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Globalization: What's New?

William Easterly, Joseph E. Stiglitz, Michael M. Weinstein, Joanne J. Myers

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Introduction

JOANNE MYERS: On behalf of the Carnegie Council, I would like to thank you all for joining us this afternoon.

Our panelists will be discussing *Globalization: What's New?* Their comments will be based on essays which are to be found in this edited volume, which will be available for you to purchase at the end of the program today.

Cynics often ask, "What's so important, what's so new, about globalization? After all, isn't this a phenomenon that has been under way for decades?" In some respects, these skeptics are correct. Globalization has been taking place at least since the European expansion of the sixteenth century, when products from distant lands radically altered consumption patterns and lifestyles in Europe and elsewhere. But even though the underlying processes have indeed been evident for some time, the impact on the world economy has, until recently, been modest. Apart from a few industries that globalized early, national economies have remained predominantly local.

But all of this is changing. New developments in communications, transportation, and computer technology have given the process of globalization new impetus, resulting in fresh new markets and wealth for many, while for others rapid changes can often undermine local and national politics, driving poor countries into further poverty, bringing about widespread suffering, disorder, and unrest.

In *Globalization: What's New?*, Michael Weinstein invited ten highly respected economists to offer their views about what we need to know to understand current international economic relationships. These essays look at the main features of globalization, asking what is new, what drives the process, how it changes politics, and how it affects global institutions like the UN.

The critiques come from some of globalization's most prominent supporters, as well as its most vocal critics, and from some who are in between. This afternoon our speakers are the editor of two of the articles in this volume and two of the contributors, who also will be speaking. Although you will find the speakers' bios on a separate list, let me just take a moment to briefly introduce them to you.

In alphabetical order, they are Bill Easterly, who will talk about foreign aid and why he believes it has been ineffective in reducing poverty in poor countries; Joe Stiglitz, whom we are always delighted to have here with us—welcome back—who will address the issue of governance; and Michael Weinstein, who will introduce this subject and act as our moderator. Thank you for joining us today.

Michael M. Weinstein

Thank you.

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This was a shameless exercise. I went to the Council on Foreign Relations to set up a think tank, and figured I had better learn quickly all aspects of globalization. I figured, what is a better way to do that than to put the volume together and invite, literally, the ten best economists that I know of, subject by subject? Indeed, no one said no, and we have a volume put together by the people we deemed to be the best experts in the respective fields.

I will take you on a real quick Cook's tour of the chapters, just to get a sense of what is going on, and then turn it over to these guys to go into some details on the two chapters that they themselves wrote. Then I thought, at the end, we would pose some questions for them and let them do battle.

The point of this collection was as follows: I used to be an academic, and then I was a journalist. In the latter role, I grew increasingly frustrated at stuff that was claimed to be true about globalization, espoused by people who didn't know the first thing about it. What we wanted to do in this book was really to give voice to people who were subtle, people who didn't make statements unless they had data and evidence to back them up, had a theoretical bent, and the propositions they put forward had been tested in some sense of that word. So you don't necessarily get the extreme views in this book that you would otherwise, because they are not braying in the wind.

I think of this as an exercise in some subtlety, and the pros and cons of these issues. You don't get sweeping generalizations about "globalization's great," "globalization's terrible." That is not what this book is about. This is a book, as I said, about the best and brightest on these subjects telling you what it is they think they know about the subjects. Often that can be quite muted.

It starts off with three chapters that just go to the traditional, classical way of thinking about what gets swapped across borders. Doug Irwin's chapter on trade goes through the normal things about the explosive rise in trade — 80 percent over the last twenty years, compared with a 30 percent rise in income. Obviously, he touches on the fact that services are taking over an increasingly large part of trade, but then gets to some really interesting points, not the least of which is outsourcing—just a change in the production scheme by which goods are swapped across borders.

I will just give you one anecdote, because this summarizes so much that is interesting. He estimates that 60 percent of the products that come in from Mexico to the United States, as imports into the United States, were made of parts manufactured in the United States. We are importing from ourselves.

He makes the interesting point that although we are moving towards a more service-based world, and services are inherently traded less than manufactured products, in fact if you look at the products that are traded, like manufacturers, they are absolutely dominated now by the export/import world. So relatively little of it is now produced and consumed in the same place — just interesting comments on a world of trade that is indeed subtle.

Some of these chapters I will just glance over, for reasons of time. Charlie Calomiris has written a very interesting chapter on the second major factor, capital flows, and spends a long time worrying about why capital flows seem to be so dangerous today—far more dangerous, he says, than they were through much of the twentieth century. He—not surprisingly, if you know Charlie—attributes no small part of this threat to mismanagement by the major international organizations, specifically the IMF, that is designed to tamp down the threats from capital flows and such matters. But I will leave it to you to read the delicious details.

George Borjas of Harvard writes about the third factor, labor, immigration, again, a very interesting chapter. By the way, I hope that these are all in readable English. I can't tell you what a hero I am for having edited nine academics. But all these chapters, despite the best efforts of the original authors, I think, are, in fact, quite readable.

Borjas talks about—and I am not picking on George, by any means—the change in the composition of immigrants to the United States, tilting toward South America, Mexico. It used to be, not too long ago, immigrants were better educated than the labor force in the United States, on average, and spent less time on welfare, et cetera. That is all now shifting, and shifting in a way that he finds quite—"ominous" may be exaggerated, but certainly quite disturbing.

He summarizes work that I think is commonplace now. If you look at the impact of immigration as a whole on the U.S. economy, it is pretty small potatoes. But certainly the distributional impacts are not small. At one point he attributes about a $1,000-a-year decrease in low-wage labor salaries to the immigration of low-skilled labor—a no small hit to people who can least manage the consequences.

Jeffrey Frankel has a very interesting chapter on environment. It summarizes, I think, a pretty classic case of economists who don't regard trade or growth as endemic to the environment. I will let it go at that. It is a long and detailed chapter. I can come back to it. If anybody wants to ask about it, I will talk about it at length.

Bill Easterly has written is a marvelous chapter. There are wonderful vignettes that tell you about how he views foreign aid. I will let him take the first swat at describing what he said, and if he doesn't do a very good job, then I will pick up the pieces afterwards.

Jeff Sachs, has written a chapter that really tries to come to grips with where his thinking has gone over the last five or more years. He makes the argument that although economists are used to obsessing about institutions and that the development of poor countries depends on good institutions, he wants to say, "No. If you tell me where they are geographically and whether they're landlocked and whether they're in a malarial zone, I'll tell you their GNP." It is a very important chapter, and it is obviously what motivates him to come to the policy proposals that he has about the need for massive increases in financial aid.

That is to say, Bill Easterly and Jeff share a degree called economics, but as far as I can tell, they share nothing else.

Joe Stiglitz is, again, someone I would be perfectly prepared to speak instead of, but I think I will let him speak for himself about the overselling of globalization — a quite intricate chapter and one that is tremendously worth reading.

Dani Rodrik, in probably the most offbeat part of this book, talks about governance issues and what he calls "feasible globalizations." He points to yesteryear, the Bretton Woods Agreements, as throwing a lot of sand in the gears of globalization, keeping capital flows and trade flows at less than maximum volume so that the countries could preserve a certain autonomy over what they do and how they do it, and not subject everything they do to furious competition from the rest of the world. Dani's fascinating chapter is about thinking through what he calls "feasible globalizations" — to what extent you do want to preserve a zone of independence, which, in part, for him, means tamping down the pressures of competition, at least to some extent, to preserve what he thinks of as democracy and self-control.

There is also a chapter by David Dollar, probably the most unabashed cheerleading for globalization in this book. Anybody who knows David's work will find some of this familiar. But again, it is a powerful story of unprecedented reductions over the last twenty years in poverty, cutting poverty in half. The poverty he is talking about is not United States poverty of between $10,000 and $20,000 a year, depending on the size of the family, but dollar-a-day poverty being cut in half, India and China being hugely responsible for that.

In his work, he talks about how countries that are globalizers, opening themselves up to the international world, have grown a lot faster, without any clear, obvious consequences for inequality within their countries. He points to a fact that lots of people parade around today—and I will leave it at that—which is that there is no known case, so this argument goes, of a country that has insulated itself from the world of trade and yet grown at rapid rates; that all the fast growers have opened themselves up to some extent —exports, perhaps, more than imports— they have played to the international market and built their development strategy around that.

Again, the lessons are subtle; the lessons are complicated. Globalization doesn't come off as the be-all and cure-all. It certainly doesn't come off as a goat. It comes off as presenting opportunities and providing problems. Two of those let me leave to the speakers: first, Bill Easterly, to talk about foreign aid, and then Joe.

William Easterly

Good evening, everyone.

The title of my chapter in the book is "The Rich Have Markets, the Poor Have Bureaucrats." I am speaking as someone who used to be a bureaucrat myself, and then I saw the light and I repented.

The sad thing about the global economy today is that while we rich people can easily get our needs met through markets, the world's poor, of whom there are 1 billion living on less than a dollar a day and almost 3 billion living on less than two dollars a day, are pretty much stuck with the bureaucracy of foreign aid agencies. What is the answer of foreign aid agencies to alleviating poverty and creating economic growth and opportunity? It is to give more foreign aid.

In fact, there is an interesting historical constant that I have noticed in reading the history of foreign aid. Whenever anyone in the rich world starts paying attention again to the poor—usually after having forgotten all about them for a while—their reflexive response is to say, "Let's double foreign aid. That's the answer."

This started as long ago as 1960. I remember this well, myself, although my views weren't taken very seriously at the time because I was three years old. Walt Rostow, motivated by the acceleration of the Cold War, called for the doubling of foreign aid in 1960, although he said it would only be needed for ten or fifteen years, after which it would no longer be necessary because it would launch countries into self-sustained growth.

That idea of doubling has kind of persisted ever since. World Bank President Robert McNamara, in 1973, called for a doubling of foreign aid. With the end of the Cold War in 1990, the World Bank again called for a doubling of foreign aid. With the beginning of the war on terror, World Bank President James Wolfensohn called for a doubling of foreign aid. So I guess the only other regularity I can determine here is, whenever a war either begins or ends, we should double foreign aid—and also any other time.

Now, as we speak, we have Tony Blair from the U.K. meeting with George W. Bush in Washington. Tony Blair is President Bush to double foreign aid. He calls for a Marshall Plan for Africa. He calls for doubling foreign aid in order to meet what are called the Millennium Development Goals, which are these ambitious goals to improve the well-being of poor people around the world—cut poverty in half, lower infant mortality—all very worthy objectives and all things that I really wish were something that we could take seriously and find a way to achieve.

But the reflexive response seems to stop at "double foreign aid." That wouldn't be so bad, and similar recommendations are emanating from people like Joe's colleague, Jeff Sachs, at Columbia. Gordon Brown is also jostling with Tony Blair to try to get the doubling foreign aid vote in the U.K. The IMF and the World Bank are onboard, along with many people around the world, even such noted economists as Bono, the lead singer of the group U2, and Brad Pitt, who, in an interview with Barbara Walters on network television, called for a doubling of foreign aid—although all of these advocates say that foreign aid will only be needed temporarily, just as Walt Rostow did 45 years ago.

This wouldn't be so bad if foreign aid did actually have a known relationship with creating economic growth. I would be all for doubling foreign aid if we could show that the flow of foreign aid is a good way to stimulate growth. But there has been exhaustive testing of this relationship and unfortunately the statistical evidence is overwhelming that aid does not create growth. The latest research concludes that aid does not have any effect on the economic growth of the recipient country.

Then it begins to look a bit strange that everyone is emphasizing the total volume of money spent on foreign aid, forgetting that foreign aid is an input to reducing poverty. It is not the output. It is not the results.

Realizing that foreign aid is an input, take, for example, General Motors, which according to today's *New York Times* headline, just laid off 25,000 workers and has been downgraded to junk bond status. You don't see General Motors executives go around bragging that they achieved $176 billion worth of costs in producing cars in 2004. That is what their actual costs were. They don't say, "Wow, this year we achieved a record $176 billion in costs. Let's try to increase costs further." (Maybe that is why they are in trouble; maybe there are some former aid agency executives running around there.) That would not be a winning business strategy. It seems equally irrational to call for just an increased volume of foreign aid, without trying to find some way in which foreign aid can actually achieve results, rather than just continuing to multiply the volumes of the inputs to reducing poverty.

Why doesn't foreign aid do better at producing results? Here we have what I think is a really sad situation. Gordon Brown, when he was campaigning for foreign aid, mentioned that there are solutions available that would really help poor people. He remarked that there are twelve-cent medicines available, which cost twelve cents a dose, that, if you could get them to children sick with malaria, would prevent a lot of deaths from malaria. This is his case for increasing foreign aid.

But being a skeptical academic, the way I take it, unfortunately, is that if we have already spent $568 billion over the last forty years on aid to Africa, in today's dollars, and we still haven't gotten the twelve-cent medicines to the children who are dying from malaria, then something is wrong. I think it is very important to find out what that something is.

The tragedy of the system is that foreign aid seems to be failing to get twelve-cent medicines to save the lives of dying children, yet much more trivial needs are met very easily for us rich people. If I am concerned with a trivial problem like hair loss, say—which, if you examine me closely, you will see that I have some reason to be concerned about—I have no trouble getting Rogaine from my neighborhood drugstore, a two-minute walk away from my apartment. It is probably manufactured in Mexico and assembled from chemicals in China—the glories of globalization. There is no trouble at all getting Rogaine to rich middle-aged men like me.

What is wrong here, that it is so easy for me to get Rogaine and it is so hard for dying children to get twelve-cent medicines? There wasn't any Marshall Plan for Rogaine, by the way, in case you missed it. There weren't any Millennium Development Goals about hair loss. Yet somehow the market manages to do this. The market is this genius of a decentralized system where people have the incentive to satisfy the needs of anyone with money.

Then we have another very brilliant system called democracy, which satisfies the needs of rich people for public goods, like roads and schools. The poor's problem is that they don't have the income to access markets, and so that closes them off from the markets. The real problem is even worse: their reliance on aid agencies to meet their needs, since they are relying on bureaucracies that are not democratically accountable to poor people for getting results, such as getting 12-cent medicines to the children.

I can solve a public-goods problem fairly easily. I once had a pothole outside my house, when I lived in Takoma Park, Maryland. I picked up the phone and I called my city councilwoman, whose name was Kathy Porter, and said, "Kathy, I have a pothole in front of my house." That was my first step. The next day, Takoma Park Public Works came and fixed the pothole. It took just two steps to fix the pothole.

But in contrast, to fix a pothole in Tanzania, we have the donors spending $2 billion over the last twenty years on roads there. Yet throughout this time there have been independent evaluations of the roads in Tanzania, and independent evaluators have said that the roads have not improved over twenty years, after $2 billion worth of spending. The only thing that has been going up is aid bureaucracy, because the poor Tanzanians have had to produce 2,400 reports a year for the aid bureaucracy, reporting on what they are doing, and they have to receive 1,000 missions of visiting donor-agency officials per year, more than three per day.

It is clear why nobody has any time to go work on the roads. This bureaucracy is tying everything up. So why is bureaucracy so dysfunctional in foreign aid? The problem is, really, that there is no feedback and no accountability in foreign aid. In markets, the reason markets work so well is that you have feedback from the customers. If the Rogaine doesn't work, then I take it back and I get my money back, or I stop buying it and I tell my friends to stop buying it, and the company goes out of business, just like General Motors. If my pothole doesn't get fixed, I call up Kathy Porter and scream.

But the poor have no way to access the foreign aid agencies to complain that their potholes are not getting fixed, to complain that their children are not getting 12-cent medicines. They have no mechanism to get feedback to the aid bureaucracy. So the aid agencies do not face a market test or a voter test. That allows them to expend their efforts in bureaucracy and producing glossy aid reports and producing millennium development goals and frameworks on how to reduce poverty. But it does not actually hold them accountable and create the incentives for them to get results.

Unfortunately, the rich-country public is just not paying enough attention and doesn't have enough information about what is happening to the faraway poor to really know that the aid agencies are not getting these results. The sad outcome is that we have ineffective aid agencies that the poor are dependent on, and the aid agencies are not getting results to the poor.

So what is the solution? The aid agencies very badly need much, much more independent scrutiny. The problem is, they are really operating in the dark now, with no one holding them accountable. There needs to be a much more vocal lobby in both rich countries and poor countries, holding them accountable for results.

If there could be outside watchdogs independent of the aid agencies that will do a scientific evaluation of all aid agency programs and projects and see if they are working, then I think we can make a lot of progress on actually having aid agencies get more results. I conclude by saying that rich people would not put up with an ineffective bureaucracy like those in the aid agencies, and so let's not wish such a bureaucracy on poor people.

MICHAEL WEINSTEIN: Thanks.

Joe? Another former bureaucrat.

Joseph E. Stiglitz

Yes, but more enthusiastic about some of these bureaucracies.

I would like to, if I may, spend a minute at the end commenting on Bill's remarks. Is that okay? Because I am not sure I agree with everything he said. In fact, I am quite sure I don't.

The title of my chapter is "The Overselling of Globalization." I begin with the notion that from the beginning up to the middle of the 1990s, globalization was often sold as the best thing since sliced bread; it would bring benefits to everybody. Then it came as a little bit of a surprise that both sides—both the advanced, industrial countries and the developing countries—were unhappy. Why was it that something that was supposed to make everybody happier, supposed to bring benefits to everybody, actually seemed to make everybody unhappy? In the United States, they were unhappy, and in the less developed countries all seemed to indicate that it wasn't living up to its potential.

One view is that it is basically not a problem of economics, but a problem of psychiatry: These people are better off, but they don't know it. But the evidence is that, actually, a lot of people—in fact, most people—can be worse off. That can even be true when GDP increases. That is to say, if globalization leads to more inequality, then you can have rich countries with poor people. That is part of what is going on. The process of globalization has been associated with increasing inequality in both the advanced, industrial countries and in the poor countries. So you can have the process that has happened in the United States over the last four years. GDP has increased, but the median household income has actually declined by about $1,500. Everybody in the middle and down is actually worse off, even though GDP has gone up.

Some of these changes, though not all of them, are associated with globalization.

One of the theses that I try to put forward is that while globalization has been oversold, globalization does have an enormous potential. Some of the best performances among the developing countries are those in East Asia and are a result of globalization: a result of access to international markets, international technology; in some cases, international capital. But the distinctive aspect of East Asia is that they manage globalization on their own terms. They didn't buy into a lot of the IMF-Washington consensus ideology. They rejected many of those terms. As a result, they were able to take advantage of the benefits of globalization without having all the adverse effects that have been associated with it.

Much of the chapter is devoted to trying to detail why it has had such adverse effects and why the world, in some sense, has allowed those adverse effects to occur. That has to do with issues of governance, on the one hand, but also issues of the role of ideology, the role of special interests, the defects in the governing structure by which decisions get made in the international arena.

I want to pick up on one of the things that Michael said in his introduction, and that is the role of evidence and research in coming to views on these issues. One of the things, I think, that has become very widespread since we began working on this book is that there is a skepticism about faith-based policy. Faith-based policy, we have seen in the last four years, has led to enormous costs, especially to people in other countries. Probably 100,000 people have died as a result of faith-based policy.

This is an area of economics not quite so destructive, but it has some quite adverse effects. It is important to base these policies on research. The problem is that quite often what goes by the name of research is actually what we might call advocacy research. People know what the answer is and then look for the data that support it, and are very selective in that. Quite often they say that the facts speak for themselves. In fact, they don't. It is often hard to interpret it.

But I want to talk about one area where there is a growing consensus, where, for a long time, the international institutions ignored research and finally got around to it, that is beginning to have an impact on thinking. Then I'll talk about an area where the research has been ambiguous and there has been a sleight-of-hand in going from research to policy.

The area where research was badly needed but wasn't done has to do with capital market liberalization. That was opening up markets to the free flow of short-term, destabilizing capital. Maybe the way I put it has already tipped my hand on where I stand on the issue. In 1997, the IMF, at its meeting in Hong Kong, tried to have its charter changed to allow it to force all the countries of the world to change their rules to open up their markets to short-term capital flows. The United States doesn't have any restrictions, in general. Most of Western Europe doesn't. But China, India, and many other countries do. In the period of Europe's most rapid growth, they had these very strong restrictions. Since they eliminated them, the growth has slowed down.

That sentence by itself illustrates some of the difficulty of doing research. That is to say, a lot else happened since they eliminated those capital market restrictions, and so you would not try to infer from the fact that they have eliminated those restrictions that that is the cause of the slowdown of Western Europe.

But what is very clear from that piece of evidence is that some countries have been able to grow very rapidly even with these restrictions. China has these restrictions and has been able, for twenty-five years, to grow very rapidly. So these examples are very telling. The inference that you can make is that the most successful developing countries have maintained those restrictions.

When the IMF proposed that change in its charter, I was chief economist at the World Bank, and I said, where was the evidence that that was good for development? At the World Bank, we had done some research and we showed that it was bad for stability, that countries that opened up would have capital come in and capital go out, and that would increase volatility, and volatility was bad for growth. So I thought there was a prima facie case that this was not a good thing to push on developing countries.

The IMF stance was that they didn't need the research. It was obvious: Free markets were good; capital market restrictions were evidence of not a free market. QED. That was all the evidence they thought you needed. They said, "We don't have to do research." I found that very disturbing, particularly since I had just come from academia. I just didn't understand this.

There was a little research beginning, by Dani Rodrik at Harvard, that showed that it was unrelated to economic growth. I kept trying to get people at the World Bank to get people at the IMF to do the research, and they didn't want to do it. You start getting suspicious, that maybe they were doing the research, they were doing the regressions, the statistics, and they weren't coming out the way they wanted, and therefore they wouldn't publish it.

Eventually—about a year-and-a-half to two years ago—the IMF finally did the research, and the results came out exactly as one had thought they would, which is that capital market liberalization for the least developed countries was not associated with enhanced economic growth.

That was an easy case, because the research was pretty clear. When they tried to do the theory—we always try to match theory and empirical—when they did the theory and wrote their paper, they said, "This is very surprising, because it goes against all economic theory."

What was very interesting about the IMF research, quote/unquote, was that what they meant by economic theory was a theory that was predicated on models of perfect information and perfect capital markets. Anybody that studies developing countries knows that capital markets are imperfect. Obviously, somebody like me, who has made his living off of imperfections of information, believes that information is not perfect.

So what they call theory I call bad theory, 19th-century theory, not 20-century theory. They were arguing, here is theory; in fact, it wasn't modern theory. It is easy to do theory, to write down theoretical models in which you don't have these assumptions of perfect capital markets, perfect risk markets, and so forth. Then capital market liberalization leads to more instability, and not higher growth.

So that is one example where it would have been a good thing had they done the research before they tried to change the policy. The policy was a major factor contributing to the global financial instability of 1997-98, with enormous consequences for poverty and living standards.

The second example of research is a more controversial one. It has to do with the relationship between trade and growth. Michael referred to the study that was done by David Dollar saying that globalization is associated with growth. The question that most people are asking is not whether globalization is good or bad, but how you manage globalization, what rules you have. It is not whether trade is good or bad, but how you manage trade.

So the countries that don't trade—and therefore, David Dollar says, are not globalized—are countries that have such low incomes that they have nothing to trade. It is not that they have failed to grow because they haven't globalized; they haven't globalized because they have nothing to sell. If you are a primitive subsistence economy, you are not going to be globalized.

The country that has liberalized the most in the Western Hemisphere—the one country that has stripped away all its tariffs—is Haiti. It hasn't grown very well. If I were doing bad research, I would say, "Look, eliminating tariffs leads you to Haiti, at lowest income. Therefore, trade liberalization is a bad thing." That is obviously not the right conclusion. But the problem with the research is that it confuses causality; it confuses what is driving what.

If you look around the world, what were the countries that were most successful in growth over the last twenty-five years? It was East Asia, countries like China. They globalized, but they didn't liberalize. They exported an enormous amount, but they didn't start taking down their tariff barriers until fifteen years after they had very strong growth. In fact, they have matched their taking down of tariff barriers with their growth, so that they have never had a process of unemployment. They have always tried to create new enterprises as they liberalized. So now they have joined WTO. They are taking down trade barriers. They are integrating into the global economy. But the causality is a very different causality than that kind of literature would have you believe.

This is where, if you read a lot of the papers, there is a sleight-of-hand. What they show is that growth and globalization are associated, and they want you to believe that trade liberalization, therefore, is what you ought to do. But if you are going to do a study, you ought to look explicitly at trade liberalization: Does that lead to economic growth? There is a UNDP study, with a very pretty chart where they have, on one axis, trade liberalization, and on the other hand, they have growth. There is no relationship between trade liberalization and economic growth.

But even that isn't the right question. No country thinks of itself as average. You want to know, for countries in my particular circumstances, is it likely to lead to growth or not? If I have a high unemployment rate and I liberalize, what is likely to happen? Maybe it is going to lead to more unemployment, not to more growth.

The economic theory behind trade liberalization is that it facilitates movement from inefficient, protected sectors to more efficient export sectors. But if you already have 25 percent of your labor force unemployed, you don't need to liberate those resources. You don't need to redeploy. You just need to employ. If you liberalize, you will just move more people from low-productivity, protected sectors to zero-productivity unemployment.

So that is the kind of study that ought to be done. What is remarkable is how few of those studies have been done. We are beginning to do some work at Columbia. It shows that if you look at countries where there is high unemployment, liberalization is not associated with higher growth; but it may be associated with higher growth in countries where there is full employment. So traditional theory works when the traditional circumstances are relevant.

May I have one minute to talk about Bill?

MICHAEL WEINSTEIN: To bash him? Absolutely.

JOSEPH STIGLITZ: An example of how difficult this research is, is the relationship between aid and growth. You can look at the historical studies. It is ambiguous. When I was at the World Bank we published a book called *Assessing Aid,* which said that there was a positive association between the two. In countries with good governance and some other characteristics, aid in those countries led to more growth.

One of the problems is that, historically, aid has not been motivated in terms of promoting economic growth and development. The reason we gave aid to Congo was not because we thought, by giving money to Mobutu, it would lead to more growth. We were buying his friendship in the Cold War. We knew he was shipping the money to Switzerland. All it did was to leave the people in Congo more in debt. It is one of the arguments, I believe, for debt forgiveness, which is a form of aid, for Congo. They now have to repay money that we gave for Mobutu. It was not development aid; it was Cold War buying of friendship. And it worked, in a way, for that purpose.

First, the historical record does not prove anything, other than that it was not the objective. As I look around the countries and projects, I think there is money given to particular projects, to particular countries that are well-managed. I am very convinced that that particular aid will have high returns.

MICHAEL WEINSTEIN: Why don't you give one example? Then Bill can respond.

JOSEPH STIGLITZ: There are an enormous number of particular projects that one can identify. There are now governments, like that of Meles Zenawi in Ethiopia, where the economies have good macro policies, where the governments are not corrupt, and where they work for increasing accountability. They have frameworks where the government says, "If we get money, we'll show you where the money goes." So they are having the kind of accountability that Bill says they ought to have. I agree that there ought to be more accountability—

WILLIAM EASTERLY: Should I reply now?

MICHAEL WEINSTEIN: Yes.

WILLIAM EASTERLY: A quick response. First of all, on the research you cited at the World Bank that showed more positive results: Joe, you were my boss at that time, and I was at the working level. I have to tell you that the research you were seeing was actually following more the pattern you mentioned earlier about workers at the working level reporting the results that people wanted to hear. So I don't think that research actually holds up very well under further scrutiny.

As far as aid being given for the wrong reasons, we actually have a test of that. Not all aid was given for the wrong reasons. I totally agree about Mobutu. People were out of their minds when they gave any money to Mobutu. It was just completely insane. But that did not make up even the typical case in the majority of aid. There was multilateral aid that was not as politically influenced. There were also the Scandinavians giving aid, for reasons that were not so Cold War-oriented.

But people find, when you test separately the types of aid—aid by Scandinavian donors or multilateral aid that is not so political—that aid also doesn't have any effect on growth.

MICHAEL WEINSTEIN: Why don't we now throw it open to you guys for questions?

Questions and Answers

QUESTION: If I could bring you both back to one of the central issues of globalization, which is the relative worth of free-trade agreements, if I understand the implication of Professor Easterly's argument, it is that the market is the best poverty reducer, rather than official aid programs. But the free-trade agreements which have been sold as poverty reducers—for instance, NAFTA or the free-trade agreements in South America—have, in fact, led to wider gaps between rich and poor. Take Mexico, for instance: the richer people in the north and the increasingly less well-off people in southern Mexico.

There is one issue that is right now before Congress, which is CAFTA, the Central American Free Trade Agreement. That seems to me a stark example of the differences between theory and practice that both of you are addressing, where unemployment is high, as Joe Stiglitz said, and it is not a given that lowering the barriers in those countries, even though they are all democracies, will necessarily increase employment. In fact, it may do the exact opposite, which is why there is a huge amount of opposition in those countries—not even talking about the opposition here.

I wonder if you could talk, using that as a specific example—about the relative merits of free trade.

WILLIAM EASTERLY: Markets are, in the long run, definitely the key to prosperity. But they can be oversold as a panacea also, because there are certain conditions that you need for markets to work well, to take advantage of globalization and free trade. You need government institutions in place that are not corrupt, that don't have a lot of red tape, where you don't have to bribe the customs inspectors, where you don't fear expropriation or abrupt changes in economic policy that destroy your business. Those are all things that are required to make markets work. Those are the conditions that have often been missing in a lot of these trade liberalization episodes that have not led to such happy outcomes.

JOSEPH STIGLITZ: Let me agree with you very strongly that NAFTA has not produced the benefits that people promised. Ten years after NAFTA, the growth in that decade was slower than it had been in earlier decades. Real wages were actually lower at the end of the decade than they were at the beginning—average real wages, let alone people at the bottom.

What was the failure? There are several parts to it. Part of it is that it is not just the problems that Bill has emphasized. For markets to work, to take advantage of trade, you have to have roads, you have to have educated people that can compete in the global marketplace, and for that, you have to have revenues. Part of the thing that has happened with free trade is that developing countries depend very heavily on tariffs. It is very hard to collect revenues from income taxes and other forms of taxation. So as trade liberalization has undermined revenue sources, that means you don't have money for roads and for education. Tax revenues in Mexico are 12 percent of GDP. At that level, they can't compete with China, where they are investing a lot in education and in roads. So while there was a little period at the beginning where jobs were created, in the last few years they've lost jobs to China.

The second thing: The trade agreements are not free-trade agreements. They have that as a name, but they're rife with non-tariff barriers and all other kinds of trade restrictions.

Thirdly, on the side of the advanced, industrial countries, we maintain our subsidies to agriculture. The poorest people in Mexico are the corn farmers. They have to compete with subsidized American agriculture. That depresses their income. That is one of the reasons that it leads to lower incomes in these countries.

Finally, there is a whole set of concerns generating opposition. There is a whole dimension of globalization that we haven't talked about, which is that it undermines national sovereignty. For instance, the infamous Chapter 11 of NAFTA restricts the ability of countries to have environmental protections. So if a Mexican village wants to restrict an American firm from dumping toxic waste, the American firm can sue and get compensation, because it says that's a restriction on their property rights. So it's overprotecting property rights in ways that make it very difficult to have improvements in standards of living that can adversely affect environmental legislation, in all three of the countries of NAFTA.

QUESTIONER: So it is an argument against CAFTA.

JOSEPH STIGLITZ: It is an argument saying that one has to be very careful, and one has to look, I think, very carefully at the provisions of CAFTA. Free-trade agreements do not by themselves necessarily benefit the developing countries. You have to look very carefully at the assessment of the tradeoffs. That is a hard question, and it's a very individual question.

QUESTION: I have two quick questions. Please take into consideration that the questions are coming from someone who doesn't have a very profound knowledge of economics, so excuse me. You spoke about research. Has there been research done on growth and the relationship of growth and culture? Obviously, there are some countries that have different histories, have different religions, have different work ethics. They have different, essentially, cultures. It would seem to me that this could affect growth and how people behave and how they produce and function.

Secondly, in the 19th century, when the Industrial Revolution was taking place, machines replaced human beings, physical labor, manual labor. There was tremendous chaos. People were emotionally distraught. They felt dehumanized. They felt useless. They became poorer. There was a cultural lag. Until society caught up with these machines and people learned new skills and so forth, there was this kind of chaos.

Here we have outsourcing. Median income has gone down. Some people are upset about globalization. Are we going through this same kind of lag now? When we catch up, will things then settle down, the way they did in the nineteenth century?

JOSEPH STIGLITZ: On the first question, this highlights one difficult aspect of research. Economists and other social scientists have a harder time dealing with issues like culture that can't be quantified. If you're going to do a statistical study, you have to somehow quantify it. There are other kinds of research, historical research, that looks at this issue. People have obviously talked about it in a variety of ways. But it's highly contentious.

Let me just give one anecdote that illustrates this. When I was involved in the study of what we have called the Asian miracle — the fact that the countries of East Asia have grown very rapidly — I went around to all the East Asian countries. About half of them are Confucian and half are non-Confucian.

When I went to the Confucian countries, they would say, as part of the explanation of their success—there are all these other factors, high savings and all that—that one of the things that was very important was their culture, their Confucian heritage. When I went to the non-Confucian countries, they said there were lots of other factors, but one of the things that was very important to understand was their non-Confucian heritage.

So I think what is important in many cases—and there is some work at the World Bank that has talked about this—is that many of these countries had a strong sense of identity. Economists and sociologists have been talking about notions of social capital, the sense of societies of themselves, a sense of—how do I describe it?—that people don't steal from each other, all kinds of tacit aspects of society that make it function. It is not just markets. There are other things, like trust, that are beyond the market and have to do with culture.

QUESTIONER: And work ethic.

JOSEPH STIGLITZ: And work ethic. Those go beyond economics and are very important. That is a subject of extensive discussion. As for the other question, there is a book called *The Great Transformation* by Polanyi, describing some of the problems of the nineteenth century. About two years ago, I wrote an introduction to the reissue of that book, where I tried to illustrate some of the parallels between that time and the current era of globalization.

There is something fundamentally different, though, and that is that when this process was going on in the 18th and 19th century, you had the beginnings of a democracy that was tempering the problems, that was tempering capitalism, that said, "We cannot have all these people suffering enormously." They passed minimum-wage laws, minimum work conditions.

QUESTIONER: What about Great Britain?

JOSEPH STIGLITZ: In Great Britain, they had the Great Reform Act of 1832. There were a number of things like that that were going on.

The difference with globalization is that the institutions in the global environment are not very democratic. They are very removed. In fact, they have been trying to reduce the degree of democratic accountability. One of the strands going on for instance, is that macroeconomic policy is set by central banks; central banks are told to be independent and non-democratically accountable. You are trying to get restrictions on environmental law in Chapter 11 of NAFTA that says the government can't do anything. You have tied the hands of governments.

So part of the agenda of globalization has been a de-democratization agenda. They call it depoliticization; I would call it de-democratization. That makes it more difficult for it to respond to the problems. That is one of the things that has me worried.

QUESTION: Recently, *The New York Times* and *Wall Street Journal* have both been running articles about globalization. Wal-Mart is a big part of this issue. There was a guy who was a stocker or counted goods at Wal-Mart, and he was complaining that now he couldn't afford to buy a new car; he had to settle for a ten-year-old car.

My question is this: Before, maybe a guy who's doing a job that requires no more than a sixth-grade education could afford these things. But nowadays why should a guy with a sixth-grade education be able to buy a new car, but not the poor person in China? Isn't that the right thing to do, to say he can't buy a new car—in fact, he's lucky to have a car at all—and the good news is all those people in India and China who, instead of making two dollars a day, are making twenty dollars a day, and eventually can maybe buy a scooter?

MICHAEL WEINSTEIN: Bill, do you want to answer that?

WILLIAM EASTERLY: That's too hard a question. I think a Nobel Prize winner should answer it.

JOSEPH STIGLITZ: Let me try to answer two parts of that. First, there is a very fundamental result in economics that was due to Paul Samuelson, my teacher, called the factor price equalization theorem. There was also another result called the Samuelson-Stolper theorem, that basically said that if you have free trade and the same technology, then factor prices will be equalized around the world.

What you describe is what he forecast would happen; that unskilled workers in America would eventually get the same wages as unskilled workers in India and China. The mystery, as it were, for economics is, why hasn't that happened in the past? It's a very simple model, very strong predictions. The predictions were not only that it would be fully equalized, but even if you didn't have free trade, it would move in this direction. A very stark result.

There are a number of assumptions that go into the theory, but one of the assumptions was that they had the same technology. One of the things that has happened as a result of globalization is that China and India are getting the same technology that we have in the United States and in Europe. Globalization has moved ideas, knowledge across borders probably more than anything else. And they come to America to study. It is not completely equalized, but it's moving very much in that way.

So I think the big news of globalization, which probably we don't emphasize enough here, is that at last, fifty years after the end of colonialism, 2.5 billion people in India and China that were excluded from the global economy are now being included. The theory that we described before is happening, and that is, if you look at it from a global perspective, very good for a very large number of people. A larger number of people are better off globally.

On the other hand, it is causing some problems here in the United States and Western Europe. One can't ignore the effects that that has politically, because we still have a democratic government. If a large enough number of people become disadvantaged, it becomes a political issue. People start agitating for protectionism.

You can say, "Look, you don't deserve a higher income. Why should you get a higher income than the guy with the same skills in India? What entitlement do you have?" No one in Congress has made that argument forcefully. The way they argue is, "It is obvious that China is playing unfair, because we are more efficient, we are better, we deserve higher incomes, and if they are doing better, it must be that they are cheating."

The fact is, they aren't cheating. It is the workings of the laws of globalization.

My response to this is that this is the absolutely worst time that one could have imagined to lower taxes on upper-incomeAmericans. In other words, to increase inequality in the United States. We ought to be trying to counter the economic forces that are going on. Instead, what this administration has been doing is saying, "Those who have been doing very well ought to get even more." The result of this is, I think, enormous political attention on globalization going forward.

JOANNE MYERS: I would like to thank you all for coming.

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