

Global Imbalances and the Lessons of Bretton Woods: The Cairoli Lectures. *By Barry Eichengreen*. Cambridge, Mass.: MIT Press, 2007 xiv + 187 pp. Index, notes, bibliography, figures, tables. Cloth, \$26.00. ISBN: 0-262-05084-6

Reviewed by Rawi Abdelal

Barry Eichengreen's book deals primarily with the fact that today's world economy is in disequilibrium. The U.S. current account deficit has reached unprecedented proportions, and the deficit has been matched—and thus financed—by the accumulation of dollar assets in emerging markets. These so-called global imbalances will inevitably be unraveled, either through an orderly evolution or after a profound disruption. Historians, political scientists, economists, and policymakers have engaged one another about this unraveling, and it is no overstatement to say that the global imbalances present the defining challenge for the sustainability of this era of globalization.

There are two reasons why practically everyone should either read this book or ask (or hire) someone who has done so to explain it. First, virtually every investor or manager in the world is obliged to have both a theory and a conclusion about how these imbalances will play out. So, too, should most American households, though that is another matter. The stakes are that large, and this lucid and brief account is an excellent place to start.

Second, Eichengreen is uniquely well qualified to provide an answer. One of the world's foremost historians of the international monetary and financial system, Eichengreen is also influential in policymaking circles. And he is simply a very good writer, who consistently produces crisp, lucid prose accessible even to nonspecialists.

Although Eichengreen is also obliged to take on the unenviable task of prognosis on the basis of historical diagnosis, his conclusions are sensible and convincing. Briefly, he argues that exchange-rate adjustments, probably large ones, will likely occur soon, as the system is too unstable to persist. Those adjustments will probably be precipitated by Asian and Middle Eastern central banks.

Those conclusions contrast with the analysis of three other influential economists, Michael Dooley, David Folkerts-Landau, and Peter Garber, who found parallels between

the Bretton Woods international monetary system and today's global imbalances. Dooley, Folkerts-Landau, and Garber have argued that those parallels make what appear to be inherently unstable patterns of exchange-rate movements and capital flows more likely to persist for the foreseeable future. Eichengreen takes these arguments as his point of departure, and they provide the foil for his account.

Eichengreen disagrees with their analysis of the history of the Bretton Woods system; their reading of contemporary politics (though neither Eichengreen nor the economists describe these monetary problems as political); their assessment of viable alternatives to the dollar as the world's most important reserve currency; their assessment of the willingness of foreign central banks to trust in American commitments to sound macroeconomic management; and their implicit discounting of the effects of financial liberalization on the speed at which the imbalances might unravel.

Eichengreen's arguments are informed by careful history and economic reasoning. Whereas in the Bretton Woods system a relatively small, cohesive group of countries in Europe were willing and able to overcome the collective-action problem inherent in maintaining the stability of exchange-rate arrangements, today a larger, more heterogeneous group of predominantly Asian countries with divergent preferences about Asian regionalism seems much less able and willing to promote the status quo. (The second chapter of the book is based on an astute analysis of the Gold Pool, which was used during the 1960s by a handful of European countries to support the stability of the system.) There are other crucial differences. Although during the 1950s and 1960s there was no realistic alternative to the dollar, today financial markets and central banks have the euro and euro-denominated assets. While the United States during those earlier decades experienced current account surpluses based on a relatively high savings rate, the American economy today is characterized by a low savings rate, macroeconomic mismanagement, and huge current account deficits. Financial markets were neither internationalized nor liberalized then, but today capital flows freely across countries and, within national economies, across sectors. And while Asian policymakers have promoted rapid economic development with their export-led policies, enabled by undervalued exchange rates, those very economic models are evolving quickly toward a greater focus on domestic and otherwise non-U.S. demand for their production.

The third chapter, coauthored by Mariko Hatase, is about the lessons for China of Japan's abandonment of its own currency peg upon the demise of the Bretton Woods system. Being more technical, this chapter may be less accessible to the average reader, but the conclusions are still important. According to Eichengreen, China should be able to move toward greater exchange-rate flexibility without undermining growth or being obliged to liberalize capital controls that continue to be an important part of the development model. The fourth chapter addresses the dollar's prospects in the light of the transition from sterling to the dollar as the world's most important reserve currency. While sterling's status was prolonged by the Commonwealth and British colonies, Asian and Middle Eastern central banks are not likely to feel as obliged to remain committed to the dollar.

I have a few minor criticisms, though they are largely concerns about ideas that are not fully developed. And each of them has to do with the international politics threatening the system and the domestic politics, particularly in the United States, that sustain the American commitment to globalization. Although Eichengreen writes primarily about the problem of Asian central banks and their relation to dollar reserve assets and exchange-rate pegs, Middle Eastern investors and central banks play a large and, as energy prices climb, growing role in the stability of the system. While export-led development models prevailing in Asia may be dependent on the value of the dollar and the American consuming public, growth and development in the Middle East are not. A political crisis that would lead Middle Eastern investors and central banks to diversify quickly out of dollars and thus unravel the system rapidly is not difficult to imagine. Even more important, a diplomatic crisis over, for example, the Taiwan Straits, might lead the Chinese central bank to exercise its leverage over the value of the dollar, regardless of whether such a move would contradict the narrow, material incentives facing the Chinese economy. World politics have always been defined by precisely those sorts of strategic decisions, wherein politics trump economics. Similarly, Eichengreen also writes briefly (p. 143) about the Federal Reserve's likely response to a falling dollar, questioning whether the Reserve would allow accelerating inflation or raise interest rates, inducing a recession. Given the susceptibility of the American economy to inexpensive credit and the already wavering commitment of the American public to economic

openness, another, unavoidably political, reaction would likely follow. That is, a decisive American turn away from openness to foreign goods or capital might provoke a crisis in the global economy that extends well beyond the resolution of largely macroeconomic imbalances.

Still, these are political elaborations on a coherent, convincing historical and economic analysis. Eichengreen's book should be the starting point for the debate about what will happen after the inevitable end of an unsustainable system. With this and his many other books, Eichengreen has established himself as one of the most important voices in that debate.

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