Globalism's Discontents

Joseph E. Stiglitz

Few subjects have polarized people throughout the world as much as globalization. Some see it as the way of the future, bringing unprecedented prosperity to everyone, everywhere. Others, symbolized by the Seattle protestors of December 1999, fault globalization as the source of untold problems, from the destruction of native cultures to increasing poverty and immiseration. In this article, I want to sort out the different meanings of globalization. In many countries, globalization has brought huge benefits to a few with few benefits to the many. But in the case of a few countries, it has brought enormous benefit to the many. Why have there been these huge differences in experiences? The answer is that globalization has meant different things in different places.

The countries that have managed globalization on their own, such as those in East Asia, have, by and large, ensured that they reaped huge benefits and that those benefits were equitably shared; they were able substantially to control the terms on which they engaged with the global economy. By contrast, the countries that have, by and large, had globalization managed for them by the International Monetary Fund and other international economic institutions have not done so well. The problem is thus not with globalization but with how it has been managed.

The international financial institutions have pushed a particular ideology--market fundamentalism--that is both bad economics and bad politics; it is based on premises concerning how markets work that do not hold even for developed countries, much less for developing countries. The IMF has pushed these economics policies without a broader vision of society or the role of economics within society. And it has pushed these policies in ways that have undermined emerging democracies.

More generally, globalization itself has been governed in ways that are undemocratic and have been disadvantageous to developing countries, especially the poor within those countries. The Seattle protestors pointed to the absence of democracy and of transparency, the governance of the international economic institutions by and for special corporate and financial interests, and the absence of countervailing democratic checks to ensure that these informal and *public* institutions serve a general interest. In these complaints, there is more than a grain of truth.

Beneficial Globalization

Of the countries of the world, those in East Asia have grown the fastest and done most to reduce poverty. And they have done so, emphatically, via "globalization." Their growth has been based on exports--by taking advantage of the global market for exports and by closing the technology gap. It was not just gaps in capital and other resources that separated the developed from the less-developed countries, but differences in knowledge. East Asian countries took advantage of the "globalization of knowledge" to reduce these disparities. But while some of the countries in the region grew by opening themselves up

to multinational companies, others, such as Korea and Taiwan, grew by creating their own enterprises. Here is the key distinction: Each of the most successful globalizing countries determined its own pace of change; each made sure as it grew that the benefits were shared equitably; each rejected the basic tenets of the "Washington Consensus," which argued for a minimalist role for government and rapid privatization and liberalization.

In East Asia, government took an active role in managing the economy. The steel industry that the Korean government created was among the most efficient in the world--performing far better than its private-sector rivals in the United States (which, though private, are constantly turning to the government for protection and for subsidies). Financial markets were highly regulated. My research shows that those regulations promoted growth. It was only when these countries stripped away the regulations, under pressure from the U.S. Treasury and the IMF, that they encountered problems.

During the 1960s, 1970s, and 1980s, the East Asian economies not only grew rapidly but were remarkably stable. Two of the countries most touched by the 1997-1998 economic crisis had had in the preceding three decades not a single year of negative growth; two had only one year--a better performance than the United States or the other wealthy nations that make up the Organization for Economic Cooperation and Development (OECD). The single most important factor leading to the troubles that several of the East Asian countries encountered in the late 1990s--the East Asian crisis--was the rapid liberalization of financial and capital markets. In short, the countries of East Asia benefited from globalization because they made globalization work for them; it was when they succumbed to the pressures from the outside that they ran into problems that were beyond their own capacity to manage well.

Globalization can yield immense benefits. Elsewhere in the developing world, globalization of knowledge has brought improved health, with life spans increasing at a rapid pace. How can one put a price on these benefits of globalization? Globalization has brought still other benefits: Today there is the beginning of a globalized civil society that has begun to succeed with such reforms as the Mine Ban Treaty and debt forgiveness for the poorest highly indebted countries (the Jubilee movement). The globalization protest movement itself would not have been possible without globalization.

The Darker Side of Globalization

How then could a trend with the power to have so many benefits have produced such opposition? Simply because it has not only failed to live up to its potential but frequently has had very adverse effects. But this forces us to ask, why has it had such adverse effects? The answer can be seen by looking at each of the economic elements of globalization as pursued by the international financial institutions and especially by the IMF.

The most adverse effects have arisen from the liberalization of financial and capital markets--which has posed risks to developing countries without commensurate rewards.

The liberalization has left them prey to hot money pouring into the country, an influx that has fueled speculative real-estate booms; just as suddenly, as investor sentiment changes, the money is pulled out, leaving in its wake economic devastation. Early on, the IMF said that these countries were being rightly punished for pursuing bad economic policies. But as the crisis spread from country to country, even those that the IMF had given high marks found themselves ravaged.

The IMF often speaks about the importance of the discipline provided by capital markets. In doing so, it exhibits a certain paternalism, a new form of the old colonial mentality: "We in the establishment, we in the North who run our capital markets, know best. Do what we tell you to do, and you will prosper." The arrogance is offensive, but the objection is more than just to style. The position is highly undemocratic: There is an implied assumption that democracy by itself does not provide sufficient discipline. But if one is to have an external disciplinarian, one should choose a good disciplinarian who knows what is good for growth, who shares one's values. One doesn't want an arbitrary and capricious taskmaster who one moment praises you for your virtues and the next screams at you for being rotten to the core. But capital markets are just such a fickle taskmaster; even ardent advocates talk about their bouts of irrational exuberance followed by equally irrational pessimism.

Lessons of Crisis

Nowhere was the fickleness more evident than in the last global financial crisis. Historically, most of the disturbances in capital flows into and out of a country are not the result of factors inside the country. Major disturbances arise, rather, from influences outside the country. When Argentina suddenly faced high interest rates in 1998, it wasn't because of what Argentina did but because of what happened in Russia. Argentina cannot be blamed for Russia's crisis.

Small developing countries find it virtually impossible to withstand this volatility. I have described capital-market liberalization with a simple metaphor: Small countries are like small boats. Liberalizing capital markets is like setting them loose on a rough sea. Even if the boats are well captained, even if the boats are sound, they are likely to be hit broadside by a big wave and capsize. But the IMF pushed for the boats to set forth into the roughest parts of the sea before they were seaworthy, with untrained captains and crews, and without life vests. No wonder matters turned out so badly!

To see why it is important to choose a disciplinarian who shares one's values, consider a world in which there were free mobility of skilled labor. Skilled labor would then provide discipline. Today, a country that does not treat capital well will find capital quickly withdrawing; in a world of free labor mobility, if a country did not treat skilled labor well, it too would withdraw. Workers would worry about the quality of their children's education and their family's health care, the quality of their environment and of their own wages and working conditions. They would say to the government: If you fail to provide these essentials, we will move elsewhere. That is a far cry from the kind of discipline that free-flowing capital provides.

The liberalization of capital markets has not brought growth: How can one build factories or create jobs with money that can come in and out of a country overnight? And it gets worse: Prudential behavior requires countries to set aside reserves equal to the amount of short-term lending; so if a firm in a poor country borrows $100 million at, say, 20 percent interest rates short-term from a bank in the United States, the government must set aside a corresponding amount. The reserves are typically held in U.S. Treasury bills--a safe, liquid asset. In effect, the country is borrowing $100 million from the United States and lending $100 million to the United States. But when it borrows, it pays a high interest rate, 20 percent; when it lends, it receives a low interest rate, around 4 percent. This may be great for the United States, but it can hardly help the growth of the poor country. There is also a high *opportunity* cost of the reserves; the money could have been much better spent on building rural roads or constructing schools or health clinics. But instead, the country is, in effect, forced to lend money to the United States.

Thailand illustrates the true ironies of such policies: There, the free market led to investments in empty office buildings, starving other sectors--such as education and transportation--of badly needed resources. Until the IMF and the U.S. Treasury came along, Thailand had restricted bank lending for speculative real estate. The Thais had seen the record: Such lending is an essential part of the boom-bust cycle that has characterized capitalism for 200 years. It wanted to be sure that the scarce capital went to create jobs. But the IMF nixed this intervention in the free market. If the free market said, "Build empty office buildings," so be it! The market knew better than any government bureaucrat who mistakenly might have thought it wiser to build schools or factories.

The Costs of Volatility

Capital-market liberalization is inevitably accompanied by huge volatility, and this volatility impedes growth and increases poverty. It increases the risks of investing in the country, and thus investors demand a risk premium in the form of higher-than-normal profits. Not only is growth not enhanced but poverty is increased through several channels. The high volatility increases the likelihood of recessions--and the poor always bear the brunt of such downturns. Even in developed countries, safety nets are weak or nonexistent among the selfemployed and in the rural sector. But these are the dominant sectors in developing countries. Without adequate safety nets, the recessions that follow from capital-market liberalization lead to impoverishment. In the name of imposing budget discipline and reassuring investors, the IMF invariably demands expenditure reductions, which almost inevitably result in cuts in outlays for safety nets that are already threadbare.

But matters are even worse--for under the doctrines of the "discipline of the capital markets," if countries try to tax capital, capital flees. Thus, the IMF doctrines inevitably lead to an increase in tax burdens on the poor and the middle classes. Thus, while IMF bailouts enable the rich to take their money out of the country at more favorable terms (at the overvalued exchange rates), the burden of repaying the loans lies with the workers who remain behind.

The reason that I emphasize capital-market liberalization is that the case against it--and against the IMF's stance in pushing it--is so compelling. It illustrates what can go wrong with globalization. Even economists like Jagdish Bhagwati, strong advocates of free trade, see the folly in liberalizing capital markets. Belatedly, so too has the IMF--at least in its official rhetoric, though less so in its policy stances--but too late for all those countries that have suffered so much from following the IMF's prescriptions.

But while the case for trade liberalization--when properly done--is quite compelling, the way it has been pushed by the IMF has been far more problematic. The basic logic is simple: Trade liberalization is supposed to result in resources moving from inefficient protected sectors to more efficient export sectors. The problem is not only that job destruction comes before the job creation--so that unemployment and poverty result--but that the IMF's "structural adjustment programs" (designed in ways that allegedly would reassure global investors) make job creation almost impossible. For these programs are often accompanied by high interest rates that are often justified by a single-minded focus on inflation. Sometimes that concern is deserved; often, though, it is carried to an extreme. In the United States, we worry that small increases in the interest rate will discourage investment. The IMF has pushed for far higher interest rates in countries with a far less hospitable investment environment. The high interest rates mean that new jobs and enterprises are not created. What happens is that trade liberalization, rather than moving workers from low-productivity jobs to high-productivity ones, moves them from low-productivity jobs to unemployment. Rather than enhanced growth, the effect is increased poverty. To make matters even worse, the unfair trade-liberalization agenda forces poor countries to compete with highly subsidized American and European agriculture.

The Governance of Globalization

As the market economy has matured within countries, there has been increasing recognition of the importance of having rules to govern it. One hundred fifty years ago, in many parts of the world, there was a domestic process that was in some ways analogous to globalization. In the United States, government promoted the formation of the national economy, the building of the railroads, and the development of the telegraph--all of which reduced transportation and communication costs within the United States. As that process occurred, the democratically elected national government provided oversight: supervising and regulating, balancing interests, tempering crises, and limiting adverse consequences of this very large change in economic structure. So, for instance, in 1863 the U.S. government established the first financial-banking regulatory authority--the Office of the Comptroller of Currency--because it was important to have strong national banks, and that requires strong regulation.

The United States, among the least statist of the industrial democracies, adopted other policies. Agriculture, the central industry of the United States in the mid-nineteenth century, was supported by the 1862 Morrill Act, which established research, extension, and teaching programs. That system worked extremely well and is widely credited with playing a central role in the enormous increases in agricultural productivity over the last

century and a half. We established an industrial policy for other fledgling industries, including radio and civil aviation. The beginning of the telecommunications industry, with the first telegraph line between Baltimore and Washington, D.C., was funded by the federal government. And it is a tradition that has continued, with the U.S. government's founding of the Internet.

By contrast, in the current process of globalization we have a system of what I call global governance without global government. International institutions like the World Trade Organization, the IMF, the World Bank, and others provide an ad hoc system of global governance, but it is a far cry from global government and lacks democratic accountability. Although it is perhaps better than not having any system of global governance, the system is structured not to serve general interests or assure equitable results. This not only raises issues of whether broader values are given short shrift; it does not even promote growth as much as an alternative might.

Governance through Ideology

Consider the contrast between how economic decisions are made inside the United States and how they are made in the international economic institutions. In this country, economic decisions within the administration are undertaken largely by the National Economic Council, which includes the secretary of labor, the secretary of commerce, the chairman of the Council of Economic Advisers, the treasury secretary, the assistant attorney general for antitrust, and the U.S. trade representative. The Treasury is only one vote and often gets voted down. All of these officials, of course, are part of an administration that must face Congress and the democratic electorate. But in the international arena, only the voices of the financial community are heard. The IMF reports to the ministers of finance and the governors of the central banks, and one of the important items on its agenda is to make these central banks more independent--and less democratically accountable. It might make little difference if the IMF dealt only with matters of concern to the financial community, such as the clearance of checks; but in fact, its policies affect every aspect of life. It forces countries to have tight monetary and fiscal policies: It evaluates the trade-off between inflation and unemployment, and in that trade-off it always puts far more weight on inflation than on jobs.

The problem with having the rules of the game dictated by the IMF--and thus by the financial community--is not just a question of values (though that is important) but also a question of ideology. The financial community's view of the world predominates--even when there is little evidence in its support. Indeed, beliefs on key issues are held so strongly that theoretical and empirical support of the positions is viewed as hardly necessary.

Recall again the IMF's position on liberalizing capital markets. As noted, the IMF pushed a set of policies that exposed countries to serious risk. One might have thought, given the evidence of the costs, that the IMF could offer plenty of evidence that the policies also did some good. In fact, there was no such evidence; the evidence that was available suggested that there was little if any positive effect on growth. Ideology enabled IMF

officials not only to ignore the absence of benefits but also to overlook the evidence of the huge costs imposed on countries.

An Unfair Trade Agenda

The trade-liberalization agenda has been set by the North, or more accurately, by special interests in the North. Consequently, a disproportionate part of the gains has accrued to the advanced industrial countries, and in some cases the less-developed countries have actually been worse off. After the last round of trade negotiations, the Uruguay Round that ended in 1994, the World Bank calculated the gains and losses to each of the regions of the world. The United States and Europe gained enormously. But sub-Saharan Africa, the poorest region of the world, lost by about 2 percent because of terms-of-trade effects: The trade negotiations opened their markets to manufactured goods produced by the industrialized countries but did not open up the markets of Europe and the United States to the agricultural goods in which poor countries often have a comparative advantage. Nor did the trade agreements eliminate the subsidies to agriculture that make it so hard for the developing countries to compete.

The U.S. negotiations with China over its membership in the WTO displayed a double standard bordering on the surreal. The U.S. trade representative, the chief negotiator for the United States, began by insisting that China was a developed country. Under WTO rules, developing countries are allowed longer transition periods in which state subsidies and other departures from the WTO strictures are permitted. China certainly wishes it were a developed country, with Western-style per capita incomes. And since China has a lot of "capitas," it's possible to multiply a huge number of people by very small average incomes and conclude that the People's Republic is a big economy. But China is not only a developing economy; it is a low-income developing country. Yet the United States insisted that China be treated like a developed country! China went along with the fiction; the negotiations dragged on so long that China got some extra time to adjust. But the true hypocrisy was shown when U.S. negotiators asked, in effect, for developing-country status for the United States to get extra time to shelter the American textile industry.

Trade negotiations in the service industries also illustrate the unlevel nature of the playing field. Which service industries did the United States say were *very* important? Financial services--industries in which Wall Street has a comparative advantage. Construction industries and maritime services were not on the agenda, because the developing countries would have a comparative advantage in these sectors.

Consider also intellectual-property rights, which are important if innovators are to have incentives to innovate (though many of the corporate advocates of intellectual property exaggerate its importance and fail to note that much of the most important research, as in basic science and mathematics, is not patentable). Intellectual-property rights, such as patents and trademarks, need to balance the interests of producers with those of users--not only users in developing countries, but researchers in developed countries. If we underprice the profitability of innovation to the inventor, we deter invention. If we

overprice its cost to the research community and the end user, we retard its diffusion and beneficial effects on living standards.

In the final stages of the Uruguay negotiations, both the White House Office of Science and Technology Policy and the Council of Economic Advisers worried that we had not got the balance right--that the agreement put producers' interests over users'. We worried that, with this imbalance, the rate of progress and innovation might actually be impeded. After all, knowledge is the most important input into research, and overly strong intellectual-property rights can, in effect, increase the price of this input. We were also concerned about the consequences of denying lifesaving medicines to the poor. This issue subsequently gained international attention in the context of the provision of AIDS medicines in South Africa [see "Medicine as a Luxury" by Merrill Goozner, on page A7]. The international outrage forced the drug companies to back down--and it appears that, going forward, the most adverse consequences will be circumscribed. But it is worth noting that initially, even the Democratic U.S. administration supported the pharmaceutical companies.

What we were not fully aware of was another danger--what has come to be called "biopiracy," which involves international drug companies patenting traditional medicines. Not only do they seek to make money from "resources" and knowledge that rightfully belong to the developing countries, but in doing so they squelch domestic firms who long provided these traditional medicines. While it is not clear whether these patents would hold up in court if they were effectively challenged, it is clear that the less-developed countries may not have the legal and financial resources required to mount such a challenge. The issue has become the source of enormous emotional, and potentially economic, concern throughout the developing world. This fall, while I was in Ecuador visiting a village in the high Andes, the Indian mayor railed against how globalization had led to biopiracy.

Globalization and September 11

September 11 brought home a still darker side of globalization--it provided a global arena for terrorists. But the ensuing events and discussions highlighted broader aspects of the globalization debate. It made clear how untenable American unilateralist positions were. President Bush, who had unilaterally rejected the international agreement to address one of the long-term global risks perceived by countries around the world--global warming, in which the United States is the largest culprit--called for a global alliance against terrorism. The administration realized that success would require concerted action by all.

One of the ways to fight terrorists, Washington soon discovered, was to cut off their sources of funding. Ever since the East Asian crisis, global attention had focused on the secretive offshore banking centers. Discussions following that crisis focused on the importance of good information--transparency, or openness--but this was intended for the developing countries. As international discussions turned to the lack of transparency shown by the IMF and the offshore banking centers, the U.S. Treasury changed its tune. It is not because these secretive banking havens provide better services than those

provided by banks in New York or London that billions have been put there; the secrecy serves a variety of nefarious purposes--including avoiding taxation and money laundering. These institutions could be shut down overnight--or forced to comply with international norms--if the United States and the other leading countries wanted. They continue to exist because they serve the interests of the financial community and the wealthy. Their continuing existence is no accident. Indeed, the OECD drafted an agreement to limit their scope--and before September 11, the Bush administration unilaterally walked away from this agreement too. How foolish this looks now in retrospect! Had it been embraced, we would have been further along the road to controlling the flow of money into the hands of the terrorists.

There is one more aspect to the aftermath of September 11 worth noting here. The United States was already in recession, but the attack made matters worse. It used to be said that when the United States sneezed, Mexico caught a cold. With globalization, when the United States sneezes, much of the rest of the world risks catching pneumonia. And the United States now has a bad case of the flu. With globalization, mismanaged macroeconomic policy in the United States--the failure to design an effective stimulus package--has global consequences. But around the world, anger at the traditional IMF policies is growing. The developing countries are saying to the industrialized nations: "When you face a slowdown, you follow the precepts that we are all taught in our economic courses: You adopt expansionary monetary and fiscal policies. But when we face a slowdown, you insist on contractionary policies. For you, deficits are okay; for us, they are impermissible--even if we can raise the funds through 'selling forward,' say, some natural resources." A heightened sense of inequity prevails, partly because the consequences of maintaining contractionary policies are so great.

Global Social Justice

Today, in much of the developing world, globalization is being questioned. For instance, in Latin America, after a short burst of growth in the early 1990s, stagnation and recession have set in. The growth was not sustained--some might say, was not sustainable. Indeed, at this juncture, the growth record of the so-called post-reform era looks no better, and in some countries much worse, than in the widely criticized import-substitution period of the 1950s and 1960s when Latin countries tried to industrialize by discouraging imports. Indeed, reform critics point out that the burst of growth in the early 1990s was little more than a "catch-up" that did not even make up for the lost decade of the 1980s.

Throughout the region, people are asking: "Has reform failed or has globalization failed?" The distinction is perhaps artificial, for globalization was at the center of the reforms. Even in those countries that have managed to grow, such as Mexico, the benefits have accrued largely to the upper 30 percent and have been even more concentrated in the top 10 percent. Those at the bottom have gained little; many are even worse off. The reforms have exposed countries to greater risk, and the risks have been borne disproportionately by those least able to cope with them. Just as in many countries where the pacing and sequencing of reforms has resulted in job destruction outmatching job creation, so too has

the exposure to risk outmatched the ability to create institutions for coping with risk, including effective safety nets.

In this bleak landscape, there are some positive signs. Those in the North have become more aware of the inequities of the global economic architecture. The agreement at Doha to hold a new round of trade negotiations--the "Development Round"--promises to rectify some of the imbalances of the past. There has been a marked change in the rhetoric of the international economic institutions--at least they talk about poverty. At the World Bank, there have been some real reforms; there has been some progress in translating the rhetoric into reality--in ensuring that the voices of the poor are heard and the concerns of the developing countries are listened to. But elsewhere, there is often a gap between the rhetoric and the reality. Serious reforms in governance, in who makes decisions and how they are made, are not on the table. If one of the problems at the IMF has been that the ideology, interests, and perspectives of the financial community in the advanced industrialized countries have been given disproportionate weight (in matters whose effects go well beyond finance), then the prospects for success in the current discussions of reform, in which the same parties continue to predominate, are bleak. They are more likely to result in slight changes in the shape of the table, not changes in who is *at* the table or what is on the agenda.

September 11 has resulted in a global alliance against terrorism. What we now need is not just an alliance *against* evil, but an alliance *for* something positive--a global alliance for reducing poverty and for creating a better environment, an alliance for creating a global society with more social justice.

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