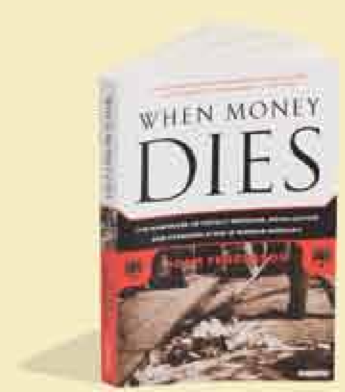
Easy Money

Adam Fergusson

When Money Dies

The Nightmare of Deficit Spending, Devaluation, and Hyperinflation in Weimar Germany

PublicAffairs, New York, 2010, 288 pp., $14.95 (paper)



When Money Dies is not a new book, but a reprint. Although it first appeared in the United Kingdom in 1975, it has only recently been published in the United States. This relatively obscure volume achieved something of a cult status among financiers after reports that Warren Buffett, the billionaire investor, advised a Dutch financier to read the book as an illustration of what could happen today if European governments attempted to spend their way out of the downturn. Whether the exchange between the two men really took place or not, the rumor helped push the asking price of secondhand copies of the book over $1,000. A U.S. publisher responded by rushing out a paperback version.

So the book has now gained a degree of topicality as governments use "quantitative easing" as a tool to stimulate the economy following the recent financial crises. It recounts the dire effects of hyperinflation in Germany in the early 1920s when the German central bank—the Reichsbank—financed the public deficit by simply printing more money. This, despite the fact that the country had already experienced one bout of inflation after World War I.

The author, Adam Fergusson—a one-time advisor to U.K. Chancellor of the Exchequer, or Finance Minister, Geoffrey Howe—writes powerfully of the corrosive effect of inflation as he describes the seeds of the hyperinflation that would grip Germany following World War I.

"Inflation aggravated every evil, ruined every chance of national revival or individual success, and eventually produced precisely the conditions in which extremists of Right and Left could raise the mob against the State, set class against class, race against race, family against family, husband against wife, trade against trade, town against country. It undermined national resolution when simple want or need might have bolstered it. Partly because of its unfairly discriminatory nature, it brought out the worst in everybody—industrialist and worker, farmer and peasant, banker and shopkeeper, politician and civil servant, housewife, soldier, merchant, tradesman, miner, moneylender, pensioner, doctor, trade union leader, student, tourist—especially the tourist."

Despite the burden of war reparations, in the face of opposition from increasingly powerful right-wing political parties in the country, the government of the Weimar Republic—established in 1919—dared not raise taxes against heavy industry and other manufacturers who had profited from the war. As a result, in Germany, only 14 percent of war expenditure was financed by taxes compared with 30 percent in Great Britain. The rest was financed by loans or directly by the Reichsbank.

As a consequence, the Weimar Republic inherited an enormous public debt on which it was forced to pay high rates and huge amounts of interest. Despite other difficulties and obligations, the Weimar Republic continued to finance a part of its annual deficits directly with the help of the Reichsbank. German inflation then ran out of control completely when French troops occupied the "Ruhrgebiet" region. A general strike ensued and the German government responded by agreeing to pay the salaries of the workers. Without any understanding of the consequences, the Reichsbank's president decided to finance this commitment by allowing the Reichsbank to print all the paper money "needed" by the enterprises and the people. Inflation rapidly led to hyperinflation, accompanied by a massive devaluation of the Reichsmark and astronomical rises in the price of goods.

The author draws on first-hand accounts to describe the devastating affects of the ever-deeper economic spiral and its social impact: "Frau von Pustau explained that one house was sold because the couple living there had had both sons killed in the war, had no one to care for them, had had their life savings devalued, and so had gassed themselves. 'Our times,' she went on, 'made us cynical.'"

Fergusson's book depicts the desperation and helplessness felt by large swathes of the population and the difficult political situation in Germany that drove the Reichsbank's decisions, but the author fails to discuss in any detail the relationship between inflation and the devaluation of the Reichsmark. Nor does he offer any theoretical explanation for the traumatic events that took place in Germany, including the conditions under which the printing of money leads to high, accelerating, or hyper-inflation.

The book contains many data references, but there are no tables or figures to back up these facts and so readers are likely to find it difficult to fill in this gap for themselves. Also missing is any weighing of the pros and cons of moderate inflation against the available alternatives. It is a powerful historical account, but the book is of limited use in helping us draw lessons for our current situation.

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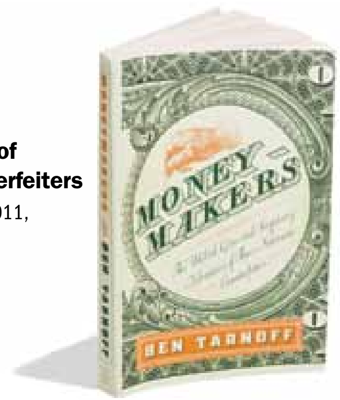
The Trials of Counterfeiting a Cow

Ben Tarnoff

Moneymakers

The Wicked Lives and Surprising Adventures of Three Notorious Counterfeiters

The Penguin Press, New York, 2011, 370 pp., $27.95 (cloth).



Sometime later this spring, those lucky enough to have fairly well furnished wallets will start to acquire from their ATMs or their paymasters a brand-new kind of hundred dollar bill. These new notes had initially been due to enter circulation in February, but so complex is their design; so sophisticated their dog's breakfast of watermarks, metal strips, and color-changing intaglios; and so unpredictable the behavior of the paper on which everything is printed (test versions apparently creased badly under the harsh impress of the printing rollers) that it will now be several more weeks before our pockets and billfolds are graced with them.

The U.S. government has said sorry, but has intimated that all should in fact have faith in the delay, since if those in Washington find these new bills so agonizingly tricky to print, then surely the legions of fakers out there will find them even more difficult to forge.

And such, of course, is the eternally expressed hope of the Fed and other central banks: that our worldwide system of money, fashioned only from inherently valueless pieces of paper, doesn't utterly collapse because of the ceaseless efforts of the equally worldwide community of counterfeiters.

Such a risk has been recognized for 300 years and more—maybe longer, since it was the Chinese, inevitably, who first used paper money well over a thousand years ago. We in the stripling West have employed notes of exchange—worthless in themselves, but ultimately backed by an all-too-fragile public faith—for only a modest three centuries (the Swedes being the first, in the late 1660s). Until then, the entities we used generally possessed inherent value, and fakery of them was both well-nigh impossible and ultimately pointless. For who would ever wish to try to fake a cow (the word "pecuniary," with its roots in the Latin word for cattle, tells of a time when cows were indeed negotiable instruments, in Italy), or copy a camel or a cowrie shell, or forge a woodpecker scalp or a brick of tea—or even an ingot of gold, if perhaps by the magic of alchemy? All manner of things of value have been employed as mediums of exchange, and though most of them have proved inconvenient to trade or store or lug about, they did, by and large, have the signal advantage of being exceptionally difficult to copy.

Not so with paper, though. Everything changed in the Americas once the Massachusetts Bay Colony began to print its own money in the late 1690s—for, as Ben Tarnoff makes clear in this most entertaining romp through the anarchic monetary universe of early America, within moments of the first appearance of printed bills, entrepreneurs with an abundance of artistic ability, a moiety of cunning and chutzpah, and a willingness to take the considerable risk of jail, exile, or death began copying or forging them as a means to easy riches.

Tarnoff first came across the three counterfeiters on which he has chosen to focus two years ago, while he was working on the "Money" issue of the admirable new journal *Lapham's Quarterly*. They were the relatively obscure pair of Owen Sullivan in colonial New England and David Lewis in early 19th century Pennsylvania, and the heroically infamous patriot Samuel Upham, who forged Confederate bills from his perfume shop in downtown Philadelphia. Tarnoff tells each of their stories with clarity and brio—stories of printing presses hidden in caves, of gunfights in darkened bars, of posse chases through mountain ranges and across snow-covered cornfields. There are tales of embezzlement, derring-do, and chicanery on the one hand and, on the other, fascinating accounts of the growing authority and acumen of those bank agents and the Secret Service investigators who then tried, and usually ultimately succeeded, in tracking the miscreants down.

But there is a great deal more. Besides also explaining very well the philosophical complexities behind the meaning of value in money—making his book as instructive as it is entertaining—Tarnoff turns out also to be a past master of the diverting tangent and brilliantly adept at creating atmosphere and suspense. One can almost see the screenplay here, can feel the hot breath of the interest from such as the Coen brothers, can imagine just who (Steve Buscemi? Jeff Bridges?) might most suitably play the villains.

For in truth, all three of his men turn out to be the most amiable of rogues, to be somewhat lovable Robin Hoods—the kinds of figures who, even two centuries on, win our sympathy. After all, they were merely trying to hoodwink the very bankers who have been hoodwinking the rest of us for far too long.

Given our current view of the financial community, the publication of Tarnoff's most amusing book could scarcely have been better timed. And so, when Washington has solved its printing problems, it is probably well worth handing over one of these fancy new one hundred dollar bills for a copy of the book. Take good care, however, to examine very closely the quality of the paper money that you are handed back in change. It has no worth. It could also—if you appreciate the difference—turn out to be quite worthless.

Simon Winchester

Author of several books, including Atlantic *and the forthcoming* The Alice Behind Wonderland