

seduce the mobile MNCs' specific "created assets."

Although the emphasis on intra-firm and intra-industry trade and their strategic manipulation by the MNCs is noteworthy, the depiction of the financial sector in the "globalized" world economy is a little superficial, aside from a few words on recent financial crises.

The political conclusions are not for government inaction, but rather in favor of a strongly interventionist policy in selecting the industries (and even the firms) that should "win," and in taking quick and articulated macro-meso- and micro-economic policies, as well as in negotiating regional integration in blocs of homogeneous countries. In this sense the author stresses the multidimensional "involvement" character of contemporary and future international relationships. However, since the electorate is assumed generically unable to assess the long-run effects of policy proposals, while at the same time the author stresses the lobbying power of the MNCs through lawful and unlawful means, the reader is likely to remain skeptical about these conclusions.

The book seems to address its main questions in as satisfactory a fashion as the literature it tries to summarize. The conclusions are not original, and the underlying analysis is not at the level of its political relevance. Moreover the book repeatedly emphasizes the inadequacies of the old and "new international economics," and advocates abandoning a general equilibrium modeling approach simply because it is "too complicated." The reader may wonder if the existence of S-goods and MNCs really warrant such an abrupt liquidation of the efforts of highly regarded empirical and theoretical economists.

The author's ambitious project evokes at least as much criticism as it provides, and the reader will best view this book as a provocative and stimulating reflection on some aspects of the recent international economy that have been neglected by mainstream international economic theory. In my opinion the book's main contribution is that of collecting in a thoughtful and stimulating way some concepts that are potentially useful to international economics. It is a clear and

comprehensive survey of an economic literature often considered marginal to mainstream economics. Setting aside its disdain for equilibrium methods, one finds that the approach provides good insights into important real world phenomena. Moreover, the author's mastery and fair evaluation of the "old" theory of international trade makes him describe the variables of his paradigm in a language that will sound familiar to more "orthodox" economists. This is less true for his treatment of the "new" one based on dynamic Schumpeterian models.

Such economists should regard this book neither as a synthesis of modern international economics nor as the construction of a comprehensive alternative paradigm, but as a challenge to enrich the field of international economics through incorporating an analysis of the MNC's activities, an emphasis on governmental issues, and a better understanding of the economic implications of the increasing importance of technologically reliant goods and services.

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Global Capital Flows: Should They Be Regulated? By Stephany Griffith-Jones. Foreword by James Tobin. New York: St Martin's Press, London: Macmillan Press, 1998. Pp. xix, 206. \$65.00. ISBN 0-312-21562-2. JEL 99-0546

It is easy to be impressed and frightened by the world of global capital, where the size of flows is measured in trillions, rather than billions of dollars, and one crisis follows another (in the 1990s: European Monetary System, Mexican Peso, and Asian Currency, consecutively). Stephany Griffith-Jones wants us to be impressed and frightened, as the title of the section "The Massive Financial Crisis Explodes" (p. 124) shows, mainly because it will help pave the way to answer the question in her title, *Global Capital Flows: Should They Be Regulated?*, with an unequivocal: "yes!"

The volume is readily accessible and valuable to a wide audience, as it is written in a non-technical style with an attractive mixture of theory, data, results from interviews, a case study and a keen eye toward policy implications.

The author starts out with a broad overview

of the theoretical literature, from Keynes' "beauty contest" (where judges don't pick the prettiest faces, but those that they think will catch the fancy of others; similarly, investors may not be interested in the intrinsic worth of an investment, but with what the market will value it at), to the literature of self-fulfilling speculative attacks (justified by future shifts in monetary, fiscal, or exchange rate policies caused by the attack itself).

Next, she gives an overview of the composition and size of financial flows, both source and destination, for the world in general and Latin America in more detail. Based in part on interview studies, this section stresses in particular (i) the increase in the share of financial flows going to developing nations, (ii) the high volatility of short-term portfolio flows as compared to foreign direct investment and bank lending, (iii) the high share of short-term portfolio flows for Mexico (67 percent in 1990-93, p. 106), (iv) the increasing importance of mutual funds, and (v) the high volatility of mutual fund flows as compared to those from pension funds and insurance companies.

Based on that knowledge the case study of the Mexican Peso crisis which follows contains few surprises. The high dependence on short-term capital flows made Mexico vulnerable. Combined with some clear *ex post* policy mistakes (an overvalued currency to fight inflation, unsustainable current account deficits, sterilizing intervention, and the assumption of foreign exchange risk in short-term government debt), this crisis can be largely explained. Griffith-Jones shows time and again that she is well informed, and does not want to put all the blame on bad policy: "a clear understanding of the Mexican peso crisis cannot just (or perhaps even mainly) emphasize policy mistakes of the Mexican authorities, but needs to focus also on the imperfections of international capital markets" (p. 125).

The remainder of the book focuses on evaluating policies to fight these imperfections, in particular proposals to limit and discourage short-term capital flows. Griffith-Jones wants coordinated supervision of securities (banks and non-banks) extended to financial conglomerates, international agreement on standards (for accounting and disclosure), integration of

contract law, and creation of a strong institutional capacity at the international level. The book culminates in the last two pages in a plea to impose a "Tobin Tax": an international uniform tax on spot transactions in foreign exchange. Not surprisingly, this plea is welcomed by James Tobin in his foreword.

Although informative and in general a pleasure to read the book could have been a little bit better balanced in some respects. Let me mention just a few.

Some of the policy proposals are almost impossible to implement as they require intensive international coordination and agreement. The long negotiations in the various GATT rounds can give us an idea of what to expect. The end result will undoubtedly be quite different from what Griffith-Jones has in mind.

Most policy recommendations are based on a logical argument, but the plea for the Tobin Tax is not. I can understand recommendations to make better information available to combat market imperfections, although I would not go quite as far as Griffith-Jones. The Tobin Tax is imposed simply to create an obstacle to global capital flows. An international economist reminds me "not to put bricks into our harbor simply because our neighbors do it as well." The one financial center in the world which does not impose such a tax will attract a lot of business.

The costs of restricting capital flows can be large. In a sense Mexico and Southeast Asia suffered "welfare" or "success" financial crises which many nations in Africa would have liked to have.

A broader view in space might have been helpful. In particular, after stressing the volatility of short-term capital flows and the high dependence of such flows for Mexico as compared to Southeast Asian countries throughout the book, the reader is obviously wondering why the Asian Currency crisis occurred.

A broader, relative view in time would also have been helpful. Most data cover a period of about seven years (end 1980s, beginning 1990s) in current dollars, which paints a picture of massive, rapidly rising global capital flows. If we look instead at the size of net capital flows in relative terms over a longer time period, as Maurice Obstfeld does for 12

major countries (1998, *J. Econ. Perspectives* 12(4), p. 12) and compare the period 1870–1889 with 1990–1996 we see that they have fallen on average from 3.7 percent of GDP to 2.3 percent of GDP. The most drastic decline is for Argentina, the only Latin American country, from 18.7 percent of GDP to 2.2 percent of GDP. Perhaps the "meagre" capital flows of today require less regulation after all.

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Capital Flows and Financial Crises. Edited by Miles Kahler. A Council on Foreign Relations Book. Ithaca: Cornell University Press, 1998. Pp. xi, 268. \$49.94, cloth; \$19.95, paper. ISBN 0-8014-3579-X, cloth; 0-8014-8562-2, pbk.

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This is a timely book on a topic that should be of much interest to economists today. Mexico, Argentina, Russia, Thailand, Korea, Indonesia, Brazil—the list is long, and perhaps still growing. How can we come to terms with the suddenness and extent of crises in these emerging markets? And what lessons can we take away from these experiences? The sharp declines in asset prices and double-digit contractions in real activity stand very much as a puzzle to most observers.

Where traditional views of crises placed the blame on large current account deficits, much of the recent attention among both policymakers and academics has been on the volatility of capital flows. This book is a collection of eight papers by several influential scholars (edited and with an introduction by Miles Kahler) laying out facts, experiences, and arguments regarding capital flows.

An emerging economy is one in which project returns are high but capital is scarce. Thus neoclassical theory tells us that capital flows are valuable since they enable growth that would not otherwise be achievable. However, experience has shown us otherwise. Smooth flows have been the exception to the rule of "boom-bust" cycles in lending. In this light, Barry Eichengreen and Albert Fishlow ask in Chapter 2 whether the boom-bust cycles in the 1990's have been any different than those of the 1920's or 1970's. Their chapter reads as a history lesson on crises,

touching on a number of interesting points. Foreign governments were borrowers in public bond markets from private and institutional investors in the 20's. In the 70's, commercial banks were the lenders to private and public borrowers in emerging markets. In the past decade, private investors have been responsible for the dramatic increase in the scale of flows as they purchased equity stakes in emerging markets. Losses due to defaults in the 20's were concentrated in private portfolios and as such there was little government intervention. In contrast, the losses to commercial banks in the 70's threatened the strength of lender financial systems and prompted intervention and bailouts. Finally the Tequila and Asian crises led to some intervention due to the exposure of U.S. investors (Mexico) and Japanese banks (Asia).

A common complaint is that much of the recent flow into emerging markets has been short term in nature ("hot money"). Two chapters in the book delve more deeply into the composition of capital flows. Rachel McCulloch and Peter Petri detail the growth in portfolio equity flows and direct foreign investment into Asia, noting that portfolio flows grew from one percent in the 80's to eleven percent of capital inflows in the 90's. Dorothy Sobol performs a similar analysis for Central and Eastern Europe. Broadly, flows to Poland, the Czech Republic, and Hungary rose from \$5 billion in 1990 to \$20 billion in 1995. Of these flows the share of bank and bond finance fell 87 percent to 34 percent over these years. Equity flows and direct foreign investment made up the balance. Sobol proceeds to provide more detailed accounting of the flows and sectors in each of these countries.

What have countries done in the face of volatile capital flows? Andres Velasco and Pablo Cabezas provide excellent case studies of Mexico and Chile in this regard. The sequence of events they lay out are: "large capital inflow, real appreciation, a bubble in asset prices, a domestic lending boom, weakening financial institutions, a sudden reversal of expectations, and intertwined banking and currency collapses" (p. 129). They discuss the policy choices of Mexico and Chile in this environment: exchange rate regime, sterilization