

SPEECH

Globalization and Its Discontents

Joseph Stiglitz

The following text is a transcript of the Fourth Annual JAMA Lecture presented by Dr. Stiglitz on 13 March 2003 at the Elliott School of International Affairs at The George Washington University.

Hugh Agnew (HA): Well a very warm good evening to everyone. Welcome to the George Washington University on behalf of the Elliott School of International Affairs. We hope that the weather won't make this a cool welcome. My name is Hugh Agnew I am the Associate Dean and a professor of history and international affairs here at the George Washington University in the Elliott School of International Affairs, and it is my very pleasant duty not only to welcome you to the fourth in a series of annual lectures on international economic issues but also to introduce our speaker tonight.

This series of lectures on economic issues has been made possible by the generosity of the Japan Automobile Manufacturer's Association or JAMA. JAMA's support has enabled the Elliot School to invite leaders from the academic world, from business, government, and the non-profit sector, to address major issues related to trade investment and development. The first speaker in the series back in the year 2000 was Jeffery Sachs of Harvard University who spoke about how globalization could be used to promote international development Robert Hormats Vice-Chairman

Dr. Stiglitz is a Professor of Economics at Columbia University and the recipient of the 2001 Nobel Prize in Economics.

of Goldman-Sachs International and former assistant Secretary of State for Economic and Business Affairs was the second guest lecturer for the series and he addressed the need to reduce international divisions in the global economy. Last year Daniel Yergin, chairman of Cambridge Energy Research Associates or CERA, spoke on “Rethinking the Commanding the Heights: The Future of Globalization,” and showed excerpts from his PBS documentary on this subject. Transcripts of these stimulating presentations are available on the Elliott School’s website, so I hope you’ll take some time and cruise the web to find out what has preceded our distinguished speaker this evening.

Our guest speaker tonight is Joseph Stiglitz, Nobel Economic Laureate in the year 2001 and professor of economics at Columbia University; he will speak on the subject of “Globalization and Its Discontents.”

But before we introduce Professor Stiglitz let me introduce William Duncan, General Director of the Washington office of the Japan Automobile Manufacturer’s Association to say a few words. The Elliot School is very grateful to JAMA for its support of this outstanding series of lectures, which offers to the George Washington University faculty, students and the Washington community an opportunity to examine the wide range of international changes that we have come to call globalization. Bill we are delighted to have you here this evening.

William Duncan: Thank you, Dr. Agnew.

President Rodriguez, Dr. Stiglitz, members of the faculty, students, colleagues, and friends: It is a pleasure to be here again at George Washington University and the Elliott School of International Affairs for the fourth annual JAMA-sponsored lecture on globalization. And I do appreciate being able to say just a few words on behalf of the Japan Automobile Manufacturers Association.

This is clearly a difficult time in international politics as the community of nations struggles with the threat of rogue dictators and the horrors of terrorism. However it is equally clear that the rapid development of financial and industrial globalization over the past several decades has created a bond between nations that serves to bring them closer together in the common cause of mutual prosperity through expanding trade and investment. The JAMA member companies, along with automobile companies around the world, have played a key role in developing this bond.

JAMA as most of you may be aware is a trade association representing vehicle manufacturers that produce vehicles in Japan. As such, JAMA is a nationally-based trade association. However, while JAMA is national in this sense, JAMA and its members are in reality citizens of the world. Not only do JAMA members produce automobiles in over 75 countries, but also they have close ownership and equity ties with other leading automobile companies. General Motors, for example, has equity ownership in Isuzu, Fuji Heavy Industries and Suzuki; Renault holds equity in Nissan and Nissan holds equity in Renault; Ford has equity in Mazda and Daimler-Chrysler

holds equity in Mitsubishi. Many of JAMA's members and their affiliates are members of automobile trade associations around the world and General Motors Japan is a member of JAMA.

As an active participant in a growing global culture, JAMA has welcomed the opportunity to join with the Elliott School in promoting an open discussion of globalization in its many manifestations. We are particularly honored that the renowned economist Dr. Joseph Stiglitz is with us this evening and we wish to express our appreciation to him for taking the time from his busy schedule to travel to Washington to share his views with us on globalization.

I would also like to express JAMA's appreciation to President Rodriguez, Dean Harding, who is not with us this evening, Dr. Agnew and the faculty of the Elliott School for hosting this lecture. I'd also like to give a particular thanks to Kathleen Reilly for skillfully managing all the myriad details, which have made this event possible. We now look forward to hearing Dr. Stiglitz's remarks. I thank you all for coming.

HA: Since anticipation makes the dish better, I am going to introduce not our guest, but our guest's introducer. I would now like to introduce one of the distinguished visitors adorning the campus this year, Miguel Angel Rodriguez, who is the J.B. and Maurice C. Shapiro Visiting Professor of International Affairs at the Elliott School. Dr. Rodriguez, who happens also to be a personal friend of our guest speaker tonight, recently completed his term as President of Costa Rica, from 1998 to 2002. He was a long time leader in the United Social Christian party, and has also served in public office as President of the Costa Rican Legislative Assembly, and as President of the Christian Democrats of America. But before becoming a public official, Professor Rodriguez had a highly successful career as a businessman. He has been the director of the Agro-Industrial Export Bank S.A., and the President of Agro-dynamic International S.A. He received his Ph.D. in Economics from U.C. Berkeley and has taught economics at the University of Costa Rica and the autonomous University of Central America. He has published several articles and books on economic and social issues in Costa Rica and Latin America, and is working on a reflection on the move from academia into policy and out of policy back into academia, which has certainly been a blessing to the George Washington University. So please join me now in welcoming Dr. Rodriguez.

Dr. Miguel Rodriguez: Ladies and Gentleman. Good Evening! I am sure that you understand quite well that it would be a vain effort on my part to attempt to show all the achievements in the field of economics made by Dr. Stiglitz. This has already been done by the world's economic community, and, in a very special way, by his Nobel Prize. Let me just remind you that he has taught at Princeton, MIT, Cambridge, and Oxford, and, presently, he is Professor of Economics and Finance at Columbia

University. He was Member and Chairman of the Council of Economic Advisors for President Clinton, and later Chief Economist and Senior Vice President of the World Bank. His contributions to economic theory are tremendously important in the study of market failure, especially in the area of limits in information.

On a personal note, I would like to tell you, that I had the pleasure of becoming acquainted with Joe when he acted as academic advisor to Andrés, my son, while he was working towards his Ph. D. in Economics at Stanford University. I also had the fortune of being a host for Joe and his family in Costa Rica during a family vacation trip. They toured all around the country by car. I have fond memories of this one night Joe and his family came to dinner at our home. Joe told us the story that they had a flat tire in a country road. Then came a farmer on a horse, delivering milk to the local market. The farmer stopped and helped him change the tire. Since that occasion he has returned the “favor” to the country in at least two other subsequent trips to Costa Rica.

On the first trip, months before the integration of my government, he led a seminar for new high-ranking officers on public policy issues. His personal participation and assistance were most valuable for the group of participants who later were appointed to lead the economic team. He went as far as putting together a specific proposal for a reform plan for the social security system. He came up with the specific idea that the pension plan and unemployment insurance should come together as one comprehensive package as opposed to being two different plans. This idea later became one of the major cornerstones and an integral part to our reform achievements.

Sometime later, He once again re-paid his “indebtedness” to the kind milk delivery farmer but in a different way. We had the fortune to see him come back to Costa Rica as a tour guide. He took his daughter and her friends on a guided visit all over the country, lecturing them on the most striking features of the major regions and provinces. I am very grateful to Joe for the way in which he has identified with our country.

Tonight, I am certain it is a great pleasure for all of us to have the opportunity to have Dr. Stiglitz as our speaker.

Thank you very much.

Joseph Stiglitz (JS): Well it is a pleasure to be here, the subject of my talk is the problems that have to do with globalization. And globalization, the way I am using it, is simply the idea that as a result of reductions in transportation costs, communications costs, and artificial barriers to movements of goods and services, and the factors of production, the countries of the world have become much more closely integrated.

There have been two alternative views of globalization. One view of globalization is that it is the best thing since sliced bread. For those who do not know American expressions, this means it was supposed to bring unprecedented prosperity

to all the countries of the world including the developing countries. The other view of globalization is a little less positive; in fact it is quite negative in that it has brought a whole host of difficulties and problems, exacerbated poverty, undermined democracy, undermined domestic culture.

In the first view the discontent with globalization is somewhat of a puzzle, and it's almost as if it is a problem not for economists to solve, but for psychologists: why is it that people who have been made so much better off are so unhappy? And it has brought them all these benefits in terms of increased income but they don't seem to understand that they are happier. Therefore economists can't really answer a question like that.

Well I am going to argue that in fact the discontent with globalization has a real basis to it, that there are some real reasons for that discontent. But before doing that I want to emphasize that globalization is really a very multifaceted phenomenon and that there are some aspects of it that are unambiguously positive. For instance, globalization has brought with it the globalization of ideas, ideas like democracy, human rights, which have had an enormous impact in many parts of the world. Globalization of knowledge has resulted in increased life expectancy in many countries even among the poorest countries of the world.

One manifestation of globalization are the universities that we have in the United States and Europe where we have students from all of the world; and Andres Rodriguez was an example of this kind of globalization, which I think is enormously beneficial.

There has also been globalization of civil society and that too has brought some enormous benefits, in fact the globalization of the anti-globalization movement is an example of that and I think there are certain benefits that have come out of that.

Two other examples of the successes of global civil society, is the land mine treaty that was signed a few years ago, over the opposition of the U.S. Defense Department. The support for it around the world was so strong that it actually got adopted.

Another example is the Jubilee 2000 movement, which resulted in debt relief for over 20 of the poorest countries in the world. You may remember three or four years earlier that there had been an initiative called HIPIC (Highly Indebted Poor Countries' Initiative) for debt relief. The IMF was put in charge of debt relief and it likes countries being indebted to it. So the last thing it wanted was for countries to be relieved of their debt, and in the space of three years, only three countries met their standards, I jokingly say that if you met their standards you would no longer be a developing country. But as a result of the pressure of globalized civil society in the Jubilee 2000 movement, as I say, twenty additional countries got debt relief.

Even in the area of economics, globalization, in some parts of the world, has had enormous benefits, in particular in East Asia, which has been the most successful part of the world. That success was based on globalization, on exports, and JAMA is one example of the export of Japanese cars. But the region as a whole has benefited

enormously from exports, which would not have been possible had it not been for globalization.

They also benefited from the transfer of technology. One of the things we recognize today is that what separates less developed from more developed countries is not only a gap in resources, a gap in capital, but also a gap in knowledge. And globalization has resulted in the reduction of that gap in knowledge. It took active policies to reduce that gap, but it was really a manifestation of globalization. What separates East Asia from much of the rest of the world is that in East Asia they govern globalization. They managed globalization on their own terms and made it work for themselves, and that is in marked contrast to much of the rest of the world where globalization has not worked quite as well.

Just as one example let me turn to Latin America, which during the early 90's was heralded as the region of the world in which the precepts of globalization were most adopted. Not only did all the dictatorships become democracies, except for Cuba, but also they adhered much more to the doctrines of what is sometimes called the Washington Consensus: the set of advice that was developed between the U.S. Treasury, the World Bank, and the IMF, the eight streets to your north here. That itself says a great deal about the development strategy: it wasn't developed in the developing countries, it was developed right here. And that explains a number of the flaws.

What has happened in Latin America as a result of globalization? Well they have had now more than a decade of what is called reform, a decade of globalization, and throughout the continent people are asking questions like, has reform failed us, has globalization failed us, because clearly things have not worked out the way they were told they ought to. Just to give you a picture, they were told that reform would lead to faster economic growth. After a decade what are the numbers? The numbers are that growth in the 90's was just over half of what it was in the 50's, 60's and 70's before reform. That is not a very inspiring success story. Even in the beginning part of the decade, and I'll come to that in a minute, growth was still below what it was in 50's 60's and 70's but the growth it got in the beginning of the period, was not sustainable, and it was not sustained. But even where the growth occurred, the benefits accrued disproportionately to the rich, to the people in the upper 30% and in many cases to the upper 10%. Throughout the region poverty as measured on the \$2 a day standard as a percentage of the population was actually up.

One of the things that went on throughout the region was the reforms in labor markets. They didn't go all the way, but there were substantial reforms that were supposed to increase flexibility and the consequence of that was that it was supposed to bring down unemployment. Average unemployment rates for the region went up by 3 percentage points. Moreover, a larger fraction of those who were employed were working in the informal sector, the part the economy without any job protections, without any security, without social security or pensions. So as a result of all of this,

many places within Latin America are feeling extremely disillusioned with what they were told. There was a short period of growth in the beginning of the 90's the result of short-term capital flowing in, and that gave an impression of success. But that was a really false impression, and in a way it illustrates how important it is to have good accounting frameworks.

We have learned a lot in the private sector about the dangers of bad accounting, and as some of you who are studying accounting probably know, and you're learning those techniques, and now you know you have to find other techniques in order to lower your taxes and mislead investors. But there is also a long tradition in the public sector of misleading statistic, or using statistics that don't really give you what you want. One of the things that we always talk about is GDP, as a measure of income. But there are other measures, including Gross National Income or Net National Income. Well, what's the difference? One of the differences between GDP and GNP or NNP is that GDP makes no account of the fact that capital is coming in when you are selling away you natural resources, when your selling away your previous investments.

During the 50s, 60s and 70s the countries did make enormous investments in power plants, and other kinds of capital goods that increased their productivity, they were not all well managed, but they were still assets. But then in the 90's under pressure from the IMF they privatized those— whether that was a good decision or not, is another question and I'll come back to it later— but the fact it that when you are selling away your assets to foreigners you are becoming poorer. They should have taken out of their statistics, the fact that while income was coming in and they had more money to spend on consumption, their wealth was in some sense becoming lower, and they were becoming poorer. Moreover, much of the capital that came in the early part of the decade was short-term capital and you can't build factories on the basis of capital that can come in and out overnight. What gives growth is jobs and investments, real investment not short term capital that is speculative in nature.

So the result of these was that as the decade went on, the fact that the growth of the early part of the 90s was unsustainable became clearer and clearer. In the last year not only has income come almost to a halt, but income, GDP per capita, income per capita has been getting reduced and actually falling in the last year. In Latin America, quite often when you talk about countries, you talk about examples of particular countries, and let me talk about the two countries that had been given the A+ rating from the IMF in the early part of the decade.

The first of these is Argentina—now somebody is grimacing when I mention that. The fact is it was given an A+ rating and on the basis of that, a lot of capital flowed in and we now know what happened. They maintained a fixed exchange rate long beyond when it was viable. They should have moved off the fixed exchange rate in 1996-97 but they were encouraged to maintain that fixed exchange rate. The result of that is that they had an overvalued exchange rate, which made it more and more

difficult to export.

As the country faced a crisis all kinds of accusations were leveled against Argentina, they were corrupt, mismanaging their money and spending huge amounts of money. Interesting when two years before, you never heard those things, they were given an A+ rating. The corruption was there but was not mentioned when they were giving them billions of dollars. The fact is they would have had a crisis even if they had no corruption. The economic regime, the fixed exchange rate, meant that the crisis was inevitable.

What about the charge of fiscal profligacy? Well if you look at their deficit-GDP ratio, it was not particularly bad. Their deficit to GDP ratio was only about 3% at the time of the crisis. To put that into perspective they were in a deep recession, unemployment was approaching 20%. In the United States in 1992, when we had a very mild, relatively mild recession, unemployment was somewhere between 7-8% and our deficit to GDP ratio was almost 5%. So if they were profligate we were even more profligate. But it is even worse than that if you look at the source of their deficit: their entire deficit was caused by privatization of social security. If they had not privatized social security, which gives a flow of income into the government, they would have had zero deficit, they would have had a surplus. To put it another way, if the United States had followed the IMF's advice and privatized social security our deficit to GDP in 1992 would have been 8% of GDP; we would have been ranked among the reckless countries.

I could go on but the basic point I want to make is that accusations against Argentina were exaggerated. They did not take into account the fact that the fundamental problems of Argentina were partly attributed to the advice given to them by the IMF. The economy went into a downturn. The major change in the economics was a change, not in what Argentina did, but in the outside world. In 1995 there was the Tequila crisis, in 1997 there was the East Asian Crisis, 1998 there was the global financial crisis, and each of these crises lead to high interest rates. So they had to pay very high interest rates on their debt and their debt-GDP ratio was not particularly high; at the time it was around 45%, even at the time of the end of the crisis it was 50%.

Our colleagues from Japan can tell you what their debt-GDP ratio is; it is around 130%. So Argentina's wasn't particularly high, it was a little bit lower than the United States. But if you have to pay very high interest rates even a moderate debt-GDP ratio becomes unaffordable. But it wasn't anything they did that raised these interest rates to that level, it was what went on in the outside world including in East Asia, which was caused by a whole other set of mismanagements and not caused by what Argentina had done. But then the IMF went in and exacerbated the problem.

Those of you who take economic courses know that almost every macroeconomic course says that when the economy faces a downturn you are supposed to have a stimulus package, you are supposed to have expansionary monetary and fiscal policy.

In the recession of 2001, both the Democrats and the Republicans agreed that there ought to be a stimulus package. One of them wasn't really a stimulus package, but the principle was there that there ought to be a stimulus package. But what did the IMF do, the same thing that they had done in East Asia. They told these countries to have a contractionary fiscal policy.

Now the good thing is that they substantiated the economic theory of the last 70 years. It had exactly the effects that most economists would have predicted. It led the economy to go further and further into a downturn. Since 1995 Argentina had double-digit unemployment, but with the IMF program they pushed it all the way up to 20% open unemployment and another 10-15% disguised unemployment. It was almost inevitable that eventually social and political turmoil would break out. What was more remarkable is that it took so long, not that it eventually broke out.

Well that is one case. That was one A+ student of the IMF and around much of Latin America people are saying if that is what happens to an A+ student that is not a school we want to go to. We want a different kind of an education. The other example is Chile and Chile is often cited because it did have remarkable success. In the period from 1990-1997 it was growing at about 7% a year. I had the fortune of being down in Chile this summer and had discussions with a large number of people including the president about to what to attribute Chile's success. The answer was because they did not follow the Washington Consensus, not because they followed it.

Now that is not the general story and let me try to explain why. What I said before about East Asia was that they were selective in doing what was on the Washington consensus policy. It wasn't that they rejected everything, but they managed the process in their own way. So for instance, China still has not fully liberalized its capital markets, it does not allow short-term speculative capital markets to have capital flow in and out in the way that Thailand, South Korean and Indonesia did, which caused enormous devastation. Chile also restricted short-term capital flows in the growth period from 1990-1997. The result of that was that when the global financial crisis hit in 1998 they were in a much better position because they had less capital they'd let flow in. There was much less capital to flee out as the global financial crisis hit and, therefore, they were much less devastated than they otherwise would have been. That's one example.

The second example is the IMF always and everywhere recommends privatization. I was in Korea this October and I had the opportunity to visit Pohang steel factory, which is among the most efficient steel factories in the world. It had been a little bit of a mystery to me why in the East Asia crisis the IMF had insisted that Korea privatize the steel mill. After all, it was more efficient than any privately owned steel mill, or almost any privately owned steel mill. And to the usual question, "why do you do it?" the answer is, "we always do it." There was no particular reason. There are some people in Korea who believe that the hidden agenda was that by privatizing it, they would make it less efficient and therefore enable American com-

panies who were very inefficient to compete.

When I was in the Council of Economic Advisors we had watched the problems within the American steel industry; it was very, very slow to reform, to restructure itself. This has a big effect on the automobile industry because, of course, if the price of steel is up, it is very hard to compete. Well I was interested in visiting the steel mill to find out what difference privatization made. It turned out it didn't make very much difference, they had the same management, and they were just as efficient, just as environmentally sound as they had been before. The two differences, which might be interesting, the two differences are, they said, "now that we are private we are audited less." When they were a public steel company they got audited both by the Congress and by the Administration, but now that they are private they have a lot more discretion. They didn't say what they did with that discretion, but they did say that they were audited less.

The second difference was that when they were a national steel company they felt an obligation to support the country and so they had done things like found what has been called the MIT of Korea, which has been a major source of intellectual strength for Korea. Now they say they can't do that. Their only responsibility is to get money to their shareholders. So those are the two major changes that privatization have made to Korea.

In the case of Chile, over 50% of their exports remain in the public sector, they have not privatized. Their public copper mines are just as efficient as the private copper mines. The difference, though, is that the public copper mines give the government 10 times the revenue than the private copper mines do, which are roughly the same size. So while the revenues from the private go off to the foreign owners, the revenues from the public help support the country as a whole. They contend that the state-owned copper mines would be even more efficient if they were allowed to do more investment, but the IMF restricts their ability to invest. The way they do it is actually very interesting and again is an example of using accounting for hidden agendas.

The way they do it, and it is a problem in Mexico and Brazil and in many other countries, is that if the state-owned copper mines borrow money to finance investment, increasing the productivity of the country and increasing the productivity of the copper mine, they add it to the national deficit, and they treat it as if the government had borrowed. But when the private company borrows, of course it is not treated that way. In Europe when a government-owned enterprise borrows it is not added to the national debt, it is not treated as public debt. And there is a real asymmetry between the way they treat Latin America and the way they treat Europe.

Well, the point I wanted to make is that Chile has done a number of things that are within the Washington Consensus, like it is maintaining fiscal stability, good budgetary position, it has done a lot of liberalization, not always reciprocated, but it has been selective in its economic policies. It did not liberalize capital markets in the

way the IMF recommended and it did not privatize in the way that had been recommended. But even more important, what the president emphasized, was that they accompanied those policies with a social agenda, that they had heavy emphasis on education and health, which are not even mentioned within the Washington Consensus. Now the sad part about it is that with all those social expenditures, inequality in Chile has not come down. But the view is at least it hasn't increased the way that it has in so much of the rest of Latin America. It is an uphill battle but at least by doing this, they prevented things from getting worse.

As I said in the beginning of my talk there is a lot of discontent with globalization and the underlying reason for that discontent is that it has not delivered on what has been promised. A country like Bolivia, a very poor country, one of the poorest countries in Latin America, reforms there began much earlier. In fact, Professor Sachs was your first speaker in this series and he was one of the advisors to Bolivia in the early to mid 80's. Under his advice they had a very strong stabilization program, which brought inflation down. It is now 17-18 years later, and they are asking the question, "we felt the pain, when do we start getting the gain?" They still don't have growth, and the result of this, as you may have heard, is that very recently they have had very strong public demonstrations.

Well, I want to try to summarize four of the major issues, problems, sources of discontent with globalization as it has been managed. The first is that there is enormous inequity in the rules of the game and in the way the international institutions are managed. This is most manifest in the area of trade relations. The United States and the other advanced industrial countries told the south, the less developed countries, that they needed to open up their markets and get rid of their subsidies on the goods that the North was selling. But the North did not reciprocate on the agricultural goods and the textiles, which are the natural comparative advantage of the South, those goods still face trade barriers.

Agricultural subsidies in the United States are not only large but they have actually increased. That is true in Europe and Japan as well. The magnitude of these subsidies is really hard to fathom. Let me just give you a couple numbers to help give you a picture. The standard for poverty that the World Bank uses, it uses a couple of standards, but the standard for poverty is \$2 a day. Sometimes we joke about how our children if they got only \$2 a day would think that their parents were giving them an excessively tight allowance. But 50% of the people in the world, live for food, shelter, clothing, medicine, everything, on \$2 a day or less. The average cow in Europe, cow, gets a \$2 a day subsidy, that is the subsidy it gets from the EU. To give you another picture of the magnitude of these subsidies, the total amount of agricultural subsidies, in the United States, Europe and Japan exceed the total income, not just agricultural, the total income of sub-Saharan Africa.

It is virtually impossible for these countries to compete, and the way these trade agreements have been done, and the way the subsidies are done, actually work

to impoverish the poor. After the last round of trade negotiations, the Uruguay Round that was completed in 1994 and about which the United States spoke with such pride, how many jobs it was creating and how much income it was creating in the United States. Nobody talked about what it was doing to the rest of the world, to the developing countries. It wasn't just that the United States and Europe were getting the lion's share of the game. One expects that, they are strong bargainers, but some of the games were actually at the expense of the less developed countries.

A study by the World Bank showed that after the Uruguay Round incomes in Africa were decreased as a result of it by over 2% and the mechanism for this is very simple and easy to understand. It comes out of the asymmetric way in which liberalization occurred, that it was not balanced and you can see that in the following kind of example.

The United States has very large cotton subsidies. The subsidies go to about 25,000 farmers. The amounts of the subsidies are around \$4 billion. The amount of cotton produced is around 3 ½ billion so it is over 100% subsidy. But the way the subsidy is designed is that you have to produce cotton to get the subsidy. So it provides a very strong incentive to produce more cotton. Well, what happens if American producers produce more cotton—it is just the law of supply and demand—the price of cotton goes down. The result of that is that incomes for African farmers who are dependent on cotton go down. The magnitude of this is enormous; some countries in Africa have seen their incomes go down from 1-2% from this single subsidy alone and just from the United States let alone any other country. This amounts to more than all the foreign aid we give to these countries. So all our foreign aid is just not even compensating for the damage that we have done.

There are a number of other inequities or imbalances, and let me just mention one more that is currently under discussion. One of the things that happened in the Uruguay Round was it was extended from trade into other areas, and many people who are strong advocates of trade liberalization such as Jagdish Bhagwati believe that this was a major mistake. One of the areas that this was extended to was intellectual property. Now everybody believes that intellectual property is important. In the Constitution of the United States it is one of the powers that is given to the federal government. You need intellectual property rights because it is important in providing incentives for innovation. But you should first recognize that most of the important innovations are not protected by intellectual property. All the ideas that I talked about today, none of them are protected by intellectual property. That was a joke. But, mathematical algorithms mathematical notions, ideas that lie behind the computer, many of most important ideas are not protected by intellectual property. Science for the most part is not protected by intellectual property, and the motivation for most scientists is quite different and the incentives are quite different than that provided by intellectual property. So that's the first observation.

The second one is to recognize that intellectual property is man-made, and it

is man-made to balance the perspectives of users and producers. At the time the Uruguay Round of discussions were going on there was a great deal of concern inside the White House in the Council of Economic Advisors and the Office of Science and Technology Policy about the imbalance in intellectual property regime, which was coming out of the Uruguay Round, that the U.S. Trade Representative was pushing. What is the most important input to research? It is other ideas. If you have an imbalanced intellectual property regime you can actually slow down the pace of innovation, and right now this is a considerable source of concern in the National Academy of Science. So that was one of the reasons that we opposed the unbalanced intellectual property regime that was being pushed by the U.S. drug companies and the media.

The second was we were worried about what it would do to the access to drugs in the poorest countries in the world. Whether Africans can buy AIDS drugs or not will make a miniscule difference to the profits of the pharmaceutical companies. It will not affect their incentives. It will make a great deal of difference to the people in Africa that have AIDS. And yet, the intellectual property regime that was put in, basically ran the risk of depriving these countries, people, of access to these benefits.

In a way, one of the concerns I had, and I'll come back to that in a few minutes, was that there was no public discussion of these consequences. Nobody was saying when they signed that trade agreement that you were condemning thousands people to death. In the aftermath, several years later, it began to become clear what it had done, and then there was an enormous amount of public turmoil. The United States at first equivocated and then finally took the position that we needed to somehow find ways of getting them drugs. And the focus was on AIDS because that was area of greatest activity, but the issue is far broader than AIDS it goes to many other areas.

The inequities in the global trade regime are so great and are now so widely recognized that when they began to have a new round of trade agreements, they agreed that they would try to redress some of the imbalances of the past, and that's why they are calling it a Development Round. But already that Development Round is running into problems, and let me just illustrate that with this current example.

The United States has said, ok we will allow licensing for countries to produce the drugs in their own country, and that is good for Brazil, for South Africa and for India. But most of the countries in the developing world are too small. Botswana is a country that has been ravished by AIDS but it can't afford the drugs from the United States and they can't produce the drugs themselves, they want to buy them from South Africa. But this is not being allowed. The United States right now is the single country, I believe, that is holding out on this issue. All the other countries have agreed that this is outrageous, but the U.S. drug companies have continued to maintain a concern. They say, that if they are allowed to sell it to Botswana, who knows, the drugs might come back to the United States and be available in the United States

at affordable prices. But that is not really a worry because almost all the drugs that are used in the United States are covered by insurance or administered in hospitals. It is one of the most tightly controlled sectors of the economy. If we cannot control the reflow of drugs from these countries back to the United States then we cannot control the production of drugs at all. The fact is, it is a greatly exaggerated worry.

Well I could go on, but I think I have illustrated the problems of the inequities, and why there is such concern. The second problem is that while the international regime has been putting forth these negotiations that have led to this kind of imbalance, they have not addressed some of the more fundamental failures in the global market economy. Let me illustrate that with a couple of examples.

If markets worked well, rich countries would bear a lot of the risk, most of the risk of international financial transactions. If a poor country borrows from a rich country there is always risk associated with changes in interest rates and changes in exchange rates. But who is better able to bear risk, a poor country or a rich country? The general theory of financial markets is that one of the things financial markets are supposed to do is transfer risk from those less able to bear the risk to those more able to bear the risks. That is one of the central functions of financial markets. But if you look at it globally, internationally, what you see is that the developing countries are forced to bear the risk. And it has had enormous consequences.

The fact that they were forced to bear the risks of interest rate fluctuations was a central cause of the Latin American crisis of the early 1980's. Because what happened is they borrowed from the United States and from other countries, and they were not told, "this is very dangerous for you health", they were told, "This is good for your growth." They should have had a big warning label on it. What happened is then the broker, the Federal Reserve, raised interest rates to unheard of levels. It destroyed our savings and loan associations, costing the American taxpayers \$500 billion. But we are a rich country and we could afford it. But while it bankrupted our savings and loan it also bankrupted most of the countries in Latin America. If we had had a more efficient market, where the developed countries bore the risk, it would not have had that consequence.

Exchange rate fluctuations are exactly the same thing that the risk of exchange rate changes should be borne in principle by the rich who are able to bear it. This summer I was in Moldova, which is one of the poorest countries. It was a member of the former Soviet Union, which since switching to a market economy—which remember was supposed to bring unprecedented prosperity—brought unprecedented poverty. The GDP in Moldova has gone down 70% since they moved to a market economy. Yet last year they had to spend 75% of their meager public resources to service their foreign debt. The reason for it was that in 1998 there was a ruble crisis; the exchange rate on the ruble fell, their currency was linked to the ruble. So it wasn't as if they had done anything wrong, but their currency depreciated, their debt was denominated in dollars and Euros, and they wound up owing enormous amounts.

That is one example of a market failure, which if the international economic institutions were doing their business, they would be trying to remedy this market failure and make risk distribution more efficient. But there is no talk of doing anything like that.

Let me give a second example, standard economic theory says that rich countries should lend money to poor countries. Rich countries have more money than they need in some sense, and the poor countries need it and have high returns, and that's the way the flow should go, from rich to poor. What country is largest borrower in the world? The richest, the United States borrows over \$1 billion a day, much of it from poor countries.

To see how it works, part of the problem is the underlying problem with global reserve system. It is an intricate and complicated subject, but let me just sort of indicate some aspects to illustrate the problematic nature. If a country borrows money in dollars, short term; say a firm in a poor African country borrows \$100 million from an American bank. It will have to pay something like 18-25% interest, but then it will be told, because you are borrowing short term you have to put a corresponding \$100 million into reserves. After all, the bank might demand the dollars back and we want to make sure that the country has the dollars. So the standard prudential advice is to put \$100 million back into reserves. Reserves are money that you hold in case of a rainy day, as a contingency.

Well how do most countries hold those reserves? They hold them in dollar bills or more accurately in T-bills. What are T-bills? T-bills are loans to the U.S. Treasury, short-term loans to the U.S. Treasury. What interest rates do T-bills provide? Right now about 1.75% and going down. Now think about what this means: this poor country is borrowing from the United States \$100 million and lending the United States \$100 million. When it borrows it pays the United States \$20 million dollars, when it lends to the United States it receives back, say at most \$2 million. What does that mean? A net cash flow from the developing country to the United States. Now you can understand why the United States thinks that this is good for growth here; and you can understand the enthusiasm for this kind economic arrangement in the U.S. Treasury. It is bi-partisan. But it very hard to see how this is supposed to help growth in the developing country. And this is just one aspect of a fundamental problem of our global reserve system in which we have done nothing, *nothing*, over the more than fifty years in which these problems have long been recognized. And again it is something that the IMF and the United States should have done something about but for obvious reasons there are strong incentives not to do that.

The third problem is that it is not just that the global economic arrangements are inequitable, that the global economic arrangements exhibit all kinds of problems of market failure, but that the international economic institutions have been pushing and advocating a particular variant of capitalism. There are many different variants

of capitalism, there is American capitalism, there is Swedish capitalism, Japanese capitalism, and they all have different characteristics. The version of capitalism that the IMF particularly has been pushing is not a form of capitalism that is conceived anywhere in a successful country. It is not American style capitalism although they often talk about it as if it were.

Let me just give you a couple of examples. In the United States we have a central bank whose mandate is to focus on inflation, unemployment and growth, all three macroeconomic variables that are important. The IMF has been telling countries all over the world to focus exclusively on inflation. Again, in December 1997, in the middle of the Korean crisis, I was in Korea and Korea never had a problem in recent history of high inflation, and the IMF was telling the Korean central bank focus exclusively on inflation. The problem right then was that unemployment was growing. So I asked the IMF why, and they said, "Well we always do that." I said why, "Well, if we don't do it, our board will tell us to do it," and that was the circular reasoning that they were using.

Here is a really interesting issue, we'll make this a campaign issue, do we want our central bank to focus on inflation or do we care about jobs, and of course it was an issue that the president felt very strongly about. Well it was interesting, as soon as he said that Senator Connie Mack, in effect, who was the senator pushing this said, "Oh I didn't really mean that. It was just an idea I wanted to float to stimulate discussion." But the important point is that in many developing countries they have no choice they are told by the IMF that they have to have a central bank focusing exclusively on inflation. Whether it is right or wrong for the country they are given that particular medicine.

I gave another example before of this kind of particular variant of capitalism in terms of managing macroeconomic policy. In the United States, we believe in counter-cyclical fiscal and monetary policy and yet the IMF consistently around the world has had pro-cyclical fiscal policy.

A third example has to do with social security. I mentioned before that the privatization of social security is one of the factors that contributed to the budgetary imbalances in many developing countries. But the whole issue of the privatization of social security is a highly controversial issue; it is a very political issue. In the United States it is very clear that the social security system has been very effective in eliminating poverty among the aged. It has provided a kind of security for the aged; a security against inflation, which is not provided by any private policy. It has provided them insurance against fluctuations in the stock market, which some people have discovered exist in the United States. It has provided these services at very low transaction costs.

In Britain, where they are engaged in some partial privatization there was a study recently done that looked at the magnitude of the transaction costs. What they showed was that the result of the transaction costs in Britain was to lower the benefits

received by retirees in the part that was privatized by 40%. They ate up that much of the benefits. I sometimes say that transactions costs for the aged are a bad thing, but the flip side of a transaction cost is that someone is receiving that money, and those people happen to like that kind of a system.

There is a debate about the privatization of social security. I think that social security system in the United States has worked well. But the important point I want to make is that again the IMF has pushed on country after country the notion of privatization without a full democratic debate, and without full recognition of the downside. So the policies that have been pushed are markedly different from those that characterize American capitalism.

That brings me to the fourth reason why there is such discontent with globalization, and that is that it has undermined democracy. It has undermined democracy in two ways. First, many of these countries are told that they have to do what the IMF tells them to do, and the consequences are so horrendous if they don't, that they basically lose their form of economic sovereignty. There are other ways in which they have undermined democracy. We sold democracy very strongly throughout the world, but then when it comes to economic policies, these countries are told, "Oh, these are too important to be left to democratic processes." We have to have independent central banks, you have to trust the IMF, and whenever there is a popular discussion, they say "That is populism," particularly when the discussion happens to disagree with what they recommend.

For instance, some of you may be from Mexico, you know that the Mexican government tried a year ago to have a VAT. They had a VAT that exempted medicines and food, but they were told, "Oh you ought to have a comprehensive VAT, tax medicine and the food for the poor." Well, what do you think the politicians said, they said, "We are accountable to the people, we don't think this is necessarily a good idea." Their congress rejected that. That was criticized as populism. There were other taxes they could have imposed. They could have increased the corporate income tax. There are huge profits in the telecom industry because of the monopolies; they could have taxed the monopoly profits, there were other sources of revenue. It is important to have a balanced budget, but there is a question of how you get those budgets balanced. It doesn't necessarily make sense to tax the medicines of the poor, and yet that was called good policy and its opponents were called populists.

That is one of the aspects in which democracy has been undermined. There is a second one that I think is increasingly of concern, and that is that the pace of economic globalization has outpaced political globalization. As countries of the world get more closely integrated you need more collective action, you have to do things together. And political processes are ways of deciding things collectively. We believe, we ought to believe, we are told, we've been selling the idea of democracy and the problem is that many countries actually believe what we have sold them. They have actually come to believe in democracy and they believe it not only for their own

country but also for global decision-making. That global decision-making ought to be done in ways that are democratic, that those who are affected ought to have a voice. But that is not the way international economic institutions are organized.

At the IMF a single country has the veto power. That means that if things don't go the way they want it they can veto it. Votes are not determined on the basis of one-person one vote, but on the basis of one dollar one vote. It is not even one dollar today it is one dollar as of 50 years ago, with some adjustment since then, so that there are some real problems with political globalization. In a way what has happened is that notions of social justice, notions of social solidarity have not been globalized as rapidly as notions of global economic integration. I think that is one of the major sources of the problem. Let me just give you one more example and then conclude.

We have come to demand or expect transparency in public institutions, there is a basic citizens right to know. In the United States that is embodied in the notion of the Freedom of Information Act, which has been a very important vehicle for keeping oversight of what the government is doing. There is no Freedom of Information Act, no right to know for what the international economic institutions are doing. In fact, it is so bad that you as an American citizen cannot find out how your representative has voted in the IMF or the World Bank. You don't have any right to know that.

As a result of that there has been at least one instance where Congress gave instructions to the representative of the United States to vote in a particular way. The vote was on the issue of what is called cost recovery for education, a neutral sounding term. What does cost recovery mean? Charging tuition for the poorest kids in the world.

The view was that we believe in free public education for everybody, including the poorest, and so the view was that the United States would not support any program that had cost recovery for primary education for poor kids. And yet the U.S. representative did that, but of course the U.S. Congress didn't know about it. The only way they found out—and one good thing about these institutions, like a lot of good public institutions, is that they are rife with leaks—eventually that information got out and Congress found out and then it called people on the carpet, and said you can't do that. But the point I am trying to make is that we have come to expect democratic accountability in our own country, and these public institutions ought to be accountable. The fact that there are no democratic elections should make that transparency all the more important. Because there are no elections we cannot throw out the guys who don't represent our interests. The only way we can know about what is going on is if there is transparency and yet there isn't very effective transparency.

Well, I have tried to hint at some of the reasons why I think there is discontent with globalization, and the bottom line is, I think, that discontent is largely deserved. The fact is though, as I said in the beginning, globalization can be a very powerful, positive force. It has these positive dimensions that I talked about, and it

can be actually even a very positive force for economic development and for reducing poverty. But if that is to be the case there have to be reforms in the way globalization is managed, and that is really the simple theme that I wanted to bring out. I do think that globalization can help the developing countries, can help reduce poverty, but if it is there have to be major reforms in the way globalization is managed. Thank you.

HA: Ladies and Gentlemen we are fortunate that Professor Stiglitz is willing to take a few questions, there is some time remaining. There are two cordless microphones on the floor of the hall. Professor Stiglitz will recognize questioners, we then ask that you take a microphone so that we can all hear the question.

Question 1: My name is Robin Broad and I am Professor of international development at American University and I am a former international economist at the Treasury Department. Let me just begin with some quick clarifications leading up to my question. First of all, clarification one, you talked about the anti-globalization movement, I would clarify that for my question and say rather that you are talking about the anti-Washington Consensus movement or the anti-neoliberalism movement. Second clarification, you suggest that there are two views, one for globalization or for the Washington Consensus, and one against it. I would argue that is a great oversimplification, that the media folks fall for that and that we shouldn't fall for it. Rather it seems to me what I am talking about, and what I think you are talking about, is a spectrum of views about the Washington Consensus, a spectrum of views from the Washington Consensus on one side to a spectrum of views on reshaping or rolling back economic globalization.

So my question is let's take that spectrum lets put the Washington Consensus on one side, and let's stick the IMF and the Treasury Department on that side. I might want to stick the World Bank on that side, but I don't think that you're comfortable that so let's not do that. On the other side let's stick what I call the global backlash, I would stick (inaudible) and others. So my question is there's you, there's Dani Rodrik, there's Soros, there's Jagdish Bhagwati, you're all floating around somewhere in between. Tell me where you actually are, who is with you and what is your prevailing paradigm. To what extent are you pushing for global Keynesianism and to what extent are you pushing for something beyond that?

JS: I think your clarifications were useful. The first point was that the difficulties with globalization are actually more than just the objections to the Washington Consensus. The Washington Consensus is a very important set of problems. That is what I called my third point, the particular version of capitalism that is being pushed. But there are problems with the inequities of the global regimes; as an example there are problems with market failures of the global regime that have not been addressed.

That is another example. So I think that the anti-globalization movement, if you want to call it that, is concerned not just with the problems of the Washington Consensus, it goes broader. The second point is the view should not be whether anti- or pro-globalization. The real issue is how to reshape globalization. I think that is really what my book is trying to do. What we ought to be trying to do is change the way globalization has been working, and it can and it has worked positively in some places. In that sense it is a fairly optimistic note.

One of the things that I tried to emphasize is that there are a variety of issues on which reasonable people can differ. The other way of putting it is that in fact there are lots of separate issues and there is no reason why people have to walk lock step. I think I put more emphasis on reforming the global reserve system than most other people do, but George Soros thinks that that also is very important. Jagdish Bhagwati and I both think that the intellectual property regime has some real problems, but he is much less concerned with some of the inequities. He wants to push trade liberalization, whereas I want to push trade liberalization but only if it is done in a symmetric way. I worry about the non-tariff barriers, like dumping, which have been significant impediment to real symmetric trade liberalization.

Question 2: Yes, my name is Kent Norton. I am interested in the views you have expressed but I was wondering if you could comment on how you think unilateralism might affect a country's desire to maintain this type of interdependence.

JS: That is a very good question and it really echoes the last point I was trying to raise, that as we move to greater interdependence we need to have rules. We need to have those rules, if they are going to have legitimacy democratically arrived at in some multilateral participatory way. The problem is that United States in its pursuit of unilateralism has undermined that and in doing that is undermining, I think in a very negative way, the whole process of globalization. And one has to remember that five years ago people used to say that globalization is inevitable. People almost talked about it like it was a medicine and you have to accept it. The first point was we don't just have to accept it, we can reshape it. But the second point is to remember that there was an era of globalization at the end of the 19th century/early 20th century that WWI reversed. When you mismanage globalization badly enough, it can be reversed.

Question 3: Yes Mr. Stiglitz I have a question. I would like to add to your litany of the discontents of globalization and perhaps add to that litany the impact of automobiles on the world. It seems to me that the automobile industry is choking the world in a number of ways, in terms of traffic congestion, in terms of accidents, in terms of pollution and in terms of destruction of public transportation. So I was wondering if you would care to add that or delete that from your list of discontents with globalization.

JS: Let me first put it in a broader context. I think the issue of the environment, the global environment, is a very serious issue, and I think the fact the United States walked away from the Kyoto agreement is another example of unilateralism that undermines globalization. Our pollution has adverse effects on people all over the world. Some people are talking about the United States as a rouge state. Everybody is agreeing on trying to keep pollution down and eliminating green house gases, yet the United States is unrestrained. Now in the beginning of the Clinton administration we tried to get through the BTU tax to use a market mechanism to try to control the level of pollution, not just of automobiles, but of all other activities that generate green-house gases.

Automobiles are a major pollutant, and I think that the kind of approach where you make it broad based, seems from an economic point of view, preferable. The problems of congestion and what happens to the inner cities, is also a very serious problem. And again I think that is another argument for taking actions like Singapore has done, where they put a very high fee for the use of the automobile, to try to reduce congestion. It is a classic example of an externality. Just to put this a little bit in context, one thing that can be said about international competition in this area is that the Japanese manufacturers have been much better about trying to reduce the level of pollution than the American manufacturers. There is a joke that some of you might have heard. Whenever there is a discussion of pollution and the U.S. Congress doing something about it, the Japanese manufacturers run to their engineers and say we have to get the energy efficiency up and the pollution down, while the American manufacturers run to their lawyers and say we have to stop the legislation.

Question 4: My name is Harvey Feigenbaum, I am one of the Associate Deans at the Elliott School. I just have a quick question. You have a reputation for being somewhat critical of some of your colleagues in economics and I would like to help you along with that. I am wondering if you might be able to speculate on why it is that so many of your colleagues can't seem to tell the difference between science and ideology.

JS: I don't fully know the answer, but let me emphasize how important the question is. What distinguishes science from ideology are two things. One of them is that the nature of science is that you recognize that there is uncertainty, that you recognize that there are some propositions that you know with a great deal of confidence, but there are many other propositions that you know without a great deal of confidence. When you are doing physics or chemistry you always talk about the margin of error. One of the real problems at the IMF and with some of my colleagues elsewhere is that they pretend they know certain propositions with greater confidence than the evidence would warrant. That has very serious consequences because when you go into a developing country or to any country and you give advice, you ought to let them

know the risks associated with different policies.

There is another aspect of that that I think also needs to be emphasized in an important way. Different policies have different consequences for different people. One of the things we talk about in the first chapter of principles of economics, at least in the good textbooks, like mine... is that there are trade offs. That means that as you think about trade offs you think about who benefits and who loses in different policy mixes. What is the implication of that? The implication is that there is not a single best policy.

In economics jargon, the question is, is there a pareto dominant policy, a policy that makes everybody else better off than any other policy. There almost never is a pareto dominant policy. There are almost always choices and the role of the economic advisor is to lay out the alternatives, to lay out the choices and the risks associated with those choices. That is true in developed as well as less developed countries. When economic advisors come in and say you should do this, they're actually not performing the role of the economic advisor they are really performing the role of the politician. The role of the economist is to lay out the alternatives, and the role of democratic political system is to make the choices. The role of the economist is to help them make those choices, by clarifying what the alternatives are, sometimes creatively thinking about new alternatives but then laying out the consequences.

One of the things that I have tried to do since I left the World Bank is create an institution called the Initiative for Policy Dialogue, which has received an enormous amount of support from a number foundations and a number of countries and has created a network of economists and social scientists around the world, North and South. It is trying precisely to do that, to lay out these alternatives and to say let's be clear about what economic science has to say about each of these alternatives. What degree of confidence should we have, and let's try to keep ideology out of the discussion. I think as economists we inevitably start moving into thinking about incentives, and what are the incentives for people to take particular positions. But that is a very dangerous area to go and I am not going to go into that area. I think that the bottom line that I wanted to emphasize is that that is really one of the real problems with the way globalization has been managed. We have tried to tell countries that they don't have choices, when in fact they do.

HA: Ladies and Gentleman that concludes the talk. Thank you very much for your presence; we hope to welcome you to GW again. Many many thanks once more to the Japan Automobile Manufacturers Association for their generous sponsorship, and especially to our guest of honor and speaker, Professor Stiglitz, who will now have something else to adorn his desk as a memento of his visit to GW.