Joseph Stiglitz Former Chief Economist, World Bank

Northern countries dominate decision-making processes that are part of gloablization, and the rules they establish are unfair to developing countries. The rich countries subsidize their own farmers and impose tariffs on manufactured goods from the global South. Both actions impede development. The Washington Consensus caused policies to be imposed on developing countries that were harmful, particularly the liberalization of short-term capital investment, which has destabilized economies. The key principle of development is "balance." That includes a balance between government and markets, a balance between growth and equity, a balance between pragmatism and ideology. There is no single solution to the problem of development.

The False Promise of Globalization

In the beginning of the modern era of globalization it was hoped that a rising tide would lift all boats. We did not have to worry about the problems of inequality. We were told that globalization would lead to more growth and everybody would benefit. A more apt metaphor is to say a riptide knocks down some of the smaller boats, and if you do not have life vests you drown. Globalization has exposed countries and individuals to new risks, new challenges. Predictably, some people have been made worse off. The theory predicted that the winners could compensate the losers, that there would be huge gains to offset the losses. In fact, the winners have not compensated the losers. Too often globalization has been used as an excuse to weaken social protections and to lower taxes in order to compete. As that happens, the underlying problems represented by the economic disparities are exacerbated.

Globalization has been mismanaged at two different levels: 1) the rules of the game have not been fair to the developing countries and 2) the advice that has been given by the International Monetary Fund (IMF) and the World Bank has also increased the vulnerabilities of the most vulnerable.

The fact that the rules of the game have been unfair is exemplified by the trade agreement that was signed in 1994 in Marrakesh. The poorest countries of the world, particularly in Africa, were made worse off. Everybody had expected the United States and the European Union to get the lion's share of the gain, but they had not really expected that they would force an agreement on the poorer countries that was so asymmetric that the poorest countries were actually worse off.

The IMF and the World Bank foist policies on developing countries based on a commitment to an ideology, a flawed ideology that says markets will solve all problems, that puts little or no emphasis on problems of inequality. That ideology has pushed policies like liberalization and privatization. In some cases they have led to growth. In others they have not. But in many cases, even when they have led to growth, they have led to some groups in the society being exposed to new risks, some groups in societies being pushed into poverty, and there have not been the concomitant social safety nets to protect those who have been made worse off.

Northern Agriculture Subsidies Depress Southern Prices

That is an example of how the rules of the game are stacked against the developing countries. The developed countries have kept their subsidies on agriculture, on cotton, on corn and other crops, and at the same time have forced the developing countries to take away their subsidies, open up their markets. The result has been that the price of agricultural goods is depressed. This is so important for developing countries because 70% of the people depend directly or indirectly on agriculture.

In the United States, farmers are richer than average. Three to four billion dollars a year is divided among 25,000 rich American cotton farmers. As a result of these cotton subsidies, they are encouraged to produce more. As they produce more it drives down the global price of cotton. Without those subsidies, America would not be exporting cotton at all. With these subsidies, America is the largest cotton producer in the world. As the price gets lower and lower, approximately ten million sub-Saharan cotton farmers are made worse off. Many of them live on the verge of subsistence, and so when you make the prices lower and their incomes lower it can have a devastating effect. That is an example of how the rules of the game are stacked against the developing countries.

Flawed Thinking Behind Globalization

I know some people who believed that globalization would make everybody better off. They believed in trickle down economics. They believed that if you only made the economy grow, everybody would benefit. But growth alone does not raise people out of poverty.

What was particularly flawed about a lot of these theories of globalization was that they did not lead to economic growth. That suggests to some extent flawed economics but also an important role for interest. Take the most dramatic example of this, capital market liberalization, opening up capital markets to the free flow of short-term capital. Everybody thought it was important to open up markets to foreign direct investment. But you cannot build a factory on the basis of money that can come in and out of a country overnight. The IMF tried to change its charter in September of 1997 to force countries to liberalize, to open up their capital markets. At the time they did it, they had no evidence that it would promote economic growth, and there was ample evidence, both in the World Bank and elsewhere, that it would lead to more instability. And yet they pursued it. My interpretation is that Wall Street wanted it. Later on they began to look at the evidence and they concluded that its effects are, at best, ambiguous and, in the case of many developing countries, significantly adverse.

World Bank, IMF as Rich-Nation Clubs

The IMF was established with the World Bank at the end of World War II. They are called the Bretton Woods organizations because they were established at an international conference at Bretton Woods, New Hampshire in 1944. At that time, most of the developing countries were colonies. The IMF and World Bank formed a club of the rich countries that would pursue their own interests.

At the IMF, there is only one country that has the veto power and that is the United States. The G7, the richest industrial countries, collectively get more than 50% of the vote. The head of the IMF is chosen by a European, by convention. The head of the World Bank is always chosen by the American President. When the World Bank recently had to choose a new leader, the person chosen had no experience as an economist, even though the major objective of that institution is promoting economic growth.

It is not surprising, given the problems of governance, that the effectiveness of the institutions is often limited. For instance, there is a lack of transparency. After some of us criticized them for lack of transparency, there were better websites. But that is not what people meant by transparency. They meant participation, understanding of decisions before they get made, not afterwards. International institutions are dominated by special interests within the rich countries that shape an agenda that advances their interests at the expense of the least developed countries and the poorest peoples in these countries.

Those special interests put their own interests over those of their own country, let alone over the world. So, for instance, if you look at the structure of tariffs that are imposed by the United States and the EU, not only do they have the effect of discriminating against the developing countries, the tariffs of the developed countries against the developing countries are four times higher than they are against other developed countries. So it is really discriminatory. The structure of those tariffs has the effect of impeding industrialization. There are much higher tariffs on finished goods than on less finished goods. These tariffs prevent the development in poor countries of the first stage of natural industrialization, by protecting the industries in the US and EU that process raw agricultural goods.

Comparing Latin America and East Asia in Terms of the Washington Consensus

The Washington consensus was a set of policies that was a consensus between Fifteenth Street in Washington and Nineteenth Street. Fifteenth Street is where US Treasury is, Eighteenth is the World Bank, Nineteenth is the IMF. It was not a consensus among the developing countries. It was a consensus among a relatively small group of people who had a particular mindset. You have to remember that Reagan was President of the United States, Thatcher was leader in the UK. It was a very conservative mindset that did not reflect good economic policy or economic theory as I would understand those terms. It had a particular political view of economics, one that voters in both the United States and the UK rejected in elections at the end of the 1980s and the beginning of the 1990s. But ironically, as voters in these democracies rejected this particular set of flawed economic policies, it remained in place at these international economic institutions. They continued to push these policies through.

Latin America was the best student of the IMF, of the Washington Consensus policies that focused on price stability, privatization, and liberalization. Argentina was the A+ student within Latin America. And we know these policies have failed. Growth in the 1990s, the decade in which they fully absorbed these lessons, was just over half what it was in the 1950s, 1960s, and 1970s before we taught it how to grow. Not only has growth been lower, it has also been less stable.

East Asia followed a very different model. They focused on macro stability but they meant not just price stability but also real stability, full employment. But they did not focus on privatization and liberalization. When they were forced to, as Korea was when they rapidly liberalized their capital markets, they did run into trouble. But what they did focus on were policies to promote equity, fairness, making sure that the fruits of growth were widely shared, that everybody was educated and in good health. They also focused on technology and on education—to avoid a disparity in knowledge.

The critical difference between East Asia and Latin America was that East Asian countries managed globalization in their own terms.* They were not ideologically driven. Latin America followed the IMF prescriptions. Some of the prescriptions were right but some of the prescriptions were clearly wrong. By following that package they had a disastrous record.

The Situation in Africa

Africa, in many ways, is the saddest story of development. Africa today has twice the number of people in poverty than it had twenty years ago. In the case of Africa, globalization is partly accountable for its low economic growth. The rest of the world took advantage of Africa's natural resources in ways that did not fairly compensate these countries, but which did contribute to corruption.

Corruption not only has an adverse economic effect. It also undermines completely the politics of these countries. But it makes sense for a business. If you can bribe a government official, pay him ten million dollars, and get the resources at half value, your profits will be higher. That is the same logic used by advocates of free markets, without government regulation. They say, "Our responsibility is to our shareholders. Our shareholders are better off if we bribe, because we get the raw materials at lower prices

* Ed.: Elsewhere in the interview, not reported here, Stiglitz emphasized that government has played a strong role in the development of every successful national economy One role of the state is to provide a social insurance system. He explained that Argentina created a massive budget deficit by privatizing its social insurance system under IMF orders, leading to a financial crisis. Americans wisely rejected privatization.

and it increases our profits. What do you expect of us? Isn't this a market economy, what capitalism is all about?"

If globalization is to work we have to have rules and regulations to make it work fairly for the countries of Africa, the poorest countries of the world. So this is an example of one of the ways in which globalization has actually had a negative effect on Africa.

Both in Africa and other developing countries, problems of globalization have mainly stemmed from letting free markets rip without taking into account the asymmetries of power relationships, the asymmetries of economic relationships. For example, when mineral or oil extraction contracts were signed, they often had clauses protecting oil or companies against falling prices of oil. But when oil prices rose from $20 to $80 a barrel, there were no clauses that took more of the revenue for the nation. No one gave developing countries advice about designing contracts that would benefit the people.

Trade Liberalization has Damaged Farmers

In some countries rapid liberalization of trade has meant that corn farmers have to compete with heavily subsidized corn. Their income goes down by as much as fifty per cent as a result of that competition. In each of the commodities we can talk about, opening the markets to highly subsidized agriculture drives down the price and forces farmers out of business or, if they stay in business, leads them to have much lower income. And these are often among the poorest people in the country. So, that is an example where there is a direct link between the policies and the particular people who are suffering.

The IMF would say trade liberalization is going to create new jobs. IMF policies were very effective in causing jobs to disappear, but they did not have the concomitant policies that led to more job creation. People went from low productivity jobs, not to high productivity export industries, but to zero productivity unemployment.

Capital Market Liberalization

The IMF often pushed capital market liberalization, opening up markets to speculative capital flows. You cannot build factories with money that can come in and out overnight. But what you can do is expose a country to enormous instability. Those policies were not sustainable, so the country went into a recession or depression. Unemployment soared. In Indonesia, at one point it was estimated 40 per cent of the people of the island of Java were unemployed, 16 per cent of the people in the country as a whole. In other countries, unemployment would be 10 to 15 per cent. That results in enormous distress and increasing poverty for these people. The effects can be long lasting. When children are put out of school, they typically do not go back again when the economy recovers. So you have a whole cohort of people whose education has been stymied. Malnutrition increased and that can leave a lifelong effect. The final effect is lack of growth. In Latin America, growth was half of what it was in the 1950s, 1960s, and 1970s. In the span of twenty years that kind of discrepancy mounts up and that means incomes are substantially lower than they otherwise would have been. As a result, there are more people in poverty and more suffering than there otherwise would have been.

Can Globalization Work?

There is no single recipe for making globalization work. I have criticized the simplistic policies of the past where they have looked for a magic bullet. There are two things we need to do. We have to become more aware of these adverse effects of globalization on developing countries, such as rising inequality, and we have to improve our political institutions to make them more democratic.

We tempered capitalism in the early twentieth century because we had democracies. In the nineteenth century in many places living standards were dismal. Democracy said we cannot go on this way. It checked unfettered capitalism. In globalization we have not yet done that. We have not learned how to temper globalization. So in my mind the most important thing is to increase the democratic nature of globalization to temper it.

In *Making Globalization Work* I have a whole host of specific reform proposals affecting each of the major areas: intellectual property, trade, natural resources (to make sure countries get paid more for their natural resources), multinational corporations, environment, global financial markets. It is a rich agenda that extends over a whole variety of areas. Let me just mention two areas.

1) After the riots in Seattle at the beginning of a new trade round, the developing countries said we do not want any more of this, because last time we were made worse off. The developed countries came back and said, "Trust us." In November of 2001, they signed an agreement, it was called the Development Round, to remedy the past and help the developing countries. The

United States and the EU reneged on the promises they made. So, one of the things is to go back and renew those promises, but this time to mean it. In *Making Globalization Work,* I offer a comprehensive agenda of a true development round—reforms that could actually help developing countries.

2) Another example is intellectual property. The intellectual property regime has made access to life-saving drugs much more difficult for the poor countries. Taking generics off the market was essentially signing a death warrant for thousands of people who could not afford the medicines. The developing countries have demanded a development-oriented intellectual property regime. What separates the developed and the less developed countries is not just the disparity of resources but a disparity of knowledge. The latter need access to knowledge to overcome the terrible burdens that they face.

The US and the Debt Problem

Repayment of international debt imposes a massive burden on developing countries. In Moldova, a former Soviet republic, the move to a market led to a 70 per cent decline in GDP. When I visited, 75 per cent of that country's budget was being devoted to servicing the foreign debt. It could not afford roads, lighting. We could see the process of de-development in process. The consequences were clearly devastating for the country.

In *Making Globalization Work* I try to identify why the brunt of global instability is felt by the developing countries. Having diagnosed the sources of the problem, I propose concrete solutions to reduce volatility and shift more of its burden to the advanced industrial countries.

The United States is now borrowing three billion dollars a day from countries that are much poorer and still lecturing them about their responsibility. Money that goes to the United States is not available to other countries to promote their development. In the long run, most economists would predict that that would lead to higher interest rates. In the short run, there is this high level of low risk premium that most people in the markets simply cannot understand. When the risk premiums come down, interest rates will rise and the poorer developing countries with high levels of indebtness will face a very serious problem. In short, the imbalances that derive from America's huge government debt are contributing to global financial instability.

Rethinking Development Models

When I was at the World Bank we tried to approach development from a comprehensive point of view. We wanted to avoid the piecemeal way, such as liberalizing trade before you create jobs—a policy that creates unemployment and poverty; not growth and prosperity. The comprehensive approach naturally leads you to think about what are important ingredients to successful development. One of my concerns is always to help strengthen communities, not weaken them. A second ingredient is people, not only in terms of human capital—the instruments of growth—but also in terms of their general well-being—the beneficiaries of growth. Education improves both sides of that equation: improving productivity and improving lives. Education makes their lives richer. Amartya Sen talked about enriching their lives, development as freedom. It is that broader sense of development that I emphasize.

Development requires you to balance between the market and the government. Both have played an important role in every successful economy. In some parts of the world government has been very strong and markets very weak. And so in those countries there has to be an increase in the role of markets. China and Vietnam are examples. But in many other cases, the problem is that the government is weak. Failing states are countries where the government is not doing what it is supposed to do.

The size of government is not as important as what and how the government does what it does. In some cases, it is doing what it should not be doing and not doing what it should be doing. I see success in countries that have done what they should have done, done it well, and the benefits have redounded to everybody in society. Getting the right balance between the role of market, the role of government, and the role of civil society more broadly is absolutely essential for successful development. The attempt to force a simple-minded recipe on all the countries has been a failure.

The Role of Land Tenure and Land Reform

There are two ways in which land is important in connection with poverty. First, there are large numbers of landless workers who have to work as tenants, often on the fringes of society. There is a long history of studies showing that farmers who own their own plots often do better than under sharecropping or as wage laborers. So the lack of ownership of land is a problem. Land reform has been at the beginning of many of the most successful developments. Japan, Korea, Taiwan all began with very important land reforms. So redistributing land is important.

Second, some people have emphasized that titling is important and gone on to argue that it is important because it allows people to borrow against the land and that makes markets more efficient. First, that is not the most important problem in many countries. In Brazil, for instance, people can find access to capital without ownership. Second, there is a problem that if you give land title and people borrow against that land to pay for health care or a wedding, they will not be able to repay easily. Then you will wind up with a large supply of landless workers. Some countries are considering allowing people to borrow against the fruit of the land, against their crop, but not against the land. They have title to the crop so they can borrow some money to pay for seed and fertilizer, but not so much to have a consumption binge. You have to look at this systemically and look at it with caution. Making capital markets work better is a potential source of increased efficiency. But in the long run, if we wind up with more landless people, we will have an economy marked by more poverty.