

and America is running a *global* trade deficit that is due to the low U.S. savings rate relative to domestic investment. To fill that gap, the United States must rely on foreigners to run trade surpluses and extend credit. Lardy expects the U.S. trade deficit with China to increase as trade barriers are removed and Chinese apparel and other labor-intensive products gain ground in the U.S. market, largely at the expense of other developing countries. Prior to China's entry to the WTO, U.S.-China trade had expanded from \$1 billion in 1978 to \$116 billion in 2000, and that upward trend will continue.

If the United States wants to reduce its global trade deficit, it will have to increase its savings rate or reduce domestic investment. Moreover, as Lardy notes, "Selective trade liberalization abroad only affects the country-by-country distribution of the U.S. global trade deficit, not its overall size" (p. 158). Those are points worth remembering whenever deficit hawks seek to single China out as a threat to U.S. national security.

The key challenge, according to Lardy, "will be to maintain open markets in advanced industrial countries. . . . China's prospects of adjusting to more imports from the West will be dim if developed market economies impose restrictions on products for which they are unlikely to have a comparative advantage" (p. 176). That is a message worth repeating.

Those who wish to understand the complexity of the international trading system and the growing importance of China in the world economy will do well to read Lardy's fascinating book.

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Globalization and Its Discontents

Joseph E. Stiglitz

New York: W. W. Norton & Company, 2002, 282 pp.

A more accurate title for this book should have been, *Joseph Stiglitz and His Discontents*. What could have been an enlightening look at globalization by one of the nation's best-known economists proves instead to be a score-settling exercise distorted by the author's own political prejudices and personal animus.

The book is all the more disappointing because Joseph Stiglitz is an economist's economist. He's written acclaimed textbooks on public finance and contributed enough to the profession to earn a Nobel Prize in 2001. He served in key advisory positions during what the Chinese would call interesting times, first as chairman of President Clinton's Council of Economic Advisers and then as chief economist at the World Bank during the East Asian financial meltdown and its aftermath.

The author pays lip service to the power of free trade and markets to promote growth and reduce poverty, but then devotes the rest of the book to an attack on "market fundamentalism." The immediate object of

his discontent is the World Bank's sister institution, the International Monetary Fund, the tax-supported, multilateral lending agency he accuses of peddling the market gospel to vulnerable poor countries. His dislike of the IMF and its personnel surfaces early in the book. In contrast to his caring colleagues at the World Bank, IMF personnel "pore over numbers in the finance ministries and central banks and make themselves comfortable in five-star hotels in the capitals." He likens them to high-altitude bombers: "[F]rom one's luxury hotel, one can callously impose policies about which one would think twice if one knew the people whose lives one was destroying."

Contrary to economic thinking since Adam Smith, the book reinforces the myth that protectionism enriches those nations that practice it. Stiglitz accuses the West of driving the globalization agenda, "ensuring that it garners a disproportionate share of the benefits, at the expense of the developing world." How have the rich countries garnered those "benefits"? According to Stiglitz, by failing to open their markets to poor-country exports such as textiles and sugar, while insisting that poor countries open their markets to rich-country exports, and by continuing to subsidize agriculture while insisting poor countries stop subsidizing industrial production.

All of that is economic snake oil. The most basic undergraduate analysis would demonstrate that imposing trade barriers on imports from poor countries is a liability to rich countries, not a benefit. Western farm subsidies cost domestic taxpayers and consumers dearly, leaving society as a whole worse off. Of course, rich-country barriers and subsidies hurt poor countries, but they hurt the rich countries themselves even more. A recent study by the IMF found that rich-country intervention in agriculture costs the rich countries \$92 billion in lost welfare compared to an \$8 billion loss in poor countries. Deviation from free trade does not garner the West a "disproportionate share of the benefits," but in fact a disproportionate share of the costs.

Stiglitz echoes the Pat Buchanan thesis that the West grew rich by "wisely and selectively protecting some of their industries until they were strong enough to compete with foreign companies." In reality, the United States grew rich despite the heavy protectionism of the 19th century. Research by Douglas Irwin of Dartmouth and others shows that the protected industries were not productivity leaders, and that protectionism actually retarded growth by creating domestic monopolies and raising the cost of capital goods. By portraying protectionism as a "benefit" and a proven path to prosperity, Stiglitz only encourages policies in poor countries that keep hundreds of millions of people trapped in grinding poverty.

When he is not questioning free trade, Stiglitz is disparaging the free flow of capital. The book blames the East Asian financial crisis almost entirely on one factor: capital account liberalization. He blames liberalization pushed by the IMF for allowing short-term "hot money" to flee

vulnerable countries at the first sign of trouble. If capital controls had been imposed, as Stiglitz urged at the time, the meltdown would supposedly have been ameliorated if not avoided altogether.

Stiglitz praises Malaysia for spurring IMF advice during the 1997–98 crisis by imposing capital controls to stem the flight of short-term flows. As a result, according to Stiglitz, “Malaysia’s downturn was shorter and shallower than that of any of the other countries,” but he provides no evidence to back his claim. A few pages later, he cites GDP figures that show the steep fall in output in Indonesia, Thailand, and South Korea in 1998, but oddly he omits Malaysia from the list. Malaysia’s GDP actually fell further than Korea’s that year—contracting 7.3 percent vs. 6.7 percent—and recovered less rapidly in 1999 and 2000 even though Korea did not resort to the capital controls Stiglitz champions.

Another crucial fact omitted was that certain East Asian countries weathered the storm without resorting to capital controls. Hong Kong fared no worse than Malaysia, and Singapore, a Grand Central Station of short-term flows, performed far better. Indeed, the whole of developing Asia outperformed Malaysia during the crisis, with only Thailand and Indonesia faring worse. An intellectually honest look at the data makes clear that Malaysia’s capital controls did not set it apart from the pack.

Stiglitz tries to clinch his argument by noting that India and China, two countries that maintain strict controls on foreign capital, were almost untouched by the crisis. He even holds China up as a kind of model, extolling the gradualism and mixed nature of its reforms. This is akin to arguing that one advantage of driving a horse and buggy is that you avoid 60-mph pileups on the freeway. Yes, China has enjoyed spectacular growth in the last two decades, but the growth has been from a small base and China today remains a poor and underdeveloped country. Elsewhere in the book, when it is convenient to his argument, Stiglitz notes that China, “with its per capita income of \$450,” remains a developing country, and that South Korea was once poorer than India but is now a member of the OECD. Could the relative poverty of China and India be at least partly explained by their closed capital markets and halfway reforms? The question never arises in Stiglitz’ book.

More broadly, Stiglitz distorts the history of the “East Asian Miracle” itself. He credits the spectacular rise of living standards in certain East Asian countries, most notably Japan, South Korea, Taiwan, Hong Kong, and Singapore, to “the combination of high savings rates, government investment in education, and state-directed industry policy.” To back his claim, he cites an important study, *The East Asian Miracle*, published in 1993 by the good guys at the World Bank. But the World Bank study was much more circumspect about the success of industrial policy than is Stiglitz. In fact, it concluded that such efforts in South Korea and Taiwan were failures, with promoted sectors performing worse than those left alone. Stiglitz never addresses the question of why, if industrial policy and infant industry protection were essential to the East Asian miracle,

Hong Kong prospered without either policy, and why did so many other poor nations that did adopt such policies fail to grow?

In another chapter, Stiglitz blames Russia's difficult transition from communism and its own financial crisis of 1998 almost entirely on the IMF and its demand for rapid market liberalization. He ignores the fact that Russia's initial reforms were timid and half-baked, its legal and tax systems a mess, and its trade barriers high. In 2000, nearly a decade after the fall of communism, Russia still ranked only 116th out of 123 countries rated by the Fraser Institute's *Economic Freedom of the World Report*. Nowhere does Stiglitz mention the economic and political success of Estonia, the former Soviet Republic that has moved the most rapidly toward market liberalization.

To reject the Stiglitz critique of the free market is not to defend the IMF. The IMF has peddled questionable policies for years, among them higher taxes and non-market exchange rates. By bailing out countries in distress, the IMF rescues governments from their own bad policy choices and makes future crises more likely through "moral hazard," a key economic concept that I did not find mentioned once in the entire book. Come to think of it, isn't it a bit strange that an international agency founded by governments, funded by tax dollars and driven by politics should become, to Stiglitz and other critics of globalization, the great symbol of "market fundamentalism"?

In the course of the book, Stiglitz rightly points out the economic nonsense of "fair trade" laws, the dangers of imposing rigid intellectual property rules on less developed countries, and the Western hypocrisy of espousing free trade while maintaining high barriers on goods that poor countries export. But those isolated glimmers of good sense do not begin to offset the damage done, to economic understanding and the goal of a more prosperous world, by his sustained assault on a more liberal global economy.

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World on Fire: How Exporting Free Market Democracy Breeds Ethnic Hatred and Global Instability

Amy Chua
New York, N.Y.: Doubleday, 2003, 340 pp.

World on Fire is a more nuanced book than the title suggests. Chua's publisher selected the title despite, so she claimed, her better judgment. Indeed, with its equally provocative subtitle, Chua's book must be read carefully as much for the things it says as for the things it does not say. The book is not a diatribe that will warm the hearts of the anti-globalization protesters. In fact, Chua acknowledges that free markets may offer the "best" economic hope in the long run.

Instead, Chua claims that "simultaneous" liberalization of the markets