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HIGH & LOW FINANCE

## The Upside to Resisting Globalization

By [FLOYD NORRIS](#)

As globalization spread in recent decades, the pace of world economic growth picked up. Open economies, it turns out, can grow faster than closed ones.

But now, as the financial crisis has turned to an economic one, it appears that those running a closed economy may be in better shape to weather the storm.

Kenneth S. Rogoff, the Harvard economist, [noted](#) at the International Monetary Forum in Davos, Switzerland, last week that India, which has “comparatively stringent restrictions on international capital flows,” also seemed to have the most optimists and seemed to be in line for economic growth in a year when few countries are.

“Thank heavens for the strong regulatory framework we have in our financial system,” he quoted one Indian corporate executive as saying.

In contrast, the countries that opened the most to the international capital markets, and that sought to bring in business with relatively lax regulations, now are suffering the most. Iceland was the wonder economy of the world; now it is broke.

The metaphor that comes to mind is that of a large ship. A single-hull ship will cost less to build and operate than a similar ship with a double hull. It will therefore earn more money on every trip, but it is more likely to be sunk if it encounters a severe storm or large iceberg.

The financial system was allowed to spin out of control at just the time it could do the most damage to the world.

Before this episode, the evidence seemed to show that developing countries could benefit from being financially open, assuming other factors were present. “Full-fledged opening of the capital accounts in the absence of essential supporting conditions can vitiate the realization of any benefits, while making a country more vulnerable to sudden stops of capital flows,” Mr. Rogoff, a former chief of research at the [International Monetary Fund](#), wrote a couple of years ago. That [paper](#) was written jointly with three economists then with the I.M.F., M. Ayhan Kose, Eswar Prasad and Shang-Jin Wei.

Those essential conditions, the paper added, “include stable macroeconomic policies as well as sufficiently strong financial and other institutions, regulation and governance.”

When Mr. Rogoff and his colleagues wrote those words, they had in mind the regulation in the country doing the opening, not in the United States and Britain, where most of the world's major banks were based.

But it is just those countries that have proved the truth of the warning. "We were just incredibly irresponsible," Mr. Rogoff said of the American regulators. "We had all the blinking red lights. Our leaders were blind to what was happening."

Mr. Rogoff is far too much of an economist to think that the solution is to close economies. "The lesson cannot be that you should go to financial autarchy," he said.

But the world might be in better shape now if more countries had chosen that route, and thus been more insulated from the credit storm that has left companies and countries around the world fearful that they will be unable to obtain needed financing.

There is sure to be a new American regulatory architecture coming out of all this, and there will be more efforts at international collaboration.

Among regulators, a buzzword now is "countercyclical," and efforts will be made to incorporate that into any new system. In essence, that says that regulators should force banks to take fewer risks when things are very good — perhaps by raising required capital levels — and to relax the standards when things are very bad and the world is desperate for credit. The current system tended to react to everything being good by concluding less capital was needed.

We'll see in some new cycle if that idea would really work. Would the regulators be willing to act when things are very good, as they failed to do in the last cycle? Some have doubts, among them Walter B. Kielholz, the chairman of [Credit Suisse](#), who says he thinks governments are unlikely to support regulators if banks and customers complain.

This crisis has shown the Achilles' heel of a globalized financial system to be a lack of high-quality, and consistent, regulation to prevent overconfident bankers from taking irresponsible risks. A year and a half ago, when it appeared to be a subprime mortgage issue for the United States, most countries thought they could glide past it. But it turned out that everyone in that globalized system was vulnerable to the collapse that began at the center.

"I believe we need a global financial regulator with real teeth," Mr. Rogoff said this week, "to prevent the lowest common denominator problem." Before this crisis, capital flowed to the place where it was least regulated, and some countries competed to be that place. It is worth remembering that the Bush administration was trying to use the threat of overseas competition to relax regulation before the financial system blew up.

If that doesn't happen, then the most rational thing for many countries may be to insulate themselves from the globalized economy. "Countries will feel required to put on more capital controls so they are not exposed to countries that are taking risks," Mr. Rogoff said.

As with the buyers of double-hulled ships, countries that follow that course are likely to be less successful most of the time. Opportunities for international banks will be reduced.

Taking steps to stop that from happening — by getting an effective regulatory system — would help the global economy and, in the long run, the institutions being regulated. Accomplishing that will be a lot harder, and less popular politically, than putting limits on executive bonuses. But it could do a lot more good.

*Floyd Norris's blog on finance and economics is at [nytimes.com/norris](http://nytimes.com/norris).*

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