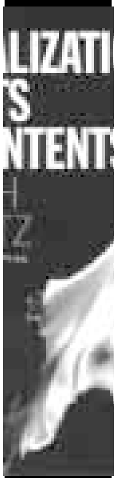

Three Takes on the Globalisation Debate

Joseph Stiglitz, *Globalisation and Its Discontents*
Melbourne, Allen Lane, 2002,
304pp, $24.95, ISBN 014101638X

Diane Coyle, *Paradoxes of Prosperity: Why the New Capitalism Benefits All*
New York, Texere, 2001
316pp, $29.95, ISBN 1587991454

Charles Leadbeater, *Up the Down Escalator: Why the Global Pessimists are Wrong*
London, Viking, 2002
384pp, $45, ISBN 0670913227

Reviewed by Malcolm Roberts

Globalisation is the root of all evil. Cheap imports are destroying manufacturing in developed countries. American mass media is infiltrating a bland global monoculture. Income inequality is widening. Poverty in the developing world persists. Living standards are depressed as countries compete to attract footloose capital.

Or so many pundits would have us believe. Globalisation is a fashionable target for social democrats and social conservatives. The left fears that corporate power is eclipsing state power. Conservatives fear that power is passing to minorities at home and supranational institutions abroad. Their arguments mix anti-capitalism, nostalgic nationalism and cultural pessimism. By comparison, the case *for* globalisation often seems too dry and technical to inspire public enthusiasm. The losses, real and putative, from trade liberalisation can be felt more keenly than the gains. The absence of free trade in some sectors, notably agriculture, taints the system as a whole.

The three books under review examine different aspects of this globalisation debate. Joseph Stiglitz's *Globalisation and Its Discontents* is savagely critical of the international financial system. In *The Paradoxes of Prosperity*, Diane Coyle, a financial journalist, argues that the new technology driving globalisation is liberating. Charles Leadbeater, from the left-of-centre Demos think tank in the UK, tackles what he sees as the culture of pessimism sustaining the anti-globalisation movement.

Financial crisis in hindsight

Joseph Stiglitz has impressive credentials. For four years, he was chairman of the Council of Economic Advisers to President Clinton, followed by almost three years as chief economist for the World Bank. In 2001, he received the ultimate professional accolade, the Nobel Prize in Economics.

Globalisation and Its Discontents is Stiglitz's account of his experiences at the World Bank from 1997 to 2000. The times were certainly interesting. In 1997, Asia fell into financial crisis. Russia followed in 1998. Over the decade, poverty increased sharply in Eastern Europe and Central Asia. Surveying these disturbing events, Stiglitz reaches some unorthodox conclusions.

Stiglitz concedes the potential of globalisation for eliminating poverty but he quickly passes to the more satisfying task of identifying its failures. According to Stiglitz, the 'Washington consensus'—free trade and minimal government—is misconceived, if not self-serving. The link between trade liberalisation and development is more tenuous than its supporters claim. Capital market liberalisation is not essential to economic growth, at least in countries with high domestic savings rates. Privatisation is not necessarily a stimulus to growth. The International Monetary Fund (IMF) may favour the 'shock therapy' of opening markets immediately to competition, but Stiglitz sees this as economic dogma or serving the interests of Wall Street. Citing the example of China, Stiglitz prefers a gradual transition to an open market, with the state nurturing export industries while slowly reducing the tariff wall. The priority for developing countries should be trade rather than trade liberalisation.

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Stiglitz illustrates these points by recounting the trials of reform in Russia and Asia in the 1990s. In Russia, price liberalisation in 1992 set off rapid inflation which forced the adoption of tight monetary policies. As reforms were introduced without adequate regulation or welfare safety nets, living standards fell sharply. The privatisation favoured by the IMF amounted to sordid asset stripping. In Asia, capital market liberalisation brought financial crisis. The primary reason for the Asian crisis, Stiglitz argues, was the premature opening of local financial markets to foreign capital. The flight of capital in 1997 caused severe recessions; the subsequent IMF adjustment programs thrust onto Thailand, Indonesia and Korea exacerbated these recessions. In both instances, what Stiglitz labels the 'market fundamentalism' of powerful Western states, championed by the IMF, forced developing countries into disastrous policies.

Stiglitz is most animated when describing the IMF's response to the Asian crisis. The IMF applied its standard adjustment programme, as it had in Latin America in the 1980s. In Latin America, IMF packages had addressed government profligacy which had unleashed hyper-inflation. However, in Asia, the problem was private not public debt—an investment bubble financed by 'hot money'. Inflation was low. The IMF response of tight fiscal and monetary policy was intended to restore investor confidence and contain the inflation set off by devaluation. In practice, Stiglitz complains, these policies plunged countries into deeper recessions. There is no doubt that these recessions were devastating. In 1998, real GDP fell by 15.3% in Indonesia, 8% in Thailand and 7% in Korea.[1]

There is no doubt that financial crises have a self-fulfilling momentum which shows markets at their worse.

At the time, Stiglitz challenged the IMF's emphasis on restoring macroeconomic stability. In *Globalisation and Its Discontents*, he sketches his alternative. The IMF should have used its funds to provide liquidity for hard pressed governments. Expansionary policies would have ensured a soft landing. Capital controls, as introduced by Malaysia in September 1998, should have been used to prevent the flight of foreign capital. In the US, Chapter 11 of the bankruptcy code allows firms to continue to trade while negotiating debt relief with creditors. Stiglitz suggests that a 'super Chapter 11' should have been introduced to promote corporate restructuring rather than liquidation. Finally, to respect Asian sensitivities, the IMF should have minimised the conditions attached to its loans.

It is important for Stiglitz's argument that the Asian crisis is seen as an investor panic striking otherwise sound economies. His criticism of opening capital markets relies on a view of investors as, literally, flighty. While this is true to a degree, it offers a limited explanation of the Asian crisis. Some fundamental factors were at work. With the Baht pegged to a soaring US dollar, Thailand faced a growing current account deficit in 1997. To defend the overvalued Baht, Thailand raised interest rates and drew on its foreign reserves. However retaining the fixed exchange rate fuelled currency speculation; as Jeffery Sachs put it, 'the more these economies tried to defend their currencies, the more they incited panic'.[2] Corporate debt was enormous. Moreover, with little regulatory oversight, Thai companies had mismatched investment, ploughing short-term US denominated loans into long-term local investments. By 1996, Thailand's short-term debt was 160% of the country's foreign reserves. Thailand was thus vulnerable to changes in both interest rates and exchange rates. Combining a fixed exchange rate and free capital market flows proved dangerously unstable.

That said, many of Stiglitz's criticisms are valid if far from surprising. The IMF accepts the obvious point that effective regulation of the financial system should precede liberalisation.[3] Using capital controls as a short-term measure to manage financial crises is contentious but it is not a startling idea; it was proposed in 1997-1998 by Paul Krugman and Sachs amongst others.[4] The US has even accepted some capital controls in its free trade agreement with Chile. Corporate restructuring is clearly better than wholesale liquidation. There is no doubt that financial crises have a self-fulfilling momentum which shows markets at their worst.

Other points are less substantial. Many of the conditions attached to IMF programs—such as restructuring the banks or curtailing wasteful pet projects such as Indonesia's national car—were sensible. Expansionary policies would almost certainly have compounded rather than eased the crisis.[5] As usual, Krugman makes a telling point:

> In late 1997 the Korean won lost half its value in a matter of weeks. Wouldn't it have plunged

> even further, perhaps even gone into free fall, if Korea hadn't raised interest rates? And wouldn't that have risked spurring a hyperinflation—not to mention instantly bankrupting all those banks and companies that had large dollar debts?[6]

More generally, Stiglitz's enthusiasm for the Chinese path to development overlooks inconvenient facts, such as its reliance on an authoritarian central state. The comparison of Russia and China ignores the historical context. Unlike China, Russia has had to restart industrialisation. Reformers had to dismantle a vast, inefficient state sector and create competitive firms in competitive markets. Privatisation was intended but failed to install new entrepreneurial managers; the same approach seems to have had more success in Hungary, Poland and other former communist states.[7]

Globalisation and Its Discontents is shallow and tediously self-righteous. The reader expecting to learn something of globalisation as an ongoing process will be disappointed. Stiglitz's obsession with the IMF overshadows any general argument. His attack on 'market fundamentalism' simplifies the policy choices available. There is an important debate about the merits of free capital flows and managing the international financial system. Some commentators believe that the system generally works and are wary of the moral hazard of providing soft loans. Others are less sanguine and wish to constrain the herd instinct of investors. Many prominent economists share Keynes' view that free markets for capital pose unacceptable risks. Unfortunately, despite his experience at the World Bank, Professor Stiglitz sheds little light on these issues.[8]

The new capitalism

Diane Coyle is earning a reputation in the UK as a staunch advocate for trade liberalisation. In the columns of the *Guardian*, she has defended globalisation against the usual critics. In the *Paradoxes of Prosperity*, Coyle draws together findings from leading researchers to interpret the emerging global economy. The synthesis is impressive in its scope and shows an awareness of the risks as well as the opportunities presented by globalisation. Unlike the gloomy Stiglitz, Coyle dares to suggest that 'the time has come to rediscover the unfashionable idea of progress'.

Coyle's optimism is based on her belief that, in affluent countries, technology has finally made consumers sovereign. Technology means more accessible information and more choice. Consumers can rightly expect more from the market. Standardised production no longer satisfies; mass markets are fragmenting into niche markets. Coyle argues that this is not only good for consumers but also for workers. Economic success will increasingly depend on human capital. Value will be created by intangibles—such as design or marketing—rather than physical inputs. Trust, quality and innovation will be essential. In the 'new capitalism', technology will make people more, not less, important. For Coyle, 'command and control capitalism [by corporations or the state] is as defunct as centrally planned Communism'.

The new capitalism is propelled by innovation. Innovation has long been recognised as the most important source of economic growth: it was responsible for as much as two-thirds of economic growth in the US during the 20th century. Coyle expects innovation to become even more important. Advances in information and communications technology have already sustained a permanent lift in productivity. Production and distribution costs have been slashed. Coyle also suggests that with more efficient communication and 'just-in-time' delivery firms can better manage inventories thereby moderating the business cycle.

Coyle is confident that the need to stimulate innovation and human capital will overcome many traditional constraints. The cost of excluding women and minorities from economic participation, or of failing to provide transparent governance, will eventually be too high. Competitive economies seem to need competitive democracies: 'The new politics and New Economy are mutually reinforcing, with liberal values helping sustain growth and the technologically driven prosperity helping boost political accountability and disperse power.'

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This is comforting news. However, innovation can be seen in a less benign light. New growth theorists, such as Paul Romer, suggest that innovation may diminish competition. Firms may succeed in capturing the benefits of a key innovation. If increasing returns to scale are possible, a firm (or even a country) may convert its initial advantage into lasting market dominance. Competition can be less than perfect. Coyle does not address directly these points. Her argument assumes, reasonably, that consumer preferences are too fluid, and technological change too rapid, for monopolies to survive. What some see as a sign of rampant corporate power—the emphasis placed on the power of brands—is actually an admission of corporate weakness.

Coyle concedes that the new capitalism has coincided with, if not caused, changes many people find threatening. She accepts, for example, that income inequality has increased in the strongly market-oriented Western countries such as the US and the UK. In the US, for example, the earnings of new college graduates rose 33% relative to high school graduates between 1979 and 1995. Coyle rightly dismisses the claim that wages for unskilled workers have fallen primarily because of foreign competition. The volume of trade is too small to have such an impact.[9] As others have noted, while manufacturing in developed countries is now more exposed to trade, the sector also employs a much smaller share of the workforce. The proportion of American workers in sectors facing direct foreign competition has fallen from about 40% in 1960 to 17%.[10] The largest, and growing, sector of the economy—services—faces relatively little foreign competition. It is likely that trade has led to some fall in real wages in particular industries but the main cause is technological change which has reduced the demand for unskilled labour.

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Coyle is concerned that the legitimacy of globalisation is threatened by economic and social tensions. Governments need to attack the root causes of these divisions—such as ineffectual public education, welfare programmes which discourage work, and the negative clustering of marginalised people. Coyle worries that economic opportunities are tied to social skills and networks inaccessible to people in disadvantaged areas. This concern applies equally to developing countries—Coyle strongly supports the free movement of people as well as capital and goods.

As the title of her book suggests, Coyle is intrigued by the apparent paradoxes posed by the new capitalism. A flexible labour market (the US) which offers little formal protection for workers has low unemployment; European markets with extensive labour regulations suffer from stubbornly high unemployment. Many of the most strident critics of globalisation enjoy the lion's share of its benefits. In the so-called borderless world, place is more important than ever; free to locate almost anywhere, firms are drawn to clusters such as Silicon Valley where a critical mass of related businesses thrive. Globalisation may make national cultures commodities but in doing so 'it grows the franchise'. The creation of a truly global market has seen not only large corporations expand but also small enterprises increase in number and significance.

Third Way thinking

Up the Down Escalator shares many common themes with *The Paradoxes of Prosperity*. Both books are focused on the impact of new technology on work and individual opportunity. As the subtitle suggests, Charles Leadbeater is struck by the conjunction of affluence and pessimism in many countries but he is confident that the future offers far more reasons for optimism.

Leadbeater examines, one by one, some of the more common pessimist visions of the future. There are the nostalgic critiques of modern Britain, such as Roger Scruton's grumpy lament for English village life and the railings of *Daily Telegraph* journalists against the Euro, the metric system and other insidious threats. A British sense of national decline underlies these feelings. The longing for an idealised past is also evident on the other side of the Atlantic with families drawn to the Disney town of Celebration and its promise of safe suburbia. Robert Putnam's *Bowling Alone* has touched a nerve in the US about the weakening of post-war community ties. On the left, critics focus on the apparent growing power of corporations, the growth in income inequality, environmental damage and the sinister implications of technology.

Leadbeater devotes much space to presenting, and gently criticising, these arguments. Like Coyle, Leadbeater believes these criticisms overlook how capitalism itself is changing with technology. Like Coyle, he predicts that the new capitalism will expand opportunities because of its need for continual innovation. Innovation will take many forms. New products and services will be created, and bundled together in new ways. New functions will be added to familiar technology: 3G mobile telephones, for example, connect users to a broad range of services. Innovation will also mean cross-fertilisation between cultures. Open multicultural societies will benefit from their capacity to absorb such new influences.

The pursuit of innovation will have profound effects in the workplace. Leadbeater repeats some common criticisms of large corporations as bureaucratic and slow to recognise opportunities. To overcome these weaknesses, corporations seek to capture expertise through out-sourcing or buy-outs of more dynamic smaller firms. Creative workers will need to be attracted, and retained, by offering more satisfying, self-managed work. Old style hierarchical management is increasingly a liability.

If corporations must attract human capital, national governments face the daunting challenge of creating it. In all developed countries, the skilled white collar workforce has grown considerably. In the US, the demand for scientific and technical workers has grown from a mere 20,000 in 1900 to 1.5 million in 2000 (albeit in a workforce of 128 million). Higher education has expanded to become a mainstream experience; more than one-third of British school children will go to university. The knowledge economy may not be as imminent as its advocates hope but the signs are unmistakeable.

With education so critical to life chances, Leadbeater is alarmed that governments are failing to provide real equality of opportunity. In the UK, university students are overwhelmingly middle class—80% of middle class children attend university compared to just 14% of working class children. It is a familiar pattern which reflects not only different aspirations but also the obstacles of inadequate state schools and, often, fractured family lives. Leadbeater believes this last point is vital: 'home is where the human capital is'. In this sense, Leadbeater prefers the Scandinavian social democratic model as best combining social support with economic growth. As an anointed Third Way thinker, Leadbeater's preference is not surprising (the blurb for *Up the Down Escalator* carries endorsements of the author from Tony Blair, *The Guardian* and *The Independent*).

Conclusion

There are no signs that the flood of books on globalisation will abate soon. Each of the books reviewed cover important aspects of the debate, with varying success. What all three books demonstrate is that the debate about globalisation turns on competing views of the merits of free markets. It is reassuring to see that the positive case for globalisation is now being made for a wide public audience.

Endnotes

1 Andrew Berg and Catherine Pattillo, *Economic Issues Number 22: The Challenges of Predicting Economic Crises* (Washington, DC: International Monetary Fund, 2000), p.6.

2 Jeffery Sachs, 'Global Capitalism: Making It Work', *The Economist* (12 September 1998), p.20.

3 Horst Köhler, 'Investing In Better Globalization' (Washington DC: Council on Foreign Relations, 2002). Köhler is the managing director of the IMF. Kenneth Rogoff of the IMF has responded to the critics in his 'The IMF Strikes Back', *Foreign Policy* (January-February 2003).

4 Jeffery Sachs, 'Personal View', *Financial Times* (30 July 1997); Paul Krugman, 'Capital Control Freaks: How Malaysia Got Away With Economic Heresy', *Slate* (27 September 1999), and 'Saving Asia: It's Time to Get Radical', *Fortune* (7 September 1998).

5 Rudi Dornbusch, 'After Asia: New Directions for the International Financial System', (July 1998), p.6 at Dornbusch's website (http://web.mit.edu/rudi/www/papers.html). Dornbusch suggests that the collapse of the Thai banks pushed substantial liabilities back onto the public sector, requiring offsetting budget reductions. In a similar situation, China was obliged in 1998 to recapitalise its major banks by US$32 billion. Morris Goldstein claims that 'When much of the banking system becomes insolvent, debt that starts out in the private sector doesn't stay there long': Morris Goldstein, *The Asian Financial Crisis* (Washington DC: Institute for International Economics, 1998), p.66.

6 Paul Krugman 'Saving Asia'.

7 World Bank, *Transition: The First Ten Years* (Washington, DC: World Bank, 2002), p.vxiii.

8 *Globalisation and Its Discontents* is almost a cliché in its own right. The phrase was the title of a 1998 article (Richard N. Haass and Robert E. Litan 'Globalisation and its Discontents' *Foreign Affairs*, 77, 3, May/June 1998, pp.2-6) and a chapter heading in Robert Gilpin *The Challenge of Global Capitalism* (Princeton: Princeton University Press, 2000).

9 William R. Cline, 'Trade and Income Distribution: The Debate and New Evidence' (Washington DC: Institute for International Economics, 1999) is a handy if slightly dated survey of the arguments about the linkage between trade and incomes.

10 Douglas Irwin, *Free Trade Under Fire* (Princeton: Princeton University Press, 2002), p.11.