Responding to Seattle

Interview with Jagdish Bhagwati

Economist Jagdish Bhagwati was one of the most vocal critics of the Seattle protesters against the World Trade Organization. But he insists he agrees with many of their goals. And he is also a determined opponent of the completely free flow of capital around the world.

Q. Trade has been liberalized for half a century, yet in many respects the large areas of the world have done poorly, especially compared to rich nations. This situation has given rise to a chorus of discontent. What role does the liberalization and freeing of trade play in this unequal distribution of the world's income?

A. We have to be careful about whether, in fact, we have been liberalized for over half a century. What has really happened is that the developing, poor countries were extremely skeptical of the benefits of free trade, particularly when they were going up against rich countries. Most countries, actually, except in the Far

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Challenge, vol. 44, no. 1, January/February 2001, pp. 6–18.

ISSN 0577–5132 / 2001 $9.50 + 0.00.

East, were very skeptical of free trade—much like Mexico, for example, which saw the United States as a threat rather than an opportunity. Until about the middle to late 1980s, the policymakers were still generally skeptical. What has changed in the last ten or fifteen years, and the reason people have come around, is that they think they carried the denial of opportunities presented by international markets too far.

Q. But you would not claim that there has been significant success for the less developed world in the last fifteen years, would you?

A. Not all parts of it, of course. Africa, in particular, was dominated by what we used to call infrastructure problems—political infrastructure, the basic social infrastructure, and so on. They were racked by tribal warfare, military takeovers, and malign dictators. I think that Africa regressed somewhat, and the only interesting question there is, since they were regressing, would they have done better if they had kept their economies more open, rather than more inward-looking? That is a hard question to answer. But I cannot think of persuasive reasons protectionism should work better under such chaos.

As for the hugely successful Far Eastern economies, they certainly used protectionism, but with a major difference. The real problem with protectionism is that, by turning countries to sheltered domestic markets, it encourages "goofing off." The Far Eastern governments aimed at getting their industries into "world class" quite explictly. So, they deliberately aimed at offsetting protectionism's creation of the extra advantage of the domestic market by making foreign markets equally attractive. A lot of studies, some of which I organized in the 1970s and 1980s, seem to document that basically these governments made the home market comparatively even less attractive for their businessmen. Once you are out in the international markets, you tend to get more competitive. So they devised a creative way to offset their tariffs and trade barriers by exposing their companies to international markets and trade.

Q. Please explain that further.

A. Well, the principal disadvantage of protectionism is the "goofing-off effect." I mean that protectionism makes the home market more attractive than foreign markets for domestic producers because the prices earned in the domestic markets rise compared to international prices. If you are an entrepreneur, you focus then on the domestic market. Your export performance does not matter. Politically, also, you become wedded to your sheltered markets because your government can help you keep and cultivate those markets through protectionist policies.

Q. So what you are saying is that the export orientation of, say, the Japanese model offset the protectionism of its earlier years?

A. Exactly. I do believe that in the Far East there was an intense desire and corresponding policy to reach world-class competitiveness. They were not interested in goofing off.

Q. Outside the Far East, it is hard to find many success stories.

A. That is largely because you had the protectionist model. That is the problem. You really have to begin with the 1980s to see the consequences of more outward orientation there. Then you do see some evidence of success outside the Far East. Let us take India, for example. In the 1980s, India began to grow faster. For a quarter of a century before then, it was stuck at very low levels of growth rates. In fact, in 1991, when the real reform started, we had only $100 million worth of equity inflow in a country of India's size. We had gone to the other extreme. In the 1980s, we essentially borrowed and spent excessively at home. By 1991 we got a full-blown balance-of-payments crisis. Then we started opening up the markets to trade in a much bigger way. We had been toying with this reform through the 1980s, but did nothing in a dramatic fashion. In 1991 the outward orientation began in greater earnest and the growth rate has continued ever since at 6–6½ percent. After much debate on what has happened to poverty, nearly all economists are agreed that we have managed to finally make a dent in poverty.

Q. But this is still a decidedly mixed policy between free trade and imports.

A. Yes, we are still far from free trade. And there were other measures undertaken, such as cleaning out bureaucratic problems, that do not necessarily have to do with removing inward, protectionist orientation.

Q Would you also argue that more free trade has helped in South America on balance? Inequality has worsened, for example.

A. I will tell you what I think has happened. South America also opened up dramatically on the financial side. That has led to a kind of yo-yo effect. In my judgment, the South Americans were spoiled first in the 1970s, when they went into the debt-led growth. At that time I was also worried that they would lose political independence. When the OPEC [Organization of Petroleum Exporting Countries] oil funds were sloshing around, banks were coming with barrels full of OPEC dollars to lend them. Mrs. Gandhi was prudent and resisted the borrowing in India. On the whole, she was right. But the South Americans fell for it. They borrowed intensively, and for a while they had very rapid growth rates, of course, because debt-led growth does lead to that. You get lots of capital, all kinds of investment. Then when the crisis broke, it broke in a big way. I was worried in those days because this was not like opening up to free trade. When you get involved and dependent on people in bowler hats with rolled umbrellas—the old symbol of loans made in London—you are playing in a different game. Today, the funds are managed by young men and women who wear Bermuda shorts and are glued to the screens. But the economic and political consequences are the same on the downturn.

Q. So you are saying that the experiment in liberalized trade was hindered by the liberalization of financial flows?

A. Financial flows and trade liberalization are different phenomena, the former requiring prudence and regulation.

Q You were very disturbed by protests in Seattle against the World Trade Organization [WTO] and elsewhere. But to many people, such protests were highly justified. They were saying, "When we import products made in sweatshops and in countries with no labor standards and a deteriorating environment, we are encouraging that." What is your response to that kind of criticism?

A. My response is that it depends on what you mean by sweatshops. If you simply mean low wages, that does not bother me at all, simply because these are poor countries and their wages are low. In fact, many earn higher wages than others when they work for foreign companies. But I would like to see minimum safety standards, and I would like to see our firms treating workers with a sense of dignity. I would also like to see them meet public obligations the way good firms do here: build schools, create opportunities for the community.

Q. But why can we not use trade policy to do that? Why can we not attach requirements on freeing trade policy to do that?

A. Because using trade policy to do that is generally inefficient and often counterproductive, whereas methods that are more effective can be used instead. Note that when unions want a social clause at the WTO (or in other trade treaties and institutions), they are actually asking to legitimate trade sanctions against practices they disapprove of. When I talk about letting the ILO do the job, I am implying that non–trade sanctions approaches are better and that the trade sanctions approach is ineffective and wrong.

Put very briefly, the trade sanctions approach undermines both the pursuit of freer trade (which, as I already said, is a social good because it brings prosperity and helps reduce poverty in the poor countries) *and* the pursuit, paradoxically, of the social agenda as well. Why? Remember the president's failure to get fast-track renewed. The Republicans did not want these issues in the trade negotiations. At Seattle, the developing countries opposed them, too, contributing mightily to the failure to launch a new round of trade negotiations. Equally, the pursuit of the social agendas is undermined because the developing countries, given the use of trade sanctions, conclude that the talk of morality is only a mask to hide a protectionist agenda. They are not wrong, either, in my view, because the choice of agendas for such sanctions on a rapid schedule is always issues like child labor and unionization, where the poor countries are always seen as defendants. Issues such as sweatshops in the garment industry in New York, or the quasi-slavery agricultural conditions in the South for migrant labor, are not matters that get into the social clause for highlighted mention, forget about immediate and effective action! So, we are confronting poor countries, and not just their governments but also their labor unions and NGOs [nongovernmental organizations]. Certainly thirteen major unions in India with 8.3 million members are all opposed to the social clause, as are leading environmental and child-labor NGOs and intellectuals, who feel passionately that the trade sanctions approach, even if altruistically motivated for some groups here, is a protectionist dagger aimed at their exports and at their well-being.

Q. You mean that these countries feel that they will lose markets?

A. Yes, that is exactly what they fear.

Q What is the alternative?

A. The alternative is to recognize the complexity of the problem and develop proactive policies outside the trade agencies, for example, at the International Labor Organization (ILO). Let me just illustrate with the child labor issue. If our goal is to flag an issue that nobody is paying attention to, which is what the kids in Seattle seemed to want to do . . .

Q. You mean the kids who were protesting?

A. The kids on the street, yes, the idealistic kids. I have nothing against those kids because they are full of idealism. I would like to be able to engage them in dialogue, and I do quite a bit on campuses. But going back to the child labor, we now have a proactive ILO program for the eradication of child labor that the Germans started and of which, as usual, we are the big financiers. The program works with local NGOs in Asia. They do the heavy lifting. They make sure that the children get to school when they are taken off factory employment, and that the particularly famished, undernourished, poor families get additional support when children's income is lost. So child labor is a problem that requires constant, determined heavy lifting. That program is working well, from everything I have heard.

Q. But do we not have more leverage with using trade than we do with such programs?

A. I do not think so because trade really does not even matter for child labor, for instance. Only 5 percent of the production attributable to children is exported. Trade sanctions run the danger of pushing children off into worse occupations, such as prostitution. Also, as I argued already, trade sanctions aimed only at poor-country shortfalls raise concerns about lack of symmetry in taking on the right countries.

Q. In other words, we have a pretty good record on child labor, so you think it becomes an asymmetric issue? You believe now that the Clinton administration is particularly guilty of this kind of insensitivity?

A. I think the president was convinced that trade was good for us, but these protesters were a nuisance from his perspective. I do not think he is genuinely concerned about all these concerns, so he never developed good, proactive alternative policies to address them.

Q. But I am not following what you are saying. Which people were a nuisance?

A. The people in the street. Not just the street demonstrators, but a lot of civil society groups, like Human Rights Watch, as well. They want better standards elsewhere, on moral grounds, in many cases. In my view, Clinton saw this goal as a nuisance to be gotten out of the way because they were clogging up the trade process. If we are genuinely interested in advancing standards elsewhere, why do we not develop proactively a number of programs in the ILO? True, traditionally the ILO has not been as powerful as we might like, but now as a hyperpower, as the French call us, why do we not put our shoulder to the wheel and make it work better? We support the international program for the eradication of child labor through ILO. That is one of the success stories. We could do much more.

We should also remember how understaffed the WTO is. Take unionization rights. If we go through the WTO for this, you will have maybe a quarter of a person looking after that. Suppose we were to put in a clause demanding some unionization rights. But unionization without the right to strike, what does it mean? Nothing, really. So, if we want to address that issue, we have to look at the right to replace workers, the right to have sympathetic strikes in other companies and industries, and a variety of matters that bear on effective unionization. But we are not eager to discuss these things. Just having a phrase like "unionization" is almost meaningless. So we need to do a lot of nitty-gritty work, using modern economics, ethics, and sociology before we can meaningfully address the issue of "unionization rights." President Clinton was one of the great articulators of all time. He should have been able to do a much better job of developing these proactive policies and then actually advancing these other social agendas and moral agendas alongside freer trade. But his heart has been in freer trade rather than in these other agendas.

Q. Do you think that that is due to advisers around him?

A. I think he has not had good advisers, most certainly on this issue. Our trade policy is run essentially by trade lawyers who have no vision that can view these matters architecturally. Besides, the polls that the president watches rarely give you a handle on these complex issues. Even the pollsters do not understand the issues and cannot ask meaningful questions.

Q Let me go on to the issue of the Treasury–Wall Street Complex, as I think you call it: the relationship between Clinton's advisers and Wall Street. On the one hand, you are quite concerned about continuing the liberalization of trade. By contrast, you are almost equally disturbed about liberalizing capital flows too quickly. What is the theoretical basis of that concern? The Clinton administration was gung-ho about both.

A. Theoretically there are similarities between free trade and free capital flows because economists believe that without both, there is a loss in efficiency. At the same time, if you think in terms of economic freedom, clearly controls on capital flow are circumscribing the people's ability to invest elsewhere, just as trade restrictions limit our right to trade.

But the problem is that when you recognize that capital flows are subject to speculation, manias, panics, and crashes, there is simply no counterpart in trade. If I exchange my toothbrush for your toothpaste, it needs a deranged mind to think that panics and crashes could break out. This is where I would blame Treasury Secretary Robert Rubin. His defining experience was Wall Street. Wall Street kept pushing for more and more liberalization and the Treasury went along with it. Then even a brilliant economist like Larry Summers began to forget the lessons in the classroom, that you can have this kind of financial panic and quite disastrous downturns, which we still have not learned how to eliminate.

Q Do you attribute the crisis largely to what we might call hot money?

A. Yes, I do. Thailand was a mixed case, but I think most definitely the borrowing was so enormous that if they had had no financial liberalization, it would have been much less of a problem. Take South Korea. Part of its requirement for joining the OECD [Organization for Economic Cooperation and Development] was financial liberalization. The International Monetary Fund [IMF] clearly was pushing for it, the U.S. Treasury was pushing for it. Wall Street was continuously pushing for it. And they were putting across this view that somehow the greater the financial liberalization, the greater the good that would come one's way. And I could read you quotations about how "Democracy would break out and huge gains in growth rates would develop." No argumentation, just flat assertions.

Q. What would you like to see done now?

A. I think we know a bit more now. Everyone is agreed that we cannot have gung-ho financial capitalism, meaning that we just free up capital flows and go home to enjoy the resulting prosperity. Institutional changes and support are accepted as necessary. For example, South Korea cannot have capital borrowed abroad to support conventional 7:1 debt-equity ratios because a domestic liquidity crisis could then immediately lead to a balance-of-payments crisis if the debts were owed abroad. Also, the external short-term borrowing must be monitored and be compatible with your fundamentals and reserves. Finally the potential use of a Chilean-type tax on capital flows, to moderate them if necessary to more credible levels against fear of panic-fueled capital outflows, seems sensible.

Q Please explain the Chilean-type tax.

A. You say, I am going to start taxing the inflow of capital. You place a 100 percent surcharge on interest rates. A 100 percent surcharge would mean that instead of getting a 10 percent domestic return, you will get 5 percent. That is the way you slow it down. That is not direct control, like a quota, but rather a price control, a price mechanism. Another thing I would not do is to intimidate and push around countries that are hesitant to open their capital markets rapidly. We should let them go at their own pace.

Q That is the last issue I wanted to discuss. The World Bank and the IMF seem to be more concerned with the developing of institutions that let countries, as they put it, "own" their own policies. Do you agree with this movement in general?

A. On the need for institutions, yes. But it is a complicated problem. I think one of the problems is that it is very hard to say exactly which institution is going to work. Part of the problem in Russia was clearly that a lot of people thought the way to establish free markets was to privatize very rapidly, to establish "facts on the ground." Now, it is very easy to do Monday-morning quarterbacking also—to talk about how rapid privatization failed. Institutions often fail to take root the way one hopes. In fact, all you can really do is move back and forth the way you parallel-park a car, hoping not to hit the car on the side. Unfortunately, there is a neoliberal school that probably has never understood the role of institutions. I would not point a finger at anyone in particular, but there is that strand in economic theorizing with any kind of policy-making where they say, I just provide the free-market incentives, and somehow everything will work. This is not the case.

Q. Yes, you just create property rights.

A. Or markets. But I should add that I have been openly critical of World Bank president James Wolfensohn's "holistic" approach to development, which brings everything you can think of into the policy arena. Nothing is left out, no priorities are established. But, of course, nothing cited is new. Indeed, direct focus on poverty alleviation, literacy programs, community development efforts, improving access of the poor to credit, social reforms, and much else were part of the Indian five-year plans and targeting from the 1950s. A lot of policies and ideas were tried, and many of them did not really work out. The key question is, why didn't they work out? Do we know today something more about institutions? I would say, yes, in some cases we do, such as microcredit. That works without collateral, too, like the old collateral-free but risky and largely wasted loans, but here you have successful small loans where the people who borrow become monitors of one another. That is a brilliant move, actually. So, we have learned something. What I find in the rhetoric that comes out of the World Bank today is that somehow nobody ever thought about governance or about institutions before. The point is that people have, and the really interesting question is: What did we learn from that experience and can we avoid some mistakes, can we move forward? Is there a magic bullet now?

Q What do you tell people, especially those who have not studied any economics, when they look across the world and see that only east Asia has made extraordinary gains among developing countries in this great era of liberalized trade and liberalized capital markets.

A. I would simply say that there is no one factor that could ever deliver everything to you. The reason the Far East made tremendous progress is, first, that they had reasonably homogeneous populations. It was easier for them not to get into some of the distributive conflicts that have arisen when ethnic minorities, like the Chinese in Indonesia, have produced and received the gains from globalization. Second, they had inherited very high rates of literacy, and they were very much interested in education. Third, outward orientation really made a lot of difference because they received huge amounts of foreign exchange earnings, imported highly productive equipment that then became even more very productive because of high levels of education. All these factors became a virtuous circle. That gave them something like 10 percent growth rates over an entire generation. It was truly a miracle of high rates of productive investment, and you will probably never get anything like that again because that is a very fortuitous set of circumstances. But as we have gone outward in other countries and taken some components of these policies, we have had some successes. We have managed to improve conditions in important areas like India. The question I would ask of people who are very skeptical of the benefits from international orientation is, would you have been better off if you had not opened trade? I would simply say, that, on balance—and, of course, I can produce examples where things have gotten worse as a result of trade—the central tendency has been to improve well being.

Q You were not in favor of the Seattle protests.

A. I was not in favor of the Seattle protests simply because there were a lot of people there who simply were unaware of the issues. The kids were out in the streets, and most of them were idealistic and just felt that there was something wrong. So I was asking a lot of them: What bothers you, what exactly is your worry? I never failed to engage. I even debated Ralph Nader in the Town Hall, and I hope he learned as much as I did. We need more such exchanges and debates.