

Professor Stiglitz:

The recent article in the Wall Street Journal discussing your views on globalization prompts me to write with a few comments.

Globalization of business and liberalization of trade rules promises to be disruptive, both for the developed as well as the developing countries. Indeed, I will concede what others apparently will not – the process will be "painful." Globalization and liberalization will also be messy, inefficient and unfair. Many playing fields will not be level for quite some time.

Nevertheless, the integration of economic activity across national borders is crucial both to the welfare of mankind and the quality of the natural environment. It is the only hope for long term peace and prosperity for future generations, both in the First World and the Third World.

The problem is that the liberalization of trade rules to facilitate cross-border economic activity is only one half of a "chicken and egg" problem, the other half being a political science problem – the establishment of the rule of law in developing countries. The problems that you see as having resulted from globalization to date are a consequence of a lack of advanced legal systems in many developing countries.

In advising my corporate clients contemplating investment in developing countries, I counsel that the issues of importance are not the potential benefits of reduced labor or environmental compliance costs, but the risks posed by the lack of due process rights, predictable legal rules and impartial adjudication of disputes. Without a sophisticated legal system with integrity, investors will not make substantial capital investments. Without substantial capital investments, any employment created will be limited predominantly to low skill, low value-add jobs. Meanwhile, of course, trade rule liberalization will have subjected the workers in the developing country to the risks of the market.

Once a sophisticated legal system is in place, however, investors will make investments with a long-term perspective. This would include investments in labor skill development. Over time, wages in the developing country will rise (something that will create demand in the developing country for goods and services produced both domestically and internationally). Only then will the benefits of globalization and trade liberalization be realized.

Unfortunately, prior to that time investment in developing countries will be based on opportunities to exploit labor and environmental, health and safety compliance cost advantages. This will, of course, have adverse consequences in both the developed and the developing countries.

Ideally, sophisticated legal systems would be in place before trade rules are liberalized, but the last 50 years have shown that inducing political change in developing countries is very difficult, particularly when the benefits of that change are not readily apparent to the ruling cohort or the general population. Hopefully, liberalized trade rules will be more efficient in inducing political change as the ruling cohorts of developing countries come to recognize the benefits they could enjoy if they embraced change. This recognition should come about as investors make clear that they would be prepared to make significant, long-term commitments (and, in our imperfect world, involve the current ruling cohorts as partners) if sophisticated legal systems are adopted.

Without political change in a number of developing countries and the economic development that will result from the combination of that change and liberalized trade rules, hopes for

the future are less promising, both in the developed as well as the developing countries. So long as investment in developing countries is motivated by labor and other cost advantages, both labor rates and prices in developed countries will be under negative pressure.

Countries with sophisticated legal systems and successful growing economies with steadily increasing standards of living do not start wars. Such countries do not need to rely on colonial economic strategies, and their economic growth and productivity are not correlated to the size of the lands they control.

Moreover, protection of the natural environment is closely tied to labor value. Where labor value is low, the population will exploit natural resources (whether these are old growth forests, mineral resources, or indigenous animal populations), because however nominal the value of these resources might be, it materially supplements the nominal value of human labor. Also, limited labor value is a disincentive to population control. Meanwhile, whatever environmental problems might result from controlled use of fossil fuels, they pale in comparison to burning dung or wood. And, water pollution issues from modern commercial and manufacturing operations are minimal in contrast to the environmental and public health impacts from the lack of modern sanitation systems. Indeed, revenues from fees for commercial and industrial waste water treatment can contribute significantly to the costs of waste water treatment infrastructure.

Finally, economic growth in the developed world will, of course, be lower if the economies of developing countries do not improve enough to increase demand for goods and services. Demand growth in developed countries is relatively limited, because population growth is small, poverty (by which I mean insufficient income to purchase generally desired goods and services) is relatively low and a significant portion of demand is based on replacement or repair of obsolete goods (as opposed to the purchase of goods and related services new to the consumer).

There will be costs to trade liberalization and economic globalization and these costs will not be insignificant. But the long term benefits, both in economic and quality of life terms, should ultimately far exceed these costs. We have tried alternatives to induce political change without success. Trade liberalization and economic globalization is the best hope for promoting sustainable development, human rights, and the improvement of the human condition for billions of people all over the world. I do not know enough about the operations of the IMF or the World Bank to have a view as to whether they are properly discharging their responsibilities. But, while improvements may be necessary, we must make trade liberalization and economic globalization work.

/s/

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