

## **Globalization and the Role of the IMF**

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## I. INTRODUCTION: WHAT IS GLOBALIZATION?

Last week I visited South India. I went to a stud farm that my uncle manages on the outskirts of Bangalore. While I was there I was told that the farm had adopted the American way of training the horses—this meant that the horses were not beaten up anymore while being taught how to gallop. Now, using simple eye movements and sign language, it was possible to train the animals. A big leap from the barbaric old ways. Then, as we drove from Bangalore to Mysore, we saw bullock carts with rubber tires—a variation of those used for cars, I presume. This simple innovation had not only eased the burden on the animals but had enabled the village workers to carry a greater load. Not a single beggar did I encounter on the way. Unheard of—only a decade ago. These small instances are constant reminders to me of the consequences of opening up the Indian economy, especially in the past decade. The India that you see today is very different from my India when I was a student in the late 1970s.

Globalization means different things to different people. I am sure if I asked you what it means to you, I would get somewhat different answers. Let me take two extremes. At the one end, the proglobalizers claim that globalization has allowed for *a sharp increase in world incomes and a rapid decline in absolute poverty in the world*. At the other end, the likes of Joseph Stiglitz, a Nobel Prize laureate, talk of *“the devastating effect that globalization can have on developing countries, especially the poor...”* Can both statements be true? We will see that a little later.

What everyone would agree on is that globalization is multi-faceted, with many dimensions—economic, social, political, environmental, cultural, and religious, affecting everyone in some way or the other. In its essence, *globalization can be defined as an ongoing trend to greater integration (economic or otherwise) among nations*. There is an increase in the flow of ideas, goods, services, capital, and people among countries and within countries. What does that mean in our daily lives? That we are more likely to buy foreign goods now than ever before; invest our money abroad; earn our income from other countries; chat more with people in other countries, by telephone or the internet; visit other countries; or simply know more about other parts of the world.

## II. PROS AND CONS OF GLOBALIZATION

Let's go into a little more detail on what the pro and anti-globalizers have to say. If you hear each side, it is not difficult to get persuaded by both, depending on who you read or heard last! No doubt the debate is quite confusing.

*The proglobalizers say:*

- Globalization is good because it *increases trading opportunities* among nations, helps exporters earn more, consumers to buy cheaper goods, and via second round effects raises the income of others also
- Globalization is good because it *capital tends to flow where its returns are more*—that means higher foreign investment in capital scarce countries like India. Why is that good? Because it brings with it money, higher wages, skills, technology, jobs
- Globalization is good because it *allows labor surplus countries to export labor abroad* (if foreign governments allow it). In the case of India, good examples are programmers and nurses going to the U.S. and construction workers, engineers and teachers to the Middle East. This means not only that our residents earn more but that they send money home to their relatives or for investing in their home country. Many times they come back and bring skills acquired abroad
- Globalization is good because it is associated with *technological innovations and reduced transportation and communications costs*. This helps raise productivity and the global standard of living, as we have seen over time
- Globalization is good because it has *improved our quality of life*—not merely in the variety and quality of goods and services we buy but also in improving our health and education and our knowledge about the world and beyond

*What do the antiglobalizers have to say?*

- Globalization is bad because it has led to a *worsening of the world income distribution*, with the developing countries worse off than before
- Globalization is the *cause of economic crises in poor countries*—number of crises around the world is rising over time, affecting the poorer countries more
- Globalization is unfair because *richer countries benefit more than the poorer ones*. There are two reasons: first, the rich countries have a bigger voice in international fora, and second, the richer countries trade goods whose prices are high or rise, while poorer countries trade those goods whose prices are low or falling (for example, primary commodities). It is also unfair when rich countries ask poor countries to open their markets but don't open their own markets to the main exports of poor countries. President Museveni of Uganda said, "*Globalization is the same old order with new means of control, new means of oppression, new means of marginalisation.*"

- Globalization *hurts the poorer sections of society more*. Industrial countries claim that, for example, blue-collar steel and textile workers lose their jobs, while in developing countries, technological improvements that are labor saving hurt the poor
- Globalization *worsens the environment and weakens labor and product quality*
- Finally, there are those who are protective of their cultural heritage and feel that *globalization leads to a loss of the local culture and ethnic values*

### III. FACTS

It is a fact that *globalization is proceeding at a rapid pace*, causing a lot of change around the world. Change creates uncertainty in the lives of people and that in itself creates concern. But then, globalization is not a new phenomenon. Since the industrial revolution at the end of the 18<sup>th</sup> century until World War I, the world was characterized by unprecedented economic growth and increasing global integration. It was only between the two world wars that countries closed their borders, resorting to protectionism and isolationist policies. It is well known that growth suffered a lot during this period. In the case of India, as Romila Thapar, a famous Indian historian, points out, Indians have been “inveterate travelers (and traders) for many millennia.” It was only following the British rule that “the ventures of the Indian merchant was curtailed.” In more recent times, India did not open up soon after World War II. It did starting somewhere around the mid-1980s.

*Many benefits of globalization were observed in the 20<sup>th</sup> century*. After the second World War, we again witnessed a period of increasing globalization and growth. Moreover, even as population exploded (2.25 billion in 1950 versus 6 billion now), *our longevity increased* from 40 years in 1950 to 64 years now in developing countries. Also, the gap in longevity between the rich and the poor countries has narrowed from 30 years to 10 years during the same period). *We eat more now* (daily calorie intake increased from 1900 in 1950 to 2700 calories in developing countries, with the difference between rich and poor countries also narrowing in this area). Finally, *more of us live in a free world* (the proportion of countries with some form of democratic governments rose from 28 percent in 1974 to 62 percent in 2000). Many of us Indians underestimate the value of democracy since we have not seen any other in our lifetime.

Comparing across countries, we find that *the globalizers, that is, those who opened up more and faster have registered the highest growth rates*. In post World War II, globalizers grew by 5 percent per year, industrial countries by 2 percent, and the nonglobalizers by 1.5 percent. Developing countries now account for one-third of world trade (compared to one-fourth in early 1970s), and manufactured exports account for nearly 80 percent of their exports

Not only that, but as you would expect the *fast growing countries have also been able to reduce their poverty more*. Countries that grew at 3 percent or more in per capita terms for sustained periods of time reduced poverty substantially, while those with less than 1 percent did not. Surjit Bhalla shows that the most dramatic fall in the number of the poor in India occurred since 1987—a period that coincides with rapid globalization in India. The reason is simple: without growth, you have no pie to distribute; faster growth generates more resources to finance anti-poverty programs and improve the infrastructure that the poor depend on. We, of course, know the story of the fast growing Asian countries like Korea, Singapore, and Thailand which witnessed a rapid decline in poverty rates as they grew.

*It is only partly true the global income inequalities have widened during the last century*. It depends on how you measure it. If you use the United Nations definition (that is, weight each country equally) global inequality worsened somewhat. However, there is new evidence that as many developing countries were catching up, this rising trend was arrested around 1980. But if you use the John Lennon (of the Beatles fame) definition in “Imagine there are no countries...” (that is, weight each country by their population) new evidence seems to point in the opposite direction. In industrial countries, within country inequality seems to have widened not as much due to increased openness but an increase in the wage gap between skilled and nonskilled workers that occurred with technological innovation. In developing countries the data is more mixed and often not available. For the fast growing Asian countries, the gap narrowed, while for countries in Africa, where there was slow or no growth, the gap widened.

*It is not true that poor countries are worse off than before*—not in absolute terms. The total number of the poor have declined in the last decade, despite the fact that population has grown during this period. The World Bank finds that between 1988 and 1998, the number of the poor have declined by 200 million. Using the World Bank’s definition, Sala-i-Martin, a Professor at Columbia University, finds that the number of the poor have declined by 400 million since 1974. Paul Krugman of MIT observes that, with greater world-wide communication and spread of media, the poor have become more visible now, not necessarily that the number of the poor has increased.

*It is not true that the average trade barriers in industrial countries are higher than in developing countries*. Barriers in developing countries are three to four times higher than in developed countries in industrial products; in agriculture they are about 20 percent higher. However, *it is true that the barriers that do exist in industrial countries (agriculture, textiles) are the ones that harm the developing countries the most*. Average tariff protection in agriculture in developed countries is nine times that in manufacturing. By some estimates, agricultural subsidies in developed countries amount in total to nearly 75 percent of the total GDP of Africa. This is quite shocking and a valid area of concern.

*It is not true that protectionism protects the poor.* In fact, protectionism is the main vehicle for protecting vested interests of the rich. Do you think that the poor, say in India benefited from high tariffs and subsidies? Arvind Panagariya, Professor at the University of Maryland, gives an excellent example. The food and fertilizer subsidies account for between 1 and 2 percent of India's GDP. Interestingly, *less than 5 percent* of the food subsidy currently goes to those below the poverty line. The main beneficiaries are rich farmers from three states (Punjab, Haryana, and Uttar Pradesh) and the inefficient fertilizer and food industries. Many developing countries hanker for preferential schemes from developed countries; this strategy does not pay off in the long run because there are limits to such schemes and because it prevents a country from becoming truly competitive world wide.

*It is true that the opening up of the capital markets has led to an increase in the volume and volatility of international capital flows.* It is a fact that most financing of developing countries now occurs via private capital rather than official capital. Total private inflows to developing countries rose to over \$100 billion per year in the early 1990s as compared to less than \$10 billion in the 1980s—a ten-fold increase. However, while it is true that crisis have tended to be larger, *it is not true that the number of crises has risen with globalization* if you compare the 1970s, 1980s, and the 1990s.

#### **IV. SQUARING THE CIRCLE: IF GLOBALIZATION IS GOOD, WHY ARE THERE ANTI-GLOBALIZERS?**

If I had confused you by the arguments, for and against globalization, I hope I have persuaded you by the facts that I presented that globalization is, on balance, good. But then, if globalization is beneficial, why have we do we see many anti-globalizers in the world?

*Let's look more carefully at the anti-globalizers.* Who are they? Where are they? Stanley Fischer summarized their characteristics very well. They can be divided into two camps. *Those that want better globalization and those that want to isolate themselves*. To my mind, most developing countries that protest globalization fall into the former category. You will be surprised to know that President Museveni of Uganda who spoke so eloquently against globalization, led Uganda successfully through more than 10 years of global integration, market-oriented reforms and very high growth. His protests were mainly against protectionism in the North. He was in fact arguing for the North to open up and not for the South to close down. That, if the developing countries are opening their trade barriers, they want the industrial countries to get rid of tariffs and subsidies in those goods where the developing countries have a comparative advantage—mainly agricultural products and labor intensive manufacturing. The textile industry is a good example. Fair point. The policy implication is not that we should close our borders but that we should become more vocal in ensuring fairness across countries.

Now, *let's look at the isolationists. In industrial countries, this is the group which is hurt by the exports of developing countries.* Under the pretense of environmental and quality standards, they would like to preserve the vested interests of a small group in rich countries. I have no sympathy for them and neither should you. If you look carefully, you will note that *the so called anti-globalizers of developing countries are on the opposite side of many anti-globalizers of industrial countries.* Strange that they march together in protest against international institutions like the World Bank and the IMF!

Next, let's look carefully at the *isolationists of the developing countries.* These are leaders who want protectionism, either consciously or subconsciously, because it hurts the rich not the poor of their countries. The post-independence anti-monopoly (MRTP) act in India, despite its intended purpose of restricting the profits of large corporations, actually helped preserve them. Not only that, it prevented quality products from being produced or imported.

Finally, let me add a third set of isolationists. I hesitate to call them isolationists, so I will simply call them "*pseudo-isolationists.*" These are governments who want to blame the global markets for *problems created by themselves in their own countries.* These are also people who think *it is fashionable to protest against the rich countries in support of the poor.* I am not saying that there aren't protestors with genuine cases. But if you look at the profile of the anti-globalization protests in industrial countries, you hardly see a handful of those from low income countries. They are a very diverse lot on the issues they are against and sometimes don't even know why they are protesting! In the spring of 2000, I mingled with the protestors in Washington DC. and talked with many of them. One even reminisced about the 1960s, acknowledging that there weren't that many good causes to fight for anymore.

Before I move on, let me point out an interesting viewpoint that one reads these days. Those that find it hard to accept that globalization can be good define fast growing countries as slow globalizers. This is best illustrated by an example. Some such as Dani Rodrik and Joe Stiglitz say that China, the fastest growing economy since 1979, and India, the recent bloomer, are not globalizers because they did not adopt all market oriented reforms at the same time. But how is it possible that China and India are not globalizers? Their trade grew even faster than their per capita income! More importantly, globalization does not mean that you have to open up all the markets at the same time. The sequencing, pace, and areas of liberalization do matter. For example, opening the capital account too fast can be harmful. That can wait until domestic reforms, especially of the financial sector has occurred. But here, too, one has to be careful. This should not be used as a means to delay domestic reforms either.

## V. ROLE OF THE IMF

Where does the IMF fit into all this? The answer is that because markets, including global markets, are not perfect there is a role for such institutions. What role does the IMF play?

First, *the IMF is a good forum for representing the interests of all countries*. A place where information and ideas are exchanged and decisions are taken. The IMF's Managing Director repeatedly espouses the cause of developing countries by urging the industrial countries to open their markets and remove subsidies and tariffs.

Second, for countries that do not have technical expertise in certain areas, such as in central banking, in reforming the financial sector, or in fiscal expenditure management, *the IMF provides technical assistance to help build domestic institutions*.

Third, many low-income countries want to undertake reform but are financially constrained. *The IMF extend loans, on more or less concessional terms, for short or medium term, depending on the needs*. What's more, it helps facilitate bilateral aid from donor countries.

Fourth, the IMF *gives policy advice to member countries*. In so doing, it brings cross country experience in undertaking economic reforms, such as in trade liberalization, exchange rate regimes, and adjusting to external shocks. The last is particularly important for countries that are primary commodity-dependent and whose prices have been on a trend decline.

Fifth, when countries experience financial crisis, *the IMF provides short term financing to tide over the crisis period and to bring the economies back on track*. You have seen that in Mexico in 1994, in Asia in 1997, Russia in 1998, and Latin America in more recent times.

Sixth, *IMF provides a framework to work out sovereign debt problems*, either by greater private sector involvement, relevant for emerging markets (a new proposal by the IMF's First Deputy Managing Director, Anne Krueger, is under discussion) or by greater official involvement, relevant for low income countries (the HIPC initiative).

Finally, sometimes reforms and financial crises cause pain to certain sections of the society. The IMF not only provides temporary financial support but also *helps design social safety nets to tide over the difficult period*.

So, if we do all these wonderful things why is the IMF under so much attack? In part, "the controversies over the Fund are a mark of its unique role in the international financial system," Stanley Fischer, the IMF's former First Deputy Managing Director, explains. "Because the Fund makes decisions, because those decisions are frequently taken at a time

of crisis in a member country, and because there are differing views on those decisions, it is inevitable that the Fund will be at the center of controversy... That is simply a fact of life that those who have the responsibility for making decisions have to accept.” But it is also true that the Fund has often served as the scapegoat for politicians who implement politically difficult domestic reforms.

## VI. CONCLUSION

As we have seen, countries that globalize benefit more than those that do not. However, it is true that globalization in itself does not guarantee a better standard of living for everyone. What is undeniable, of course, is that it gives you more choices: what to eat or wear, where to travel or study or work. How can one argue that more choices are bad? What you do with the opportunities is your business. Not only at the country level but at each individual level. If you close yourself, you not only deprive yourself from material improvements in life but also the intangibles—the wide ranging exposure to the diverse culture that the world has to offer. You also have the choice to reject them if you wish. In short, *globalization expands your opportunity set. Take what you want and leave the rest.*

Many of you have asked, “But what about the poor that are marginalized because they are neither educated nor part of the market economy?” In this case, you need to go after your own government to ensure that everyone is educated and given the opportunity to partake the benefits of globalization. These governments also need to make sure that those who are poor and hurt during the transition have a public safety net to fall back on. Of course, don’t forget to go after the industrial countries to ask for fair trade—and I must confess that I believe much more in trade than aid from what I saw in India. Aid creates its own dependencies that are not necessarily good. But it is faulty reasoning if you believe that globalization *causes* the lack of education or opportunity of the poor. It is just that the inequities become more apparent as those that have the opportunity benefit more than others. Still, even the most unskilled and the poor seem to benefit if there are significantly large gains—this is what I observed during my trip to South India. So, let me conclude by paraphrasing Joe Stiglitz: *I have seen the beneficial effects that globalization can have on developing countries—especially on the poor.*