WRR

SCIENTIFIC COUNCIL FOR GOVERNMENT POLICY

Saving Globalization from its Cheerleaders

Nancy Birdsall
Ha-Joon Chang
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WRR lecture 2008

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CONTENTS

Introduction
Wim van de Donk 5

The development agenda as a global social contract; or, we are all in this development boat together
Nancy Birdsall 9

Globalization and the role of the state
Ha-Joon Chang 27

Global public goods and global governance: an agenda
Herman Wijffels 41

About the authors 51

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INTRODUCTION

Wim van de Donk

Excellencies, Distinguished Guests,

It is an honour for me to be able to welcome you to this seventh edition of our annual lecture. As you have seen, the theme we have chosen for this year's lecture is : 'Saving globalization from its cheerleaders'. Those of you who were able to attend last year's lecture will know that the Council is rather fond of the metaphor of dancing. You may remember the impressive performance that was given here on this stage by two of the most talented ballet-dancers we have here in the Netherlands.

Unfortunately, I have bad news for those of you who were expecting to see dancing again this year; we are not about to see some real cheerleaders. I am really sorry to disappoint you. However, there is some good news. We may not have managed to get any cheerleaders, but we have succeeded in securing a number of excellent and distinguished experts and speakers, who will be enlightening us about that topic, as important as it is complex, which we call globalization. We have moreover chosen to focus on the significance of globalization (both as a context and as a process) for the future of development aid.

Of course, I wouldn't want to disappoint you too much. So I have chosen a few pictures that show the difficult human constructions that cheerleaders are able to build. They look as fragile as the new world order that is emerging as a consequence of the economic, technological, political, legal and technological drivers of globalization. At a time when we are witnessing a major crisis in the world's financial and economic systems, I imagine that there is no one who still has to be convinced of the importance of the development of a new world order. Just like the constructions that those cheerleaders are able to build, globalisation is still a very fragile structure. To a large extent, therefore, it is still uncertain whether the global institutions that we are preparing really will prove able to address adequately the

kind of endeavours that are emerging in and from the multi-layered, complex and highly interdependent kind of world in which we find ourselves today.

You are warmly welcomed to this lecture. We as a Council, I believe, have a duty to help prepare future government policy and strategy for and within that new world order. Of course, we as a nation are fully aware that globalization is by no means a new phenomenon. It is, however, accelerating at a very rapid pace. It may be that none of us could have imagined this ten years ago. Globalization is the new setting in which all kinds of 'national' questions for future policy-making are being posed and, perhaps, answered. I say 'perhaps', because it might be too early for answers yet; in fact, we may even be forced to admit that we still need to find the right questions to ask about the phenomenon. Whatever the case may be, one thing is certain: for both intelligent questions and answers about globalization, we need experts. With this in mind, I am delighted that we are able this afternoon to welcome three leading experts in this field, all of whom will be giving us the benefit of their wisdom today. You will first be invited to listen to these three keynote speeches, whom I will introduce in a moment. After a short break, there will be a panel discussion chaired by my distinguished colleague, member of the Council and a professor at Utrecht University, Peter van Lieshout, who has the specific responsibility within the Council of leading the group that is preparing an advisory report on the future strategy of development policy (and which we hope to publish towards the end of next year).

Dear guests; our first speaker, and I want to emphasize how honoured we are to have her in our midst, is Nancy Birdsall. Dr. Birdsall is the president of the Washington-based Center for Global Development. The Centre is a leading think-tank, which not only carries out a great deal of intellectual research, but which also produces practical ideas for global prosperity. We are very happy, Dr. Birdsall, that you have accepted our invitation to be here today, especially in these turbulent times. I have been told that you have lost some of your best people to the transitional team that is helping president-elect Barack Obama to develop new policies in fields such as development aid.

Dr. Birdsall will be speaking to us this afternoon about the political economy of market transitions, developing nations, aid-effectiveness, capital flows and financial crisis.

After Nancy Birdsall we will hear the Cambridge economist Dr. Ha-Joon Chang, originally from Korea. He is a well-known and highly successful author in the field of development aid. You may have read one of his thought-provoking books, 'Kicking Away the Ladder' or 'Bad Samaritans', in which he challenges some widely held but not, as it turns out, very productive ideas about development aid. His main point will be that, historically speaking, neoliberal policies have never made any country rich. This afternoon, he will focus on the role of the nation-state in a context of globalization. Dr. Chang was also a very influential member of the advisory panel for the human development report that was published in 1999. We are very pleased, Dr. Chang, to have you as our guest this afternoon and tomorrow, when you will be speaking at a small expert seminar being organised by the Council.

After we have heard these first two speakers we will take a short break . We will then listen to Dr. Herman Wijffels, who has just retired as an executive director of the World Bank. As he told me a few weeks ago, it was the first time in his life, after 40 years, that he had been jobless. But, Herman, we are quite sure that you will continue to be involved in many of the key strategic questions facing Dutch society and even the world at large, in response to the many invitations and responsibilities that will undoubtedly come your way. We are very proud and honoured that you have accepted our invitation to be our third speaker here this afternoon.

We are very happy to have you all here. So let me not dwell too long on this introduction, and immediately give the floor to our first speaker, Dr. Nancy Birdsall.

Thank you very much.

THE DEVELOPMENT AGENDA AS A GLOBAL SOCIAL CONTRACT; OR, WE ARE ALL IN THIS DEVELOPMENT BOAT TOGETHER

Nancy Birdsall

I am honored to speak to this distinguished audience in this impressive setting. I am reminded being here that I think of the Netherlands as a key birthplace of the modern middle-class – captured so well by Vermeer and other painters of the late 16th century. The fate and role of the middle class is a theme that will recur in my remarks here today.

Reframing the traditional development agenda

We are in the midst of an extraordinary moment. On the one hand, in my country, there are enormously high expectations of a more pragmatic, active government calling on Americans' shared interest in a better world beyond as well as within our borders. On the other hand, we are all absorbing the grim new reality of a financial crisis born in America now escalating into a global economic disaster, threatening the well-being of people everywhere and, sadly, undoing the recent gains against the terrible poverty so many people suffer in emerging-market and low-income economies.

I believe those of us in the development community need to seize this moment – and to make of the current crisis an opportunity for a major change in the way we think about the development agenda. Today I want to suggest that we reframe the conventionally defined development agenda as, in large part, the construction by an activist international community of a global social contract. A 21st century global social contract should be designed to maximize the benefits of global economic interdependence (or to use the popular term 'globalization') while minimizing the risks and costs not only for the world's poor but for the world's indispensable middle-class – both the large middle-class in the rich world's mature democratic economies and the incipient middle-class in emerging markets and a few low-income countries.

Defining development as construction of a global social contract suggests two challenges for development advocates. First, it suggests a definition of development as a global imperative in which all nations and people have a common interest – rather than as a matter primarily of aid as charity passed from rich to poor nations. Indeed, if the current crisis increases awareness on the part of the world's rich and powerful (people and nation-states) of their dependence on prosperity and security in emerging market and other developing economies, that would be the silver lining in today's cloud of gloom over the sinking global economy since it could motivate citizens and voters in the rich world to pay more serious attention to their own interest in progress in the developing world. Second, it suggests putting high priority on strengthening the institutions that manage and protect our common interest by fostering growth and sustainable development worldwide. In our global economy these institutions – including the multilateral development banks, the World Bank, the United Nations agencies, the International Monetary Fund, the World Trade Organization, the Basel Committee, and many more – constitute the global 'polity' we need to manage the investment, protection and other functions a robust global social contract implies.

The ongoing crisis: a more activist state; a hyper-connected global economy

I want to preface my discussion of these points with two observations about the current crisis that bear on my overall message.

First, the ongoing crisis will not lead to a fundamental rejection of markets but to a redrawing of the line between the state and the market in the mature Western economies. On the one hand, what Churchill said about democracy is also true of market-driven economies: terrible until you consider the alternatives. On the other hand, there is little doubt that American-style capitalism is under siege. The state is resurgent, especially in the United States and the United Kingdom, where the era of Reagan and Thatcher had run its course anyway and is now decidedly over. In all the advanced economies, markets, particularly financial markets (the cowboy sector of American capitalism, which has in turn spread to Europe as well as it

turns out), will be 'fettered', that is, more regulated. In the next few years, the views of my fellow speaker today, Ha-Joon Chang, will be far more influential than they have been as the balance of state and market in what are mixed economies shifts and a more activist state emerges in Europe, Japan, and America.

One likely change in the balance will come in the form of an expanded domestic social contract by which citizens contract with each other through the state to guarantee access to health, education and other public goods and protect against individual risks and the systemic risks that markets generate. This will be true especially in the United States, leading to a kind of convergence with Europe in the nature of the welfare state. Everywhere that democratic politics works reasonably well, the domestic social contract will be strengthened, especially to protect the middle class. In the United States, where the median wage has not risen in almost two decades and where 'globalization' has become the scapegoat of a stagnant median wage and failed health and other social insurance policies, it will otherwise be politically impossible to retain even begrudging support for open trade markets and minimal levels of legally sanctioned immigration.

The only question is whether a strengthened domestic social contract will take the form of increased public spending on health, education, and public infrastructure and a shift in the tax burden toward the rich in order to reduce taxes on the middle class, or direct government subsidies to protect 'middle-class' jobs in domestic industries, with attendant risks to the current global trade regime. I hope it will be the former, but one way or another, implicitly or explicitly, governments in affluent democracies will be emphasizing increased support for their middle-class majorities.

The second observation is that the hyper-connectivity of the global market, including the reality of the rich world's interdependence with the poor world, has been driven home. We have seen in the last couple of months a desperate effort at greater international coordination of macroeconomic and financial-sector policies because a failure of international coordination, as in the 1930s, risks turning a recession into a long and deep global depression. There are calls to eschew

beggar-thy-neighbor policies, both on the financial side (as when guaranteeing deposits in Ireland led to flight out of banks elsewhere) and in the real economy, to avoid (under the umbrella of "social" efforts to protect jobs) new trade and industrial protection programs (though by early December such programmes were already being actively discussed in Russia, France, and the United States).

Perhaps most noteworthy, is that with the first-ever meeting last month of the heads of state of the G-20 (the G-7 plus 13 emerging markets including Brazil, Russia, India, China, Indonesia, South Africa, and others), we may have seen the beginning of the end of the increasingly irrelevant G-7 club of nations. The G-20 meeting came near the end of this year in which almost all of the paltry growth in the United States was due to exports – of which almost 40 per cent went to developing countries. In contrast to the past, this time it is the United States and to some extent Western Europe that bear responsibility – among other things due to their regulatory failures – for today's economic losses throughout the world. And for the first time the rich countries are dependent on growth and effective countercyclical policy in China, Brazil, the Middle East, and elsewhere to help keep their own economies afloat next year; they cannot manage any recovery, for themselves or for others, alone.

For today's rich countries, there is potential tension between a more activist state, at the national level, more likely to intervene in support of home industries and jobs, and the demands on coordination of interdependence. Let us hope that in 2008-09, in contrast to the 1930s, 'activism' takes a different form and the world's richest and most powerful sovereign states will be able to subsume short-term domestic political interests to the general global welfare – if only because protecting global welfare is actually more consistent with their own overall long-term interests.

What do these two observations – a more activist sovereign state and continuing interdependence among sovereigns – have to do with the idea of a global social contract? The following: to save the hyperconnected global economy from its excesses and to make it fair and politically sustainable, there is a need for some sort of 'activist' polity

at the global level analogous to the state at the domestic level. An activist global polity is needed to construct and manage a contract at the global level analogous to the social contract at the domestic level that exists in one form or another in most mature democratic societies. On the one hand a global social contract sounds worryingly utopian. On the other hand, it is simply about adapting to the reality of a global market-driven economy – implying a convergence of global political necessity with the longstanding development agenda.

In the remainder of this essay, I discuss further the logic of a 'global' social contract for rich nations, given their increasing interdependence with developing countries; describe the logic of a 'social' contract, given the shortcomings and risks of market-based globalization; and then set out briefly four actions rich countries should put on their development agenda to build a durable and enforceable global contract.

A global social contract

Why global? Global interdependence
The rich world's own security and material prosperity depend increasingly on shared growth and on stable and competent governments responding to their people's demands and needs 'out there' in poor countries. One straightforward reason why this is true is that the relative size of the rich world economies and populations is declining. Under reasonable assumptions about future growth rates, the combined economies of the BRIC's (Brazil, Russia, India, and China) will soon be larger than those of the G-7; they are simply likely to grow faster in the next several decades than rich countries, as their much lower per-capita incomes continue to converge slowly to those of the rich world. The middle-class in those and other emerging markets is likely to be twice the size of the entire population of the United States within the next 20 years. Three of the world's five largest companies by market capitalization are Chinese, and by some accounts four of the top ten richest people in the world are Indian nationals. As this century unfolds, it is in these fast-growing economies that rich-world producers will find new markets and rich, new investment opportunities, and from them that will emerge the ideas, people, and innovations that will improve consumers lives everywhere.

At the same time, most developing countries, even geopolitically ascendant China and India, contend with widespread poverty and misery and the attendant social and political problems. In India, approximately 2 million children die before age five, and 21 million children of primary school age are not in school. Their new middle-classes are weak and often disengaged politically except when their own parochial interests can be served. (Indeed, my own analysis of income distribution data for over 50 countries indicates that most developing countries have no more than 20 per cent of their populations in what I would define as the middle-class – living on at least $10 a day per person and below the income of the 95th percentile of the total population; what we think of as middle-class consumers in Egypt, India, Indonesia, and Peru are actually among the 5 per cent of richest households in their countries and thus not in the 'middle' at all.) A small middle-class cannot provide the ballast that undergirds responsible and effective government as in the rich-world economies, where the large middle-class supports the rule of law, respect for property rights and human rights, and access for all to education and economic opportunities. Growth without development in Pakistan and in Bolivia, Nigeria and other natural resource–based economies, and setbacks following a decade or more of growth in the Ivory Coast, Zimbabwe, and even Venezuela have been far more about local political failures than economic ones. Even those low-income economies with responsible leadership – Ghana, Mali, Morocco – face daunting problems of management and capacity constraints that deeply undermine their well-intentioned efforts to reduce poverty

Yet the global community, including all of you and me, relies on competent governments everywhere to play by certain rules in our global society. Incompetent and corrupt governments are weak links in the chain that provides global security and enables global prosperity. Deforestation and the resulting climate risks in the Congo and Indonesia; avian flu incubated in Vietnam; consumer safety breakdowns in food and toy manufacturing in China; terrorist groups in the Philippines and Pakistan – all these risks cannot be contained within the borders of the poor countries where they start.

From both the perspective of new opportunities out there, and of new cross-border risks, development matters. It is in the interests of rich countries to bind themselves in some contractual form to engagement with poor countries.

Why social? Three market shortcomings
Market reform and outward-oriented economic policies are not to be disdained. They are a good part of the explanation for the rapid growth and huge reductions in poverty of the last two decades and more in China, India, Bangladesh, and Vietnam, just as they were earlier in the East Asian Tigers. In China, it was liberalization of agriculture that started the process; in China and in India since the late 1980s a more business-friendly environment and openness to foreign investment have contributed. In Latin America and Africa, good macroeconomic policies in the last two decades, helped along recently by the global commodity boom, have brought growth rates as high as six percent – and in the democracies of Africa seven to eight percent, finally bringing reductions not only in the rate of poverty but the absolute numbers of people living in poverty in many countries.

But I am no globophile. Markets as a mechanism for organizing societies have fundamental shortcomings, and the effects of these are easily intensified in the case of global markets. Let me mention three.

First, markets leave people and countries without the right assets behind. First, markets reward productive assets. They tend to lock in pre-existing income and wealth inequality or generate, along with growth, increasing inequality.

For individual people, the right asset in today's global economy is higher education (and the skills and flexibility that higher education signals and reinforces). Since the late 1980s, the salary premium to higher education has been rising virtually everywhere. Although the supply of graduates of higher education has been increasing almost everywhere in the world, the demand for their skills has increased even faster, fueled by rapid technological change (consider the influence alone of the World Wide Web) and the nearly instant diffusion of new technologies in globally connected markets. The demand for

highly skilled and talented people at the global level has set off intense competition among rich countries to institute immigration policies not just to permit but to encourage the entry of skilled workers – contributing to the much higher emigration rates of skilled compared to unskilled people from developing countries. (New research suggests that the benefits of that emigration for sending countries probably exceed the costs; I mention it here as an indicator of the reality of a global market rewarding education, not necessarily as a problem in itself.)

For countries, the key asset appears to be stable and sound government institutions committed to the rule of law, human rights, and property rights. An example of the wrong 'asset' for countries is a comparative advantage in production and export of primary commodities, whether agriculture or, especially for immature democracies with minimal accountability to citizens, oil or other non-renewable mineral resources. Countries that entered the 1980s highly dependent on commodity exports – whether Angola, Bolivia, Ghana, Malawi, Nicaragua, or Nigeria – and failed to diversify into manufacturing lost out on more than two decades of growth, in contrast to China, Malaysia, and (more recently) Vietnam. One plausible explanation is that entry into manufacturing (and now perhaps into IT services) encourages the accumulation of skills by increasing the returns to human capital, and the diffusion of innovations that fuel endogenous growth.)

We entered the 1990s with pre-existing inequalities within countries in education and a dramatic gap between the competence and stability of rich-country governments and that of the poorest countries. The differences in assets have helped ensure that income inequality has risen in the majority of developing countries enjoying at least some growth; and that between the initially richest and poorest countries the gap in average incomes has grown dramatically – essentially because the poorest countries have grown little if at all while the richest have continued to move ahead.

A second shortcoming of markets, particularly financial markets, is volatility. In 2008, we saw how the tightening of fuel and food markets led to price spikes that were particularly painful for importing

countries that had relied on global trade of these products. In the absence of any global arrangement or rules to make those markets more resilient and less volatile, it is not surprising to hear renewed calls for energy independence in the United States and food security in the Philippines and Indonesia, despite the efficiency losses and other costs that shifting from openness to real autarchy in these markets would imply. But of the triple whammy in food, fuel, and finance that poor countries suffered this past year, it is the financial one that will be the most costly and the best remembered, particularly in the emerging-market economies that had opened their financial and capital markets.

Financial crises hurt all countries, but developing countries have tended to suffer much greater relative losses in the past, losses of 10 per cent of GDP and more compared to two to three percent in rich countries following banking crises. And within countries, the poor who lose jobs and income often sell assets or take their children out of school, implying permanently lower lifetime income. In Mexico many children who left school during the 1994-95 tequila crisis never returned.

The results are long-lasting for the relatively poor in other ways as well. One example: the high public debt that follows government rescues of banks and other financial institutions crowds out private investment and job creation and reduces the fiscal space for spending on infrastructure, education, and health programmes that benefit the poor the most and help build a middle-class. There is good evidence that the labor share of total income relative to capital declines during crises and never fully recovers. Thus volatility is complicit in contributing to income inequality.

A third shortcoming of markets is that they cannot and do not address 'public' goods, i.e. products and services on which market actors cannot make a profit (or fully capture the benefits were they to invest or spend). Basic education is publicly financed almost everywhere in the world because basic education is a quasi-public good – parents (and their children) can capture some of the benefits of going to school but not all the benefits that societies reap when more people are schooled. By the same logic, most governments spend public resources to pre-

vent contagious diseases. The classic case of a public good is control of pollution: the factory owner who implements pollution controls pays the cost of control (in the absence of a subsidy) but captures only a small part of the benefits to his community. At the global level, the classic counterpart case is the reduction of greenhouse gas emissions: countries that commit resources to reduce emissions cannot capture all the benefits for themselves. Just as local pollution control requires that some government entity impose regulations or create offsetting incentives through taxes or subsidies, global-level control of greenhouse gas emissions is likely to require that an activist international community (including at the least the major polluter countries) impose controls or agree on incentives.

Climate change is another example of a global problem that hits the poor people and countries hardest. By an unfortunate twist of fate, tropical countries that contributed least to the accumulation of gas are likely to suffer the worst declines in agricultural productivity, in precisely the sector where the poor within countries are heavily concentrated. In the absence of corrective action at the global level, projected declines in agriculture in India are on the order of 30 per cent in the next 70 years – and as much or worse in parts of Africa. Sea level rise in Bangladesh, drought and floods, and the expanding reach of malaria and other diseases in many tropical areas will also hit those most vulnerable hardest. And even for the same risks, poorer people and poor countries have fewer resources with which to protect themselves and adjust to changes and will therefore suffer much higher welfare costs if not higher absolute costs from the effects of climate change.

Other global public goods that the market naturally neglects (in these cases a pecuniary market failure) include agricultural research and development likely to benefit people and places with low incomes and limited market power and health research and development on malaria and other diseases that primarily afflict the poor. These are areas where in the last several decades large philanthropies like the Gates Foundation have stepped in to compensate for chronic underfunding by rich-country 'donor' governments.

In short, in the absence of government intervention, markets alone are not a sufficient organizing principle for socially and politically stable societies. They tend to generate inequality, since alone they favor those who already have financial or human capital or other assets (such as political privileges or family connections); they fail to protect the poor and vulnerable during financial and other crises, and alone will not provide the pension, health and other social insurance needs that reduce insecurity among the middle-class (and invite reasonable risk-taking and innovation); and they naturally fail to provide for key public goods (due to what economists refer to as missing markets or market failures).

Building a global social contract: A development agenda

The conventional development agenda begins (and too often ends) with an emphasis on the quantity of aid. Let me suggest a four-part agenda for building and sustaining a robust global social contract, which includes but goes well beyond aid.

First, as is the case within country borders, there should be a laser-like focus on avoiding harm to any members of the global community. An apt example is the imperative, from a development point of view, that rich countries during this global economic crisis do not yield to the protectionist pressures that were so calamitous in the 1930s for the then 'world' economy. I am optimistic they will not – perhaps with leadership from here in the Netherlands, since you are a small sea-going economy that has mastered and is dependent on global trading opportunities.

Doing no harm also requires changing some current rich-country policies and programmes. The Common Agricultural Policy, which ends up hurting developing country agricultural producers, is an obvious example in Europe – as are cotton, sugar, and other forms of agricultural protection in the United States. The subsidy and protection for corn-based biofuel in the United States is discouraging investment in biofuels in which developing countries have or could have a comparative advantage. The WTO-agreed intellectual property rights regime reflects a tradeoff between access and innovation pushed by

the United States and others in the 1990s that is inappropriate for the world's poorest countries – where the premium has to be on access, particularly to new medicines; Ha-Joon Chang discusses this problem in more detail in his remarks. And then there is the tough issue of migration. A colleague of mine at the Center for Global Development argues that emigration is development. Certainly for the unskilled, emigration from a poor country to a rich country is the single easiest and most effective escape from poverty. Nigerian, Haitian, and Honduran construction workers and taxi drivers with little education can instantly increase their incomes fivefold and more by simply moving from their home to a rich country. Immigration is a difficult domestic political issue in all countries – rich and poor – and it would be naïve to expect all countries to liberalize this market as they have liberalized trade and capital markets. But development advocates could be more assertive in calling for easing of current illiberal restrictions on the movement of people across borders, given the growing evidence of the benefits of such movements for both sending and receiving countries.

The idea of do no harm extends as well to enforcing anti-corruption rules on investors abroad and supporting actively the Extractive Industries Transparency Initiative, the Equator Principles, the Kimberly process, and other efforts to bind private and public agents to good behavior in their dealings with developing countries. Cooperating on programs to document and fight illegitimate and illegal tax and capital flight also falls into this category.

Second, again as is the case within country borders, all governments should allocate more resources to global public goods by spending both at home and abroad. As happens within countries, there should be some redistribution through taxes and expenditures of the burden and benefits of such spending from rich to poor – in this case across countries – in the enlightened self-interest of the rich. A good example is investments in clean energy technologies to minimize climate change, including spending within rich countries on energy research and development. Naturally there is concern that rich governments will divert resources from traditional aid programmes to 'global' programmes; but, in fact, recent evidence suggests that the effects of

climate change are already imposing high welfare costs on the world's poor, so whatever tradeoff there may be is far less clear than heretofore assumed. Ideally in the context of a climate change treaty, the much greater per-capita emissions of rich countries compared to poor will imply major compensatory financial transfers from the former to the latter to purchase emissions rights. Those transfers would not be aid, with its administrative and proto-paternalistic burdens on poor countries, but legally based transactions in which all parties honor contractual obligations. In any event, R&D on clean energy would ideally include a major focus on sun, wind, and biofuel technologies that would tap the comparative advantage of developing countries, many of which literally have more sun than rich countries, and would be compatible with the needs of low-income and rural populations.

Other global public goods include public investment in new and improved medicines and health delivery technologies and in agriculture (for example to create a Green Revolution in Africa and elsewhere) oriented to the needs of people in developing countries, and public contractual commitments to finance successful development and deployment of such technologies by the private sector.

Whether called "aid" (or better not – Jean-Michel Severino who heads the Agence Francaise de Developpement with his co-author Olivier Ray suggests the term "global public finance" in a recent paper), rich countries should develop and agree on clear norms and agreed financing mechanisms (the European Union aviation tax is an apt example) for the allocation of resources to global public goods relevant for poor countries and poor people.

Third, donor countries should focus on the quality and at the least maintain the current quantity of traditional aid. In domestic social contracts, some transfers (publicly financed education) are meant to support future growth by maximizing society's investment in human capital and to level the playing field in ensuring access to health and education; some transfers (public subsidies and provisions for old age and health insurance) provide social insurance across the board for all income groups; some transfers (welfare payments to the indigent and unemployable) are primarily humanitarian in the interests of social

solidarity. It is not always easy or useful to draw clear lines around these three purposes. As with domestic transfers, so with foreign aid: it is not always easy or useful to distinguish between aid for "growth" and aid in the interest of global solidarity. The Millennium Development Goals obviously address both growth and solidarity objectives; budget support provides for both; infrastructure investments and agriculture are usually viewed as mostly about long-term growth. The bottom line is that aid can be framed as the counterpart of domestic public spending on health, education, credit programmes for small businesses and so on – which, as with domestic spending, has multiple purposes. It compensates for the shortcomings of markets set out above, both in the political interest of retaining the benefits of an open, global economy for all and in response to the solidarity impulse in an increasingly interlinked world on which the rich world. The striking difference of course is in the amounts spent – on the global social contract by rich countries less than one per cent of GDP, while on the domestic counterpart upwards of 20 per cent.

The shadow of a 'contract' exists at the global level in the form of the commitment of the traditional donor countries to spend at least 0.7 per cent of their own GPD on aid – but of course (as amply demonstrated at the UN Doha Conference last month on financing for development) it is in fact only the shadow of a contract. In the face of political resistance to increasing aid in the next year, donor agencies would be smart to focus on getting better results for resources they already commit – in ways that would create accountability of recipient governments to their own citizens, rather than to donors. At the Center for Global Development, we have suggested one practical innovation toward that end (we call it cash-on-delivery aid), and there are others worth trying and systematically evaluating. Donors could easily and instantly move on far greater transparency of their allocations and expenditures, and all could increase the proportion of their aid that goes through multilateral institutions as one way to minimize recipient governments' transactions and administrative costs.

Fourth, and perhaps most fundamental, is the tougher issue of creating an effective global polity to manage a global social contract. The global economy has far outstripped the institutions and clubs

of nations that make up the global polity. In effect the economics of globalization has run far ahead of the politics of globalization. At the international level we have only the faintest shadow of the equivalent of the activist state at the national level – to fetter or manage a global economy or to provide the protection against its ravages for vulnerable global citizens concentrated in developing countries. What we do have is a hodgepodge of official and quasi-official institutions in which various combinations of nations make up the membership (the UN and its 20-odd separate agencies, the IMF, the WTO, the multilateral banks, the Bank for International Settlements, the club-like groups of nations (G-7, G-20, G-77, G-24). But in contrast to the sovereign state, this international polity is relatively weak and ineffective. In contrast to the democratic legitimacy of most states, this polity lacks legitimacy. As a result, in contrast to the condition of the domestic social contract in the world's mature Western economies, the global social contract for which this international polity is responsible is fragile indeed.

Yet the interdependence among nations illustrated by today's financial and economic crisis highlights the need for a more 'activist' international polity – not with the power of sovereign states but certainly with more resources and responsibilities than it has today. In the near term, an activist international polity is needed not only for the coordination of a timely global fiscal stimulus and agreement on regulation of global financial markets – but also to agree on some minimal levels of protection (without protectionist trade and other policies) against the downside for vulnerable global citizens everywhere. Beyond today's crisis, ensuring that the global market works better for the poor and middle as well as the rich – in some imitation at the global level of the domestic social contract – seems critical to the political sustainability of market-based globalization.

So I would put high on the development agenda the need to move beyond ad hoc bilateral arrangements between rich and poor countries in two ways. First is the strengthening of the international institutions where the solidarity norms and the global equivalent of taxes and subsidies and regulations for the global polity need to be embedded. In the case of the development agenda, these include most

obviously the IMF, the multilateral banks, and the United Nations – but also the WTO, the Basel Committee and so on. Second, for the financial institutions, is the reform of their governance to make them more representative and therefore more credible and effective in developing countries; I and others have written extensively on this issue. It is not surprising that the global trade, intellectual property migration and other regimes reflect the greater market (and military) power of rich countries; and that on such difficult issues as immigration that the domestic political constraints within rich countries tend to trump the needs of world's poor. That does not mean that for solidarity reasons, and to politically sustain a global market system, with all its benefits, the development community should stand aside and accept the hand dealt. On the contrary, it means there is logic in constant vigilance or readiness as global citizens to swim against the tide of market and political power at the global level, just as we do as responsible citizens within each of our countries – in the interests of a better world for all.

In conclusion: Restating two points about the global social contract

A global market-based economy has tremendous potential benefits for improving lives by generating and allocating resources well – but only if it is complemented by a robust global social contract through which rich and poor nations bind each other to commitments in the interest of the common global good. In conclusion, I would like to restate two points about this global contract.

First, it provides a way for the development community to think differently about aid and to think beyond aid. Aid as part of a social contract across nations and peoples can be thought of not only in its traditional form of investment in people, infrastructure, and better government, likely to raise economic growth over the medium term, but also in the form of solidarity or redistributive transfers to protect and improve the welfare of unlucky fellow global citizens today. Furthermore, aid is only one mechanism by which rich and poor nations interact. Beyond aid are trade, migration, investment, climate change, and other policies of rich nations by which they directly or indirectly

affect poor nations and which should be shaped to promote development and the common global interest.

Second, management of a robust global social contract requires a strong and effective global 'polity' to provide opportunities for the unlucky, protect the vulnerable, and bind us all to agreed rules and commitments through and by which those opportunities and protections are guaranteed. Development advocates in this 21st century setting of global hyper-connectivity ought to put considerable priority on strengthening the institutions that make up our current global polity. A key aspect of their strengthening is to make them more representative and legitimate; without greater representation of developing countries, both small and poor and large and geopolitically ascendant, we put at risk the political and social sustainability of the market-based global economy itself. It is in the end through these institutions that the habits and norms, as well as the rules of a global social contract, are most likely to be shaped in a way that will put global markets and globalization to work for the majority of people everywhere.

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GLOBALIZATION AND THE ROLE OF THE STATE

Ha-Joon Chang

The progress of globalization – or more precisely neo-liberal globalization, for globalization can take different forms – since the 1980s has been impressive. Cross-border flows of ideas, people, goods, services, and especially capital have increased dramatically. However, its socio-economic outcomes have been, to put it mildly, less than impressive.

To begin with, neo-liberal globalization has increased inequality in most societies, often dramatically. When confronted with this point, proponents of neo-liberal globalization argue that we have to create wealth before we can redistribute it. I agree with this argument, but the question is whether neo-liberal globalization has been good at creating wealth.

Neo-liberals love to tell us that "we are richer than ever, thanks to globalization". However, this is a mathematical triviality turned into a clever advertising slogan. We will always be 'richer than ever', as long as the world economy does not shrink for a prolonged period. The real question is whether, under a different regime, we could have been 'even richer', and the answer to that is 'yes'.

During the neo-liberal period, the growth of the world economy has actually decelerated, not accelerated, compared to the 'bad old days' of greater protectionism and interventionism in the 1960s and 70s. The world economy grew at around three per cent a year during the 1960s and the 1970s, while it has struggled to grow at two per cent per annum in the last quarter of a century of neo-liberalism (and let us not forget that quite a lot of that growth has been due to the explosive growth of China and, to a lesser extent, India – two countries that, while gradually liberalizing and opening up, have not really followed the neo-liberal path). The growth performance of neo-liberal globalization will look even worse when the current crisis ends, although it is not possible to say by how much, as we cannot yet predict the depth and the duration of this crisis.

Growth deceleration has been particularly severe in developing regions like Latin America and Sub-Saharan Africa, which for various reasons have implemented neo-liberal policies more thoroughly than other regions. In the 'bad old days' of the 1960s and the 70s, per capita income in Latin America grew at an impressive 3.1 per cent per year. In the 'brave new world' (1980-2004), it has been growing at a paltry 0.5 per cent. Even if we leave out the 1980s as the decade of adjustment when the effects of the 'bad' policies in the previous periods were still being felt, the annual growth rate is only about 1.3 per cent. In Sub-Saharan Africa, per capita income grew at 1.6 percent a year even during the 'bad old days' of 1960-80, but since then the region has seen a *fall* in living standards (by 0.3 % a year).

Slower growth also came with greater instability, produced by uncontrolled financial liberalization and opening up. Neo-liberals may argue that economies have become more stable in the neo-liberal period because the rate of inflation has fallen. However, on a broader measure of economic stability that takes into account stability of output and employment, and not just prices, the neo-liberal period has a terrible record. Starting with the 1982 Third World Debt Crisis, we have seen so many financial and economic crises caused by neo-liberal financial deregulation and monetarist macroeconomic policies that it is difficult to remember them all – the Scandinavian crisis and the US Savings & Loans crisis in the late 1980s, the bursting of the Japanese bubble in the mid-1990s, the Mexican crisis of 1995, the 1997 Asian crisis that affected several countries (Thailand, Indonesia, Malaysia, Hong Kong, Korea and the Philippines), the 1998 Russian and Brazilian crises, the bursting of the dot.com bubble in the early 2000s, the Argentine crisis of 2002, and today's world financial crisis, to name just some of the most prominent examples.

Actually, greater instability and lower growth are related, because major negative shocks have negative impacts on long-term growth, through the irreversible destruction of productive capabilities at the individual company level (e.g. skills, organizational routines) as well as the stunting of individual development (e.g. disruption in health care and education for children). The negative growth effects of economic instability are likely to be much greater in developing coun-

tries, where productive capabilities are less well established and thus more vulnerable to shocks, and where there are many more individuals who are so close to the subsistence level that even a minor shock can stunt the development of many of them.

Despite the mounting evidence that neo-liberal globalization is not working, neo-liberals argue that trying to regulate – or worse, reverse – the current process of globalization through more public intervention would be like trying to turn back the clock. They argue that globalization is happening because of the rapid developments in transportation and communications technologies, and that those who want to slow or reverse it are the modern Luddites, the 19th century British textile workers who thought they could get their jobs back by destroying the machines that had replaced them.

However, this is a fundamentally mistaken and misleading view. The best way to show this is to go back a century, to the period of 'first globalization'. As has been well documented by many economic historians, the world economy in the late 19th and early 20th century was almost as globalized as it is today. The interesting thing is that this earlier globalization was achieved on the basis of rather primitive transportation and communications technologies – the steamship and wired – not even wireless – telegraphy. In contrast, the degree of globalization between the 1950s and the 1970s was much lower than in either period of high globalization, despite the fact that by then we had basically all the communications and transportation technologies that we have today, except for the Internet, albeit in somewhat less efficient forms. So if the world economy during this period was not very globalized, it was not because of the lack of technologies; it was because during that period there was a general consensus at national and international level that cross-border economic activities need to be carefully regulated. This comparison shows that it is not technological development that is driving globalization. Technologies only define the outer boundaries of the realm of possibilities, and it is ultimately politics that determine exactly where we end up within that realm, which is a pretty big place. The recent episode of globalization has progressed in the way it has only because the powerful countries have decided to rewrite the rules of the global economy in a particular

way. They have deregulated and opened up their own economies. More importantly, they have put far more pressure than before on the developing countries to do the same (but much more thoroughly) through their aid budgets, their influence on the IMF and the World Bank, and their enormously superior power to set the agenda and to engage in negotiations in the WTO and other trade talks.

Arguing that the real driver of globalization is politics, not technology, is not to say that globalization is therefore something that can be reversed at will. Once changes are made to global rules and national policies regarding international interactions, they become difficult to change, not least because vested interests grow up around the new rules and practices. We are currently witnessing this in the reluctance of the major government to radically overhaul the global financial system, despite the huge economic crisis that it has brought about. However, even if we acknowledge the practical limits to reversing globalization, recognising its political origins at least allows us to dispense with the notion that nothing can be done to change what is going on.

If globalization is a politically modifiable process, the role of the state becomes crucial, for state action (mostly by the states of the rich countries) is what has driven the process. Actions by the nation-state have also been the most important ways in which societies have dealt with the negative consequences of globalization. Of course, this is not to say that other actors can be ignored – individual consumers, consumer groups, trade unions, cooperatives, corporations, civil-society groups, international organizations, and so on. However, nation-states remain the most important actors in shaping human destiny, despite the neo-liberal contention that now we live in a ‘borderless world’ in which the nation-state does not matter any more or, worse, has become an obstacle to human material progress.

One simple example to show the enormous power that the nation-state still has is to ask why a bus driver in The Hague gets paid dozens of more times than a bus driver in Delhi. Is it because the Dutch driver is a more skilled driver, with higher productivity? No. If anything, the Indian driver is the more skilled one; when driving in Delhi, the

Indian bus driver is practically negotiating an obstacle course – he has to negotiate not only cars that do not keep to traffic rules but also cows, rickshaws, bicycles pulling a huge stack of crates behind them, pedestrians jumping traffic lights, children playing on the street, you name it. The Dutch bus driver in The Hague does not have to worry about such things, unless he is really having a bad day. So it is not the difference in their driving skills that determines the huge difference in wages between the Indian bus driver and the Dutch bus driver. It is, for the most part, the strict regulation on the international movement of labour, imposed by the richer nation-states.

Another example showing the importance of the nation-state, at the other end of the social spectrum, are the massive bail-outs of financial and industrial firms that have been implemented by the governments of the rich countries in the current crisis. Companies that were busy denouncing their national roots and criticising the nation-states for their counter-productive taxes and regulations have turned to those very same nation-states for rescue through those very tax and regulatory powers. This episode has revealed how the arguments declaring the demise of the nation-state are , at best, based on a poor understanding or, at worst, are a self-serving argument for corporate interests.

Now, how should we think of the role of the state in relation to globalization? It may be useful to think about this at two levels. First, we should think about the ways in which globalization is affecting the role of the state in individual countries, taking the current international distribution of economic power, the current global rules of economic engagement, and the current global governance system as given. Second, we need to discuss how the global governance system may be reformed and the global rules rewritten, given the unsatisfactory nature of neo-liberal globalization.

First, let us think about the role of the national state in the age of globalization. Globalization has made national economic management more difficult in a number of ways. First of all, the problems that states need to solve have become more demanding. More open trade, while creating opportunities for some and sometimes even making

the national economy as a whole better off, has made countries more vulnerable to external shocks by making them more specialized. For example, the recent food crises in developing countries have shown the dangers of excessive trade specialization away from basic things for countries at lower levels of development. More importantly, more open capital markets have increased the power of capital, especially finance capital, enormously, thereby forcing countries to adopt policies that maximize the short-term financial returns of the 'rentiers' above everything, even when in the long run they hurt investment and growth as well as employment and equality – represented by the practice of 'downsizing'.

Second, if the problems that nation-states face have become bigger, their capacities to solve them have been diminished, especially in the developing countries. The rewriting of global rules has made the use of many 'standard' economic policy tools much more difficult, if not impossible. For example, the WTO has banned import quotas and export subsidies, despite the fact that they have been important tools of industrial policy throughout history. The regulation of foreign investment, the use of tariffs and the use of subsidies have also become far more constrained under the WTO, further reducing the policy options available. In the case of developing countries, even where some policies are allowed under formal global rules (such as the WTO rules), many of them cannot be applied in practice, because they go against conditionalities imposed by the rich countries that are giving aid to them and the Bretton Woods institutions from which they borrow. Of course, in the case of IMF/World Bank programmes, the developing countries can in theory reverse their policies once the programmes finish, but in practice reversing liberalization in an environment of global neo-liberal financial, political, and intellectual dominance takes a huge amount of intellectual independence and political courage that the leaders of these countries usually do not possess.

Having said all this, I would like to emphasise that, serious though they may be, neither the difficulties of national economic management posed by globalization nor the reduction in policy freedom due to the rewriting of the global rules should be exaggerated. The

'corrosive' power of globalization on the autonomy of nation-states has not been as serious as it is believed to be. The best evidence for this is that, despite the widespread prediction that generous welfare states of the European kind will not survive global competition in the highly open economies of Europe, the European economies have basically maintained their commitments to the welfare state. This shows that policies that countries really want to maintain can be sustained even in the face of globalization. I would go a step further and argue that the ability of the European economies to remain open is critically dependent on their ability to maintain a good welfare state that protects people from shocks and helps them 're-tool' themselves with new skills, but that is another story.

In terms of the limitations on the actions of nation-states imposed by the new global rules, it is not as if these rules prohibit all policy intervention. The rich countries in particular still have a lot of policy freedom, not least because they have made sure that the tools of intervention that they need the most are allowed under the new global rules – agricultural subsidies, subsidies for R&D, subsidies to reduce regional inequality, anti-dumping provisions. Policy freedom has been considerably reduced for developing countries, but larger developing countries with international political clout – such as China, India, Brazil and South Africa – have the economic leverage and political confidence to utilise the formally available policy space to the maximum. Even some smaller, weaker developing countries have some room for manoeuvre and have successfully used policies that go against the orthodoxy, despite external pressures. For example, after their 2002 financial crises, Argentina and Uruguay abandoned orthodox policies and have done well. In another example, Malawi reintroduced fertiliser subsidies against World Bank advice but its agriculture has done very well since then, forcing even the World Bank to re-examine its policy on fertiliser subsidies.

When told that globalization has reduced the room for manoeuvre for nation-states, the proponents of neo-liberal globalization respond that this is actually a good thing. Globalization imposes 'discipline' on wayward countries to stick to 'good' policies. If some national political autonomy is sacrificed in the process, they say, so be it. How-

ever, as I have been arguing, the neo-liberal policies have not been 'good'. The financial mess that we are seeing today in the heartlands of neo-liberal capitalism, such as the US and Britain, is an eloquent testimony to this. As I mentioned earlier, for developing countries especially, the kind of open, deregulated capitalism that has been promoted by the proponents of neo-liberal globalization has produced very poor results in terms of growth, stability and equality. Indeed, the history of capitalism shows that there is hardly any country that has become rich without violating at least some aspects of neo-liberal orthodoxy.

All of today's rich countries, except for the Netherlands and (pre-WWI) Switzerland employed protectionism for lengthy periods. Even these two countries did not fully conform to free-market orthodoxy, in that they refused to protect patents until 1912 and 1907, respectively.[1]

Despite their pretence that they more or less invented free trade, Britain and the US were among the most protectionist economies in the world for long periods in their respective catch-up phases (from the 1720s to the 1850s in the case of Britain; from the 1830s to the 1940s in the case of the US) . The US heavily regulated FDI (foreign direct investment) in finance, shipping, mining and logging in the 19th century – especially in banking, where only American citizens could become directors in a national (as opposed to state) bank and foreign shareholders were not allowed to vote at AGMs. Between the 1930s and the 1980s, Finland officially classified all companies with more than 20 per cent foreign ownership as 'dangerous enterprises'. The SOE (state-owned enterprise) sector produces 22 per cent of GPD in Singapore and 16 per cent in Taiwan. And so on. Further details can be found in my books, *Kicking Away the Ladder* and *Bad Samaritans*, but the point is that, historically, neo-liberal policies have never made any country rich.

This brings us to our second point, that is, how we can reform the global system so that we allow, if not necessarily encourage, countries to adopt policies that are appropriate given their goals and needs. I have neither the space nor the intention to spell out here the details of how I think the global economic system needs to be reformed, so I will state only the main principles that I think we need to employ in reforming the global economic system so that all countries, not just

the economically strong and the politically powerful, can benefit. But before doing so , let me state one meta-principle that I think we should keep to – the principle that we need to maximize the diversity of approaches that are permitted.

During the neo-liberal period there has been great pressure on developing countries to implement a set of 'good' policies and institutions that suit the neo-liberal ideal. Of course, this 'one-size-fits-all' approach has been subject to severe criticisms and as a result the neo-liberals now routinely pay lip-service to their respect for diversity and programme 'ownership' by the developing countries. However, the notion of diversity they have is what I call the Henry Ford principle of diversity – when asked whether he would stop insisting on painting all his Model-T cars black, he famously quipped: "Any customer can have a car painted any colour that he wants so long as it is black". Despite their talk of diversity, the range of local variation that the neo-liberal orthodoxy is willing to accept is very narrow. Let me illustrate this point.

Will the neo-liberals, who have typically advocated inflation rates of one to three percent, be willing to accept a 20 per cent inflation rate for a 20-year period? Will they, despite the hopes they pin on FDI, be comfortable with a country virtually banning FDI? Can they, so convinced as they are of the superiority of private ownership, stomach a country with a public sector producing around 20 per cent of GDP? I don't think so, but these 'outrageous' cases are all examples from real success stories – South Korea's with an inflation rate of around eighteen per cent in the 1960s and 70s, Japan and Finland virtually banning FDI between the 1930s and the 1980s, and Taiwan's and Singapore's SOE sectors producing sixteen per cent and 22 per cent, respectively, of GDP. These examples suggest that there is an enormous range of policy combinations that can produce success and therefore that the drive towards uniform (or very narrow ranges of) policies and institutions that the neo-liberal orthodoxy have been pushing in the last quarter of a century needs to be abandoned, if we are to design a desirable global economic system.

Having made the case for the meta-principle of diversity, let me state three principles that I think we should apply in thinking about reforming the global system. First, the global rules should be changed to allow countries to pursue policies that are geared more towards long-term productive development. Trade rules should be redesigned to encourage upgrading by developing countries, rather than encouraging them to follow their comparative advantages and therefore sustain their current production structure. More importantly, the financial architecture, both at the national and the global levels, should be redesigned so that there is more room for countries and their corporations to pursue long-term productive development. In practice this means encouraging developing countries not to open up their capital markets, severely restricting the flows of short-term financial capital, banning or heavily regulating derivatives, and regulating M&A in a way that is more compatible with productive development. Nokia is an example that illustrates perfectly the importance of these policies – its electronics subsidiary, which now is considered one of the greatest companies in human history, was able to become what it is today only because the closed and tightly regulated financial market allowed the Nokia group to cross-subsidize it for a staggering seventeen years (1960-77), when it did not make a single penny of profit.

Second, the global rules should be changed to promote counter-cyclical policies. For example, the notoriously pro-cyclical BIS capital adequacy standard should be changed. For another example, the IMF should stop telling developing countries in financial crisis to cut their public expenditure and to raise interest rates to usurious levels (for example, during the 1997-8 financial crises, Korea and Indonesia were forced to raise interest rates to 30 per cent and 80 per cent, respectively). While we are witnessing it in the most dramatic manner today, since at least the 1930s the rich countries have been willing to maintain aggregate demand by running budget deficits and cutting interest rates whenever they experienced economic downturns. My advocacy of counter-cyclical policies is not simply for the sake of smoothing the business cycle, so to speak. It is also because negative shocks have irreversible long-term negative effects on long-term growth by destroying activity-specific physical capital, skills and organizational routines.

Third, the global rules should be changed to allow 'asymmetric' interaction between countries with differential goals and abilities. For example, the richer countries should be more open in terms of international trade, because the poorer countries need more protection as they need to develop their infant industries and as they also have lower adjustment capabilities. Rich countries object to such suggestions, invoking the notion of the 'level playing field'. However, the level playing field is the wrong principle to apply when the players are unequal. When one team in a football game is, say, the Brazilian national team and the other team is made up of my thirteen-year-old daughter Yuna's friends, it is only fair that the girls are allowed to attack downhill. In this case, a tilted, rather than a level playing field is the way to ensure fair competition. If you think this is an extreme example, you should recall that in sports like boxing, wrestling, and weightlifting we have weight classes, while golf has the handicap system. And the definitions of 'equal players' in these sports are very stringent. For example, in boxing, the lighter weight classes are literally within two or three-pound (1-1.5-kilo) bands. How is it that we think a boxing match between people with more than a couple of kilos' difference in weights is so unfair that we structurally ban such competition, yet we accept that the USA and Honduras should compete on equal terms?

Even when they agree with it, some people express scepticism about my proposal for asymmetric protection because they believe it is not in the interests of the rich countries to adopt such a regime. However, what I am advocating is not self-sacrifice on the part of the rich countries, but rather enlightened self-interest. If they are allowed to use policies that suit them better, developing countries are going to grow faster and provide a much bigger market for the rich countries in the long run. China is the best example to illustrate this point. Judging from the way the poorer former Soviet republics have been struggling since the transition, it is certain that China would not have grown very much had it gone for a 'big bang' type of neo-liberal reform. In reality, its gradualist reform path since 1978 has allowed its economy to become ten times bigger than it was then, and today the rich countries have a market to exploit that is ten times bigger than it used to be.

To sum up, globalization has made it more difficult for the state to manage the national economy. At the same time, it has reduced its ability to do so. These changes, although they should not be exaggerated, need to be taken into account when formulating national policies. However, this should not lead us to conclude that neo-liberal globalization should be unquestioningly accepted and that the nation-states should give up influencing their national economies. Globalization is largely driven by politics rather than technology, and can therefore be reshaped by deliberate decisions, especially by the rich countries. Especially given that neo-liberal globalisation has produced very poor results over the last 20-25 years, there is an urgent need to redesign the global rules so that national policies can become more oriented towards the long term, counter-cyclical and asymmetric between rich and poor countries.

What does all this mean for the development policy of the Netherlands? I believe that the Netherlands has some unique characteristics that will allow it to play a critical role in rethinking globalization and economic development along the lines I have suggested.

First of all, the Netherlands has a tradition of defying the convention. In the 19th and early 20th century, when most other rich countries were engaged in protectionism of one form or another, the Netherlands stuck to free trade. It abolished its patent law in 1869, precisely when other countries were busy strengthening theirs. Despite having very little land and thus having no obvious (absolute or comparative) advantage in agriculture, it has developed its agricultural industry to the extent that it is the world's third largest exporter of agricultural products.[2] The Netherlands should live up to this tradition and take a leading role in questioning the conventional wisdom regarding globalization and economic development.

Second, in the post-World War II period, the Netherlands has built a reputation of being an independent and relatively impartial actor in global politics. This gives it a unique position in playing the role of an honest broker, facilitating a new global debate on the future of globalization and economic development.

Lastly, and on a lighter note, the Dutch are officially the tallest people in the world, and therefore should be able to take a more far-sighted view in the thinking about globalization and economic development.

NOTES

1 The Dutch case is actually more complex than this. The Netherlands had introduced a patent law in 1817 but abolished it in 1869, partly because its patent law was considered deficient even by the standards of the time, but mainly because the country thought that patent law, which creates artificial monopolies, was incompatible with the free trade principles to which the country was committed at the time.

2 At 395 persons per sq. km, the Netherlands has the fifth highest population density in the world, excluding city states and small island states with territories smaller than, and including, that of Hong Kong (1,099 sq. km). Only Bangladesh (1,045 persons per sq. km), Taiwan (636 persons per sq. km), Mauritius (610 persons per sq. km) and South Korea (498 persons per sq. km) have higher population densities. This is not counting the Palestinian territories (6,020 sq. km and a population density of 667 per sq. km) and Puerto Rico (8,875 sq. km and a population density of 446 per sq. km), which are not fully independent states. See http://en.wikipedia.org/wiki/List_of_countries_by_population_density.

GLOBAL PUBLIC GOODS AND GLOBAL GOVERNANCE: AN AGENDA

Dr. Herman Wijffels

Ladies and gentlemen,

This is an excellent opportunity to discharge some of my experiences and related thinking of the last couple of years. I am also pleased to be part of this very distinguished panel. I will try to reflect on some of the points the previous speakers made. I would like to start with fully embracing Nancy. That is to say, Nancy's proposal for a global social contract, because I think that is a very good way to state what we need in the world going forward. So let me explain. I will do that from my own perspective and in my own way of reasoning. My view is also based on what I have seen and learned during my stay at the World Bank during the last couple of years.
I have learned to look at the world mainly as one interconnected and interdependent 'Life Support System'. From that perspective it has become very clear to me that this system is in effect in many respects out of balance; that crucial balances are disturbed or are underway of becoming so. This is quite evident for the monetary system which has come broken. But in my view this is only one manifestation of the crisis we are in. At the same time we have crises with climate change, the energy system, water and food, maybe even beyond that with the availability of essential resources like forests, fertile land and fish stocks in the high seas and biodiversity is declining.

All of this is primarily, –Nancy also mentioned that– a threat to those people who live from only a couple of dollars a day or less. But ultimately it will impact in a negative way the quality of life, and if we don't change our ways, ultimately life itself of all people and all living species on the planet. The combination of 6.5 billion people and our present way of life, of producing and consuming, creates a claim on the planets resources that is not sustainable. We want and use more than is available in a sustainable way. Our ecological footprint is exceeding the sustainable so called carrying capacity of the earth at this

point by at least 25 per cent. In fact, looking from that perspective, we are consuming the future. And again, looking from this perspective also shows the common background of the credit crisis and the ecological and related social crises. Both cases are about living on credit, about borrowing from the future. Labeling it in that way, it is in fact a cultural crisis. It is a crisis of especially our western way of life. Looking forward, this can only get worse with seven, eight or possibly nine billion people on the planet. Unless, and that is the main thing, we change the nature and the structure of our economies, the way we cater for our needs.

So the big challenge in the 21st century is to develop a culture, a way of life, a way of producing and consuming that is compatible in a sustainable way with the carrying capacity of the earth. That represents a really big challenge, but also one, and that is the good news, that is quite achievable, based on all that I have seen and on reports of the World Bank, but also on different research results that have been published, I am of the opinion that the concepts and the technologies necessary to make that change are already available. We know what we have to do and we already have the knowledge and the related technologies to do it. So what it comes down to now is creating awareness, political will and capacity to execute what is needed. I am not trying to say that this is going to be easy; to the contrary, it will be an uphill battle. Not because we don't know what to do and how to do it, but it will directly counter the vested interests in business, in people's lives and in the interests vested in national governments. So that, especially in the Western world, is going to be the real battle.

But, there is not much of a choice. In fact, I think there is no choice. The mayor issues of our time are global in nature and related to the very base of life itself. They are life threatening issues. The only way to confront these issues effectively is by a common effort, directed and coordinated at the global level. And that is why I strongly support Nancy's proposal for a global social contract. That is really the way to do it. It is also the way we have approached development at the national level. In Europe we added the European level of decision making to tackle issues beyond the national reach. Now time has come to make the move to the global level. In order to create and

execute a global social contract that effectively addresses global issues, we urgently need an updated system of global governance. The present system dates from the post Second World War time. It does not reflect our 21st century world and it is not suited to deal with the present global issues. What is required first of all is acceptance by nation states that dialogue and subsequent cooperation at the global level are an absolute necessity to address the issues facing us. I think that the subsidiarity principal that guided the development of the European Union in recent years, could also serve us quite well at the global level. This is about delegating the issues that we can't deal with effectively at the lower level, to the next higher level. We need effective global institutions to deliver global public goods such as the eradication of poverty, monetary stability, security, sustainable use of eco resources, a fair global trade system and also effective health care systems to prevent pandemics.

The existing global institutions are insufficient at this point, and also lack legitimacy. Institutions like the IMF and the World Bank urgently need reform, or even transformation into real 21st century institutions, reflecting 21st century realities and being mandated to act in the interest of the world as a whole, instead of being dominated by some major shareholders and interests in countries of these major shareholders.
My hope is that this will become possible because of the seriousness of the issues we are dealing with; but also because of what I see as the emergence of a 'multi-polar world power structure'. This would mean that nation states really open up for more cooperation in order to get things done. Of course much will depend on the approach that the new US-president and administration will take. My guess is that Barack Obama holds the view that cooperation on issues of common interest should be pursued, even if there is difference of opinions on other issues. That is also why he says: "I am going to talk to what Mr. Bush labels as 'enemies'." He wants to seek the common ground. That is anyway my impression after having watched him very closely during the campaign.

So in my view, in the next couple of years, a window of opportunity might open up to create a global governance network. I think about

it as a network of institutions that is better suited to tackle the huge challenges facing humanity in the next few decades. Of course, it remains to be seen, what kind of influence the present credit crisis and recession will have on all of this. It might go both ways. I am realistic enough to see that. It might be helpful in the sense of bringing the message home that cooperation is the only way out, but it could also be an impediment to develop the kind of cooperation that is needed.

What I discussed so far, fully in agreement with Nancy's introduction, is the need for a global social contract and a transformed global governance system. But that still leaves open how the system should operate in fostering development.

So next, I will share with you some thoughts about development cooperation or, as it is still called internationally, development aid. Again, here I am in agreement with Nancy. The emphasis should shift from development aid as primarily unilateral charity to the broader notion of development cooperation seen as working together to further common interest. This shift can also be helpful in the quite tense debate about the future of development cooperation that is going on in our country at this point. In the past, development aid has mainly been 'sold' as solidarity with the poor. There is nothing wrong with that. In itself, that is noble, but I think it will be insufficient to tackle the world's problems.
If the world is one interconnected and interdependent system, if we are in this boat together, it is in our own self-interest to support developing nations. It is our own interest to tackle in a common effort the huge challenges these countries are facing. And if we don't do that, we will experience the consequences in the form of scarcities, unchecked climate change, failing states, terrorism and migration flows. We have to give these people a reason to stay where they, to keep those parts of the world habitable. We have to move beyond development as charity and the paternalism that goes with that approach. Development cooperation in the real sense is supporting people to develop themselves, based on their preferences and fitting their specific circumstances and cultures. That might sound obvious, but I have seen too much of the old style "we know it and we should teach them how to do it" during the last couple of years. This

is the so called Washington Consensus. Extensive conditionality is just that: paternalism, we tell them how to do it. Fortunately, both – the Washington Consensus and conditionality – have eroded in the recent years, but the transformation to a well-coordinated country-based and country-owned development model is far from completed. In my experience that goes back to donor countries, wanting to keep waving their own flags and following national priorities that they can sell to national electorates.
In an institution like the World Bank there is a lot of resistance, both from donor countries and from staff, to decentralization of operations. By opposing this really needed change, they oppose what Chang was talking about: differentiation and increasing the capacity of this institution to address specific circumstances and needs.

I worked very hard during my years as an executive director and with full support of the Dutch government, to overcome that resistance. We have made some progress. Now, in the World Bank we are not talking any more about 'if' it has to happen, but how to do it and to what extend. That is the progress we have made. It remains to be seen how far this will go. It might take a far reaching overhaul of the Banks governance system, before we can turn the classic top-down development model around. With around, I mean turn it upside down. What I would like to see happen in this context is the creation of a development model that combines the three of following features: One, a development model based on country ownership and country development programs with sufficient room for differentiation between countries, with specificity in the country programs. Secondly, country assistance strategies or country partnership strategies will have to function as a framework for a strong multilateral coordination and strengthening of the role and position of multilateral institutions. So: go multilateral, that is another point where I agree with Nancy. Thirdly development programmes at the national level and the support programmes in multilateral institutions will have to be embedded in the global public goods approach. If you don't address climate change for example in Africa, it is, as we say in Dutch: 'dweilen met de kraan open.' We really have to include the notion of global public goods into development policies.

This model would probably also deal with one of the main points raised by Ha-Joon Chang: his criticism about the neo-liberal model of globalization. Although I might not be as critical as he is about certain market oriented policies, he really has a point in signaling the shortcomings of neoliberal market fundamentalism; especially, but not only, for developing countries. While visiting developing countries – and I got the opportunity to visit quite a few – I have come across several examples of governments rightly refusing to follow Bretton Woods' advice. One was the government of Ethiopia, following a very cautious approach in developing the domestic banking sector and refusing, at least in this stage of development, to open this sector up for foreign banks. Certainly looking back from where we are today, that was pure wisdom. Further I visited Malawi, where I got some lectures about their fertilizer subsidies and got convinced that it was a very effective measure. They really solved a big domestic food production problem with introducing that subsidy. In the meantime the World Bank has followed suit and is now funding subsidized fertilizer programs in quite a few countries.

More generally, travelling in Africa I have met very competent people and very competent governments, knowing exactly what they want and how to develop their countries. All they need is our support. They don't need lectures and preaches from our side. Wisdom about what works in today's world is not our monopoly. I want to take this point even further. Our development stems from the industrial age, which in my view is now drawing to a close. At this point in time we are moving beyond the ideas that created the industrial age and developing new ways to organize societies and our economies. So it becomes increasingly doubtful whether that experience will be fully relevant for the future of developing countries.
We are moving from what I use to call a fossils-based economy to an economy based on what will ultimately be harvesting from natural flows. That especially goes for energy. Until today we are digging holes in the ground and mining fossils. But this is fast becoming a dead end street, mainly but not only for environmental reasons. What we will have to learn to do - and the technologies are already available - is to catch from the flow: solar, wind, biomass, hydro, geothermal. This flow is abundant, especially in African countries, and

more generally in the tropical areas in the world. So they have a huge potential in developing economies based on sustainable resources and new technologies. I would be inclined to think that developing countries may well have an advantage here, because – and that is another reason – they do not have an installed base of previous generation technologies which will be hampering us and putting at a break on that transition here in the west. Developing countries in a way can work from a blank sheet.
So, building the economies of these countries should be based on the new generation of concepts and technologies enabling sustainable ways of production. I see that as a huge opportunity. And we better refrain from telling them how we have done it, because that is not the reference they need. Exchanging experience and best practices in the future might well become a two-way-street, enhancing the notion of cooperation between equals.

That being said, I want to briefly comment on two points made by Ha-Joon. One is about the role of the state which in his view should get more emphasis. The other one is about global rules, and especially that these global rules should allow for asymmetry between developing and developed countries.
First, the role of the state. In my opinion, after the recent events and the mess we are in now, market fundamentalism has in a way taken care of itself. Even before that happened a reevaluation of the role of the state was underway. After studying development experience of a whole range of countries, the so called growth commission of the World Bank, created by my friend mr. Wolfowitz, came to the conclusion that strong government institutions and regulation are crucial ingredients of successful development policies. It was a group of market-oriented economists, who did that research and made that report.
In my view intelligent combinations of market systems and government intervention will make the future. The mix of the two will depend on the specific circumstances and the stage of development and of local preferences. I don't see that as a choice between capitalism and socialism; that is not the issue. The issue is to find a way forward that is transcending this divide. We could do that by developing different blends in which the creativity and entrepreneurship of individ-

uals is employed to its fullest extend, – that is an absolute necessary ingredient of development and also illustrates the need to continue market based policies -, is combined with 'intelligent regulation and government intervention' directed at working for the common good and to address the issues I have been talking about before.

The second point is asymmetry. I tend to be open to it, based on what I have seen over the years. If again, developing the poor countries is in our interest, I think we should be prepared to except for a number of reasons, at least temporarily, asymmetric trade rules. One, mentioned already, is that the notion of level playing field just works against the less developed. Another one is that, in the medium to long term, we will also benefit from it. Thirdly it is a powerful way to include developing countries in common efforts to address global issues. So we have to put something into the global contract that is really attractive to these countries, in order to make them agree with for example the Copenhagen agreement. A fourth point, which is kind of remote to this, but might also be addressed in that context, is that it might even help to tackle the issue of illicit financial flows. That is an issue not much discussed and not much open in the public domain, but it is a scandal. The financial flows leaving the developing countries every year are bigger, much bigger, than official ODA-flows going from rich countries to the poor. In a way – it is a kind of a rude way of labeling it – in that sense colonialism is not over. Mispricing raw materials etcetera is something we have to look at. I would like to see it addressed in a new set of global rules. So, although this is a very tricky field, I would be inclined to carefully investigate what is possible in this domain as part of Nancy's global social contract.

Let me go back now to the subject we are discussing this afternoon: Saving globalization from its cheerleaders. I have two remarks about the cheerleaders of globalization. First you have those who define globalization as an exclusively economic phenomenon, as increasing volumes of international trade. This brand of globalization has certainly made some positive contributions, but also, it was mentioned already this afternoon, exacerbated major problems in our world, like inequality and also some of the ecological issues. As such, I think this approach of globalization might quite well slow down in the coming

years, certainly when we start basing our economies increasingly on natural cycles, because that will slow down the trade in fossils. If that happens – and that is a possible future – economies will become more localized than they are today. There will be more local production than we have today. That is about one brand of globalization.
But you also have those who approach globalization as really understanding the interconnectedness, the interdependency and the common interest of all of us living on this planet. This brand, in my view, is on the rise. In a way, the fact that time has brought somebody like Barack Obama to power is proof of that. In terms of background, upbringing and ideas he is a reflection of this kind of globalization.
My hope is that further increasing the understanding and awareness that the world is one interconnected and interdependent system will prepare the common ground and the common efforts necessary to effectively tackle the huge global issues we are facing. So looking at it in this way, I would say: saving globalization is about bringing the right; that is the second brand of cheerleaders to the fore. Thank you.

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Dr. Ha-Joon Chang is Assistant Director of Development Studies in the Faculty of Economics and Politics, University of Cambridge. Born in the Republic of Korea, and educated at the Seoul National University and subsequently at Cambridge, professor Chang's books include Kicking Away the Ladder: Development Strategy in Historical Perspective and Globalization, Economic Development, and the Role of the State. Since 1992 he has also served on the editorial board of the Cambridge Journal of Economics. He was a member of the Advisory Panel for the Human Development Report (1999) and has acted a research project coordinator and consultant to numerous UN agencies and international agencies, including the World Bank, the Asian Development Bank, the British Government's Department for International Development, and the International Development Research Centre in Canada, and the South African Government's Department of Trade and Industry.

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