

ETHICS, MARKET AND GOVERNMENT FAILURE, AND GLOBALISATION

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In this essay, I want to look at certain ethical aspects of the way that globalization has proceeded in recent years. I shall argue that in the way that they have sought to shape globalization, the advanced industrial countries have violated some basic ethical norms. Elsewhere,² I have argued for the reform of the institutions and policies which have governed globalization, that these institutions and policies, while they may have served the interests of the advanced industrial countries, or at least special interests within those countries, has not served well the interests of the developing world, and especially the poor within those countries. I suggested that unless there were serious reforms in governance, the legitimacy of the institutions would be undermined; unless there were serious reforms in the practices, there well may be a backlash. While there are strong forces pushing globalization forward – in particular, the lowering of transportation and communication costs – the forward march of globalization is by no means inevitable. After World War I, there were marked reductions in capital and trade flows (rela-

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² See, in particular, Joseph Stiglitz, *Globalization and Its Discontents* (Norton, 2002).

tive to the size of GDP). Today, within the developed world, there is a growing awareness of some of the darker sides of globalization, as terrorism too can move more easily across borders. But the developing countries have long experienced many of the other darker sides of globalization.

Here, however, I want to approach the subject more from the perspective of practical ethics, a task I had begun two years ago in a paper I delivered in Milan on the occasion of the Vatican's celebration of the new millennium. I want to explore two themes: there are certain *market* failures which not only lead to inefficiencies (Pareto inefficient outcomes) but the incidence of those inefficiencies bears disproportionately on the poor; and there are certain *government* failures in the advanced industrial countries, which too result in Pareto inefficiencies, but the incidence again is mainly on the poor.

Before beginning the analysis, I should perhaps lay out the particular aspects of practical ethics upon which I shall be focusing. I begin from the ethical premise that 'all men are created equal...' and I accordingly take it as a primitive that our perspectives concerning social justice should be nationally and ethnically blind as much as they should be blind to gender and color.³ Globalization, in short, should extend not only to economics, but to views on social justice and solidarity. While I will not follow Rawls in arguing that social justice requires that we look exclusively at the welfare of the worst off individual (in any country), I shall argue that it is socially unjust if we benefit at the expense of someone who is poorer: at the very least, we should view negative redistributions as ethically wrong.

Some economists have questioned whether ethics has much or anything to do with economics. After all, Adam Smith's basic insight was that individuals, in pursuing their own self interest, were actually pursuing the general interest. There was, after all, seemingly no conflict. Economics, of course, had its limitations: it could not solve all problems. It was not intended to solve issues of social justice, only of efficiency. It was the responsibility of government, and political processes, to address the distributive issues. And these were matters about which economists had little to say – they could only point out the consequence of different policies.

As a practical matter, as I shall comment in the concluding section of this paper, economists, especially at the U.S. Treasury and the IMF, have long well overstepped these bounds. They have put forward as *economic*

³ One could articulate these views within a Rawlian framework, but I shall not do so here.

advice policies which advantage one group at the expense of others. Moreover, economists play only a part – though an important part – in the evolution of globalization. There is a broader political process, in which economists have as often as not been *used*. My critique is more a critique of that political process, and the politicians and bureaucrats who have been responsible for it. I saw first hand how even in a government, like the Clinton Administration, committed to social justice at home, policies were pushed which were at variance with these principles.

When there are market failures, however, individuals in the pursuit of their own interests may not pursue general interests. There can be real conflicts of interest. These have been brought out forcefully in the literature on asymmetric information, where agents may not take actions which are in the best interests of those for whom they are supposed to be acting. They can violate their trust. There is a fine line between ordinary incentive problems and broader ethical issues. We typically do not say a worker who does not give his all for his employer is unethical; we are as likely to blame the employer, for failing to provide adequate incentive structures. But we are likely to say that a worker who steals from his employer is unethical. We do not say that the problem is only that the employer has failed to give the right incentive structure – including providing adequate monitoring. But between these two extremes there are many subtle shades of gray. In the United States, the corporate, accounting, and banking scandals – in each of which individuals were simply acting in ways which reflected their own interests, and most of which were, at the time, totally legal – raised (for most people) serious ethical issues. CEOs and other executives deliberately took advantage of their positions of trust to enrich themselves at the expense of those they were supposed to serve. They did not disclose information that they should have.

These are market failures, failures which led to what I (and most others) view as unethical behavior. There were also public failures. The government not only failed to address the problems posed by the conflicts of interest and the misleading accounting – even after public attention to these problems had been drawn – but with the repeal of the Glass Steagall Act they even expanded the scope for these conflicts of interest. Rather than correcting the market failures they exacerbated them.

At what point do these actions cross over the line, so that they can contribute not only to economic inefficiency but can be considered unethical? Those who commit these acts almost always come forward with self-serving arguments for why what they are doing is in the public interest. For example

the elimination of the restrictions designed to prevent conflicts of interest are described as allowing for more market flexibility, enabling the market to respond better to the ever changing landscape. Likewise, the intellectual property rights that deprived so many in the developing countries of access to life saving drugs are described as necessary to ensure that there is a steady supply of new drugs to meet the health care needs of the world. These arguments often have a grain of truth in them, and those who put them forward may even believe them. But they have only a grain of truth. There is a moral responsibility to think of the consequences of one's actions on others, including the poor, and the failure to do so constitutes an ethical lapse.

In any case, it is areas where markets fail – where, for instance, there are information asymmetries and imperfections of competition, where the informed and powerful can take advantage of the uninformed and weak – that problems of unethical behavior are most likely to manifest. And it is in these arenas that ethical discourse may have the most important impact; by calling attention to these problems, it may be possible to limit the scope of such behavior, to enact policies and reform institutions so that they are less likely to occur.

There is one more preliminary remark. There are some circumstances in which there are a chain of actions which together lead to particular results. The 'package' might be considered unethical, in the sense that great harm is done to the poor, and in some cases those who perpetrate the harm benefit from the actions. (Put aside, for the moment, the question of motive.) But now, assume that the actions are taken piecemeal, that none of the pieces themselves result in the dire consequences. I would argue, however, that if there is a reasonable probability that the adverse consequences follow, that is, that if the other actions which are part of the package are likely to occur, and therefore that the dire results are likely to occur, then the individual actions themselves can and should be viewed as unethical. (This is reflected, for instance, in the fact that we charge someone who has supplied a gun in a murder as an accomplice to a crime, even if it was not inevitable that the crime be committed, that is, even if there was some chance that the person to whom the gun was supplied might not have committed the crime, or even if there was some chance that the person to whom the gun was supplied might have found another mechanism by which to commit the crime.)

Because the ethical issues in trade have already received more attention than those in finance, I shall turn to the latter first.

ETHICAL ISSUES IN THE GLOBALIZATION OF FINANCE

There are three central issues to which I wish to call attention: first, the design of debt contracts between developed and less developed countries and other aspects of lending behavior; second, dealing with the consequences of excessive debt; and finally, broader issues associated with the global reserve system.

Lending behavior

In most religions, there has long been strong ethical guidance regarding lending behavior; partly, I suspect, reflecting the imbalance of economic power between lenders and borrowers. The imbalance of power has a potential to give rise to abuse, with the lender taking advantage of the exigencies of the borrower. There are thus proscriptions against usury. The Jubilee focused on the importance of debt forgiveness, of giving those who have become indebted a chance at a fresh start. Market economics has shunted these concerns aside. Interest rates are determined by the law of demand and supply, just as the law of demand and supply determines the prices of apples and oranges. But the competitive market perspective is, I think, wrong. Credit markets are highly imperfect, borrowers typically have access only to a limited number (usually one, two or three) sources of credit, while creditors face a large number of potential borrowers. Borrowers typically are poorer than lenders, and often they turn to lenders in times of crisis, when their needs cannot be put off. Lenders are sorely tempted to take advantage of the asymmetries in power to gain for themselves an advantage. But even short of this, the structure of international capital markets puts poor and developing countries at a marked disadvantage.

Richer countries are better able to bear the risks associated with interest rate and exchange rate volatility, and such volatility has been enormous in recent years. But in fact, debt contracts – even when the lending is done not by private creditors but by governments and multilateral institutions – place the risk burden on the poor developing countries. The consequences have been disastrous. When the United States raised interest rates in the late 70s and early 80s, it explicitly paid no attention to the consequences this had on others, including to those in Latin America, who had been persuaded to borrow enormous amounts of money (at negative real interest rates). This in turn led to the Latin American debt crisis, and the lost decade of the 80s. In 2002, Moldova, which has seen its income decline 70% since the end of

Communism, had to spend three quarters of its meager public budget to service foreign debt; the burden had increased vastly when the Russian ruble, to which its currency was tied, devalued enormously in 1998.

The more developed countries and especially the multilateral institutions have a duty to advise countries on what are prudent levels of debt, and on how to manage their risks. And, more importantly they should do so in ways which are particularly sensitive to the consequences for the poor. But the lenders have not done so, and arguably, they have often provided advice which has exacerbated the risks to which they are exposed. Most notable in this respect was their repeated advice to developing countries to liberalize their capital markets, opening them up to destabilizing speculative capital flows.

This is an instance in which they put aside their fiduciary responsibility, and allowed the imbedded conflicts of interest to dominate their behavior. Wall Street speculators may have made money by the opening of markets in developing countries, but there was at the time no evidence, or theory, that capital market liberalization led to faster growth, and there was considerable evidence, and theory, that it led to greater instability; and it is the poor that disproportionately bear the burden of this instability. More recently, even the IMF has recognized this – too late for those countries that were forced to follow its advice, with disastrous consequences.

By the same token, before the Russian crisis, the IMF advised Russia to convert more of its debt from ruble to dollar denominated debt. It knew, or should have known, that doing so was exposing the country to enormous risk and inhibiting its ability to adapt. It was clear that the exchange rate was overvalued. But with dollar denominated debt, when Russia devalued, the benefit it got in exports and import substitution from the devaluation would be offset by the cost on the balance sheets.

Rather than working to reduce the market failure or offset the consequences (i.e. to help markets develop incentive compatible contracts in which the rich bear more of the risks associated with exchange rate and interest rate fluctuations) the IMF and other developed country lenders have done what they could to make sure that those who have entered into these unfair contracts fulfill them, whatever the costs to their people.

Perhaps the most dramatic manifestation of this has been in the take-or-pay power contracts which, under the Washington consensus mantra of privatization, were pushed on so many developing countries. One might have thought that large, well informed multinational companies are in a better position to evaluate and bear the commercial risks associated with

such investments than poor developing countries (there are moral hazard issues associated with political risks, but these are insured through multi-lateral and bilateral agencies, such as MIGA and OPIC). Yet, the international economic institutions, the U.S., and other governments encouraged such contracts. Indeed, in the most notorious example, the U.S. government encouraged India to sign such a contract with Enron that (were it carried out) would have generated a return in excess of 20% – even though the company was bearing little risk, and even though at that return, the price of electricity would have to be so high as to impede India's competitiveness – or forced the Indian government to provide huge subsidies, crowding out badly needed expenditures on health and education. Worse still, when the problems have been exposed, even when there have been clear suggestions of bribery and corruption (emphasized by the U.S., for instance, in the case of Indonesia) the U.S. has insisted on the sanctity of the contracts, exercising pressure not to abrogate contracts, putting U.S. commercial interests above the well being of those in the developing country.⁴

Responding to crises: I. Policy

Given the huge burden of risk that developing countries have borne, it is not surprising that they have faced repeated crises, and, as we have noted, often these crises are largely the result of events beyond their borders. There are then hard choices on how to respond. There are risks associated with different responses, and different policies affect who bears those risks. Ethics again can help us decide whose interests should be put first: those, for instance, of the international banks who have lent the crisis country money, or the poor people within the country. Indonesia again provides the most telling example, where the IMF provided some \$22 billion to bail out Western banks, but then insisted that food and fuel subsidies to the poor be cut back – there simply was not enough money (though the costs were a mere fraction of what was provided for the bank bailouts). This came after unemployment had soared tenfold and real wages had plummeted – partly because of the policies that the IMF had insisted upon. Evidently, welfare for the poor was not acceptable, whereas corporate welfare was not only acceptable, it was encouraged.

⁴ At the same time, some G 7 governments have put pressure on developing countries to renegotiate contracts with their companies, when rates of return that have been yielded have turned out to be too low.

The IMF also insisted on contractionary fiscal and monetary policy, with the predictable result that the economic downturn became worse – indeed, it became a real depression (though the U.S. Treasury insisted that that word not be used) – with enormous hardship. The policies did mean that there was a positive trade surplus, enabling the countries of the region to repay the money that was owed. Again, the interests of foreign lenders were put ahead of those within the country, and especially the poor.

By the same token, international institutions and other countries can decide on whether or how to help the crisis country. Japan provides an example of a model of what might be viewed as ethical behavior (which need not be disassociated from self-interested behavior) in the generous offer of \$100 billion it made to its neighbors in East Asia during the crisis of 1997-1998. It targeted that aid to help rejuvenate their economies. The contrast with the United States is striking. Putting what it viewed as geopolitical interests above the well being of the people in the region, the U.S. did everything it could to squash this initiative (and it was successful in doing so). Then, later, when Japan put forward the more modest, but still generous, \$30 billion Miyazawa initiative, the U.S. tried to ensure that as much money as possible went to restructuring – to bailing out western investors and lenders. Although the U.S. occasionally tried to provide self-serving arguments for why spending the money in that way was also best for the crisis countries, it in effect put its concerns over those of the crisis countries.

Responding to a crisis: II. The case of Argentina

The sequence of events leading up to Argentina's crisis, and the unfolding events afterwards, provides a landscape on which to examine a host of ethical issues of considerable complexity. Of this there can be no doubt: great harm was done to the people of Argentina. Starvation and malnourishment became widespread in a country rich in natural and agricultural resources. The incidence of poverty increased. There is shared culpability. Many contributed to the occurrence and magnitude of the disaster, and there was much finger pointing. The IMF, for instance, who had treated Argentina as its A + student, thereby earning Argentina easy access to international capital markets, suddenly changed its grade and began blaming corrupt politicians (many of them the same politicians who had only shortly before been praised for their good judgment in following IMF advice, without mention of their corruption) and provincial governors for overspending. I have argued that though there is shared culpability, a quick look

at the data puts a different perspective on the events. The federal government was not profligate – at the time of the crisis, its deficit as a percentage of GDP was only 3%, and given the magnitude of the recession, this was a remarkably small number, not a large number. The economists' usual benchmark is the structural, or full employment, deficit, that is what the deficit would have been had the economy operated at full employment. In these terms, it almost surely had a surplus. By way of comparison, the U.S. in 1992, during its last recession (one that was far milder than that in Argentina) had a deficit of close to 5% of GDP. Indeed, it could have been blamed for not pursuing a sufficiently expansionary policy. The government had in fact cut back primary expenditures (that is expenditures net of interest) by 10% over the preceding two years, an impressive political feat. The origins of the deficit that did occur were interest on previously contracted debt, including foreign debt, the privatization of social security, and the severe economic recession. If the government had not borrowed so much earlier, it would have had a surplus. If the government had not privatized social security, it would have had a balanced budget, or even a slight surplus. If the government had pursued expansionary fiscal policies, or had devalued the currency, so that exports could start to grow and imports could have been restricted, then too there would not have been a deficit, or it would have been much smaller. The country had been provided with policy advice, which it followed, and which earned it kudos in the early 90s. But these policies led, with a high probability, to the disastrous outcomes. Providing this advice, without adequate warning of the likely consequences, I suggest was unethical, even more so when the same party provided several pieces of advice, which worked together in the predictable way. For instance, privatization of social security essentially *always* worsens a government's budgetary position. In the U.S., had social security been privatized, our deficit GDP ratio would have been 8% in 1992. This, by itself, would not necessarily be a problem, if the recipient of the (now privatized) social security funds were directed to invest the funds in government bonds, so that there is a ready supply of additional funds to match the (apparent) increase in the government deficit. But it is a problem if the government is told, as it goes into a recession, that it must maintain fiscal balance, regardless of the fact that it has privatized social security. For that imposes an additional large contractionary burden on the economy. Recessions are inevitable, especially in today's highly volatile market economy. If recessions are inevitable, if an institution (the IMF) *always* has a policy of insisting on budget balance, or even near budget balance, even in

a recession, *then* it follows that the act of privatizing social security will almost surely result in an increased severity of the economic downturn.

By the same token, the IMF itself lent, and did not discourage, and by its praise even encouraged lending to Argentina, so that that country became the world's largest debtor. The funds, it was alleged, would enable Argentina to adjust to the structural changes which would enable it to grow faster in the future. We put aside here the judgments about the likely efficacy of the changes in promoting growth. I focus on whether, in lending so much to Argentina, especially given its fixed exchange rate system, they were exposing it to undue risks. Linked to the dollar, with considerable trade outside the dollar region, with Brazil and Europe, there was more than a small likelihood that its exchange rate would become overvalued. Even seeming moderate levels of debt become untenable when interest rates increase enormously, sometimes through no fault of the borrower; as we noted, the developed countries have forced developing countries to bear the risk of interest rate and exchange rate volatility. The East Asian crisis led to high emerging market risk premia, so that Argentina's debt service increasingly became a problem. And there was then a vicious circle: the overvalued exchange rate and the high debt service both contributed to still higher interest rates, exacerbating that country's problems. Even a moderate devaluation might lead to an unbearable debt GDP ratio; the actual devaluation led to a debt GDP ratio of in excess of 150%. Lenders should have known that there is a reasonable risk of devaluation of any overvalued currency – the notion that the overvaluation might be corrected by rapid improvements in productivity or large decreases in domestic prices was simply not very credible – and hence they should have realized the risk to which they were exposing Argentina.

One might say, it is the borrowers' responsibility, not the lenders, but that, I think is too easy an out. For the lenders are supposed to be more sophisticated in risk analysis and in making judgments about a reasonable debt burden. Now having lent too much, the question is, how did the lender (the IMF) respond when it became apparent that the borrower did not or could not repay? The lenders have more than a little culpability in the situation having arisen (as do others providing the advice). The world is stochastic, and a turnaround of well designed and intentional events may lead to excessive debt burdens. In the case of Argentina, however, there was a *prima facie* case that the debt burdens were too high, given the level of international volatility in exchange rates and interest rates: there would be a significant probability of a default. When lenders have a high degree of

culpability in the generation of the excessive debt, there is, as I have said, a moral responsibility to act so in ways which protect the poor.

But that is not what the IMF did. Rather, it imposed strongly contractionary fiscal policies and it encouraged the country to stick with the fixed exchange rate, a policy which had strong political support within the country, influenced no doubt by constant IMF lecturing on the topic and a concern for the risks that hyperinflation might break out once the constraint of the convertibility (fixed exchange rate) was abandoned.

Surely, the 'package' of acts caused, and could reasonably have been expected to cause, untold suffering; and given the predictability of the subsequent actions, even the earlier actions could be considered 'unethical'.

Responding to crises: III. Bankruptcy regimes

Whenever there is lending, there is the risk that the borrower will not be able to repay what is borrowed, or can only do so with enormous hardship upon himself and his family. How countries resolve these situations can be viewed as both an ethical and an economic issue. It is an ethical issue in part because it tests in the extreme how society balances the interests of the well off and powerful against those who are less fortunate. In ancient times, individuals who did not repay what they owed sometimes were thrown in the water with a stone tied around their feet: the punishment was severe. In nineteenth century Britain, individuals were sent to debtor prisons, so graphically portrayed in some of Dickens' novels. Sovereigns who did not repay were subject to invasion by governments of creditor countries: Mexico was taken over jointly by Britain and France, Egypt by the same duo. The practice continued even into the twentieth century, with the bombardment of Caracas by European powers in 1902. Argentina's foreign minister, Drago, roundly condemned the attack on Venezuela, pointing out that lenders should have known that there was a risk of non-repayment. Even more recently, the U.S. has used such defaults as part of the pretense of occupation of Caribbean and Central American republics.

Debt forgiveness has long been part of Judeo-Christian tradition, symbolized by the Jubilee, giving individuals the ability to make a fresh start. Bankruptcy can be viewed within the same tradition. Today, debtor prisons and military interventions are no longer viewed as acceptable. Yet the conditions under which individuals and countries are allowed to make a fresh start – and what that exactly means – remain questions of extreme

controversy, with some arguing for more debtor friendly regimes, some for more creditor friendly policies.

An ethical approach should take into account not only the differing economic circumstances of the parties, but also the origins of the problem of indebtedness. Most of us would say that if a lender, say a bank, provides a credit card to a child, and the child uses the credit card to run up huge indebtedness, then the child should not have to spend the rest of his or her life repaying the accumulated debt. The creditor was in a position to judge the consequences of the indebtedness, indeed in a better position than the child. There is a long history of such exploitation on the part of creditors, leading debtors into bondage, and forcing them to pay usurious interest rates.

I would suggest that the loans made, say, to Congo under Mobutu by international financial institutions and western governments are of a similar nature. The lenders knew, or should have known, that the money would not go to the betterment of the people of the Congo, but rather was flowing to the Swiss bank accounts of Mobutu. Given the dictatorship, ordinary citizens could do nothing – but the lenders were in a position to deny him funds. Whatever the motivation – whether it was political (to buy favor in the cold war) or economic (to get access to that country's rich mineral resources) – it is arguably immoral to force the people of Congo to repay these otiose debts. Indeed, the citizens of Congo rightly have a case to bring against the lenders, charging them with having aided and abetted Mobutu in his pillage of their country by providing him with funds, and they should not only forgive the debts, but pay compensatory damages. Several court cases are likely to proceed against lenders to South Africa and the Congo based on these perspectives.

There are other cases where the debt problem is caused, in no small measure, by actions in the lending country. For instance, given the 'market failures' in the debt instruments – which forced the developing countries to bear the risk of exchange rate and interest rate fluctuations – when the United States raised interest rates, it imposed enormous costs on borrowing countries, effectively forcing them into bankruptcy. The U.S. had encouraged the lending – it had not warned the borrowers of the risks which they might encounter from such marked changes in U.S. policy. And when the US raised interest rates, it focused only on the benefits of bringing down American inflation, not the costs, a lost decade of growth that would be imposed on the Latin American countries. Given its culpability, it should have moved quickly towards debt forgiveness;

instead it dithered for almost a decade, forcing Latin American countries to send money back to Washington – a procyclical policy which was at the center of tens years of stagnation.

Similarly, a factor, perhaps a key factor, in the Argentinean crisis and the Ruble crisis was the mismanagement of the East Asian crisis by the IMF. The global slowdown which resulted in low oil prices – combined with a policy strategy that contributed to a shrinking GDP – was a central factor in Russia's inability to meet its debt obligations.

There are some cases, where the consequences of forcing the debtors to repay what is owed are so onerous, that even if the culpability of the lender is limited, debt forgiveness seems ethically compelling. Consider the plight of Moldova, which has seen its income decline some 70% since the beginning of the transition to a market economy. In 2002, some 75% of its meager public finances went to service the foreign debt. Hospitals were without basic supplies. Public services were starved. Poverty was soaring, so badly that many women were turning to a life of prostitution abroad. This would seem to present a compelling case for debt forgiveness.

There are, of course, a number of cases where the moral judgments are difficult. The borrowing country bears some blame for the difficulties which it faces. Russia and Argentina did not have to follow the advice of the IMF. Argentina and Russia did not have to borrow as much as they did. At times the boundaries of blame are blurred.

In some cases, though, the degree of culpability of the lenders may be sufficiently great that the moral case for debt forgiveness seems compelling. Consider, for instance, the IMF loan to Yeltsin in July 1998. The evidence was overwhelming that the exchange rate was overvalued, that the loan would not be able to sustain the exchange rate for very long, that the country would be left more in debt, with little to show for it. Moreover, there was a strong likelihood of corruption – that the money would quickly flow out of the country, quite likely into the pockets of the oligarchs. The lending was largely politically motivated – the U.S. wanted to keep Yeltsin in power. It did not want to face the fact that policies that it, together with the IMF, had pushed had resulted in steep declines in that country's GDP, so that by 1998 GDP was a third lower – and poverty more than ten times higher – than it had been at the beginning of the transition. The loan failed. The money left the country to Swiss and Cypriot bank accounts even faster than the critics had thought possible. The question is, ethically, who should bear the consequences – the people of Russia, who had no say in the loan, or the lenders?

In both the East Asia and Latin American crises, critics of the IMF argued for greater reliance on bankruptcy, and less reliance on bail-outs, which simply put the burden on the borrowers. Especially objectionable were the cases where governments were encouraged, in some instances effectively forced, to assume the liabilities of private borrowers. In effect, the IMF was bailing out the foreign lenders – putting their interests above those of workers and others in the developing country. Belatedly, after the failure of the sixth mega-bailout in almost as many years, the IMF finally recognized the need for greater reliance on bankruptcy and the development of systematic procedures. But its approach again raised ethical concerns. In the case of sovereign debt restructurings, there are other claimants besides foreign (or even domestic) creditors, such as pensioners and children. These needs should, in fact, have primacy; yet the IMF had no systematic way to bring their concerns into the resolution process. Moreover, the IMF, a major creditor, proposed that it be at the center of the resolution, almost a bankruptcy judge; but it is ‘wrong’ to have a vested interest play such a role. There is no way that it can be impartial.

The global reserve system

The global economic system has exhibited enormous instability, and arguably the IMF, which was set up to help stabilize the global economy and provide finance to enable countries to have countercyclical fiscal policies, has pushed policies that have exacerbated that instability and led to unnecessarily hardship. It has failed to address the problems of market failure (as we noted, poor countries wind up bearing the risk of interest rate and exchange rate fluctuations), and has pushed policies like capital market liberalization for which there is overwhelming evidence that they increase instability – but do not increase growth.

An outsider looking at the global financial system would note one further peculiarity: the richest country in the world seems to find it impossible to live within its means, borrowing some \$500 billion a year (5% of its GDP) from abroad – including almost half from poor, developing countries. Standard economic theory suggests that the rich should lend to the poor; in fact, it appears that just the opposite is happening.

Part of the problem lies with the global reserve system, which entails countries putting aside money in case of an emergency. The ‘reserves’ are typically held in hard currencies – particularly in dollars. This implies that poor countries, in effect, lend to the United States substantial sums every

year. Capital market liberalization, which allows any firm in any country to borrow as much as it can, has only exacerbated the problem. Prudential requirements entail countries holding in reserve an amount equal to their short term foreign denominated liabilities; this means that if a firm within a country borrows, say \$100 million from a U.S. bank short term, the government of that country must set aside \$100 million in reserves – that is, it must lend to the United States \$100 million. Net, the country receives nothing. But when it borrows, it must pay say 18%, while when it lends, it receives less than 2%. There is a net transfer to the United States of more than \$16 million a year – the U.S. benefits, but the developing country suffers.

The instabilities and inequities associated with the global reserve system impose high costs on the poor. There are reforms that would address these problems, including an annual emission of SDRs (global greenbacks), which could be used to finance development and other global public goods. America might be directly disadvantaged (it would no longer benefit as much from the benefits of being the major global reserve currency), but it would gain from the greater stability to the world's financial system. In any case, clearly, it is wrong for the United States to put its own self-interest ahead of those who suffer under the current arrangement.

GLOBALIZATION, TRADE, AND ETHICS

I have devoted most of this essay to ethical problems posed by globalization in finance, largely because they have received less attention than the ethical issues which are posed by the global trading system. Here I simply list some of the major ethical problems posed by the current system:

- The asymmetric trade liberalization (in which the South has been forced to reduce its tariffs and trade barriers, while the North has not fully reciprocated) has resulted not only in the North gaining a disproportionate share of the gains from trade liberalization, but some of its gains have come at the expense of poor countries. The poorest region of the world, sub-Saharan Africa, actually saw its income decline as a result of the Uruguay round.

- Agriculture subsidies have been provided in a way which actually *harms* those in developing countries, by forcing the prices of the goods they produce down.

- Developed countries (and especially the U.S.) use non-tariff barriers, such as dumping duties, in ways which are unfair, which exclude the goods

of developing countries, even when, in any objective sense, those countries are not dumping. The administrative procedures are designed to put the developing countries at a disadvantage.

– When, in the Uruguay round, trade opening was extended to services, it was the service sectors which represented the goods produced by the United States upon which attention was focused – particular financial market liberalization – with little attention to the consequences for the growth and stability of developing countries; moreover, service sectors, like maritime and construction services, that represented the comparative advantage of the developing world, were excluded.

– The intellectual property regime does not balance the interests of producers and users (including users in developing countries) appropriately. In particular, the concerns of drug companies for strengthened intellectual property rights trumped broader societal concerns that the poor in developing countries have access to life saving drugs. It has led to biopiracy, where longstanding traditional products in developing countries have been patented by firms from the North.

– While improved labor market mobility would do more to improve global economic efficiency than improved capital market mobility, attention has focused on the latter to the exclusion of the former.

– Some trade agreements have attempted to restrict government's rights to enact legislation and regulations intended to improve the well-being of their citizens. The most recent bilateral trade agreement between Chile and the United States attempts to restrict Chile's ability to impose the kinds of capital controls which were vital in that country's successful macro management in the 90s, and which enabled it to escape the ravages of the global financial crisis. Other restrictions may be even more invidious, affecting the ability to address health, safety, and environmental concerns.

Interactions among policies

I should note briefly that problems in one sphere interact with those in another. Asymmetric trade liberalization makes the difficulties of adjusting to trade liberalization all the greater for developing countries; but when IMF policies and problems in global financial markets result in developing countries facing high interest rates, liberalization is especially likely to result in increased poverty and lower growth: rather than resources being redeployed from low productivity protected sectors to

high productivity export sectors, they simply move from the protected sectors into unemployment.

Similarly, the V.A.T. tax pushed by the IMF on so many countries not only is inequitable – it is equivalent to a proportional consumption tax – it also impedes development, as in practice it imposes a tax on the ‘formal sector’, the sector which developing countries should be trying to strengthen, since in most developing countries it is virtually impossible to tax the informal sector. But this policy (as well as policies which encourage primary education and discourage tertiary education in developing countries) has the effect of lowering the output price of the informal sector, including the raw materials which are inputs purchased by the developed countries, relative to the goods produced by the developed countries. (In effect, goods which are substitutes, competitive with those produced by developed countries, are discouraged, those which are complements encouraged.) Whether intentionally or not, such policies increase the welfare of the developed countries at the expense of the developing.

In my earlier paper on ethics and globalization, I noted that those who provided advice to the less developed countries also often violated basic ethical – and professional – norms. The advice they gave was incomplete: they did not disclose either the risks associated with the policy of the limited evidence in support of the policies; they did not disclose or analyze the full consequences of the policy, including the consequences for the poor; they tried to sell policies as if they were Pareto dominant, when there were in fact tradeoffs, and in doing so, they undermined democratic processes; in their lack of transparency, often quite deliberate, they undermined democratic processes in the developed countries as well as in the less developed; and they did not fully disclose the conflicts of interest which underlay some of their policies – the gains that they (their countries, and especially particular interests within their countries) would gain. As a result, the ‘minimal’ aspect of the Hippocrates oath – do no harm – has repeatedly been violated.

The issues I have described in this paper can, and have been, looked at through more neutral lenses. We can simply describe the market failures, the departures from efficiency in the design of credit instruments, the consequences to the developing countries. We can describe the incidence of alternative policies. We can engage in economic and political analysis to explain why these failures have arisen. Does the normative-ethical vocabulary enhance these discussions? What is its role?

I want to return to the theme I struck at the onset, that in a Smithian world, in pursuing one's interest one pursues the general interest; you at least help bring about a Pareto efficient outcome. Moral analysis entered in a much more circumscribed way, in the choice among alternative Pareto efficient structures and how they might be maintained (typically, there was little consideration of the moral weight to be given to alternative ways by which a particular goal could be achieved).

In the non-Smithian world with which we are concerned, there are a host of other circumstances in which moral considerations ought to be brought to the table, in which we know that self interest does not lead to socially desirable outcomes. It is arguable that if individuals think about their fiduciary responsibilities, as well as what would advance their own interests better, outcomes would be better. In short, ethics provides an alternative if sometimes uncertain compass with which to guide behavior, but one which may be as or more certain than an undivided devotion to the simplistic pursuit of self-interest. At the very least, it would make individuals feel better about themselves. When selfishness also does not produce efficient outcomes, and could have been predicted to not do so, what satisfaction can the individual have in having done what Smith naively told him to do. Surely, there should be some comfort from knowing that one is at least trying to pursue policies which are not just trying to advance one's own interest. Policies that pay due attention to the plight of those who are less fortunate than oneself.

In a modern economy, individuals constantly face situations where there are asymmetries of information or of market power. Smith's advice in such situations is misguided. When one is in such a situation, one should not necessarily do what is in one's own self-interest. Think about the moral dimensions of our actions, how the poor and weak are likely to suffer, or benefit.

Too often, however, the market failures have been matched with government failures. As we look over the problems of globalization which we have discussed in this paper, it is clear that governments of the advanced industrial countries have tried to manage globalization in ways which benefit themselves, or more particularly special interests within their boundaries. Principles of social justice (or even of democratic processes) which have motivated political activity *within* countries have played little role in driving global economic policies or in shaping the global economic institutions. In a sense, economic globalization has outpaced political globalization, if we understand by that the creation of a polity in which shared values of democracy, social justice, and social solidarity play out

on a global scale. Globalization – the closer integration of the countries of the world – implies greater interdependence, and therefore a greater need for more collective action. While determining the principles which should underlie this collective action is no easy matter, this much is clear: processes in which each nation attempts to push for those policies which are narrowly in its own self-interest are not likely to produce outcomes which are in the general interest.

Ethical guidance may be an uncertain and imprecise compass, but it at least provides some guidance in a world in which the only beacon, all too often, points in the wrong direction.