Globalization and Its Discontents

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To my mother and father who taught me to care and reason,
and to Anya who put it all together and more

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PREFACE

IN 1993 I left academia to serve on the Council of Economic Advisers under President Bill Clinton. After years of research and teaching this was my first major foray into policy making, and more to the point, politics. From there I moved to the World Bank in 1997, where I served as chief economist and senior vice president for almost three years, leaving in January 2000. I couldn't have chosen a more fascinating time to go into policy making. I was in the White House as Russia began its transition from communism and I worked at the Bank during the financial crisis that began in East Asia in 1997 and eventually enveloped the world. I had always been interested in economic development and what I saw radically changed my views of both globalization and development. I have written this book because while I was at the World Bank, I saw firsthand the devastating effect that globalization can have on developing countries, and especially the poor within those countries. I believe that globalization—the removal of barriers to free trade and the closer integration of national economies—can be a force for good and that it has the *potential* to enrich everyone in the world, particularly the poor. But I also believe that if this is to be the case, the way globalization has been managed, including the international trade agreements that have played such a large role in removing those barriers and the policies that have been imposed on developing countries in the process of globalization, need to be radically rethought.

As a professor, I spent a lot of time researching and thinking about the economic and social issues I dealt with during my seven years in Washington. I believe it is important to view problems in a dispassionate way, to put aside ideology and to look at the evidence before making a decision about what is the best course of action. Unfortunately, though hardly surprisingly, in my time at the White House as a member and then chairman of the Council of Economic Advisers (a panel of three experts appointed by the president to provide economic advice in the executive branch of the U.S. government), and at the World Bank, I saw that decisions were often made because of ideology and politics. As a result many wrong-headed actions were taken, ones that did not solve the problem at hand but that fit with the interests or beliefs of the people in power. The French intellectual Pierre Bourdieu has written about the need for politicians to behave more like scholars and to engage in scientific debate, based on hard facts and evidence. Regrettably, the opposite happens too often, when academics involved in making policy recommendations become politicized and start to bend the evidence to fit the ideas of those in charge.

If my academic career did not prepare me for all that I encountered in Washington, DC, at least it did prepare me professionally. Before entering the White House, I had divided my time spent on research and writing between abstract mathematical economics (helping to develop a branch of economics that has since come to be called the economics of information), and more applied subjects, including the economics of the public sector, development, and monetary policy. I spent more than twenty-five years writing about subjects such as bankruptcy, corporate governance, and the openness of and access to information (what economists call *transparency*). These were crucial issues when the global financial crisis began in 1997. I had also been involved for nearly twenty years in discussions concerning transitions from Communist to market economies. My experience with how to handle such transitions began in 1980, when I first discussed these issues with leaders in China, as it was beginning its move toward a market economy. I had been a strong advocate of the gradualist policies adopted by the Chinese, policies that have proven their merit over the past two decades; and I have been a strong critic of some of the extreme reform strategies such as "shock therapy" that have failed so miserably in Russia and some of the other countries of the former Soviet Union.

My involvement in issues of development dates back even further—to the time I spent in Kenya on an academic posting (1969–71) shortly after its independence in 1963. Some of my most important theoretical work had been inspired by what I saw there. I knew the challenges facing Kenya were difficult, but I hoped that it might be possible to do something to improve the lives of the billions of people there and in the rest of the world who live in extreme poverty. Economics may seem like a dry, esoteric subject but, in fact, good economic policies have the power to change the lives of these poor people. I believe governments need to—and can—adopt policies that help countries grow but that also ensure that growth is shared more equitably. To take but one issue, I believe in privatization (selling off, say, government monopolies to private companies), but only if it helps companies become more efficient and lowers prices for consumers. This is more likely to happen if markets are competitive, which is one of the reasons I support strong competition policies.

Both at the World Bank and the White House, there was a close link between the policies I advocated and my earlier, largely theoretical work in economics, much of it related to market imperfections—why markets do not work perfectly, in the way that simplistic models which assume perfect competition and perfect information claim they do. I brought to policy making my work on the economics of information, in particular, on *asymmetries of information*—the differences in information between, say, the worker and his employer, the lender and the borrower, the insurance company and the insured. These asymmetries are pervasive in all economies. This work provided the foundations for more realistic theories of labor and financial markets, explaining, for instance, why there is unemployment and why those most in need of credit often cannot get it—there is, to use the economist's jargon, credit-rationing. The standard models that economists had used for generations argued either that markets worked perfectly—some even denied the existence of genuine unemployment—or that the only reason that unemployment existed was that wages were too high, suggesting the obvious remedy: lower wages. Information economics, with its better analyses of labor, capital, and product markets, enabled the construction of macroeconomic models that provided deeper insights into unemployment, models that explained the fluctuations, the recessions and depressions, that had marked capitalism since its beginnings. These theories have strong policy implications—some of which are obvious to almost anyone in touch with the real world—such as that if you raise interest rates to exorbitant levels, firms that are highly indebted can be forced into bankruptcy, and this will be bad for the economy. While I thought they were obvious, these policy prescriptions ran counter to those that were frequently insisted upon by the International Monetary Fund (IMF).

The IMF's policies, in part based on the outworn presumption that markets, by themselves, lead to efficient outcomes, failed to allow for desirable government interventions in the market, measures which can guide economic growth and make *everyone* better off. What was at issue, then, in many of the disputes that I describe in the following pages is a matter of *ideas*, and conceptions of the role of the government that derive from those ideas.

Although such ideas have had an important role in shaping policy prescriptions—in development, in managing crises, and in transition—they are also central to my thinking about reforming the international institutions that are supposed to drive economic development, manage crises, and facilitate economic transition. My research on information made me particularly attentive to the consequences of the lack of information. I was glad to see the emphasis during the global financial crisis in 1997–98 of the importance of transparency; but saddened by the hypocrisy that the institutions, the IMF and the U.S. Treasury, which emphasized it in East Asia, were among the least transparent that I had encountered in public life. This is why in the discussion of reform I emphasize the necessity for increased transparency, improving the information that citizens have about what these institutions do, allowing those who are affected by the policies to have a greater say in their formulation. The analysis of the role of information in *political* institutions evolved quite naturally from my earlier work on the role of information in economics.

One of the exciting aspects of coming to Washington was the opportunity not only to get a better understanding of how government works but also to put forward some of the perspectives to which my research had led. For instance, as chairman of Clinton's Council of Economic Advisers, I tried to forge an economic policy and philosophy that viewed the relationship between government and markets as complementary, both working in partnership, and recognized that while markets were at the center of the economy, there was an important, if limited, role for government to play. I had studied the failures of both markets *and* government, and was not so naive as to think that government could remedy every market failure. Neither was I so foolish as to believe that markets by themselves solved every societal problem. Inequality, unemployment, pollution: these were all issues in which government had to take an important role. I had worked on the initiative for "reinventing government"—making government more efficient and more responsive; I had seen where government was neither; I had seen how difficult reform is; but I had also seen that improvements, modest as they might be, were possible. When I moved to the World Bank, I had hoped to bring this balanced perspective, and the lessons I had learned, to the far more difficult problems facing the developing world.

Inside the Clinton administration, I enjoyed the political debate, winning some battles, losing others. As a member of the president's cabinet, I was well positioned not only to observe the debates and see how they were resolved but, especially in areas that touched upon economics, to participate in them. I knew that ideas mattered but so did politics, and one of my jobs was to persuade others not just that what I advocated was good economics but also that it was good politics. But as I moved to the international arena, I discovered that neither dominated the formulation of policy, especially at the International Monetary Fund. Decisions were made on the basis of what seemed a curious blend of ideology and bad economics, dogma that sometimes seemed to be thinly veiling special interests. When crises hit, the IMF prescribed outmoded, inappropriate, if "standard" solutions, without considering the effects they would have on the people in the countries told to follow these policies. Rarely did I see forecasts about what the policies would do to poverty. Rarely did I see thoughtful discussions and analyses of the consequences of alternative policies. There was a single prescription. Alternative opinions were not sought. Open, frank discussion was discouraged—there was no room for it. Ideology guided policy prescription and countries were expected to follow the IMF guidelines without debate.

These attitudes made me cringe. It was not just that they often produced poor results; they were antidemocratic. In our personal lives we would never follow ideas blindly without seeking alternative advice. Yet countries all over the world were instructed to do just that. The problems facing developing countries are difficult, and the IMF is often called upon in the worst of situations, when the country is facing a crisis. But its remedies failed as often, or even more often than they worked. IMF structural adjustment policies—the policies designed to help a country adjust to crises as well as to more persistent imbalances—led to hunger and riots in many countries; and even when results were not so dire, even when they managed to eke out some growth for a while, often the benefits went disproportionately to the better-off, with those at the bottom sometimes facing even greater poverty. What astounded me, however, was that those policies weren't questioned by many of the people in power in the IMF, by those who were making the critical decisions. They were often questioned by people in the developing countries, but many were so afraid they might lose IMF funding, and with it funding from others, that they articulated their doubts most cautiously, if at all, and then only in private. But while no one was happy about the suffering that often accompanied the IMF programs, inside the IMF it was simply assumed that whatever suffering occurred was a necessary part of the pain countries had to experience on the way to becoming a successful market economy, and that their measures would, in fact, reduce the pain the countries would have to face in the long run.

Undoubtedly, some pain was necessary; but in my judgment, the level of pain in developing countries created in the process of globalization and development as it has been guided by the IMF and the international economic organizations has been far greater than necessary. The backlash against globalization draws its force not only from the perceived damage done to developing countries by policies driven by ideology but also from the inequities in the global trading system. Today, few—apart from those with vested interests who benefit from keeping out the goods produced by the poor countries—defend the hypocrisy of pretending to help developing countries by forcing them to open up their markets to the goods of the advanced industrial countries while keeping their own markets protected, policies that make the rich richer and the poor more impoverished—and increasingly angry.

The barbaric attacks of September 11, 2001, have brought home with great force that we all share a single planet. We are a global community, and like all communities have to follow some rules so that we can live together. These rules must be—and must be seen to be—fair and just, must pay due attention to the poor as well as the powerful, must reflect a basic sense of decency and social justice. In today's world, those rules have to be arrived at through democratic processes; the rules under which the governing bodies and authorities work must ensure that they will heed and respond to the desires and needs of all those affected by policies and decisions made in distant places.

THIS BOOK IS based on my experiences. There aren't nearly as many footnotes and citations as there would be in an academic paper. Instead, I tried to describe the events I witnessed and tell some of the stories that I heard. There are no smoking guns here. You won't find hard evidence of a terrible conspiracy by Wall Street and the IMF to take over the world. I don't believe such a conspiracy exists. The truth is subtler. Often it's a tone of voice, or a meeting behind closed doors, or a memo that determines the outcome of discussions. Many of the people I criticize will say I have gotten it wrong; they may even produce evidence that contradicts my views of what happened. I can only offer my interpretation of what I saw.

When I joined the World Bank, I had intended to spend most of my time on issues of development and the problems of the countries trying to make the transition to a market economy; but the global financial crisis and the debates about reforming the international economic architecture—the system by which the international economic and financial system are governed—in order to make globalization more humane, effective, and equitable occupied a large fraction of my time. I visited dozens of countries all over the world and spoke to thousands of government officials, finance ministers, central bank governors, academics, development workers, people at nongovernmental organizations (NGOs), bankers, business people, students, political activists, and farmers. I visited Islamic guerrillas in Mindanao (the Philippine island which has long been in a state of rebellion), trekked through the Himalayas to see remote schools in Bhutan or a village irrigation project in Nepal, saw the impact of rural credit schemes and programs for mobilizing women in Bangladesh, and witnessed the impact of programs to reduce poverty in villages in some of the poorest mountainous parts of China. I saw history being made and I learned a lot. I have tried to distill the essence of what I saw and learned and present it in this book.

I hope my book will open a debate, a debate that should occur not just behind the closed doors of government and the international organizations, or even in the more open atmosphere of universities. Those whose lives will be affected by the decisions about how globalization is managed have a right to participate in that debate, and they have a right to know how such decisions have been made in the past. At the very least, this book should provide more information about the events of the past decade. More information will surely lead to better policies and those will lead to better results. If that happens, then I will feel I have made a contribution.

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THERE IS AN ENDLESS list of those to whom I am greatly indebted, without whom this book could not be written: President Bill Clinton and World Bank President Jim Wolfensohn, in giving me opportunities to serve my country and the peoples of the developing world, also gave me an opportunity, relatively rare for an academic, to glimpse decision making that affects all of our lives. I am indebted to hundreds of colleagues at the World Bank, not only for the vigorous discussions that we had over the years about all the issues discussed in this book but for sharing with me their years of experience in the field. They also helped arrange the many trips through which I could get unique perspectives on what was happening in the developing countries. I hesitate to single out anyone, lest I slight others, but at the same time I would be remiss if I did not acknowledge at least some of those with whom I worked most closely, including Masood Ahmed, Lucie Albert, Amar Bhattacharya, Francois Bourgignon, Gerard Caprio, Ajay Chhibber, Uri Dadush, Carl Dahlman, Bill Easterly, Giovanni Ferri, Coralie Gevers, Noemi Giszpenc, Maria Ionata, Roumeen Islam, Anupam Khanna, Lawrence MacDonald, Ngozi Ojonjo-Iweala, Guillermo Perry, Boris Pleskovic, Jo Ritzen, Halsey Rogers, Lyn Squire, Vinod

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I am also grateful to the numerous government officials in the developing countries, from large countries like China and India to small countries like Uganda and Bolivia, from prime ministers and

heads of state to finance ministers and central bank governors, to education ministers and other cabinet officials on down, who willingly shared their time to discuss with me their visions for their countries, as well as the problems and frustrations they faced. In our long meetings, they often talked to me in confidence. Many of those, such as Vaclav Klaus, the former prime minister of the Czech Republic, would disagree with much that I have to say, yet I learned a great deal from talking to them. Others, such as Andrei Illarionov, currently Putin's chief economic adviser, and Grzegorz W. Kolodko, former deputy prime minister and finance minister of Poland, Meles Zenawi, prime minister of Ethiopia, or Yoweri Museveni, president of Uganda, would be sympathetic with much, if not most, of what I have to say. Some of those at the international economic organizations who have been helpful have also asked me not to thank them, and I have honored their request.

While much of my time was spent in discussions with government officials, I was also able to meet large numbers of businessmen, who also gave of their time as they described the challenges that they faced and provided their interpretations of what was going on in their countries. While it is difficult to single out any single individual, I should mention Howard Golden, whose detailed descriptions of experiences in a multitude of countries were particularly insightful.

As an academic, I had my own entrée into the countries I visited, so I could see matters from perspectives that were not dictated by "official positions." This book owes a great deal to this global network of academic colleagues—one of the healthier aspects of globalization. I am particularly indebted to my colleagues at Stanford, Larry Lau, at the time head of the Asia Pacific Center, Masa Aoki, currently research director at the Ministry of Economics and International Trade in Japan, and Yingyi Qian, not only for the insights that they provided into Asia but for the many doors they opened. Over the years, academic colleagues and former students such as Jungyoll Yun in Korea, Mrinal Datta Chaudhuri in India, K. S. Jomo in Malaysia, Justin Lin in China, and Amar Siamwalla in Thailand helped me see and understand their countries.

The hectic years at the World Bank and the Council of Economic Advisers have been followed by a more reflective period of research and teaching. I am deeply indebted to the Brookings Institution, Stanford, and Columbia—and my students and colleagues at those institutions—for invaluable discussions on the ideas contained here, and to my associates Ann Florini and Tim Kessler, who worked with me to create the Initiative for Policy Dialogue, originally centered at Stanford University, and the Carnegie Endowment for Peace, now located at Columbia University (www.gsb.edu/ipd), to promote the kind of informed democratic discussion of alternative policies that I call for in this book During this period, financial support has also been provided by the Ford, MacArthur, and Rockefeller Foundations, the UNDP, the Canadian International Development Agency, and the UNDP.

In writing a book like this, while I have relied mostly on my own experiences, those have been amplified not only by my colleagues but by a host of reporters. A theme in this book that I hope has some resonance is the importance of open access to *information*: many of the problems I describe arise because so much goes on behind closed doors. I have always believed that an active and free press is a critical check on these abuses and is necessary for democracy, and many of the reporters with whom I dealt regularly were dedicated to that mission. I learned much from them, as we shared our interpretation of the events that were occurring. Again, at the risk of singling out a couple when so many should be recognized: Chrystia Freeland was a huge help with the Russia chapter, and Paul Blustein and Mark Clifford provided valuable insights on the East Asian experience.

Economics is the science of choice. From the wealth of insights and information, on the subjects as complicated and fascinating as those discussed here, volumes could be written. Unfortunately, that was one of my main challenges in writing this book: the volumes I did write had to be shaped into a far shorter narrative. I had to let go of some of the ideas and skip some of the qualifications, as important as I thought they were. I had grown accustomed to two forms of writing: serious academic tomes and brief popular speeches. This work represents, for me, a new genre. It could not have been published without the tireless efforts of Anya Schiffrin, who spent months working with me on the writing and the revisions, helping me make those hard choices, as painful as they sometimes seemed.

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This work rests on a considerable body of academic work, both my own, in conjunction with a large number of coauthors, and that of others, again too numerous to cite. I have also benefited from innumerable discussions with colleagues around the world. I should mention Professor Robert Wade of the London School of Economics, a former World Bank staff member, who has written insightfully not only about the general problems of the international economic institutions but also about several of the specific topics covered here, East Asia and Ethiopia. The transition from Communism to a market economy has been a subject that has engaged the interest of academic economists greatly over the past fifteen years. I have benefited in particular from Janos Kornai's insights. I should also mention four other leading scholars: Peter Murrell, Jan Svejnar, Marshall Goldman, and Gerard Roland. A central theme of this book is the value of open debate, and I have learned much from discussions with and reading those whose interpretations of events I sometimes, perhaps often, disagree with—in particular Richard Layard, Jeff Sachs, Anders Aslund, and Andrei Shleifer. I have also benefited from discussions with a multitude of academicians in the economies in transition, including Oleg Bogomolov and Stanislav Menshikov in Russia.

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Globalization and Its Discontents

The Promise of Global Institutions

INTERNATIONAL BUREAUCRATS—THE faceless symbols of the world economic order—are under attack everywhere. Formerly uneventful meetings of obscure technocrats discussing mundane subjects such as concessional loans and trade quotas have now become the scene of raging street battles and huge demonstrations. The protests at the Seattle meeting of the World Trade Organization in 1999 were a shock. Since then, the movement has grown stronger and the fury has spread. Virtually every major meeting of the International Monetary Fund, the World Bank, and the World Trade Organization is now the scene of conflict and turmoil. The death of a protestor in Genoa in 2001 was just the beginning of what may be many more casualties in the war against globalization.

Riots and protests against the policies of and actions by institutions of globalization are hardly new. For decades, people in the developing world have rioted when the austerity programs imposed on their countries proved to be too harsh, but their protests were largely unheard in the West. What is new is the wave of protests in the developed countries.

It used to be that subjects such as structural adjustment loans (the programs that were designed to help countries adjust to and weather crises) and banana quotas (the limits that some European countries