"MAKING GLOBALIZATION WORK"

THE 32ND SIR WINSTON SCOTT MEMORIAL LECTURE
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DELIVERED BY PROFESSOR JOSEPH STIGLITZ

Senior Minister of Foreign Affairs and Foreign Trade, the Honourable Dame Billy Millar, other members of the cabinet, members of the Diplomatic Corp., members of the Senate, former Prime Minister Sir Lloyd Erskine Sandiford and Lady Sandiford, Governor of the Central Bank of Barbados, Dr. Marion Williams and Mr. Clyde Williams, members of the Board of Directors of the Central Bank, former Governor of the Central Bank of Barbados, Mr. Calvin Springer, and the Scott family, visiting dignitaries, members of staff of the Central Bank of Barbados, distinguish ladies and gentlemen.

It is a pleasure to be here again in Barbados, and it is also a special pleasure to be here as Barbados celebrates its 41st anniversary of independence. It was only after independence that Barbados undertook the kinds of education and health policies that have led to the impressive performance that was alluded to earlier and that is reflected in its human development indicators. One of the reasons that globalization is not working well today, four decades later, is that many people's mindsets have not fully changed; in my talk this evening I will describe some of these problems. The title of my talk as well as of my book is "Making Globalization Work," and the title tries to summarize in those three words a great deal of what I want to say. First, it suggests that globalization is not working, and I will describe the ways in which and the reasons why it is not working. But the title "Making Globalization Work" also suggests the kind of optimism that the Minister referred to, an optimism that we could make globalization work by diagnosing what is wrong. Finally, I will describe some of the reforms that could make globalization work. Actually, if my publisher had allowed me to have four words in the title, I would have called my book "Making Globalization Work Better," because my objective is not a question of making it work but of making it work better. I want to share with you some of those ideas and reasons that I am somewhat optimistic, although not completely, that we could make globalization work a lot better.

There are a number of reasons that there is today such discontent with globalization around the world. Beginning with the protest movements against globalization, like the riots at the World Trade Organization meeting in Seattle that happened just about ten years ago, many who were the cheerleaders of globalization were puzzled. Many of them said the discontent was really not a problem of economics but of psychiatry: people were better off but they just did not know it, and so all we have to do is explain to them why they should be happier. But in fact, when you look at the data and at what has happened, there were actually a lot of reasons why people were unhappy. One of the main aspects was that there had been in the developing world large failures in development, with large contrasts between the successes in East Asia and the disappointments elsewhere. For instance, in growth Latin America in the nineties was half of what it was in the fifties, sixties and seventies. The Washington Consensus, which referred to a set of ideas shared by the US Treasury, World Bank and the IMF about what strategies would lead to development, was not a consensus within the developing world. Countries around the world were put under a lot of pressure to follow these prescriptions, and the result has been a disappointment. As I said, in Latin America growth has been half of what it was before we told it how to grow. In the case of Brazil, there were seventy-five years of growth at five to seven percent before 1980, but today in Brazil, they view growth of three percent as a major success. Not only has there been very limited growth, but also the benefits of what growth has occurred have accrued disproportionately to those at the top. There is growing poverty, unemployment, and crime, and an increasing fraction of the population in the informal sector is without job protections.

In Africa, the disappointments have even been greater. I was doing research in Kenya at the end of the sixties and early seventies, the years right after the end of colonialism, and there was a real spirit of optimism, a hope that free from the shackles of Colonialism, they would begin to grow. However, the last two decades have seen a decline in per capita income, and on average these countries are poorer than they were twenty-five years ago. There are some problems in the transition from communism to the market; given the inefficiencies of communism, everybody expected that these countries would have bursts of output and that GDP would grow, getting rid of this inefficient system. However, what actually happened was, after following the strategies of the IMF and the Washington Consensus the transition countries experienced not just one or two years of decline but a decade. Six or seven years after the beginning of transition GDP in Russia was 30% or more below what it was at the beginning of the transition. This was also reflected in other indicators of well-being; for instance, life expectancy declined markedly while around the rest of the world people were living longer. Many of you may know a book that was written by a friend of mine, Tom Freidman, called “The World is Flat,” which has become a best seller in the United States. I have been trying to explain to him, since we often share the stage at lectures , that the world is not flat. In fact, what I tried to explain is that not only is the world not flat, but also in many ways it is getting less flat. Now, he has come out with a new edition of his book where he is a little bit less of a cheerleader of globalization, but the way he sometimes puts it is that he looks at a glass that is half full and he sees the part that is half full while I look down and see the part that is half empty.

In fact, I think the glass is more than half empty, as there has been growing inequality between the rich and the poor in most countries around the world both, in the developed and the developing countries. Even in the United States, the level of equality is higher than it has been in three quarters of a century. The problems are so great that not only is poverty increasing, but the people in the middle are worse off as well. More than 50% of Americans today are worse off than they were about seven years ago.

In other words, while some people are doing very well, for instance Bill Gates, most Americans are not enjoying the fruits of the growth that is occurring. This is not just a short run problem; it has become a long run problem. A recent study looked at the income median, which means 50% of people above and 50% below, of males in their thirties today when adjusted for inflation have a lower income than their parents did thirty years ago. Thus, the dream of every generation being better off is just a dream, and globalization is one of the factors that has contributed to that.

This problem is particularly severe in the developed countries, but there is growing inequality both within developing and developed countries. The other concern is that there is growing inequality between the richest and the poorest countries of the world. Some countries have done very well while many others have not, and globalization has played an important role in all these failures. For instance, unfair trade agreements have exacerbated the problems in the developing countries. I recently wrote a book called “Fair Trade for All” where I look at the problem of the Doha development round of trade negotiations. In 1999 when I was Chief Economist of the World Bank and preparing for the new round of trade negotiations, I went to Geneva to present some of the research done at the World Bank which showed that in fact the developing countries had not really shared in the gains of the last trade agreement completed in 1994. In fact, it was so unfair that the poorest countries of the world were actually worse off, and therefore I was heartened when in November of 2001 at Doha the trade ministers agreed to have a round of negotiations focusing on developing countries. Unfortunately, the developed countries, and Europe and the United States in particular, have reneged on the promises they made in Doha, and what was called the development round does not deserve that name anymore.

These problems are illustrated by the asymmetric nature of liberalization that has occurred. There has been a great deal of focus, for instance, on liberalization of capital markets and of investment, and protection of investment. However, if the question is whether liberalization of capital markets or liberalization of labor markets would bring about greater gains in global output, the answer is simple: allowing people to move more freely from one country to another would have an order of magnitude bigger effect than liberalization of capital. But the trade agreements and negotiations have focused on capital and investment and not on labor, for understandable reasons given the politics of the trade negotiations. The effect of this is not only to give an advantage to the developed countries and a disadvantage to the developing countries, many of whom are abundant in labor, but it also means that the bargaining power between capital and labor is changed. If a country threatens to tax capital to enforce environmental regulations or to enforce worker conditions, investors can threaten to take their money to another country where taxes are lower and the regulations are weaker. In other words, the asymmetric liberalization of capital and labor has contributed to what might be described as a race to the bottom. Think what a different world we would live in if capital could not move at all but labor was freely mobile; every country would then be competing to get skilled and unskilled labor to move into their country because capital would not able to move. Countries would have to worry about the quality of their air, schools, and health care system, all the things that are being cut back now under the pressure of globalization.

One of the ways in which globalization has played an important role in these failures is due to the advice given by the IMF and the World Bank under the Washington Consensus policies that I mentioned before. Perhaps the most dramatic example was Argentina, which was described as the A+ student of the IMF; in fact, it was such a good student that the President of Argentina, Carlos Menem, was brought to Washington and paraded at the annual meeting of the IMF in 1999 as an example for other countries to follow. We all know what happened to Argentina a little over two years after that, and now, in many countries around Latin America, people believe that if this is what happens to the A+ student then that is not a school in which they want to enroll.

A particular problem with small open economies has to do with capital market liberalization. International pressure makes it difficult not to liberalize your capital markets, but liberalizing your capital market also causes many difficulties. One of the problems is that capital market liberalization exposes countries to huge volatility, as capital flows in and out, which was the fundamental source of the East Asia crisis that had such a devastating effect, not only in that region but around the world. The contrast between those countries who followed the advice of the World Bank and the IMF and those that did not is seen most clearly in the differences in the performance of the economies in transition, that is, economies going from Communism to capitalism. Those that followed the Washington Consensus policies had a disastrous performance, and GDP fell. In contrast, China and Vietnam, which followed different policies, had enormous successes. China has grown at close to 10% for over thirty years, and in Vietnam the pace of poverty alleviation has been perhaps the most rapid of anywhere in the world in the 1990s.

The failures of development and the growth of inequality represent two of the perhaps most important problems of globalization. There are, however, further problems, and I am going to just very lightly touch on several of these. One of them has to do with finance; what we have seen in the last few months is an example of how inadequate regulation and bad macro-economic policies in the United States have had consequences all over the world. In August, I was in Indonesia, a country that had not even bought these sub-prime toxic mortgages, but the changes in the global appetite for risk led to a huge fall in their stock market. Investors did not want to put money in developing countries, so Indonesia's liberalized open economy suffered enormously from a problem that had nothing to do with what was going on in the country.

The United States managed to export its bad mortgages to Australia and to Europe, and now there are global financial worries because of problems in lending to poor people in the United States. Of course, the brunt of the crisis will be felt in the United States: it is expected that 1.7 million American households will lose their homes as a result of this financial crisis, making it both a financial and a social problem, but because of globalization, it has become a global economic problem. This is, however, not the only instance; there have actually been a hundred crises or more in the last thirty years. In fact, it is more unusual for developing country not to have had a crisis than to have had one.

Another peculiarity of the global financial system today is that money is flowing from poor countries to rich countries; a road on which water went uphill would be the subject of a good science fiction movie. Similarly, money is supposed to go from the rich to the poor, but in the modern world of globalization, it is going the other way. Last year, over half a trillion dollars went from poor countries to the rich, and the richest country in the world, the United States, borrowed eight hundred and fifty billion dollars, almost three billion dollars a day, from countries that are poor. The richest country of the world could not live within its means, and yet it lectures other countries about fiscal prudence. In spite of the advances and the ability to slice and dice the risks that Wall Street prides itself on, poor countries still bear the brunt of the risk. In other words, while money is flowing from the poor to the rich, risk is also supposed to go from the poor to the rich, but instead it is being left with the poor. This is one of the reasons why there are so many crises. Poor countries continue to borrow, in short term, dollar denominated or hard currency denominated debt, exposing themselves to volatility in interest and exchange rates

Another example of something wrong with globalization is that, hidden in many of the trade agreements such as NAFTA (the North American Free Trade Agreement), there are also investment agreements. In the case of NAFTA, chapter eleven was described as protecting investors from appropriations, but it had nothing really to do with that risk. It was really giving foreign investors protections against changes in regulations, some of which were very important, like foreign empowerment. For instance, a Mexican village decided that it did not want to have a toxic waste dump in the middle of the village, something that many of us could sympathise with, but because of chapter 11 of NAFTA, Mexico had to compensate the American owner of the toxic waste dump for not having the toxic waste dump in the middle of the village. The case of Indonesia was even more dramatic. Indonesia under Suharto had signed a contract that was almost surely corrupt, and when the East Asia crisis occurred, a huge percentage (?) of the sources were missing.

I had hoped that a set of frameworks and principles for dealing with these problems would emerge from Bali. One possible principle that may be particularly of relevance to developing countries is the idea that developing countries should be compensated for providing environmental services. This is another one of the important inequities of the global system: the developing countries with rain forests provide enormous environmental services in the form of bio-diversity and carbon sequestration. We can put a value on these carbon services; we know the value of carbon because there is a value on a ton of carbon in the European trading system. The value of the carbon services provided by the rain forest countries is in the tens of billions of dollars. In other words, the contribution of the developing countries to the problem of the environment is greater than all the foreign aid that these countries receive. This is another example of the imbalances in our global system.

In summary, we can make globalization work, or as I said in the beginning, at least work better, both for the rich and for the poor in the developing world as well as in the developed world. One of the important aspects of making globalization work is recognizing that one size doesn't fit all: different countries have different circumstances, and one has to adapt rules to fit those different circumstances. The general principle of differentiation has been recognized, but unfortunately too often it has not been adequately implemented. The challenge for developing countries is figuring out how to manage globalization on their own terms so that they can enjoy the benefits without facing the downsides, which have been enormous. For instance, successful countries have recognized the concept of dynamic comparative advantage, that the true strength of a country doesn't just correspond with its strengths today but can change and evolve as a result of investment. The most dramatic example of this was Korea. Forty five years ago, Korea was mainly growing rice, and advisers from the World Bank and IMF told Korea that it ought to take advantage of its comparative advantage and become a good rice grower. Korea, however, said it did not want to just grow rice; it wanted to do something else, because even if it was the most successful rice grower it would still be poor. The country wanted to change its comparative advantage, andthe most important resources were people and not mines or mineral resources. At the time, the education level was only about four to five years, but the country decided to invest enormously in its people and in technology in order to change its comparative advantage. There were a lot of doubters and critics, but Korea succeeded. Today, for instance, in a huge range of industries it is among the global frontier, and Korea is a member of the advanced industrial countries. Of course, it means taking advantage of the changing global landscape and changing technologies.

The challenges open countries meet in managing globalization are an important; if they feel the problems of poverty and unemployment, the situation may get worse. If they succeed—and there have been a number of successes—they could make inroads in the major problems they face. This is why making globalization work is such an important challenge for both the developed and the developing countries. In conclusion, I will leave you with the sense of optimism that I conveyed in the beginning, that yes, there are lots of things wrong with globalization, and perhaps I spent too much time talking about the problems. I do, however, want to share with you this sense of optimism that we know what needs to be done and what can be done to make globalization work, or at least work better. Thank you.

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