

The Overselling of Globalization

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GLOBALIZATION HAS BEEN SOLD as bringing unprecedented prosperity to the billions of people who have remained mired in poverty for centuries. Yet, globalization faces enormous resistance especially in the Third World. Why so?

I argue that globalization today has been oversold. I use the term to refer not only to closer integration of the countries and peoples of the world that has resulted from the lowering of transportation and communication costs and manmade barriers but also to the particular policies, the so-called "Washington Consensus," that have been commonly associated with globalization and pushed on developing countries by the international economic institutions. The Washington Consensus emphasizes deregulated markets over government provision, balanced budgets and open borders across which goods and capital freely flow and flexible exchange rates. Many critics of globalization, like myself, are opposed not so much to globalization per se but to the particular set of policies that the International Monetary Fund (IMF) and the United States have imposed on developing countries in recent decades. During this period, many countries have suffered rising poverty, a degraded environment, and destroyed indigenous culture. Right or wrong, critics blame globalization. Moreover, there is widespread feeling that globalization, as practiced, has undermined democratic processes.

Managing globalization well, so that its potential benefits emerge, will not be easy. But unless we understand how globalization came to be misshapen we will not succeed in reforming globalization. In the discussion below (and in my recent book *Globalization and Its Discontents*), I argue that the failures are related to governance of globalization. By and large, the rules of globalization have been determined by the advanced industrial countries, for their interests, or more precisely for the interests of special interests, often to the marked dis-

advantage of the developing world. Within the democracies of the advanced industrial countries, there is a natural set of checks and balances. Financial and commercial interests loom large, but other groups—like labor and consumers and environmentalists—have a seat at the table. In the international arena this is not so. At the IMF, it is only finance ministers and central bankers whose voices are heard; in trade negotiations, it is the trade ministers, often with close links to commercial and financial interests, who set the agenda. In the last section of the chapter, I make recommendations how to right the governance structure for globalization.

THE ADVOCATES' CASE FOR GLOBALIZATION

Advocates of globalization cite studies which show that globalization, with increased trade and investment, has brought increased growth. According to this line of argument, countries that have remained removed from the world economy, like Myanmar, do worse than countries that have become integrated. True. And as I shall explain shortly, the most successful countries in the world, those in East Asia, had development strategies based on globalization, absorbing technology from more advanced countries and basing growth on exports. But these countries did not follow the prescriptions of the IMF or United States Treasury. They governed globalization in their own way. By contrast, the countries that followed the IMF's "Washington Consensus" policies performed worse. It is this observation which supports the conclusion that the problem is not with globalization per se, but with the way it has been managed.

Finally, the advocates of globalization, when confronted with its glaring failures, try to shift the blame to the developing countries themselves, to their corruption, to their lack of transparency, to their lack of resolve in making the needed reforms. There is little doubt that such problems exist in developing countries, just as they do in developed ones, and that had they addressed their problems, the countries would be better off. But recognizing these problems does not really answer the critics of globalization. With or without corruption, globalization, in the way that it has been carried out, has worsened the plight of many developing countries. I believe that Argentina would have had its crisis, given its fixed exchange rate, given the fall in the value of the currency of its trading partners, especially that of Brazil, even if there had been absolutely no corruption. The crisis might have happened a little later (or a little sooner), and it might have been a little less severe. But there would have been a crisis. And indeed, I have argued elsewhere that the policies, including the privatizations,

that the IMF imposed on Argentina made the crisis worse. In many countries around the world, the privatizations that the IMF pushed increased corruption. In short, the failures of globalization cannot really be blamed on the policies of the developing world.

Some Unsung Successes of Globalization

Certain aspects of globalization have been undersold. Globalization of knowledge has, especially where governments have undertaken active technology policies, narrowed the knowledge gap between developed and less developed countries, a gap that is every bit as important in explaining disparities in income as the gaps in resources.¹ The rapid spread of knowledge across boundaries has led to improved health, contributed to the global reduction and in some cases even elimination of diseases. Global civil society—of which the global protest movements against globalization is but one manifestation—has had some notable successes: The Land Mines' Treaty was adopted, over the strong opposition of the U.S. Defense Department; the Jubilee 2000 movement succeeded in pushing through debt relief for 27 of the poorest countries in the world, after years of foot dragging on the part of the IMF (during which only seven countries² succeeded in getting debt relief.) The global environmental movement succeeded in putting a halt to most large dam projects. Globalization of ideas, such as democracy and transparency and women's rights, has had enormous impacts on political processes throughout the world. These all represent dimensions of globalization which are too seldom noted.

East Asia

Moreover, China and many of the other countries in East Asia succeeded in rapid growth—accompanied by large reductions in poverty—largely as a result of globalization: their economic strategies, in which government played a key role, was based on the expansion of exports, taking advantage of international markets. But these countries did not follow the full array of Washington Consensus policies. They liberalized gradually (rather than quickly), they had government-managed industrial policies, and used government, rather than the private sector, create new state enterprises³ They did not open themselves up to short-term capital flows early in their development; some, like China, still have not done so; others, such as Malaysia, re-imposed controls during the global financial crisis. In short, the countries of East Asia grew because of globalization, but they managed it, shaped it, in ways that worked to their own

advantage. It was only when they succumbed to outside pressures, only when they went faster and further with liberalization, that globalization no longer served them well.

Reconsidering the Economic Theory of Globalization

The economist's case for globalization is straightforward: it increases a country's economic well-being because it increases the country's opportunities. Countries have more markets in which to sell their goods, more sources of funds with which to finance their development, and access to new technologies to enhance productivity. Increasing opportunities, almost by definition, enhance well-being.

But there are serious flaws in this textbook conclusion. For starters, even if globalization improved average living standards, it would hurt some sectors badly. Second, the notion that free trade and investment promote growth relies on the assumption that private markets are competitive and well functioning. When that is not the case—a circumstance rampant in the world—then, as my work and that of other economists makes clear, trade can actually make an economy worse-off. Economists have recently explored the consequences of imperfect markets. Take the issue of imperfect contracting—so-called agency problems, when one person (a manager) acts on behalf of another person (an owner) though their incentives are not perfectly aligned.

Take as a second example reputation problems—for example when buyers must rely on the reputation of the seller to gauge the quality of products. In both cases, the fact that buyers and sellers do not share the same information may worsen as the size of the market increases, and the ability of mechanisms, like reputation, to control markets may be weakened. Because globalization increases the size of markets it can, under circumstances of imperfect markets, devastate innocent economies.⁴ Take Latin America. When the United States Federal Reserve Bank hiked interest rates to unprecedented levels in the early 1980s, it threw Latin America into a decade-long tailspin.

Third, with globalization comes new rules, often imposed by industrialized countries, that can strip countries of the economic tools they could previously use to manage economic crises.

Fourth, globalization, as implemented, has driven down the price of products that poor countries export relative to the price of goods they import. Agricultural subsidies in the North increase production, thereby lowering the price of products grown in the South.

As shown below, globalization has been hijacked by the special interests in the North, often at the expense of the poor in developing countries. For example, the

1994 international trade accord, known as the Uruguay Round, has been hailed in the North as a major achievement. But a recent report says it made the poorest region of the world, Sub-Saharan Africa, worse off (by some 2 percent), largely as a result of the worldwide effects cited earlier.

CULTURAL AND OTHER NONECONOMIC MATTERS

The critics of globalization do not limit themselves to purely economic benefits and costs. While my main focus is on those economic costs and benefits, I want to say a few words about the democracy and culture.

Democratization

Advocates claim that globalization has led to an increased number of democracies. And certainly, the globalization of ideas has been an important impetus. But critics argue that globalization, as practiced, has undermined effective and stable democracy. The economic instability associated with globalization (which I describe more fully below) has brought with it political instability: democratically elected governments have been toppled in Ecuador and Argentina.

A key component of the Washington Consensus has been to open developing countries to short-term speculative capital flows. But that hands foreign investors enormous sway over political processes within these countries. If foreign investors dislike a political candidate, for example, they can withhold loans, driving up interest rates and toppling the economy into depression. In other words, foreign investors can increase the cost of electing someone they dislike.⁵ While the recent election of Lula in Brazil shows that capital markets do not yet have a full veto, the episode nonetheless demonstrates that capital markets enter into the political process in an important way. Advocates of globalization say that this is all to the good—foreign investors provide a check against populism and help push good economic policies. But critics point out that the financial markets are myopic; they are not concerned with long-term economic growth, let alone broader social values. They feel happier if an economy has a smaller fiscal deficit, even if that leaves larger unmet education or infrastructure needs.

While the virtues of democracy have been lauded, countries have been told to cede the most important economic decisions, those concerning monetary policy, to independent central banks, focusing exclusively on inflation.

International trade agreements have ceded further authority, e.g. about a wide range of issues, the full impact of which remains uncertain.

For countries that have to turn to the international financial institutions in times of crisis there has been an even greater derogation of economic sovereignty. The conditions imposed go well beyond those which an ordinary bank would impose to ensure repayment. The internationally imposed settlements go deep into areas which, in countries like the United States, would be viewed as quintessentially political. Even when countries might have undertaken policies on their own, there is something unseemly in today's world of having those policies forced on a country, particularly given yesteryear's colonialism. To those in the developing world, the image of the cross-armed Michel Camdessus, the IMF's Managing director, standing over Indonesia's Suharto, as he put his signature on a piece of paper, seemingly signing away that country's economic sovereignty, will never be forgotten.⁶

Issues which are of intense political debate in the United States and Europe—whether to privatize Social Security or whether the central bank should worry about unemployment and growth along with inflation—are taken off the political agenda. The IMF tells the country what to do. I thought it was wrong for the IMF to tell crisis-stricken countries in Asia what to do in 1997 and 1998. The role of the economic adviser is to describe the consequences of alternatives, including the risks, and who benefits and who loses. The political process—not some international bureaucrat lacking any political accountability—should make the decision. But another reason I reacted so strongly to what the IMF and Washington told Asian countries to do is that the advice was not, in many cases, based on economic science.

Globalization and Collective Action

International institutions and agreements should focus on areas where global collective action is desired. Private markets sometimes fail, and for well-understood reasons. Two stand out. First, externalities—transactions between country A and country B can affect an innocent third part, country C. Second, public goods. Take public health. Country A's ability to control the spread of AIDS can affect the well being of the population of its neighbors. Or take the reasons why the IMF was created. Economic crisis in one country can drag down another (an externality) and foreign investors, because of imperfections in the way that international capital markets work, cannot be counted on to supply funds to expand fiscal policy even if the country would almost certainly repay its loans. There is, then, a need for global collective action to overcome financial crises.⁷

In recent years, the United States has refused even to discuss issues of global collective action in these terms. The worry is that both the American government, and the special interests which seem to have such influence over its international

economic policy, see international agreements as instruments for advancing their particular interests. Consider the way the United States handled negotiations over the rules governing the protection of patents over pharmaceutical drugs. The United States did not ask what would be the intellectual property arrangement which will best balance the interests of buyers and sellers of drugs or which rules would best promote the advancement of science and provide needed medicines at affordable prices to those in developing countries. From the perspective of the U.S. Trade Representative, negotiating the intellectual property agreement, the question was what kind of protection would best advance the interests of American pharmaceutical companies. Even many in America's scientific community thought that the agreement may have impeded advances in science; and while both the Council of Economic Advisers and the Office of Science and Technology Policy raised strong objections to the positions of the U.S. Trade Representative seemed to be taking in the recently completed round of international trade talks, special interests prevailed.

Ceding Sovereignty

Thus, democratic processes even in countries with strong democracies, like the United States, have been undermined by globalization, in the manner in which it has proceeded. Of course, any international agreement can be thought of as ceding some sovereignty. There are gains from global collective action, and these gains may well exceed the costs, including the costs associated with ceding sovereignty. But when international agreements are more designed to advance particular interests, and are not motivated at all by considerations of global public goods or externalities, it is more likely that the costs exceed the benefits.

In some areas, recent trade treaties have raised the issue in a stark form. In the 1993 NAFTA trade agreement among the United States, Canada, and Mexico, a foreign firm that believes that a domestic regulation impairs its profitability can directly sue for compensation. The backdrop for that provision is the fact that regulations can reduce the value of corporate assets, just as a tax can, and such reductions are referred to as regulatory takings. In the United States, conservatives have repeatedly attempted to enact legislation to make government pay whenever there is such a taking, arguing that such takings represent a deprivation of basic property rights. The courts, however, have almost always said that there is no right to compensation, and legislators, both at the federal and state levels, have ignored these pleadings. Yet in some recent international trade agreements, foreign firms seem to have been able to extract for themselves what firms inside the economy could not. Critics worry that if this becomes

widespread, it will impair the ability of government to enact regulations, for instance, concerning health or safety or the preservation of the environment or natural resources. Unknowingly, citizens seem to have given up important rights, hidden away inside a trade bill that was supposed to open up economic opportunities.

Much of the fine print in the 1994 (Uruguay round) international trade accord has yet to be fully interpreted, let alone adjudicated in courts. Some of the provisions—such as the requirement that preference should be given to measures that have “the least disruptive effect on trade” (Understanding on the Balance-of-Payments Provisions of the General Agreement on Tariffs and Trade 1994, article no.2)—threaten the autonomy of countries to set prudent rules. Will the United States, for example, be able to set new accounting rules, in the wake of the Enron scandal, without fear of retaliation if foreign firms cannot meet its tighter standards?

Weakening of the Nation State

For the past two centuries or so, the center of political power in most of the successful countries has been at the level of the nation state. Globalization has entailed a loss of national sovereignty. International organizations, imposing international agreements, have seized power. So have international capital markets as they have been deregulated. And there are a variety of indirect ways in which globalization has impaired the effectiveness of the nation state, including the erosion of national cultures (to be discussed shortly). In early stages of development, the United States and most other countries relied heavily on tariffs, because they were easy to collect. But under the World Trade Organization (WTO) and especially under pressure from the IMF, countries are restricted in their ability to raise revenues through tariffs, and without good sources of revenue, the state is weakened. Some claim that this may be one of the purposes of these restrictions.

So though globalization may not be the cause of the failed states, it has in some instances contributed to them.

Lack of Democracy at the Global Level

One of the arguments for devolution and decentralization is that real democracy is more effective at the local level. More voices can be heard. There are greater incentives for democratic participation. The converse argument presumably also holds: democratic processes would be expected to be weaker at the global level, and there is ample evidence supporting this conclusion. The

international economic organizations are organized, and behave, in ways which are troubling. Voting at the IMF is not based on one-person-one-vote, or one-country-one vote, or even one dollar-one-vote. Voting power is partly related to historical accident, mostly the size of the economy fifty years ago, with some adjustments since. China enjoys less voting power than its economic and political size deserve. The United States, in effect, wields a veto. And while the IMF makes decisions which affect every aspect of society, only the voices of finance ministers and central bank governors are heard.

Other protections that we have come to expect of democratic institutions are missing. The organizations are not transparent—there is no freedom of information act. Some of the critical protections against conflicts of interest are missing.

Similarly, dispute-resolution mechanisms at the WTO, lack the openness that we have come to expect in judicial processes in the United States and the United Kingdom. And there is a fear that the judges, while they might be experts in trade law, may not give enough weight to other concerns, whether they are good corporate governance, health and safety, or the environment.

Of course, none of this would make a difference if there were technocratic solutions to the problems confronting globalization; that is, if there were a set of international rules of the game such that everyone were better off with that set of rules than any other. But that is not the case. The lack of democracy means that the rules that get promulgated are not necessarily those that would have emerged had there been a more open, democratic process.

Weakening Social Cohesion and Weakening Local Culture

Finally, the critics of globalization worry about the impact on social cohesion, on traditional values, on culture. But advocates of globalization either pay little attention to these concerns, or see this as another attempt to intrude on consumer sovereignty: just as there should be competition for goods, there should be competition for “cultures”; and if McDonald’s triumphs, so be it. Critics see society from a more holistic perspective: contrary to Adam Smith’s claims, especially in this arena, individual choices may not lead to socially desirable outcomes. Globalization’s critics claim that, in focusing on economics, advocates have too narrow a vision of society, and of individual welfare.

The Intertwining of Economics, Politics, and Society

My focus is on economic issues, but I should emphasize that one cannot fully separate out economic issues from a broader context. If the critics are right—

and I believe that they are—there are adverse economic consequences from the failure to pay due attention to the noneconomic factors. For instance, the IMF failed to take into account the predictable (and predicted) consequences during the Asian financial crisis in 1997 and 1998 of combining measures that cracked down on the economy, leading to huge increases in unemployment and reductions in real wages, and measures to eliminate food and fuel subsidies. And all the austerity was imposed at the same time that billions were being provided to bail out international creditors.⁸ The political and social turmoil led to the flight of capital and high-skilled individuals, creating adverse economic consequences for years to come. The same story applies to Argentina.

More broadly, there are a large number of social interactions, which have effects on economic relations. Consider the most basic of economic relationships, a simple contract. It takes “trust” to achieve enforcement without recourse to litigation. Such trust results from repeated cooperative relations. But predictable repetition of commercial interactions is undermined by rapid economic change brought on, for example, by sky-high interest rates imposed by the IMF in the aftermath of economic crisis.⁹ Social control mechanisms are extremely important in ensuring the efficient use of common resources, including environmental resources.¹⁰

Critics of globalization argue that social relations are not just means to economic ends. They are ends in themselves and means to ends which have more than economic dimensions. The international community has recognized the importance of preserving biodiversity from the ravages of unrelated markets. Neither can markets be trusted to protect ethnic and cultural diversity.¹¹

A century ago, Social Darwinism had its advocates. Those who could not compete in the modern world should be left to wilt on their own. To do otherwise was to interfere with the progress of civilization. Today, within Western democracies, there are few adherents to these extremist views; even conservatives advocate compassion. But in the global arena, some of the more ardent advocates of globalization advance a position not far different from that of social Darwinism: tough luck for the cultures that cannot survive in the face of the forces of globalization; they should be left to die, and the quicker the death the better. Some in the anti-globalization camp take an almost equally extreme position: recognizing the possible fragility of cultures, the possibility that local customs and practices, no less than local firms, will be overridden by the onslaught of globalization, which too often is simply seen as Americanization, they wish to have none of it. In *Globalization and its Discontents*, I support a third way, between these two extremes—one which seeks to control the pace of globalization to give societies time to adapt. It is often the encounter of differing civilizations, the fusion of cultures, that gives rise to the greatest episodes of

human creativity. But the pace and manner needs to be controlled so that the process vanquishes neither.

UNBALANCED GLOBALIZATION

Within the narrow realm of economics, critics of globalization have charged that globalization reflects an unbalanced political agenda. I largely agree.

Global Inequities

The inequities are highlighted by the international trade regime. The North has insisted that the South eliminate subsidies and open up their markets, yet the North has maintained protectionist measures and huge agriculture subsidies: the United States recently increased these subsidies with a \$190 billion farm bill. Agriculture subsidies in the North are so large that they exceed the entire incomes of sub-Saharan Africa. The question naturally arises: how can these poor countries compete?

One of the alleged achievements of the Uruguay Round was the application of free-trade principles to services. But what services? Opening up markets to financial services, to the comparative advantage of the United States, was included. But opening markets to maritime and construction services, of interest to developing countries, was excluded.

The intellectual property regime embedded in the Uruguay Round (the so-called TRIPS agreement) reflected the interests of the pharmaceutical industry and other producers of intellectual property. In pushing for the interests of the drug companies, the 1994 accord might slow the overall pace of innovation. Knowledge itself is one of the most important inputs to the production of knowledge, and the intellectual property regime put into place makes access to knowledge by researchers more difficult. Even at the time the agreement was being negotiated, I and others at the Council of Economic Advisers worried about access to drugs by the very poor in the least developed countries—a concern that subsequent events showed was well justified, as the world watched in horror as AIDS patients in the poorest countries found their access to life-preserving drugs cut off and as the American government rallied behind the drug companies.

An Unbalanced Political Agenda

If the WTO showed most forcefully the inequities of the global regime, the IMF repeatedly showed its lack of balance, as it pursued policies that George Soros and others have labeled “market fundamentalism”—extreme reliance on unregulated

private markets. The Clinton Administration, of which I was a part, reflected the imbalance as it pushed international financial institutions to pursue policies that it opposed at home. At the same time that administration was busy implementing tough financial regulations in the wake of the collapse of saving and loan banks in the 1980s, the IMF, largely controlled by the United States, pushed for sweeping deregulation of financial markets in developing countries. Similarly, while successfully opposing an amendment to the United States Constitution that threatened to rule out deficits as a tool to reverse economic contraction, the Clinton Administration backed deficit reduction in crisis-stricken East Asia. And though the administration fought off proposals that would have the United States Federal Reserve Bank focus exclusively on fighting inflation, the IMF, largely controlled by the United States, insistently called on the central banks of developing countries to adopt exactly that single-minded focus. The IMF also called on those countries to provide central banks with more independence, and less direct accountability to democratically elected politicians. While the Clinton Administration attacked the first Bush administration for the seeming belief in trickle-down economics, it supported international financial institutions that argued for policies that could, at best, be described as trickle-down plus.

While the Clinton administration resisted attempts by creditors to push creditor-friendly bankruptcy provisions into law, it backed efforts by the IMF to push bankruptcy reform on developing countries, acting as if bankruptcy law was simply a matter that should be left to technocrats ("best practice"). And, of course, what they thought of as the "best practice" closely reflected the perspectives of the financial community.

Economic science emphasizes the limitations in our knowledge and information, so that there are large risks associated with any policy. The role of the economists is to describe the risks. The role of the political process is to make the choices. Yet, critics of globalization argue that it has been used to force choices on poor countries which reflect special interests. The IMF-imposed contractionary policies on East Asia during its financial crisis hit workers and small businesses the hardest. More fundamental, deregulating capital markets before deregulating labor markets—permitting capital to pick up and leave before permitting laborers to do the same—dramatically change the bargaining strength of investors. They can take their capital and leave if they view taxes or wages as too high. Workers cannot.

THE ECONOMIC FAILURES OF GLOBALIZATION

While East Asia benefited greatly by taking advantage of globalization, elsewhere globalization has fallen far short of the promise. In developing countries, in the

race between population growth and improving living standards, population won. Though the percentage of people in poverty fell, the absolute number of poor people rose. And poverty reduction occurred almost entirely in China and India, both of which deviated in central ways from the market fundamentalism of the Washington Consensus.

In Latin America, the statistics for the first full decade under reform and globalization are in. Growth rates during the 1990s were little more than half of what they were in the pre-reform decades of the 1950s, 60s, and 70s, let alone the so-called lost decade of the 1980s.¹² The rapid growth that occurred in the early part of the 1990s was not sustained. Critics of globalization might dismiss the fast growth of the early 1990s as unsustainable—just as advocates of globalization dismiss the high-flying growth during the pre-reform decades after World War II as unsustainable. And even in countries which have succeeded in growing strongly, such as Mexico, much of the gains went to the richest 30 percent of the population, and especially the top 10 percent, with many in the bottom worse off.¹³

Increased Global instability

Meanwhile, globalization has been accompanied by increased instability: close to a hundred countries have had crises in the past three decades.¹⁴ Globalization created economic volatility, and those at the bottom of the income distribution in poor countries often suffer the most. They have no reserves to shield them from economic shocks, and the social safety nets in most developing countries are anemic.¹⁵ With inadequate safety nets, the suffering in these crises of those who lose their jobs is enormous. As the roster of seemingly well managed countries experiencing crises, including those who were given A +’s by the IMF, grows, everyone asks, who will we be next? Among the major emerging markets, only those which have not fully deregulated their capital accounts, like India and China, have been spared. I argue that this is no accident.

INTERPRETING THE RECORD

The defenders of globalization retort that globalization could not, and was not intended to, solve all the world’s problems. It could not eliminate poverty, at least overnight. The relevant question is the counterfactual: in the absence of globalization, would growth have been slower? Would poverty have

fallen? These questions are always hard to answer: each country globalizes only once.

The Limits of Statistical Studies

To get around this problem, some economists conduct elaborate statistical studies, comparing the records of countries that have opened up their borders to international trade and investment to those that have not. They ask whether, on average, globalization promotes growth. Such statistical studies are fraught with problems, not the least of which is that countries are concerned with particular policies in their particular circumstances. The statistical studies often shed little light on these issues. Indeed, the studies have been part of the general process of overselling globalization. Consider, for instance, the recent World Bank studies¹⁶ which argue that globalizers, the countries that have become more engaged internationally, have done better. The existence of a systematic relationship between engagement with the outside world and growth does not, of course, prove causality: it could be that very poor, subsistence economies have little to trade with the outside world and that they would trade little even if they were to strip away all trade barriers. Said another way, countries aren't poor because they don't trade; they don't trade because they are poor.

Moreover, any look across the performance of the countries around the world will note that East Asia was the most successful region. Its rapid growth was based on exports. In that sense the countries were globalizers. But they violated all other components of the pro-market Washington, consensus. The East Asians were slow to take down import barriers and they invoked active industrial policies. Some welcomed foreign investments. But others, like Korea, did not. Few fully opened up their capital markets to foreign investors. The new big entry into the success cases in the 1990s, India, has not fully opened up its capital markets. There are, to be sure, a few instances of successful liberalization. The frequency with which Chile is cited is evidence of the paucity of examples. But as I shall comment shortly, it is not clear how to interpret the Chilean experience.

Statistical studies that focus on policy differences among countries have ambiguous results. The most widely cited study on the impact of deregulated capital markets—using as a measure of deregulation the extent to which the actual policies pushed by the IMF were adopted—shows no significant effect on growth or investment.¹⁷ While there have been several studies claiming that trade liberalization is systematically related to growth, Rodrik and Rodriguez

have provided a devastating criticism of those studies, one to which the advocates of globalization have yet to provide a persuasive response.¹⁸

CASE STUDIES

What matters, in the end, are not just particular policies but combinations of policies and the circumstances and manner in which the policies are implemented. That is one of the reasons why it is often so difficult to interpret what has happened, and why most of the cross country regressions looking at particular policies (so far) have been so unconvincing.

Given the limitations on the statistical analysis, economists of one persuasion or another have had to rely on case studies, anecdotes, analytical arguments, and more broadly “theory.”

Korea, India, and Chile provide examples of how those with different perspectives can look at the same country’s experience and come to different conclusions. To some, such as Ann Krueger,¹⁹ second in command at the IMF, Korea’s success is a case study in the success of liberalization (the economist’s term for deregulation); to others, it proved the opposite. I side far more with the latter interpretation. Its growth was based on the expansion of exports, not the removal of import duties. It did not liberalize financial or capital markets until late. To some, the collapse of Korea proved that its particular variant of a market economy, in which the government plays a central role, was prone to crony capitalism and doomed to failure. To many, the quick recovery of Korea shows that that the Korean model is sound—if its problems were as fundamental as the IMF had argued, then its problems could not have been corrected so quickly. Many market fundamentalists seemed to have wanted Korea and the other East Asia countries to fail, because their success had been based on a different model far different from the one advocated by the Washington Consensus.

Another country often cited as “evidence” of the virtues of the liberalization strategy is India. There has been robust growth since 1991, when it began liberalizing, averaging almost 6 percent per year. But critics respond that (a) it did not fully liberalize—it has yet to open its capital account—and its ability to withstand the global financial crisis, its ability to have sustained growth, rested on the fact that it only partially liberalized; (b) its growth spurt relative to other developing countries began well before the strategy of liberalization²⁰; and (c) the one area of widely cited success, its “Silicon Valley” in Bangalore, was not related to its liberalization strategy, but to the traditional stress on education and the strong links between its diaspora, particularly the more well educated recent emigrants, and the home country. In this respect, India may have

benefited from globalization, but it is not the part of globalization that is ever stressed. It benefited from the movement of people rather than the movement of capital or goods. Critics of globalization, in the form advocated by the United States and Western Europe, emphasize the asymmetry between free mobility of capital, which has been high on the agenda, a free mobility of labor, which is hardly mentioned (and in fact there have been efforts within the United States to restrict immigration). From the perspective of global economic efficiency, free mobility of labor has the potential to contribute as much, more to growth than free mobility of capital, though, as we note below, the distributive consequences are markedly different.

Chile is the one country that allegedly followed the Washington consensus policies, and succeeded. But even the president of Chile has suggested that it was successful because it was selective in following the advice of outsiders. Chile did some of the things that the IMF recommended, but not others. Also, it did some things that were not stressed by the Washington consensus. Its early flirtation with market-fundamentalist policies, including the deregulation of the financial system, had ended in disaster, and most of the country's debt can be traced to the financial crisis which followed. During the period of their rapid economic growth, they had restrictions on the inflow of capital; they were slow to privatize, and even today government-owned copper mines generate a substantial fraction of export earnings. These government enterprises are just as efficient as the private enterprises, but yield far more revenue to the government. And Chile emphasized education and health, promoting policies of social cohesion that are particularly important in a country with a troubled political history. To be sure, Chile undertook some of the policies that were part of the Washington consensus. It maintained sound macroeconomic policies and kept borders open to imports.

China, India, and Chile provide evidence of the role that globalization can play in enhancing growth. Each involved some form of openness to the outside world. In each case, though, the success lay in the country managing globalization, using policies that deviated in significant ways from the Washington Consensus policies.

The Theory of Capital Market Liberalization

To understand why globalization has so often failed, it is important to look at the arguments for, and against, trade and capital market liberalization. For instance, the standard argument for capital market liberalization is that removing impediments to the free flow of capital increases the efficiency of resource allocation, hence increases incomes, hence contributes to growth. Indeed, even workers benefit, as the additional capital competes for the services of workers,

driving up wages. But that assumes that markets, by and large, work well, without the artificial constraint of government. But capital markets in particular are plagued with a host of imperfections, many related to imperfections of information. For example, almost no well-trained economist believes today in unregulated banking. There must be some regulation of banks. (See, e.g. Stiglitz 1993). Given the imperfections that infect capital markets, eliminating controls on short-term capital flows may well lead to greater risk, lower growth, and a less efficient allocation of resources. The empirical evidence that capital market liberalization leads to greater risk is clear.²¹ Greater risk leads lenders to insist on higher interest rates, which impede growth. In economies with underdeveloped stock markets, firms that cannot afford to borrow must rely on self-finance. But that in turn means that capital will be allocated less effectively. The implication is clear. Deregulation of capital markets can hurt investment and economic growth. Countries that borrow foreign currencies short term have to put aside more into reserves to reassure investors that they will be able to get their money back when their loans come due. These reserves come at a high cost. This represents another way in which unregulated, short-term foreign investment can dampen investment and growth.*

The Theory of Trade Liberalization

There are similar issues associated with the arguments for trade liberalization. The simplistic argument is that any impediment to trade interferes with the efficient allocation of resources, and therefore lowers incomes. But, as economists have recently shown, the conclusion hinges critically on a false assumption, that private markets work perfectly. If it is acknowledged that people cannot buy insurance to protect themselves against financial volatility, then trade liberalization can make the economy worse off. Economic disruption that comes with heightened trade can drive investors to move their money into safe investment, with lower overall benefit to the economy.

But at a practical level, there is an even more important point: liberalization is supposed to move resources—labor in particular—from low productivity

*Technically, the problem here is that there is an externality; the firm borrowing the funds short term in foreign currency does not take into account the risks to the overall economy which are associated with that borrowing, and the societal costs of the increased reserves. Given the importance of these externalities, no wonder that resources are not well allocated. There is another market failure: countries, and firms and households within the country, cannot insure themselves against the induced risks.

uses into higher productivity uses. But if markets are not working well—perhaps because interest rates are so high that investment does not occur—then resources idled because of competition from imports simply move from low productivity uses into unemployment. The East Asian countries paced their liberalization measures with macroeconomic policies that ensured that employment remained high. They recognized, too, that they could open up markets to imports of intermediate and capital goods, thereby lowering the costs of production for domestic firms, without incurring the dislocation of opening up markets for consumer goods.

Advocates of trade liberalization are correct that often the protectionist measures have been abused, that often they have done more to enrich a few wealthy “rent-seekers” in the countries than to promote economic development, that the infants that the “infant industry protection” was supposed to give time to grow up never did so. Industrial policies often failed. But they succeeded sometimes. It is no accident that there are few examples of countries that achieved high growth rates without taking an active role in their economy, especially by promoting education and technology and regulating the financial system.

EXPLAINING THE FAILURES

Some of the failures of globalization come from employing “wrong” economic models, in particular models based on over simplistic views of the economy, based on perfect information, perfect competition, well functioning markets, ignoring the second and third best considerations that are central. I have already provided two examples, in the discussion of capital markets and trade liberalization.

Not surprisingly, bad economic analysis leads to wrong prescriptions. What I have found surprising is the frequency with which seemingly incoherent positions have been taken. For instance, the IMF often seems to argue against government intervention in markets (that is the basis for the argument for capital market liberalization). Yet the rationale for some of its massive bailouts (which are themselves a form of massive market intervention) is market failure like contagion—the spread of financial crisis from one trading partner to another. When there is an externality like contagion, private markets do use resources effectively, and there is a possible role for government or international institutions to improve matters. The intervention should presumably not only come after the crisis occurs, but also before, to prevent the crisis. If short-term capital flows are a major cause of crises, then those flows should be regulated.

Similarly, in the East Asia crisis, the IMF recognized the problems posed by weak banks and the unwillingness of lenders to roll over loans. But their models did not include an analysis of the fact that their monetary and fiscal crackdown would throw businesses into default, cutting their demand for goods and workers and triggering a cascading economy-wide contraction. I have argued elsewhere that the IMF relied on sky-high interest rates to stabilize economics in East Asia after the onslaught of financial crises, but that the policy backfired (See Furman and Stiglitz, 1998). The interest rate spikes bankrupted many businesses, driving foreign investors away and sending the economies deeper into depression. The attempts I and others at the World Bank made to engage the IMF in discussions on these issues suggest, however, that something else was going on: they seemed less interested in alternative perspectives than they should have been.

The obvious explanation relates to the role of ideology (or to put it more mildly, "particular perspectives.") There was a belief in markets. To be sure, the IMF has a research department, one which a recent independent review commissioned by its board did not exactly award accolades.²² But it is no accident that it did not sponsor the research of critics, like Dani Rodrik, suggesting that deregulated capital markets did not promote economic growth. To a large extent, the purpose of the research was to confirm prior beliefs, not to question them.

But that raises the question: why was it possible that this particular ideology, these particular failed models, should dominate? Economic and political analysis begins by asking: whose interests have been served and moves on to ask, why have these interests come to prevail. We thus return to the central theme: governance. The ideology reflected the perspectives of those who govern the financial community. The ideology, broadly, also reflected their interests.

Here, I should be slightly more careful. There are disparate interests within the financial community (even if there is a dominant ideology or perspective). Capital market liberalization, for instance, reflected more the interests of short-term speculators and those who marketed short-term instruments. Many of the long-term investors recognized that capital market liberalization enhanced instability. They only wanted to be sure that the regulations allowed them to take out their money. Just as there is a distinction between Wall Street and Main Street, so too there is a distinction between short-term financial investors and long-term real investors. The IMF reflects more the interests of the former than the latter.

Some counter the argument that the IMF has been pro-lender by pointing out that lenders in fact lost considerable amounts. Bailouts were only partial. But the important point is that the IMF did not see its objective as doing

everything it could to maintain the economies at as close to full employment as it could. It was far more concerned with ensuring the stability of the exchange rate and the repayment of creditors.

REFORMS

To make globalization work better, I will focus on reform of the IMF; though similar reforms could be advanced for other institutions. My proposals fall into six categories.

Basic governance

The basic problem is that we have a system of global institutions, therefore governance, but without global government. Part of the problem flows from the "chimney" structure of regulation. Trade policy is set by trade ministers, financial policy is set by finance ministers, central-bank policy is set by central-bank governors. This would not matter much if the policies set by each had no ramifications for others; no one would care if central bank governors got together and decided on mechanisms to clear checks. But IMF policies have effects that go well beyond financial markets. If the IMF pushes excessively fiscal austerity, education or health may suffer, and joblessness may increase. If it pushes for excessively tight monetary policy, excessively high interest rates, small businesses may go bankrupt and Main Street suffers. If, in another realm, international banking authorities push for rigid rules, banks may become incapable of lending come the next economic downturn—turning downturn into disaster. If the WTO adopts regulations that interfere with environmental protection, then everyone (but a select group of corporations) may suffer. As the WTO adopted an intellectual property regime, the voices of drug companies were heard more loudly than were the academics, or even disinterested public policy analysts who were concerned about impacts on the overall rate of innovation.

In the case of the IMF, there are thus two problems. Each country is represented by finance ministers and central bank governors. And the IMF has pushed for independent central banks. Increasingly, the IMF has become accountable to those who are themselves not directly accountable to voters, even as the fund pushes for policies with far-flung political impacts. Worse, only a select group of the finance ministers and central bank governors—those from the rich countries—wield real power. Indeed, one country, the United States, can veto important IMF decisions. Some argue that rich countries deserve to dominate the IMF because they bear the costs of bailouts. But in fact, IMF loans

are almost always repaid and it is the taxpayers in the poor countries that bear the cost.

With senior people in the institution being political appointees, there is a high likelihood they will do their political biddings, a fact that seemed all too apparent in recent years.

I am not optimistic that the IMF and other international institutions will change anytime soon. So we must look for other reforms.

Transparency and Other Democratic Protections

Transparency—making what institutions do public—is the first needed reform. Given the remoteness from direct political accountability, especially at the IMF, where one of the two governors for each country is a central bank governor not directly politically accountable, transparency is all the more important. In the United States, there is the Freedom of Information Act, which severely limits the information that can be withheld from the public. But American citizens wishing to know what is going on in the IMF have no such recourse. Besides, the international financial institutions have been accused of pursuing an agenda that advances the interests of special interests. Knowing more about who benefits from their policies, who exerted influence in shaping their policies, can not only enable us to better assess those claims, but also to curtail such behavior. As the expression goes, sunshine is the best antiseptic.

If decisions are made in public, with appropriate prior notice, at least those who are affected can express their concerns and galvanize public support on their behalf. Transparency can help improve policy directly. When the IMF makes a forecast, it should disclose its model and assumptions so outsiders can second guess the predictions. What were the assumptions?

In addition, committee structures can affect the “voice” of other groups, creating a labor committee that has to vet all major decisions would ensure that labor’s concerns are heard, even if labor did not have a formal vote.

There are other changes in the representation system for executive directors that might increase the effective voice of developing countries. Even without changing voting rights, seats could be reapportioned so that Africa gained additional representation.

Accountability

Before the IMF goes into a country with a program, it should forecast the impact not only on economic growth and the balance of trade, but also on employment and poverty. And when there are large discrepancies between what it

forecasts and what happens, the institution and its employees should be held accountable. If there is disclosure about the models used, then it will become possible to identify sources of the errors and, over time, improve the models. The evaluation of the forecasts needs to be conducted by an independent agency. Some critics of the IMF have suggested that the problem is the politicization of the institution. For these critics, the appropriate reform is to make it more independent.²³ I think that is fundamentally wrong. To be sure, the charter enjoins the IMF from engaging in political actions, but the boundary between politics and economics is a fine one, and the IMF has, when it suits its purposes, not been shy about crossing that boundary. The issue of corruption was viewed as a political issue, until President James Wolfenson of the World Bank began emphasizing its adverse effect on development, a view substantiated by World Bank and other studies.²⁴ As I have noted elsewhere, many of the stances of the IMF on privatization, the role of central banks and other policies are as much based on politics as they are on economic analysis. Giving more power to bureaucrats that are not democratically accountable would make matters worse.

Modes of Operating

There are other changes at the IMF that are underway that have to be reinforced. For instance, it is now widely recognized that in the past, IMF imposed conditions for getting bailouts that reached into areas that were political in nature and had little to do with addressing the immediate financial crisis. There is a widespread perception that conditionality, as it has been practiced in the past, by reducing the scope for democratic determination of economic policies, undermined democracy in many of the developing countries. Conditionality went well beyond the kinds of requirements that lenders always impose designed to enhance the likelihood of repayment.

The most important change in the mode of operation would be to reflect the perspectives of economic science noted earlier: the IMF should be giving advice about the alternatives, the tradeoffs, the risks, the incidence of alternative policies. It should encourage the presentation of alternative perspectives, rather than to force through a particular perspective.

Competition

A general principle that I repeatedly observed in the years I was in the administration was that everyone believed in competition, except in their sector, in which case it was more likely that competition was destructive rather than constructive. This parallels two other principles: everyone believed that there should be no subsidies,

except in their industry, and everyone believed in openness and transparency, except in their line of business. The IMF is no exception. It suppressed talk of creating an Asian Monetary Fund to handle the Asian financial crisis of the late 1990s, even though Japan had offered to donate generously to such a fund.

Regional institutions may be able to play a useful role in surveillance, providing a welcomed alternative to the staff of the IMF.

Mandate

There is now a virtual consensus²⁵ that the IMF should return to focusing on its original mandate, which is helping countries in times of crisis. It should not be involved in long-term development or in transition. There should be a presumption that something is wrong if an IMF program lasts more than a couple of years: such a country has a chronic problem, not a crisis.

Reforms in the Global Economic Architecture

In the aftermath of the East Asian financial crisis, extensive discussion about global economic architecture took place among industrialized countries and major emerging economies. The one concrete step that the discussions generated concerned standards.²⁶ Within the developing world, there was a concern that this represented another example of the more advanced industrial countries putting new demands on them, designing standards that were insufficiently attentive to the economic situation in their countries. The full impact of these standards is not yet clear.

The recognition that weak banks had played a role in the Asian financial crisis led to a rethinking of bank regulation. It was noted that the regulatory framework in the more advanced industrial countries had contributed to the problem—banks were given an incentive for short-term lending. Excessive reliance on capital adequacy standards and stringent enforcement can backfire, leading to financial instability, since it can cause all banks in an economy to excessively cut back on lending at the same time in case of a macroeconomic shock, leading to a credit crunch.²⁷ Proposed international bank reforms remain a subject for debate.

Bankruptcy and Standstills

The most fundamental set of reforms concerns how to deal with countries which cannot repay their debts, or in which large numbers of their corporations

cannot repay debts. It was the refusal of banks to roll over their loans which, for instance, precipitated Korea's crisis, and it was worries about Argentina's ability to repay its sovereign debt which precipitated its crisis.

Early in the East Asia crisis, there were discussions of standstills and bankruptcy mechanisms, but the IMF quickly dismissed these approaches. Senior IMF officials suggested that such approaches would represent a violation of the debt contract, even though bankruptcy is an implicit part of every contract. Had bankruptcies occurred sooner, I believe, the problem of bad loans could have been resolved earlier and capital flows resumed. Indeed, it was only when Korea finally negotiated a suspension of payment to foreign lenders that its exchange rate and economy stabilized. Besides, greater reliance on bankruptcy, rather than bailout, could make lenders more careful from the get go. I argued that what was required were legal reforms to facilitate the speed with which restructuring could occur, that when there are massive defaults (as was the case in the region), there are macroeconomic consequences associated with delay, and accordingly what was needed was a "super chapter 11," by which I mean an international analog to bankruptcy provisions that provide for quick and orderly resolution of debts of private corporations operating in the United States.²⁸

The failure of the IMF bailout in Argentina led to a focus on the use of bankruptcy and standstills for government debt. While such discussions were prominent in the years following the 1980s debt crisis,²⁹ in the enthusiasm for the big bailouts of the 1990s these discussions were put aside. The IMF, in my judgment, rightly argued that there needed to be a more orderly way of resolving these debt crises and restructuring debts, and what was needed was a statutory approach. They recognized that speed was of the essence, and hence the reference to "Chapter 11." But the more relevant analogy is to provisions of United States bankruptcy codes (Chapter 9) that apply to government units and take account of the fact that governments not only have explicit obligations to creditors but also implicit obligations to pensioners and others. Moreover, the IMF, as a large creditor laying claim to preferred status, cannot play a pivotal role at any stage in the bankruptcy proceeding, other than as one of several key creditors.

The Bush Administration has argued against a statutory approach, saying all that was required was for sovereign borrowers to include voluntary clauses—known as collective action clauses—in their debt contracts providing for standstills in the wake of financial crisis. Neither theory nor evidence supports President Bush's position. If collective action clauses were all that is needed, why is it that no country relies on them to resolve bankruptcies within its borders?

In Stiglitz (2002) I provide a more comprehensive discussion of why such an approach is unlikely to work.

The Global Reserve System

There is some reason to believe that underlying much of the observed instability in the global economic system are problems with the global money supply. Every year, countries around the world have to set aside substantial amounts of money into reserves against unexpected external demands for cash—say by foreign lenders who want quick repayment when their loans come due. Because countries have to build reserves, some of their earnings cannot flow back into the system as demand for other country's products. The amounts are substantial. There are roughly \$1.6 trillion held in reserves around the world. Countries like to keep reserves growing in tandem with imports and foreign denominated liabilities. If these grow at 10 percent a year, then countries need to set aside \$160 billion every year. Today, they hold these reserves in a variety of forms, including gold and U.S. Treasury bills. While the United States may benefit from the increasing demand for its Treasury bills, the cost to the developing countries is high: they receive a return of 2 percent on their Treasury bills even though they could invest that money at much higher return in their own economies. It is the price for developing countries to reassure their creditors that they can cash in their investments upon demand.

Thus, the current system not only creates a downward bias, but also inequity. What has made the system work in the past is the role that the United States plays as the "deficit country of last resort." This has resulted in the peculiar situation where the richest country spends beyond its means year in and year out. But as the United States has moved from being perhaps the largest creditor country to the largest debtor country, there is a potential for enormous global instability. If, for one reason or the other, foreigners lose temporary confidence in the United States, the dollar will weaken. With lots of international debt denominated in dollars, a falling dollar will trigger economic dislocation.

There is a simple reform that would do much to redress both the instabilities and inequities associated with the current system: the issuance of a global reserve currency, distributed primarily to poor countries. They could exchange the new currency for dollars, euros, or yen. I am proposing, in effect, to raise the world's money supply. Some of extra money would be used to build reserves of poor countries. The rest could be used to pay for education and health programs in poor countries. In the current arrangement, only the United States can print money, in effect buying more than it produces and living beyond its means. But under my proposal, poor countries would gain the same opportunity—supplying the world with money by spending beyond their means. Surely, it makes

more sense for the poorest countries to spend more than they produce than it does for the United States to continue to do so. Relative to global income, now about \$40 trillion, the injections of new money into the world economy will be minuscule. Worldwide inflation will not rise. But these injections of purchasing power can loom large in poor countries.

Global Public Goods

As globalization has proceeded, it is increasingly recognized that closer integration of the countries and peoples of the world leads to greater needs for global collective action. Global public goods—goods that simultaneously benefit populations of different countries—are becoming increasingly important. Among these global public goods are international security and peace (including freedom from the threat of terrorism), international economic stability and growth, public health, including protection from communicable diseases like AIDS, the global environment and global knowledge. Just as national public goods (like national defense, the benefits of which accrue within a national jurisdiction) are provided by national governments, so too global public goods must be provided by governments. The problem is that there is no assured source of finance for global public goods; currently, finance is largely derived from voluntary contributions of national governments.

The proposal described in the previous section is one way by which such goods can be financed, but there are other ways which will need to be explored.

Revenues from the Sale of Global Natural Resources. There are large bodies of economic resources which do not lie within the national boundaries. These include the minerals under the oceans and the fish within them, the potential resources in Antarctica, and the resources of the atmosphere; and perhaps eventually resources in the moon and planets. These resources rightfully belong to all of the citizens of the planet, and should be shared among them in an equitable manner. The manner and pace of exploitation of the resources should be done in a way that respects the interests and rights of future generations as well as those alive today, and should be done so as to maximize revenues obtained (subject to the above constraint). Among the most important global resources is the atmosphere. Economic activity that has an adverse effect on the quality of the atmosphere (e.g. depleting the ozone layer) has a potentially large global economic cost, and accordingly those who “use” up the atmosphere should be charged for doing so, with prices set so as to ensure the sustainability of atmospheric quality for future generations.

Revenues from Global Taxes. Two major global taxes have recently been the subject of extensive discussions. A “Tobin Tax” would apply to cross-border

financial transactions, triggered every time foreign investors buy and sell currencies. A carbon tax would apply to emissions of greenhouse gases into the atmosphere. Both taxes would do double duty—discourage activities that do social harm (in the first case, destabilizing short-term currency trading; in the second case, environmental damage) and generate revenue for valuable public goods.

CONCLUDING REMARKS

Some critics of the critics of globalization have argued that globalization is inevitable: to resist it is futile. That, I would argue, is the wrong perspective. Globalization may be inevitable, but how countries respond to it is not. They do not, for instance, have to open up their capital markets to short-term capital flows. Different countries have, in fact, responded to globalization in different ways, and some have managed globalization better than others.

In the introduction, I suggested that globalization had been oversold, that certainly it has not brought to many of the poorest people in the world the benefits that were promised. In many quarters, it has led to the erosion of cultures. In others it has been associated with the degradation of the environment. Many countries have experienced higher levels of instability and insecurity than in the past.

But in the introduction, I also distinguished between globalization and the particular set of policies that have come to be associated with globalization in much of the world, the market fundamentalist policies, urging rapid privatization and liberalization, focusing more on the risks of inflation than the risks of underemployment and lack of growth, ignoring the impacts of policies on social stability. It is these policies that have been oversold, not globalization itself.

The past three decades have seen some phenomenal successes in development—beyond the wildest expectations of most economists; but they have seen some enormous disappointments as well. Globalization played an important role in both the successes and the failures. The critical distinction is how the individual countries go about integrating into the global economy. For those, like in East Asia, the benefits on the whole have far exceeded the costs. Their growth was based on globalization. For the most part, the countries figured out how to make globalization work for them. They were selective in which policies they adopted, in the pacing and sequencing of reforms. In the late 1980s, however, some of the countries succumbed to international pressure for capital market liberalization, the freeing up of markets to the movements of short-term speculative capital in and out of the country, and they paid dearly for this mistake. For this “episode” of globalization, the costs far exceeded the benefits. With savings rates in excess of 25 percent, sometimes even 35 percent, they didn’t

TABLE 10.1 GDP growth rates in Latin America 1951-2000

COUNTRY	1951-1980		1951-1990		1980-1990		1990-2000		1980-2000	
	GDP pc	GDP	GDP pc	GDP	GDP pc	GDP	GDP pc	GDP	GDP pc	GDP
Argentina	1.81%	3.45%	0.44%	2.05%	-3.10%	-1.62%	3.53%	4.84%	0.51%	1.91%
Bolivia	0.47%	2.78%	-0.19%	2.07%	-2.21%	-0.13%	1.09%	3.48%	-0.64%	1.59%
Brazil	4.65%	7.46%	3.44%	6.05%	0.40%	2.41%	0.86%	2.30%	0.92%	2.65%
Chile	1.79%	3.81%	1.71%	3.63%	1.64%	3.26%	4.62%	6.15%	3.22%	4.78%
Colombia	2.28%	5.07%	2.05%	4.67%	1.40%	3.50%	1.03%	2.96%	1.16%	3.17%
Costa Rica	2.71%	6.25%	1.82%	5.16%	-0.99%	1.79%	1.71%	4.15%	0.34%	2.96%
Dom. Rep.	3.02%	5.99%	2.46%	5.24%	1.06%	3.31%	4.38%	6.08%	3.08%	5.04%
Ecuador	3.41%	6.37%	2.26%	5.11%	-0.74%	1.86%	-0.71%	1.41%	-0.76%	1.60%
Guatemala	2.14%	4.97%	1.31%	4.06%	-0.74%	1.79%	0.82%	3.47%	0.02%	2.61%
Honduras	0.89%	4.16%	0.61%	3.86%	-0.39%	2.81%	-1.02%	1.79%	-0.56%	2.44%
Mexico	3.22%	6.41%	2.32%	5.25%	0.07%	2.31%	1.95%	3.72%	0.93%	2.93%
Nicaragua	1.48%	4.46%	0.42%	3.34%	-3.02%	-0.24%	-1.95%	0.85%	-2.68%	0.14%
Panama	3.48%	6.30%	2.47%	5.11%	1.13%	3.24%	2.06%	3.85%	1.54%	3.49%
Peru	2.38%	5.09%	1.11%	3.69%	-2.34%	-0.09%	1.76%	3.53%	0.00%	2.01%
Paraguay	2.23%	4.88%	1.94%	4.70%	1.20%	4.29%	-0.31%	2.41%	0.38%	3.28%
El Salvador	1.35%	4.25%	0.62%	3.07%	-2.50%	-1.37%	2.05%	4.10%	-0.20%	1.38%
Uruguay	1.52%	2.48%	0.95%	1.83%	-0.25%	0.38%	2.58%	3.32%	1.26%	1.94%
Venezuela	1.11%	4.75%	0.51%	3.89%	-1.76%	0.88%	-0.35%	1.90%	-1.28%	1.14%
Mean	2.22%	4.94%	1.46%	4.04%	-0.62%	1.58%	1.34%	3.35%	0.40%	2.50%

Source: Alan Heston, Robert Summers and Bettina Aten, Penn World Table Version 6.1, Center for International Comparisons at the University of Pennsylvania (CICUP), October 2002

need additional capital. For them, capital market liberalization simply brought increased risk—with little promise of reward.

Elsewhere, the calculus on globalization is far more problematic. Often trade liberalization led not to increased growth, but to increased unemployment; and while many countries outside East Asia desperately needed foreign capital, the increased instability that capital market liberalization brought made their countries less, not more, attractive: money flocked to China, which had not liberalized.

The successes of China and the other countries which managed globalization on their own terms is even more impressive, because it took place in the context of globalization where the rules of the game have, for the most part, been set by the advanced industrial countries in their own interests, or more precisely, in the interests of special interests within these countries.

It is the inequities in the global trade agreements, the lack of balance with which the global economic agenda has been pursued and the economic policies that have often accompanied globalization that are the problem, not globalization itself.

There is, in a sense, a close link between these failures: the economic policies that have accompanied globalization have been driven by market fundamentalist ideologies, while the economic policies that have been pursued in countries that have been successful are those that reflect a balance between government and the market. Just as market fundamentalism has been pushed by special interests, which have taken advantage of the rhetoric to advance their interests at home (though they have not been so foolish as to allow the rhetoric get in the way of using government to advance their interests, even accepting large subsidies, if they can get away with it), so too has the global economic agenda been shaped by the same forces. Indeed, we have suggested that it is partly because the democratic checks and balances work less perfectly at the global level than they do domestically that they have had greater sway in this arena.

Globalization's impact has been oversold. But not its potential. It has the potential of raising living standards, reducing poverty, even enhancing global economic stability. While the potential benefits of globalization have perhaps only been slightly exaggerated, the potential costs of globalization have been vastly underestimated—as have the difficulties in making globalization work for most people in most of the developing countries. Even if globalization had been managed by those who had the interests of the developing countries at heart, there would have been a large risk of failure. But globalization has not been managed with the interests of the developing countries at the center; accordingly, we should not be surprised that it has worked so poorly for the poor.

It is unlikely that globalization will live up to that potential unless there are fundamental reforms in the way that it is managed. Countries need to learn to cope with globalization better. But even if they do so, if the current system, in

which not only the rich gain a disproportionate share of the gains, but the poor may actually be worse off, in which the rich can withstand the instability, but the poor are left to cope on their own, prevails, then opposition to globalization will continue to grow.

ENDNOTES

1. More generally, transparency does not inoculate a country against having a crisis: the last set of major crises prior to those in East Asia was in Scandinavia, the countries with perhaps the greatest transparency.
2. See, e.g. World Bank (1998), Stiglitz (1999), Wolfensohn (1996).
3. Under the original HIPC (Highly Indebted Poor Countries) Initiative, launched in 1997, the countries who received relief were in chronological order: Uganda (April 1997), Bolivia (September 1997), Burkina Faso (September 1997), Guyana (December 1997), Côte d'Ivoire (March 1998), Mozambique (April 1998) and Mali (September 1998) (see Andrews *et al.* [1999]). In 1999 the initiative was thoroughly revised leading to the approval of a total of 23 countries in the program (see IMF [2001].) The 27 countries currently in the program are: Benin, Bolivia, Burkina Faso, Cameroon, Chad, the Democratic Republic of Congo, Ethiopia, The Gambia, Ghana, Guinea, Guinea-Bissau, Guyana, Honduras, Madagascar, Malawi, Mali, Mauritania, Mozambique, Nicaragua, Niger, Rwanda, São Tomé and Príncipe, Senegal, Sierra Leone, Tanzania, Uganda, and Zambia (see IMF [2004].)
4. See, e.g. World Bank (1993), Stiglitz (1996), Wade (1992), Amsden (1989).
5. See, in particular, Dixit (2003) and Stiglitz (2000a).
6. Cf. recent experiences in Brazil
7. The defense, that Camdessus was unaware that the picture was being taken, is of little help: the picture encapsulated the body language that said so much, both to those in Indonesia, and to those elsewhere.
8. See Stiglitz (2002) for an elaboration of this perspective.
9. The latter is relevant because social and political turmoil is related to *perceptions* of equitable treatment (see Rodrik [1997] and IMF [1998].) Note that in an "individualistic" analysis, individuals only care about their own treatment, not how they are treated *compared* with how others are.
10. Cooperation is sustained by individuals comparing the benefits of "cheating" in the short run, with the long run gains from cooperation. The present discounted value of those future long run gains is reduced by higher interest rates. Rapid change means the likelihood of future interactions is reduced, so that the value of cooperative behavior is reduced. See Stiglitz (2000c).
11. See also Seabright (1993), Dasgupta and Serageldin (2000).
12. See Sen (2000), Rao and Walton (2004).
13. The growth rate averaged 3.2% between 1990 and 1999 versus the 5.5% recorded between 1950 and 1980 (see Cardoso and Fishlow [1992], Ocampo and Martin [2003].) As always, there is some controversy concerning how to interpret such numbers. Critics of globalization point out that frequently, a period of stagnation

is followed by a catch; the high growth thus gives an exaggerated picture of the economy's sustainable performance. A better picture is provided by averaging the period of stagnation with the subsequent period. Table 10.1 shows that, viewed from this perspective, the decade of reform/globalization looks even more dismal (on this point see also Ocampo [2003].)

On the other hand, many critics of the growth in the earlier decades suggest it was not sustainable—it certainly wasn't sustained, but whether it was because of intrinsic weaknesses in the system, or because the countries were induced, by this earlier period of capital market globalization, to borrow more than was prudent, remains a subject of debate. In any case, in this perspective, one should include the lost decade of the 80s in the calculations of the earlier period—it was part of the price that had to be paid; even in this perspective, the decade of reform/globalization does not shine well.

14. Bouillon et al. (1998); Inter-American Development Bank (1999), Ros and Bouillon (2000).
15. See Caprio and Klingebiel (1997, 1999) and Caprio et al. (2003).
16. This is true even in the United States. See Furman and Stiglitz (1998).
17. See for example World Bank (2002).
18. See Rodrik (1998), Demirguc-Kunt and Detragiache (1999), and Kaminsky and Schmukler (2001).
19. See Rodriguez and Rodrik (1999).
20. See Krueger (1995).
21. Growth in the decade prior to the start of the reforms averaged 5.8%.
22. See Prasad et al. (2003).
23. See Independent Evaluation Office (2003).
24. See e.g. Eichengreen (1999).
25. For examples, see Bardhan (1997) or Rose-Ackerman (1998).
26. See, for instance, the report of the Meltzer Commission (2000) and my discussion in Stiglitz (2001).
27. See Bonte (1999).
28. See, for instance, Hellman, Murdoch and Stiglitz (1995).
29. See Miller and Stiglitz (1999) and Stiglitz (2000b).
30. See for example Sachs (1984), Cohen and Sachs (1984), and Eaton, Gersovitz, and Stiglitz (1986).

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