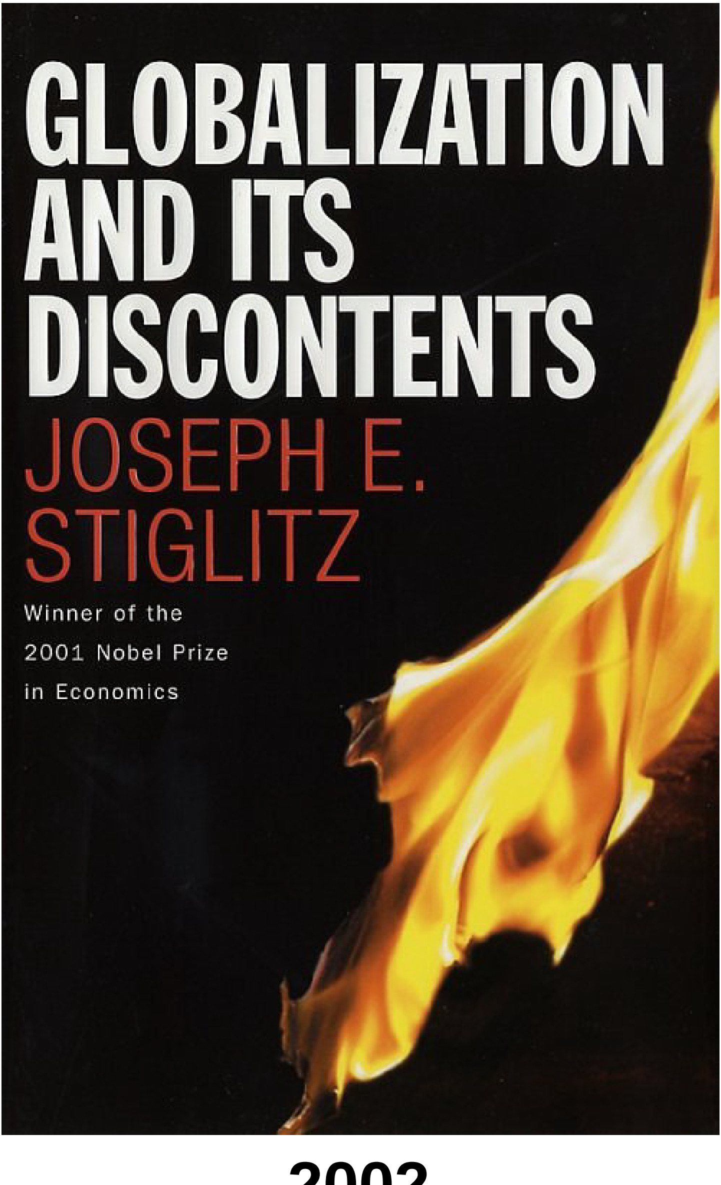
GLOBALIZATION AND ITS DISCONTENTS
JOSEPH E. STIGLITZ
Winner of the 2001 Nobel Prize in Economics

2002

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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.

ACKNOWLEDGMENTS

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

Thomas, Maya Tudor, Mike Walton, Shahid Yusuf, and Hassan Zaman.

Others at the World Bank whom I would like to thank include Martha Ainsworth, Myrna Alexander, Shaida Badiee, Stijn Claessens, Paul Collier, Kemal Dervis, Dennis de Tray, Shanta Devarajan, Ishac Diwan, David Dollar, Mark Dutz, Alan Gelb, Isabel Guerrero, Cheryl Gray, Robert Holzman, Ishrat Husain, Greg Ingram, Manny Jimenez, Mats Karlsson, Danny Kaufman, Ioannis Kessides, Homi Kharas, Aart Kray, Sarwar Lateef, Danny Leipziger, Brian Levy, Johannes Linn, Oey Astra Meesook, Jean-Claude Milleron, Pradeep Mitra, Mustapha Nabli, Gobind Nankani, John Nellis, Akbar Noman, Fayez Omar, John Page, Guy Pfeffermann, Ray Rist, Christof Ruehl, Jessica Seddon, Marcelo Selowski, Jean Michel Severino, Ibrahim Shihata, Sergio Shmuckler, Andres Solimano, Eric Swanson, Marilou Uy, Tara Viswanath, Debbie Wetzel, David Wheeler, and Roberto Zagha.

I am also indebted to the many people in the other international economic organizations with whom I discussed the numerous issues that are reflected upon here—including Rubens Ricupero at UNCTAD (the UN Conference on Trade and Development); Marc Malloch Brown at the UNDP; Enrique Iglesias, Nancy Birdsall, and Ricardo Haussman at the Inter-American Development Bank; Jacques de Larosière, the former head of theEuropean Bank for Reconstruction and Development; and a host of others at the UN regional offices and the Asian and African Development Banks. Next to my colleagues at the World Bank, I perhaps interacted more with those at the IMF, and, while it will be clear from the ensuing pages that I often disagreed with much of what they did and how they went about doing it, I learned much from them and the long discussions we had, not the least of which was a better understanding of *their* mind-sets. I should also be clear: while I am highly critical, I also appreciate the hard work that they put in, the difficult circumstances under which they work, and their willingness at a personal level to have far more open and free discussions than they can at an official level.

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.

Drake McFeely—my editor for twenty years—encouraged and supported me throughout. Sarah Stewart's edits were terrific, Jim Wade worked tirelessly to pull the final manuscript together, and Eve Lazovitz offered important support at several key stages.

Nadia Roumani has been my right-hand woman for years. Nothing would be possible without her. Sergio Godoy and Monica Fuentes diligently checked the facts and found the statistics I needed. Leah Brooks helped a lot with the earlier drafts. Niny Khor and Ravi Singh, my research assistants at Stanford, worked hard on the penultimate version.

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.

Steve Lewis, Peter Eigen, and Charles Harvey all provided me with insights into Botswana from their firsthand experiences, and Charles Harvey gave me detailed comments on chapter 2. Over the years, work and discussions with Nick Stern (who succeeded me at the World Bank after serving as chief economist at the EBRD), Partha Dasgupta, Ravi Kanbur (who was responsible for the landmark World Development Report on Poverty of 2001, initiated

while I was still chief economist at the World Bank), Avi Braverman (now president of Ben-Gurion University but a longtime researcher at the World Bank), Karla Hoff, Raaj Sah, David Bevan, Mark Gersovitz, David Newbery, Jim Mirrlees, Amartya Sen, and David Ellerman have been particularly influential in shaping my thinking. I am particularly indebted to Andy Weiss for his practical insights into the problems of transition, for his empirical analyses of the consequences of privatization, and for his broader insights into capital market imperfections. My earlier work on East Asia for the World Bank, done with Marilou Uy, in conjunction with, among others, Howard Pack, Nancy Birdsall, Danny Leipziger, and Kevin Murdoch, provided me with insights into the region that put me in good stead in dealing with the crisis when it occurred. I owe an especial debt of gratitude to Jason Furman, who worked with me both at the White House and at the World Bank, for all his work, but especially that on East Asia and the critique of the Washington Consensus. Thanks are due to Hal Varian for suggesting the title. Anyone who reads this book will also see clearly the influence of ideas concerning imperfect information and markets—central, I believe, for understanding how any market economy works, but especially developing ones. Work with Carl Shapiro, Michael Rothschild, Sandy Grossman, Steve Salop, and Richard Arnott helped provide insights into unemployment, capital market imperfections, the limitations of competition, and the importance—and limitations—of institutions. At the end of it all, there is always Bruce Greenwald—my collaborator and friend for more than twenty-five years.

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 impose on the importing of bananas from countries other than their former colonies) were of interest to only a few. Now sixteen-year-old kids from the suburbs have strong opinions on such esoteric treaties as GATT (the General Agreement on Tariffs and Trade) and NAFTA (the North American Free Trade Area, the agreement signed in 1992 between Mexico, United States, and Canada that allows for the freer movement of goods, services, and investment—but not people—among those countries). These protests have provoked an enormous amount of soul-searching from those in power. Even conservative politicians such as France's president, Jacques Chirac, have expressed concern that globalization is not making life better for those most in need of its promised benefits.[1] It is clear to almost everyone that something has gone horribly wrong. Almost overnight, globalization has become the most pressing issue of our time, something debated from boardrooms to op-ed pages and in schools all over the world.

WHY HAS GLOBALIZATION—a force that has brought so much good—become so controversial? Opening up to international trade has helped many countries grow far more quickly than they would otherwise have done. International trade helps economic development when a country's exports drive its economic growth. Export-led growth was the centerpiece of the industrial policy that enriched much of Asia and left millions of people there far better off. Because of globalization many people in the world now live longer than before and their standard of living is far better. People in the West may regard low-paying jobs at Nike as exploitation, but for many people in the developing world, working in a factory is a far better option than staying down on the farm and growing rice.

Globalization has reduced the sense of isolation felt in much of the developing world and has given many people in the developing countries access to knowledge well beyond the reach of even the wealthiest in any country a century ago. The antiglobalization protests themselves are a result of this connectedness. Links between activists in different parts of the world, particularly those links forged through Internet communication, brought about the pressure that resulted in the international landmines treaty—despite the opposition of many powerful governments. Signed by 121 countries as of 1997, it reduces the likelihood that children and other innocent victims will be maimed by mines. Similar, well-orchestrated public pressure forced the international community to forgive the debts of some of the poorest countries. Even when there are negative sides to globalization, there are often benefits. Opening up the Jamaican milk market to U.S. imports in 1992 may have hurt local dairy farmers but it also meant poor children could get milk more cheaply. New foreign firms may hurt protected state-owned enterprises but they can also lead to the introduction of new technologies, access to new markets, and the creation of new industries.

Foreign aid, another aspect of the globalized world, for all its faults still has brought benefits to millions, often in ways that have almost gone unnoticed: guerrillas in the Philippines were provided jobs by a World Bank–financed project as they laid down their arms; irrigation projects have more than doubled the incomes of farmers lucky enough to get water; education projects have brought literacy to the rural areas; in a few countries AIDS projects have helped contain the spread of this deadly disease.

Those who vilify globalization too often overlook its benefits. But the proponents of globalization have been, if anything, even more unbalanced. To them, globalization (which typically is associated with accepting triumphant capitalism, American style) *is* progress; developing countries must accept it, if they are to grow and to fight poverty effectively. But to many in the developing world, globalization has not brought the promised economic benefits.

A growing divide between the haves and the have-nots has left increasing numbers in the Third World in dire poverty, living on less than a dollar a day. Despite repeated promises of poverty reduction made over the last decade of the twentieth century, the actual number of people living in poverty has actually increased by almost 100 million.[2] This occurred at the same time that total world income actually increased by an average of 2.5 percent annually.

In Africa, the high aspirations following colonial independence have been largely unfulfilled. Instead, the continent plunges deeper into misery, as incomes fall and standards of living decline. The hard-won improvements in life expectancy gained in the past few decades have begun to reverse. While the scourge of AIDS is at the center of this decline, poverty is also a killer. Even countries that have abandoned African socialism, managed to install reasonably honest governments, balanced their budgets, and kept inflation down find that they simply cannot attract private investors. Without this investment, they cannot have sustainable growth.

If globalization has not succeeded in reducing poverty, neither has it succeeded in ensuring stability. Crises in Asia and in Latin America have threatened the economies and the stability of all developing countries. There are fears of financial contagion spreading around the world, that the collapse of one emerging market currency will mean that others fall as well. For a while, in 1997 and 1998, the Asian crisis appeared to pose a threat to the entire world economy.

Globalization and the introduction of a market economy has not produced the promised results in Russia and most of the other economies making the transition from communism to the market. These countries were told by the West that the new economic system would bring them unprecedented prosperity. Instead, it brought unprecedented poverty: in many respects, for most of the people, the market economy proved even worse than their Communist leaders had predicted. The contrast between Russia's transition, as engineered by the international economic institutions, and that of China, designed by itself, could not be greater: While in 1990 China's gross domestic product (GDP) was 60 percent that of Russia, by the end of the decade the numbers had been reversed. While Russia saw an unprecedented increase in poverty, China saw an unprecedented decrease.

The critics of globalization accuse Western countries of hypocrisy, and the critics are right. The Western countries have pushed poor countries to eliminate trade barriers, but kept up their own barriers, preventing developing countries from exporting their agricultural products and so depriving them of desperately needed export income. The United States was, of course, one of the prime culprits, and this was an issue about which I felt intensely. When I was chairman of the Council of Economic Advisers, I fought hard against this hypocrisy. It not only hurt the developing countries; it also cost Americans, both as consumers, in the higher prices they paid, and as taxpayers, to finance the huge subsidies, billions of dollars. My struggles were, all too often, unsuccessful. Special commercial and financial interests prevailed—and when I moved over to the World Bank, I saw the consequences to the developing countries all too clearly.

But even when not guilty of hypocrisy, the West has driven the globalization agenda, ensuring that it garners a disproportionate share of the benefits, at the expense of the developing world. It was not just that the more advanced industrial countries declined to open up their markets to the goods of the developing countries—for instance, keeping their quotas on a multitude of goods from textiles to sugar—while insisting that those countries open up their markets to the goods of the wealthier countries; it was not just that the more advanced industrial countries continued to subsidize agriculture, making it difficult for the developing countries to compete, while insisting that the developing countries eliminate their subsidies on industrial goods. Looking at the "terms of trade"—the prices which developed and less developed countries get for the products they produce—after the last trade agreement in 1995 (the eighth), the *net* effect was to lower the prices some of the poorest countries in the world received relative to what they paid for their imports.* The result was that some of the poorest countries in the world were actually made worse off.

Western banks benefited from the loosening of capital market controls in Latin America and Asia, but those regions suffered when inflows of speculative hot money (money that comes into and out of a country, often overnight, often little more than betting on whether a currency is going to appreciate or depreciate) that had poured into countries suddenly reversed. The abrupt outflow of money left behind collapsed currencies and weakened banking systems. The Uruguay Round also strengthened intellectual property rights.

*This eighth agreement was the result of negotiations called the *Uruguay Round* because the negotiations began in 1986 in Punta del Este, Uruguay. The round was concluded in Marrakech on December 15, 1993, when 117 countries joined in this trade liberalization agreement. The agreement was finally signed for the United States by President Clinton on December 8, 1994. The World Trade Organization came into formal effect on January 1, 1995, and over 100 nations had signed on by July. One provision of the agreement entailed converting the GATT into the WTO.

American and other Western drug companies could now stop drug companies in India and Brazil from "stealing" their intellectual property. But these drug companies in the developing world were making these life-saving drugs available to their citizens at a fraction of the price at which the drugs were sold by the Western drug companies. There were thus two sides to the decisions made in the Uruguay Round. Profits of the Western drug companies would go up. Advocates said this would provide them more incentive to innovate; but the increased profits from sales in the developing world were small, since few could afford the drugs, and hence the incentive effect, at best, might be limited. The other side was that thousands were effectively condemned to death, because governments and individuals in developing countries could no longer pay the high prices demanded. In the case of AIDS, the international outrage was so great that drug companies had to back down, eventually agreeing to lower their prices, to sell the drugs at cost in late 2001. But the underlying problems—the fact that the intellectual property regime established under the Uruguay Round was not balanced, that it overwhelmingly reflected the interests and perspectives of the producers, as opposed to the users, whether in developed or developing countries—remain.

Not only in trade liberalization but in every other aspect of globalization even seemingly well-intentioned efforts have often backfired. When projects, whether agriculture or infrastructure, recommended by the West, designed with the advice of Western advisers, and financed by the World Bank or others have failed, unless there is some form of debt forgiveness, the poor people in the developing world still must repay the loans.

If, in too many instances, the benefits of globalization have been less than its advocates claim, the price paid has been greater, as the environment has been destroyed, as political processes have been corrupted, and as the rapid pace of change has not allowed countries time for cultural adaptation. The crises that have brought in their wake massive unemployment have, in turn, been followed by longer-term problems of social dissolution—from urban violence in Latin America to ethnic conflicts in other parts of the world, such as Indonesia.

These problems are hardly new—but the increasingly vehement worldwide reaction against the policies that drive globalization is a significant change. For decades, the cries of the poor in Africa and in developing countries in other parts of the world have been largely unheard in the West. Those who labored in the developing countries knew something was wrong when they saw financial crises becoming more commonplace and the numbers of poor increasing. But they had no way to change the rules or to influence the international financial institutions that wrote them. Those who valued democratic processes saw how "conditionality"—the conditions that international lenders imposed in return for their assistance—undermined national sovereignty. But until the protestors came along there was little hope for change and no outlets for complaint. *Some* of the protestors went to excesses; *some* of the protestors were arguing for higher protectionist barriers against the developing countries, which would have made their plight even worse. But despite these problems, it is the trade unionists, students, environmentalists—ordinary citizens—marching in the streets of Prague, Seattle, Washington, and Genoa who have put the need for reform on the agenda of the developed world.

Protestors see globalization in a very different light than the treasury secretary of the United States, or the finance and trade ministers of most of the advanced industrial countries. The differences in views are so great that one wonders, are the protestors and the policy makers talking about the same phenomena? Are they looking at the same data? Are the visions of those in power so clouded by special and particular interests?

What is this phenomenon of globalization that has been subject, at the same time, to such vilification and such praise? Fundamentally, it is the closer integration of the countries and peoples of the world which has been brought about by the enormous reduction of costs of transportation and communication, and the breaking down of artificial barriers to the flows of goods, services, capital, knowledge, and (to a lesser extent) people across borders. Globalization has been accompanied by the creation of new institutions that have joined with existing ones to work across borders. In the arena of international civil society, new groups, like the Jubilee movement pushing for debt reduction for the poorest countries, have joined long-established organizations like the International Red Cross. Globalization is powerfully driven by international corporations, which move not only capital and goods across borders but also technology. Globalization has also led to renewed attention to long-established international *intergovernmental* institutions: the United Nations, which attempts to maintain peace; the International Labor Organization (ILO), originally created in 1919, which promotes its agenda around the world under its slogan "decent work"; and the World Health Organization (WHO), which has been especially concerned with improving health conditions in the developing world.

Many, perhaps most, of these aspects of globalization have been welcomed everywhere. No one wants to see their child die, when knowledge and medicines are available somewhere else in the world. It is the more narrowly defined *economic* aspects of globalization that have been the subject of controversy, and the international institutions that have written the rules, which mandate or push things like liberalization of capital markets (the elimination of the rules and regulations in many developing countries that are designed to stabilize the flows of volatile money into and out of the country).

To understand what went wrong, it's important to look at the three main institutions that govern globalization: the IMF, the World Bank, and the WTO. There are, in addition, a host of other institutions that play a role in the international economic system—a number of regional banks, smaller and younger sisters to the World Bank, and a large number of UN organizations, such as the UN Development Program or the UN Conference on Trade and Development (UNCTAD). These organizations often have views that are markedly different from the IMF and the World Bank. The ILO, for example, worries that the IMF pays too little attention to workers' rights, while the Asian Development Bank argues for "competitive pluralism," whereby developing countries will be provided with alternative views of development strategies, including the "Asian model"—in which governments, while relying on markets, have taken an active role in creating, shaping, and guiding markets, including promoting new technologies, and in which firms take considerable responsibility for the social welfare of their employees—which the Asian Development Bank sees as distinctly different from the American model pushed by the Washington-based institutions.

In this book, I focus mostly on the IMF and the World Bank, largely because they have been at the center of the major economic issues of the last two decades, including the financial crises and the transition of the former Communist countries to market economies. The IMF and the World Bank both originated in World War II as a result of the UN Monetary and Financial Conference at Bretton Woods, New Hampshire, in July 1944, part of a concerted effort to finance the rebuilding of Europe after the devastation of World War II and to save the world from future economic depressions. The proper name of the World Bank—the International Bank for Reconstruction and Development—reflects its original mission; the last part, "Development," was added almost as an afterthought. At the time, most of the countries in the developing world were still colonies, and what meager economic development efforts could or would be undertaken were considered the responsibility of their European masters.

The more difficult task of ensuring global economic stability was assigned to the IMF. Those who convened at Bretton Woods had the global depression of the 1930s very much on their minds. Almost three quarters of a century ago, capitalism faced its most severe crisis to date. The Great Depression enveloped the whole world and led to unprecedented increases in unemployment. At the worst point, a quarter of America's workforce was unemployed. The British economist John Maynard Keynes, who would later be a key participant at Bretton Woods, put forward a simple explanation, and a correspondingly simple set of prescriptions: lack of sufficient aggregate demand explained economic downturns; government policies could help stimulate aggregate demand. In cases where monetary policy is ineffective, governments could rely on fiscal policies, either by increasing expenditures or cutting taxes. While the models underlying Keynes's analysis have subsequently been criticized and refined, bringing a deeper understanding of why market forces do not work quickly to adjust the economy to full employment, the basic lessons remain valid.

The International Monetary Fund was charged with preventing another global depression. It would do this by putting international pressure on countries that were not doing their fair share to maintain global aggregate demand, by allowing their own economies to go into a slump. When necessary it would also provide liquidity in the form of loans to those countries facing an economic downturn and unable to stimulate aggregate demand with their own resources.

In its original conception, then, the IMF was based on a recognition that markets often did not work well—that they could result in massive unemployment and might fail to make needed funds available to countries to help them restore their economies. The IMF was founded on the belief that there was a need for *collective action at the global level* for economic stability, just as the United Nations had been founded on the belief that there was a need for collective action at the global level for political stability. The IMF is a *public* institution, established with money provided by taxpayers around the world. This is important to remember because it does not report directly to either the citizens who finance it or those whose lives it affects. Rather, it reports to the ministries of finance and the central banks of the governments of the world. They assert their control through a complicated voting arrangement based largely on the economic power of the countries at the end of World War II. There have been some minor adjustments since, but the major developed countries run the show, with only one country, the United States, having effective veto. (In this sense, it is similar to the UN, where a historical anachronism determines who holds the veto—the victorious powers of World War II—but at least there the veto power is shared among five countries.)

Over the years since its inception, the IMF has changed markedly. Founded on the belief that markets often worked badly, it now champions market supremacy with ideological fervor. Founded on the belief that there is a need for international pressure on countries to have more expansionary economic policies—such as increasing expenditures, reducing taxes, or lowering interest rates to stimulate the economy—today the IMF typically provides funds only if countries engage in policies like cutting deficits, raising taxes, or raising interest rates that lead to a contraction of the economy. Keynes would be rolling over in his grave were he to see what has happened to his child.

The most dramatic change in these institutions occurred in the 1980s, the era when Ronald Reagan and Margaret Thatcher preached free market ideology in the United States and the United Kingdom. The IMF and the World Bank became the new missionary institutions, through which these ideas were pushed on the reluctant poor countries that often badly needed their loans and grants. The ministries of finance in poor countries were willing to become converts, if necessary, to obtain the funds, though the vast majority of government officials, and, more to the point, people in these countries often remained skeptical. In the early 1980s, a purge occurred inside the World Bank, in its research department, which guided the Bank's thinking and direction. Hollis Chenery, one of America's most distinguished development economists, a professor at Harvard who had made fundamental contributions to research in the economics of development and other areas as well, had been Robert McNamara's confidant and adviser. McNamara had been appointed president of the World Bank in 1968. Touched by the poverty that he saw throughout the Third World, McNamara had redirected the Bank's effort at its elimination, and Chenery assembled a first-class group of economists from around the world to work with him. But with the changing of the guard came a new president in 1981, William Clausen, and a new chief economist, Ann Krueger, an international trade specialist, best known for her work on "rent seeking"—how special interests use tariffs and other protectionist measures to increase their incomes at the expense of others. While Chenery and his team had focused on how markets failed in developing countries and what governments could do to improve markets and reduce poverty, Krueger saw government as the problem. Free markets were the solution to the problems of developing countries. In the new ideological fervor, many of the first-rate economists that Chenery had assembled left.

Although the missions of the two institutions remained distinct, it was at this time that their activities became increasingly intertwined.

In the 1980s, the Bank went beyond just lending for projects (like roads and dams) to providing broad-based support, in the form of *structural adjustment loans;* but it did this only when the IMF gave its approval—and with that approval came IMF-imposed conditions on the country. The IMF was supposed to focus on crises; but developing countries were always in need of help, so the IMF became a permanent part of life in most of the developing world.

The fall of the Berlin Wall provided a new arena for the IMF: managing the transition to a market economy in the former Soviet Union and the Communist bloc countries in Europe. More recently, as the crises have gotten bigger, and even the deep coffers of the IMF seemed insufficient, the World Bank was called in to provide tens of billions of dollars of emergency support, but strictly as a junior partner, with the guidelines of the programs dictated by the IMF. In principle, there was a division of labor. The IMF was supposed to limit itself to matters of *macroeconomics* in dealing with a country, to the government's budget deficit, its monetary policy, its inflation, its trade deficit, its borrowing from abroad; and the World Bank was supposed to be in charge of *structural issues*—what the country's government spent money on, the country's financial institutions, its labor markets, its trade policies. But the IMF took a rather imperialistic view of the matter: since almost any structural issue could affect the overall performance of the economy, and hence the government's budget or the trade deficit, it viewed almost everything as falling within its domain. It often got impatient with the World Bank, where even in the years when free market ideology reigned supreme there were frequent controversies about what policies would best suit the conditions of the country. The IMF had the answers (basically, the same ones for every country), didn't see the need for all this discussion, and, while the World Bank debated what should be done, saw itself as stepping into the vacuum to provide the answers.

The two institutions could have provided countries with alternative perspectives on some of the challenges of development and transition, and in doing so they might have strengthened democratic processes. But they were both driven by the collective will of the G-7 (the governments of the seven most important advanced industrial countries),* and especially their finance ministers and treasury secretaries, and too often, the last thing they wanted was a lively democratic debate about alternative strategies.

A half century after its founding, it is clear that the IMF has failed in its mission. It has not done what it was supposed to do—provide funds for countries facing an economic downturn, to enable the country to restore itself to close to full employment. In spite of the fact that our understanding of economic processes has increased enormously during the last fifty years, and in spite of IMF's efforts during the past quarter century, crises around the world have been more frequent and (with the exception of the Great Depression) deeper. By some reckonings, close to a hundred countries have faced crises.[3] Worse, many of the policies that the IMF pushed, in particular, premature capital market liberalization, have contributed to global instability. And once a country was in crisis, IMF funds and programs not only failed to stabilize the situation but in many cases actually made matters worse, especially for the poor. The IMF failed in its original mission of promoting global stability; it has also been no more successful in the new missions that it has undertaken, such as guiding the transition of countries from communism to a market economy.

The Bretton Woods agreement had called for a third international economic organization—a World Trade Organization to govern international trade relations, a job similar to the IMF's governing of international financial relations. Beggar-thy-neighbor trade policies, in which countries raised tariffs to maintain their own economies but at the expense of their neighbors, were largely blamed for the spread of the depression and its depth. An international organization was required not just to prevent a recurrence but to encourage the free flow of goods and services. Although the General Agreement on

*These are the United States, Japan, Germany, Canada, Italy, France, and the UK. Today, the G-7 typically meets together with Russia (the G-8). The seven countries are no longer the seven largest economies in the world. Membership in the G-7, like permanent membership in the UN Security Council, is partly a matter of historical accident.

Tariffs and Trade (GATT) did succeed in lowering tariffs enormously, it was difficult to reach the final accord; it was not until 1995, a half century after the end of the war and two thirds of a century after the Great Depression, that the World Trade Organization came into being. But the WTO is markedly different from the other two organizations. It does not set rules itself; rather, it provides a forum in which trade negotiations go on and it ensures that its agreements are lived up to.

The ideas and intentions behind the creation of the international economic institutions were good ones, yet they gradually evolved over the years to become something very different. The Keynesian orientation of the IMF, which emphasized market failures and the role for government in job creation, was replaced by the free market mantra of the 1980s, part of a new "Washington Consensus"—a consensus between the IMF, the World Bank, and the U.S. Treasury about the "right" policies for developing countries—that signaled a radically different approach to economic development and stabilization.

Many of the ideas incorporated in the consensus were developed in response to the problems in Latin America, where governments had let budgets get out of control while loose monetary policies had led to rampant inflation. A burst of growth in some of that region's countries in the decades immediately after World War II had not been sustained, allegedly because of excessive state intervention in the economy. The ideas that were developed to cope with problems arguably specific to Latin American countries, and which I will outline later in the book, subsequently been deemed applicable to countries around the world. Capital market liberalization has been pushed despite the fact that there is no evidence showing it spurs economic growth. In other cases, the economic policies that evolved into the Washington Consensus and were introduced into developing countries were not appropriate for countries in the early stages of development or early stages of transition.

To take just a few examples, most of the advanced industrial countries—including the United States and Japan—had built up their economies by wisely and selectively protecting some of their industries until they were strong enough to compete with foreign companies. While blanket protectionism has often not worked for countries that have tried it, neither has rapid trade liberalization. Forcing a developing country to open itself up to imported products that would compete with those produced by certain of its industries, industries that were dangerously vulnerable to competition from much stronger counterpart industries in other countries, can have disastrous consequences—socially and economically. Jobs have systematically been destroyed—poor farmers in developing countries simply couldn't compete with the highly subsidized goods from Europe and America—before the countries' industrial and agricultural sectors were able to grow strong and create new jobs. Even worse, the IMF's insistence on developing countries maintaining tight monetary policies has led to interest rates that would make job creation impossible even in the best of circumstances. And because trade liberalization occurred before safety nets were put into place, those who lost their jobs were forced into poverty. Liberalization has thus, too often, not been followed by the promised growth, but by increased misery. And even those who have not lost their jobs have been hit by a heightened sense of insecurity.

Capital controls are another example: European countries banned the free flow of capital until the seventies. Some might say it's not fair to insist that developing countries with a barely functioning bank system risk opening their markets. But putting aside such notions of fairness, it's bad economics; the influx of hot money into and out of the country that so frequently follows after capital market liberalization leaves havoc in its wake. Small developing countries are like small boats. Rapid capital market liberalization, in the manner pushed by the IMF, amounted to setting them off on a voyage on a rough sea, before the holes in their hulls have been repaired, before the captain has received training, before life vests have been put on board. Even in the best of circumstances, there was a high likelihood that they would be overturned when they were hit broadside by a big wave.

The application of mistaken economic theories would not be such a problem if the end of first colonialism and then communism had not given the IMF and the World Bank the opportunity to greatly expand their respective original mandates, to vastly extend their reach. Today these institutions have become dominant players in the world economy. Not only countries seeking their help but also those seeking their "seal of approval" so that they can better access international capital markets must follow their economic prescriptions, prescriptions which reflect their free market ideologies and theories.

The result for many people has been poverty and for many countries social and political chaos. The IMF has made mistakes in all the areas it has been involved in: development, crisis management, and in countries making the transition from communism to capitalism. Structural adjustment programs did not bring sustained growth even to those, like Bolivia, that adhered to its strictures; in many countries, excessive austerity stifled growth; successful economic programs require extreme care in *sequencing*—the order in which reforms occur—and pacing. If, for instance, markets are opened up for competition too rapidly, before strong financial institutions are established, then jobs will be destroyed faster than new jobs are created. In many countries, mistakes in sequencing and pacing led to rising unemployment and increased poverty.[4] After the 1997 Asian crisis, IMF policies exacerbated the crises in Indonesia and Thailand. Free market reforms in Latin America have had one or two successes—Chile is repeatedly cited—but much of the rest of the continent has still to make up for the lost decade of growth following the so-called successful IMF bailouts of the early 1980s, and many today have persistently high rates of unemployment—in Argentina, for instance, at double-digit levels since 1995—even as inflation has been brought down. The collapse in Argentina in 2001 is one of the most recent of a series of failures over the past few years. Given the high unemployment rate for almost seven years, the wonder is not that the citizens eventually rioted, but that they suffered quietly so much for so long. Even those countries that have experienced some limited growth have seen the benefits accrue to the well-off, and especially the *very* well-off—the top 10 percent—while poverty has remained high, and in some cases the income of those at the bottom has even fallen.

Underlying the problems of the IMF and the other international economic institutions is the problem of governance: who decides what they do. The institutions are dominated not just by the wealthiest industrial countries but by commercial and financial interests in those countries, and the policies of the institutions naturally reflect this. The choice of heads for these institutions symbolizes the institutions' problem, and too often has contributed to their dysfunction. While almost all of the activities of the IMF and the World Bank today are in the developing world (certainly, all of their lending), they are led by representatives from the industrialized nations. (By custom or tacit agreement the head of the IMF is always a European, that of the World Bank an American.) They are chosen behind closed doors, and it has never even been viewed as a prerequisite that the head should have any experience in the developing world. The institutions are not representative of the nations they serve.

The problems also arise from who *speaks* for the country. At the IMF, it is the finance ministers and the central bank governors. At the WTO, it is the trade ministers. Each of these ministers is closely aligned with particular constituencies *within* their countries. The trade ministries reflect the concerns of the business community—both exporters who want to see new markets opened up for their products and producers of goods which compete with new imports. These constituencies, of course, want to maintain as many barriers to trade as they can and keep whatever subsidies they can persuade Congress (or their parliament) to give them. The fact that the trade barriers raise the prices consumers pay or that the subsidies impose burdens on taxpayers is of less concern than the profits of the producers—and environmental and labor issues are of even less concern, other than as obstacles that have to be overcome. The finance ministers and central bank governors typically are closely tied to the financial community; they come from financial firms, and after their period of government service, that is where they return. Robert Rubin, the treasury secretary during much of the period described in this book, came from the largest investment bank, Goldman Sachs, and returned to the firm, Citigroup, that controlled the largest commercial bank, Citibank. The number-two person at the IMF during this period, Stan Fischer, went straight from the IMF to Citigroup. These individuals naturally see the world through the eyes of the financial community. The decisions of any institution naturally reflect the perspectives and interests of those who make the decisions; not surprisingly, as we shall see repeatedly in the following chapters, the policies of the international economic institutions are all too often closely aligned with the commercial and financial interests of those in the advanced industrial countries.

For the peasants in developing countries who toil to pay off their countries' IMF debts or the businessmen who suffer from higher value-added taxes upon the insistence of the IMF, the current system run by the IMF is one of taxation without representation. Disillusion with the international system of globalization under the aegis of the IMF grows as the poor in Indonesia, Morocco, or Papua New Guinea have fuel and food subsidies cut, as those in Thailand see AIDS increase as a result of IMF-forced cutbacks in health expenditures, and as families in many developing countries, having to pay for their children's education under so-called cost recovery programs, make the painful choice not to send their daughters to school.

Left with no alternatives, no way to express their concern, to press for change, people riot. The streets, of course, are not the place where issues are discussed, policies formulated, or compromises forged. But the protests have made government officials and economists around the world think about alternatives to these Washington Consensus policies as the one and true way for growth and development. It has become increasingly clear not to just ordinary citizens but to policy makers as well, and not just those in the developing countries but those in the developed countries as well, that globalization as it has been practiced has not lived up to what its advocates promised it would accomplish—or to what it can and should do. In some cases it has not even resulted in growth, but when it has, it has not brought benefits to all; the net effect of the policies set by the Washington Consensus has all too often been to benefit the few at the expense of the many, the well-off at the expense of the poor. In many cases commercial interests and values have superseded concern for the environment, democracy, human rights, and social justice.

Globalization itself is neither good nor bad. It has the *power* to do enormous good, and for the countries of East Asia, who have embraced globalization *under their own terms*, at their own pace, it has been an enormous benefit, in spite of the setback of the 1997 crisis. But in much of the world it has not brought comparable benefits. For many, it seems closer to an unmitigated disaster.

The experience of the United States during the nineteenth century makes a good parallel for today's globalization—and the contrast helps illustrate the successes of the past and today's failures. At that time, when transportation and communication costs fell and previously local markets expanded, new national economies formed, and with these new national economies came national companies, doing business throughout the country. But the markets were not left to develop willy-nilly on their own; government played a vital role in shaping the evolution of the economy. The U.S. government obtained wide economic latitude when the courts broadly interpreted the constitutional provision that allows the federal government to regulate interstate commerce. The federal government began to regulate the financial system, set minimum wages and working conditions, and eventually provided unemployment and welfare systems to deal with the problems posed by a market system. The federal government also promoted some industries (the first telegraph line, for example, was laid by the federal government between Baltimore and Washington in 1842) and encouraged others, like agriculture, not just helping set up universities to do research but providing extension services to train farmers in the new technologies. The federal government played a central role not only in promoting American growth. Even if it did not engage in the kinds of active redistribution policies, at least it had programs whose benefits were widely shared—not just those that extended education and improved agricultural productivity, but also land grants that provided a minimum opportunity for all Americans.

Today, with the continuing decline in transportation and communication costs, and the reduction of man-made barriers to the flow of goods, services, and capital (though there remain serious barriers to the free flow of labor), we have a process of "globalization" analogous to the earlier processes in which national economies were formed. Unfortunately, we have no world government, accountable to the people of every country, to oversee the globalization process in a fashion comparable to the way national governments guided the nationalization process. Instead, we have a system that might be called *global governance without global government*, one in which a few institutions—the World Bank, the IMF, the WTO—and a few players—the finance, commerce, and trade ministries, closely linked to certain financial and commercial interests—dominate the scene, but in which many of those affected by their decisions are left almost voiceless. It's time to change some of the rules governing the international economic order, to think once again about how decisions get made at the international level—and in whose interests—and to place less emphasis on ideology and to look more at what works. It is crucial that the successful development we have seen in East Asia be achieved elsewhere. There is an enormous cost to continuing global instability. Globalization can be reshaped, and when it is, when it is properly, fairly run, with all countries having a voice in policies affecting them, there is a possibility that it will help create a new global economy in which growth is not only more sustainable and less volatile but the fruits of this growth are more equitably shared.

CHAPTER 2

BROKEN PROMISES

On my first day, February 13, 1997, as chief economist and senior vice president of the World Bank, as I walked into its gigantic, modern, gleaming main building on 19th Street in Washington, DC, the institution's motto was the first thing that caught my eye: *Our dream is a world without poverty*. In the center of the thirteen-story atrium there is a statue of a young boy leading an old blind man, a memorial to the eradication of river blindness (*onchocerciasis*). Before the World Bank, the World Health Organization, and others pooled their efforts, thousands were blinded annually in Africa from this preventable disease. Across the street stands another gleaming monument to public wealth, the headquarters of the International Monetary Fund. The marble atrium inside, graced with abundant flora, serves to remind visiting finance ministers from countries around the world that the IMF represents the centers of wealth and power.

These two institutions, often confused in the public mind, present marked contrasts that underline the differences in their cultures, styles, and missions: one is devoted to eradicating poverty, one to maintaining global stability. While both have teams of economists flying into developing countries for three-week missions, the World

Bank has worked hard to make sure that a substantial fraction of its staff live permanently in the country they are trying to assist; the IMF generally has only a single "resident representative," whose powers are limited. IMF programs are typically dictated from Washington, and shaped by the short missions during which its staff members pore over numbers in the finance ministries and central banks and make themselves comfortable in five-star hotels in the capitals. There is more than symbolism in this difference: one cannot come to learn about, and love, a nation unless one gets out to the countryside. One should not see unemployment as just a statistic, an economic "body count," the unintended casualties in the fight against inflation or to ensure that Western banks get repaid. The unemployed are people, with families, whose lives are affected—sometimes devastated—by the economic policies that outsiders recommend, and, in the case of the IMF, effectively impose. Modern high-tech warfare is designed to remove physical contact: dropping bombs from 50,000 feet ensures that one does not "feel" what one does. Modern economic management is similar: from one's luxury hotel, one can callously impose policies about which one would think twice if one knew the people whose lives one was destroying.

Statistics bear out what those who travel outside the capital see in the villages of Africa, Nepal, Mindanao, or Ethiopia; the gap between the poor and the rich has been growing, and even the number in absolutely poverty—living on less than a dollar a day—has increased. Even where river blindness has been eliminated, poverty endures—this despite all the good intentions and promises made by the developed nations to the developing nations, most of which were once the colonial possessions of the developed nations.

Mind-sets are not changed overnight, and this is as true in the developed as in the developing countries. Giving developing countries their freedom (generally after little preparation for autonomy) often did not change the view of their former colonial masters, who continued to feel that they knew best. The colonial mentality—the "white man's burden" and the presumption that they knew what was best for the developing countries—persisted. America, which came to dominate the global economic scene, had much less of a colonial heritage, yet America's credentials too had been tarred, not so much by its "Manifest Destiny" expansionism as by the cold war, in which principles of democracy were compromised or ignored, in the all-encompassing struggle against communism.

THE NIGHT BEFORE I started at the Bank, I held my last press conference as chairman of the President's Council of Economic Advisers. With the domestic economy so well under control, I felt that the greatest challenges for an economist now lay in the growing problem of world poverty. What could we do about the 1.2 billion people around the world living on less than a dollar a day, or the 2.8 billion people living on less than $2 a day—more than 45 percent of the world's population? What could I do to bring to reality the dream of a world without poverty? How could I embark on the more modest dream of a world with less poverty? I saw my task as threefold: thinking through what strategies might be most effective in promoting growth and reducing poverty; working with governments in the developing countries to put these strategies in place; and doing everything I could within the developed countries to advance the interests and concerns of the developing world, whether it was pushing for opening up their markets or providing more effective assistance. I knew the tasks were difficult, but I never dreamed that one of the major obstacles the developing countries faced was man-made, totally unnecessary, and lay right across the street—at my "sister" institution, the IMF. I had expected that not everyone in the international financial institutions or in the governments that supported them was committed to the goal of eliminating poverty; but I thought there would be an open debate about strategies—strategies which in so many areas seem to be failing, and especially failing the poor. In this, I was to be disappointed.

Ethiopia and the Struggle Between Power Politics and Poverty

After four years in Washington, I had become used to the strange world of bureaucracies and politicians. But it was not until I traveled to Ethiopia, one of the poorest countries in the world, in March 1997, barely a month into the World Bank job, that I became fully immersed in the astonishing world of IMF politics and arithmetic.

Ethiopia's per capita income was $110 a year and the country had suffered from successive droughts and famines that had killed 2 million people. I went to meet Prime Minister Meles Zenawi, a man who had led a seventeen-year guerrilla war against the bloody Marxist regime of Mengistu Haile Mariam. Meles's forces won in 1991 and then the government began the hard work of rebuilding the country. A doctor by training, Meles had formally studied economics because he knew that to bring his country out of centuries of poverty would require nothing less than economic transformation, and he demonstrated a knowledge of economics—and indeed a creativity—that would have put him at the head of any of my university classes. He showed a deeper understanding of economic principles—and certainly a greater knowledge of the circumstances in his country—than many of the international economic bureaucrats that I had to deal with in the succeeding three years.

Meles combined these intellectual attributes with personal integrity: no one doubted his honesty and there were few accusations of corruption within his government. His political opponents came mostly from the long-dominant groups around the capital who had lost political power with his accession, and they raised questions about his commitment to democratic principles. However, he was not an old-fashioned autocrat. Both he and the government were generally committed to a process of decentralization, bringing government closer to the people and ensuring that the center did not lose touch with the separate regions. The new constitution even gave each region the right to vote democratically to secede, ensuring that the political elites in the capital city, whoever they might be, could not risk ignoring the concerns of ordinary citizens in every part of the country, or that one part of the country could not impose its views on the rest. The government actually lived up to its commitment, when Eritrea declared its independence in 1993. (Subsequent events—such as the government's occupation of the university in Addis Ababa in the spring of 2000, with the imprisonment of some students and professors—show the precariousness, in Ethiopia as elsewhere, of basic democratic rights.)

When I arrived in 1997, Meles was engaged in a heated dispute with the IMF, and the Fund had suspended its lending program.

Ethiopia's macroeconomic "results"—upon which the Fund was supposed to focus—could not have been better. There was no inflation; in fact, prices were falling. Output had been growing steadily since he had succeeded in ousting Mengistu.[1] Meles showed that, with the right policies in place, even a poor African country could experience sustained economic growth. After years of war and rebuilding, international assistance was beginning to return to the country. But Meles was having problems with the IMF. What was at stake was not just $127 million of IMF money provided through its so-called Enhanced Structural Adjustment Facility (ESAF) program (a lending program at highly subsidized rates to help very poor countries), but World Bank monies as well.

The IMF has a distinct role in international assistance. It is supposed to review each recipient's macroeconomic situation and make sure that the country is living within its means. If it is not, there is inevitably trouble down the road. In the short run, a country can live beyond its means by borrowing, but eventually a day of reckoning comes, and there is a crisis. The IMF is particularly concerned about inflation. Countries whose governments spend more than they take in in taxes and foreign aid often will face inflation, especially if they finance their deficits by printing money. Of course, there are other dimensions to good macroeconomic policy besides inflation. The term *macro* refers to the *aggregate* behavior, the overall levels of growth, unemployment, and inflation, and a country can have low inflation but no growth and high unemployment. To most economists, such a country would rate as having a disastrous macroeconomic framework. To most economists, inflation is not so much an end in itself, but a means to an end: it is because *excessively* high inflation often leads to low growth, and low growth leads to high unemployment, that inflation is so frowned upon. But the IMF often seems to confuse means with ends, thereby losing sight of what is ultimately of concern. A country like Argentina can get an "A" grade, even if it has double-digit unemployment for years, so long as its budget seems in balance and its inflation seems in control!

If a country does not come up to certain minimum standards, the IMF suspends assistance; and typically, when it does, so do other donors. Understandably, the World Bank and the IMF don't lend to countries unless they have a good macroframework in place. If countries have huge deficits and soaring inflation, there is a risk that money will not be well spent. Governments that fail to manage their overall economy generally typically do a poor job managing foreign aid. But if the macroeconomic indicators—inflation and growth—are solid, as they were in Ethiopia, surely the underlying macroeconomic framework must be good. Not only did Ethiopia have a sound macroeconomic framework but the World Bank had direct evidence of the competence of the government and its commitment to the poor. Ethiopia had formulated a rural development strategy, focusing its attention on the poor, and especially the 85 percent of the population living in the rural sector. It had dramatically cut back on military expenditures—remarkable for a government which had come to power through military means—because it knew that funds spent on weapons were funds that could not be spent on fighting poverty. Surely, this was precisely the kind of government to which the international community should have been giving assistance. But the IMF had suspended its program with Ethiopia, in spite of the good macroeconomic performance, saying it was worried about Ethiopia's budgetary position.

The Ethiopian government had two revenue sources, taxes and foreign assistance. A government's budget is in balance so long as its revenue sources equal its expenditures. Ethiopia, like many developing countries, derived much of its revenues from foreign assistance. The IMF worried that if this aid dried up, Ethiopia would be in trouble. Hence it argued that Ethiopia's budgetary position could only be judged solid if expenditures were limited to the taxes it collected.

The obvious problem with the IMF's logic is that it implies no poor country can ever spend money on anything it gets aid for. If Sweden, say, gives money to Ethiopia to build schools, this logic dictates that Ethiopia should instead put the money into its reserves. (All countries have, or should have, reserve accounts that hold funds for the proverbial rainy day. Gold is the traditional reserve, but today it has been replaced by hard currency and its interest-bearing relatives. The most common way to hold reserves is in U.S. Treasury bills.) But this is not why international donors give aid. In Ethiopia, the donors, who were working independently and not beholden to the IMF, wanted to see new schools and health clinics built, and so did Ethiopia. Meles put the matter more forcefully: He told me that he had not fought so hard for seventeen years to be instructed by some international bureaucrat that he could not build schools and clinics for his people once he had succeeded in convincing donors to pay for them.

The IMF view was not rooted in a long-held concern about project sustainability. Sometimes countries had used aid dollars to construct schools or clinics. When the aid money ran out, there was no money to maintain these facilities. The donors had recognized this problem and built it into their assistance programs in Ethiopia and elsewhere. But what the IMF alleged in the case of Ethiopia went beyond that concern. The Fund contended that international assistance was too unstable to be relied upon. To me, the IMF's position made no sense, and not just because of its absurd implications. I knew that assistance was often far more stable than tax revenues, which can vary markedly with economic conditions. When I got back to Washington, I asked my staff to check the statistics, and they confirmed that international assistance was more stable than tax revenues. Using the IMF reasoning about stable sources of revenue, Ethiopia, and other developing countries, should have counted foreign aid but not included tax revenues in their budgets. And if neither taxes nor foreign assistance were to be included in the revenue side of budgets, *every* country would be considered to be in bad shape.

But the IMF's reasoning was even more flawed. There are a number of appropriate responses to instability of revenues, such as setting aside additional reserves and maintaining flexibility of expenditures. If revenues, from any source, decline, and there are not reserves to draw upon, then the government has to be prepared to cut back expenditures. But for the kinds of assistance that constitute so much of what a poor country like Ethiopia receives, there is a built-in flexibility; if the country does not receive money to build an additional school, it simply does not build the school. Ethiopia's government officials understood what was at issue, they understood the concern about what might happen if *either* tax revenues or foreign assistance should fall, and they had designed policies to deal with these contingencies. What they couldn't understand—and I couldn't understand—is why the IMF couldn't see the logic of their position. And much was at stake: schools and health clinics for some of the poorest people in the world.

In addition to the disagreement over how to treat foreign aid, I also became immediately entangled in another IMF-Ethiopia dispute over early loan repayment. Ethiopia had repaid an American bank loan early, using some of its reserves. The transaction made perfect *economic* sense. In spite of the quality of the collateral (an airplane), Ethiopia was paying a far higher interest rate on its loan than it was receiving on its reserves. I, too, would have advised them to repay, particularly since in the event that funds would later be required, the government could presumably readily obtain funds using the plane as collateral. The United States and the IMF objected to the early repayment. They objected not to the logic of the strategy, but to the fact that Ethiopia had undertaken this course without IMF approval. But why should a sovereign country ask permission of the IMF for every action which it undertakes? One might have understood if Ethiopia's action threatened its ability to repay what was owed the IMF; but quite the contrary, because it was a sensible financial decision, it enhanced the country's ability to repay what was due.

For years, the mantra at the 19th Street headquarters of the IMF in Washington had been accountability and judgment by results. The results of Ethiopia's largely self-determined policies should have demonstrated convincingly that it was a capable master of its own destiny. But the IMF felt countries receiving money from it had an obligation to report everything that might be germane; not to do so was grounds for suspension of the program, regardless of the reasonableness of the action. To Ethiopia, such intrusiveness smacked of a new form of colonialism; to the IMF, it was just standard operating procedure.

There were other sticking points in IMF-Ethiopia relations, concerning Ethiopian financial market liberalization. Good capital markets are the hallmark of capitalism, but nowhere is the disparity between developed and less developed countries greater than in their capital markets. Ethiopia's entire banking system (measured, for instance, by the size of its assets) is somewhat smaller than that of

Bethesda, Maryland, a suburb on the outskirts of Washington with a population of 55,277. The IMF wanted Ethiopia not only to open up its financial markets to Western competition but also to divide its largest bank into several pieces. In a world in which U.S. megafinancial institutions like Citibank and Travelers, or Manufacturers Hanover and Chemical, say they have to merge to compete effectively, a bank the size of North East Bethesda National Bank really has no way to compete against a global giant like Citibank. When global financial institutions enter a country, they can squelch the domestic competition. And as they attract depositors away from the local banks in a country like Ethiopia, they may be far more attentive and generous when it comes to making loans to large multinational corporations than they will to providing credit to small businesses and farmers.

The IMF wanted to do more than just open up the banking system to foreign competition. It wanted to "strengthen" the financial system by creating an auction market for Ethiopia's government Treasury bills—a reform, as desirable as it might be in many countries, which was completely out of tune with that country's state of development. It also wanted Ethiopia to "liberalize" its financial market, that is, allow interest rates to be freely determined by market forces—something the United States and Western Europe did not do until after 1970, when their markets, and the requisite regulatory apparatus, were far more developed. The IMF was confusing ends with means. One of the prime objectives of a good banking system is to provide credit at good terms to those who will repay. In a largely rural country like Ethiopia, it is especially important for farmers to be able to obtain credit at reasonable terms to buy seed and fertilizer. The task of providing such credit is not easy; even in the United States, at critical stages of its development when agriculture was more important, the government took a crucial role in providing needed credit. The Ethiopian banking system was at least seemingly quite efficient, the difference between borrowing and lending rates being far lower than those in other developing countries that had followed the IMF's advice. Still, the Fund was unhappy, simply because it believed interest rates should be freely determined by international market forces, whether those markets were or were not competitive. To the Fund, a liberalized financial system was an end in itself. Its naive faith in markets made it confident that a liberalized financial system would lower interest rates paid on loans and thereby make more funds available. The IMF was so certain about the correctness of its dogmatic position that it had little interest in looking at actual experiences.

Ethiopia resisted the IMF's demand that it "open" its banking system, for good reason. It had seen what happened when one of its East African neighbors gave in to IMF demands. The IMF had insisted on financial market liberalization, believing that competition among banks would lead to lower interest rates. The results were disastrous: the move was followed by the very rapid growth of local and indigenous commercial banks, at a time when the banking legislation and bank supervision were inadequate, with the predictable results—fourteen banking failures in Kenya in 1993 and 1994 alone. In the end, interest rates increased, not decreased. Understandably, the government of Ethiopia was wary. Committed to improving the living standards of its citizens in the rural sector, it feared that liberalization would have a devastating effect on its economy. Those farmers who had previously managed to obtain credit would find themselves unable to buy seed or fertilizer because they would be unable to get cheap credit or would be forced to pay higher interest rates which they could ill afford. This is a country wracked by droughts which result in massive starvation. Its leaders did not want to make matters worse. The Ethiopians worried that the IMF's advice would cause farmers' incomes to fall, exacerbating an already dismal situation.

Faced with Ethiopian reluctance to accede to its demands, the IMF suggested the government was not serious about reform and, as I have said, suspended its program. Happily, other economists in the World Bank and I managed to persuade the Bank management that lending more money to Ethiopia made good sense: it was a country desperately in need, with a first-rate economic framework and a government committed to improving the plight of its poor. World Bank lending tripled, even though it took months before the IMF finally relented on its position. In order to turn the situation around I had, with the invaluable help and support of colleagues, mounted a determined campaign of "intellectual lobbying." In Washington, my colleagues and I held conferences to encourage people at both the IMF and the World Bank to look again at issues of financial sector liberalization in very underdeveloped nations, and the consequences of unnecessarily imposed budgetary austerity in foreign aid–dependent poor countries, as in Ethiopia. I attempted to reach senior managers at the Fund, both directly and through colleagues at the World Bank, and those at the Bank working in Ethiopia made similar efforts to persuade their counterparts at the Fund. I used what influence I could through my connections with the Clinton administration, including talking to America's representative on the Fund. In short, I did everything I could to get the IMF program reinstated.

Assistance was restored, and I would like to think that my efforts helped Ethiopia. I learned, however, that immense time and effort are required to effect change, even from the inside, in an international bureaucracy. Such organizations are opaque rather than transparent, and not only does far too little information radiate from inside to the outside world, perhaps even less information from outside is able to penetrate the organization. The opaqueness also means that it is hard for information from the bottom of the organization to percolate to the top.

The tussle over lending to Ethiopia taught me a lot about how the IMF works. There was clear evidence the IMF was wrong about financial market liberalization and Ethiopia's macroeconomic position, but the IMF had to have its way. It seemingly would not listen to others, no matter how well informed, no matter how disinterested. Matters of substance became subsidiary to matters of process. Whether it made sense for Ethiopia to repay the loan was less important than the fact that it failed to consult the IMF. Financial market liberalization—how best this should be done in a country at Ethiopia's stage of development—was a matter of substance and experts could have been asked for their opinion. The fact that outside experts were not called in to help arbitrate what was clearly a contentious issue is consonant with the style of the IMF, in which the Fund casts itself as the monopoly supplier of "sound" advice. Even matters like the repayment of the loan—though properly not something on which the IMF should have taken a position at all, so long as Ethiopia's action enhanced rather than subtracted from its ability to repay what was owed—could have been referred to outsiders, to see whether the action was "reasonable." But doing so would have been anathema to the IMF. Because so much of its decision making was done behind closed doors—there was virtually no public discussion of the issues just raised—the IMF left itself open to suspicions that power politics, special interests, or other hidden reasons not related to the IMF's mandate and stated objectives were influencing its institutional policies and conduct.

It is hard even for a moderate-sized institution like the IMF to know a great deal about every economy in the world. Some of the best IMF economists were assigned to work on the United States, but when I served as chairman of the Council of Economic Advisers, I often felt that the IMF's limited understanding of the U.S. economy had led it to make misguided policy recommendations for America. The IMF economists felt, for instance, that inflation would start rising in the United States as soon as unemployment fell below 6 percent. At the Council, our models said they were wrong, but they were not terribly interested in our input. We were right, and the IMF was wrong: unemployment in the United States fell to below 4 percent and still inflation did not increase. Based on their faulty analysis of the U.S. economy, the IMF economists came up with a misguided policy prescription: raise interest rates. Fortunately, the Fed paid no attention to the IMF recommendation. Other countries could not ignore it so easily.

But to the IMF the lack of detailed knowledge is of less moment, because it tends to take a "one-size-fits-all" approach. The problems of this approach become particularly acute when facing the challenges of the developing and transition economies. The institution does not really claim expertise in development—its original mandate is supporting global economic stability, as I have said, not reducing poverty in developing countries—yet it does not hesitate to weigh in, and weigh in heavily, on development issues. Development issues are complicated; in many ways developing countries present far greater difficulties than more developed countries. This is because in developing nations, markets are often absent, and when present, often work imperfectly. Information problems abound, and cultural mores may significantly affect economic behavior.

Unfortunately, too often the training of the macroeconomists does