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Poverty: Enhanced or Diminished?

In Act III, Scene 4 of *King Lear,* the proud old king, transported profoundly by the tragedy that relentlessly unfolds and engulfs him, kneels to pray as a storm rages around him, to regret his neglect of the wretched of the earth:

> Poor naked wretches, whereso'er you are,
> That bide the pelting of this pitiless storm,
> How shall your houseless heads and unfed sides,
> Your looped and windowed raggedness, defend you
> From seasons such as these? O, I have ta'en
> Too little care of this!

and then to cry for empathy and justice:

> Take physic, pomp;
> Expose thyself to feel what wretches feel,
> That thou mayst shake the superflux to them,
> And show the heavens more just.

How well Shakespeare's Lear seems to capture our present situation! Echoing Lear's sentiments half a millennium later, nearly 150 prime ministers and presidents of the world's nations converged in September 2000 for the UN's Millennium Summit, embracing poverty removal as their goal. They resolved to "halve, by the year 2015, the proportion of the world's people whose income is less than one dollar a day and the proportion of people who suffer from hunger."[1]

They were joined at the time by countless NGOs that had congregated for parallel events, by the bureaucrats that head the international institutions (such as the World Bank and the UN Development Programme) charged with developmental objectives, and by the liberal media.

Of course, the acute sensitivity to poverty and the moral commitment to reduce it are nothing new. It would be strange indeed if the many enlightened leaders and intellectuals of these nations had not already resolved to wage a war on poverty half a century ago. That, in fact, was the very focus of the leaders in the many independence movements that resulted in extensive decolonization at the end of the Second World War. Let me just cite India's first prime minister, Pandit Jawaharlal Nehru, a Fabian by temperament and training from his student days in Cambridge. Writing in 1946, he recalled the resolve of the prewar National Planning Committee of Mahatma Gandhi's Indian National Congress to

> insure an adequate standard of living for the masses; in other words, to get rid of the appalling poverty of the people . . . [to] insure an irreducible minimum standard for everybody.[2]

Writing some decades earlier, even the conservative Winston Churchill, who had observed acutely a shift in public opinion in the decade of the 1880s, had remarked:

> The great victories had been won. All sorts of lumbering tyrannies had been toppled over. Authority was everywhere broken. Slaves were free. Conscience was free. Trade was free. But hunger and squalor were also free and the people demanded something more than liberty.[3]

Indeed, few in the twentieth century have not had poverty on their minds and a passion to remove it in their hearts.

It's the Policy, Stupid

So, the compelling question is altogether different as we consider the issue of poverty as the new century, and even the new millennium, begins: what do we know now, after five decades of experimentation, that will make our efforts even more effective? In short, drawing on former President Clinton's words, we must assert: "It's the policy, stupid." But then, which policy?

And that returns us to the central question: does globalization, in the specific form of freer trade (and inward direct foreign investment, addressed directly in Chapter 12), imply a closer integration into the world economy, part of that poverty-reducing policy, or are wisdom and knowledge on the side of those who claim the contrary? As it happens, the proponents of globalization have it right.

Two types of supporting argumentation can be produced: shrewd observation and scientific evidence. A brilliant observer such as the Swedish journalist Tomas Larsson in his new book, *The Race to the Top: The Real Story of Globalization,* has written from his firsthand experiences in Asia and described with telling stories and portraits from the ground how poverty has been licked by globalization. Let me cite one example that stayed with me long after I had read the book:

> [B]etting on poultry [in cockfighting] wasn't what I had in mind when I came to Navanakorn, an industrial area in the northern outskirts of Bangkok. I'd taken the afternoon off from the UNCTAD conference to find out for myself what globalization looks like up close. The combined chicken farm and gambling den is right next door to a Lucent factory that manufactures microelectronics components—the factory floor of the broadband revolution and the knowledge economy.
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> The work is done in large square buildings that look like giant sugar cubes. At the entrance stands a shrine honoring Brahma with yellow garlands and small wooden elephants. . . . Inside are thousands of Thai laborers.
>
> "When they started, the workers came on foot. Then they got motorbikes. Now they drive cars," says the rooster guardian. "Everyone wants to work there, but it is hard to get in."
>
> . . . On my way back into town I amble through the industrial estate in search of a ride. A shift is ending. Thousands of women (for it is mostly women who work in the foreign-owned electronics factories) pour through the factory gates. I pass restaurants, drugstores, supermarkets, jewelers, tailors, film shops, vendors of automatic washing machines.[4]

The scientific analysis of the effect of trade on poverty is even more compelling. It has centered on a two-step argument: that trade enhances growth, and that growth reduces poverty.

These propositions have been supported by many economists and policy makers of very different persuasions over the years. Thus as long ago as 1940 the famous Cambridge economist Sir Dennis Robertson characterized trade as an "engine of growth," a colorful phrase that has caught on in the scholarly literature on trade and growth.

But the argument that growth would reduce poverty can be found in Adam Smith himself, as when he wrote that when society is "advancing to further acquisition . . . the condition of the laboring poor, of the great body of the people, seems to be the happiest."[5] And in modern times, Jawaharlal Nehru wrote just as India was about to become independent and all minds were turning to the enormous task of reducing India's massive poverty through planning:

> [To] insure an irreducible minimum standard for everybody, the national income had to be greatly increased. . . . We calculated that a really progressive standard of living would necessitate the increase of wealth by 500 or 600 per cent. That was however too big a jump for us, and we aimed at a 200 or 300 per cent increase within ten years.[6]

Indeed, this connection between growth and poverty reduction was built into the earliest five-year plans, starting from 1951: they tried to accelerate the growth of the Indian economy while remaining focused on poverty reduction as a general target. But it was made yet sharper by the leading Indian planners in the early 1960s when they zeroed in on the target of raising the income of the bottom 30 percent of India's population to a minimum level within a specified period.

It fell to me to work on this problem since I had just returned from Oxford and was the economist assigned to assist the proponents in the Indian Planning Commission of this plan to raise the minimum incomes of the poor. I assembled the income distribution data that were available at the time; their quality was pretty awful because of inadequate statistical expertise in most countries, nor were they standardized for international comparability. But a quick scan seemed to suggest that there was no magic bullet: countries seemed to have somewhat similar income distributions regardless of their political and economic cast. So the primary inference I made was that if there was no way to significantly affect the share of the pie going to the bottom 30 percent, the most important thing was to grow the pie. In short, my advice—what I might call with some immodesty the Bhagwati hypothesis and prescription—was that growth had to be the *principal* (but, as I argue below, not the only) strategy for raising the incomes, and hence consumption and living standards, of the poor.

In this view, growth was not a passive, trickle-down strategy for helping the poor. It was an active, pull-up strategy instead. It required a government that would energetically take steps to accelerate growth, through a variety of policies, including building infrastructure such as roads and ports and attracting foreign funds. By supplementing meager domestic savings, the foreign funds would increase capital formation and hence jobs. Those of us who were present at the creation therefore dismiss as nothing but ignorance and self-serving nonsense the popular and populist propositions that, first, growth was regarded as an end in itself and poverty removal was forgotten until a new, socially conscious generation of economists who worried about poverty arrived on the scene, and second, that the strategy of growth in order to reduce poverty was a laissez-faire, hands-off, passive strategy.

Growth and Poverty

We were also aware that growth had to be differentiated. Some types of growth would help the poor more than others. For instance, as argued more fully below, an outward trade orientation helped the Far Eastern economies in the postwar years to export labor-intensive goods; this added to employment and reduced poverty rapidly. In India, the emphasis on autarky and on capital-intensive projects reduced both growth rates and increase in the demand for labor, so the impact on poverty was minimal.

Then again, growth can paradoxically immiserize a country and hence its poor as well (unless corrective policies are undertaken simultaneously). In 1958, I published a paper on what I called "immiserizing growth," where I demonstrated that an economy could become worse off even though it had grown through accumulating capital or improving productivity.[7] The argument was straightforward. Consider Bangladesh, which exports a lot of jute. Growth in the shape of more jute production, resulting in greater exports, would depress the international price of jute. Suppose then that one hundred additional bales of jute have been produced. If the world price of jute remains the same at $50 a bale, Bangladesh's export earnings go up by $5,000. But if the world price falls such that Bangladesh's total export earnings fall drastically as the additional hundred bales are exported, the total earnings of Bangladeshi jute exports could fall by as much as $6,000. This loss of $6,000 (from what economists call, in jargon, the fall in the Bangladeshi terms of trade) then outweighs the $5,000 gain from growth. Immiseration is the result.

This paradox earned me a lot of attention, partly because economists love paradoxes; whoever got attention for saying the obvious?[8] But partly it was also because many developing countries feared that international markets were tight in exactly the way I had hypothesized in arriving at the paradox of immiserizing growth. This was either because of economic reasons such as market saturation or because of protectionism that would choke off markets as soon as more exports materialized. My theory of immiserizing growth showed exactly how crippling that could be to a developing country's growth prospects.[9] The way to avoid this adverse outcome, of course, is to diversify away from jute production and exports.[10] So when you can depress your export prices by selling more because you are a major supplier, restrain yourself; push in other directions. A suitable policy can always nip the immiserizing growth paradox in the bud, ensuring that growth does amount to an increase in the size of the pie.

But then consider simpler and more obvious, but no less compelling, examples of immiseration that follows from *others'*, as against one's own, growth. Think of the green revolution, the evocative phrase used to describe the arrival and use of new and vastly more productive varieties of wheat and rice that had been invented with support from the Ford and Rockefeller Foundations and for which Dr. Norman Borlaug got the Nobel prize for peace in 1970.[11] When the new seeds arrived, the farmers who benefited were naturally either those who had access to credit because they had assets and hence adequate collateral, or those who could afford to be risk takers with new technology because they had a cushion of wealth to fall back on in case things did not work out. So there you have the divide that attends every transition to a major new technology: rarely do all march in step like a Roman legion. But then imagine what happens when some innovate and increase their production so that the price falls, while others have not innovated and their stagnant output now is sold at a lower price. Those who lag behind do not merely fall behind; they fall by the wayside, struck by a blow not of their making. Thus many feared that the green revolution would usher in the red revolution! But this did not come to pass. Why?

For one thing, policies were devised to ensure that immiseration of the laggards generally did not occur. Agricultural prices did not fall because of increasing demand, which resulted from investments that added new jobs and incomes. The government in India also actively used price support schemes, providing a floor to possible declines in prices. And as for the different fear that landless labor would be replaced by the higher yields, the reality turned out to be far more agreeable. The joint use of new seeds and irrigation led to multiple cropping; this resulted in an increased demand for labor on farms, prompting improvement in wages. Yet another possible source of immiseration with new seeds is the emergence of new pests and diseases that can be destructive of yields and of farming more generally. In the Indian case again, the government was careful to establish a substantial scientific support system that contained these dangerous possibilities.

So appropriate policies will always enable us to profit from growth and to moderate, even prevent, unpleasant outcomes for the poor. While some governments have not been careful (as discussed in Chapter 16 on coping with the potential downsides of globalization), other governments have not been blind to these problems. Other interesting issues, however, must be addressed.

First, recall that different types of growth (e.g., growth paths resulting from reliance on heavy industry as against light industry, or those favoring capital-intensive as against labor-intensive investments) affect the poor differentially. Many economists in the early years of development planning favored a growth strategy that relied on massive import substitution in heavy industry (such as steel and electrical machinery) rather than on the exports of light manufactures (such as toys and garments), on the choice of high capital intensity in production techniques, and on the proliferation of public enterprises (beyond utilities) that turned out to be white elephants making gargantuan losses. Such a development strategy undermined the cause of the poor by reducing growth and by delinking it from increased demand for the low-grade labor that constitutes the bulk of the poor.[12] If growth had been outward-oriented, with labor-intensive goods and light manufactures being exported in far greater quantities, it would have increased the demand for labor and helped the poor far more.[13] So freer trade would have promoted growth that was even more effective in reducing poverty through the salutary effects of increased demand for unskilled labor.

Second, what can we do to improve the access of the poor to expanding opportunities in a growing economy? It is not always true that growth will pull up the poor into gainful employment. Even though growth opens the doors, the traction in the legs of the poor may not be enough to carry them through these doors. For example, tribal areas in India where poverty is acute may not be connected sufficiently to the mainstream economy where growth occurs. And we know from inner-city problems in the United States that the supply response of its youth to jobs downtown may be minimal unless we also address structural problems such as the allure of drugs, transportation bottlenecks, and the lack of role models in broken and single-parent families struggling against terrible odds. I should add that those who grow up in the inner city also need to acquire the carriage and demeanor that are critical for service sector jobs downtown—though you need them less in the kitchen, where you flip hamburgers, than in the front, where you face the customers. This reminds me of the economist Alan Blinder's sophisticated spoof of the tendency by us economists to reduce everything to economic terms: he produced an economic analysis of why chefs have bad teeth and waiters have good teeth!

But if you know the history of developmental economics, then you also know that the earliest development-policy makers tried hard to improve the access of the poor to growing incomes by making it easier for them to borrow to invest. This was done in India by forcing banks to open branches in rural areas and by asking them to lower collateral requirements. The problem with this policy was that it often resulted in bad debts. A breakthrough, however, came with the invention of microcredit programs, which go down to the very poor. The problem was solved by lending very small sums to a number of poor clients for tiny investments that improved their ability to earn a livelihood, and by letting each borrower (or "agent," as economists call her) effectively monitor other borrowers. This, as against the lender (or "principal") trying to monitor the borrower, works wonders: it reduces bad debts dramatically.[14]

But an alternative innovative idea for improving the poor's access to investment has come from the economist Hernando de Soto in his book *The Mystery of Capital.*[15] Essentially, de Soto argues not that we ought to forgo collateral from the poor, but that we must recognize that they often have a huge amount of capital in the form of land and other property. The problem, de Soto says, is that these assets do not enjoy property rights and the associated rule of law that protects and enforces those rights. This prevents the poor from being able to collateralize these assets in order to borrow and invest. De Soto has made this case beautifully and convincingly, citing the nineteenth-century American experience. There is no doubt that his prescription must be tried.

We must also improve the poor's access to investment by making sure that bureaucrats are replaced by markets wherever possible. As I remarked earlier, the anti-market protesters do not adequately appreciate that, as has been documented by numerous development economists who have studied both the working of controls and the rise of corruption in developing countries, far too many bureaucrats impose senseless restrictions just to collect bribes or to exercise power.[16] Letting markets function is therefore often an egalitarian allocation mechanism. I can do no better if I am to persuade skeptics than to tell here the bon mot that Sir Arthur Lewis, the Nobel laureate in development economics from St. Lucia (which has the distinction of having produced two Nobel laureates, the other being the poet Walcott) shared with me.[17] Lewis was adviser to the centrist, intellectually inclined Hugh Gaitskell in the British Labor Party. When he met Thomas Balogh, a radical economic adviser to British prime minister Harold Wilson, he told him: "Tommy, the difference between your socialism and mine is that when you think of yourself as a socialist, you think of yourself as behind the counter; when I think of myself as a socialist, I think of myself as being in front of it."[18]

But the ability of the poor to access the growth process and to share in the prosperity depends at least as much on their ability to get their voices heard in the political process. Without a voice, it is highly unlikely that they will get appropriate and effective legislation.[19] Democracy gives the poor precisely that voice, but it obviously works well only when there are political alternatives instead of a single-party state. NGOs provide yet another support mechanism for the poor; and the Indian supreme court took great strides in the 1980s and 1990s by giving legal standing to social action groups (as the Indian NGOs are called) to bring action before the courts on behalf of the poor.[20]

Let me add that growth is also a powerful mechanism that brings to life social legislation aimed at helping the poor and peripheral groups. Thus, rights and benefits for women may be guaranteed by legislation that prohibits dowry, proscribes polygamy, mandates primary school enrollment for all children (including girls), and much else. But it will often amount to a hill of beans unless a growing economy gives women the economic independence to walk out and even to sue at the risk of being discarded. A battered wife who cannot find a new job is less likely to take advantage of legislation that says a husband cannot beat his wife. An impoverished parent is unlikely, no matter what the legislation says, to send a child to school if the prospect of finding a job is dismal because of a stagnant economy. In short, empowerment, as it is called today—a fancy word for what we development economists have long understood and written about—proceeds from both political democracy and economic prosperity, and it is a powerful tool for aiding the poor.

Finally, we need to go beyond just having incomes of the poor grow. Growing incomes would do little good if frittered away, for instance. So, drawing on a 1987 lecture I gave on poverty and public policy, let me say that we have a final set of problems that need to be addressed once income has been provided:

> First, as sociologists of poverty have long known, the poor may spend their incomes on frills rather than on food. As the Japanese proverb goes, to each according to his taste; some prefer nettles. Perhaps you have heard of the seamen's folklore that recounts the story of the sailor who inherited a fortune, spent a third on women, a third on gin, and "frittered away" the rest.
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> In fact, there is now considerable econometric evidence . . . that supports the commonsense view that increases in income do not automatically result in nutritional improvement even for very poor and malnourished populations.[21] Their high income elasticities of expenditure on food reflect a strong demand for the nonnutritive attributes of food (such as taste, aroma, status and variety), suggesting strongly that income generation will not automatically translate into better nutrition.
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> . . . Should we actively intervene so that the poor are seduced into better fulfillment of what we regard as their basic needs? I do [think so]. In fact, I see great virtue in quasi-paternalistic moves to induce, by supply and taste-shifting policy measures, more nutrient food intake, greater use of clean water, among other things, by the poor. In thus compromising the principle of unimpeded and uninfluenced choice, for the poor and not for the others, evidently I adopt the moral-philosophical position that I do not care if the rich are malnourished from feeding on too many cakes but do if the poor are malnourished from buying too little bread, when their incomes can buy them both proper nourishment if only they were to choose to do so. In this, I am in the ethical company of Sofya (Sonia) Marmeladova in Dostoevsky's *Crime and Punishment* who, in turning to prostitution to support her destitute mother, sacrifices virtue for a greater good.[22]

Of course, the question then also arises as to the distribution of the consumption, even when adequate and desirable, *within the household*. This obviously takes us right into the question of gender discrimination, a question whose relationship to globalization is discussed in Chapter 6. This is, of course, an active issue today, with the rise of feminism.[23]

Trade and Growth

But then, was our earlier optimism about the benign relationship between trade and growth also justified despite the fact that one could readily imagine circumstances where, instead of helping growth, trade could harm or even bypass growth? Indeed, economists can, and do, readily build formal models to derive these unpleasant possibilities.[24] We need, however, to know *empirically* what happens in practice. And empirical evidence supports the optimism.

First, consider the late nineteenth century. Historians of this period have often thought that protection, not free trade, was associated with high growth. Paul Bairoch, in the *Cambridge Economic History of Europe,* has argued that "protectionism [went with] economic growth and expansion of trade; liberalism [went with] stagnation in both."[25] Recently, the economic historians Kevin O'Rourke and Jeff Williamson have reinforced this impression by deriving a statistical association, through running what statisticians call regressions, between economic growth and import tariffs from 1875 to 1914.[26]

But the later work of Douglas Irwin has refuted that proposition.[27] By adding to the regression analysis several countries that were on the periphery of the world economy but integrating into it, as one should, Irwin manages to break the positive association between tariffs and growth. Equally important, he shows that the rapidly growing countries, Canada and Argentina, had high tariffs but that these tariffs were for revenue and had few protective side effects. The two countries were in fact splendid examples of outward-oriented countries that built prosperity on their pro-trade orientation.

Second, we can also turn to analyses that take into account complexities that the many-country regressions necessarily ignore. These typically involve deeper examination of specific episodes that speak to the issue at hand or consist of sophisticated country studies in depth.

Two examples of such analyses, both supportive of the merits of freer trade, can be found in the empirical literature. Just because specific tariffs led an industry to grow, we cannot conclude that the strategy contributed to economic prosperity and hence growth. Recognizing this, Irwin has produced a fascinating case study of whether a classic "infant industry" tariff levied in the late nineteenth century in the United States on the tinplate industry really promoted that industry *and* whether that promotion was cost-effective.[28] Irwin's careful answer is that the McKinley tariff protection accelerated the establishment of the industry by a mere ten years, since the U.S. prices of iron and steel inputs were already converging with those in Britain and therefore making U.S. production of tinplate profitable in any event, but that this acceleration was economically expensive because it does not pass a cost-benefit test.

At the same time, the modern evidence against an inward-looking or import substitution trade strategy is really quite overwhelming. In the 1960s and 1970s, several full-length studies of the trade and industrialization strategies of over a dozen major developing countries, including India, Ghana, Egypt, South Korea, the Philippines, Chile, Brazil, and Mexico, were undertaken at the Organization for Economic Cooperation and Development (OECD) and the National Bureau of Economic Research, the leading research institution in the United States.[29] These studies were very substantial and examined several complexities that would be ignored in a simplistic regression analysis across a multitude of nations. Thus, for instance, in examining whether the 1966 trade liberalization in India worked, T. N. Srinivasan and I wrote a whole chapter assessing whether, after making allowance for a severe drought that blighted exports, the liberalization could be considered to have been beneficial compared to a decision to avoid it. Only after systematic examination of the actual details of these countries' experience could we judge whether trade liberalization had truly occurred and when; only then we could shift meaningfully to a limited regression analysis that stood on the shoulders of this sophisticated analysis. The result was to overturn decisively the prevailing wisdom in favor of autarkic policies.[30] Indeed, many of us had started with the presumption that inward-looking policies would be seen to be welfare-enhancing, but the results were strikingly in the opposite direction, supportive of outward orientation in trade and direct foreign investment instead. Why?[31]

- The outward-oriented economies were better able to gain from trade. The layman finds it hard to appreciate this because, as the Nobel laureate Paul Samuelson has remarked, perhaps the most counterintuitive but true proposition in economics has to be that one can specialize and do better.
- Economists today also appreciate that there are scale economies in production that can be exploited when trade expands markets. This is particularly the case for small countries. For this reason, Tanzania, Uganda, and Kenya, which had protected themselves with high tariffs against imports in the 1960s, found that the cost of their protection was excessively high, with each

country producing a few units of several items. They decided in the 1970s therefore to have an East African Common Market so that they could specialize among themselves and each could produce at lower cost for the larger combined market.

- Then there are the gains from increased competition. Restriction of trade often is the chief cause of domestic monopolies. Freer trade produces enhanced competition and gains therefrom. India provides an amusing illustration. Sheltered from import competition, Indian car manufacturers produced such shoddy cars that, when they went up to India's Tariff Commission for renewal of their protection, the commissioners wryly remarked that in Indian cars, everything made a noise except the horn!
- In order to maintain outward orientation, countries must create macroeconomic stability (chiefly, low inflation). Inflation-prone economies with fixed exchange rate regimes, where countries only reluctantly adjust their exchange rates in response to inflation, would soon find that their currency had become overvalued. This overvaluation would make exporting less profitable and importing more rewarding, thus undermining the outward-oriented trade strategy. Hence countries committed to export-promoting trade strategy had to have macroeconomic stability, and they therefore earned the economic advantages that follow from good management of the economy.

  Today, some critics of the advantages of outward-oriented trade strategy argue that we proponents of such a trade strategy fail to appreciate that the gains come not from the trade strategy but from "fundamentals" such as macroeconomic stability. They are wrong. Aside from the fact that we did think of this almost a quarter of a century ago, it is wrong to suggest that macroeconomic stability—for example, an economy not plagued by high inflation—will necessarily lead to an export-promoting trade strategy. India and the Soviet-bloc countries enjoyed splendid macroeconomic stability, to the point where a wit observed that Karl Marx and Milton Friedman were strange bedfellows. But the economies were autarkic in trade: trade policy itself nullified the advantages that macroeconomic stability would bring.
- Finally, as discussed in Chapter 12, direct foreign investment would also be lower in the presence of trade restrictions. It would also be less productive. Trade barriers would mean that such investment would have to be primarily for the domestic market, which was generally limited, whereas in outward-oriented economies it would be for world markets, which were not. Then again, just as trade barriers reduce the efficiency of domestic investments and incur the loss from protection, so do they reduce the efficiency of foreign investments.

Third, consider the contrasting experience of India and the Far East. From the 1960s to the 1980s, India remained locked in relatively autarkic trade policies; the Far Eastern countries—Singapore, Hong Kong, South Korea, and Taiwan, the four Little Tigers—shifted to outward orientation dramatically. The results speak for themselves: exports and income grew at abysmal rates in India, at dramatic rates in the Far East. India missed the bus. No, it missed the Concorde!

Of course, the trade strategy has to be put into the full context of other policies that enabled it to translate into gigantic growth-enhancing outcomes for the Far East and into tragic shortfalls for India. To see this, consider the East Asian "miracle," as economists christened it: it is not surprising that the practitioners of the dismal science call a splendid economic performance a miracle! This spectacular performance was, it is widely recognized now, due to very high rates of productive investment almost unparalleled elsewhere. Sure enough, the Soviet-bloc countries had experienced similar rates of investment, but it had all turned out to be unproductive investment. The "blood, sweat, and tears" strategy of getting Soviet citizens to forgo consumption in the interest of investment and growth of income had proven to be a failure.

The high rates of investment reflected, in turn, the fact that the East Asian countries turned outward beginning in the 1960s and therefore had world markets to work with when planning their investments. By contrast, India turned inward, so its investment was constrained by the growth of the domestic market. Growth in that market in a largely agricultural country meant the growth of agricultural output and incomes. But nowhere in the world has agriculture grown, on a sustained basis, at more than 4 percent annually, making it a weak basis for a strong investment performance!

The Far East's phenomenally high investment rates also were exceptionally productive. They were based on export earnings, which therefore enabled the investment to occur with imported capital equipment embodying advanced and productive technology.[32] Besides, these countries had inherited tremendously high literacy rates that ensured the productive use of new technologies. Accommodating, even ahead-of-the-curve expansion of higher education also helped to increase the productivity of the investment. So the Far East generally was characterized by a virtuous interaction among beneficial policies: outward orientation, high literacy, and emphasis on higher education.

But the primary role must be assigned to the outward orientation that set up the system for high and productive investments.[33] Education by itself, especially higher education, is unlikely to help. Unemployed educated youth will likely burn tram cars rather than lead to greater growth. The Kevin Costner movie *Field of Dreams,* in which this gifted actor's character builds a baseball field and dreams that the superstars of baseball have come there to play (but do not in fact when the reality check is in) is probably the best corrective to those who think that education by itself was the magic bullet that created the East Asian miracle.

Fourth, what do the many multi-country cross-sectional studies of this question show today? Not all show a positive relationship between trade and growth. What one can say, however, is that such statistical evidence, by and large, is consonant with the views of the free trade proponents.

The latest set of such studies, by David Dollar and Aart Kraay of the World Bank, show that if one focuses on post-1980 globalizers such as Vietnam and Mexico, which were in the top third of developing countries in terms of the increase in the share of trade in GDP during 1977–1997, they show better growth performance. Since trade will generally grow even if trade barriers are not reduced, it is important to note that this group also cut import tariffs by three times as much as the non-globalizing two-thirds.[34] These authors also observe that while growth rates in the non-globalizing developing countries have generally slowed down in the past two decades, globalizers have shown exactly the opposite pattern, with their growth rates accelerating from the level of the 1960s and 1970s.[35] This is certainly true for China, and to a lesser but certain degree for India, two countries that together have nearly 2.5 billion people within their borders.

India, China, and Elsewhere

So, with the usual caveat that in the social sciences one can rarely establish the degree of credibility for one's argument that one can aspire to in the physical sciences, one can conclude that freer trade is associated with higher growth and that higher growth is associated with reduced poverty. Hence, growth reduces poverty.

The best way to see that is to focus on the two countries, India and China, that have the largest pool of world poverty. Both shifted to outward orientation roughly two decades ago, and this contributed to their higher growth in the 1980s and 1990s. China adopted aggressively outward-oriented economic policies in 1978. India also began opening its insular economy in a limited fashion in the 1980s and more systematically and boldly in the 1990s. According to World Bank estimates, real income (gross domestic product) grew at an annual average rate of 10 percent in China and 6 percent in India during the two decades ending in 2000. No country in the world had growth as rapid as China's, and fewer than ten countries (and, except for China, none with poverty rates and population size comparable to India's) had a growth rate exceeding India's during these years. What happened to their poverty? Just what common sense suggests: it declined.

Thus, according to the Asian Development Bank, poverty declined from an estimated 28 percent in 1978 to 9 percent in 1998 in China. Official Indian estimates report that poverty fell from 51 percent in 1977–78 to 26 percent in 1999–2000. Contrast what happened in India during the quarter of a century prior to the economic reforms and the abysmally low annual growth rate of 3.5 percent. During that period, the poverty rate remained stagnant, fluctuating around 55 percent. China's track record on poverty reduction in the pre-reform period is dismal as well, but there were also major adverse effects from the huge famine during the Great Leap Forward of Chairman Mao and from the disruptive Cultural Revolution. This experience, showing how growth will in fact reduce poverty, just as I had predicted and prescribed at the Indian Planning Commission in the early 1960s, has been shown to be valid in other countries where Dollar and Kraay have examined the experience carefully, among them Vietnam and Uganda.

More recent estimates by my Columbia colleague Xavier Sala-i-Martin have underlined the same conclusion dramatically. He has estimated poverty rates worldwide, using data for ninety-seven countries between 1970 and 1998. His conclusion on the relationship of growth to poverty reduction is as strong a corroboration as I can find of my 1960s conjecture that growth must be reckoned to be the principal force in alleviating poverty:

> [T]he last three decades saw a reversal of roles between Africa and Asia: in the 1970s, 11% of the world's poor were in Africa and 76% in Asia. By 1998, Africa hosted 66% of the poor and Asia's share had declined to 15%. Clearly, this reversal was caused by the very different aggregate growth performances. Poverty reduced remarkably in Asia because Asian countries grew. Poverty increased dramatically in Africa because African countries did not grow. As a result, perhaps the most important lesson to be learned . . . is that a central question economists interested in human welfare should ask, therefore, is how to make Africa grow.[36]

So when we have moved away from the anti-globalization rhetoric and looked at the fears, even convictions, dispassionately with the available empirical evidence, we can conclude that globalization (in shape of trade and, I will argue later in Chapter 12, direct equity investment as well) helps, not harms, the cause of poverty reduction in the poor countries.

What about Inequality?

Poverty, of course, is different from inequality. True, as many sociologists have reminded us, I may feel poorer if the rich consume commodities in a way that makes me feel more deprived. Equally, the same degree of inequality will often appear more intolerable if it is in the presence of acute poverty. Thus in a country such as India, where poverty is still immense, affluence and its display are particularly galling. So are they in Russia today, where the nouveaux riches, a few of whom have fortunes similar to those of Western tycoons such as George Soros and Ted Turner, and their offspring, who spend holidays in St. Moritz and drive through Moscow in BMWs and Mercedes-Benzes, coexist with substantial numbers of people immiserized during a mismanaged transition.

Whether increased inequality matters, and if so, how, depends therefore very much on the society in question. In contrast to modern Russia, a society where income and wealth are unequal may nonetheless be stable if that income is not spent ostentatiously but instead devoted to social uplift. The Jains of India and the Dutch burghers who suffered the "embarrassment of riches" referred to in the title of Simon Schama's book about them accumulated capital and amassed wealth but spent it not on self-indulgence but on doing social good.[37] That made capitalism's unequal outcomes inoffensive, softening capitalism and its inequalities. Yet another way in which inequality becomes acceptable is if those who are at the bottom of the scale feel that they can also make it: inequality is accepted because it excites not envy but aspiration and hope. Capitalism's inequalities then become tolerable, not because the rich deny themselves self-indulgence but because they make the poor fancy that these prizes may come to them someday too. Evidently this part of the American dream frustrates the inequality-conscious Americans, who see the poor not voting the way they "should."

Indeed, the consequences of increased inequality, in any event, might be paradoxically benign, rather than malign. If a thousand people become millionaires, the inequality is less than if Bill Gates gets to make a billion all by himself. But the thousand millionaires, with only a million each, will likely buy expensive vacations, BMWs, houses in the Hamptons, and toys at FAO Schwarz. In contrast, Gates will not be able to spend his billion even if he were to buy a European castle a day, and the unconscionable wealth would likely propel him, as in fact it has, to spend the bulk of the money on social good. So extreme inequality will have turned out to be better than less acute inequality!

In short, the preoccupation with inequality measures—and there are several—is somewhat ludicrous unless the economist has bothered to put them into social and political context. Cross-country comparisons, no matter what measure is deployed, are just so much irrelevant data mongering, it must be confessed, since societies are diverse on relevant dimensions and therefore inequality cannot be judged outside particular contexts.

And this lunacy—how else can one describe it?—extends to what the World Bank, with its abundance of economists and funds, has been doing in recent years, which is to put all the households of the world onto one chart to measure worldwide inequality of incomes.[38] But what sense does it make to put a household in Mongolia alongside a household in Chile, one in Bangladesh, another in the United States, and still another in Congo? These households do not belong to a "society" in which they compare themselves with the others, and so a measure that includes all of them is practically a meaningless construct.

But since some play this particular global inequality game, others must follow suit. Since the World Bank found, in a 2001 study, that a small increase in inequality had occurred between the late 1980s and the early 1990s—an astonishingly small period to work with since the measured changes are likely then to be transient, just a blip—the question has been posed in just this way by others. Thus, in the thorough study cited earlier on poverty, Sala-i-Martin calculates also the inequality à la World Bank, using nine alternative measures thereof. He concludes that according to all these measures, global inequality declined substantially during the last two decades. These findings are supported also by the recent work of Surjit Bhalla.[39] Between them, they raise a massive discordant note in the chorus singing from a libretto lamenting increasing inequality in the age of globalization.

And so globalization cannot be plausibly argued to have increased poverty in the poor nations or to have widened world inequality. The evidence points in just the opposite direction.

6

Child Labor: Increased or Reduced?

Child labor is a continuing scourge in poor countries, and has sadly not disappeared from the rich countries altogether (even a country as rich as the United States still has children at work, not just selling lemonade and cookies on the roadside or hosing down your car for a buck, but in the poor counties in the South where migrant labor works under exploitative conditions). The International Labor Organization (ILO), the international agency charged with overseeing the world's labor issues, has estimated that 100 million to 200 million children under fifteen are at work. Of these, ILO estimates that almost 95 percent are in poor countries, and half of these are in Asia. An estimated 100 million of these children often do not go to primary school.[1]

The problem has been long-standing and is historically inherited. It is extremely improbable, therefore, that it has much to do with today's—or even yesterday's, rather than yesteryear's—globalization. Its principal causes are altogether different and lie rooted in poverty instead. Yet some anti-globalization and anti-child-labor activists tend to merge into a symbiotic relationship. Globalization is regarded by them, if not as a cause of child labor in the workforce, at least as a phenomenon that increases the incentive to use it and hence as a cause of its perpetuation and even enlargement. Yet there is little evidence of this perverse and malevolent relationship. The truth is that globalization—wherever it translates into greater general prosperity and reduced poverty—only accelerates the reduction of child labor and enhances primary school enrollment and hence literacy. And as I argued from my analysis of the East Asian miracle, literacy in turn enables rapid growth. So we have here a virtuous circle.

Often the word *globalization* is smuggled into a galling description of exploitative child labor, creating the impression that globalization somehow has something to do with the wicked situation. Many examples could be cited. One might suffice.

In a disturbing pamphlet on the exploitation of children as domestic servants—indeed, their occasional subjection to near-slavery and even physically abusive treatment—the South Asian Coalition on Child Servitude (SACCS) writes, in a pamphlet titled *Invisible Slaves*, about a child, Ashraf, who was beaten and badly burned by his employer, Hamid Hussain, a senior civil servant in New Delhi, for the crime of drinking the remnants of milk left over by the employer's children:

> Now Ashraf [after being rescued] is staying at Mukti Ashram, one of the rehabilitation centers of SACCS. . . . SACCS after observing the *growing cases of torture on domestic child laborers in different levels of society in post-globalization India* . . . vowed to focus on this sector. [Italics added][2]

Of course, SACCS has not documented that there are "growing cases" of such reprehensible torture. And even were its increasing incidence true, the organization certainly has not linked the phenomenon to globalization. Yet the admirable activists who lead SACCS have fallen into the trap, so assiduously set by some of their civil society counterparts abroad, that lays all the ills of the world at the door of globalization. Indeed, as you read and are shaken by the story of what happened to Ashraf, it needs a wild imagination to think that Hussain's actions had anything to do with India's globalization, halting and limited as it has been in the half century after independence in 1947.

What Does Economic Analysis Tell Us?

But forget what SACCS and other activists believe and let us look at what economic analysis suggests and what careful studies show.

Now, it is easy enough to construct models of family household behavior where improved incomes—as a result of increased trade opportunity, for instance—prompt greedy parents to put children to work. Yet the evidence seems to suggest exactly the opposite, for a variety of reasons. Poor parents, no less than rich parents, generally want the best for their children. Poverty is what drives many to put children to work rather than into school. Parents will choose to feed their children instead of schooling them if forced to make a choice. When incomes improve, poor parents can generally be expected to respond by putting children back in school. This is what economists call the "income effect": education of one's children is a superior good, the consumption of which rises as incomes rise.

Besides, even if one thinks of children's education as an investment good, one might well expect the parents to react to increasing income by sending children to schools—often it means that the third or fourth child, or the female child, who was at work, is now put into school—for two reasons. First, the incentive to invest in children's education should rise because a stagnant economy offers fewer job prospects than a growing one. This incentive will not always translate into effective response if there are serious structural constraints (for example, inner-city children cannot access jobs that are in areas they cannot get to because of lack of transportation), but these inadequacies themselves may change as the demand to ease these constraints rises with available opportunities that people want to exploit.

More importantly, increased income can also enable poor parents who have been previously constrained from sending children to school by lack of access to credit to do so now. In fact, there is substantial evidence that the credit-constraint argument has relevance in many poor countries.

The economists Priya Ranjan, Jean-Marie Baland, and James Robinson have argued that the returns to primary education have been estimated as being so attractive in many poor countries with a great deal of child labor that the most likely hypothesis for children not being sent to school is that poor parents are unable to borrow money to send their children to school and then repay their loans later.[3] In short, the credit markets are imperfect. So the growth of parental income and hence the easing of this credit constraint (which can certainly follow from improved incomes following globalization) should lead to greater school enrollment and reduced child labor.

The economists Rajeev Dehejia and Roberta Gatti have empirically explored this theory, with data for 163 countries. They argue that development in the form of improvements in the financial sector, which in turn is correlated in other studies with the ability of small borrowers to access credit, is associated with a reduction in the use of child labor.[4] These authors and Kathleen Beegle use household-level data in Tanzania to demonstrate more convincingly the role of credit constraints in the phenomenon of child labor. They examined how agricultural households responded to temporary declines in income. Since the fall in income is temporary, one would expect households to borrow, if they could, rather than take children from schools and put them to work in order to earn. They found that in response to such income shocks, the credit-constrained households increased the use of child labor, whereas households with access to credit in fact borrowed and were able in consequence to offset over half of the increase in child labor.[5]

This implies, of course, that simply proscribing the use of child labor is unlikely to eliminate it; it will only drive poor parents to send their children to work by stealth and often into even worse "occupations" such as prostitution.[6] This happened in Bangladesh, with some young girls falling into prostitution when garment employers who feared the passage of the U.S. Child Labor Deterrence Act (1993)—known as the Harkin Bill because of its sponsor, the well-known liberal senator Tom Harkin—which would have banned imports of textiles using child labor, dismissed an estimated fifty thousand children from factories.[7]

More Evidence

As it happens, we do have some additional, compelling evidence, based on state-of-the-art econometric analysis using extensive data on Vietnamese households, that supports the view that globalization actually reduces child labor. The economists Eric Edmonds and Nina Pavcnik of Dartmouth College essentially use change in the domestic price of Vietnam's primary staple and export product, rice, to examine the link between globalization and the use of child labor. From 1993 to 1998, they find that the average price of rice in Vietnam increased 29 percent, partly because a rice export quota self-imposed on Vietnamese exports had been relaxed.[8] "Since [1989], the government had gradually liberalized its export regime, allowing rice exports to more than double (to about 3 million tons in 1996). By 1997, Vietnam's export quota was no longer binding, and Vietnam was fully exposed to the international price of rice."

Vietnam happens to be a country where 26 percent of children ages six through fifteen work in agriculture and about 7 percent work elsewhere, providing therefore an opportunity to study how globalization might affect the use of child labor. It turned out that households that earned extra income from higher rice prices substituted these extra earnings for the earnings from their children's work. Interestingly, anticipating my focus in the next chapter on the gender implications of globalization, the extra income appeared to benefit older girls, who experienced "the largest declines in child labor and the largest increases in school enrollment."[9]

And so economic argumentation and the empirical evidence do not lend support to the feared adverse link between child labor and globalization in the shape of trade.

Nonetheless, one caveat must be entered. I have considered the effect on child labor within the poor countries when globalization proceeds. But what about globalization and trade in children across borders? Here there is some reason for concern and action.

The increased demand for labor in some of the labor-scarce Middle Eastern nations without modern protections and rights, especially Saudi Arabia, has led to the cross-border movements of women and their children, employed as domestic labor, often in poor conditions. Child prostitution has also intensified, with female children being transported across borders and sold into brothels. These are products of globalization only in the sense that there are profits to be had in movements across borders. And all are agreed that these developments call for corrective action.

7

Women: Harmed or Helped?

Japan comes at us like images in a kaleidoscope. Less than two decades ago we were panicked by its economic prowess into declaring the end of the American century and the arrival of the Pacific century. Its economic might and its uniquely different and impenetrable ways also fed our paranoia: many thought of the Japanese as Superman and Lex Luthor rolled together, omnipotence and evil genius, into the formidable Godzilla of Japanese monster movies. But today the country is almost an economic wasteland, mired in recession and paralyzed into inaction. Today Japan is seen as a threat not because of its strength but because of its weakness.[1]

Japan's paradoxes continue when we think of Japanese women. Japan has the unique distinction of having produced the first female novelist of gravitas, Lady Murasaki, in the eleventh century. Her novel *The Tale of Genji* is widely considered to be the greatest work of Japanese literature; in its nostalgia for the passing society, it recalls Marcel Proust's *Remembrance of Things Past* and Junichiro Tanizaki's *In Praise of Shadows*. And no student of Japanese literature can ignore her contemporary, ten years her senior, Sei Shonagon: a talented writer, her major opus, *Makura no Soshi,* is a classic read even now. Yet when one sees Japan today, the state of its women is almost tragic, closer to that in traditional societies than in the West; indeed, it offends our modern sensibilities.

This was brought home to me when, several years ago, I was at a conference in Tokyo. My Oxford tutor, Sir Donald MacDougall, who had been a wartime adviser to Winston Churchill and was now in London, was there along with his economist wife, Lady Margaret Hall, an Oxford don at the time. As we were boarding the bus, the respectful bureaucrat from Japan's Economic Planning Agency shepherding us announced the MacDougalls as "Professor MacDougall and Mrs. MacDougall." So I interrupted him to say: "Excuse me, they are Mr. MacDougall and Professor Mrs. MacDougall." My reward came not in heaven but in this world, and it was immediate: Margaret came over and gave me a warm kiss on my cheek, with a glowing "Thanks, Jagdish." It made my day.

Globalization Helps Women: Two Examples

One can go around the world and find discrimination against women. It arises at several levels and in different ways. Gender studies has brought this pervasive phenomenon to center stage. But again, my focus here is not on the documentation of this phenomenon or its explanation. Rather, it is on the central question: has globalization accentuated, or has it been corrosive of, the discriminations against women that many of us deplore and wish to destroy?

Japanese Multinationals Going Abroad

That globalization can help rather than harm women emerges dramatically when one examines how globalization has affected the women of Japan. In the aftermath of the great outward expansion of Japan's multinationals in the 1980s and early 1990s, Japanese men executives were sent to the United States, England, France, and other Western nations (Japanese women then rarely made it through a very low glass ceiling). These men brought with them their Japanese wives and children. In New York, they lived in Scarsdale, Riverdale, and Manhattan. And the wives saw at first hand that Western women, though they have some way to go, were treated better. So did the young children become not docile Japanese who are taught the value of social conformity and harmony but rambunctious little Americans who value instead the individualism that every immigrant parent confronts when the children return home from school and say, "That is the way *I* want to do it." Schools are where cultural conditioning occurs subliminally, even explicitly. The women and children who then returned to Japan became agents for change. They would never be the same again.

Feminism, women's rights, other human rights, due process for citizens and immigrants, and a host of other attributes of a modern society began slowly to replace the traditional ways of Japanese culture, and globalization in the shape of Japanese corporations' expansion abroad had played a critical role.

That influence has also come, of course, from other (non-economic) forms of globalization such as the vast increase in Japanese students in Western universities in recent years. Just a decade ago at Columbia, where I teach, the largest nationality in an entering class of over four hundred in the School of International and Public Affairs was Japanese. Many of these students steadily adapted themselves to American ways. Instead of bowing low to the "revered teacher," the *sensei,* they learned to put their feet on the table, even crudely blow bubble gum, in class. And as they returned to Japan (though now a few began to stay on, like students from most other countries) they brought American responses to the increasing trade feuds with the United States. Thus, when the Hosokawa-Clinton summit in Washington failed in 1993, the Japanese prime minister's staff essentially said, "If you object to our trade practices, see you in court!" But President Clinton's staff thought we could still deal with the Japanese in the old ways, through bilateral confrontations and deals. As I explained in an article in *Foreign Affairs* at the time, we thought we were fighting the samurai, but we were fighting GIs.[2]

in a closed economy

Price and Prejudice: Trade and the Wage Gender Gap

But the favorable effect on women's issues in Japan because of globalization in the form of extensive outward flow of Japanese multinationals to the West is not the only example one can find. My favorite example is the study of globalization in trade on the gender wage gap between 1976 and 1993 in the United States by the economists Sandra Black and Elizabeth Brainerd.[3]

Such wage discrimination can be explained in alternative ways. One persuasive theory, due to the Nobel laureate Gary Becker, is that men are paid more than women by employers, even though they have no greater merit and productivity within the firm, simply because of prejudice.[4] But this prejudice has its price: any firm that indulges it is going to be at a competitive disadvantage vis-à-vis firms that hire without this prejudice and pay men no more than they pay women.

Now, if we have a closed economy and all domestic firms share this prejudice, it will not make any one firm less competitive: all firms will be equally handicapped. But when we introduce foreign competition, the foreign firms that do not share this prejudice will be able to gain in competitiveness over domestic firms that indulge the prejudice. Liberalized trade, which enables foreign firms to compete with the domestic firms in open markets, therefore puts pressure on domestic firms to shed their prejudice. The gender wage gap will then narrow in the industries that must compete with imports produced by unprejudiced firms elsewhere.

But consider a related but different and more potent argument. If markets open to trade, competition will intensify, whatever the reason that enables foreign firms to compete with our firms in our domestic and international markets. Faced with increased competition, firms that were happy to indulge their prejudice will now find that survival requires that any and all fat be removed from the firm; cost cutting will mean that the price paid for prejudice will become unaffordable. Again, the gender wage gap will narrow.

The remarkable thing is that Black and Brainerd find that this did actually happen, confirming the predictive power of sophisticated economic reasoning. Firms in the United States that had been subject to relatively less competitive pressure but which then experienced competitive pressure due to openness to trade showed a more rapid reduction in their gender wage gap.

Women's Fears

Yet some influential women's groups and prominent feminist scholars have expressed fears concerning the impact of globalization on their agendas and interests, among them the following.

Global Care Chains

Consider the recent argument, which has gained some currency, by the sociologist Arlie Russell Hochschild regarding the so-called global care chains and their deleterious effect on women.[5] These refer to the phenomenon where women migrants from poor countries have children who are being looked after by girl siblings, grandmothers, or other female relatives while the migrants, as maids and nannies, look after the children of women in the cities of the rich countries. Hochschild argues that this global care chain puts all women at every point in the chain at a disadvantage.

Why? For the migrant women: "Studies suggest that migrants . . . remain attached to the homes and people they leave. . . . Indeed, most of the migrant workers . . . interviewed talked of going back but, in the end, it was their wages that went home while they themselves stayed on in the USA and Italy. Many of the migrants . . . seemed to develop a 'hypothetical self'—the idea of the person they would be if only they were back home. About their own motherhood they seemed to feel two ways: on one hand, being a 'good mother' was earning money for the family, and they were used to a culture of shared mothering with kith and kin at home; at the same time, they felt that being a good mother required them to be with their children and not away from them." Being in a care chain, the author concludes, is "a brave odyssey . . . with deep costs."[6]

Regarding the children back home, the phenomenon was also considered distressing, with the migrants' affections "diverted to their young charges" away from "their own young." Hochschild quotes Sauling Wong as lamenting that "mothers are diverted from those who, by kinship or communal ties, are their more rightful recipients." Moreover, in sociological and psychological terms, the care chain raised added questions: "Can attention, solicitude and love be 'displaced' from, say, [the migrant] Vicky Diaz's son Alfredo, onto, say, Tommy, the son of her employers in Los Angeles? And is the direction of displacement upwards in privilege and power?"[7]

But even if these sentiments had emerged from a proper sample rather than from interviews of not necessarily representative migrants, they would have to confront the fact that as long as the choice to migrate had been made voluntarily, the psychic costs—and possibly gains, as in the case of our own maid of many years from Haiti, who escaped from an abusive husband—were outweighed by the psychic and economic gains. It is important to emphasize also the fact of psychic gains that can accrue because the migrating woman enjoys the liberating environment, both economic and social, that working away from her family, in a feudal and male-dominated environment back home, will imply. I have seen it with our maid, who has grown over the years in self-respect and dignity.

Besides, Hochschild seems to transfer to the migrant workers the values of her own culture: the great emphasis on the nuclear family is often alien to the culture of the poor countries with their extended families, as is well known to students of economic development. Children are often close to, and get looked after by, siblings, aunts, and grandmothers; migration or no migration, that is utterly normal even if it is a phenomenon that will pass as economic development takes off. As the nuclear family has become dominant in the rich countries, the men and women who constitute it are thrown back on one another for virtually all tasks, including child rearing, adding to the stress that an extended family can relieve.[8]

Thus, even if attention was paid naively only to psychological consequences, it is more likely that many women in the global care chain are better off rather than suffering from emotional "deficit" and distress. The migrant female worker is better off in the new world of attachments and autonomy; the migrants' children are happy being looked after by their grandmothers, who are also happy to be looking after the children; and the employer mothers, when they find good nannies, are also happy that they can work without the emotionally wrenching sense that they are neglecting their children. In short, the idea of the global care chain as a chain that binds rather than liberates is almost certainly a wrongheaded one. It fits into the preconception that Hochschild seems to be afflicted with regarding economic globalization as well, as when she says:

> The declining value of child-care anywhere in the world can be compared with the declining value of basic food crops, relative to manufactured goods on the international market. Though clearly more necessary to life, crops such as wheat, rice, or cocoa fetch low and declining prices while the prices of manufactured goods (relative to primary goods) continue to soar on the world market. Just as the market price of primary produce keeps the Third World low in the community of nations, so the low market value of care keeps the status of the women who do it—and, by association, all women—low.[9]

I am afraid this is nothing short of gibberish. The assertions about the declining prices of primary products are familiar decades-old assertions that are untrue but keep recurring in uninformed circles. But even concerning child care, on what evidence does she arrive at the notion that it has a declining value? In truth, as women have gone into the workplace, the demand for child care, whether at home or in centers outside the home, has only grown, and the price of such child care has risen. In fact, one sees a shortage of high-quality child care facilities everywhere as women struggle to find them so they can be freed from all-too-explicit and facile charges of child neglect and the guilt that follows from them.

But it is not just the (economic) *price* of child care that has risen, creating a demand in turn for subsidy to child care. The (social) *value* of child care also becomes more manifest as mothers seek it from others instead of providing it themselves freely at home because of their traditional role.

In fact, there is another important consequence to ponder as women have entered the workforce in great numbers. This has meant that the subsidy they were implicitly providing to child care at home is no longer available. So, from a social viewpoint, one can argue that this traditional subsidy now must be replaced by an explicit subsidy to child care if children, who need nurture and care, are to turn into good adults and citizens. This also means that child care's importance, its social value, is now visible, not hidden by the submerged and subsidized provision of it by women confined to the home.

Unpaid Household Work

Women's Edge, which is a leading NGO promoting gender agendas, has registered several complaints, among them: "The economic theories the WTO espouses and the macro-economic policies that the WTO oversees fail to take into account women's unpaid household work (maintaining the household, growing food for the family, caring for children and relatives). . . . The United Nations estimates that if monetized, the value of unpaid women's household work would equal $11 trillion . . . per year."[10]

National income statisticians have long recognized this neglect, and it is not the only non-market activity that has been considered: volunteer work outside the family, whether by women or men, is yet another example. What is unclear, however, is why we should get the WTO to worry about getting national income accounts adjusted for this and other deficiencies!

Does the fact that women often do unpaid work affect the efficiency of resource allocation in an economy? Surely it does. It implies that the true cost of the output, chiefly child rearing, from that unpaid work is being underestimated. Therefore, this output will be overproduced relative to the case where the women were being paid at market wages. But then there is also an offsetting argument suggesting that the output will be underproduced instead. This is because child care and child rearing have socially desirable spillover effects for which the market does not reward women as it should. If the latter argument is weightier than the former, this would provide an argument for subsidizing child care.

Of course, since the participation of women in the workforce is both good in itself, as it provides women with a choice to work in the home or outside, and is also good for us, since it has several economic payoffs such as bringing into play the talents and contributions of a hitherto neglected half of the workforce, there is a further argument for a subsidy to women in the form of child care support.

But these and other implications of women's unpaid work are matters of domestic policy. It defies common sense to attack either the WTO or the freeing of trade for the absence of such policy initiatives by nation-states that are members of the WTO or that are seeking gains from trade by freeing trade. Yet Women's Edge and other groups do make that illogical leap, and others, when they make assertions such as "Trade agreements need to recognize women's competing demands and ensure that women benefit from trade to the same extent that men do."[11] The "same extent"? Can we manage to achieve such parity of results from trade liberalization for any group, whether women, Dalits (India's untouchables), or

African-Americans or Hispanics in the United States? Can we manage such equality of outcomes for *any* policy reform? And yet these are assertions by serious groups: Women's Edge *is* at the cutting edge of the women's NGOs.

Other Aspects of Women's Work

Yet another issue these groups raise is that in some traditional societies, women produce crops for home consumption and men produce cash crops. If cash crops expand due to trade liberalization and access to world markets, their argument goes, men will benefit but not women; the women might even be harmed. Consider also the claim that "in sub-Saharan Africa . . . a switch to export-promotion crops . . . has often diverted resources from domestic consumption. Men have controlled the extra cash earned from this strategy and the nutritional status of women and children declined."[12]

But what the author is saying is that intra-family decision making can lead to increased incomes being spent on frills rather than on food. Indeed, it can. But then (as I discussed in Chapter 5, on poverty) there is a case here not for bypassing the opportunity to bring increased incomes but for social policy to accompany the increased prosperity such that the untoward effects on nutrition and the health of women and children are avoided. A situation where incomes are stagnant, or even undermined by the imposition of costly trade protection and other harmful economic policies, can also put pressure on men to indulge their taste for frills at the expense of the nutritional status and health of their families; I would submit that it is equally likely to do so. It is smarter to have income-enhancing policies go hand in hand with progressive social ones (which will be more likely to emerge and take hold if we empower women by providing them with the economic opportunities that a growing and prosperous economy will create) instead of reducing incomes so that they are divided and spent better for women.

Trade Agreements and the WTO Pursue Trade and Profits, Not Development and Women's Welfare

The National Organization for Women (NOW) and Feminist Majority, the former an important organization that has done notable work to advance women's rights in the domestic sphere in the United States, have argued:

> Current international trade agreements, liker NAFTA, violate the rights of women workers. Women workers in many factories, located in Export Processing Zones (EPZs [zones set aside to attract export-oriented firms]), have reported physical abuse, sexual harassment, and violence, and mandatory pregnancy testing as a condition for employment. Women workers in EPZs are forced to work long hours for extraordinarily low wages in poor working conditions. In Ciudad Juarez, Mexico, over 200 women have been murdered, many of them on their way to and from their work in the EPZs.[13]

But these groups fail to ask: what are the conditions of work in Mexico outside the EPZs? Are not the Mexican unskilled workers suffering yet worse conditions in local, trade-unrelated industries and occupations? Do women enjoy shorter hours of work as they, and men, struggle to survive on the farms and in rural occupations? If two hundred women have been murdered on their way to and from work, is the blame to be assigned to the foreign firms that provide the employment or to the Mexican state that, not just here but through much of Mexico, is unable to provide security to women as they move to and from work? Or one may well ask how many women have been raped or murdered in American cities, often as they go to and from work; do we blame American businesses for this atrocious state of affairs, or do we ask politicians to improve and augment police patrols? In short, what has freer trade got to do with it?

This problem does not exist in a vast majority of EPZs because the young female workers live on campus instead of commuting back to their families at night (and perhaps having to walk through unguarded fields since the buses do not carry them all the way). But where it does, a socially responsible policy toward their employees would be for the larger firms in the EPZs, when the state fails to provide such security to women workers, to take steps, in concert with other large firms, to impress on the host government that the firms' continuing presence in the EPZs will be imperiled if such security is not immediately provided for their workers. Indeed, since the basic safety of its workers has to be part of what a firm must accept as an obligation at the factory level, it must also be regarded as a firm's obligation to ensure their safety in getting to and from work, even if that provision must be made by the host government rather than the firm itself.

Again, Oxfam has argued in its earlier-cited 2002 report on the world trading system that unregulated multinationals are "producing poverty-level wages and severe forms of exploitation, with female workers suffering the worst excesses."[14] Fortunately, the notion that multinationals are the cause of low wages rather than an antidote to them by increasing the demand for labor in the poor countries, or that they exploit workers, male or female, when they actually pay higher wages than the average in alternative occupations, will not stand scrutiny, as discussed fully in

Chapter 12.[15] So the proposition that female workers "suffer the worst excesses" makes little sense when the excesses themselves are illusory and the bulk of the evidence is to the contrary.

Yet another influential women's group, the International Gender and Trade Network (IGTN) agrees that "trade serves as one of the instruments for achieving the goals that we seek: prosperity, stability, freedom, and gender equality." But then it claims that "there is no guarantee that free trade is the best policy for women" and that "[t]he current WTO trade process is predatory, mercenary and destructive to livelihoods."[16]

In reaching such hard-line conclusions, IGTN makes the standard mistake of assuming that the WTO, and presumably free-traders, subscribe to the doctrine that trade is a goal rather than an instrument. Thus they assert: "The current world trade regime poses the wrong questions. Instead of asking what kind of multilateral system maximizes foreign trade and investment opportunities, it should ask what kind of multilateral system best enable[s] the people of our nations to pursue their own social priorities and developmental objectives."[17] But this ignores massive evidence that freeing of trade is pursued because it is argued, on both theoretical and empirical grounds, that it produces prosperity and, as firmly argued in Chapter 5, has a favorable impact on poverty as well. As an economist normally accused of being "the world's foremost free trader," I have always argued for freer trade, not as an objective but rather (in the context of the poor nations such as India, from where I come) as an often powerful weapon in the arsenal of policies that we can deploy to fight poverty. Perhaps the misunderstanding on the part of critics such as IGTN comes from the fact that every time we push for free trade, we do not restate its value as an instrument: we just fight for free trade. As my famous Cambridge teacher the radical Joan Robinson used to say, it is only humorless economists who spell everything out. And certainly only the dreary ones do that every time. But now that we must contend with strong voices and weak ears, perhaps we cannot afford not to be explicit and to reiterate endlessly why we want what we want!

I must add, in all fairness, that IGTN also makes the valid, and important, criticism that the WTO has been corrupted by various lobbies (in the rich countries) into being no longer a pure trade institution: "the WTO does not fundamentally pursue free trade. . . . We believe that it has taken on board non-trade issues. The role of the WTO should be reduced to enable it to deal solely with trade."[18] Indeed, as Chapter 12 makes clear, the multinationals, chiefly the pharmaceutical and software firms, lobbied successfully to get the United States, and then other rich-country governments, to back the WTO's Agreement on Trade-related Aspects of Intellectual Property Rights, turning the WTO into a royalty collection agency. And now the labor lobbies want to introduce labor standards into the WTO as well, emulating the corporate lobbies. The fact of the matter is that every lobby in the rich world—there are far too few in the poor countries—now wants to capture the WTO and turn it into an institution that advances its own agenda, using the WTO's ability to implement trade sanctions. Ironically, one could view the attempts of women's groups to include the gender agenda and gender-impact preconditions in the WTO as yet one more instance of such an ambition, whose result would be to further cripple with overload the efficiency and objectives of an essentially trade-related institution.

Obsession with Export Processing Zones

A number of women's groups are obsessed with EPZs, seeing them as the brutal face of globalization and, in ways discussed below, as the source of much of the devastation that globalization wreaks on women in the poor countries.

But note first that the EPZs, while they have played a part in the outward-oriented strategy of several countries, are rarely as dominant as critics imagine. Besides, their relative importance in overall exports often diminishes over time because the advantages offered by EPZs gradually become available nationwide. Thus, Taiwan's exports from its three EPZs—at Nantze, at Kaohsiung Harbor, and near Taichung—were no more than 10 percent of her overall exports in the 1960s; by the early 1980s, their share had fallen yet further, to 6 percent. As James Shapiro reported for Taiwan in 1981, focusing on better infrastructure facilities and reduced bureaucratic hassles: "The zones are no longer as attractive to investors as they were in the 1960s because the conditions have changed. Many of the original attractions of the zones are now available everywhere in Taiwan."[19]

In the case of inward-looking countries, as they begin to gradually shift to an export orientation, the EPZs represent attempts at introducing a set of reformist policies, such as zero tariffs, that cannot be introduced widely because of political obstacles in the country at large. This initial step leads to a steady loosening of the rest of the country through demonstration in the EPZs of the advantages of such a policy reform. The success of the EPZs leads to acceleration of reforms in the rest of the country, which then leads to better performance by the entire country. This is the story of China, where the coastal province of Guangdong turned into a gigantic export platform and then the rest of the country followed, however haltingly.

Next, the preference for young women workers in the EPZs is deplored as a tactic by which employers get pliable, docile, and uncomplaining workers who are unwilling to unionize to improve their wages and working conditions. Besides, the fact that many are let go and are replaced by other young women cripples their *ability* to unionize as well. Typically, Spike Peterson and Anne Runyon argue, "In many countries, women's proportion of formal-sector employment has significantly increased—with women sometimes displacing men—as employers seek the cheapest, most reliable workers. In this case, women are gaining employment, but typically under *conditions that exacerbate worker vulnerabilities and exploitation*" (italics added).[20]

But this critique is not the slam dunk that it seems. For example, the decline in unionization in the United States over nearly a half century is principally due to several trade-unrelated factors.[21] Improvements in minimum wages, the general rise in wages, and governmentally enacted legislation for workplace safety—the OSHA regulations—have reduced the value of unions for many workers. If workers in the EPZs feel that while they may not be doing as well as they would like, these jobs are still better than others they might obtain, their interest in unionizing may be less than compelling. That, rather than the lack of bargaining power because workers are female or temporary or both, could well be the decisive factor.

In some cases, workers who stay longer with firms will be less likely to want to join unions than less permanent workers: the former may have a more cooperative and conciliatory attitude toward their employers than the latter. Moreover, sociological studies of female workers in Central America, for instance, report interviews with women such as "Maria, who has worked for the plant for seventeen years"; "the company for which she works is known for maintaining and rewarding its better and stable workers."[22] It is therefore perhaps an exaggeration to argue that firms in EPZs necessarily see more profit in keeping workers on a short leash. Besides, as Nicholas Kristof and Sheryl WuDunn, whose work on Asian sweatshops is cited more fully in Chapter 12, have noted, the young women they interviewed wanted to accumulate money, worked hard and long hours by choice, and returned home by choice.[23]

Evidently, there is a diversity of experiences here. What does seem to emerge persistently from many studies is that the work in the EPZ factories is subject to more discipline and may not be suited to all. Assembly lines, for instance, impose more discipline—one worker off the line for ten minutes can disrupt the work of all during that time—than work that can be done at one's own machine. Economic historians have documented how in the textile factories in nineteenth-century India, where families were assigned their own spindles and looms to work with, there was little discipline. But in the Tata steel plant at Jamshedpur, started in 1913 by a remarkable Indian entrepreneur who would go on to found one of India's progressive business dynasties, a disciplined labor force was critical, given the altogether demanding nature of the production process.[24] An example closer to home is the contrast between the leisurely style and hours of work of professors such as myself, on whom the university does not impose a strict and uniform regimen regarding hours worked and daily attendance, and the excruciatingly long hours of disciplined work imposed on the young men and women who join Wall Street firms, glued to their screens and reduced to take-out foods and a dog's life even though the collar may be diamond-studded.

Thus, in the Taiwan EPZs cited earlier, the women talked of "bells, buzzers, punch-cards, supervisors and strict monetary penalties," but this was necessary because a manager observed that, in electronics, "products are either perfect or useless" and a disciplined labor force mattered. Interestingly, the author adds: "One young woman I talked with grew up in Kaohsiung, and during the summer months, for two consecutive years, worked in the KEPZ, first in an electronics factory assembling printed circuits and later sewing in a glove factory. 'The routine nearly bored me to death,' she recalled, 'but jobs in the EPZ are easy to find, and, for a few months, you can put up with anything.'"[25]

In Bangladesh, there was evidence that "[u]nmarried girls employed in these garment factories [which, in 1995, were employing 1.2 million workers, 90 percent of them female] may endure onerous working conditions, but they also experience pride in their earnings, maintain a higher standard of dress than their unemployed counterparts and, most significantly, develop an identity apart from being a child or wife . . . legitimate income-generating work could transform the nature of girls' adolescent experience. It could provide them with a degree of autonomy, self-respect, and freedom from traditional gender work."[26]

Indeed, this account of the liberating effect of EPZ-offered work to young girls in Bangladesh underlines the necessity of judging EPZs in light of alternatives available in these poor countries. I was impressed particularly by the account by a sociologist of a woman named Eva who had left the free trade zone in the Dominican Republic and now "work[ed] as a housekeeper for a private villa adjoining a hotel complex in La Romana. She left because she could no longer stand the pressure of working in the free trade zone. . . . She earns 1000 pesos every two weeks, and not only cleans, but washes, cooks, and serves dinner when the Dominican family for whom she works or one of their guests is in town.

Though she has worked for five years, she receives no paid holidays or social security benefits, *which even free trade zone workers enjoy*" (italics added).[27]

Nonetheless, since unions are not commonplace at all in many EPZs, even when permitted, and often young girls are at work, we do need mechanisms other than the absent unions to ensure that basic safety (extending to protections against rape and sexual harassment) and related health regulations are put in place by the governments and enforced. If unions believe that temporary workers lack bargaining power, then simply having a union is not going to change that bargaining power: unions without bargaining power would be paper tigers. By contrast, the power of the government in providing the necessary regulations is immensely greater.[28] And the regulations to protect and support women should evidently be applicable nationwide, not just to EPZs, where in fact female workers are likely to be doing better!

WTO Rulings and Women

Women's Edge has also objected to the WTO Appellate Body's rulings that preferences given to the Caribbean nations on their exports of bananas to the European Union violated WTO agreements and that the European Union's restrictions on the sale of hormone-fed beef were in violation of the agreed rules requiring that a scientific test must be met if such restrictions are imposed.[29] They complain that the gender effects were not analyzed by the WTO. But their critique amounts to little more than saying that those who are affected by these decisions, whether in terms of the removal of protection or preference (e.g., the banana case) or by authorized retaliation through tariffs (e.g., the hormone-fed beef case), happen to include women. But then, almost any policy change will directly affect some women.

These WTO Appellate Body decisions raise many issues, some critical to the economic well-being of the poor countries, and fixing the system for them would automatically benefit both women and men in the workforce and as consumers. But the notion that the WTO is somehow damnably deficient in not highlighting gender issues and micro-level gender impact each time it pronounces a decision seems to be off the wall.

A telling example of such feminist concern occurred after the EU lost its case for restrictions on American hormone-fed beef. Women's Edge complained about the effects of the ensuing tariff retaliation against Dutch tomatoes and other EU exports. This retaliation by the United States against the EU was authorized by WTO rules because the EU could not eliminate the WTO-illegal ban. Women's Edge argued:

> The 100 percent tariffs imposed on Dutch tomatoes will affect Janice Honisberg, a woman business owner [who imports Dutch tomatoes]. She estimates that her company will lose 40 percent of its revenues as a result of the tariff and she will be forced to layoff half of her 65 employees, the majority of whom are women from low-income communities in Washington D.C. and Chicago.[30]

Tariff retaliation is a much-debated issue among economists, lawyers, and international relations scholars. To put into this important debate the sorry fate of Honisberg and her staff is to lose all proportion; it is as if a dam had burst, flooding villages and cities and destroying human life, and yet the fate of just a few women concerned you!

Aside from the gross disproportionality of such a focus, it is also misplaced. The WTO Appellate Body was exactly right to find against the legitimacy of the hormone-fed beef legislation of the European Union in light of the agreement at the Uruguay Round, which precluded such restrictions unless backed by a scientific test. And many of us are right to ask for a renegotiation of that agreement because of problems such as the hormone-fed beef concerns that were not anticipated at the time of that agreement. But to demand that this agreement, and every other, be reexamined and redesigned specifically from the viewpoint of women's welfare seems about as compelling as saying that the removal of potholes from New York's roads be subjected to a prior examination of whether women are more likely to fall into them (as they well might if they wear high heels).

The proper response to demands for attention to women's welfare in a society has to be to consider ways in which women in that society and economy may be more vulnerable to the consequences of policy changes such as trade liberalization, projects such as the building of roads and railways or the provision of irrigation or drinking water, and indeed the myriad ways in which change comes. Rather than setting up roadblocks on every policy change, big and small, and demanding that each policy change be made conditional on an examination of its impact on women—a tall order in many cases, since the indirect estimates at that level of detail can only be guesstimates at best—it is more useful to think of policies that alleviate the *totality* of distress to women from the multitude of policy changes.

Women, as a class, are not destined to lose from progress any more than other groups are. To block off progress, ostensibly to help them, at every turn of the policy screw is to indulge in a policy response that is both inappropriate and likely to be counterproductive to their well-being—and men's as well.

IMF, World Bank, and Women

An equal opprobrium is assigned by several women's groups to the effects on women of the stabilization programs of the IMF, which assist countries having macroeconomic difficulties such as balance-of-payments crises, and the structural adjustment programs of the World Bank, which are generally longer-term and assist countries that are implementing economic reforms. In both cases, these institutions impose "conditionality," that is, conditions such as commitment to reducing the budget deficit or tightening monetary policy, which must be met by the assisted country.

The concerns of the women's groups are twofold. First, the typical conditionalities in these programs hurt women because when the belt is tightened, the resulting unemployment disproportionately hurts women, who will be fired ahead of the men or who are simply among the workforce that is laid off. Second, the belt-tightening often involves reducing social expenditures on health and education, which in turn forces women back into the home to provide such services instead.

But these criticisms are misdirected. The IMF hands out loans when there is a stabilization crisis. Almost always this means that the country in crisis must bring its overall expenditures in line with its income. If the IMF did not come in with loans—and this counterfactual cannot be ignored—then it is likely that matters would be worse, since the country would then have no option except to live immediately within its means. In fact, IMF support often eases the ability of the country in the stabilization crisis to borrow more funds and to make the transition to a better macroeconomic situation yet easier. This should generally assist, rather than harm, women.

It is hard to argue also that it is the IMF that systematically prefers slashing expenditures to raising revenues and that this expenditure cutting is biased against health and education expenditures. Regarding the former, it is well known, for example, that for many years the IMF was reluctant to ask countries to reduce tariffs, not because it did not believe, as it should, that the high tariffs frequently encountered in the poor countries at the time and even now were harmful, but because the IMF was worried about the potential loss of tariff revenue when a stabilization crisis required more revenue and less expenditure.[31]

As regards expenditure-cutting bias against social expenditures, the IMF and all of us would have loved to get the crisis-afflicted countries to reduce their armaments expenditures instead, for instance. But these priorities, in the end, are set by these governments themselves; the IMF sticks generally to targets that have to do with the budget deficit, that is, the difference between income and expenditure of the government, which in turn must affect the overall national imbalance that attends a stabilization crisis.

The question of removing tariffs on imports and subsidies to electricity, fertilizers, freight, and so on has been more a question of structural reforms addressed by the World Bank. These reforms have certainly been promoted in an effort to change the economic policies that have been recognized as having failed. But it is a mistake to think that these reforms have been necessarily imposed from Washington via the World Bank. Often, as I argue in Chapter 18, these reforms have been advocated and embraced by intellectuals, economists, and policy makers in these countries on their own initiative. Recognition of one's folly is often a powerful factor making for change. Foreign pressure, particularly when aid funds are at stake, can make a difference. But again, the assumption that conditionality, whether of the IMF or the World Bank, is unbending and effective is also erroneous.

Globalization: Working Abroad, Prostitution for Tourists, and Trafficking

There are, however, three critical phenomena, tangentially related to globalization, that pose unambiguous threats to women's well-being.

- Women going abroad as domestic servants—often to the Middle East, where local women are typically living in the Middle Ages and under Islamic laws as interpreted by illiterate and conservative religious leaders in countries such as Saudi Arabia—have been subjected to abuse and need protection.
- The growth of tourism has inevitably been accompanied by a rise in female and even male prostitution in countries such as Thailand.
- Trafficking in women has grown, especially with the economic distress that has attended attempts at transition in countries such as Russia and from financial crises in afflicted Asian countries.

The perils afflicting women as empires expanded and commerce increased offer a historical parallel, of course, although the precise pathologies have been diverse. Thus, Margaret Macmillan, writing in

Women of the Raj, recollects the plight of the women who followed the men into India, in words that have resonance today:

> [The employees of the East India Company] took Indian mistresses; worse, from the point of view of the Company's staunch Protestant directors, they married Catholics, daughters or widows of the Portuguese. To save the souls of its men, the Company, for a time, played matchmaker. In the later part of the seventeenth century it shipped batches of young women from Britain to India. The cargo, divided into "gentlewomen" and "others," were given one set of clothes each and were supported for a year—quite long enough, it was thought, for them to find themselves husbands. *Some did not; and the Company tried to deny that it had any obligation to look after them further.* Most unfairly it also warned them to mind their morals: "Whereas some of these women are grown scandalous to our nation, religion and Government interest," said a letter from London to the Deputy Governor of Bombay in 1675, "we require you to give them fair warning that they do apply themselves to a more sober and Christian conversation." *If that warning did not have the right effect, the women were to be fed on bread and water and shipped back to Britain.* [Italics added][32]

A more recent and less excusable example is that of the Korean "comfort women" who were forced into servicing the Japanese armed forces in the Second World War as they brutally moved westward into Korea and China—an issue that has led to continual demands for compensatory reparations by Japan.

The modern afflictions—abuse of female workers abroad, tourism-induced prostitution, and trafficking across borders—that can attend normal, empire-unrelated globalization require attention and both international and domestic action. They simply illustrate how even benign changes—such as the opportunity to earn more as a domestic, an opportunity prized and seized by hundreds of thousands of women in the Philippines, Bangladesh, India, Pakistan and Indonesia—can have some downside effects for women who are left unprotected against probable abuses by their employers. More disturbingly, these opportunities can be exploited by unscrupulous elements—traffickers and mafia such as the Japanese *yakuza*—to indulge in dreadful crimes against women such as trafficking in them for unremunerated prostitution and virtual slavery.

Fortunately, the unceasing activities of individual activists and NGOs, among them the Thailand-based ECPAT (End Child Prostitution, Child Pornography and Trafficking in Children for Sexual Purposes) and the Delhi-based STOP (Stop Trafficking, Oppression, and Prostitution of Children and Women, which works to end the traffic in women and children from Bangladesh and Nepal) have increased awareness of these problems at the international level for some years now. Many conventions have been signed and several ratified, to prevent trafficking, for instance, and the enormous gaps between laws and conventions and between laws and enforcement have been the target of continual critical scrutiny and agitation. Progress is slow, not just because of lack of political will but because of the complexity of the enforcement required. But it is relentless.

So while there are serious issues to be addressed in these specific areas, where the welfare and well-being of women can be imperiled and must be protected, I would conclude from the analysis in this chapter that the broader criticisms that many women's groups have voiced about the negative effects of globalization on women are not convincing.

10

Wages and Labor Standards at Stake?

Marx was famously wrong when he predicted the progressive immiseration of the proletariat.[1] The real wages and living conditions of the working classes improved over the span of the nineteenth century, reducing the squalor that has been captured for posterity by social critics such as Chadwick and Hegel and by writers such as Dickens.[2] Marx got the effects of accumulation under capitalism wrong: it can, and often will, raise wages by increasing the demand for labor. But the improvement in working conditions was a result of social legislation such as the Factory Acts of England, which paved the way for the protection of workers.

Anti-globalizers fear that Marx is striking again: that, thanks to globalization, his prediction of falling wages is finally coming to pass. Labor unions in rich countries fear that trade with poor countries with low wages will drive down the real wages of their own workers and produce paupers in their midst. They also sense a threat to their labor standards, achieved through well over a century of anguish and agitation, as trade with poor countries with lower standards intensifies and some multinationals are seen to move to these low-standards locations, "taking jobs away." The resulting pressure to lower standards produces in this view a race to the bottom as these rich countries abandon their high standards to ensure competitiveness.

These fears appear plausible, no doubt about it. Yet the facts strongly suggest that they are not supported by evidence. Most studies of the real wages of workers assign to trade at best a small fraction of the decline in real wages in the 1980s and much of the 1990s. I will argue here the stronger proposition that trade has actually helped the workers, not just harmed them insignificantly, by moderating the decline that was

instead caused by technical change that economized on the use of unskilled labor.

At the same time, there is no evidence for a race to the bottom. The reality is that political pressures have developed instead for imposing higher standards, whether appropriate or not, on the poor countries. So we witness paradoxically, as is demonstrated in this chapter, what is in fact a race to the top.

Globalization and Workers' Wages

It is certainly possible that closer integration by the richer nations with the poor countries, with a more abundant supply of unskilled labor, will depress the wages of the richer countries' workers. What is the intuition behind this fear? It makes sense to assume that lower prices for labor-intensive goods, among which textiles and shoes are obvious examples, brought about by imports from the poor countries, should translate into lower wages for labor. Therefore, one can legitimately regard trade with poor countries as an *indirect* way in which their impoverished masses will drive down our wages, just as their emigration to our countries will do it *directly*.

As it happens, this parallel between the effects of free immigration and of free trade in goods found an echo in political debates over immigration policy in the last century. It is interesting to recall the fierce debate that broke out in England over the proposed immigration legislation in 1905 that would have created quota restrictions on immigrants in response to the "alien invasion" by Central European Jews of London at the end of the nineteenth century. In that political fracas, the free-traders were also free-immigrationists, while the immigration restrictionists were also trade protectionists.

This intuitive parallel with immigration, which makes trade with poor countries a cause of concern by the labor unions seeking to protect their members' earnings, was also manifest in the firestorm that broke out in the United States over the inclusion of Mexico in NAFTA in the early 1990s. The influx of impoverished Mexicans across the Rio Grande— the so-called peso refugees, many illegal migrants—had already provoked calls to curtail that flow in order to safeguard American workers' wages and working conditions. The prospect of NAFTA raised similar objections: imports from Mexico would also have this adverse impact on American workers.

So while some thought that trade would improve Mexican prosperity and cut down on Mexican emigration to America eventually, many others, including the labor unions and influential Democrats such as Richard Gephardt and David Bonior, were concerned instead with the immediate pressure on American workers' wages that they expected from NAFTA. And, in a throwback to the English debate at the end of the nineteenth century, some opposed NAFTA and simultaneously proposed tougher immigration control measures.

Available evidence makes it difficult, however, to argue that trade with poor countries has been responsible for the stagnation, perhaps even a decline, in the real wages of workers in the rich countries, particularly in America. Several economists have examined this question, and the overwhelming majority, including Paul Krugman of Princeton (now a fiercely liberal *New York Times* columnist) and Robert Lawrence of Harvard, are agreed that the role of trade with poor countries in depressing wages is small, perhaps even negligible. But even they give too much away. If the evidence is examined somewhat closely, it can be argued that trade with poor countries is likely to have *improved* wages, in the sense that it has moderated the decline that would have occurred due to non-trade-related factors, chiefly labor-saving technical change.

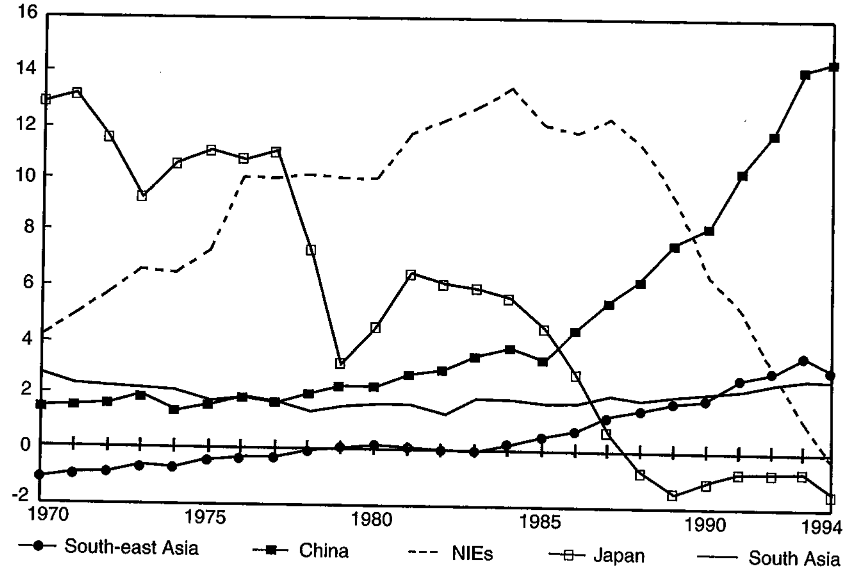
To understand why, remember that this fear follows from the fact that the poor countries export labor-intensive goods such as textiles, garments, shoes, and toys to us. If the prices of these goods fall in trade because of increasing supplies from the poor countries, this will trigger a decline in the reward to unskilled workers: an intuitive effect, as explained earlier, going from lower prices of the goods produced to lower real wages of the workers producing them.[3] Thus the key issue is whether the prices of such goods have actually been falling, triggering the declining real wages.

Here the evidence really does not support the assertion. During the 1980s, when the real wages of American workers were stagnant, the prices of the labor-intensive goods as a group actually rose relative to the prices of the set of all other goods in world trade. And their prices actually fell during the 1970s, when American real wages, defined both as compensation per worker and as the less satisfactory average hourly earnings (which do not include non-wage benefits), rose.[4]

What happens to the prices of these goods depends on a host of factors that affect the production and consumption of those goods, chiefly in the poor countries. If their production rises faster than consumption, the effect is to increase exports of these goods. Increased exports, in turn, will reduce the world prices of these goods . The factors that affect production include capital accumulation and technical change. Economists have demonstrated that both these constituents of growth tend to reduce the production and hence the exports of labor-intensive goods. Capital accumulation increases the supply of capital and therefore creates an extra incentive to producers of capital-intensive goods. Technical change will do the same since it is concentrated in practice in industries producing capital-intensive goods, and technical progress there tends to pull in resources from the less progressive industries that typically produce labor-intensive goods.[5] Therefore, the rapid accumulation of capital and absorption of technology in the Far East and then in the Near East have led to a progressive fall in the relative prices of labor-intensive goods, rather than in their rise, as feared by the unions.

The common mistake is to assume that trade in labor-intensive manufactures will result in exports from one poor country being piled on top of those of another in an endless process that would make them come like gangbusters into the markets of the rich countries, depressing prices and lowering real wages. In truth, because of technical change and capital accumulation in the countries that are growing out of the poor-country ranks (e.g., East Asia in the 1970s and 1980s), the entry of new exports of labor-intensive manufactures by poor countries is offset by the withdrawal of exports of labor-intensive manufactures by the rapidly growing erstwhile poor countries. The latter group of countries become exporters of capital-intensive manufactures and importers of labor-intensive manufactures instead. Therefore, the *net* exports of labor-intensive manufactures to the rich countries grow far less dramatically than if one conjured up the image of everything piling on, burying the rich countries in an avalanche of exports. The fear that the "yellow peril" (as the phenomenon of rapidly expanding exports from Japan was described in the 1930s) would be joined by the "brown peril" and eventually by the "black peril" as poor countries emerged as exporters of labor-intensive manufactures is belied by the fact that the "yellow peril" is *replaced* by the "brown peril," and so forth. International economists have long understood this phenomenon empirically, calling it the phenomenon of ladders of comparative advantage.

This more comforting picture is exactly what the Australian economist Ross Garnaut showed in 1996. Thus in the chart below one can witness how East Asia steadily increased net exports of labor-intensive manufactures in the 1970s while Japan (whose income had been growing rapidly) reduced them. The same pattern repeated itself in the period from 1980 to 1994, when the net exports of East Asian countries (the NICs, newly industrializing countries) declined from over 10 percent of world trade in labor-intensive manufactures to nearly zero, while China went in a crossing diagonal from around 2 percent to over 14 percent. The difference between the two leaves a greatly reduced net impact on what Garnaut calls the "old industrial countries," the rich nations, on average.



Ration of net exports to world imports of labor-intensive manufactures, East and South Asia 1970–94 (%). *Note:* South-east Asia includes ASEAN (including Singapore) and Vietnam; NIEs include Taiwan, Hong Kong, Korea, and Singapore; and South Asia includes India, Pakistan, Bangladesh, and Sri Lanka. *Source:* UN trade data, International Economic DataBank, The Australian National University, prepared by Ross Garnaut.

A recent empirical study by the economists Robert Feenstra and Gordon Hanson examined the effect on real wages of unskilled American workers as a result of outsourcing (i.e., buying components from other producers instead of producing these components oneself) to foreign suppliers of labor-intensive components in U.S. manufacturing during the period 1972–90. This study also concluded that the effect of such imports of labor-intensive goods for producers (rather than as goods for consumers, such as textiles and shoes), much of it also from poor countries, actually *raised* the real wages of the workers.[6]

So the principal cause of worry for the unions and their political allies, that a trade-driven fall in the (relative) prices of labor-intensive manufactures, whether of consumer goods or of outsourced components, will drive down the real wages of workers in rich countries is not compelling. Nor are other trade-related explanations that have been produced for this pessimistic scenario. Thus, for instance, it has been argued that labor-saving technical change, which is the real culprit, is itself induced by international competition faced by labor-intensive industries and the pressure on wages there. But think about it a little. If wages are declining, then induced technical change is likely to bias the search for technology in a direction that will use *more,* rather than less, of the cheapening labor. But the problem for real wages of the unskilled workers comes from labor-*saving* technical change.

In short, the contention that trade with the poor countries will produce wage declines in our midst is not compelling when examined: the underlying premises do not square with the facts.[7] Moreover, if we shift the focus of our analysis to how protection as presently practiced actually affects workers, we get yet another picture that portrays protection as harmful to workers. Current protection in the United States seems particularly aimed at lower-end consumer goods (such as flip-flops) that have virtually gone out of production in the United States by now and where the net effect on our workers' well-being comes not from the effect on their wages in employment, but overwhelmingly from their role as consumers.

The further findings on this question by Edward Gresser, reported in *Foreign Affairs,* are startling: "Tariff policy, without any deliberate intent, has evolved into something astonishingly tough on the poor. Young single mothers buying cheap clothes and shoes now pay tariffs five to ten times higher than middle-class or rich families pay in elite stores."[8] The removal of these tariffs would destroy this highly differentiated and inegalitarian tariff structure, which undercuts the real incomes of the poorest consumers and therefore of the working class.

Race to the Top, Not to the Bottom

The fear that the labor standards in the rich countries will be corroded by trade with, and investment in, the poor countries bothers workers and unions as much as the fear of an induced decline in wages. They are afraid that, faced with international competition or threats of employers to leave for locations where the standards are lower, employers will successfully manage politically to persuade governments to revise labor (and environmental) standards downward. Again, this seems likely, but does it happen systematically?

It generally does not seem to, at least if you look at recent American experience. Two examples suggest skepticism, if not rejection, of the race-to-the-bottom hypothesis. Take the fiercely competitive garment industry, where the politically active Union of Needletrades, Industrial, and Textile Employees (UNITE) operates. Its former president, Jay Mazur, and the current president, Bruce Raynor, have been strong proponents of the race-to-the-bottom view. But there is no evidence that this competition has led to a decline in labor and safety standards in the garment district in New York City, for instance. It is true that there are many sweatshops in the garment district. But the causes of these low standards, in violation of legislated standards, are twofold: the appalling lack of enforcement (because of a dearth of inspectors through the 1980s and 1990s) for the industry nationwide, and the presence of illegal immigrants who cannot demand legislated rights because of fear of deportation. In fact, if the degree to which standards actually fall below the legislated standards in these sweatshops has increased in the last two decades, it is surely likely to reflect the increased bipartisan agreement on introducing greater domestic enforcement (including through the use of employer sanctions) against illegal immigrants—an illiberal consensus that included the union movement itself until just recently![9]

As a contribution to the growing NAFTA debate, the General Accounting Office conducted a study of furniture firms faced with tough lead paint regulations in California and their migration across the Rio Grande.[10] The GAO estimated that a small fraction of wood products firms had moved, and concluded that their responses to questions concerning what profit-making factors had induced them to leave for Mexico were quite mixed.[11] Nonetheless, this study was widely cited at the time as evidence suggesting that a race to the bottom in lead paint regulations would follow. But a phone interview with the South Coast Air Quality Management District, southern California's agency responsible for regulation of air quality, elicited the response that emission control standards for paint coatings and solvents had "never been relaxed."[12] Evidently, the widely held perception that California's strict lead paint restrictions would induce furniture firms to cross the Rio Grande had led to no downward revision of these restrictions.

But there is little doubt that during the Reagan and first Bush administrations the Republican view that regulation had gone too far created in the public mind the fear of a race to the bottom. As scholars of the subject have noted, if you wished to deregulate for reasons that had nothing do with international competition (e.g., if cost-benefit analysis implied there was too much regulation, or if there was an ideological preference for deregulation), the smart thing nonetheless was to say that you were suffering from competition from rivals elsewhere who were less regulated.

President George H. W. Bush created in 1989 a Council on Competitiveness.[13] The council, which was headed by Vice President Dan Quayle, was intended to continue the work of the Council on Regulatory Relief, a task force that had been chaired by Bush during the Reagan administration.

The history of this council awaits careful research. But available materials indicate that its major deregulatory efforts appear to have been justified in cost-benefit terms rather than on grounds of improved competitiveness. Cost-benefit arguments were used in its many brushes with the Environmental Protection Agency on issues such as the burning of lead batteries and the softening of development restrictions on wetlands. It is hard to find significant examples where the council successfully reduced environmental or labor standards by invoking improved international competitiveness as a key reason.[14]

Recall also that if one is concerned about the decline in labor standards that might follow from the downward trend in the United States over more than a quarter century in the degree of unionization of the labor force, down by now to less than 10 percent in the private sector, globalization has not had much to do with it. It has far more to do with the draconian Taft-Hartley anti-labor legislation that goes back half a century. Under that legislation, the ability to use the strike as a weapon was seriously curtailed: sympathetic strikes by unions outside the industry were restricted, and the ability to hire replacement workers (scabs) was protected. This crippling of the right to strike, many union activists conclude, led to ineffective unions, as a union without adequate ability to strike is almost like a tiger without teeth.[15]

The political scientist Daniel Denzer, himself no captive of corporate interests nor a foe of unionism, wrote recently, in an influential article in *Foreign Policy*, that the public use of the phrase "race to the bottom" was a popular rhetorical device with negligible basis in fact.[16] Indeed, in a recent article in *Foreign Affairs*, Robert Ross and Anita Chan abandon the notion that the North suffers from a race to the bottom because of competition from the South, and try to shift focus to the notion of a race to the bottom within the South itself, producing no real evidence in support of such an intra-poor-countries race to the bottom either, plausible as it sounds.[17] Nor are they correct in implying that concern with the race to the bottom is now behind us in the rich countries. If only it were true!

Economists have also tried to get at this question from another angle. They have asked if there is evidence that multinationals are partial to investing in poor countries that have weak protection of workers' rights to unionize and to enjoy a safe workplace. Consider first, however, whether lower wages (as distinct from lower worker standards) are a magnet for investors. One needs to be careful and not just look at wages; they must be adjusted for labor productivity differences because lower wages may simply reflect lower productivity. The studies that do this adjustment, though they are focused not on poor countries but rather on investment flows among the rich countries or among different states within the United States, show that (productivity-adjusted) wages do matter to corporations that are considering where to invest.

But evidence also suggests that this is only one of many factors determining location decisions by multinationals.[18] The question of interest here, however, is whether the other factors affecting the locational decision of the firms include lower worker standards. Interestingly, cross-sectional analysis—that is, analysis of a number of countries at one point in time—of the outward investment by U.S. corporations shows that the greater the extent to which ILO workers' rights conventions are ratified by a country, the greater its share of U.S. investment tends to be.[19] Of course, the United States has in truth a better record on workers' rights, no matter how defined, than China; but China has ratified more conventions than the United States because the U.S. political and legal scene requires that ratifications lead to real obligations, whereas in China it does not. So ratifications are not a good guide to what protections exist for workers in reality. Analysts at the ILO have also found that higher unionization rates are associated with higher investment inflows, whereas fewer episodes of repression of rights of collective bargaining and association also go with higher inflows.[20] In fact, much of the other international evidence on whether the location of multinationals reflects attraction to the absence of high standards and particularly on whether multinationals use technology that is less environmentally friendly in locations where there are lower environmental standards, also shows that this is not a significant issue.[21]

In short, the evidence suggests that multinationals, generally speaking, do not go streaking to where labor rights are ignored or flouted. If true, this suggests a lack of empirical support for the notion that multinationals, by moving to where workers' rights are violated, encourage their violation by the poor governments seeking to attract those companies.

Why, then, is the race to the bottom, so easy to imagine and dread, not the dragon it is feared to be by the anti-globalization activists? For two reasons, one having to do with the economic behavior of multinationals in poor countries and the other, much the more important, relating to the political behavior of the unions and their allies in rich countries. The former (discussed at great length in Chapter 12 alongside several critiques of multinationals) is simply that just because lower standards exist in the poor countries, it does not follow that multinationals will take advantage of them. The gains to be made by doing so can be outweighed by several economic factors. Take just reputational effects. The multinationals, which account for an overwhelming percentage of direct foreign investment in the poor countries, cannot afford to be seen to dump dangerous effluents into the waters or into the air or treat their workers badly. With incipient or even full-blown democracies in many poor countries, with the growth of NGOs, with CNN and the BBC everywhere, the ability of multinationals to do something legal but offensive in terms of widely shared morality is seriously diminished. The reputational consequences of profiting from host-country laxity are sufficiently serious today to outweigh for many multinationals the extra profits that might be made by the "taking advantage" strategy.[22] Whether this means that legislative safeguards are not important is of course another matter, one of appropriate governance, which I turn to in Chapter 17.

Much the more important reason why a race to the bottom has not occurred lies instead in the fact that the effects of pressures from trade and outgoing investments on our standards are simply not substantial enough to undo the gains we have made after decades of political action. Our institutions are simply too strong to permit this. The unions, even though weaker than they were, and the environmental groups, which are stronger than ever, are politically active, not ciphers, and the Democratic Party sees them as core constituencies. Anytime rollbacks of regulations are sought on any grounds, the pro-regulatory bulbs light up and the political activists go to work. This is seen in energetic agitations against rolling back regulations on wetlands, on cutting down forests, and on the ability of unions to finance electoral campaigns of pro-union candidates for Congress and the presidency from general union dues. And while the anti-regulatory forces are abundantly financed by business lobbies such as the Chamber of Commerce and associations for specific industries such as logging, this is matched by two advantages that favor the pro-regulatory groups: their cause resonates with the public as socially responsible, and they substitute their labor for the capital they are short on, ringing doorbells, using the Internet, and working the political circuit with fervor and energy. On issues such as the rights of labor and the protection of the environment, the labor-intensive strategy has been demonstrated to be the more effective one in analysis of California referendums on such issues.

So American standards remain generally unaffected by the race to the bottom. But, paradoxically, the politics then shifts to a race to the top. Worried about international competition from producers in poor countries who have lower standards, the unions then turn to *raising* standards in these countries. Seen as a political ploy to moderate competition from rival suppliers abroad, this can be described as a form of "export protectionism" or "intrusionism," where you virtually force the exporters into accepting measures that raise their cost of production and hence cut down on their competitiveness. This is, in fact, what importing countries do when, not desiring to resort to import protection, they get the exporting countries instead to adopt export restraints (ironically called "voluntary" export restrictions), as was done, for example, when the Japanese were persuaded to limit exports of their cars to the United States to 2.2 million units in the early 1980s or face the imposition of import barriers. That export restraints are ways of reducing trade as much as import barriers are is best seen through analogy. Faced with a charging beast, you may hold it by its horns, much as import restraints do in trade, or you may reach behind the beast and catch it by its tail to break the charge, much as export restraints and forced raising of standards and hence of production costs in exporting countries do.

What is remarkable about this political process, where our lobbying groups seek to capture our all-too-powerful government to push for higher standards abroad, is that it is couched in the potent language of fair trade. They argue that we should not have to compete with, and lose to, others with lower standards. In short, we want to be virtuous but not have to pay for it! To see the morally unattractive nature of this position, consider what would happen if the United States were a closed economy. Suppose then that we raise our labor standards and ask polluters to pay. In that case, the industries that use a lot of labor and the polluting industries will contract. This is only the flip side of our labor and environmental policy choices. But when it comes to an international economy, the labor and environmental lobbies want to have the higher standards *and* not to lose the industries! In their frantic desire, they are willing to walk over the exporting countries and force on them standards that may not be appropriate or may be different from what would be desirable from their own perspective, which is often democratically determined. It is not surprising, therefore, that this political posturing by our labor and environmental groups is occasionally seen in poor countries, including by some unions and environmental NGOs there, as a kind of neo-imperialism![23]

In fact, the politics of protectionism can manifest itself in the domestic setting of the high standards themselves. Cynics go to the length of arguing that where high standards are imposed on traded goods, such as air bags in cars (as distinct from standards on how cars are produced), and are automatically extended to imported cars, the motives may be precisely to reduce the competitiveness of rivals abroad. This is because it may be more expensive for foreign car manufacturers to retool themselves for air bags.

Different Reasons for Seeking Higher Standards Elsewhere

But if it is not a race to the bottom but a race to the top (with the goal of moderating competition) that we observe, and if the poor countries generally resist this race, which they see as a dagger aimed at their export competitiveness, there are still other, moral and altruistic (rather than egoistical or self-serving competition-reducing) reasons that higher standards are sometimes sought abroad by some in the rich countries.

First, for some standards, the issue is simply one of morality, not competitiveness. If, say, goods are produced anywhere with child labor, I may not want to consume them, no matter that they are cheaper when produced in the poor countries, because I believe that they are immorally produced. Thus I may refuse to sup with the devil even though the consequence is that I miss a free meal! My position here is *not* that I am seeking with my action to produce higher standards abroad. I may well believe that my action will have absolutely no effect whatsoever on the use of child labor abroad. Yet I abstain from participating in consuming goods that use child labor, to satisfy my own conscience.

If this is the moral argument, then all it can imply is that I should have the ability in the marketplace to choose goods made without the use of child labor. This suggests that if sufficient numbers of people who think like me are willing to pay more for their principles, then positive labeling will become feasible. The Germans helped to develop the label Rugmark, which goes to firms producing rugs without the use of child labor. The new organic product label in the United States is yet another example. Somewhat differently, firms may advertise, and get a reputation for, their goodness in certain respects, catering to the moral preferences of their intended customers; this is what Ben & Jerry's does in its production of ice cream, as does the Body Shop chain of personal care product stores.

The advantage of this, as against negative labeling where goods are marked "made with child labor," is that negative lists bring with them many difficulties. They can tar a wide range of behaviors, of greatly varying degrees of offensiveness, with the same brush. The mere accusation that child labor is used, without addressing questions such as how the children are treated, whether they work just a few hours and then are escorted to school, and so on, makes it unlikely that an informed moral choice will be made. Further, a negative list would be enormously expensive and administratively difficult for poor countries to administer. Indeed, often the exports from these countries are in primitive bottles and packages where the labels would be harder to affix and may not be fully legible, whereas positive labels are more likely to be applicable to better-endowed and better-equipped firms.

But the moral argument also takes a more common form: the standards are often sought to be extended to poor nations on grounds of altruism. Thus one may take the position that, even if no trade with

Mars or outflow of investment to it could occur and hence no race to the bottom need be feared, green men from Mars should not put green children to work. One's motive may entirely be interplanetary empathy and concern for children everywhere. There is undoubtedly some of this sentiment underlying the demand for standards to be raised in the poor countries. Often the policy recommended to bring this about is the use of sanctions, chiefly trade sanctions inserted through what is now called "linkage" of standards with trade liberalization and inclusion of standards in trade treaties and trade institutions. The inadvisability of such sanctions, and the use of more efficacious non-coercive methods to advance standards worldwide are considered in Chapter 17.

11

Environment in Peril?

Environmentalists have long thought of economic globalization as a threat to the environment. Trade, advocated by economists and in consequence encouraged by the bilateral and multilateral aid and development agencies and expanded by reductions of trade barriers by both unilateral action and reciprocal bargaining by policy makers, is a frequent target of their anguish and anger. To a large extent, the conflict is inevitable. Impassioned differences often arise from the altogether different philosophies and lifestyles of trade economists and environmental activists.

The economists generally belong to the philosophical tradition that sees nature as a handmaiden to mankind. This humanity-centric view of nature is deeply rooted in the tradition that originated among the Hebrews and the Christians and spread to the Western world. As the Bible says in Genesis:

> And God said, Let us make man in our image, after our likeness: and let them have dominion over the fish of the sea, and over the fowl of the air, and over the cattle, and over all the earth, and over every creeping thing that creepeth upon the earth.[1]

The views of the ancient Greeks were also consonant with those in the Bible. Aristotle famously observed:

> Plants exist for the sake of animals, and brute beasts for the sake of man—domestic animals for his use and food, wild ones (or at any rate most of them) for food and other accessories of life, such as clothing and various tools.
>
> Since nature makes nothing purposeless or in vain, it is undeniably true that she has made all animals for the sake of man.[2]

12

Corporations: Predatory or Beneficial?

In the movie *Manhattan,* Woody Allen's character talks about the hotel where the food was dreadful, and there was not enough of it, either! The critics of multinationals often make similar complaints. They argue that multinationals must be condemned because they bypass countries that need them, accentuating the divide between those who are fortunate and those who are not. Then they also complain that the multinationals cause harm where they go, exploiting the host countries and their workers.

The complaint about bypassing needy countries is misplaced. If multinationals avoid some poor countries, that is surely not surprising. They are businesses that must survive by making a profit. Indeed, no corporation ever managed to do sustained good by continually posting losses. If a country wants to attract investment, it has to provide an attractive environment. That generally implies having political stability and economic advantages such as cheap labor or exploitable natural resources. In the game of attracting investment, therefore, some countries are going to lose simply because they lack these attributes.

For these unfortunate countries, the harsh reality is that no matter how good their politics and policies are, they may not suffice to attract multinationals. I recall a Jamaican radio program where I was being quizzed by the widow of the charismatic prime minister Michael Manley, a socialist of great conviction and charm. She was complaining to me that Jamaica had done all the right things, in particular opening herself to freer trade, but it had not helped the country to attract investment. I reminded her that the proper question to ask was: would protection have led to better results? The answer was no, because it is improbable that Jamaica could have attracted investment if it had closed its small domestic market. I also

pointed out that fortunately Jamaica was not wholly lost in her quest for economic success. After all, over half of its population, among them the current U.S. secretary of state, Colin Powell, and the Harvard sociologist Orlando Patterson, worked abroad, and that too was an outward-oriented strategy that Jamaica was exploiting profitably due to its proximity to the United States. The truly unfortunate countries were those few where no routes to prosperity through exploitation of trade, inward investment, or outward migration could be found or where the ability to travel along these routes was crippled by acute problems of governance, as in the African countries ravaged by war.

It is unrealistic to expect multinationals to invest in these countries and "save" them. The only answer is to offset this private neglect by redirecting public aid, technical assistance, and corporate altruism to them so that they get the funds and know-how that will not come through the marketplace. The World Bank, for instance, should turn away from lending to countries such as India and China, which surely have the ability to develop by themselves, and focus their efforts and resources on countries that cannot hack it on their own. But, of course, the World Bank leadership seeks to maximize influence by distributing largesse to all; even altruistic institutions will occasionally be run by men whose private ambitions, rather than social good, are the primary determinants of their policies.

The real battle, however, is being fought over the multinationals that *do* go to the poor countries. In the 1950s the early development economists, among them Hans Singer, complained that multinationals created enclaves within countries, with no spillover effects, good or bad, for the host countries. There was probably something to this observation when the multinationals were in extractive industries such as diamonds and bauxite.[1] Today, however, manufacturing and, increasingly, financial and other services attract far more investment. The concern today is not about the multinationals having no effect. Rather, there is a fierce debate between those who consider multinationals to be a malign influence and those who find them to be a benign force. I will argue here that the evidence strongly suggests that the benign view is more persuasive.

Harmful Effects?

In characteristically cynical fashion, the Nobel laureate V. S. Naipaul, whose many novels do not have a single tender love scene, writes in the opening chapter of his novel *Guerrillas* of the remnants of an industrial park, "one of the failed projects of the earliest days of independence." "Tax holidays had been offered to foreign investors; many had come for the holidays and had then moved on elsewhere."[2] Naipaul darkly suggests that the multinationals had profited from the tax generosity, contributed nothing, and then moved on.

A Different Race to the Bottom

As it happens, this is precisely what many serious observers of tax breaks to attract multinationals fear: that there is a race to the bottom on tax concessions as poor countries compete among themselves to give such generous terms to foreign investors that they wind up net losers. This race is, of course, a well-known phenomenon at the level of different states under a federal government, such as in the United States; before his election as president, Bill Clinton's main exposure to the world abroad came from his joining this race as governor of Arkansas.

That, in fact, the race is so fierce that poor countries wind up net losers is doubtful, because multinationals bring many benefits that should outweigh the giveaways in tax and other benefits such as rent-free use of public lands, but such an adverse outcome cannot be ruled out. An analogy from aid policy is helpful. Aid terms are sometimes quite onerous because aid flows take the form of loans to be repaid and the interest charges on the loans are close to commercial rates (as in the early Japanese aid programs). Aid is also tied to imports from the donor countries, so the aid recipient must often import goods and accept projects from the donor at prices that exceed those that would be paid if it were allowed to import from the cheapest sources. Such tying of aid is inherent in food aid, where donor countries typically give you food produced by their own farms but not money to import food from where you want. So when the U.S. administration recently complained that the European restrictions on GM foods and seeds were preventing African countries from accepting U.S. aid to prevent famine, this was an absurd charge since it was perfectly possible for the United States to give dollar aid that could then be used to import non-GM EU food to prevent the starvation. The problem was that the United States wanted to give its own GM food to the Africans.

Given all the ways in which the value of aid dollars is typically reduced by terms and conditions imposed by the donors, it is possible that the benefits from the aid will not merely be reduced but, in some cases, may actually turn into a loss-causing proposition! Many economists have cautioned poor countries not to accept anything that is called aid just because it is so described, but to look it in the eye and to reject potential rip-offs. In short, the gift horse may well be a Trojan horse! So, indeed, may be the case with multinationals brought in by offering excessively generous tax concessions.

But often the concessions reduce rather than eliminate altogether the burden of the corporate taxes to be paid. That leaves then the presumption that the country hosting the multinational benefits because *some* taxes do get paid. Other benefits such as the employment of underemployed and unemployed labor and the occasional diffusion of technical know-how and better management practices would remain, of course, to enhance the total benefits from inward direct investments.

From the viewpoint of the multinationals, the competition among countries to attract them is a phenomenon that increases their share of the total economic gains flowing from investment in the poor countries. But, not content with that situation, multinationals have long sought to improve their bargaining power still further. To do so, they have asked for codes, even mandatory provisions (proposed by the European Union, for instance, at the WTO), to prevent the receiving countries from imposing restrictions (such as that they must use domestic components or accept export obligations) on the multinationals that come in. For instance, the OECD unsuccessfully attempted, at the urging of business groups, to devise a multilateral agreement on investment, while the European Union and Japan are trying currently to negotiate a mandatory agreement on investment in the ongoing Doha Round of multilateral trade negotiations.[3]

The efforts to get these agreements negotiated are often justified by claims that they would contribute to a more orderly and efficient allocation of the world's scarce investible resources. But if this were the true rationale for these efforts, then we would have expected these codes to eliminate not just the restrictions on multinationals but also the subsidies to them. Both restrictions and artificial encouragements (through tax breaks) equally distort world production and trade. But when the lobbying efforts of the business groups are analyzed, one finds of course that there are no provisions for ruling out such tax breaks and subsidies to themselves.

Large Companies and Small Countries

In fact, the worry about a race to the bottom is part of the more general concern that critics have when negotiations for investment occur between large companies and small countries. It is assumed that this will lead to weak, poor countries yielding to unreasonable demands from the stronger corporations.

This fear is often justified by noting that if major corporations and the world's economies are ranked together, the corporations by their sales volumes and the countries by their GDPs (a measure of their national incomes), then the corporations are half of the top one hundred performers! This dramatic statistic is misleading, however, as the two sets of data are not comparable. To see this, consider a shirt that costs $100. Its sales value (which economists would call gross value) includes the value of cloth at $70 and wages and profits (i.e., incomes earned by the productive factors in the garments industry) of $30. Economists call this $30 the value added in the garment industry. Now, GDP is simply the entire factor income or value added in all activities, including garments. So when we compare sales volumes, which are gross values, with GDP, which is value added, we are comparing oranges with apples. The comparison, while conceptually flawed, also exaggerates the role of corporations because sales figures across the entire economy will add up to numbers that will vastly exceed the GDPs of the countries where these sales occur.

The Belgian economist Paul De Grauwe and the Belgian senator Filip Camerman, who were the first to notice the illegitimacy of these types of comparisons between countries and corporations, reworked the statistics to measure corporations also by value added. That necessary correction changed the picture wholly. "In 2000, sales by General Motors were $185 billion but value added was $42 billion; sales by Ford were $170 billion but value added was $47 billion; and sales by Royal Dutch/Shell were $149 billion but value added was only $36 billion." While leading anti-corporation activists had argued that "14 of the 50 largest economies and 51 of the 100 largest were companies, [in fact] only two of the top 50 economies, measured by value added, and 37 of the top 100 were corporations."[4]

But even if the corporations, when appropriately compared, had turned out to appear dominant, this would not necessarily support the fears of corporate rip-offs. Weak countries can also play off one giant corporation against another; and they occasionally do. Thus small countries such as Poland have recently chosen between Airbus and Boeing, both huge corporations and both in continuous and fierce competition. Enron was accused of having taken India for a ride just a few years ago, before the corporation self-destructed. But the problem was that India, because it was in a rush to get energy investments going rapidly, had foolishly failed to invite tenders and have Enron compete vigorously with other potential investors.[5]

In the end, the anti-corporation critics need to remember the chief lesson that economists learned when faced in the 1930s with John Kenneth Galbraith's celebrated assertion that large corporations meant that there was monopoly power. The key to whether such monopoly power exists is to be found in effective barriers to entry. If new firms can enter, providing effective competition, the mere presence of large firms in an industry cannot guarantee sizeable monopoly profits. Sheer size is misleading. Giants in an industry who are enjoying abnormal profits must contend with other giants at the door, this potential entry cutting effectively into their monopoly power and keeping abnormal profits down. This is true also in political space as the smart nations play off multinationals from one country against those from others, eliminating dependence on just one source.

But these objections to the fear that small nations will be ripped off by large corporations are less compelling in the poor and small countries with weak governance. One must then contend with the fact that rulers, politicians, and bureaucrats in such countries may be bribed by corporations with deep pockets into creating artificially excessive profits at social expense by accepting terms and conditions that are detrimental to the host country's social advantage. The resulting spoils are split between the multinationals and the corrupt and corrupted officials of the host country. These possibilities are real; rumors about them are abundant, especially in African countries that have been plagued by wars and pestilence. But hard evidence is hard to come by, in the nature of the case.

However, the trend seems to be to make such possibilities less likely as governance has become a subject of concern and action by many aid agencies. There have been successful attempts at achieving transparency, as with the recent agreements requiring disclosure of oil royalty payments to governments that hitherto refused to make them public and which have a bad track record of a large fraction of these oil revenues going missing.[6] These were the handiwork of the Publish What You Pay coalition of NGOs led by the financier George Soros. Similar calls for transparency on the terms negotiated for entry by specific multinationals, and actions such as the enactment of the code at the OECD (thanks to efforts by the United States, which had pioneered in the enactment of such legislation for U.S. firms) to make bribes paid in host countries illegal, are examples of the way in which the joint rip-off model is steadily becoming less likely today.

Political Intrusion

Perhaps the critics' greatest fear has been that multinationals intrude dramatically into the political space of the host countries in nefarious ways.[7] Two classic examples come from South America and Africa. When Chile elected Salvador Allende, who began a decisive shift to the left in his policies toward foreign investment and economic policies in general, leading multinationals operating in Chile drew a line in the sand with the active assistance of the CIA and Henry Kissinger, whose Chilean record of human rights abuses has come under revived scrutiny. ITT and Pepsi are known now to have played a role in the coup against this elected president of Chile.[8] Christopher Hitchens, in his impassioned indictment of Kissinger, has recently recounted these misdeeds:

> In September 1970 . . . [there emerged in the presidential elections] a moral certainty that the Chilean Congress would . . . confirm Dr. Salvador Allende as the next president. But the very name of Allende was anathema to the extreme right in Chile, to certain powerful corporations (notably ITT, Pepsi-Cola and the Chase Manhattan Bank) which did business in Chile and the United States, and to the CIA.
>
> This loathing quickly communicated itself to President Nixon. He was personally beholden to Donald Kendall, the president of Pepsi-Cola, who had given him his first international account. . . . A series of Washington meetings, within eleven days of Allende's electoral victory, essentially settled the fate of Chilean democracy. After discussions with Kendall and with David Rockefeller of Chase Manhattan, and with CIA director Richard Helms, Kissinger went with Helms to the Oval Office. Helms's notes of the meeting show that Nixon wasted little breath in making his wishes known. Allende was not to assume office. ". . . No involvement of embassy. $10,000,000 available, more if necessary. Full-time job—best men we have. . . . Make the economy scream. 48 hours for plan of action."[9]

Then again, in 1960–61, the Belgian corporation Union Meunière was implicated in the episode in Katanga where Tshombe, a puppet, was installed after the overthrow in September 1960 and assassination in January 1961 of Patrice Lumumba, the first elected leader of Congo, which gained independence from Belgium on June 30, 1960. Lumumba's only crime had been his ardent anti-colonialism and left-wing orientation.[10]

These cases are not at all atypical when one recalls how, for instance, the elected Iranian prime minister Mohammad Mossadegh was overthrown by the CIA, partly if not principally because of the giant oil companies' interests, and how the CIA intervened in Central and South America to protect the commercial interests of multinationals such as the United Fruit Company.[11]

But are not such episodes much less likely, even highly improbable, today? This would indeed appear to be the case. The reasons are twofold. First, democracy has broken out in many underdeveloped countries, however imperfectly. Egregious political abuses come to light because democracy permits diverse non-governmental groups and individuals of conscience to point the accusing finger at offending corporations and governments. Second, the accusing finger now has more salience in the age of television and the Internet. Gorbachev uses troops in the Balkans, CNN carries the pictures, and his moral standing collapses until he quickly learns from his political blunder and changes course.

These correctives seem to have diminished greatly the incidence of gross meddling in domestic politics by foreign multinationals. The real danger lies instead in overreach against the multinationals, with demands that they in fact *should* meddle in domestic politics. Some NGOs today seem to accuse multinationals of neglect, rather than intervention, when it comes to advancing their own agendas.

One example comes from Nigeria in 1999. Royal Dutch/Shell was widely condemned by human rights and environmental NGOs for abuses by the government.[12] In Ogoniland, an oil-rich area in the Niger delta, the Nigerian government (a military dictatorship) was accused of siphoning oil revenues to uses outside of Ogoniland. The oil companies, when confronted with protests that involved seizures of property and their executives, were condemned for drawing on the often draconian enforcement resources of the Nigerian government. Moreover, the protesters complained that the oil companies were damaging the local environment.

But can the oil companies be blamed for the policies of the Nigerian government that redirect oil revenues to national priorities that, in the estimation of the Ogonis, reward the Ogonis inadequately? How export proceeds, revenue collections, oil royalties, and earnings are allocated among different claimants in the country is a decision of the Nigerian government and has nothing to do with human rights. If multinationals started interfering in decisions of this kind, that would be political intrusion that would be rejected by every government that values the independence that many nations fought for prior to their independence from colonial powers. That the Ogoni people would want to influence the outcome toward themselves is reasonable; that Royal Dutch/Shell should have no say in the resolution of these questions in Nigeria is equally reasonable. That the Nigerian government was not democratic and did not have legitimacy has some salience, but this cannot mean that a foreign multinational such as Royal Dutch/Shell, which has even less legitimacy to influence or dictate allocational choices in Nigeria, must be sanctioned to do the meddling.

The use of the state's enforcement resources to protect company property and personnel against seizure seems also to be appropriate; what other choices does a company have? When several universities called in the National Guard or the local police during the anti–Vietnam War demonstrations that led to seizure of university administrative offices, occasionally there were confrontations and violence, as at Kent State. But such violence must be distinguished from gratuitous and autonomous violence inflicted on demonstrations that do not involve unlawful seizures. The reports from Ogoniland are quite explicit on how the seizures prompted reaction from the authorities, even as they note and properly condemn how these same authorities often brutally harassed the local NGOs and individuals who were within their rights to protest whatever they wished to protest. Take just a few examples:

> In March 1997, youths captured a barge delivering goods to a Chevron installation. The crew of seventy Nigerians and twenty expatriates were held hostage for three days by youths demanding jobs on the vessel. Following negotiations, in which money was paid to the protesters, the barge was allowed to go offshore, when the navy then boarded it and rescued the hostages.
>
> In October 1997, the Odeama flow station in Bayelsa state was closed for several days by youths demanding that fifty of them be employed by SPDC.
>
> From December 13 to December 17, 1997, thirteen employees of Western Geophysical were held hostage by youths in a barge off the coast of Ondo State.
>
> In July 1998, SPDC reported that . . . the previous week, youths at Nembe hijacked a helicopter and forced the evacuation of staff.[13]

That the oil companies polluted without having to pay the social cost of pollution imposed on the Ogoni people is the most compelling complaint, if true. If the Nigerian government had no environmental policies, and if the oil companies then proceeded to pollute freely and knowingly, the local population certainly had an economic and moral case against the oil companies. So insofar as the protests were aimed at addressing the environmental damage (as distinct from getting the oil companies to meddle in the national policies on distribution of benefits from oil production and simply trying to extract jobs through harassment), they were justified. However, I would argue that seizures of people and property are not the way to organize the protests, but that the methods of non-violent resistance advanced by Mahatma Gandhi and practiced so well by Martin Luther King Jr. are the better way.

Exploitation of Workers?

If any conviction strongly unites the critics of multinationals today, however, it is that they exploit the workers in the poor countries. At first blush this sounds very strange, since firms that create job opportunities should be applauded, no matter that their motivation in investing abroad is to make profits, not to do good. After all, the protesters in Ogoniland were asking for more jobs from the oil companies!

So why are the critics agitated? Much of their ire has been aroused by their assumption that the multinationals, so rich and with such deep pockets, pay such low wages. Then there is also the related assertion, including by the leaders of the anti-sweatshop movement on U.S. campuses, that multinationals run sweatshops in the poor countries. Sweatshops are accused of paying "unfair" or "inadequate" or "low" wages, often of not paying a "living wage." More often, they are condemned for violating "labor rights."

Wages and Exploitation. That multinationals exploit workers in the poor countries by paying low wages is the most frequent and least persuasive charge. The typical critique asserts that if a Liz Claiborne jacket sells for $190 in New York while the female worker abroad who sews it gets only 90 cents an hour, it is obviously exploitation.[14]

But there is surely no necessary relationship between the price of a specific product and the wage paid by a company that can be interpreted in this accusatory fashion. Just for starters, for every jacket that succeeds, there are probably nine that do not. So the effective price of jacket one must consider is a tenth of the successful jacket: only $19, not $190. Then again, owing to distribution costs, and in the case of apparel tariff duties, the price of a jacket almost doubles between landing in New York and finding its way to Lord & Taylor's display hangers.

But that is not all. Consider the diamond polishing industry in the town of Surat, India, which has witnessed rising prosperity ever since Surat has become a rival to Antwerp in this business. If the final price of the diamond in Paris is a million dollars, even a wage payment of $10 an hour and total wage payment to the worker of $1,000 will appear minuscule as a fraction of the final price. But so what?

Again, I have heard people argue that wages in Jakarta or Phnom Penh are a pittance compared to Michael Jordan's multimillion-dollar advertising remuneration by Nike. But it is inappropriate to compare a company's advertising budget with the wage rate or even the wage bill: it proves nothing, certainly not exploitation under any plausible and persuasive definition.

A possible question of interest may be whether Nike and other multinationals are earning huge monopoly profits while paying their workers only a competitive wage, and whether these firms should share these "excess" profit with their workers. But, as it happens, nearly all multinationals such as Liz Claiborne and Nike are in fiercely competitive environments. A recent study of the profits performance of 214 companies in the 1999 Fortune Global 500 list showed a rather sorry performance—about 8.3 percent on foreign assets, and even a decline to 6.6 percent in 1998.[15] Where is the beef that might be shared with workers?

So let me turn to the question of low wages. Are the multinationals paying their workers wages that are *below* what these workers get in alternative occupations in what are really poor countries with low wages? This is virtually implied by the critics. We must ask if this is really true or whether the multinationals are actually paying higher wages than the workers would get elsewhere—say, from local firms in the industry or in alternative jobs.

If the wages received are actually *higher* than those available in alternative jobs, even if low according to the critics (and reflective of the poverty in the poor countries), surely it seems odd to say that the multinationals are exploiting the workers they are hiring! Now, if there were slavery elsewhere and the workers were being whipped daily, as the Romans did with the galley slaves, then the fact that multinationals were whipping them only every other day would hardly turn away the critics! But wages are another matter, obviously. So what are the facts on wage payments?

As it happens, several empirical studies do find that multinationals pay what economists now call a "wage premium": they pay an average wage that exceeds the going rate, mostly up to 10 percent and exceeding it in some cases, with affiliates of U.S. multinationals sometimes paying a premium that ranges from 40 to 100 percent.[16] The University of Michigan economist Linda Lim has reviewed much of the available evidence from a number of studies in Bangladeshi export processing zones, in Mexico, in Shanghai, in Indonesia, and in Vietnam, and reports that they overwhelmingly confirm the existence of such a premium.[17]

In one of the careful and convincing studies, the economist Paul Glewwe, using Vietnamese household data for 1997–98, was able to isolate and focus on the incomes of workers employed in foreign-owned firms, joint ventures, and wholly Vietnamese-owned enterprises. About half of the Vietnamese workers in the study worked in precisely the foreign-owned textile or leather firms that so often come in for criticism. Contrary to the steady refrain from the critics—some of whom man websites continually directed at Nike, for instance—Glewwe found that "workers in foreign-owned enterprises fare better, making an average of 42 cents per hour," almost twice that of the average wage earner. Glewwe concludes:

> Overall, the evidence shows that these workers [in foreign-owned enterprises] are better off than the average Vietnamese worker. . . . The data also show that people who obtained employment in foreign-owned enterprises and joint ventures in Vietnam in the 1990s experience increases in household income (as measured by per capita consumption expenditures) that exceeded the average increases for all Vietnamese households. This appears to contradict the claims that foreign-owned enterprises in poor countries such as Vietnam are "sweatshops." On the other hand, it is clear that the wages paid by these enterprises . . . are a fraction of wages paid in the U.S. and other wealthy countries. Yet Vietnam is so poor that it is better for a Vietnamese person to obtain this kind of employment than almost any other kind available in Vietnam.[18]

In fact, econometric studies have tried to explain why this premium exists by controlling for scale, worker quality, age of the establishment, and other differences among the firms being compared; the premium, while diminished, still persists. There is also some evidence that this irreducible premium reflects higher productivity in firms under foreign ownership.[19]

What about subcontracting by multinationals? There does not appear to be any significant evidence, that these subcontractors pay less than the going wage in domestic firms and in alternative jobs. It is likely, however, that the wages paid are closer to these alternatives; the wage premium is possibly negligible, if it obtains at all, in subcontracted work.

In both cases, whether there is direct employment at a wage premium by the multinationals or subcontracted employment at a negligible premium, these are only direct or proximate effects. By adding to the demand for labor in the host countries, multinationals are also overwhelmingly likely to improve wages all around, thus improving the incomes of the workers in these countries.

Labor Rights. But if the wage argument against multinationals must be dismissed, there is still the accusation that these corporations violate labor rights. One view is that local labor laws are violated on safety and other working conditions. Another is that the conditions at work violate not domestic laws in the host countries but customary international law. Both critiques raise difficulties.

At the outset, it is highly unlikely that multinational firms would violate domestic regulatory laws, which generally are not particularly demanding. Since the laws are often not burdensome in poor countries, it is hard to find evidence that violations are taking place in an egregious, even substantial fashion. Ironically, sweatshops exist in the New York garment district (*not* in Guatemala, mind you), where the laws *are* demanding and simultaneously the ability of the affected workers to invoke them is impaired, as in the case of illegal immigrant workers.

Moreover, sweatshops are typically small-scale workshops, not multinationals. If the subcontractors who supply parts to the multinationals, for example, are tiny enterprises, it is possible that they, like local entrepreneurs, violate legislation from time to time. But since the problem lies with lack of effective enforcement in the host country, do we hold multinationals accountable for anything that they buy from these countries, even if it is not produced directly by the multinationals? That is tantamount to saying that the multinationals must effectively boycott anything that is produced and sold by countries where labor laws are not enforced effectively. But then why impose this obligation only on the multinationals? Surely it should apply equally to all citizens and legal entities in countries whose multinationals are being asked to indulge in the boycott of the offending country. This means going to the ILO to invoke Article 35 (which permits serious censure) or, better still, to the United Nations to invoke Article 7 on embargos. Short of that, the demands on the multinationals are incoherent.

Second, the insistence that local laws be enforced raises two questions. First, what is effective enforcement? What resources must be spent? The expenditure by the United States itself on enforcement against violations of OSHA and labor regulations has been minuscule; does that mean that multinationals investing in the United States must cease operation in this country? More important, the demand that local laws be enforced flies in the face of political practice in many democratic countries. It is important to see why.

Typically, one encounters two dominant practices in regard to social legislation: either there are no laws or there are many excessively generous ones. The lack-of-enforcement critique applies naturally to the latter situation. But then we must ask why the legislation is not enforced. The most likely reason is that there was no intention to enforce the legislation in the first place. Often extraordinarily expensive provisions are mandated simply because the enforcement is going to be negligible. Thus, as a wit once said, progressive taxes are enacted to please the Democrats and the loopholes are put in to please the Republicans. In the same spirit, countries such as India have some of the most progressive, and expensive, legislation on the books concerning even minimum wages, but with no real intention to enforce it precisely because the cost of such mandates would be forbidding. So the generosity of these provisions in the face of acutely limited resources is simply meant to produce a good feeling—the legislators mean well, but beyond that, alas . . . In fact, why not offer yet more generous benefits to the workers? I recall the Nobel laureate Robert Solow, a famous wit, being told that Harvard's highest salary was $150,000 but that no one was being paid it. In that case, he replied, why not say that the highest salary was $250,000?

Indeed, legislation may often be dated, and people may have changed their minds about its advisability, but the political battle to drop or modify it would be too expensive, so the legislation remains but is ignored. Thus, New Hampshire reportedly still has anti-adultery statutes on the books, but they are dead like a skunk in deep snow.

Often, however, it is not the violation of domestic law that is at issue. It is rather that the practice of multinationals, even when in conformity to local legislation, does not meet the demands of customary international law. When asked to explain customary international law, the activists refer to ILO conventions on workers, the covenants on civil and political rights at the United Nations, and other norms established at international agencies and conferences, whether universally adopted or not. This route to condemning multinationals is predictably quite problematic, however.

For one thing, the domestic regulation may be less demanding than these international norms for good reasons, in both economics and ethics. Take the case of working hours, which can be quite long in the EPZs and suggest exploitation that violates what an activist may consider to be human rights norms. But Nicholas Kristof and Sheryl WuDunn of the *New York Times* (whom I cited in Chapter 7 on the charge that young female workers were exploited in EPZs) have pointed out in an essay in the *New York Times Magazine*, provocatively titled "Two Cheers for Sweatshops," that the young women who work long hours are often doing so voluntarily. Why? Because many want to make as quickly as possible the money they planned to earn and then return to their homes. And, like many of us who work long hours, they are not being exploited; they drive themselves. Let me quote just one account of these reporters' visit to a Chinese sweatshop:

> On our first extended trip to China, in 1987, we traveled to the Pearl River Delta in the south of the country. There we visited several factories, including one in the boomtown of Dongguan, where about 100 female workers sat at workbenches stitching together bits of leather to make purses for a Hong Kong company. We chatted with several women as their fingers flew over their work and asked them about their hours.
>
> "I start at about 6.30 after breakfast, and go until about 7 p.m.," explained one shy teenage girl. "We break for lunch, and I take half an hour off then."
>
> "You do this six days a week?"
>
> "Oh no. Every day."
>
> "Seven days a week?"
>
> "Yes." She laughed at our surprise. "But then I take a week or two off at Chinese New Year to go back to my village."
>
> The others we talked to all seemed to regard it as a plus that the factory allowed them to work long hours. Indeed, some had sought out this factory precisely because it offered them the chance to earn more.
>
> "It's actually pretty annoying how hard they want to work," said the factory manager, a Hong Kong man. "It means we have to worry about security and have a supervisor around almost constantly."[20]

Indeed, even the restraints put on union rights in export processing zones, which are considered violations of customary international law, need to be reassessed, and possibly condoned rather than criticized, when this is done in democratic poor countries. Even governments that will not tolerate draconian mistreatment of union activists and have legislation protective and supportive of union rights such as the ability to organize will put some restraints in place in EPZs. Why? Because when unions assert rights but object to obligations, as when one cannot discipline or fire workers who hold down two jobs and collect pay while working elsewhere—a common practice in parts of India, for example—and one cannot reform them, it is tempting to think of carving out little EPZs where unions do not exist, just as the free-traders who cannot reduce trade barriers due to political obstacles then think of EPZs, where free trade obtains. As Saburo Okita, one of Japan's leading internationalists and an architect of Japan's postwar recovery, once told me when he was looking at India's self-imposed economic follies, if only India could take half a dozen small areas the size of Hong Kong and turn them into EPZs that followed the outward-oriented Hong Kong polices, while the bulk of India continued to wallow in its inward-looking inefficiencies; it would only take a couple of decades for these EPZs to overtake the rest of India!

In short, it is really the wish to escape unions, because in the country's experience they act only to enjoy rights and accept no obligations, that drives these governments to say, "Let the EPZs have no unions, for the only kind we will get are those that do harm rather than good." This is certainly not the same as saying, "We do not want unions, and we will even break them brutally!" As it happens, India, which also has gone in for EPZs, has maintained union rights but with one proviso: that wildcat strikes are not allowed in the EPZs, the rationale being that export industries are "essential" industries, an exception that is allowed even in the rich Western nations, including the United States.

What worries me also is that customary international law is often quite broadly stated (e.g., gender discrimination, which can be defined in several ways, is not permissible), much like domestic constitutions and unlike legislation and executive orders (e.g., that red mercury is not to be discharged into lakes, rivers, and oceans), which are much more narrowly stated and hence clear to follow. How is the multinational then to follow "laws" that are not legislated but are norms, and which can be interpreted in so many different ways that whether you conform to them depends on who does the interpretation?

Thus today nations have agreed to, and many have ratified, conventions dealing with so-called core labor rights. These are contained in the ILO Declaration of Fundamental Principles and Rights at Work:

- Freedom of association and the effective recognition of the right to collective bargaining
- The elimination of all forms of forced or compulsory labor
- The effective abolition of child labor
- The elimination of discrimination in respect of employment and occupation

But once one gets down to brass tacks, difficulties arise. Take the simple injunction about the freedom of association—that is, the right to unionize. How is one to cope with the fact that this right has several nuances and dimensions (and that virtually all countries could be found in violation of it in some way)? Central to this right is the ability to strike; a union without an effective right to strike is almost like a paper tiger. But, as I noted in Chapter 10, for half a century the Taft-Hartley law's provisions have allowed the hiring of replacement workers and discouraged sympathetic strikes, and this has badly crippled U.S. unions' ability to strike. The earlier-cited Human Rights Watch report concluded, therefore, that "millions of workers" in the United States were denied the "freedom of association."[21] Human Rights Watch and I consider this quite a reasonable interpretation of the violation of the core agreement to respect the right to unionize, but will this interpretation be accepted or rejected for the purpose of enforcement and litigation?[22] And who will bring action against what must be all corporations in the United States, because they are all acting under these legal provisions that are judged to violate this core right agreed at the ILO?

A similar problem can be shown to arise in the case of gender discrimination, yet another core labor right. There is no society today that is free from gender discrimination in some form. Besides, recall from Chapter 7 that even something narrower, such as pay discrimination, can be diversely defined. So how does a broad statement of these core rights, interpreted as customary international law for the purpose at hand, work?

My view is that we do need to assert these broad aspirational objectives but that, for purposes of assessing whether corporations in the poor countries are to be condemned (and even litigated against, as is beginning to happen in U.S. courts), we need to arrive at much narrower and more realistic agreements on specific practices.[23] For instance, on the right to unionize, we could reach agreement today on outlawing the killing of union leaders, but not on whether replacement workers can be hired or whether the firing of workers is allowed for economic or disciplinary reasons. Agreement could be reached, I suspect, on minimum safety provisions (e.g., the issuance of goggles to foundry workers working near blast furnaces, and enforcement of the use), though not on rich-country, OSHA standards that are very expensive for poor countries. In short, just as there is virtual agreement that torture in the shape of pulling someone's fingernails out is unacceptable (there is less on whether torture through the use of isolation and significant deprivation of sleep should be permissible), it should be possible to find areas of agreement on narrowly specific practices that may be proscribed. We could then move to bring in yet others. In short, start narrow and go broad. If you start broad and seek to use NGOs and courts to object to narrowly specific practices, you are likely to create a world of subjective interpretations and unpredictable outcomes. It will produce chaos and, in fact, imperil the flow of international investment by adding serious uncertainty and risk of expensive litigation by zealous activists peddling their preferred interpretation of the core right that they allege to have been violated by the multinational defendant.

The argument that customary international law, interpreted broadly, should be used to say that multinationals are exploiting workers in the poor countries is therefore open to serious criticism. The anti-Nike and other campaigns, which allege that these multinationals do not pay a living wage or do not have OSHA standards in their factories, are little more than assertions of what these specific critics would like a corporation to do, even when customary international law and norms are invoked to justify such accusations. It is perfectly possible and proper for others, equally motivated to do good, to say that these demands will harm rather than help the workers in these poor countries by raising the cost of production and thus making the inward flow of investment and jobs less likely. If so, these critics are themselves in unwitting violation of perhaps the most important core value: that globalization, and multinationals, should help the working class, not harm it!

Bad Domestic Policies as Cause of Harmful Effects

So the conventional criticisms of multinationals as harmful to poor countries and to their workers are not persuasive. But there are also conventional caveats about the possible harmful consequences of multinationals that economists (or "neoliberals," as they are called by the anti-globalizers) have warned against. These follow, however, from the fact that domestic policies, which the poor countries could change, are the source of the problem. As the Oxford economist Ian Little has put it well, direct foreign investment is as good or as bad as your own policies.

Perhaps the most interesting caveats, with empirical support, relate to the inflow of multinationals in the presence of high tariffs and other trade barriers. In fact, in many poor countries in the earlier anti-globalization era in the 1950s and 1960s, when outward integration was feared, multinationals were discouraged along with trade as part of what was called an import substitution (IS) or inward-looking approach, which favored substantial delinking of the economy from the world economy. But some countries feared trade yet encouraged multinationals. They even used high trade barriers as a way to get multinationals to come in and invest. The tactic was to tell a multinational that was selling its products—say, radios—in your country, "We will no longer allow you to sell the radios here. You will have to set up production facilities here to be able to sell your products." This tactic, used in the context of the IS development strategy, came to be known as one that led to "tariff-jumping" inward foreign investment by the multinationals.

The problem with this type of investment inflow was that it usually led to heavy dependence on imports of components. Faced with this tactic, firms tried to get by with as little production in the country as possible and import of the rest from more efficient factories elsewhere. So while a finished car could not be imported, the car manufacturing firm often found it possible to get away by importing nearly all of it and just adding the bumpers to it in an assembly plant in the country! So industrial development became acutely import-intensive: a little value added would necessitate an enormous import burden. The multinationals were often reduced to a battle with the governments: they wanted to assemble as little as they could, while the governments wanted them to assemble as much as they could. The resulting acrimony in these IS-strategy economies, and the inefficiencies that follow, are well illustrated in the journalist Jim Mann's account in his beautifully documented book, *Beijing Jeep*, of what happened when the American Motors Corporation (AMC) went into China to produce Jeeps for the domestic market. AMC just wanted to position itself in the Chinese market, importing as many components of the car as possible; the Chinese wanted full-scale production in Beijing instead, and to make matters worse, they wanted AMC to spend resources to adapt the Jeep for the Chinese army's use, a commercially uninteresting proposition for AMC.[24] Evidently the IS model for attracting investment was fraught with difficulties.[25]

Economists soon realized that this strategy was likely to reduce the social returns to the inward flow of direct investment to the point where it might actually immiserize, rather than enrich, a country. This is because the increased import-intensity of the process that resulted from this strategy meant that economic development was being accompanied by substantial increase in import dependence. This meant that the country had to export more to pay for these extra imports. This would generally require the country to accept lower prices for its exports, a phenomenon that economists call a terms-of-trade loss. There were added negative consequences from the fact that the import barriers that were used to attract investments by firms such as AMC would impose a cost, and all these losses could outweigh any direct gains from the firms' investment.[26]

In contrast, the export-promoting (EP), known also as outward-oriented, trade strategy was adopted in the Far Eastern economies. Where the IS-strategy countries used import barriers extensively and made domestic markets profitable and foreign sales less attractive, the EP-strategy countries pursued trade and exchange rate policies that eliminated this bias against exports and created incentives to export. The EP strategy has been demonstrated in several in-depth country studies in the 1960s through the 1980s to have produced exceptional export growth and therefore extraordinary economic performance. Just as the EP strategy was favorable to growth and the social returns from domestic investment were substantial, so were the social returns to foreign investment.

South Korea did not use inward foreign investment as a principal component of her overall development strategy, following the Japanese model. But Taiwan, Hong Kong, and Singapore certainly did. And so has China since her opening up to trade in the 1980s, when the IS variety of investment was replaced by the enormous EP type of investment in the four coastal provinces whose huge export success translated into China's impressive transformation in the two decades since.

A major study by V. N. Balasubramanyam of the University of Lancaster has carefully demonstrated what I had hypothesized earlier: that the EP variety of inward investment will also rise faster than the IS variety, which is aimed at the domestic market.[27] Investors who come in to service the domestic market because trade barriers rather than the advantages of local production are the motivating factors are certain to have high costs, whereas under the EP strategy, they come in because it is cheaper to produce there. So it is unlikely that the IS variety of investment will have much traction. Moreover, the growth of the home market is always less than the growth of world markets, especially when the possibility of increasing market shares is added to the picture.

Powerful Good Effects

Economists have noted a number of good effects that multinationals can bring in their wake. Perhaps the chief good effect is what economists call spillovers. These refer to the fact that domestic firms learn productivity-enhancing techniques from multinationals with better technology and management practices. We can identify channels through which such diffusion may occur. Managers may learn by observing or hearing about better management practices or by the experience of having previously worked at multinationals. Such diffusion may also happen with production workers, who learn better discipline, for example, when employed by the foreign firms and then take it with them to local firms, where their experience is translated into a better workforce.

That such diffusion occurs and benefits the local firms and hence the host country has been the conventional view among economist students of multinationals for some time. It owes partly to early studies that showed that the growth rate of productivity in industries with a greater share of multinational output was higher. These studies did not separate out the productivity increase of the domestic firms, which, after all, are the object of inquiry. But even when the growth of productivity in domestic firms was isolated, it was seen to be higher in the presence of multinationals.[28]

In recent years, there has been a veritable explosion of such studies. In particular, economists have probed the channels through which the spillover effects could operate.

The economists Horst Gorg and Eric Strobl of the University of Nottingham, using firm-level data for a sample of manufacturing firms in Ghana, demonstrated that spillovers occur through movement of labor because workers trained in multinationals move to local firms, often start-ups, taking with them the knowledge acquired when they worked for the foreign firm.[29] An analysis of electronics and engineering sectors in the United Kingdom underlined that diffusion tends to be greater for domestic firms within the same industry and region.[30] There is also evidence, from the analysis of firm-level data in the United Kingdom, that local firms may learn from multinationals how to export, through information spillovers, demonstration effects, and increased competition.[31]

Some studies show, however, that spillovers do not occur everywhere. In principle, we could also find instances where there are harmful spillovers. For instance, local entrepreneurship may be destroyed or inhibited. The fear that large multinationals would drive small local firms into extinction and cripple domestic entrepreneurship is widespread among the critics of multinationals. This is best reflected in a cartoon I once saw, of a tiny vendor selling hot dogs under a giant skyscraper owned by a manufacturer of packaged foods. But that cartoon also showed the weakness of the argument: the two manage to coexist perfectly well! In short, once differences in quality and in the customers targeted are taken into account, the domestic and foreign firms are likely to be catering to different markets, so that there is room for big and small. The fears are overblown, to say the least; no econometric studies have turned up significant evidence of harmful spillovers to date.

International Rule Making and Multinational Lobbying

But if the overall judgment must be that multinationals do good rather than harm, whether one considers the anti-globalization critics' indictments or the economists' concerns, there is an altogether different perspective that needs to be brought into the picture. We must consider the possibility that the multinationals have, through their interest-driven lobbying, helped set rules in the world trading, intellectual property, aid, and other regimes that are occasionally harmful to the interests of the poor countries. The answers here, I am afraid, are not as sanguine and comforting.

Intellectual Property Protection and WTO Rules

A prime example of such harmful lobbying by corporations in recent years has involved intellectual property protection (IPP). The damage inflicted on the WTO system and on the poor nations has been substantial. Let me explain.

At the outset, the main issue here relates to the collection of royalties on patents and does not belong to the WTO, which is a trade institution. But pharmaceutical and software companies muscled their way into the WTO and turned it into a royalty-collection agency simply because the WTO can apply trade sanctions. Getting IPP into the WTO means that these lobbies can use trade sanctions to collect the royalty payments they want!

How did the IPP lobbies succeed? They first pressured the United States government to pass the so-called Special 301 legislation (in the 1988 Omnibus Trade and Competitive Act). Under this legislation, any country that did not extend IPP (as legislated by the United States) to U.S. companies, even though this obligation was not negotiated in any bilateral or multilateral treaty, was subjected to tariff retaliation for an "unreasonable" practice. Then NAFTA negotiations were used to get Mexico to drop its objections to IPP and to sign on to the IPP desired by the United States. U.S. lobbyists made it clear to Mexico that admission to NAFTA was conditional on this concession.

With opposition by the developing countries being weakened by this use of punishments and inducements, the world trading system was being set up to accept IPP. In addition, pseudo-intellectual justification was adduced by pretending that IPP was a trade subject: the magic words "trade-related" were added to turn IPP into TRIPs (trade-related aspects of intellectual property rights). The U.S. trade representatives, first Carla Hills and then Mickey Kantor, promoted the propaganda (on behalf of the lobbying firms) that the poor countries would benefit from having to pay for patents they had been accessing freely until then!

And since that sounded as implausible as the Mafia telling its victims that the protection money would keep them safe from arson, they also shifted the rationale to include the notions of "theft" and "piracy," implying that the matter was really one of rights to one's property. This changed rationale made little sense for two reasons. If I have an absolute right to what I have invented, this would be in perpetuity, when in fact the lobbying companies were merely arguing about lengthening the patent period. Then again, virtually all arguments made by economists use cost-benefit analysis, which means arguing for patents and their lengths in terms of whether they do good or harm—a utilitarian form of analysis instead of a rights-based approach.

So with the conclusion of the Uruguay Round of multilateral trade negotiations and the establishment of the World Trade Organization in 1994, an astonishing capture of the WTO took place: TRIPs were introduced into the WTO integrally, as one of three legs of a tripod, the other two legs being the traditional GATT (for trade in goods) and the new GATS (General Agreement on Trade in Services). The latter two legs certainly belonged in a trade body. TRIPs, by contrast, were like the introduction of cancer cells into a healthy body. For virtually the first time, the corporate lobbies in pharmaceuticals and software had distorted and deformed an important multilateral institution, turning it away from its trade mission and rationale and transforming it into a royalty collection agency.

The consequences have been momentous. Now every lobby in the rich countries wants to put its own agenda, almost always trade-unrelated, into the WTO, following in the footsteps of the IPP lobbies. This is true, as already noted in Chapter 10, of the AFL-CIO and the ICFTU (International Confederation of Free Trade Unions), which want labor standards to be included in the WTO in the form of the Social Clause, allowing trade sanctions to kick in if the included labor standards are not met. Their principal argument is that TRIPs were allowed in for the benefit of capital, so the Social Clause must be allowed to do the same for labor; environmentalists want the same done for nature. In short, the illegitimate third leg, TRIPs, is now threatening to grow other legs, and there is a real threat that the tripod will turn into a centipede, as the poor countries fight what is evidently a process of disfigurement. It is also a threat to the poor countries in that they face rules that are no less than daggers aimed at their market access rights and possibilities.

But a further criticism must be made. The pharmaceutical firms, working through the U.S. trade representative, also managed to force two objectionable features into the TRIPs agreement. First, the optimal patent period must reflect a balance of two forces: on one hand, the protection provided by IPP provides an incentive to innovate; on the other hand, it slows down the diffusion of benefits to potential users. Under the TRIPs agreement, the pharmaceutical firms (as principal players in a service industries coalition) successfully lobbied for the patents to be uniformly extended to twenty years, a period so long that few economists of repute can be found who would call it efficient in terms of balancing the two opposing forces. Second, it built in restrictions on the ability of poor countries such as Botswana to import generic drugs cheaply from other developing countries such as India and Brazil, which were more developed and had the requisite manufacturing capacities.

The question of access to drugs is both complex and simple. To understand it, and to see why the pharmaceutical companies went wrong, it is necessary to sort out the underlying economics of patent protection when drug availability and innovation must be examined with poor countries in view.

At the outset, it must be said that the very premise that drug companies are seriously handicapped in their R&D by the lack of IPP in the poor countries is flawed. Poor countries have need but no effective demand. There is little money to be made on your invented drugs, to cover your costs and make reasonable profit, in poor-country markets. To see why the drug companies nonetheless see IPP in the poor countries as a money-spinner, it is necessary to distinguish between two types of diseases: those such as malaria, which are primarily in the poor countries, and those such as AIDS, which afflict all.

For the former, evidently IPP cannot ensure any decent return because the poor countries cannot pay. So we have several ways of getting drugs invented for them by using public and quasi-public moneys to mobilize scientists (and firms) to address the task. In the old days, one had institutions such as the Institute for Tropical Medicine in England and a similar institution in the Netherlands. Remember that the Nobel laureate Norman Borlaug was financed by foundation moneys to help invent the new seeds that made the green revolution. Michael Kremer of Harvard University has proposed the setting up of guaranteed remunerative prices for invented vaccines. All of these are variations on the use of public moneys; IPP has no role to play in this, the only solution to the invention of poor-country-specific drugs.

But everything changes when drugs to fight diseases that cut across the rich and poor nations are at stake. Here, the drug companies make money in the rich country markets; IPP in this case is clearly something they value. But then they see piffling effective demand for drugs in the poor countries. So their strategy is to sell there, producing at very low marginal costs and then charging whatever these poor markets will bear.

They would like to raise *that* return as much as they can by increasing effective demand through the use of aid moneys addressed to health programs, so that the excess of what they will charge over their marginal cost is increased, raising profitability in the poor-country markets. Medical economists have known for years that medical groups, for instance, favor insurance schemes that improve the patients' ability to pay, as under insurance programs such as Blue Cross and Blue Shield in the United States, but oppose insurance schemes such as England's National Health Service, which reduce the returns to doctors.

Pharmaceutical firms such as Pfizer want to prevent India and Brazil from selling copies of their drugs in Botswana and Gabon quite simply because their low prices would effectively put a cap on how far the drug companies can raise their prices. Their preferred solution is to get the Gates Foundation, the aid agencies, and others to give money to the poor countries to buy the drugs at higher prices instead. Hence they fulminate against Brazil and India as "pirates" and "thieves," epithets I have heard freely applied to the firms in these countries, and resolutely resist their being allowed to market their cheaper drugs in the poorer countries.

Clearly the rules sought by the pharmaceutical companies are unnecessarily harmful to the poor countries. In particular, (1) TRIPs should not be in the WTO at all, (2) twenty-year patents at the WTO are excessive, and (3) access to the generic drugs produced in developing countries, such as India and Brazil, that have manufacturing capacity should be freed for the poor countries, such as Botswana, that do not have such capacities but have medical emergencies such as AIDS, as certified by the WHO, for example. As it happens, the immense public pressure on the pharmaceutical firms during the Doha Round of multilateral trade negotiations has led to concessions by them, so that imports of drugs at lower costs by poor countries from other poor nations will be permitted more readily than earlier.

Where Corporate Lobbying Has Produced Harm

Free trade in goods (and services) is good, and except for a few economists whose dissent is loud but robust, this proposition is conceded widely. However, consider other types of trade where corporate lobbying to promote them produces harm.

Bads. Suppose that we are talking about free trade in "bads"—for instance, in heroin today or the opium trade yesterday (remember that it was forced on China during the period of European colonization). Evidently, such trade is harmful to the importing nation, while it produces profits and economic gain to the exporting nation. And if multinationals put their lobbying behind such trade, asking for it to be permitted, they are to be condemned, not applauded.

The issue of trade in bads has particular salience since U.S. multinationals lobbied intensively to deny automatic extension of Food and Drug Administration (FDA) prohibitions on banned drugs to sales abroad, including in poor countries. Their objection was twofold. First, if the United States did this, then the French and the British could make money by exporting these drugs instead, since the FDA's writ does not apply there or in the poor, importing countries. Second, the lobbies say that it is up to the importing nations, not the exporting countries, to prohibit imports if they think something is harmful. Both arguments are readily refuted.

If the United States thinks and legislates (or rules through administrative action) that something is harmful and hazardous for Americans, exporting it to others is reprehensible. That others might do it is surely no excuse. My virtue should not depend on whether others are virtuous; I should be prepared to go it alone. In fact, U.S. leadership itself could put pressure on other recalcitrant nations, through NGO actions for instance, to move once the United States has taken the lead.

Next, it is naive to think that the poor nations will follow the FDA ruling and prevent imports, as they would be permitted to under WTO rules. Often these nations are not well informed. Occasionally their governance is so weak, and their politicians and bureaucrats at such low levels of income, that it is not at all inconceivable that they can be seduced, in ways that skillfully skirt the legislative bans on bribes, or through concessions obtained through lobbying in the United States (as discussed below), into accepting bads. The only surefire way to prevent such outcomes is to extend the FDA ban to both domestic and foreign sales.

Bads Here and Goods There. But a bad here may be a good there. Thus the use of DDT has been proscribed in the rich nations, where its damage to the environment has been considered decisive ever since Rachel Carson famously documented it. In the poor countries such as India, where malaria has not been successfully eradicated, DDT offers health benefits that are judged to outweigh the environmental damage. In such a case, a blanket denunciation of DDT, as some environmental lobbies would have it, is as pernicious as corporate lobbying to enable bads to be exported. In these instances, it is indeed true that automatic extension of proscriptions on sales at home should not be extended abroad, as is desirable in the case of what are bads universally.

Goods Here and Bads There. We also have products that may be goods here but bads there. A classic example that made waves was provided by baby formula, produced by Nestlé, Abbott Laboratories, and other firms, and infant foods, such as those produced by Gerber. It sounds odd that these household products, produced by reputable firms, could be bads anywhere. And yet it turned out that, marketed in poor countries and used by poor women, they were.

Two factors operated to transform them from goods into bads. First, baby formulas were distributed in the poor countries the way they were distributed in the rich countries. Typically, a particular formula will be fed to the newborn baby in the hospital and a free box will be supplied to the new mother to take home, so that she gets in the habit of using this brand and will therefore become a loyal customer, since there is little to choose among different brands and practice makes for continued purchase. When our daughter was born in the Boston Lying-in Hospital, my wife returned home with free samples of Similac; sure enough, we continued with Similac. But in poor countries, the mother is often in no position to buy formula, and many such mothers tried to stretch their free samples as far as possible, diluting the formula with unboiled water, killing their babies. Evidently, a good product, marketed with rich-country techniques, became a dangerous bad.

Second, if the mothers had continued breast-feeding, that would have conferred immunity for six months. Shifting to the formula, even if the water had been boiled, removed this naturally endowed immunity.

The result was a massive campaign against the infant formulas, with off-the-wall accusations that Nestlé and other manufacturing firms were "baby killers," when in fact this was a genuine case of a costly failure to adapt marketing strategies to local conditions. But could they be faulted also for selling a product that substituted for breast milk and seduced mothers away from breast-feeding infants, thus depriving the infants of the natural immunity from breast-feeding?

No and yes. When my wife could not breast-feed our baby daughter, a wise old friend of ours said: "Darling, do not worry; God did not intend you to be a dairy." Well, why should working women who want formula, which frees them from having to breast-feed their infants, and who have the education and the means to use formula to advantage not be able to make that choice? There was certainly a powerful subset of women's groups that failed to see this and equated breast-feeding with bra burning—a feminist breast fixation to rival the masculine breast fetishism!

But others certainly had a valid point. Among poorer mothers being targeted, especially in the poor countries, formula was a potentially dangerous product; as with cigarettes, advertising had to be regulated and designed in ways that did not encourage the use of formula and other infant milk substitutes without necessary information as to the immunity advantage conferred by sticking to breast-feeding. In fact, this is how, in the end, the WHO worked up its International Code of Marketing of Breast-Milk Substitutes, with virtually universal approbation and agreement.

Yet when you see what some firms have actually done to sell according to this code, you see continuing avoidance. In the case of the United States, which remained the strongest objector to the code, the office of the trade representative even used its muscle to threaten smaller countries into not enforcing the code. Gerber was the firm that stood out in lobbying against the code, with Guatemala the victim.

The WHO code states that "neither the container nor the label should have pictures of infants, nor should they have other pictures or text which may idealize the use of infant formula." In 1983, the Guatemalans took this as a minimum standard: "All information must state that breast milk is the best food for children under two years; none may have photos or other representations of children under two years."

Gerber, which had introduced baby foods as long ago as 1928, used the "Gerber baby" face for its advertising campaigns worldwide. Parents in Guatemala even had been found naming their children Gerber, illustrating the power of such cheerful images in selling one's wares. Alone among the foreign firms, therefore, Gerber objected to the new law. The matter went up before the Guatemalan Administrative Tribunal, which ruled in favor of the Ministry of Health. But then an obliging U.S. government threatened to take away Guatemala's MFN status for violating trademark agreements. Faced with such threats, the Guatemalan government was under serious pressure; not surprisingly, Guatemala's supreme court found in favor of Gerber.[32] This outcome naturally failed to arouse in Washington the usual complaint that the judiciary was not independent because, after all, the beneficiary was a highly visible U.S. firm (and possibly, like the tobacco firms discussed next, a contributor to the PACs of one or both political parties).

What is equally distressing is that the Interagency Group on Breastfeeding Monitoring claimed in 1998 that manufacturers in thirty-nine countries were still giving free samples to mothers, breaking and stretching the rules created by the WHO and approved by the World Health Assembly in May 1981.[33]

"Ambiguous" Goods: Legal but Lethal. Finally, there is the large class of goods, such as cigarettes, that are legal but lethal, where society is politically schizophrenic: the sales are legal but growing restrictions are placed on their sale and use. In the case of cigarettes, subsidies continue to be paid for growing tobacco!

In such cases, corporate lobbying to countervail efforts to change rules so as to restrict the use of such harmful substances properly invites opprobrium. Thus, the recent attempt by the World Health Organization under the remarkable leadership of Gro Brundtland, former prime minister of Norway, to have a treaty on tobacco use, outlawing cigarette advertising and putting other restrictions on promotion, led to a virtually unanimous agreement as of January 2003. But the resistance of the cigarette companies, especially in the United States, had been considerable.

In fact, the corporate lobbies have also successfully used existing rules on trade in goods, with the aid of their governments, to spread the use of cigarettes in a legal but harmful fashion. Thus, in the famous case filed at the GATT by the U.S. trade representative against Thailand in 1990, and decided by GATT in favor of the United States, the American tobacco companies managed to overturn Thai entry restrictions on foreign cigarette firms because they amounted, the panel correctly held, to GATT-inconsistent measures aimed at ensuring equivalence of treatment between domestic and foreign suppliers.[34] The Thai authorities, however, were correct, not in law but in the truth of the matter, in arguing that even if advertising was prohibited, the sophisticated foreign cigarette manufacturers would be far more efficient at marketing cigarettes than would the inefficient Thai state monopoly, and that the Thai cigarettes had not managed to seduce children and women into its dragnet, whereas the foreign ones would. In addition, the entry of foreign firms would greatly expand the cigarette market instead of just switching the existing sales from the Thai monopoly to themselves, contrary to what the cigarette firms claimed. The GATT rules were therefore incompatible with the way one would really want the rules written for legal but lethal goods, and the cigarette firms were of course wedded to the continuation and exploitation of the inappropriate rules. In fact, as a series of reports in the *Washington Post* pointed out, they had been actively lobbying with their congressional supporters—it has often been remarked that elsewhere we call this bribery, but in the United States we call it lobbying—and with the U.S. trade representative to effectively change the rules so as to make them explicitly consistent with their view that "tobacco export policy is an economic issue, not a health issue." Indeed, the U.S. trade representative had been petitioned by the Cigarette Export Association to have "US trade officials negotiate with Thailand to end the advertising ban," whereas the existing rules seemed to imply that the ban was all right as long as it did not discriminate between domestic and foreign cigarettes.[35] A report in the *Los Angeles Times* pointed out that

> U.S. trade negotiators [had] pressured Japan, South Korea, Taiwan and Thailand—which all had tobacco monopolies—to open their markets to American cigarettes. *At the industry's insistence, trade officials further demanded that U.S. firms be free to advertise their brands, even though cigarette advertising in the four countries had been virtually nonexistent.* [Italics added] [36]

The article also noted:

> In Hungary, as in Russia, companies have found ways around the ban on cigarette advertising. Dressed in the stripes and colors of Western brands, young women distribute free samples in cafes and bars. In the capital, Budapest, brand names such as Marlboro and Lucky Strike, sold by British-based BAT [British American Tobacco] Industries, have been incorporated in the names of pubs and coffeehouses. . . . Meanwhile, though, the industry is seeking more freedom to promote its brands. The head of corporate relations for Phillip Morris in Hungary wrote the local heads of rival firms in December, 1992, suggesting that an industry delegation "should try to test the limits of the flexibility of the government and have a better understanding about the relation of power among ministries." "The industry should continue to talk to high-level politicians to maintain pressure on the bureaucracy," said the letter, whose contents were confirmed by company officials. . . . "They are buying political influence by going into these countries and saying, 'We want to help you with your economy,'" said Scott Ballin, chairman of the Coalition on Smoking or Health, a U.S. anti-smoking group. "You don't bite the hand that feeds you."

Need anything more be said?

To conclude: given the rules of the game, multinationals cannot be seriously faulted at the level of their practices, as the anti-globalizers and more conventional critics would have it. In fact, they bring much good to the workers they employ and to the poor nations they happen to invest in. But they cannot be exempted from criticism and hence require the utmost scrutiny when they organize and spend in order to set, and to exploit, the rules of the game. This legitimate critique therefore is different from the most popular critiques.

Corporate Social Responsibility

If corporations help rather than harm the poor countries and their workers—aside from their role in defining rules that occasionally help them at the expense of the poor countries—then the case for responsible corporate social action cannot be plausibly based on the argument that the harm that corporations do must be offset by the assumption of compensatory social responsibility.

It would appear, therefore, that the true, indeed only, compelling reason for corporations to assume social responsibility is that it is the right thing to do. For in so doing, they will *enhance* the social good that their economic activities promote when they invest in these developing countries, and for which there is now much evidence. Indeed, such acts of altruism are precisely what characterized many of the socially committed families that made fortunes in trade and industry. They came from different religious and cultural traditions that encouraged philanthropic action. The principal examples are the Dutch burghers (chronicled beautifully by Simon Schama), the Jains of Gujarat in India, the Quakers (among them the Wilberforces, who led the fight against slavery), and Jewish families (perhaps most prominently the Rothschilds).[37] With the rise of corporations delinked from families, there is now a growing perception that the corporations too, and not just the floating crowd of shareholders in their personal capacities, should commit themselves to such altruism, playing their role in contributing to the public good as each corporation best sees fit.

The edifice of corporate social responsibility, however, must rest on two foundations. One has to be altruism, which deals with what corporations *should* do. But the other must deal with regulation that defines what corporations *should not* do. In fact, once this is recognized, it is apparent that, in the main, voluntary codes must characterize what corporations should do (because firms will have different preferences regarding the good they want to do, just as we do not all agree on which charities to support) and mandatory codes must address what they should not do. This also implies that we need three complementary approaches.

Social Norming

Secretary General Kofi Annan's Global Compact at the United Nations, first proposed by him in Davos three years ago, is what economists call a social-norming proposition. By signing on to it, corporations agree to uphold certain broad values such as human rights, which of course include rights as workers, as consumers, as voters, as children, and as women. The compact has now been endorsed by several leading NGOs, such as Amnesty International, and by union federations such as the ICFTU. However, as it has no monitoring, certification, or enforcement mechanism, it has been rejected by some unions and NGO activists. But they miss the point.

The very act of signing on to such a compact focuses the signatory corporations, as well as potential critics, on what they do and plan to do to achieve progress toward the objectives. These consist of widely shared and internationally affirmed social values broadly stated (such as removal of gender discrimination and child labor). Given the broad general nature of the compact's objectives, however, the specific steps they take are best left to the corporations, working with the democratic countries in which they operate.

For instance, signatory corporations operating in the United States—where, it may be recalled, a recent Human Rights Watch report has found that millions of workers in nearly all industries are denied full freedom to associate and form unions (largely but not exclusively because of restrictions that make it difficult to organize strikes effectively)—can be expected to follow national legislation and act within their national rights. They would, for example, exercise their right to hire replacement workers freely, even though that helps cripple the right to strike. But they would be expected to reduce wage discrimination against women because the United States accepts that objective explicitly and enforces it.

The complexity of the issue is illustrated further by the fact that there are both narrow and broad definitions of gender discrimination with regard to equal pay. What U.S. corporations do with regard to implementing equal pay for women to ensure conformity to workers' rights objectives will depend, therefore, on the prevalent U.S. legislation. Thus, what socially responsible American corporations do in the United States may well differ from what Sweden or India accepts as a sensible way to proceed, although all three nations accept the general concepts of granting the freedom of association and eliminating gender discrimination.

Despite this inevitable, and indeed desirable, diversity of detail, the compact will help diffuse good practices in a flexible fashion. Once corporations with reputations to protect have signed on, they are in the public view. Pressure to make some progress, no matter how diverse and situation-specific, will arise, leading the corporations to move in one way or another toward the norms they have affirmed.

The same can be said of a growing number of codes developed by industry associations. They are criticized as cop-outs, as dodges designed to mislead and misdirect watchdogs by pretending to take action. But these criticisms seem to me to miss the dynamics of social norming, which promises more over time than is immediately delivered.

Voluntary Codes

We now also have several social-accountability codes that are offered by organizations that have been set up specifically to propagate corporate social standards. Leading examples include the pioneering New York–based Social Accountability International (on whose board I have served), the UK-based Ethical Trading Initiative, the Washington-based Fair Labor Association, and others. Unlike the Global Compact, they involve specific obligations and, equally as important, include monitoring prior to and after certification. Consequences can also follow: Social Accountability International has been known to decertify factories. These codes are voluntary and can be ignored, but once signed on to, they entail well-defined obligations.

The proponents of each voluntary code would prefer to have theirs as the only one available. But this would be fundamentally wrong. The codes can and do contain so many different requirements that diversity is desirable. In fact, since virtually all codes currently available are from developed countries, I believe it is essential that some be drafted by developing countries. That would bring very different perspectives into the fray. For example, there is a great push for a living-wage requirement in nearly all of these codes. But this, according to many intellectuals and NGOs in developing countries, is misguided since, as already discussed earlier, multinationals typically pay a premium over the alternative market wage available to their workers. Why raise that further by pretending that workers are being exploited because they are not earning even more? A code that explicitly excludes a living wage requirement but includes other stipulations should also be available. But it will likely not come from the developed world.

The element of choice and the need to keep the perspectives of developing countries in view are factors underemphasized by the anti-sweatshop movement on U.S. university campuses. In fact, I believe that the currently available codes overemphasize developed-country perspectives on issues such as workers' rights and neglect developing-country perspectives. The codes reflect a certain degree of paternalism as well as the deep influence of Western labor unions, whose own perspectives are often colored by the increasingly fierce competition from poor countries.

These issues have surfaced in the efforts led by the anti-sweatshop activists on American university campuses to define social responsibility by textile firms abroad and to exclude their universities from contracting with firms that do not sign on to specific codes.[38]

Mandatory Codes

National mandatory codes have been proposed to complement the Global Compact and the voluntary codes. These codes, and the rules and regulations that define at home what the corporations cannot do as good citizens, would extend to a nation's multinational operations abroad. These mandatory national codes will naturally vary across nations (because different nations will have different ideas and laws concerning what is hugely egregious and should be disallowed and what is not), whereas the voluntary codes are obviously uniform worldwide. I suggested such a mandatory code for American firms operating in Mexico over a decade ago in the *New York Times*, in the context of the NAFTA debate: it would ask American firms abroad to "do in Rome, not as Romans do, but as New Yorkers do."[39] In short, U.S. firms must abide abroad by the basic principles that are expected at home.

Thus, under this approach, if a U.S. firm had been in South Africa when apartheid was practiced, it would have been subject to the U.S. mandate not to implement the same policy. Or if Mexico did not have legislation forbidding the dumping of mercury into its waters, American firms would be expected by the United States not to take advantage of that. Yes, some American firms will move to the Bahamas to escape these codes, but then if they get into political trouble, the U.S. marines or U.S. diplomatic muscle will not be available to help them.

Will these diverse mandatory codes imply that a universal mandatory code is to be denied? On the contrary. As these national mandatory codes come into play, the mere juxtaposition of good and bad practices will create pressures over time for convergence to good practices, given civil society and democracy today. The convergence to universal mandatory codes, as with the recent tobacco treaty at the WHO, came after decades of national legislation where some nations moved ahead of others, while the laggards caught up under the pressures generated by the good practices of the pioneers. The reverse model of starting, rather than ending, with uniform and universalist mandatory codes seems to be unrealistic except for practices that all agree are morally reprehensible, such as slavery and forced labor.

A tapestry woven in three colors, one of social-norming codes, another of a multiplicity of voluntary codes, and a third of diverse mandatory national codes, would then appear to define a nuanced and desirable approach to the question of social responsibility by global corporations today. Multinationals, unfairly accused of predation, can embrace these approaches to corporate social responsibility to emerge even more effectively in the global economy and society as institutions that truly advance the economic and social good in the countries they invest in.

13

The Perils of Gung-ho International Financial Capitalism

Starting in Thailand in the summer of 1997, the Asian financial crisis swept through Indonesia, Malaysia, and South Korea, turning the region's economic miracle into a debacle. Capital, which had been flowing in, flew out in huge amounts. Where these four economies and the Philippines had attracted inflows of over $65 billion in 1996, the annual outflows during 1997 and 1998 were almost $20 billion, amounting to an annual resource crunch of over $85 billion—a staggering amount indeed! This caused currencies to collapse, stock prices to crash, and economies to go into a tailspin.[1] This was not all. The fear of ruination by contagion sent shock waves worldwide. The Russian ruble went into turmoil in August 1998; the Brazilian real did so in January 1999.

Per capita incomes tumbled to almost one-third their 1996 level in Indonesia, with the other crisis-stricken Asian countries showing declines ranging from a quarter to nearly half of the 1996 levels. The devastation was reminiscent of the Great Crash of 1929, a searing experience that ushered in the New Deal in the United States and led to competitive escalation of tariffs worldwide. Writing about this crisis that had spread ruin within almost a hundred days, I thought of Octavio Paz's famous lines from "Happiness in Herat":

> I met the wind of the hundred days.
> It covered all the nights with sand,
> Badgered my forehead, scorched my lids.[2]

This crisis, precipitated by panic-fueled outflows of capital, was a product of hasty and imprudent financial liberalization, almost always under foreign pressure, allowing free international flows of short-term capital without adequate attention to the potentially potent downside of such globalization. There has been no shortage of excuses and strained explanations scapegoating the victims, suggesting they committed hara-kiri instead of being slaughtered. It is hard not to conclude that the motivation underlying these specious explanations is a desire to continue to maintain ideological positions in favor of a policy of free capital flows or to escape responsibility for playing a central role in pushing for what one might aptly call gung-ho international financial capitalism. Let me consider first the wrong explanations and then the right ones.

The Wrong Explanations

A benign but wrongheaded explanation was that the Asian crisis was a result of these countries' long-standing economic miracle running out of steam. That miracle, it may be recalled, was a result of long-sustained and phenomenally high rates of productive investment at levels that had no precedent in history. But if rapid accumulation of capital through rates of high investment was the source of growth, economists would fear that the growth would slow down because of diminishing returns—that is, as capital accumulated relative to labor, further investment would produce progressively less output. A man with a spade could plow an acre a day, but an extra spade, with the man not given a comrade, would add little to the work done. Economists know that this gloomy scenario can be foiled if there is technical progress that adds to output what diminishing returns subtract from it: instead of an extra spade, imagine that a motor is added to the man's spade. But my Columbia student Allwyn Young had estimated that the Asian countries had no technical change to speak of.

The lay person is bound to wonder how this could possibly be true. After all, these countries had registered huge advances in technology by importing foreign equipment embodying massive advances in technology. Just contrast the images of the hamlets and rickshaws in South Korea at the time of the Korean War, for instance, with the skyscrapers in Seoul, built no doubt with the latest cranes, that filled our screens when Korea advanced to the quarterfinals of the World Cup, to national delirium. Or look at the flood in Western markets of Hyundai cars and Samsung TVs, which cannot have been manufactured except with sophisticated technology.

The way economists calculate productivity change, however, is to attribute to investment the effects of technical change embodied in newer equipment, as in the example of the motorized spade earlier. They virtually assume that new and more productive equipment must be treated as if investment had increased: that a spade twice as productive is to be treated as if it were two spades. But the consequence is that it is somewhat startling to those who are not economists to say that the region had "no technical change"! So the pessimistic conclusions about diminishing returns are somewhat exaggerated when such equipment-embodied technical change is quite dramatic, as it has been and continues to be in Asia.

But even if the Asian economic miracle had been based on investment rather than technical progress, it is hardly plausible that the miracle would have vanished precipitously. As capital accumulated relative to labor, the future return to capital would decline only slowly, except in the most singular circumstances. But what happened in reality was that the economies *crashed*. Instead of slowly winding down, they went rapidly, within a matter of months, into negative growth rates. If you were to draw a chart of the actual growth rates of per capita incomes in the affected Asian countries, with the growth rates on the vertical axis and the years on the horizontal axis, that chart would go not into a gentle flattening out and then a steady fall, but dramatically into what everyone should remember from their geometry classes as the second quadrant, which plots negative growth rates.

The parallel with the Soviet Union was eerie. There economists had seen per capita income growth rates decline over almost two decades, and the favored explanation was diminishing returns to capital accumulation. But with the arrival of President Gorbachev and his adoption of perestroika (economic restructuring) and glasnost (political reform), the economy went crashing into negative growth rates.

The sharp, discontinuous reversal of fortune was mind-boggling in both cases. In the case of East Asia, the economists who had predicted a decline were happy to claim foresight. But to claim credit for having foreseen a crash when all one had asserted was that a decline would soon set in was not exactly persuasive. The question still remained: why did a financial crisis, and then an economic one, break out when these countries had been doing so well until then?[3]

Yet another argument, albeit a lame one, was that these countries were afflicted by crony capitalism, which led to malfeasance that produced the financial crisis under financial liberalization. As many experts on East Asia remarked, however, crony capitalism had produced the economic miracle earlier; why was it now a cancer that killed the patient? Besides, it is indeed true that many of these leaders had cronies, but which politicians do not? Are President Suharto's entourage "cronies," whereas people at Bechtel and Halliburton are Vice President Dick Cheney's "friends"? Are Barbra Streisand and Steven Spielberg President Clinton's "friends," while President Mahathir's celebrity friends are his "cronies"?

What is the difference? If it is about patronage in exchange for contributions, is it not true that Hollywood has managed to get extraordinary rewards from its lobbying in opening foreign markets for its movies (a matter I discussed in Chapter 9)?

I wrote at the time in Singapore an op-ed essay titled "A Friend in the United States, but a Crony in Asia," which drew attention to the self-serving rhetoric that was coming out of Washington as the ideologues who had pushed for international financial liberalization without adequate safeguards were rushing for cover.[4] This type of talk also fueled the notion that corruption was to be found there, not here. James Wolfensohn, president of the World Bank, took to attacking corruption around the same time, an activity that I warmly welcome, and I noticed that his staff's attention was selectively focused away from the rich countries. So I suggested that if he opened his window in Washington, D.C., and looked out, Wolfensohn would see plenty of the corruption that he and his staff were looking for in the poor countries instead. But I fully understand that it is hard to look in the face the ones whose money you must accept in order to stay in business; morality is more easily thrown at those who borrow than at those who lend.

But if these explanations of the crisis were implausible, then one had a puzzle on one's hands. After all, these economies had excellent fundamentals. Between 1991 and 1996, budgets generally showed surpluses, the investment and growth rates were as impressive as they had been since the 1960s, the inflation rate was in single digits, and current account (i.e., trade) deficits were extremely small as a percentage of national income.[5] In November 1994, when the Mexican peso crisis erupted, requiring extensive rescue efforts by the United States, the fundamentals were unsound, and the turmoil that came was not entirely surprising. East Asia was exemplary; Latin America rarely has been.

Problems with Free Capital Flows

The reason why capital inflows are tricky is simply because when confidence is shaken, the fact that the situation is inherently one of imperfect information implies that the actions of a few can initiate herd action by others.

Economists have amusingly instructive models of herd behavior under imperfect information now. If you do not know which of three restaurants in a mall is good, you could pick one at random and hope for the best. But then you see that two are empty and the third has a table taken by a well-dressed couple. You will think that they know something you don't, and therefore you will go in. The next fellow deciding on which restaurant to pick will now see two tables taken, so he will go in too, occupying a third. And pretty soon, you will have herd behavior benefiting that restaurant generously, even if it is, objectively speaking, not the best one.

This is probably the best explanation of what happened in Asia despite the splendid fundamentals. The huge borrowing of short-term capital was perhaps manageable, objectively speaking, but its sheer size had within it the seeds of panic behavior. Since there was no transparency on how much had been borrowed, the panic spread fast, feeding on itself.

The other problem with the Asian economies was that their institutional practices had not been suitably modified for transition to a regime of free capital flows. In South Korea, for instance, the debt-equity ratios in the industrial enterprises, including the big conglomerates known as *chaebols*, were traditionally twice as high as in the developed countries, where corporations relied for financing far more on equity. If the financing was with debt in wons, a panic-fed crisis could be met by conventional intervention by the central bank extending necessary cash as a lender of last resort. But if the debt was borrowed from abroad and denominated in foreign currency, this meant that there would be a balance-of-payments crisis: dollars to pay the recalled loans cannot be printed in Seoul. This should have been anticipated, and regulations to monitor and prevent massive accumulation of short-term foreign debt to dangerous levels should have been put in place before South Korea was encouraged by the IMF, and required by the OECD as a price of membership, to turn to the free-capital-mobility regime.

At the same time, a lack of banking and financial regulation compounded the problem. Many commercial banks borrowed short-term from abroad, given the new ability to do so as capital flows were freed from control, and lent the borrowed funds long-term to domestic private investors, often in real estate, without adequate safeguards. "In the five . . . economies, short-term borrowing amounted to almost a quarter of bank loans to the private sector in 1996."[6] So when the panic set in and capital began to flow out rather than in, the banks were forced to recall their loans. The central banks also cut the money supply as their foreign exchange reserves shrank due to the capital outflow. Both factors led to closing businesses and, in turn, to collapsing banks.

By contrast, India and China, which had been chalking up high growth rates through the decade prior to the Asian crisis while rejecting the calls for the elimination of capital controls, escaped the crisis altogether. One must therefore ask why the crisis-afflicted countries undertook this shift, which would soon prove expensive, to fulsome integration into the world's financial markets.

The Wall Street–Treasury Complex

The rush to abandon controls on international capital flows—economists call this a policy of capital account convertibility—was hardly a consequence of finance ministers and other policy makers in the developing countries suddenly acknowledging the folly of their ways. It reflected instead external pressures.

These came from both the IMF and the U.S. Treasury (where the leadership was doubtless provided by Treasury secretary Robert Rubin, the most influential financial figure in the Clinton administration). The economists in leadership positions in these institutions were among the most accomplished today. They could not be accused of unfamiliarity with the need for caution and prudence when it came to leaning on countries to free capital flows.

In fact, in 1989, Lawrence Summers (who was deputy to Rubin and succeeded him as Treasury secretary) and his lawyer wife, Victoria, had written a classic article about "excessive speculation," quoting with approbation statements such as:

> The freeing of financial markets to pursue their casino instincts heightens the odds of crises. . . . Because unlike a casino, the financial markets are inextricably linked with the world outside, the real economy pays the price.[7]

and the celebrated words in 1936 of John Maynard Keynes:

> As the organization of investment markets improves, the risk of the predominance of speculation does increase. In one of the greatest investment markets in the world, namely New York, the influence of speculation is enormous. Speculators may do no harm as bubbles on a steady stream of enterprise. But the position is serious when enterprise becomes the bubble on a whirlpool of speculation. When the capital development of a country becomes the by-product of the activities of a casino, the job is likely to be ill-done. The measure of success attained by Wall Street, regarded as an institution of which the proper social purpose is to direct new investment into the most profitable channels in terms of future yield cannot be claimed as one of the outstanding triumphs of laissez-faire capitalism, which is not surprising if I am right in thinking that the best brains of Wall Street have been in fact directed towards a different object.[8]

If Summers had been eloquent about free capital mobility's downside, Stanley Fischer, who was the main theoretician at the IMF as its first deputy managing director, was surely familiar with the scholarly work on financial and currency crises. So why did they go along optimistically with the notion that the time had come to hasten the elimination of barriers to capital mobility worldwide?

I suspect that this had much to do with the general shift to markets and away from controls that had occurred in the 1970s and 1980s as disillusionment grew with knee-jerk interventions worldwide. They were likely caught in the usual swing of the pendulum—one extreme follows the other. So, I am sure, was Secretary Rubin. But the explanation of his complacency is possibly more complex. His working life had been on Wall Street, with Goldman Sachs. He clearly believed that America's financial markets had brought unusual venture-capital-financed prosperity to the United States. It was natural for him to see that countries practicing capital account inconvertibility, and regulating and inhibiting the inflows of capital, were denying themselves these benefits. It was inevitable that, as with most of us, his outlook was shaped by his experience.

Then again, one must reckon with the energetic lobbying of Wall Street firms to pry open financial markets worldwide. These firms argued that their profits and social good were in sync. If they had any doubts, these were carefully concealed!

The euphoria was widespread. In the exasperated words of the Nobel laureate James Tobin, a great figure in macroeconomics:

> U.S. leadership . . . gives the mobility of capital priority over all other considerations.

And Paul Volcker, the legendary chairman of the Federal Reserve whom Alan Greenspan succeeded, remarked in consternation:

> The visual image of a vast sea of liquid capital strikes me as apt—the big and inevitable storms through which a great liner like the U.S.S. United States of America can safely sail will surely capsize even the sturdiest South Pacific canoe.[9]

It was impossible to puncture the balloon because few with dissenting opinions could penetrate what I have called the Wall Street–Treasury complex.[10] This is the loose but still fairly coherent group of Wall Street firms in New York and the political elite in Washington, the latter embracing not just the Treasury but also the State Department, the IMF, the World Bank, and so on. There is constant to-and-fro between these two groups. For instance, Rubin moved from Wall Street to the Treasury and back; Wolfensohn at the World Bank moved there from his investment firm in New York; Stanley Fischer has moved in the reverse direction from the IMF to Citigroup; Ernest Stern, the senior vice president and acting president of the World Bank, moved to Morgan Stanley; and one could go on.

I think of the Wall Street–Treasury complex not as a conspiracy but very much in the spirit of C. Wright Mills's "power elite."[11] They wear similar suits, not just similar ties; they interact on boards and in clubs;

they wind up sharing the same sentiments, reinforced by one another's wisdom. So on capital mobility, like lemmings, they took other lemmings, and us, merrily down a dangerous path.

The phrase "Wall Street–Treasury complex" has proven popular not just among radical critics or NGOs. Robert Wade, an influential writer on financial crises who teaches at the London School of Economics, has adopted it, calling it the "Wall Street–Treasury–IMF complex."[12] But "Treasury" in my phrasing stood for Washington; adding just the IMF therefore unwittingly narrows, not widens, the meaning. Barry Eichengreen, a noted economic historian and occasional consultant to the IMF, has instead called it diplomatically the "Wall Street complex," but this is to leave out half of the culpable parties![13]

In a lighter vein, remember that Dwight Eisenhower, who surprisingly launched the radical phrase "military-industrial complex," was the president of Columbia University.[14] C. Wright Mills, the author of *The Power Elite,* taught sociology at Columbia. It was at Columbia also that I wrote about the Wall Street–Treasury complex. Consequently many talk now of the "Columbia trio." I suppose this is the next best to being 'N Sync!

The Question of Malaysian Capital Controls

But the Asian crisis called into question not just the wisdom of a rapid freeing of capital flows in countries that still had capital controls. It also raised the somewhat separate question of whether a country that *already* had this freedom would be wise to temporarily abandon it and to adopt capital controls in response to panic-fueled capital flows.

As it happens, Malaysia did just that, imposing selective exchange controls in September 1998.[15] Though the IMF disapproved, Prime Minister Mahathir stuck to his guns, therefore losing IMF support but gaining freedom from its conditionality. Most observers agree that IMF conditionality was in error, requiring deflation when an expansionary response was called for. So the other crisis-afflicted Asian economies went into a deep dive and recovered later, but Malaysia managed to get to the correct, expansionary policies earlier and avoided the gratuitous deepening of the downturn.

Economists have debated whether Malaysian controls played a significant role in allowing Dr. Mahathir to expand when others were contracting under the wrong IMF medicine. That is certainly what theory would say. Just as an import tariff enables you to segment domestic from foreign markets and to raise the domestic price above the foreign price, capital controls segment the domestic capital market from the world market and this can enable you to lower interest rates (to inflate the economy) without fearing further outflows of capital because interest rates are higher abroad. The theory is not far removed from reality, in my view.[16]

Where Do We Stand?

By now, the IMF has abandoned its excessive pre-crisis enthusiasm for free capital mobility.[17] It has learned the role of prudence in opening domestic financial markets to global integration, and the need to strengthen banking structures and practices prior to the opening. It has informally accepted the possible wisdom of measures such as a tax on incoming capital flows (an innovation of Chile) if they get too large. Finally, it has painfully learned the need for diversity of responses and conditionalities should crises erupt despite the prudence and safeguards. In short, while a watchful eye over the Wall Street–Treasury complex remains a necessity, the days of gung-ho international financial capitalism are probably past.

I can do no better than to cite *The Economist,* the most influential opinion magazine today on economics and finance:

> If any cause commands the unswerving support of *The Economist,* it is that of liberal trade. For as long as it has existed, this newspaper has championed freedom of commerce across borders. Liberal trade, we have always argued, advances prosperity, encourages peace among nations and is an indispensable part of individual liberty. It seems natural to suppose that what goes for trade in goods must go for trade in capital, in which case capital controls would offend us as violently as, say, an import quota on bananas. The issues have much in common, but they are not the same. Untidy as it may be, economic liberals should acknowledge that capital controls—of a certain restricted sort, and in certain cases—have a role.[18]