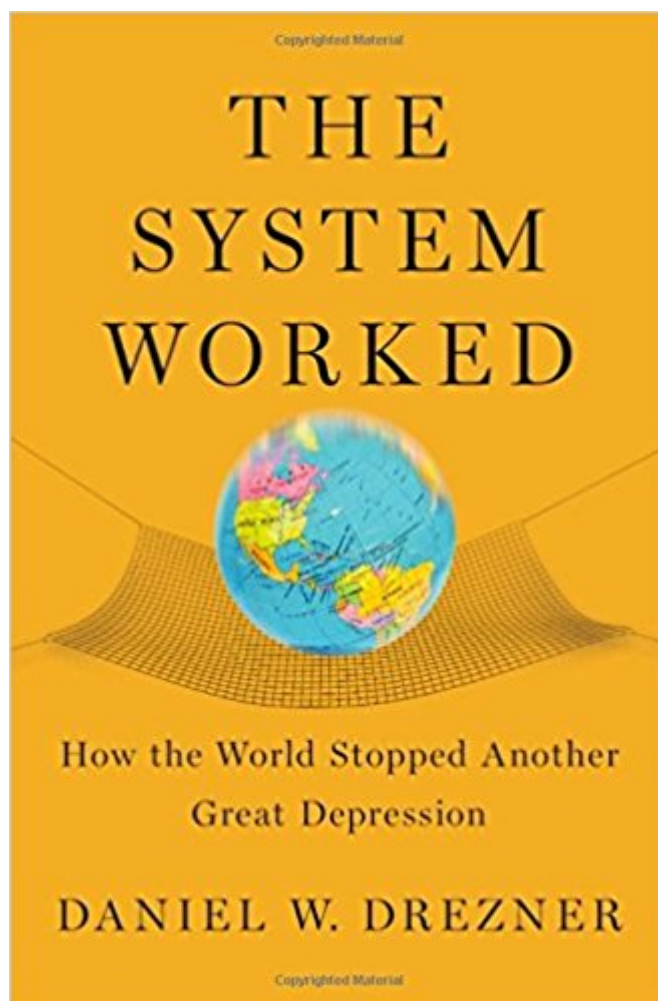


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# The System Worked: How The World Stopped Another Great Depression



## Synopsis

International institutions, from the International Monetary Fund to the International Olympic Committee, are perceived as bastions of sclerotic mediocrity at best and outright corruption at worst, and this perception is generally not far off the mark. In the wake of the 2008 financial crash, Daniel W. Drezner, like so many others, looked at the smoking ruins of the global economy and wondered why global economic governance structure had failed so spectacularly, and what could be done to reform them in the future. But then a funny thing happened. As he surveyed their actions in the wake of the crash, he realized that the evidence pointed to the exact opposite conclusion: global economic governance had succeeded. In *The System Worked*, Drezner, a renowned political scientist and international relations expert, contends that despite the massive scale and reverberations of this latest crisis (larger, arguably, than those that precipitated the Great Depression), the global economy has bounced back remarkably well. Examining the major resuscitation efforts by the G-20 IMF, WTO, and other institutions, he shows that, thanks to the efforts of central bankers and other policymakers, the international response was sufficiently coordinated to prevent the crisis from becoming a full-fledged depression. Yet the narrative about the failure of multilateral economic institutions persists, both because the Great Recession affected powerful nations whose governments managed their own economies poorly, and because the most influential policy analysts who write the books and articles on the crisis hail from those nations. Nevertheless, Drezner argues, while it's true that the global economy is still fragile, these institutions survived the "stress test" of the financial crisis, and may have even become more resilient and valuable in the process. Bucking the conventional wisdom about the new "G-Zero World," Drezner rehabilitates the image of the much-maligned international institutions and demolishes some of the most dangerous myths about the financial crisis. *The System Worked* is a vital contribution to our understanding of an area where the stakes could not be higher.

## Book Information

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## Customer Reviews

"If you find yourself disagreeing with Drezner, you need to take a good hard look at yourself and what you are doing with your life... this detailed, knowledgeable and cogent book is required reading for everyone in the global governance field -- and anyone who wants to know how, bad though things have been since the global financial crisis, they might have been a hell of a lot worse." --Alan Beattie, Financial Times

"Most analyses of the way in which countries work together to tackle international problems conclude with scathing and often justified critiques. In this original and well-written book Daniel Drezner shows how in the recent financial crisis, 'the system worked.' This book is full of surprising insights and important policy ideas." --Moses Naftali, Scholar, Carnegie Endowment and author of The End of Power

"Is today's global system of economic governance broken? The overwhelming consensus among experts and pundits, writing in the aftermath of the 2008 financial crisis, is that it is... In this astute and sharply argued book, Daniel Drezner begs to differ. In a detailed survey of international responses to the Great Recession, Drezner makes a convincing case that global institutions--the G20, IMF, WTO, and IMF--actually do still facilitate international cooperation and problem solving... Drezner does not argue that global governance is perfect, but he nicely shows that, contrary to the pessimists, there still is life in the liberal world order." --G. John Ikenberry, Albert G. Milbank Professor of Politics and International Affairs, Princeton University

"This new and excellent book by Daniel Drezner provides the best take on what we did right and why the world did not fall into a global great depression." --Tyler Cowen, Marginal Revolution

"The System Worked is a smart, thoughtful, and important book that I largely disagree with... Drezner has put forward an argument to be reckoned with, and it is more important that the book find an audience among those who disagree with its conclusions." --Jonathan Kirsch, Boston Review

"Drezner offers a thoughtful and contemporary analysis of global governing systems and their underlying politics." --National Journal

Daniel W. Drezner is professor of International Politics at the Fletcher School of Law and Diplomacy at Tufts University, a nonresident senior fellow at the Brookings Institution. He has previously held

positions with Civic Education Project, the RAND Corporation, and the U.S. Department of the Treasury. He is the author of four previous books, most recently *Theories of International Politics and Zombies*.

The book has a couple of great merits. The first and main one is to leverage the outstanding work of Eichengreen and O'Rourke (A Tale of Two Depressions, a short paper issued in early 2009) to essentially benchmark the Great Recession vs. the Great Depression. The second one is to demonstrate that contrary to everything you read in the press "The System Worked" actually pretty well. In other words, just about everything you will read in this book is somewhat counterintuitive and counter establishment. That is at least relative to how those various technical subjects have been treated by the Media. No one in the Media conveyed that the onset of the Great Recession was actually much more severe than the Great Depression. The author leveraging Eichengreen and O'Rourke work shows that in the first year of those two economic shocks, the Great Recession actually experienced a marginally more severe downturn in global industrial output, a far more severe decline in global trade flows, and even a drastically more severe downturn in global stock markets! The last one is the real shocker. In the first 12 months of the Great Depression (from June 1929 over next 12 months), the stock market had held up reasonably well and had lost only 6% of its market cap value. It is only over next two years that it will lose eventually 70% of its market value. Meanwhile, in the Great Recession (from April 2008 over the next 12 months, it will lose already 45% of its market value in the very first year (vs. only 6% for the Great Depression)! Back in 2009, Eichengreen and O'Rourke already indicated that the policy response at the onset of the Great Recession was far more rational than during the Great Depression. They showed that immediately the main central banks and governments responded with a far more accommodative monetary policy and fiscal policy during the Great Recession. Meanwhile, the Great Depression remains an historical example of everything we can do wrong in terms of Government policies (restrictive monetary and fiscal policies, protectionism). Interestingly Drezner policy framework is much broader and more aimed towards supranational entities than Eichengreen and O'Rourke. While the latter are concerned with monetary and fiscal policies as conducted by individual central banks and governments, Drezner is also concerned about the worldwide collaboration between the main economic powers to support supranational frameworks to mitigate the Great Recession. So, when Drezner talks about the system and assess its performance he refers to a group of institutions including: UN, IMF, World Bank, IDA, WTO, OECD, BIS, G-8 and G-20. Drezner demonstrates

throughout the book that those supranational institutions were really helpful in coordinating monetary and fiscal policy worldwide, maintaining international trade flows, and shoring up liquidity within the capital markets. And, that in turn this worldwide policy coordination was really helpful and effective into avoiding a second Great Depression. Early in the book, he revisits Eichengreen and O'Fáin's work that had updated their data through the first four years of the Great Recession and Great Depression. And, there is a radical difference. The Great Depression from 1929 to 1933 continues plunging or accelerating downward on all counts. It is only in the last few months of that time series that some of the metrics indicate they had finally reached a floor. By contrast the Great Recession on a relative basis on all counts shows a pretty healthy V shape recovery beyond the first year mark. In other words, the system really did work. But, you would never know it from the Media that is still exasperated that we experienced a recession at all. And, that the recovery is not as robust as the Media would have desired. The slow recovery is being in good part driven by demographics (an aging society) and economic maturation (a large well developed mature economy can't keep growing at 3.5% p.a. forever). Drezner points out to several metrics indicating that countries have remained supportive of international trade throughout the Great Recession. Those metrics include a KOF Index of Globalization that actually held up well over the 2000 to 2010 period. He also shows that the yearly number of trade restrictions have pretty much steadily declined since 2000. He also refers to business surveys indicating that the private sector was not concerned about protectionism or currency volatility throughout the 2011 to 2013 period. He later refers to a JP Morgan volatility index of exchange rate that showed a drastic increase in such exchange rate volatility in 2009 and early 2010, that had almost entirely abated by 2011 and onward. Drezner indicates that worldwide support for Free Markets and Free Trade held up well throughout the Great Recession (an offshoot of the system, as defined, working well). He supports that with yearly survey results from 2007 to 2012. Those polls are very interesting as they have many counterintuitive data points. According to them, support for Free Trade is much greater in Russia and China than in the U.S. I gather it can be explained by Russia chronically being subject to trade sanctions for foreign policy reasons; And, China being a somewhat mercantilist nation fueling its economic growth with a strong export performance. Support for Free Markets is very low in Japan. It is even much lower than in Russia. It was nearly as high in France as in the US in 2011. But, there was a marked drop in France's support for Free Market in 2012. Meanwhile, it held steady for the U.S. Near the end of the book, Drezner has an interesting coverage on the intellectual economic debate between Keynesianism and Austerity. He points out that in the end, the Keynesians won the

day as Austerity measures did not work well within the EU. And, just as importantly the leading economic paper on Austerity (Reinhart and Rogoff) was thoroughly debunked (cherry picking of data, embarrassing mistake in summing values in Excel). One of Drezner's other interesting findings is that the U.S. power is far from being as obsolete from a world leadership standpoint as people think. Indeed, a good part of the world now thinks China is the world's leading power instead of the U.S. However, when looking at GDP per capita one can question whether China will ever catch up to the U.S. The same is true for share of capital markets that pretty much channel funds worldwide. The U.S. is by far the dominant entity on this count (New York) closely followed by a close ally: U.K. (London). China on this one count is essentially nonexistent. Regarding high technology and related dominant software platforms, the U.S. is far ahead of China and anyone else. In terms of influence on the "system" as defined, the U.S. influence is far greater than China. All around this is a very interesting book that covers a lot of ground. Drezner's message is very important given that it is so counter to whatever misrepresentation of the facts the Media has indulged in over the past several years.

Well researched, but clumsily written. It could have used some pruning. We know the author's thesis from the opening. It doesn't need re-iteration throughout.

This book is reasonably short - under 200 pages, yet it will not be an easy book for the lay reader. It is akin to a political seminar at the graduate level in international economic politics during the period 2007-2012. While it is not terribly jargon-filled, his analysis is couched in terms of concepts that are apparently standard ways of teaching and talking about political science in the academy = interest analysis; the role of power; etc. The words "paradigm" and "hegemon" come up a lot. Each chapter has at least 100 footnotes. Really, it is a brief, reasonably well argued, for the proposition stated in the title: "The System Worked", meaning that the governments of the major economic powers (US, EU and China), their central banks (really just the Fed) and the principal multilateral economic organizations - IMF, e.g., and , forums-- G20, Basel, etc. -- managed to work together over this period well enough to stop the financial crisis of 2007-09 from metastasizing into another Great Depression globally. There really is no "system" in any designed sense; the term overstates what was on hand. And "worked", as one of the other reviewers astutely notes, really means "avoided global disaster" (not a small achievement). But one needs a pithy attention-grabbing title, I understand. Principally, they adhered to open economies and avoided protectionism; China and the

US provided enough Keynesian stimulus; and they all bailed out their financial sectors to keep money and credit moving decently enough. He does not claim great heights were scaled; rather, the response was "good enough", there was no plausible alternative that offered anywhere near the same results; and "the perfect is the enemy of the good". The author definitely deserves to be applauded for taking the trouble to document his unconventional thesis, it being much easier, as he notes, to find things that went wrong (without ever rigorously proving a particular counter-factual would have gone better). And the size of the book is also user-friendly. It is however all exposition and recitation of facts and quotes, with little narrative that many readers may prefer. Of the reviews that precede mine, the one by Gderf is fairly accurate, as long as you separate out his own views from his description of the author's argument (that part is accurate).

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