Globalization, Growth, and Poverty

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William Easterly, *The Elusive Quest for Growth: Economists' Adventures and Misadventures in the Tropics* (Cambridge: MIT Press, 2001): xiii, 342.

Joseph Stiglitz, *Globalization and Its Discontents* (New York: W.W. Norton, 2002): xxii, 282.

Here are two books on the world economy and the murderous poverty that separates populations of the North and South. Both books are written by distinguished economists. Both economists, in addition to making important contributions to their discipline, have years of experience in the world of international development institutions. Both are highly critical of the performance of those institutions, and of the global economy itself, which has stranded billions in destitution. And both conclude that what is most needed to improve that performance is neither more resources, nor perfected markets, but better political arrangements: in a word, democracy.

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Where they differ—as a matter of emphasis—is on what needs to be democratized. William Easterly focuses on improving government accountability and representativeness within developing countries. Joseph Stiglitz focuses on increasing the accountability and representativeness of global economic institutions. This difference in focus is less impressive, however, than the centrality of democracy to both accounts. Treated as mutual complements, indeed, their composite view comes remarkably close to one line of progressive response to globalization. The destructiveness of world capitalism owes to its indifference to humanity. Ending that indifference requires political representation for all affected interests. And such representation means more democracy. This view should be of particular interest to labor and its friends, and we conclude with a sketch of some of its implications.

William Easterly served for sixteen years as a staff economist at the World Bank, before being forced out—or strongly encouraged "to find another job" (x)[1]—after publication of this book. *Elusive Quest* sums up his experience at the Bank, and offers a masterful narrative of how economists' understanding of economic development has evolved over the past 50 years. Even as he is devastating in his criticism of much development practice, Easterly is at pains to emphasize the essential good-heartedness of its practitioners. He compares development economists like himself to those mythical heroes who fruitlessly searched

[1] Page references to the respective books under review.

for the Golden Fleece, the Holy Grail, or the Elixir of Life. Their failure has been noble, even as it has been nearly complete. The surprising failing that unites disparate development efforts, in Easterly's view, is that the economists prescribing them did not take seriously enough their own basic axiom—that people only respond to incentives, or that "[p]eople do what they're paid to do" and "what they don't get paid to do, they don't do." (xii) Instead of ensuring incentives, development theory and practice has often focused on building capacity: providing capital for investment, support for schools, and inexpensive condoms for population control. But without the right incentives, resources go to waste: capital is spent on useless dams, educated citizens become lobbyists, and kids use the condoms as water balloons.

Of course, providing the right incentives requires a reasonable view of how economies work, and aid efforts have frequently come up short in this respect. To this day, for example, a huge amount of development aid is directed to increasing investment in plant and equipment, as though capital accumulation is the key to economic growth. The trouble with this "capital fundamentalist" view of growth derives in part from its inattention to incentives: investment assistance can always be misused. But there is a second problem, and Robert Solow later got a Nobel Prize for discovering it the late 1950s. As an economy grows, the benefits from adding more machines decline ("diminishing returns" set in). So a country that starts with a large pool of surplus labor and only a few machines might benefit from their initial increase. But as employment increases, the growth rate will fall if the workers are simply given more and more machines to work with. Unless labor is used more effectively—which means technological change—the growth rate will eventually decline to the rate of population growth. In short, the key to long-term growth is technological change, not capital accumulation.

But what accounts for technological change (and increased skill)? Here is where the accumulating understanding comes into play. Over the past 15 years, research about economic growth and development has sought to understand the economic roots of technological innovation as well as the public policies and political institutions that favor such innovation. Easterley's narrative of development and its failures brings together three insights from this research: (1) new technologies and the right mix of skills are essential for economic development (they sometimes bring what economists call "increasing returns"); (2) public policy matters to achieving those benefits, which do not come from the market by itself; and (3) political institutions—including democracy—matter to getting the policy right.

1. New technologies and skills are especially important to economic development because their benefits spread well beyond the firms and workers that use them. Technologies embody knowledge, and when a firm introduces a new technology that knowledge spreads ("leaks") to other firms, and sometimes enhances the productivity of

existing technologies. Moreover, when the skills of different workers are complementary (when different skills "match"), the benefits from one skill enhance the benefits from others.[2] When there are substantial interdependencies of these kinds—with spillovers of knowledge and a need for matching skills—economic development is essentially a social problem: coordination of separate efforts—rather than more perfect market competition—is the key to growth. If most people in your economy are skilled, it makes sense to get an education, because your skill can be combined with theirs in ways that bring rewards to you while raising overall productivity. But if most people in your economy are not skilled, it makes little sense to get an education, because your investment will effectively be drained away by the lack of investment by others. When an economy faces such a "poverty trap," individual incentive seekers acting on their own will not act in ways that promote economic development.

2. Turning poverty traps into self-sustaining wealth generators is what kick-starting growth is essentially about. Here Easterly sees a positive role for government. It needs to stabilize the macroeconomic environment, provide the transportation and communication infrastructure needed for commerce, and ensure a safety net of essential health and other public services. Most delicately but important, however, government needs to pay for behavior not yet rewarded by the market, but needed to

[2] This story is, as Easterly indicates (chap. 9), very partial. The other side of the complementarities and increasing returns noted here are the "negative" complementarities that result when a new innovation—computers—makes past technology—typewriters—more or less irrelevant, and destroys the value of past investments.

for economic development: to subsidize research in and development of new technologies, support the provision of relevant skills, and foster foreign investment that imports new ideas. It needs, in short, to invest in activity with large social benefits whose market rewards are insufficient to make it pay.

3. But any government that is strong enough to play this constructive role in economic policy is also strong enough to do real damage. To avoid the damage, government must be held accountable. Easterly’s views here are broadly conventional, and market oriented. It is critical that government not play favorites, and that the public be organized enough to insist on government accountability. It is essential that property rights be established, that interest rates are positive, that there is enough education around to exploit technology, and enough new technology to stay current with trading partners.

But being able to make the right choices here, and being accountable to the broader public in making them, requires a greater measure of democratization than is common in poorer countries. This, finally, is what Easterly identifies as the barrier to their growth: the political institutions needed to identify and implement the right sorts of policies are missing. Ethnically- and class-polarized societies and corrupt governments are the norm, and this norm is bad for growth. To be sure, development requires institutional constraints on government, including the rule of law and independent central banks. But because development also requires affirmative government action, these institutions of constraint are not enough. Democracy, too, is required to ensure that a government with sufficient capacity to serve the population does not turn into its corrupt master.

Joseph Stiglitz takes a quite different tack in *Globalization and Its Discontents*. He says almost nothing about politics within developing countries. Instead, his attention is focused almost exclusively on the international development organizations, which he believes do not have the interests of the developing nations at heart, and need fundamental reform.

The International Monetary Fund (IMF) is a target of special wrath. When countries are in trouble, the IMF applies a nearly unvarying agenda of deregulation, trade liberalization, privatization, deflationary monetary policy—a “Washington Consensus” on development policy that makes little economic sense and reflects overwhelming indifference to the fate of the peoples of the South. Summarizing his experiences with the IMF: “Decisions were made on the basis of what seemed a curious blend of ideology and bad economics, dogma that sometimes seemed to be thinly veiling special interests.” But the problems extend beyond the IMF. While the World Bank’s policies have in some measure been corrected, it continues to play an unwelcome supporting role in enforcing the Washington Consensus. And such was always the purpose of the WTO.

Thus all three members of the trinity of global financial governance and development have set the rule of the game of international development and cooperation in ways that largely serve the interests of the more advanced countries—and especially commercial and financial interests within those countries.

This matters for Stiglitz not only out of concern for economic justice, but because of basic economic principle. In real world markets, actors do not behave with the omniscience attributed to them by economists. And real world countries vary in the institutional infrastructure needed to support markets in the first place. With imperfect information and markets, “there are, in principle, interventions by government—even a government that suffers from the same imperfections of information—which can increase the markets’ efficiency” (219). Most poor countries, for example, have poorly developed financial institutions. Forcing them to “liberalize” those institutions by opening their economies to world financial flows can be expected to undermine fragile credit institutions exist, while shifting rules on credit away from those local business have come to rely on. Overlaying such liberalization with a credit crunch, as happened in the East Asian economic meltdown of the late 1990s, can have truly disastrous effects. And among the world’s poorer countries, those of East Asia were in much better shape to sustain such disruption than most others.

The first step that is needed in development practice, then, is an end to free-market ideology, and a willingness to see individual circumstances in their complexity and distinctiveness. But because circumstances differ, Stiglitz does not propose not to replace the Washington Consensus with an alternative policy recipe. Instead makes a philosophical point and an economic one, which converge on the same political conclusion: "*the most fundamental change that is required to make globalization work in the way that it should is a change in governance*" (226). The philosophical point is that the major global institutions—which are needed to solve global problems of collective action—are effectively *public-political* institutions, whatever their formal status: they govern people's lives, and their decisions have profound consequences for the lives and well-being of billions. So they should be governed democratically, using the standards of "accountability that we expect of public institutions in modern democracies" (52). The economic point is that in a world of imperfect markets and incomplete information, effective development policy requires both good information on local conditions and broad consensus on aims and a sense of the legitimacy of the strategy recommended to achieve them. Getting that information and public support requires that locals play a substantial role in formulating their development plan, and have some autonomy in executing it. It thus requires a change in the governance of those institutions themselves, to ensure that interests in the poorer countries are represented.

Stiglitz says very little about how to do this. Broadly, however, his suggestion is, first, to establish norms on transparency in decisionmaking—sunlight being, as ever, the best disinfectant. Second, more ambitiously, to change the allocation of voting rights at the Bank and the IMF, and the decision rules on their country-specific recommendations, to get greater representation of developing countries. His ideal is a system in which "all countries having a voice in policies affecting them" (22). Third and finally, round out the cast of international institutions to address world problems extending beyond economic development. So, keep the UN as a multilateral mechanism for addressing security needs. But also charter new multilateral institutions on health and the environment—again with better representation of the community of nations. In sum, move toward greater global democracy by moving toward more inclusive and transparent intergovernmental bodies, governing a greater range of problems than they do at present.

Together, these two books are invaluable for their informed denunciation of present global economic governance, and their recognition of the importance of a more democratic politics in correcting it. Where they fall short is in saying much about how that politics should be designed, much less how it might be achieved.

Take Stiglitz's prescription of multiple intergovernmental bodies, each more inclusive and representative of developing nations than are the present institutions of global governance. But inclusion alone is not helpful if those included are corrupt and themselves indifferent to the fate of the destitute. As a first and friendly amendment to the Stiglitz scheme, then, national governments need to be accountable to and representative of their own populations.

A minimal threshold, for example, might be evidence of secure property rights, constitutionalized speech and associative freedoms, and a process of regular free elections to choose government. But this threshold can be passed by governments wholly dominated by economic elites who compete for control of government but show little concern for their country’s poor. Merely bringing representatives of such governments to some international table of discussion cannot then be plausibly expected to ensure that “the poor have a say in decisions that affect them” (216).

A further friendly amendment, then, might be to ensure a place in policy discussion for organizations and interests beyond those reflected directly in electoral politics. So that means a role for interest and advocacy groups—on the environment, health, labor standards, women, human rights, etc.—and secondary associations of different kinds—trade unions, community organizations, business federations, etc. In most democratic countries, and certainly in international discussion, such non-governmental organizations (NGOs) currently play an essential role in establishing the terms of public discourse and in promoting, formulating, and monitoring the implementation of regulations.

Neither Stiglitz nor Easterly say much about such groups though on the analysis of both they are essential to economic development. These are, after all, the characteristic sources of the local knowledge that Stiglitz sees as so essential to making the right contextual calls in structural policy. They are, for good or ill, key to intensifying or domesticating the ethnic conflict that concerns Easterly. In virtually all states, developing and rich alike, they are essential service providers to the poor. In the South, they often are the lead organizations through which development support runs. And—as in the case of organizations involved in certification arrangements for labor and environmental standards —they are playing a large role in an emerging global system of standard setting and enforcement.

For all these reasons, as well their more narrow representative functions, NGOs presumably should be included in any account of global democratic governance. But that inclusion generates its own problems of accountability and structure. Whom do the NGOs represent, and to whom are they accountable? What guards against their corruption? What weight should their views be assigned, relative to more formal public authorities?

Finally, and irrespective of who is involved in discussion, there are obvious questions of power. Let's say discussion is widened, one way or another, to include representatives of nations and groups now neglected. Let's say even that that discussion is made more transparent. Democracy is not only about transparency and inclusiveness in discussion, but about fairness in decision. When the wider discussion ends, who gets to decide what is done, and how? What if less powerful interests win the argument, recommending a course of action that imposes losses on the more powerful? What happens next? Stiglitz, who is the more insistent on greater inclusion, says nothing on this matter, leaving the impression that he thinks the right answer will be self-evident enough to be self-enforcing. But common sense and his own experiences in politics tell us otherwise. Worse even, without assurance of fairness in decision, there is no reason for participants in the discussion to be forthright with their views.

Stiglitz and Easterly are thus much more successful at declaring the importance of political questions in global development than they are in saying how they might be answered. But so be it. They are hardly alone in their effective silence on world-democratic design, and getting the discussion focused on democratic politics is achievement enough. What is of great relevance to labor and its friends is the shift in the terms of discussion that these books recommend. In matters of global poverty and internationalization the real questions are "about democracy, stupid"—which describes a theoretical and political space that labor should be more than happy to enter. After all, where will a new democratic international politics come from, if not from labor and other mass democratic movements, presumably in critical but supportive relation to progressive elected governments?

What remains urgent is that labor rise to this opportunity on an international scale, with new intensity and openness. That means at least three things. One, far more investment, particularly by labor movements of the north in international labor organization and communication, so that an international worker perspective can be stated. Two, more deliberate efforts by labor to include the important non-labor NGOs and mass movements in its discussion, so that the worker voice is a social voice. Considering the current distance between labor and global environmental groups, for example, that is no easy task. Still, it is politically essential. Third, more effort to limn a positive architecture of international governance, in which these voices are not just heard, but increasingly decide, development decisions. Moving on this agenda, of course, is the work of a lifetime. Credit these two books, whatever their limits, for helping bringing it into view.