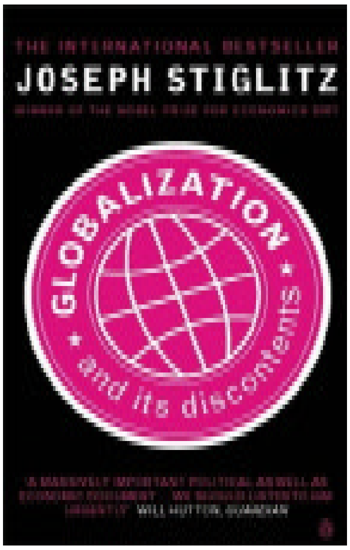
BOOK SUMMARY

Globalization and its discontents



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In this book, Joseph E Stiglitz, a winner of Nobel Prize in economics, has critisized the global economic policies of the International Monetary Fund (IMF), World Trade Organization (WTO) and World Bank. He singles out IMF for most of the blame: flawed economic theories, lack of transparency and accountability to the public, and the pursuit of special corporate interests. The author believes that the IMF and World Bank should be reformed, not dismantled. He advocates a gradual, sequential, and selective approach for its reformation.

International bureaucrats are under attack everywhere. Formerly peaceful meetings of the IMF, World Bank and WTO have now become the scene of raging street battles and huge demonstrations. The protests at the Seattle meeting of the 1999 WTO came as a shock. Since then, the movement has grown stronger. Virtually every major meeting of the IMF, the World Bank, and the WTO are witnessing massive opposition.

Many aspects of globalization have positive reception across the world. For example, no one wants to see his/her child die, when knowledge and medicines are available elsewhere in the world. It is the more narrowly defined economic aspects of globalization such as conditions imposed by the international institutions that have become the subject of controversy.

This book, focuses mostly on the IMF and the World Bank, who have been at the center of the major economic issues of the last two decades, including currency crises and the transition of the former Communist countries to market economies.

The IMF and the World Bank

The IMF, initially served as a platform for collective action at the global level for economic stability. It functioned on the premise that market left to themselves would work badly. It was founded on the belief that there is a need for international pressures on countries to have more expansionary policies.

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But over the years, IMF has changed drastically. It now champions market supremacy with an ideological fervor. Today the IMF typically provides funds countries only if they engage in contractionary policies like cutting deficits, raising taxes, or raising interest rates.

Similarly in the world bank, in the early 1980s, a shift occurred in its research department, which guided the Bank's thinking and direction. Earlier the bank focused on how markets failed in developing countries and what governments could do to improve markets and reduce poverty, later it began to see government itself as the problem. Free markets were offered as a solution to the problems of developing countries.

Although the missions of the IMF and World Bank remained distinct, in the 1980s, their activities became increasingly intertwined. The Bank went beyond lending structural adjustment loans for projects like roads and dams. But it did this only when the IMF gave its approval. Along with that approval came IMF-imposed conditions on the country. The IMF was supposed to focus on crises; but developing countries were always in need of help, so the IMF became a permanent part of life in most of the developing world.

Authors' Profile

Joseph E Stiglitz is a Professor at the Columbia Business School, the Graduate School of Arts and Sciences (Department of Economics) and the School of International and Public Affairs. He was a member of the Council of Economic Advisors from 1993-95, during the Clinton administration, and served as CEA chairman from 1995-97. He then became Chief Economist and Senior Vice-President of the World Bank from 1997-2000. He is also the Co-founder and Executive Director of the Initiative for Policy Dialogue (IPD).

In 2001, he was awarded the Nobel Prize in economics. Stiglitz helped create a new branch of economics, "The Economics of Information," exploring the consequences of information asymmetries.

Stiglitz feels that the IMF has failed in its mission. It has not done what it was supposed to do– provide funds for countries facing an economic downturn, and restore them close to full employment. Nearly 100 countries have faced crises. And once a country is in crisis, IMF programs have not only failed to stabilize the situation but in many cases made matters worse.

The Keynesian orientation of the IMF, which emphasized market failures and the role for government in job creation, was replaced by the free market mantra of the 1980s. This was part of a new "Washington Consensus" between the IMF, the World Bank, and the US Treasury about the "right" policies for developing countries. The IMF has also tended to take a "one-size-fits-all" approach. Unfortunately in developing countries, markets are often absent, or when present work imperfectly. Information problems abound, and cultural issues also significantly affect economic behavior.

IMF imposes conditions for providing loans to developing countries. But conditionality has often not worked. Even if the right conditions are imposed to ensure that loan is used well, the loan frees up resources elsewhere, which may or may not be used well. In some cases, wrong conditions were imposed. Examples include, financial market liberalization in Kenya and fiscal austerity in East Asia. In other cases, the way conditionality was imposed made the conditions politically unsustainable. When a new government came into power, they were abandoned.

Fiscal austerity, privatization, and market liberalization

Stiglitz emphasizes that fiscal austerity pushed too far, under the wrong circumstances, can induce recessions. High interest rates may impede fledgling business enterprises.There are some important preconditions that have to be satisfied before privatization can contribute to an economy's growth. And the way privatization is accomplished makes a great deal of difference. The IMF and the World Bank pursued privatization rapidly. They assumed that markets rise quickly to meet every need, when in fact, many government activities arise because markets fail to provide essential services.

The IMF argued that it is far more important to privatize quickly than to deal with the issues of competition and regulation. But the danger here is that once a vested interest is created, it has money, to maintain its monopoly position. IMF has been less concerned about competition and regulation because privatizing an unregulated monopoly can yield more revenue to the government. The IMF focuses more on macro-economic issues, such as the size of the government's deficit, than on structural issues, such as the efficiency and competitiveness of the industry. In many cases, the privatized monopolies turned out to be more efficient in exploiting their monopoly position. Consumers suffer as a result.

There is a little evidence that privatization will solve the problem in a corrupt government. After all, the same corrupt government that mismanaged the firm will also handle the privatization. In country after country, government officials realized that privatization means they no longer need to be limited to annual profit skimming. By selling a government enterprise at below market price, they can get a significant chunk of the asset value for themselves instead of leaving it for subsequent officeholders.

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While restructuring state enterprises through privatization is necessary, Stiglitz feels it needs to be part of a more comprehensive program. Jobs must be created in tandem with the jobs destruction that often results. Macroeconomic policies, including low interest rates that create jobs have to be put in place. Moving people from low-productivity jobs in state enterprises to unemployment does not increases a country's income, nor does it increase the welfare of the workers.

Trade liberalization can enhance a country's income by forcing resources to move from less productive uses to more productive ones. The most successful developing countries, those in East Asia, opened themselves to the outside world slowly and in a sequenced way. These countries took advantage of globalization to expand their exports and grew faster as a result. But they dropped protective barriers carefully and systematically, phasing them out only when new jobs were created. They ensured that there was capital available for new jobs and enterprise creation; and took an entrepreneurial role in promoting new enterprises.

The more advanced industrial countries did not attempt capital market liberalization until late in their development. For example, European nations waited until the 1970s to get rid of their capital market control. But pressure has been put on the developing nations to do this quickly. The consequences of banking crises brought on by capital market deregulation, while painful for developed countries, have been much more serious for developing countries. The poor countries have no safety net to soften the impact of recession. In addition, the limited competition in financial markets means that liberalization has not always brought the promised benefit of lower interest rates. So, farmers sometimes have to pay higher interest rates, making it more difficult for them to buy the seed and fertilizer necessary to eke out their bare subsistence living.

Capital market liberalization entails stripping away the regulations intended to control the flow of hot money[1] in and out of the country. This speculative money cannot be used to build factories or create jobs. The risk that such hot money brings with it also makes long-term investments in a developing country less attractive. The adverse effects on growth are even greater. To manage the

[1] Short term capital flows.

risk associated with these volatile capital flows, countries are routinely advised to set aside in their reserves an amount equal to their short-term foreign-denominated loans.

Perhaps of all the blunders made by IMF, it is the mistakes in sequencing and pacing, and the failure to be sensitive to the broader social context, that have received the most attention. IMF has forced liberalization before safety nets and regulatory framework have been put in place. It has introduced policies that led to job destruction before the essentials of job creation were in place. Many of the sequencing mistakes reflect fundamental misunderstandings of both economic and political processes, due to a blind faith in the market mechanism.

The IMF approach also does not acknowledge that development requires a transformation of society. While implementing reforms, social unrest must be avoided at all costs. In the 1980s, Latin America needed to bring fiscal deficits and inflation brought under control. But excessive austerity led to high unemployment. Without an adequate safety net, this contributed to high levels of urban violence, an environment hardly conducive to investment. Civil strife in Africa has been a major factor, setting back its development agenda. Strife is systematically related to adverse economic factors, including unemployment that can be produced by excessive austerity. Moderate inflation may not be ideal for creating an environment for investment, but violence and civil strife are much worse.

Attacking poverty

While it is true that sustained reductions in poverty cannot be attained without robust economic growth, the converse is not true: growth need not benefit all. It is not true that "a rising tide lifts all boats," as Stiglitz puts it, "Sometimes, a quickly rising tide, especially when accompanied by a storm, dashes weaker boats against the shore, smashing them to smithereens."

The growth-poverty debate is about development strategies – strategies that look for polices that reduce poverty as they promote growth, that shun policies that increase poverty

It is true that, on an average, countries that have grown faster have done a better job of reducing poverty, as China and East Asia amply demonstrate. It is also true that poverty eradication requires resources, which can only be obtained with growth. Thus there is a correlation between growth and poverty reduction. But this correlation does not prove that trickle-down strategies constitute the best way to attack poverty.

The growth-poverty debate is about development strategies – strategies that look for polices that reduce poverty as they promote growth, that shun policies that increase poverty with little if any gain in growth, and that, put a heavy weight on the poor.

Understanding the choices require understanding the causes and nature of poverty. It is not that the poor are lazy. They often work harder, than those who are far better off. Many are caught in a series of vicious spirals: Lack of food leads to ill health, which limits their earning ability, leading to still poorer health. Barely surviving, they cannot send their children to school, and without education, their children are condemned to a life of poverty. Poverty is passed along from one generation to another. Poor farmers also cannot afford to pay the money for the fertilizers and high-yielding seeds that would increase their productivity.

The East Asian crisis

Capital account liberalization can impose enormous risks, even when countries have strong banks, a mature stock market, and other institutions that many of the Asian countries did not have. The IMF and the US Treasury argued, that full capital account liberalization would help East Asia to grow even faster. Actually, the countries had no need for additional capital, given their high savings rate.

In October 1997, at the very beginning of the crisis, the IMF was advocating the expansion of precisely those polices which precipitated the crisis. For example, before liberalization, Thailand had severe limitations on the extent to which banks could lend for speculative real estate. Thailand believed that investing the country's scarce capital in manufacturing would both create jobs and enhance growth. It also knew that throughout the world, speculative real estate lending is a major source of economic instability.

The IMF, however, contended that the kinds of restraints that Thailand had imposed to prevent a crisis interfered with the efficient market allocation of resources. While Thailand was desperate for more public investment to strengthen its infrastructure and relatively weak secondary and university education systems, billions were squandered on commercial real estate.

The IMF was also wrong in its recommendation of fiscal policy. East Asia was vastly different from Latin America. Governments had surpluses and the economy enjoyed low inflation. In the highly inflationary environment of Latin America, excess demand had to be reduced. In East Asia, the problem was insufficient demand. Dampening demand only made matters worse.

Moreover, with high levels of corporate indebtedness, imposing high interest rates, even for short periods of time, is like signing a death warrant for many of the firms and for the economy. By continuing to advocate contractionary policies, the IMF aggravated the contagion. As each country went into a recession, it reduced its imports from its neighbors, thereby pulling its neighbors down.

The IMF was wrong in its recommendation of fiscal policy. East Asia was vastly different from Latin America. Governments had surpluses and the economy enjoyed low inflation

The IMF felt that if a country raised interest rates, it would make it more attractive for capital to flow into that country. Capital flows into the country would help support the exchange rate and thus stabilize the currency. But, the underlying problems in East Asia were weak financial institutions and overleveraged firms. So high interest rate policies exacerbated those problems. They increased the number of firms in distress, and thereby increased the number of banks facing non-performing loans. This weakened the banks further. The increased distress in the corporate and financial sectors worsened the downturn.

The argument that if interest rates were not increased, the exchange rate would collapse was not valid. Higher interest rates did not stabilize the currency. Moreover, the IMF never bothered to look at the details of what was going on inside the countries. In Thailand, for instance, it was the already bankrupt real estate firms and those that lent to them who had the most dollars denominated debt. Further devaluations might have harmed the foreign creditors but would not have made these firms any more dead. In effect, the IMF made the small businesses and other innocent bystanders pay for those who had engaged in excessive dollar borrowing.

The IMF's insistence on banks quickly meeting capital adequacy standards further aggravated the downturn. The Fund overlooked "the fallacy of composition." When only one bank has a problem, insisting on its meeting its capital adequacy standards make sense. But when many banks are in trouble, that policy can be disastrous. There are two ways of increasing the ratio of capital to loans: Increasing capital or reducing loans. In the midst of a downturn, especially of the magnitude of that in East Asia, it is hard to raise new capital. The alternative is to reduce outstanding loans. But as each bank calls in its loans, more and more firms are put into distress. Without adequate working capital, they are forced to cut back on their production, cutting into the demand for products from other firms. The downward spiral is worsened.

Nowhere was the IMF's lack of understanding of financial markets so evident as in its policies in Indonesia. Some 16 private banks were closed down, and notice was given that other banks might be subsequently shut down as well; but depositors, except for those with very small accounts, would be left to fend for themselves. Not surprisingly, this engendered a run on the remaining private banks, and deposits were quickly shifted to state banks, which were thought to have an implicit government guarantee. The impact on the Indonesian banking system, and economy, was disastrous. In contrast, South Korea ignored outside advice, and recapitalized its two largest banks rather than closing them down. This probably is the reason for a relatively quick recovery of Korea.

The IMF's strategy for corporate restructuring was equally unsuccessful. It confused financial restructuring with real restructuring, what the firm should produce, how it should produce its output, and how it should be organized. The government should have played an active role in pushing financial restructuring. Once ownership issues were resolved, the new owners should have dealt with real restructuring. The IMF took the opposite view, saying that the government should not take an active role in financial restructuring, but push for real restructuring, selling assets, for instance, to reduce South Korea's excess capacity in chips and bringing in outside (typically foreign) management. Bureaucrats, do not have any special insight into corporate restructuring. The governments of Korea and Malaysia concentrated on and succeeded in completing the financial restructuring of a remarkably large fraction of the firms in distress. By contrast, restructuring in Thailand, which followed the IMF strategy, languished.

The IMF's strategy for corporate restructuring was equally unsuccessful. It confused financial restructuring with real restructuring

Riots do not restore business confidence. They drive capital out of a country. And riots are predictable with some certainty. It was clear Indonesia was ripe for such social upheaval. The IMF itself should have known this. Around the world, the IMF has inspired riots when its policies cut off food subsidies.

Malaysia's capital controls allowed it to recover more quickly, with a milder downturn, and with a smaller debt burden. The controls facilitated lower interest rates. So fewer firms went bankrupt, and the magnitude of publicly funded corporate and financial bailout was smaller. Recovery could occur with less reliance on fiscal policy, and consequently less government borrowing. Today, Malaysia is in a far better position than those countries that took IMF's advice.

After a short period of policy vacillation from July through October 1997, Thailand followed IMF prescriptions almost perfectly. Yet more than three years after the beginning of the crisis, it was still in recession, with its GDP approximately 2.3% below the pre-crisis level. Little corporate restructuring had taken place, and close to 40% of the loans were still non-performing.

In contrast, Korea did not close down banks according to the standard IMF prescription, Korea kept its exchange rate low, rather than letting it rebound in order to sustain exports and limit imports. Moreover, Korea did not follow the IMF's advice concerning physical restructuring. The IMF acted as if it knew a lot about the global chip industry, and argued that Korea should quickly get rid of the excess capacity. Korea ignored this advice. As the demand for chips recovered, the economy recovered. Had the IMF's advice been followed, the recovery would have been far more muted.

The Russian crisis

The first mistakes in Russia occurred almost immediately as the transition began. In the enthusiasm to get on with a market economy, most prices were freed overnight in 1992, setting in motion an inflation that wiped out savings. It was clear that with hyperinflation it would be difficult to have a successful transition. Thus, the first round of shock therapy, instantaneous price liberalization, necessitated the second round, raising interest rates.

While most of the prices were completely freed, some of the most important prices were kept low – those for natural resources. With the newly declared "market economy," this created an open invitation, to buy oil and resell it in the West, and make millions or even billions of dollars. Instead of making money by creating new enterprises, businessmen got rich by exploiting misguided government policies. Reform, even in well-functioning political and economic systems, is always "messy." Even if it made sense to push for instantaneous liberalization, the more relevant question is, how should one have proceeded with liberalization if one could not succeed in getting important sectors, like energy prices, liberalized quickly?

The IMF policies also led to capital flight. An oligarch who had just been able to use political influence to garner assets worth billions, after paying only a pittance, would naturally want to get his money out of the country

The IMF policies also led to capital flight. An oligarch who had just been able to use political influence to garner assets worth billions, after paying only a pittance, would naturally want to get his money out of the country. Keeping money in Russia meant investing it in a country in deep depression, and risking not only low returns but having the assets seized by the next government. Anyone smart enough to be a winner in the privatization sweepstakes would be smart enough to put their money in the booming US stock market, or into the safe haven of secretive offshore bank accounts. Not surprisingly, billions poured out of the country.

Thus, at the time of the East Asia crisis, Russia was in a peculiar position. It had an abundance of natural resources, but its government was poor. The government was virtually giving away its valuable state assets. Yet it was unable to provide pensions for the elderly or welfare payments for the poor. The government was borrowing billions from the IMF, becoming increasingly indebted, while the oligarchs, who had received such largesse from the government, were taking billions out of the country. The IMF had encouraged the government to open up its capital accounts, allowing a free flow of capital. The policy was supposed to make the country more attractive for foreign investors. Actually it facilitated a rush of money out of the country.

The July 1998 bailout was just as much a bailout of Western banks that stood to lose billions of dollars as it was a bailout of Russia. But it was not just Wall Street's direct interests that influenced policy; it was the ideology that prevailed in the financial community. For Wall Street, inflation is bad as it erodes the real value of what is owed to creditors. Unemployment is far less of a concern. For Wall Street, nothing could be more sacrosanct than private property; hence the emphasis on privatization. Wall Street's commitment to competition is far less passionate. And the financial community is not remotely concerned with social capital and political participation.

Better roads to the market

There are better examples of countries making a smother transition to market economies. Poland started with "shock therapy" to bring hyperinflation down to more moderate levels. But Poland quickly realized that shock therapy was appropriate for bringing down hyperinflation, not for societal change. It pursued a gradualist policy of privatization, while simultaneously building up the basic institutions of a market economy, such as banks that actually lend, and a legal system that enforces contracts and processes bankruptcies fairly. It recognized that without those institutions, a market economy could not function. The country did not engage in rapid privatization, and it did not give priority to reducing inflation beyond a point. Instead it democratic support for the reforms, by trying to keep unemployment low, providing benefits to the unemployed and adjustment pensions for inflation, and creating the institutional infrastructure required to make a market economy function. The gradual process of privatization allowed restructuring to take place prior to privatization. So and the large firms could be reorganized into smaller units. A new, vibrant small enterprise sector was thus created, headed by young managers willing to invest for their future.

China recognized the importance of macro-stabilization. But it never confused ends with means, and it never took fighting inflation to an extreme

China recognized the importance of macro-stabilization. But it never confused ends with means, and it never took fighting inflation to an extreme. It recognized that if it was to maintain social stability, it had to avoid massive unemployment. China liberalized, gradually so that resources that were displaced were redeployed to more efficient uses, not left in fruitless unemployment. Monetary policy and financial institutions facilitated the creation of new enterprises and jobs. Some money did go to support inefficient state enterprises, but China thought that it was more important, not only politically but also economically, to maintain social stability, which would be undermined by high unemployment. Although China did not rapidly privatize its state enterprises, as new enterprises were created, the state ones dwindled in importance. Twenty years after the transition began, they accounted for only 28.2% of industrial production. China also recognized the dangers of full capital market liberalization, while it opened itself up to foreign direct investment.

IMF's other agenda

Markets may sometimes exhibit excessive pessimism. It is not just in the currency markets that these problems occur. There is a wider set of imperfections in markets, and especially capital markets, requiring a wider set of interventions.

If speculators only made money off each other, it would be an unattractive game. What makes speculation profitable is the money coming from governments, supported by the IMF. When the IMF and the Brazilian government, for instance, spent some $50 bn maintaining the exchange rate at an overvalued level in late 1998, the money simply went into the pockets of the speculators. Some speculators may win, some may lose, but speculators as a whole make an amount equal to what the government loses.

The IMF has also been responsible for creating moral hazards. In a typical market economy, if a lender makes a bad loan, he bears the consequence. The borrower may well go into bankruptcy, and market economies are supposed to have bankruptcy laws. Instead, repeatedly, the IMF programs provide funds for governments to bail out Western creditors. The creditors, anticipating an IMF bailout, have weakened incentives to ensure that the borrowers will be able to repay.

The problem of economic disruption due to exchange rate devaluations is caused by the firms that choose not to buy insurance against the collapse of the exchange rate. Firms do not buy insurance because they are confident that IMF interventions will support the exchange rate. So, the problem is the IMF itself!

The IMF is pursuing not just its original objectives of enhancing global stability and ensuring that there are funds for countries facing a threat of recession to pursue expansionary policies. It is also pursuing the interests of the financial community. The IMF may not have become the bill collector of the G-7, but it clearly works hard to make sure that the G-7 lenders get repaid. The IMF can engineer a standstill that gives the countries time to recoup, to restart their stalled economies. It can create an accelerated bankruptcy process. But bankruptcy and standstills are not welcome options, for they mean that the creditors would not be repaid.

The way ahead

Today, globalization is not working for many of the world's poor. Neither is it working for much of the environment or for the stability of the global economy. But abandoning globalization is neither feasible nor desirable.

Globalization has brought huge benefits. Globalization has brought better health, as well as an active global civil society fighting for more democracy and greater social justice. The problem is not with globalization, but with how it has been managed. Part of the problem lies with the international economic institutions, like the IMF, World Bank, and WTO. They have served the interests of the more advanced industrialized countries – and particular interests within those countries—rather than those of the developing world. They have also approached globalization with a narrow mind-sets.

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If financial interests have dominated thinking at the IMF, commercial interests have had an equally dominant role at the WTO. Just as the IMF gives short shrift to the concerns of the poor – there are billions available to bail out banks, but not the paltry sums to provide food subsidies for those thrown out of work as a result of IMF programs—the WTO puts trade over all else.

The world is a complicated place. Each group in society focuses on a part of the reality that affects it the most. Workers worry about jobs and wages, financiers about interest rates and being repaid. A high interest rate is good for a creditor – provided he or she gets paid back. But high interest rates are bad for unemployment. No wonder workers do not like high interest rates. For the financier who has lent his money out long term, the real danger is inflation. Inflation may mean that the dollars he gets repaid will be worth less than the dollars he lent.

Over the past 50 years, economic science has explained why, markets may lead to the underproduction of some things—like basic research and the overproduction of others like pollution. The most dramatic market failures are the periodic slumps, the recessions and depressions, that leave large numbers of workers unemployed and a large fraction of the capital stock underutilized. But while these are the most obvious examples of market failures, there is a variety of more subtle failures, where markets have failed to produce efficient outcomes. Government can, play an essential role not only in mitigating these market failures but also in ensuring social justice. Market processes may, by themselves, leave many people with too few resources to survive.

Social cohesion is important if an economy is to function. Excessively austere policies, such as contractionary monetary, and fiscal policies in Argentina, and cutting off food subsidies to the poor in Indonesia, predictably give rise to turmoil. This is even more likely when there are massive inequities. When billions are going to corporate and financial bailouts, leaving nothing for the jobless, social unrest is quite likely. Unfortunately, IMF and World Bank policies have not taken adequate note of the social circumstances prevailing in developing countries.

The discontent with globalization arises because market fundamentalism has been pushed over all other views. Opposition to globalization in many parts of the world is not to globalization *per se* but to the particular set of doctrines, the Washington Consensus policies that the international financial institutions have imposed. And it is not just opposition to the policies themselves, but to the notion that there is a single set of policies that is right.

We cannot go back on globalization; it is here to stay. The issue is how we can make it work. To make it work, we need global public institutions to help set the rules. There should be a change in governance. At the IMF and the World Bank, and other international economic institutions, there must be changes in voting rights to ensure that it is not just the voices of trade ministers that are heard in the WTO or the voices of the finance ministries and treasuries that are heard at the IMF and World Bank. Transparency is even more important in these public institutions, because their leaders are not elected directly.

According to Stiglitz, the following points need to be kept in mind:

Acceptance of the dangers of capital market liberalization: Short-term capital flows ("hot money") impose huge externalities, costs borne by those not directly party to the transaction (the lenders and borrows). Whenever there are such large externalities, interventions are desirable.

Bankruptcy reforms and standstills: The appropriate way of addressing problems when private borrowers cannot repay creditors, whether domestic or foreign, is through a bankruptcy provision that expedites restructuring. Such a reform will also induce more due diligence on the part of creditors, rather than encouraging the kind of reckless lending that has been so common in the past.

Less reliance on bailouts: With increased use of bankruptcies and standstills, there will be less need for the big bailouts. In bailouts, money goes either to ensure that Western creditors got paid back, or that exchange rates are kept overvalued longer than they otherwise need be. Bailouts have the problem, by reducing incentives for prudent lending, and for covering of exchange risks.

Improved banking regulation: Weak bank regulation in developed countries can lead to bad lending practices, an export of instability. Financial sector deregulation and the excessive reliance on capital adequacy standards have been misguided and destabilizing. What is required is a broader, less ideological approach to regulation, adapted to the capacities and circumstances of each country.

Improved risk management: Today, countries around the world face enormous risk from the volatility of exchange rates. Developing countries have to learn to manage these risks, probably by buying insurance against these fluctuations in the international capital makers. Unfortunately, today the countries can only buy insurance for short-run fluctuations. The developed countries should help develop their insurance markets. They must also provide loans to the developing countries in forms that mitigate the risks, e.g., by having the creditors absorb the risks of large real interest fluctuations.

Improved safety nets: Part of the task of risk management is enhancing the capabilities of the vulnerable within the country to absorb risks. Most developing countries have weak safety nets, including a lack of unemployment insurance programs.

Improved response to crises: During the 1997-98 crisis, the assistance given was badly designed and poorly implemented. The programs did not take sufficiently into account the lack of safety nets, that maintaining credit flow was of vital importance, and that collapse in trade between countries would spread the crisis. While responding to financial crises, the concerns of workers and small businesses have to be balanced with the concerns of creditors. Responses to future financial crises will have to be placed within a social and political context.

One of the reasons globalization is being attacked is that it seems to undermine traditional values. Economic growth will result in urbanization, undermining traditional rural societies. Unfortunately, so far, those responsible for managing globalization have shown insufficient appreciation of this adverse side, the threat to cultural identity and values.

Globalization can be a force for good. The globalization of ideas about democracy and of civil society have changed the way people think, while global political movements have led to debt relief and the treaty on land mines. Globalization has helped hundreds of millions of people attain higher standards of living. Globalization has benefited countries that have taken advantage of it by seeking new markets for exports and by welcoming foreign investment. Even so, the countries that have benefited the most have been those that have taken charge of their own destiny and recognized the notion of a self-regulated market that would fix its own problems.

For millions of people, globalization has not worked. Many have actually become worse off, with their jobs destroyed and lives becoming insecure. They have felt increasingly powerless against forces beyond their control. They have seen their democracies undermined, their cultures eroded.

There must be a multipronged reform strategy. There should be reform of the international economic arrangements. But reforms should also be encouraged in developing countries which must assume greater responsibility for their well-being. They can manage their budgets to live within their means, and eliminate protectionist barriers. They can put in place strong regulations to protect themselves from speculators from the outside or corporate misbehavior from the inside. Most important, developing countries need effective governments, with strong and independent judiciaries, democratic accountability, openness and transparency and freedom from the corruption that has stifled the effectiveness of the public sector and the growth of the private sector.

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While it is important to attract good people to work for the company, the more important thing is to give them their independence, otherwise they will go away.

Louis Schweitzer, Chairman & CEO, Renault France.