6 The future of globalization
Lessons from Cancún and recent financial crises

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In the 1990s, globalization was viewed with enormous optimism. “Globalization American-style” was expected to bring unprecedented prosperity to all countries in the world. International flows of capital had increased six-fold. New trade agreements were heralded as introducing a new era. We talked about what these would do for jobs and prosperity in the United States.

By the end of the decade, all of a sudden globalization looked quite different. The World Trade Organization meeting in Seattle was supposed to open up a new set of trade negotiations that President Clinton wanted to start in the US, to be called the Seattle Round or—even better—the Clinton Round. But instead of a new round, there were riots of a kind that the US had not seen in twenty years. If countries were prospering from trade agreements, they didn’t know it.

There were good reasons for much of this unhappiness. A study by the World Bank pointed out, for instance, that the poorest region in the world—sub-Saharan Africa—was actually worse off by about 2–3 percent than a decade earlier. Not only had the United States gotten the lion’s share of the gains from globalization, but some of the gains had come at the expense of other countries. By the late 1990s, a large number of problems were becoming evident: most notably the East Asia crisis of 1997, followed by the global financial crisis of 1998. A little harbinger in Mexico was a minor event compared to what happened in East Asia, Latin America, and Russia in the following few years. The US Treasury and the International Monetary Fund attempted to shift the blame for the crises, away from the policies that they had pursued and advocated, and the frameworks that they had established, and on to the countries that were badly affected, pointing to these countries’ lack of transparency and weak banking systems. These were real problems but not the main problems, as I shall explain below.

Globalization has had some successes, particularly in East Asia, where incomes increased in the 1960s, 1970s, and 1980s. Countries such as Korea increased their per capita incomes eight-fold, almost eliminated poverty, achieved universal literacy, improved health standards, and increased their life expectancy. These countries based their growth on exports and on absorbing technical knowledge from the most advanced industrial countries. They thus

based their gains on globalization—but on globalization that they defined in their own terms. China, for instance, has had enormous success over the last twenty-five years, but still has not fully liberalized its capital markets, notwithstanding the advice that was peddled by the international financial institutions. China has embraced foreign direct investment but not the kinds of destabilizing capital flows that plagued those parts of Asia that opened their markets to speculative capital.

By contrast, Latin America has experienced real difficulties as a result of globalization. At the beginning of the 1990s, Latin America reflected the same kind of optimism that we in the United States felt about globalization. The high growth of the early years masked hidden problems and, for the decade as a whole, growth was little more than half what it had been in the 1950s, 1960s, or 1970s. And of that growth, a disproportionate part went to the upper third or even the top 10 percent of the population. Countries of the region undertook reforms that increased their openness to the rest of the world and were supposed to lead to more efficient markets. Instead, unemployment rose by 3 percent each year and an increasingly large fraction of workers found themselves in the informal sector, without the normal protections offered by formal sector jobs. Something had gone wrong, and in these failures the successes of the past were almost forgotten. As reform failed, people in Latin America asked why, and why globalization had failed them.

One of the important lessons to emerge from the experience of the last decade is that when globalization is properly managed, it can deliver enormous benefits—benefits that not only bring economic growth, but make sure that the growth is widely shared. But when globalization is not well managed, it can have very adverse effects. In this chapter I first review what has gone wrong over the past decade. Then, I outline what I see as the fundamental problems of globalization. In the third section, I outline a set of lessons for policy that would make globalization work more fairly, providing a more secure world for all.

What went wrong, and how did we get to where we are?

In my book (Stiglitz 2003), I look at what happened in the 1990s, and suggest that some of what I call the seeds of destruction—the problems of globalization that emerged at the end of the 1990s, and the economic downturn that we have had in the last three years—were sown in that decade.

One of the problems is that economic globalization has outpaced political globalization. The end of the Cold War opened up new opportunities to create a new global economic order—a more principled order, based on ideas of social justice, that would provide the countries of the world a more level playing field. We missed that opportunity. Part of the reason was that we lacked a clear vision of what we wanted or what should have been created.

Meanwhile, the commercial and financial interests in the United States had
a vision of what they wanted. They seized the opportunity to open up new markets for the advanced industrial countries. And they used the US government to advance their interests. Supported by Europe to some extent, the US used its economic and military supremacy to create a set of policies that are grossly unfair—particularly in the area of trade, and particularly to the developing countries. The US pursued an approach to globalization that was based on unilateralism rather than multilateralism, and that was carried forward by global economic institutions that are fundamentally undemocratic and non-transparent. At the IMF, for instance, only one country, the US, has veto power. The US used the threat of its veto to shape the Fund’s stance on economic policy.

We are now reaping some of the consequences of unprincipled globalization. For instance, as I mentioned, sub-Saharan Africa has become worse off. The underlying reasons are fairly clear. There are asymmetries in international trade agreements, because the developed countries insisted that the developing countries remove their trade subsidies and trade barriers for goods in which the North had a comparative advantage, but the developed countries did not reciprocate.

These asymmetries can be seen not only in traditional areas of negotiation like agriculture, but also in new areas that were the hallmark of the Uruguay Round of trade discussions completed in late 1993. For instance, one of the so-called advances of the Uruguay Round was the extension of liberalization to trade in services. Seeking an agreement on services made enormous sense. Manufactured goods, the focal point of discussions on trade for the previous fifty years, had dwindled as a share of the American economy and been overtaken by services. (Today, only 14 percent of the American labor force works in manufacturing.) But the services that featured on the agenda were financial services—those services in which the US had a comparative advantage. Services such as maritime or construction services that are intensive in unskilled labor were not on the agenda. And the US remains extremely protectionist in those areas.

A few examples will show the nature of the imbalance. One of them is the subsidies of more than 100 percent that the US pays to its cotton producers. These subsidies amount to about US$4 billion, while the value of what the cotton farmers produce is about US$3.5 billion. These subsidies cost American taxpayers an enormous amount. Many of them, by inducing farmers to use heavy fertilizers, are very bad for the environment as well. The subsidies go to 25,000 very well-off American farmers. This is not the type of farm program typical of seventy-five years ago during the Great Depression. Now the average farmer in the US has an income higher than the average American, so average Americans are subsidizing the well-off Americans in the farm program.

While 25,000 American farmers are getting these large amounts of money, 10 million African cotton farmers are being hurt enormously. The way this happens is quite simple: we subsidize our farmers to produce more cotton than they should, given that their production is economically inefficient. The increasing supply lowers the price of cotton. Cotton farmers in Africa are in bare subsistence mode and we are pushing their incomes even further down. In several African countries, farmers’ loss of income from US cotton subsidies is equivalent to 1–2 percent of GDP. The loss is more than the foreign aid that the US gives, so we are not even compensating these countries for the damage that we are doing.

This is not just an American problem; Europe shares the guilt. The average cow in Europe gets a subsidy of two dollars a day, which is a better daily income than that of 2.8 billion people in the developing world.

Another topic that featured in the Uruguay Round is intellectual property. We all recognize the importance of intellectual property (it is even the subject of a provision in the American Constitution). But we should also recognize that a successful intellectual property regime regulates the interests of both users and producers. There is no natural law of intellectual property. During the discussions of intellectual property in the Uruguay Round, both the Council of Economic Advisors that I was on at the time, and the US Office of Science and Technology Policy opposed the council for intellectual property that the US trade representative was advocating. We believed that that proposal was bad for American science, and bad for innovation in America, because the most important input to research is other research, and if you make it more difficult to get access to knowledge, you can actually impede the advance of science. We were also concerned about how the Uruguay Round Agreement would affect access to life-saving drugs. When the Agreement was signed in Marrakech, it condemned thousands, perhaps millions, of people to death, by raising the prices of life-saving drugs to levels that few people in African or other developing countries could afford. It took four or five years to achieve public recognition of the problems that we argued over in 1993–94. The US trade representative paid no attention to us. US policy was driven by the pharmaceutical industry and the entertainment industry, and the official view was that the stronger the intellectual property agreement, the better.

The consequences were as we predicted. Eventually, the outrage became enormous, and the issue was put on the agenda. At the November 2001 WTO meeting in Doha (a place less receptive to public demonstrations than Seattle), an agreement was reached to proceed with an agenda of trade negotiations to correct the imbalances of the past. The Doha Round was labeled the “Development Round”, in recognition that past trade negotiations had not been fair to the developing countries.

Europe and the US essentially reneged on that agreement, but eventually all countries except the US agreed to give countries such as South Africa, Brazil, and India licenses to manufacture life-saving drugs like AIDS medicines. Small countries such as Botswana, whose AIDS incidence is 20–25 percent of the population and which are too small to have their own manufacturing capacity, were left in a difficult predicament. The US took the
view that they had to pay the US$10,000 per capita needed for buying AIDS medicines from the US, rather than buying from neighboring developing countries producing under license. Obviously, taking that view meant condemning all the AIDS sufferers in small poor countries to death, since they could not possibly afford such sums.

The way that trade negotiations have been conducted in the past is to take such unreasonable stands for a long time and on as many issues as possible and then at the last minute to make a concession and say, “See how good we are, we finally conceded.” The focus is not on creating a fair trade regime, but on “What can we do for America? What is the best bargain that we can get?”

The US made no concessions in other areas, including agriculture. Optimists had believed that although the Uruguay Round had left agriculture highly subsidized, there was an understanding that agricultural subsidies would come down. Instead, the United States doubled its subsidies. And the possible “concession” discussed at Cancún was the restoration of those subsidies to the level that they had before they doubled. Many developing countries saw that this was not in the spirit of fair play. In a nutshell, the meeting in Cancún failed because the United States and Europe reneged on their promise to make the Doha Round a development round.

**Fundamental problems underlying globalization**

While globalization might have driven what I call “a special privilege agenda,” the fundamental problems underlying globalization have not been addressed.

**Financial system**

These problems have to do, in particular, with the global financial system. Recently six crises took place in a period of six years. These were not the first crises; we have had almost a hundred crises in a period of about thirty years. But what is particularly disturbing is that, while we talk about how wonderful our financial system is at addressing the problems of risk, the developing countries are left to carry the burden of volatility in interest rates and exchange rates.

The deficiencies of the financial system have had enormous consequences for developing countries. In Latin America, at the beginning of the 1980s, countries went into a debt crisis, defaulting on their loans. The fundamental problem was that they had been forced to carry the burden of interest rate volatility. Their loans would have been manageable had their interest rates been kept at historical levels. But to fight inflation in the United States, the US Federal Reserve’s Paul Volcker raised interest rates to unprecedented levels. And at the Fed, when they were discussing this, someone from Mexico who had been a distinguished faculty member at Yale warned that this was going to have very serious adverse effects on Latin America. Even that was an understatement. But the Fed took the view that “Our responsibility is to fight inflation in America. We will fight inflation in the US and Latin America must take care of itself.” The consequences were predictable. Many of the problems in Latin America are exactly the same now as then: interest rates increased enormously after the financial crises of the late 1990s, forcing problems on to several of the Latin American countries.

Developing countries also have to cope with the risks of exchange rate volatility. A little over a year ago, I was in Moldova, which today is one of the poorer former Soviet Union countries, having been one of the richest. The transition from communism to a market economy was supposed to bring Moldova unprecedented prosperity, but in fact brought unprecedented poverty. In the course of the transition, the GDP of Moldova has fallen by 70 percent, and in 2001, the government was spending 75 percent of its meager budget on servicing the foreign debt. Moldova did not even have electricity to light its cities at night or to provide oxygen to the hospitals. While I was there, one of our team members had to go to the hospital and they ran out of oxygen, so he died.

Developing countries bear the risks of the global financial system. Economic theory says that risks should be borne by the rich; that markets functioning well should transfer risks from those who are less able to those who are more able. But the markets have not done this.

**Global reserve system**

A second problem is the global reserve system, which I believe is the underlying source of the instability that we have seen in recent years. This system has a number of peculiar attributes. One of them is that the US is effectively borrowing money from much poorer countries. The richest country in the world is unable to live within its means; it has an enormous trade deficit, running at US$600 billion a year, and it borrows more than US$1.5 billion a day. Meanwhile, the US is lecturing all the poorer countries about why they should live within their means. With a global reserve system in which the dollar is held as a reserve, poor countries need to think carefully about what this entails.

Let me give you an example. Suppose you are the government of a poor country anywhere in the world and one of your country’s firms borrows US$1 million from a US bank, paying interest at, say, 18 percent. To provide prudently against the eventuality that the money might be called, you need to set aside US$100 million in reserves. The way poor countries hold reserves is typically in US Treasury bills. What does this mean? It means that while the US is lending this country US$100 million at 18 percent, the poor country that holds a reserve in US Treasury bills is lending the United States US$100 million, and at an interest rate of 1 percent. Borrowing at 18 or 20 percent and lending at 1 percent is not good economics. It does help the meager growth rate in the US. But it is not good for growth in the developing world.
This helps us to understand why the US Treasury and the US government have opposed reforms in the global reserves system. In the narrow sense, the US benefits from the status quo. Taking a broader view, however, the global reserve system contributes to global economic instability, and all of us suffer from global economic instability.

Lessons and prospects

For economics, I draw two lessons in particular from the global economic instability that we have seen.

The first is about the liberalization of capital markets. From cross-country regression studies of the factors that contribute to economic instability, one of the factors that stands out is the rapid liberalization of capital markets and financial markets. We already knew the destabilizing effect of such liberalization before the East Asia crisis. Nonetheless, the international financial institutions continued to push the agenda of capital market liberalization. In fact, an attempt was made at the Hong Kong meeting of the IMF in 1997, just at the beginning of the East Asia crisis (the timing could not have been worse!), to revise the Fund’s charter so as to require all countries to change their economic systems and open themselves up to hot, speculative money.

Perspectives have now changed, and in March 2003 an IMF study pointed out what academics had known for a long time: that capital market liberalization not only leads to enormous instability but also does not produce faster economic growth. The simplest reason for this is that firms do not create jobs on the basis of temporary speculative foreign capital. Thus, one of the important lessons is to re-examine the role of liberalization, and to move away from the ideological perspective to look more closely at which policies actually work.

The second lesson is that, when an economy faces a downturn, it needs to be stimulated. Those who hold this Keynesian view have been appalled by the policies that the IMF has promoted around the world. In East Asia, and in Argentina, the IMF told countries that they ought to contract their fiscal and monetary policies. The good news for the economics profession is that our predictions were correct: those contractionary fiscal and monetary policies did worsen the economic downturns; there were even downturns during recessions, leading to depressions. I hope that, going forward, the lesson of those episodes will be learned.

For politics, I offer the lesson that the US might be the strongest superpower, economically and even militarily, but that having all that power does not get you what you want. In the area of trade, we have seen at Cancún that the US may have wanted another trade agreement, but could not achieve it. Mexico, with Brazil and India, played a critical role in Cancún in stating the demand for a fairer global economic system.

In a way, the outcome at Cancún is a victory for democracy. Let me explain why. For years, the US trade representative would say to the other countries' trade representatives, often quite candidly, “We agree with you that what we are asking is unreasonable, and we recognize that our agricultural subsidies hurt you, but our hands are tied. We have a democracy in America and our Congress won’t allow us to get rid of these subsidies. Maybe we will eventually be able to do something, but you know, reform can take decades.” Meanwhile, they would tell the developing countries, “Change your policies in the next 30 days,” and insist that these countries’ parliaments pass the necessary legislation. At Cancún, the developing countries said, in effect, “We too are democracies.” India has an election in 2004, and an active press, and if the Indian trade representatives were to have returned from Cancún with a treaty as unfair as the last agreement, their political bosses would have lost their jobs. So they had no choice but to say to developed countries, “Unless you can give us a fairer trade agreement, we can’t go along.” The situation is similar in Brazil and the other countries. It is a testimony, I think, to the strength of a free press and to democracy that they said, “No agreement is better than an unfair agreement.”

Specific policy lessons

Let me end by outlining briefly some of the more specific policy lessons that I think ought to emerge from the episodes of the past ten years.

Craft trade and capital market liberalization policies carefully. Capital market liberalization and trade liberalization can expose markets to enormous risks, and policies on the sequence and pace of such reforms need to be carefully crafted. The result otherwise can be enormous costs without benefits.

Improve the distribution of risk in the global reserve system. A related issue is that we must address the fundamental problems of the distribution of risk in the global reserve system.

Respond better to countries in difficulty. No matter what we do to address those underlying problems, there are going to be economic crises. (For 200 years, the history of capitalism has had ups and downs.) What to do with countries when they have recessions? The big bailout strategy is at best questionable. It failed, I would argue, in Thailand, Korea, Indonesia, Russia, Brazil, and last in Argentina. That is a remarkable record, and particularly so because the bailouts kept on coming—even while the theory was quite strong and the evidence was mounting that the bailouts were part of the problem and not part of the solution. After Argentina collapsed, there was some recognition that more systematic alternatives were needed.

Of course, the notion that borrowers may be unable to repay all they owe has been a part of capitalism for a long time. In the nineteenth century, bankruptcy was not handled very well. From Dickens’ novels, we know that people who went bankrupt were put in debtors’ prison. This wasn’t a particularly good way to get creditors repaid, because prisoners did not get high incomes. But it offered a good incentive to repay, so the virtues of the
incentives outweighed the lost debts of the people who were imprisoned. Meanwhile, international bankruptcy was handled a little more roughly, as Mexico can attest. When countries couldn’t pay their debts, European governments sent in their armies to enforce payment. Britain and France invaded Mexico in the mid-nineteenth century. They did not actually take over, but put in a puppet ruler for a while. As recently as 1902, when Venezuela could not repay its debt, European powers bombarded it—with US approval—to get it to change its mind. And in the 1930s, when Newfoundland (which was not yet part of Canada) defaulted on its loans, the creditor countries shut down the Parliament saying, “If you can’t repay your loans, you can’t have your own government.”

Today we send the IMF to address such problems. We do need a better system; in particular, we should not have a major creditor lead the bankruptcy proceedings. Nobody in the US would like it if we had Citibank (though maybe Citibank might like it—be the judge in bankruptcy proceedings.) Countries that have a problem need a fresh start just as individuals need a fresh start. Some of the proposals that have been presented do not make much sense, but the notion that there ought to be an alternative to bankruptcy and standstills is an important step forward.

Recognize that recovery is based on the real sector, not on money. The contractionary fiscal policy that was imposed on Argentina, after the country’s tremendous problems, predictably sent the economy into a deep recession, or depression. A fixed exchange rate became uncompetitive, especially when linked to the overvalued US dollar. But Argentina has begun to recover, and without money from the IMF. Its policy-makers recognized the core issue: that recovery is based on the real sector, not on money. Had they taken money from the IMF, the money would have gone straight back to the IMF—the check would never have left Washington. They figured out that the money would do little for the people in Argentina, while the conditions that stood to be imposed on their country would make Argentines worse off. They said, “We would like an IMF program but only if the conditions are right.” And because they insisted on this and because they structured their own program, Argentina successfully recovered from its very severe economic downturn.

Rich countries need to make concessions in trade. Further opening up trade and creating a more integrated world economy has the potential to raise living standards in both the North and the South. But unless the rich countries make meaningful concessions, the developing countries are unlikely to make further reciprocal trade liberalization agreements.

Why is this the case? Developing countries can see that American import tariffs are already relatively low, at about 3 percent, and that the US policies that really hurt the developing countries are agricultural subsidies, peak tariffs, and anti-dumping duties. Anti-dumping duties are important because when countries do succeed in getting access to American markets and competing with America, we very often respond by saying, “You’re dumping.”

The anti-dumping law provides that if you sell foreign goods in the US at a price below cost, you are deemed unfair, and the US imposes a tariff to represent the difference between the fair market price and what you actually charged. But the US has a double standard. For goods produced within the US, the law on unfair trade practices (the Predatory Pricing Laws) applies a standard completely different from that applied to goods produced abroad. If we applied the same standard that we use for foreign companies to companies within America, more than half of American firms would be found guilty ofdumping. Similarly, if we applied the domestic standards to goods imported from abroad, almost none of the anti-dumping cases would survive. Eliminating this double standard is not even on the agenda.

To illustrate how a free trade agreement does not guarantee free trade, I have a story about a Mexican avocado. The newly signed North American Free Trade Agreement allowed Mexican products free access into the US except for goods that might compete strongly with domestically produced items. The Californian avocado industry got very upset about the onslaught of Mexican avocados. And they finally came up with an idea. They said, “Mexican avocados have fruit flies,” and the Mexicans said, “You can’t see them,” and the Californians said, “That’s exactly the point.” So, Mexico was enormously cooperative and said, “Send down your American agricultural inspectors and you’ll see that we have no fruit flies in Mexico.” The inspectors went down and came back and they said, “We can’t see any fruit flies,” and the American avocado industry said, “That’s exactly the point. You can’t see them.” Then the Mexicans made another suggestion, which was that they would only send avocados into New England in the winter—the theory being that any fruit fly that arrived in Boston in winter would immediately freeze to death. Surely this would solve the problem of the invisible fruit fly. But still the Americans said, “How do we know that we killed them if we can’t see them?” Some of us were puzzled as to why there was such resistance to allowing avocados just into New England in the middle of winter. We discovered that there is one day in January on which the US consumes more avocados than on any other day of the year: Super Bowl Sunday. It has become part of American culture—if you can call it that—to eat guacamole dip while watching the football game.

Another example of how a free trade agreement does not equal free trade is the story of the broomcorn brooms. After the North American Free Trade Agreement, the US saw itself faced with an onslaught of Mexican broomcorn brooms. Mexican broomcorn brooms, like American broomcorn brooms, are made from the tassels from a kind of corn that is called broomcorn. The US could not argue that the broom producers were dumping. But it invoked another provision called safeguards, whereby if an imported product is a threat to the American economy, you can take strong action to keep it out of the US until the economy can adjust. Only between 100 and 300 people in the US made their livelihoods out of broomcorn brooms. We must have spent between 1,000 and 3,000 hours discussing the issue, and we finally did impose
the safeguard so that Mexico would not wreck the American economy by shipping us all those broomcorn brooms.

There are hundreds of such stories, but the point is that developing countries now recognize problems like this, and unless the rich countries change their policies and practices, the developing countries have little to gain from a new free trade agreement. The US is not willing to change its agricultural policy or the anti-dumping agreements. Even worse, in the discussions leading up to the meeting in Cancún, the US and Europe made demands that would make development even more difficult for the developing countries. Issues were put on the agenda that should not have been, and had nothing to do with trade. For example, given that the IMF had recognized that liberalized capital flows are destabilizing and do not promote economic growth, the US and Europe turned to promoting capital flows through trade negotiations.

_Democratize international decision-making_. The final lesson that emerges from these episodes is that there are some fundamental problems in international governance. I mentioned at the outset that globalization has been promoted by international economic institutions that in many ways lack consistency, democratic structures, and transparency. In the United States, the Freedom of Information Act gives citizens the right to know what their government is doing, and it is integral to our fundamental freedoms. By contrast, citizens of this or other countries do not have the right to know about the decisions and voting patterns inside economic institutions, where much of what happens goes on in secret. In one episode, for example, there was a directive on how the US representatives ought to vote on certain issues, and the US representative did not follow the directive. Congress did not know about the vote because it was secret. Thankfully these institutions leak. And so eventually it became known that these representatives had not voted the way Congress told them to and they were chastised. Things are getting better.

The international governance problem stems from what I like to call the smokestack structure of international economic decision-making. Decisions about finance are made by finance ministers and finance governors, and decisions about trade are made by trade ministers. Little would be wrong with this if trade decisions only affected trade and finance decisions only affected finance. But international agreements on trade and finance and the policies of economic institutions have an enormous impact on a whole variety of aspects of life, including health, education, and the environment. In the United States—and this is true in almost every administration—when we make decisions about economic policy, all the affected parties are seated around the table. Some voices may be louder than others, but all the voices are heard. The process is an attempt to bring into the decision-making process a wide range of views and a wide range of interests and frameworks. That does not happen in an international institution. And I think that is one of the reasons why globalization has been having such adverse effects. To go back to my earlier example about intellectual property: if that issue were being discussed within the United States, the Secretary of Health would have had a view; the

Office of Science and Technology would have had a view; the Council of Economic Advisors would have had a view. And those views would differ widely from the views that were pursued by the US trade representative. But given the way trade negotiations are actually conducted, those other views are barely heard.

To conclude, we have not managed globalization very well. Globalization entails the closer integration of the countries of the world, and closer integration means more interdependence. Our well-being will depend on others, and it will depend on how globalization is managed. America, as the sole superpower with the strongest economy, has a special role. Our failures in this area go back a long way, though I would argue they have grown far worse in the past three years. There are reforms, some of which I have briefly sketched above, that would make globalization work better, both for developed countries like America, and for developing countries. I think that if we want a better world—even if we only want a more secure America—then it is imperative that we undertake these reforms.

**Reference**


**Note**

1 The keynote address, presented October 10, 2003, at the conference _The Future of Globalization_.