The Crisis of Globalization

James K. Galbraith

The doctrine known as the Washington Consensus was, after its fashion, the Apostle’s Creed of globalization. It was an expression of faith, that markets are efficient, that states are unnecessary, that the poor and the rich have no conflicting interests, that things turn out for the best when left alone. It held that privatization and deregulation and open capital markets promote economic development, that governments should balance budgets and fight inflation and do almost nothing else. But none of this is actually true.

The truth is that poor people -- vast majorities in most countries of the world -- need to eat every day. Policies that guarantee that they can do so, and with steadily improving diets and housing and health and other material conditions of life over long time spans, are good policies. Policies that foster instability directly or indirectly, that prevent poor people from eating in the name of efficiency or liberalism or even in the name of freedom, are not good policies. And it is possible to distinguish policies that meet this minimum standard from policies that do not.

The push for competition, deregulation, privatization and open capital markets has actually undermined economic prospects for many millions of the world's poorest people. It is therefore not merely a naive and misguided crusade. To the extent that it undermines the stable provision of daily bread, it is actively dangerous to the safety and stability of the world, including to ourselves. The greatest single danger right now is in Russia, a catastrophic example of the failure of free market doctrine. But serious dangers have also emerged in Asia and Latin America and they are not going to go away soon.

There is, in short, a crisis of the Washington Consensus.

The crisis of the Washington Consensus is visible to everybody. But not everybody is willing to admit it. Indeed, as bad policies produced policy failures, those committed to the policies developed a defense mechanism. This is the argument that treats every unwelcome case as an unfortunate exception. Mexico was an exception -- there was a revolt in Chiapas, an assassination in Tijuana. Then Korea, Thailand, Indonesia became exceptions: corruption, crony capitalism on an unimaginably massive scale, was discovered, but after the crisis hit. And then there came the Russian exception. In Russia, we are told, Dostoyevskian criminality welled up from the corpse of Soviet communism to overcome the efficiencies and incentives of free markets.

But when the exceptions outnumber the examples, there must be trouble with the rules. Where are the continuing success stories of liberalization, privatization, deregulation, sound money and balanced budgets? Where are the emerging markets that have emerged, the developing countries that have developed, the transition economies that have truly completed a successful and happy transition? Look closely. Look hard. They do not exist.

In each of the supposed exceptions Russia, Korea, Mexico, and also Brazil state-directed development programs have been liberalized, privatized, deregulated. But then, capital inflows led to currency overvaluation, making imports cheap but exports uncompetitive. As early promises of "transformation" proved unrealistic, the investor
mood soured. A flight to quality began, usually following moves to raise interest rates in the "quality" countries -- notably the United States in 1994 and in early 1997. A very small move in U.S. interest rates in March 1997 precipitated the outflows of capital from Asia that led to the Thai crisis. I have elsewhere called this the "Butterfly Effect," with Alan Greenspan in the role of the butterfly.

The Russian case is especially sad and dramatic. In 1917 the Bolshevik revolution promised a war-weary Russian people liberation and deliverance from oppression. It took them seventy years to forget the essential lesson of that experience, which is that there are no easy, sudden, miraculous transitions. In 1992, the advocates of shock therapy followed the Bolshevik path, against the good sense of much of the Russian political order, by Bolshevik means. This was the true meaning of Yeltsin's 1993 military assault on the Russian parliament, an act of violence which we in the West tolerated, to our shame, in the name "economic reform."

Privatization and deregulation in Russia did not create efficient and competitive markets, but instead large and pernicious private monopolists, the oligarchs and the mafiosi, with control over competing industrial empires and the news media. And these empires sponsored their own banks, which were not banks at all but rather simply speculative pools, serving none of the essential functions of commercial banks. Meanwhile, the state followed a rigid policy of limiting expenditures, so that even wages and pension obligations duly incurred were not paid -- as if the United States government were to refuse to pay Social Security checks because of a budget deficit! The private sector literally ran out of money. The payments system ceased to function; tax collection became impossible because there was nothing to tax. The state financed itself through a pyramid scheme of short-term debts, the GKO market, which collapsed as pyramids must on August 17th, 1998. This was the end of free-market radicalism in Russia -- and still, the Washington Consensus holds that Russia must "stay the course" on "economic reform."

Throughout Asia in the 1990s, stable industrial growth gave way to go-go expansions based heavily on real-estate speculation and commercial office development. Many more office towers went up, in Bangkok, Djakarta, Hong Kong and Kuala Lumpur, than could reasonably be put to use. Once finished, these towers do not go away; they stay empty but available, and so remain a drug on the market, inhibiting new construction. Recovery from the crash of such bubbles is a slow process. It took five years or longer in Texas of the mid 1980s.

As for Brazil, through the early fall of 1998 it was said that the IMF would restore confidence and keep the Brazilian real afloat. But the real has since devalued and Brazil is heading for a deep recession. The problem here does not originate with Brazil, and cannot be resolved by any actions the Brazilians alone might take. It lies, rather, in the international capital markets. Investors with exposure in Asia, and with losses in Russia, must reduce their lending to other large borrowers, irrespective of conditions in those countries. It is this imperative that is Brazil's problem today.

Are there alternatives? Yes. The grim history I've just outlined is not uniform. Over the past half-century, successful and prolonged periods of strong global development have always occurred in countries with strong governments, mixed economic structures and weakly developed capital markets. This was the case of Europe and Japan following World War Two, of Korea and Taiwan in the 80s and 90s, of China after 1979. These cases, and not the free market liberal examples -- such as, say, Argentina after the mid-1970s or Mexico after 1986 or the Philippines or Bolivia -- are the success stories of global economic development in our time.
If one examines Korea, for instance, one finds that the great period of economic development was, indeed, a time of repressive crony capitalism. After 1975, the Korean government took note of the fate of South Vietnam, drew its own conclusions about the depth of American commitment, and embarked on a program of heavy and chemical industrialization that emphasized dual use technologies: the first major product of Hyundai Heavy Industries, for example, was a knock-off of the M-60 tank. The Korean industrialization policy was not, in any static sense, efficient. No market would have chosen this course of action. The major players in the Korean economy--the state, the banks, the conglomerates known as chaebols -- were yoked together in pursuit of their goals. Workers and their wage demands were repressed. And the initial search for markets was by no means entirely successful. There wasn't a big demand for those tanks, and so Hyundai decided to try building passenger cars, instead.

And yet, when one adds up the balance sheet of the Korean model, can anyone seriously argue that the country would be richer today if it had done nothing in 1975? That it would be more middle class, or more democratic?

It is true that Korea experienced the first harsh blows of the Asian financial crisis. But why? By 1997, the industrial policy was a thing of the distant past. Korean banks had become deregulated in 1992. What they did was to diversify -- supporting vast expansion and industrial diversification schemes of the chaebol -- Samsung's adventure into motor cars, for example -- and lending to such places as Indonesia, where the Koreans evidently bought paper recommended to them by their American counterparts.. The crash of Indonesia spread to Korea by these financial channels. It was not a crisis of crony capitalism, but of crony banking -- deregulated and globalized.

One can multiply cases, but let us look at just one other, that of China. China is a country with a fifty-year tradition of one-party government. For thirty of those years, it was a case study in regimentation, ideology, and economic failure. At one point, there occurred an entirely avoidable, catastrophic famine during which twenty or thirty million people perished. In the first years of the Great Proletarian Cultural Revolution, village rations amounted to a pound of rice per day. Beginning in 1979, however, China embarked on reforms that changed the face of the country. These began with the most massive agricultural reform in human history, reforms which effectively ended food poverty in China in five years. After that, policies that welcomed long-term direct investment, that fostered township and village enterprises, joint ventures and private enterprises, put into place a vast and continuing improvement in human living standards. Over twenty years, average living standards more than quadrupled; indeed growth has been so rapid that many people can perceive the improvement in their standard of living from month to month.

China's case demonstrates the potential effectiveness of sustained development policies -- of policies that emphasize the priority of steady improvement over long periods of time. Unlike Russia, China made the mistake of the Great Leap Forward only once. And it never liberalized its capital markets or its capital account, for fear that such actions would prove a fatal lure, unleashing a cycle of boom and bust that a poor nation cannot tolerate for long.

China is today no democracy. It is not politically free. But one must also acknowledge that the Chinese government has delivered on the essential economic demands of the Chinese people, namely food and housing, and that an alternative regime which did not deliver on these needs would not have been able to deliver internal peace, democracy or human rights either.
So, what can the United States do now? To begin with we can, recognize that globalized finance makes the Federal Reserve central banker to much of the developing world. Interest rate cuts last fall had an important stabilizing effect on global markets. But this effect is temporary; and the Fed's powers are limited. After a cut, another one is eventually required; and the cut from one to one-half percent lacks the force of the reduction from six percent to four. There is a strong case for lower interest rates, but we must also remember that that the long term arrives when such short term policies run out of steam.

Then there is fiscal policy. If it is a good idea for Japan to run a deficit to fight the global recession, why is it wise for the United States to be running a surplus that vastly offsets the deficit in Japan? It isn't wise. The United States should frankly expand its own economy using all the tools available for this purpose.

Then there is the matter of what we preach to the world and the policies we support. If it is a good idea for the government of the United States to grow in line with our economy, then it is also a good idea for the governments of other countries to grow as their economies do. Global development policy should be geared toward strengthening that capacity, not crippling it.

Every functional private economy has, and needs, a core of state, regional and municipal enterprises and distribution channels to assure food and basic necessities to low-income populations. Such systems stabilize the market institutions, which work better for people with higher incomes. They help prevent criminal monopolization of critical distribution networks by setting up an accountable alternative. International assistance should seek to strengthen these public networks where they exist, and to build them where they do not. Efforts to do just this in Russia today, under the present government, should be supported and not opposed.

There is an obvious conflict between pro-growth policies and "investor confidence." Investors like to be repaid in the short run. But given that conflict, it is a fool's bargain to place investor confidence above the pursuit of development. Strong national governments have a sovereign right to regulate capital flows and banks operating on their soil -- as much right as any nation has to control the flow of people across its national frontiers, and to regulate their activities at home. A Tobin Tax on foreign exchange should be enacted here, not only to slow speculation in the United States, but also to signal our acceptance of this principle for other countries, for whom different mechanisms of capital control may be more suitable in different cases.

Beyond this, a major reconstruction of world financial practices, aimed at restoring stability and strengthening the regulatory and planning capacities of national governments, is in order. The IMF needs new leadership, not tied to recent dogmas. But the IMF is also too small, and too thinly spread, to be useful in helping countries with the design and implementation of effective national development schemes. Regional financial institutions, such as suggested for Asia by Japanese Finance Minister Eisuke Sakakibara, are therefore also needed and U.S. opposition to them should be dropped.

Most of all, and in summary, we must give up illusions. The neoliberal experiment, is a failure. And it is a failure not because of unforeseeable events, but because it was and is systematically and fundamentally flawed. We need many changes from this naive and doomed vision of an ungoverned world order. We need large changes, and the need is great while time, I believe, is short. We must bring the Reagan era to a final end. We must return to development policies for the people whose needs matter most in the large scheme of things, namely the millions of hard-working people in poor countries who need to eat every day.
James K. Galbraith is the author of *Created Unequal: The Crisis in American Pay*. He is working on a new book on global inequality.
The biology of the global economic crisis of 2020 is new. Almost none of the politics of the crisis is new, however. Within the developed world, a populist backlash against globalization, European integration, China’s return to the center of the global system, political establishments, business elites, and immigrants has been growing more powerful for the last decade, writes Rawi Abdelal, Herbert F. Johnson Professor of International Management, Harvard Business School and Director of Davis Center for Russian and Eurasian Studies, Harvard University. The COVID-19 pandemic is being refracted through the lens of The Crisis of Globalization. James K. Galbraith â–ª Summer 1999. The doctrine known as the Washington Consensus was the Apostle’s Creed of globalization. It was an expression of faith that markets are efficient, that states are unnecessary, that the poor and the rich have no conflicting interests, that things turn out for the best when left alone. It held that privatization and deregulation and open capital markets promote economic development, that governments should balance budgets and fight inflation and do almost nothing else. In cooperation with our partners from the Friedrich-Ebert-Stiftung and the Hans Böckler Stiftung, Social Europe examines the different dimensions of the crisis of globalisation and what kind of policy mix could help addressing it. We bring together some of the best analyses and leading voices in the field and try to highlight some of the most innovative solutions to the major political and economic problems associated with the crisis of globalisation. Our Project Partners. The crisis of globalisation: interview with Mark Blyth.

Mark Blyth.