A person in a dark suit is holding a globe. The globe is the central focus, showing continents in a light brown color against a darker background. The person's hands are visible, one supporting the globe from below. The background is a plain, light-colored wall.

# GEORGE SOROS

ON

GLOBALIZATION

*"George Soros has written a brilliant,  
powerful book."*

—NEW YORK REVIEW OF BOOKS



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*Underwriting Democracy*

*Opening the Soviet System*

*The Alchemy of Finance: Reading the Mind of the Market*

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GEORGE  
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GLOBALIZATION



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# Preface

My goal in writing this book is not only to shed light on how global capitalism works but also suggest ways in which it could be improved. For this purpose, I have adopted a rather narrow definition of globalization: I equate it with the free movement of capital and the increasing domination of national economies by global financial markets and multinational corporations. This approach has the advantage of narrowing the focus of discussion. I contend that globalization has been lopsided: The development of our international institutions has not kept pace with the development of international financial markets and our political arrangements have lagged behind the globalization of the economy. Based on these premises I have formulated a set of practical proposals that would make global capitalism more stable and equitable.

I was stimulated to embark on this undertaking by what I saw as an unwitting alliance between market fundamentalists on the far Right and antiglobalization activists on the far Left. They make strange bedfellows, but between them they are well on their way to downsizing or destroying the international institutions we currently have. My goal in writing this book was to form a different kind of coalition whose mission would be to reform and strengthen our international institutions and create new ones where necessary to address the social concerns that have fueled the current discontent. Admittedly, our existing international financial and trade institutions (IFTIs)<sup>1</sup> have some defects; and all institutions do. That is a reason to improve them, not to destroy them.

I believe I have some unusual qualifications for this project. I have been a successful practitioner of global financial markets, giving me an insider's view of how they operate. More to the point, I have been actively engaged in trying to make the world a better place. I have set up a network of foundations devoted to the concept of open society. I believe that the global capitalist system in its present form is a distortion of what ought to be a global open society. I am only one of many experts on financial markets, but my active concern with the future of humanity sets me apart from most others. I have spent most of the last five years studying the defects of globalization and have written several books and articles on the subject. My last book, *Open Society: Reforming Global Capitalism*, was rather weak, however, when it came to prescribing solutions. This book is meant, in part, to make up for that deficiency.

I am often told that there is some kind of contradiction between profiting from global financial markets and trying to reform them. I do not see it. I am passionately interested in improving the system that has allowed me to be successful so that it will become more enduring. My interest predates my involvement in the financial markets. Having been born a Jew in Hungary in 1930, I lived through both Nazi and Soviet occupation. I learned at an early age how important it is to your well-being and survival what kind of political regime prevails. As a student at the London School of Economics, I was greatly influenced by the philosophy of Karl Popper, author of *Open Society and Its Enemies*.<sup>2</sup> As soon as I was successful enough as a hedge fund manager, I set up a foundation, the Open Society Fund (now Open Society Institute), to “open up closed societies, help make open societies more viable and foster a critical mode of thinking.” That was in 1979. At first, the foundation focused on opening up closed societies; then, after the collapse of the Soviet empire, on fostering the transition from closed to open societies; and more recently on addressing the ills of global capitalism. This book is the natural outgrowth of that engagement.



In trying to build a coalition for reforming and strengthening our IFTIs, I faced a difficulty: It is always easier to mobilize the public *against* something than *for* something. A constructive agenda must be general enough to meet people's aspirations yet specific enough to allow a coalition to coalesce around it. Such an agenda cannot be developed by an individual on his own. Accordingly, I circulated my book in draft form among a broad range of people and asked for their reaction. I received many valuable comments and criticisms, and I incorporated those suggestions that I considered well founded in the finished product. I believe the book in its final version puts forward a constructive agenda that the public could support and the governments of the world implement. The centerpiece of the book is a proposal to use Special Drawing Rights (SDRs) for the provision of public goods on a global scale. The scheme will not cure all the ills of globalization—nothing will—but it should help to make the world a better place.

I was well along in the process of distilling a finished product when the terrorists struck on September 11, 2001. That event created a fundamentally new situation. I felt that the book as it stood then did not go far enough. It was confined to a set of proposals that I considered practical prior to September 11, but it did not spell out the vision of a global open society that has motivated me. The present moment is auspicious for gaining a hearing for that concept. It is not enough to wage war on terrorism; people also need a positive vision of a better world ahead.

September 11 has shocked the people of the United States into realizing that others may regard them very differently from the way they see themselves. They are more ready to reassess the world and the role that the United States plays in it than in normal times. This provides an unusual opportunity to rethink and reshape the world more profoundly than would have been possible prior to September 11.

Accordingly I have decided to add a conclusion to the book outlining my vision of a global open society. It differs in texture from the rest of the book. It is more a polemical tract than a considered report on the deficiencies of global capitalism; more an abstract vision than a set of practical proposals. I intend to elaborate it further in due course. More importantly, the conclusion still needs to go through the critical process to which the rest of the book has already been exposed. Indeed, it needs it more because it discusses subjects about which I know much less than I do about the global financial system.

I was of two minds about including the conclusion because my goal in writing the book was to build a broadbased consensus, and the conclusion may endanger that objective. The SDR proposal in particular will require the support of the United States to be implemented, yet my conclusion is highly critical of the Bush administration's unilateral, hegemonic approach to international affairs. In the end, I decided to put my trust in the public that I seek to mobilize. People need not agree with all my views in order to support the SDR proposal, and if the public supports it, a democratic government must respect the will of the people even if it dislikes my criticism.

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## Acknowledgments

This book was written in an interactive manner. I distributed nearly one thousand copies of a “Draft Report on Globalization,” discussed its contents at a number of meetings, and received a large number of written comments. Based on this feedback, I revised the text of the report to create this book. I should like to use this occasion to thank everyone who contributed their comments and criticisms, for I found them immensely valuable. Everyone will be able to judge for themselves to what extent I have taken their comments to heart, but for me, the process was both instructive and enjoyable. I take so much responsibility for the final product.

I am particularly grateful to Fred Bergsten of the Institute for International Economics who gathered a highly qualified audience to a luncheon discussion, and to Carl Tham of the Olof Palme International Center in Stockholm, who arranged a panel discussion with Joe Stiglitz, Amartya Sen, Candido Grzybowski, and Susan George on short notice. The Central European University held a three-day seminar on Globalization in Budapest in partnership with the University of Warwick, and I had an opportunity to present my ideas at a luncheon meeting at the Brookings Institution, a meeting of the Group of Thirty, a retreat of the International Monetary Fund Board, a seminar of the London School of Economics, and the initial meeting of the State of the World Forum Commission. The Council on Foreign Relations arranged a small workshop on the Special Drawing Rights (SDR) proposal with the participation of Charles Calomiris, Morton Halperin, Robert Hormats, Rogo Kubarych, Geoff Lamb, Karin Lissakers, Allan Meltzer, Edmund Phelps, Benn Steil, Edwin Truman, Paul Volcker, and Michael Weinstein. I also held a number of meetings with government officials, members of Congress and people associated with my foundations.

I have received written or verbal communications from a large number of people, including: Morton Abramowitz, Martti Ahtisaari, Graham Allison, Anders Aslund, Byron Auguste, Terrice Bassler, Michael Ben-Eli, Fred Bergsten, Jagdish Bhagwati, Gavin Bingham, Alan Blinder, Emma Bonino, Jack Boorman, Leon Botstein, Mark Malloch Brown, Michel Camdessus, Thomas Campbell, Geoffrey Canada, William Cline, Robert Conrad, George Cowan, Bob Deacon, Philippe de Schoutheete, Tervarent, Joan Dunlop, Jessica Einhorn, Yehuda Elkana, Gareth Evans, Jonathan Fried, Jim Garrison, William Goetzmann, John Gray, John Grieve Smith, Wilfried Guth, Morton Halperin, Eveline Herfkens, Carla Hills, Robert Hormats, David Howell, Michael Ignatieff, Michael Jendrzeczyk, William Jordan, Miguel Kiguel, Mervyn King, Neil Kinnock, Horst Kohler, Charles Kolb, David Korten, Justin Leites, Jerome Levinson, Anatol Lieven, Mahmoud Mamdani, Paul Martin, Charles Maynes, Federico Mayor, William McDonough, Allan Meltzer, Michael Moore, Bill Moyers, Arye Neier, Andre Newburg, Sylvia Ostry, Jim Ottaway, Thomas Palley, Stewart Paperin, Christophe Patten, Maurice Peston, Jacques Polak, Gustav Ranis, Anthony Richter, Dani Rodrik, Alex Rondinelli, David Rothman, Barney Rubin, Richard Ruffin, Andrew Sacher, Gary Sampson, Robert Scalapin, Tim Scanlon, Pierre Schori, Klaus Schwab, Amartya Sen, Jaime Serra, Clare Short, John Simon, Kiril Sokoloff, Valery Soyfer, Herb Sturz, Daniel Tarschys, James Tobin, Frank Vogl, Lori Wallach, John Williamson, Mabel Wisse Smit, James Wolfensohn, Richard Wyatt, and Violetta Zentai. My apologies to those whom I failed to mention.

Karin Lissakers acted as my advisor and resident expert on SDRs. Yvonne Sheer did much more than type innumerable versions of the text; she coordinated the project and did a lot of fact checking.

Peter Osnos of PublicAffairs acted as more than a publisher; he was an integral part of the project. ~~Paul Golob and Robert Kimzey, also of PublicAffairs, managed the publishing part with their usual~~ efficiency. Michael Vachon was in charge of communications. Robert Boorstin provided a critical voice. It was a pleasure to work with them all.

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# INTRODUCTION

## The Deficiencies of Global Capitalism

*Globalization* is an overused term that can be given a wide variety of meanings. For the purposes of the present discussion, I shall take it to mean the development of global financial markets, the growth of transnational corporations, and their increasing domination over national economies. I believe that most of the problems that people associate with globalization, including the penetration of market values into areas where they do not traditionally belong, can be attributed to these phenomena. One could also discuss the globalization of information and culture; the spread of television, Internet, and other forms of communication; and the increased mobility and commercialization of ideas, but I am afraid that would take us too far afield. By narrowing the discussion in this way, I hope I can keep it within manageable bounds and produce some practical proposals for institutional improvements.

Globalization as defined here is a relatively recent phenomenon that distinguishes the present day from 50 or even 25 years ago. At the end of World War II most countries strictly controlled international capital transactions. The Bretton Woods institutions, the International Monetary Fund (IMF), and the World Bank were designed to facilitate international trade and investment in an environment of restricted private capital flows.<sup>4</sup> Controls on capital movements were gradually removed, and offshore financial markets expanded rapidly under the impetus of the oil crisis in 1973. International capital movements accelerated in the early 1980s under Ronald Reagan and Margaret Thatcher, and financial markets became truly global in the early 1990s after the collapse of the Soviet empire.

This is not the first period in which international financial markets have played such a dominant role. Similar conditions prevailed prior to World War I. International capital movements were disrupted first by World War I and then by the Great Depression of the 1930s. Clearly, the process is not irreversible.

The salient feature of globalization is that it allows financial capital to move around freely; by contrast, the movement of people remains heavily regulated. Since capital is an essential ingredient of production, individual countries must compete to attract it; this inhibits their ability to tax and regulate it. Under the influence of globalization, the character of our economic and social arrangements has undergone a radical transformation. The ability of capital to go elsewhere undermines the ability of the state to exercise control over the economy. The globalization of financial markets has rendered the welfare state that came into existence after World War II obsolete because the people who require a social safety net cannot leave the country, but the capital the welfare state used to tax can.<sup>5</sup>

This outcome is not accidental. It was the objective of the Reagan administration in the United States

and the Thatcher government in the United Kingdom to reduce the ability of the state to interfere with the economy, and globalization served their purpose well.

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The transformation that has occurred since the 1980s is not well understood. It is not even generally acknowledged.<sup>6</sup> Capital has always been eager to avoid taxation and regulation, so it is easy to interpret the current tendency to reduce taxation and regulation as merely the manifestation of universally and timelessly valid economic laws. That is, in fact, the dominant view at least in the English-speaking world. I have called it *market fundamentalism*. It holds that the allocation of resources is best left to the market mechanism, and any interference with that mechanism reduces the efficiency of the economy. Judged by the criteria of market fundamentalism, globalization has been a highly successful project.

Globalization is indeed a desirable development in many ways. Private enterprise is better at wealth creation than the state. Moreover, states have a tendency to abuse their power; globalization offers a degree of individual freedom that no individual state could ensure. Free competition on a global scale has liberated inventive and entrepreneurial talents and accelerated technological innovations.

But globalization also has a negative side. First, many people, particularly in less-developed countries, have been hurt by globalization without being supported by a social safety net; many others have been marginalized by global markets.<sup>7</sup> Second, globalization has caused a misallocation of resources between private goods and public goods. Markets are good at creating wealth but are not designed to take care of other social needs. The heedless pursuit of profit can hurt the environment and conflict with other social values. Third, global financial markets are crisis prone. People living in the developed countries may not be fully aware of the devastation wrought by financial crises because, for reasons that will be explained later, they tend to hit the developing economies much harder. All three factors combine to create a very uneven playing field.

Market fundamentalists recognize the benefits of global financial markets but ignore the shortcomings. They hold that financial markets tend toward equilibrium and produce the optimum allocation of resources. Even if markets are less than perfect, it is considered better to leave the allocation of resources to the markets rather than to interfere with them through national or international regulation.

It is dangerous, however, to place excessive reliance on the market mechanism. Markets are designed to facilitate the free exchange of goods and services among willing participants, but they are not capable, on their own, of taking care of collective needs such as law and order or the maintenance of the market mechanism itself. Nor are they competent to ensure social justice. These “public goods” can only be provided by a political process.

Political processes generally speaking are less efficient than the market mechanism, but we cannot do without them. Markets are amoral: They allow people to act in accordance with their interests, and they impose some rules on how those interests are expressed, but they pass no moral judgment on the

interests themselves. That is one of the reasons why they are so efficient. It is difficult to decide what is right and wrong; by leaving it out of account, markets allow people to pursue their interests without let or hindrance.

But society cannot function without some distinction between right and wrong. The task of making collective decisions about what is allowed and what is forbidden is left to politics—and politics suffers from the difficulties of reaching collective decisions in a world that lacks a strong moral code. Even the creation and maintenance of markets requires political action. This point is well understood by market fundamentalists. What is less well recognized is that the globalization of markets without corresponding strengthening of our international political and social arrangements has led to a very lopsided social development.

In spite of its shortcomings, I am an ardent supporter of globalization. I support it not only because of the extra wealth it produces but even more because of the freedom it can offer. What I call a *global open society* could ensure a greater degree of freedom than any individual state. I consider the present arrangements in which capital is free to move around but social concerns receive short shrift as a distorted form of a global open society. The purpose of this book is to identify the distortions and propose some practical steps toward correcting them.

Institutional reforms are needed in the following areas:

1. To contain the instability of financial markets;
2. To correct the built-in bias in our existing international trade and financial institutions (IMF, WTO) that favors the developed countries that largely control them;
3. To complement the World Trade Organization (WTO), which facilitates wealth creation, with similarly powerful international institutions devoted to other social goals, such as poverty reduction and the provision of public goods on a global scale; and
4. To improve the quality of public life in countries suffering from corrupt, repressive, and incompetent governments.

The penetration of market values into areas where they do not properly belong also must be addressed. But that cannot be accomplished by institutional reforms alone; it requires a reorientation of our values. For instance, professions such as medicine, law, and journalism have been turned into businesses. I recognize the problem, but in this book I concentrate on institutional reforms.

There is no consensus on the need for institutional reforms. Market fundamentalists are liable to object to the first three points, and antiglobalization activists are strangely blind to the fourth. Bad governments are a major source of poverty and misery in the world today. (Bad location is the other major source, but it is much harder to do anything about that.) Yet antiglobalization activists have failed to give adequate weight in their advocacy to the harm done by bad governments.

Globalization is not a zero sum game. The benefits exceed the costs in the sense that the increase in wealth produced by globalization could be used to make up for the inequities and other shortcomings of globalization and there would still be some extra wealth left over. The point is difficult to prove because the costs and benefits cannot be reduced to a common denominator: The GDP is not an appropriate measure of human welfare.<sup>8</sup> Nevertheless, all the evidence indicates that the winners

could compensate the losers and still come out ahead. The trouble is that the winners do not compensate the losers. There is no international equivalent of the political process that occurs within individual states. While markets have become global, politics remain firmly rooted in the sovereignty of the state.

Far too few resources have been devoted to correcting the deficiencies of globalization. As a result, the gap between the rich and the poor continues to grow. The richest 1 percent of the world population receive as much as the poorest 57 percent. More than a billion people live on less than a dollar a day; nearly a billion lack access to clean water; 826 million suffer from malnutrition;<sup>9</sup> 1 million die each year for lack of the most basic healthcare.<sup>10</sup> These conditions were not necessarily caused by globalization, but globalization has done little to redress them.

The inequities of globalization have given rise to widespread resentment and protest. Antiglobalization activists seek to undermine or destroy the international institutions that sustain international trade and global financial markets. Our international institutions are also threatened from the opposite direction. Market fundamentalists are opposed to any kind of interference with the market mechanism; indeed, their hostility to international institutions is even greater than their aversion to government regulation.

The unwitting coalition between the far Left and the far Right has succeeded in weakening the few international institutions we have. The antiglobalization movement has been attacking the IFTIs and particularly the WTO, while the U.S. Congress has been obstructing primarily the United Nations (UN) and only secondarily the IFTIs.

That is a pity. We need stronger international institutions, not weaker ones. We need to form a different coalition whose aim is to reform and strengthen our international arrangements, not destroy them. The purpose of this book is to propose an agenda around which such a coalition might coalesce.

The institutions that sustain international trade and global financial markets are relatively strong. They do need some reforms because they are being operated for the benefit of the rich countries that are in control, often to the detriment of the poor ones that are at the periphery of the system. But they are more effective and better endowed than the international institutions dedicated to other objectives, such as the preservation of peace, social and political development, improvement of health and labor conditions, and human rights.

The UN, which is the most important international institution other than the IFTIs, proclaims its noble intentions but does not possess either the means or the power to translate those intentions into reality. Its noble goals are expressed in the Preamble of the Charter, which is couched in terms of "We the People." But the Charter itself is based on the sovereignty of the member states, and the interests of the sovereign state do not necessarily coincide with the interests of the people who inhabit it. Many states are not democratic, and many inhabitants are not even citizens. As a result, the UN cannot possibly carry out the mission enunciated in the Preamble. It is a useful institution, and it could be made even more useful, but if it is judged by its Preamble it is bound to disappoint. In relying on the UN we must always remember that it is an association of states. As Cardinal Richelieu observed in the

seventeenth century and Henry Kissinger has reasserted more recently, states have interests but not principles.<sup>11</sup> Accordingly, member states tend to put their national interests ahead of the common interest, and that is a serious impediment to the functioning of the UN.

The most powerful element of the UN is the Security Council, because it can override the sovereignty of the member states. Only the five permanent members of the Security Council have veto rights; when they agree, they can impose their will on the rest of the world, although this does not happen very often. In effect, the UN combines two institutions within one framework: the Security Council, which takes precedence over the sovereignty of states, and the rest, which is subordinated to it. The need for unanimous consent renders the rest both ineffective and inefficient: The General Assembly is a talking shop, and the various agencies are hobbled by the need to accommodate the demands of the member states. They also serve as a patronage preserve for superfluous diplomats and out-of-power politicians.<sup>12</sup>

After the collapse of communism there was a fleeting moment when the Security Council could have functioned the way it was originally meant to, but the Western powers did not rise to the occasion. In the Bosnian crisis they could not agree among themselves, and in the Rwandan crisis they failed to act altogether. In recent years the United States failed to pay its dues and has bypassed or deemphasized the UN in other ways. Even after September 11, the United States has sought to act outside the UN whenever possible.

The disparity between our IFTIs and our international political institutions has rendered the development of our global society extremely lopsided. International trade and global financial markets are very good at generating wealth, but they cannot take care of other social needs, such as the preservation of peace, alleviation of poverty, protection of the environment, labor conditions, and human rights—what are generally called “public goods.” Economic development, that is, the production of private goods, has taken precedence over social development, that is, the provision of public goods. This distortion can be corrected only by making better arrangements for the provision of public goods. In this context, it is important to remember that international trade, well-functioning markets, and wealth creation in general are also public goods. Antiglobalization activists are woefully misguided when they try to destroy the IFTIs that ensure these public goods. To “sink or shrink” the WTO would be counterproductive; it would destroy the goose that lays the golden eggs. Instead of agitating *against* the WTO, they ought to be fighting *for* equally effective institutions that would serve the social goals that they seek.

The WTO has decided to engage in a new round of negotiations, to be called the Development Round. This ought to be accompanied by a similar round of negotiations aimed at the provision of other public goods. The needs are well known. The Millennium Summit of the UN, held in September 2000, spelled out ambitious but attainable Millennium Development Goals for poverty reduction, disease control, improved health, and universal primary education by the year 2015. The UN is holding an international conference on Financing for Development in Monterrey, Mexico, in March 2002. This conference ought to focus on the provision of public goods on a global scale. Without it, development is bound to remain lopsided.



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The task of the WTO is to facilitate the international exchange of goods and services among willing partners. It has accomplished this task by establishing binding rules and an effective enforcement mechanism. There are two potent reasons why the same approach cannot be used for the provision of other public goods. One is that many countries simply lack the resources to meet international standards and requirements. The other is that it would be difficult to find the kind of enforcement mechanism that works so well in trade, that is, the granting or withdrawing of market access. Instead there must be some financial incentives to encourage voluntary compliance with international rules and best practices. Withholding the incentives can then also serve as a penalty. This could be very helpful in a world where the sovereignty of states stands in the way of imposing rules on individual countries.

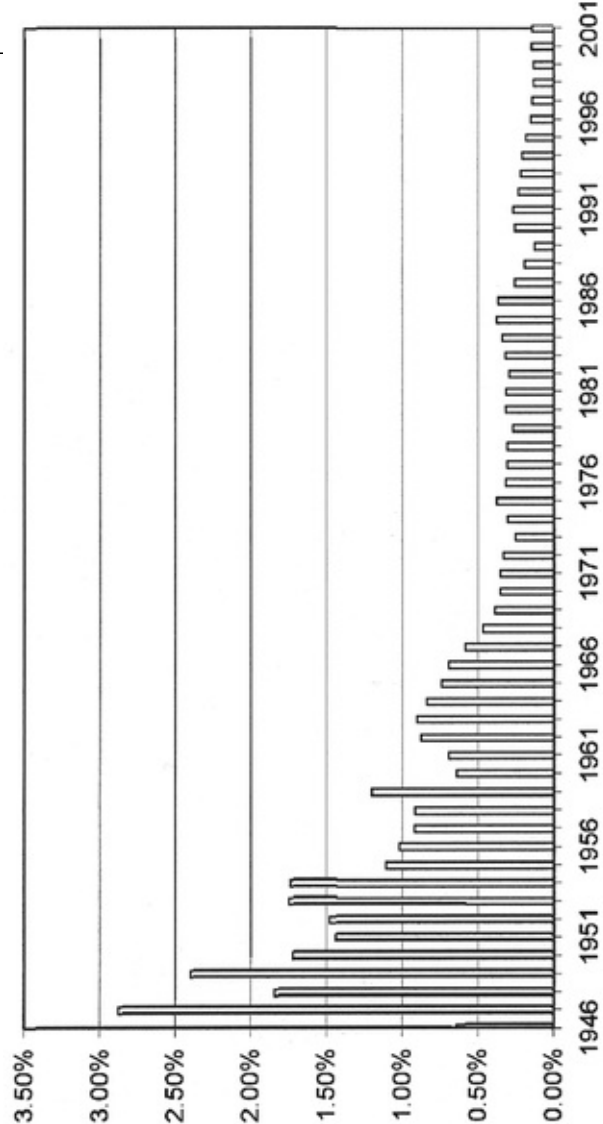
It is one of the main propositions of this book that the rules-based system of the WTO for the provision of private goods should be complemented by an incentives-based system for the provision of public goods.

Globalization cannot be held responsible for all our current ills. By far the most important causes of misery and poverty in the world today are armed conflict, oppressive and corrupt regimes, and weak states—and globalization cannot be blamed for bad governments. If anything, globalization has forced individual countries to improve their efficiency or at least to reduce the government's role in the economy. But globalization has made the world more interdependent and increased the damage that internal problems within individual countries can cause. So it is not enough to devise better arrangements for the provision of public goods on a global scale; we must also find some ways to improve political and social conditions within individual countries. That is the second main contention of this report.

The terrorist attacks on September 11 have brought home to us in a tragic fashion how interdependent the world has become and how important it is for our security what internal conditions prevail in other countries. Bin Laden could not have unleashed his attack on the United States without enjoying safe haven in Afghanistan. But the same was true prior to September 11. Ever since the end of the Cold War, most crises that have led to bloodshed were caused by internal conflicts rather than conflicts between states. During the Cold War internal conflicts were exploited but also contained by the two superpowers. After the end of the Cold War the constraints imposed by the superpowers were removed, and the conflicts had to deteriorate into bloodshed before they attracted outside intervention.

This is because outside intervention has been largely confined to punitive actions. Positive inducements have been scarce. After the end of World War II, the United States inaugurated the Marshall Plan, with lasting benefits for Europe. There were no similar initiatives after the collapse of the Soviet empire. Foreign aid amounts to a measly 0.1 percent of the GDP of the United States compared to almost 3 percent at the start of the Marshall Plan. The progression of foreign aid as a percentage of GDP does not present a pretty picture (see chart 1).

Chart 1 : Progression of U.S. Foreign Aid as a Percentage of GDP 1946-2001



Source: The Congressional Budget Office, December 2001.

Preventive action based on positive incentives is much to be preferred to intervention after a crisis has erupted. It is less expensive and causes much less human suffering. Experience shows that crisis prevention cannot start too soon. Early intervention may not grab headlines—it has been said, “a crisis aborted is rarely reported.” By the time tensions have led to bloodshed, it becomes increasingly difficult to prevent further bloodshed. Even a country like the United States where the rule of law prevails, is subject to the pressures for vengeance. But in the early stages it is difficult to predict which grievance is going to lead to deadly conflict. This is a powerful argument in favor of fostering what I call *open societies*, where grievances can be aired and institutions exist for addressing them. Conflicts can arise in open societies as well, but they are less likely to deteriorate into bloodshed. It is a vital security interest of the United States and other democracies to improve the quality of governments and foster open societies throughout the world. Fostering open societies cannot take the place of military power, but it can reduce the prospects of having to employ military power.

Democracy and open society cannot be imposed from the outside because the principle of sovereignty stands in the way of outside interference. It can be promoted only by strengthening civil society and offering incentives to governments to move toward economic and political reforms.

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The two propositions that underpin this book have a common denominator: Both the provision of public goods and the improvement of internal conditions require some resource transfers from the rich countries to the poor. This goes against the grain of market fundamentalism, which claims that free markets, left on their own, will ensure the optimum allocation of resources.

The resource transfers offered by the existing IFTIs are inadequate. Most of the IMF's money is used to rescue countries after a crisis has erupted. The main business of the World Bank is lending; its grantmaking capacity is largely limited to the profits generated by its lending activity. The WTO is not concerned with resource transfers at all. The IFTIs could play a more constructive role than they do at present—this will be discussed in chapters 1, 3, and 4—but there is a need for a new form of international resource transfer operating along different lines from the existing IFTIs. That is the missing component in the current institutional arrangements. It is the centerpiece of this book, and it will be developed further in chapter 2.

It will be very difficult to get the rich countries to engage in resource transfers on an institutional basis. It has been more than 30 years since the Pearson Commission set—and the UN endorsed—the target of 0.7 percent of GDP for official development assistance from donor countries. Only five countries meet or exceed that target;<sup>13</sup> in 2000, the U.S. contribution was only 0.1 percent, and total official development assistance reached merely 0.24 percent of the GDP of the developed countries. The biggest culprit in the shortfall is the United States.

It is not by accident that international resource transfers are running so far below the 0.7 percent of GDP target or that the United States stands lowest among the developed countries. There is a strong, long-held belief, particularly in the United States, that foreign aid is ineffective and sometimes even counterproductive. What is worse, this concern is not without foundation.

I feel well qualified to discuss the subject because I have been personally engaged in providing foreign aid on a significant scale—roughly \$425 million annually in the last five years—for the promotion of open societies. In that capacity I am intensely aware of the shortcomings of foreign aid as it is currently administered. I am convinced, on the basis of my own experience, that its effectiveness and impact could be greatly improved if it were administered differently. Moreover, I am not the only one who is aware of the shortcomings. Serious efforts have been made in recent years by aid institutions, including the World Bank, the Organisation for Economic Cooperation and Development (OECD), bilateral donors, and outside experts, to evaluate and improve effectiveness of the aid, and a new paradigm is gradually emerging.<sup>14</sup> It is built around giving the recipients a great sense of ownership and participation in the programs that are supposed to benefit them, as well as reinforcing success.

As I see it, foreign aid as it has been traditionally dispensed suffers from five main defects:

- First, foreign aid serves the interests of the donors, rather than those of the recipients. The provision of aid is often directed by national security interests based on geopolitics.

considerations, without regard for the level of poverty or the character of the recipient government. Aid to Africa during the Cold War provides some egregious examples. After the fall of the Berlin Wall, West Germany—eager to secure reunification—gave or lent large amounts of money to the Soviet Union, with little regard for how it was spent. Later, Ukraine became a geopolitical pensioner of the West. Since bad government is the major cause of poverty, it would be far better if donors paid more attention to political conditions inside the countries they support.

- A second, related point is that recipients rarely have ownership of development projects, which are designed and implemented by outsiders. When the experts leave, not much remains. Programs that are imported rather than home grown often do not take root.<sup>15</sup> Countries like [Cuba](#) channel aid through their own nationals—who also act as a constituency supporting foreign aid. Even international institutions prefer to send foreign experts rather than build domestic capacity. The experts are accountable to those who pay them. Nobody, with the exception of my foundations and more recently the United Nations Development Programme (UNDP), is willing to pay for experts who are accountable to the recipients of aid. As a result, recipients often lack the capacity to absorb aid.
- Third, foreign aid is usually intergovernmental. Recipient governments often act as gatekeepers, diverting funds to their own purposes. In some cases, aid becomes the main source of support for otherwise unpopular governments.
- Fourth, donors insist on retaining national control over the aid they provide, resulting in a lack of coordination. When donors compete to deliver aid, it is easier for the recipient government to divert the resources for its own purposes. This was the case in Bosnia, where international aid was largely wasted and served to feed local fiefdoms.
- Finally, it is not acknowledged that international assistance is a high-risk enterprise. It is much harder to do good than to run an enterprise for profit. That is because there is no single measure of the social benefit, while profits are shown in the bottom line. Yet aid is administered by bureaucrats who have much to lose and little to gain by taking risks. No wonder the results are so lackluster, especially when they are judged by the same standards as other bureaucratic activities and without any allowance for the difficulties involved. It is all the more remarkable that foreign aid has actually produced some positive results in transition countries—for instance in helping central banks, financial markets, or the judiciary function. This goes to show that in spite of all its shortcomings, foreign aid can be very valuable.

My foundation network works along different lines. Its mission is to foster the development of open societies. Whatever other merits or faults it may have, it is clearly intended to serve the interests of the recipients. To the extent possible, it is managed by nationals of the countries in which it operates. A board composed of nationals decides on the priorities. They work with the government when they can and independently of the government when they cannot; sometimes they are in outright opposition. When foundations can cooperate with the government, they can be more effective; when they cannot, their work is more needed and more appreciated because they offer an alternative source of funding for civil society. As a general rule, the worse the government, the better the foundation because it enjoys the commitment and support of civil society.

Open society is often confused with civil society. Civil society is only one of the components of a

open society; a democratic government that is responsive to the needs and wishes of the electorate and a private sector that is largely independent of the government are equally important. When a foundation can work with the government, it seeks to improve the government's capacity and make it more responsive to society. Governments that are receptive to that kind of assistance tend to be overrun by donors. But the donors have their own agenda, and the government is capacity-constrained in dealing with them. Some of the most valuable assistance the foundations have given was to increase that capacity by enabling governments to engage experts of their own choosing (and preferably the own nationality).

In addition to national foundations, my foundation network also includes a number of network-wide programs dealing with specific program areas such as education, media, health, information, culture, the justice system, small and medium enterprise development, and so on. These programs operate through the national foundations, but the national foundations can decide whether to participate; if they do, they assume ownership and responsibility for the execution of the programs within the country.<sup>16</sup> The interaction between national foundations and network programs creates a matrix that combines local needs with professional expertise. The matrix is open ended. National foundations have discretion to operate outside the confines of network programs; they tend to do so in supporting civil society and culture. Network programs may also work with local institutions other than the national foundations; typically they do so in supporting human rights and independent media.

It would be clearly inappropriate to apply the same methods and criteria in a public undertaking as a private one. Nevertheless the approach of my foundation network could and should be adapted to government-financed international aid. I shall outline how that could be done in chapter 2. My proposal is based on a special issue of SDRs earmarked by the rich countries for international assistance according to certain rules.

Governments are unlikely to adopt the SDR proposal on their own; too many bureaucratic and political interests militate against it. But democratic governments are responsive to their electorate. That is why civil society must be mobilized. The time is ripe. The loose coalition of aid activists and church groups known as the Jubilee 2000 movement has fought successfully for debt forgiveness for the heavily indebted poor countries.<sup>17</sup> The governments of the G7 and the G20 countries are looking for ways to alleviate the problems created by globalization.<sup>18</sup> The UN's March 2002 International Conference on Financing for Development provides another suitable forum. The terrorist attack of September 11 has made public opinion in the United States more aware of the rest of the world, more receptive to new ideas and more compassionate. If the public demands it, the government can be expected to act.

Unfortunately, it is more difficult to mobilize civil society *for* something than *against* something. But the SDR proposal outlined in chapter 2 is concrete enough and reasonable enough to generate broad public support. This cannot be said about the proposals contained in the other chapters concerning the reform of our existing IFTIs. These are more arcane matters that must be dealt with by experts. But public pressure could be effective in calling for the authorities to act.

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# CHAPTER 1

## International Trade: The World Trade Organization

Economic theory has shown that—other things being equal—international trade benefits all parties. In practice, other things are rarely equal. In particular, the gainers from international trade rarely compensate the losers. Nevertheless, few people would question the benefits of international trade. Individual countries may seek, however, to derive additional benefits by imposing import restrictions or subsidizing exports. The injured parties are likely to retaliate, and if the process goes unchecked the benefits of free trade are likely to be lost. That is why it is so important to establish general rules by which all parties abide, and that is what the WTO has accomplished. This makes the WTO a very valuable institution. If it didn't exist, it would have to be invented.

The WTO is, in many ways, the most advanced and fully developed of our international institutions. It has been successful not only in creating international law but also in exercising a judiciary function. Moreover, it has found a way to enforce its judgments. The device used by the WTO is to authorize the injured country to retaliate unless it receives compensation or the practice is discontinued. This is a very effective device; in most other areas the sovereignty of states poses insurmountable obstacles to the enforcement of international law.

Because of these features, I have been a great admirer of the WTO—without actually knowing too much about it. In fact, the inner workings of the WTO are so complicated that when it came to discussing the organization, my eyes used to glaze over. But more recently, the WTO has come under concerted attack by a coalition of nongovernmental organizations (NGOs) and labor unions. This has forced me to look at the WTO more closely, and I found that its critics have some valid points.

There is very little wrong with the mechanism itself. The mission of the WTO is the rules-based liberalization of international trade, and it accomplishes that mission brilliantly. Indeed, given the fact that the organization of the WTO required the unanimous consent of the founding members, it must be acknowledged as an outstanding feat of lawyerly ingenuity. Nevertheless, the critics are right in claiming that the WTO is biased in favor of the rich countries and multinational corporations. This bias is due not to the mechanism of the WTO but to the way it has been used, and to the absence of similarly effective structures for the pursuit of other social goals such as the protection of the environment, labor rights, and human rights. I shall consider these two types of deficiencies in turn.

As regards the misuse of the WTO mechanism, two issues stand out. The first, and in terms of the sheer volume of trade most important, is the disparity in the treatment of developed and developing countries' products. The removal of tariff and non-tariff restrictions on agricultural products, textiles, and footwear is phased in over a much longer period than on more advanced industrial goods. The

advanced industrial countries currently spend some \$360 billion a year on subsidizing the agriculture.<sup>19</sup> By contrast, they spend only \$53.7 billion on foreign aid.<sup>20</sup> The United States also continues to retain the benefits of its antidumping laws, which can be invoked for protection against low-cost imports. These features create a very uneven playing field.<sup>21</sup> The second issue concerns the bias in favor of corporate interests. There are agreements on Trade-Related Intellectual Property rights (TRIPs) and Trade-Related Investment Measures (TRIMs), but there is no agreement on trade-related labor rights, except prison labor, or trade-related environmental measures. The choice of subjects clearly favors corporate interests. Indeed, it was the attempt to enact a "Multilateral Agreement on Investment" that first galvanized antiglobalization activists into protest and handed them their first victory in stopping it.

There is a WTO rule that prohibits countries from treating physically similar products differently based on how they are made.<sup>22</sup> This rule is designed to prevent countries from discriminating against foreign suppliers by introducing regulations concerning production methods, but in practice it makes it difficult for individual countries to impose environmental, labor, or human rights standards. Such standards could, of course, be imposed by international treaty, but treaties are difficult to reach and even more difficult to enforce. For instance, the International Labor Organization (ILO) has established an elaborate set of conventions, but they are largely ignored. Moreover, if the ILO conventions were observed, they could come into conflict with WTO rules. For example, the ILO has authorized member countries to impose sanctions on Myanmar over forced (as distinct from prison) labor, but ILO members wishing to adopt restrictions on imports of Burmese products in response could be found to be in violation of WTO rules. WTO rules also take precedence over domestic regulations *if* those regulations can be construed to discriminate against the products of other countries.<sup>23</sup> The lack of international regulations and the obstacles to domestic regulations combine to favor corporate interests.

In the absence of equally binding regulations in other fields such as human rights, labor conditions, health, and environmental protection, the WTO gives international trade supremacy over other social objectives.<sup>24</sup> In a way, the WTO has been too successful. It is practically the only international institution to which the United States has been willing to subordinate itself. This makes it very powerful. But free trade and free markets serve only to produce wealth; society also needs some other public goods to survive and prosper. There is an imbalance between private profit and public welfare in the world today, and that is a primary reason why the WTO has come under attack.

The weakness of other institutions cannot be remedied by changing the WTO. The WTO is not qualified to deal with environmental protection, food safety, human rights, and labor rights except insofar as international trade is involved. Although some changes could and should be introduced to make the WTO more cognizant of these issues, the main remedy lies in states, particularly the United States, giving equal support to other international arrangements.

The strength of the WTO is its enforcement mechanism. There are two reasons why enforcement is not suitable for the provision of public goods. One is that the member states will not put up with it. The WTO has found an excellent device that sovereign states are willing to accept because they want

the benefits of trade. But that is an exception; states will not accept it in other areas. The rules of the WTO cannot be modified, nor can new rules be introduced, without unanimous consent. China has just joined the WTO: Is it conceivable that it would agree to the inclusion of human rights and labor rights? Would the present U.S. government be any more amenable on the environment?

The other reason is that many countries simply lack the resources to meet international standards. Instead of imposing requirements, it would be much better to provide resources that would enable poor countries to comply with those requirements on a voluntary basis.

Take child labor. Instead of introducing a rule in the WTO prohibiting child labor, we ought to provide the resources for universal primary education. We could then demand that the recipients of support eliminate child labor as a condition of receiving that support. In Brazil a successful pilot scheme called Bolsa-Escola pays subsidies to poor families if all their children regularly attend school. An additional scheme is now proposed that would reward the girls with a savings account if they complete eight grades. This is the kind of scheme that could be implemented on a larger scale with international assistance. This approach would overcome the obstacles posed by the sovereignty of states because the acceptance of support would be voluntary.

Or take the social dislocations caused by the “creative destruction” of global capitalism.<sup>25</sup> They create a need for compensation, retraining, and a social safety net. These are domestic tasks outside the scope of the international trading rules established by the WTO. But some countries are too poor to finance the necessary measures; they need international assistance. That is the missing component of our global institutional arrangements. We need to establish a voluntary compliance-based system for the provision of public goods to complement the rules-based system of the WTO for the production of private goods. I shall propose such a system in the next chapter.

In addition to a new framework for aid, there ought to be some changes in the framework for trade. A number of issues stand out: labor rights; environmental protection; intellectual property rights, TRIPs; Trade Related Investment Measures, or TRIMs; competition, anticorruption, and tax policies; and the organization of the WTO. Some of these issues are included in the Development Round; others must be dealt with in other ways.

## **LABOR RIGHTS**

The disparity in the treatment of labor and capital is an essential feature of the global capitalist system as it is currently organized. Capital moves to countries where it finds cheap labor and other favorable conditions. This helps those countries to develop; a number of them have made remarkable progress. Developed countries lose jobs, but the gains from trade allow new jobs, often with greater value added, to be created. There is also a certain amount of migration, both legal and illegal, to the rich countries to fill jobs that cannot be filled locally. But workers in the countries that offer cheap labor are often deprived of the right to organize and are mistreated in other ways. China is notorious in the



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