Reading Stiglitz in Sri Lanka: A Globalization Perspective

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(Abstract)

Stiglitz's views on globalization and trade are interesting, provocative and Utopian. His, characterization of the international trading system as inherently unfair is not valid. And, he gives developing countries wide latitude to avoid reform and treats them as victims, which may not be helpful to these countries. Stiglitz suggestions to address adjustment costs, be wary of bio-piracy, improve regulatory environments and be careful about debt are valid. On the other hand, his stance towards unilateral trade liberalization, IMF programs and suspicion of multinational corporations is not grounded on good analysis. Sri Lanka is uniquely positioned to meet today's challenges given the end of the civil war; she begins with better initial conditions than most other developing countries ,she has a fairly good, though inadequate infrastructure particularly in the North and the East and functioning institutions. National amity is within reach, if political wisdom and commitment are there to address the issues that led to the civil war in the first place. Sri Lanka has in the past responded well to reforms and attempts to meet these challenges. She is at the cusp of becoming more securely placed within the middle income country category. However, this would require maintaining macroeconomic stability beyond the current IMF Stand-by Arrangement and undertaking structural reforms. Past experience is comforting because those reforms helped to improve efficiency. But they were not sustained. More work is needed in reforming the trade and regulatory regimes and institutional areas to increase competitiveness and to anchor reforms in sound institutions. Stiglitz's three books are a good read for policy makers and the students alike. But they must be read, understood and digested with a critical eye by Sri Lankans.

1. *Introduction*

Economic theorist *extraordinaire*, Professor Joseph E. Stiglitz has written three books in the last eight years that speak to the issues of how developing countries should react to globalization in general and to international trade, in particular. He has provided a general definition of globalization, as the process that leads to greater integration of goods and services markets and capital and labor markets. The three books: Globalization and Its Discontents (2002), Fair Trade for All (2005) and Making Globalization Work (2006) are provocative and challenge orthodox views. They have their appeal for a number of reasons. First, these works look at issues mostly from a developing countries' point of view. Second, they are by a Nobel Prize laureate in Economics (in 2001, Stiglitz shared the prize with George Akerlof and A. Michael Spence) for his work on asymmetrical information and its implications for imperfect and absent markets. Third, many developing country economists have embraced these ideas since they speak to their own views on these issues. Finally, Professor Stiglitz is a quintessential Washington insider who was a member and Chairman of the Council of Economic Advisers to President Bill Clinton (1993-1997) and Senior Vice President and Chief Economist of the World Bank (1997-2000).

His views have had wide resonance among the anti-globalizers who have demonstrated at various gathering of world leaders at G-7, G-20, and Doha Development Agenda meetings at various locations and from Seattle to Cancun and Gleneagles to Davos. Naturally these views have a certain *cachet* given the credentials of the author, his style of writing in these works, non- esoteric, unlike his academic papers and meant to push his ideas forward in an uncompromising way. The two books on globalization contain a personal narrative of his travel to different developing countries, meeting their leaders and discussing issues of concern with them. The book on fair trade is closer to a lengthy policy monograph on trade without the personal narrative.

There is “curb appeal” to his ideas on globalization and trade issues particularly among the young, the environmentalists and those on the left of the political spectrum who are disappointed with the failure of socialist’s experiments around the world. He speaks as no other policy insider has done. He talks about issues from a new and unabashedly moral and ethical position, what economists in general take great pains to avoid. He is not uncomfortable about using the words “ethical” and “moral” in his policy positions. His views are more attractive to non-economists for this reason and account for his wide popularity outside the profession. He is of course highly respected within the profession for his dazzling theoretical work on information theory, public finance and insurance and credit markets[1].

At the outset one must note that leading Sri Lankan economists who are associated with the left of center would be more at home with Stiglitz’s views. [2]. Those who are at the center and to the right of the center would feel less comfortable with Stiglitz’s view even though, they would not necessarily buy into the views associated with international economic institutions. However, there is a part of the policy space in which those on both sides of the political spectrum could form a workable center coalition and eschew both the end points of the right and the left. As to whether such a convergence would be sufficient to solve Sri Lanka’s economic problems is another matter.

This essay is organized as follows. After this introduction, Section 2 presents Stiglitz’s core ideas for the global economy from Sri Lanka’s viewpoint. Section 3 sketches Sri Lanka’s development challenges and implications of Stiglitz’s views for the country. Section 4 gives the conclusions.

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[1] The present author served in the Editorial Committee of the World Bank Economic Review with Professor Stiglitz for six years and has enormous respect for him as a front-ranking theoretician and admires his interests in the well-being of developing countries.

[2] We can make a rough classification based on the published work of leading Sri Lankan economists whose revealed preferences on policy matters can be identified by their core positions on issues related globalization and trade discussed here.

2. Stiglitz's Ideas on the Global Economy from Sri Lanka's Viewpoint.

Stiglitz's policy positions are derived partly from his theoretical work that held that a free market competitive equilibrium was not optimal given that these markets have asymmetric information between buyers and sellers, borrowers and lenders and insurers and the insured. Hence policies that are derived from the notions of a free market are faulty. He calls this anchoring of economic policies on free markets "market fundamentalism". He accuses the IMF (the worst villain of the piece, in his view), World Bank and US Treasury of practicing these flawed policies. From this position he criticizes the so-called 'Washington Consensus' or policies that emphasized macroeconomic stability based on tight fiscal and monetary policies, adherence to free market principles in incentive reforms (with respect to structural matters such as trade, regulation and privatization) and institutions created to support these policies.

Stiglitz's charge that the Bretton Woods institutions and the US Treasury are 'market fundamentalists' is not correct. Far from supporting free market policies many of their programs helped to support highly restrictive and market-unfriendly policies well into the 1990s. One has to look at the support the World Bank provided to India for more than four decades for its Socialist planning policies, and practiced highly restrictive trade, regulatory policies and institutional arrangements. India was for a long time was the largest recipient of the highly subsidized International Development Agency (IDA) funds (so much so one critic called IDA, the Indian Development Agency!)[3]. Similarly, the World Bank and the IMF continued to support many Sub-Saharan African states that created highly protected, regulated and monopoly- ridden command economies. A large number of those programs failed and poverty increased due to poor policies of the countries themselves. Experts on African development have pointed out that the economic failures of the countries were due mostly to the countries not using more marked- based policies, the opposite of what Stiglitz claims[4]. Nor can the US Treasury be accused of being a market fundamentalist; it supported dictators who used old Soviet-style *dirigisme* in their competition with the former Soviet Union to gain influence in many places including Sub-Saharan Africa (the Congo, Nigeria and Zambia are leading examples). There were other countries that these institutions supported; the World Bank with structural adjustment loans, and the IMF with Stand By arrangements. These programs were tried out in the Middle East (Egypt, Jordan and Morocco and Tunisia) and in Latin America (Argentina, Ecuador, Venezuela). Most of them failed in the sense there were no sustained recoveries and resumption of growth.

[3] IDA is the concessional window of the World Bank.

[4] Moyo (2009)

While the so-called ‘ Washington Consensus’ has been strongly criticized by Stiglitz, more policy oriented academics, mainstream economists, and policy makers, contend that the policy elements put forward in the ‘Washington Consensus’ -namely restoring macroeconomic stability through fiscal and monetary discipline, using free market policies and improving institutions to maintain policy regimes with respect to property rights and the independence of policy making institutions, are valid .The author of the Washington consensus, John Williamson has defended these ideas vigorously, noting that it was not solely a Washington based idea, nor was it entirely free market in that it did not advocate capital market liberalization[5]. Sri Lankan economists, at the center and more to the right of center of the political spectrum would support the Williamson view as against the one put forward by Stiglitz. Where Stiglitz is right is not about the direction of these reforms, but the speed and intensity with which they were implemented and inadequate acknowledgment of the costs and travails of adjustment on the poor and those who became unemployed due to the reallocation of resources. In a growing economy, this adjustment becomes easier, since the surpluses created by the adjustment can pay at least a part of the cost in the short term and the entire costs and more, over the medium to the long term.

Stiglitz finds that international financial institutions are biased and non-neutral and in their management, they suffer from “a democratic deficit” since their governance is not representative of the poor countries. Particularly, Bretton Woods institutions (IMF and the World Bank) have executive boards that are weighted in favor of rich countries, since voting in the boards of these institutions are based on income, openness to trade and access to the international financial market that prevailed in 1944, with some marginal changes in the 1960s to accommodate new nations that emerged from colonial rule, mostly in Sub-Saharan Africa and in the early 1990s and to accommodate China and Russia and other members of the former Soviet Union. While the WTO (that replaced the GATT in 1995) has better representation (since it’s decisions are based on consensus through negotiation and not on country quotas) ,it has no ability to influence country trade policies(e.g. through making loans or grants). However, it can carry out surveillance of trade developments in individual countries and appoint panels to hear dispute settlement cases among member countries. In other words, it has no power of its own. Even the penalties on countries for infringing WTO rules, can be initiated only by a member country and can be imposed only with the express acceptance of those who are found to be in breach of these rules.

Stiglitz is correct when he indicates that the international financial institutions have a “democratic deficit”. Those countries that hold power are not about to yield it to a well- represented board of management and allow decisions regarding the use of the resources they have contributed to be

[5] Williamson (2002)

allocated by those who have not made substantial contributions to the resources . Nor is it clear that such an arrangement, as democratic as it seems, could be workable. The national interests of countries differ markedly in terms of their own resource endowments, economic policy frameworks, history and socio-political characteristics. One group of countries that commands a majority of votes will support a particular group of countries, while another will support its own favorites. So it is impossible to have neutral decisions. The solution rather is to give greater representation to the leading developing countries based on their present economic conditions. This would mean giving greater voting power to China, India, Brazil, South Africa and Indonesia. They represent close to seventy percent of humanity. However, those who have large quotas at present will have to yield a part of their quotas to the new countries to have their quotas increased and this would invariably mean that small countries like Sri Lanka will also need to yield a part of their quotas to the general pool. Such a rebalancing of voting quotas is necessary but it may not be sufficient to make a big difference in decision making.

In "Making Globalization Work" Stiglitz sketches out an arrangement to advance his views that "another world is possible". What he has in mind is akin to a world government with equal representation of rich and poor countries with a set of uniform regulations that can implement the will of the world majority .This is a noble principle. However it is patently unrealistic. Like many of his suggestions it ignores the political economy aspect of this issue (that different groups of countries have their own interests to pursue).

Perhaps one can look at the United Nations to get an idea how things will look like if these institutions were to follow one nation, one vote principle. Representation in the boards of the IMF and the World Bank is not based on the principle of one country one vote as pointed out above. It is time to change the representation, to give greater weight to emerging nations as suggested above. It is necessary to revise the allocation of quotas and hence the voting groups. The IMF and the World Bank are working on these matters, but much depends on the major powers of the day-the US, UK, Japan and the European Union. Those who contribute the larger proportion of resources should have greater say. Otherwise, these resources could be wasted. Where one country one vote has failed is there for all to see in the United Nations programs such as the United Nations Development Fund, Regional Commissions such as Economic Commission for Latin America and the Caribbean and the Economic Commission for Asia and the Pacific. They cannot claim any success after five decades of their existence. Of course they did not have many resources. But noting the highly interventionist and inward looking ideas they have espoused over the years, it is clear that more funds would have not been used well by these agencies.

Stiglitz notes that poverty has increased in the two decades to 2002 despite greater integration of the trade and services, capital and even labor markets in the world[6]. By implication he points the finger at rich countries' policies, governance issues relating to the international financial institutions and their alleged wrong-headed policies with respect to macroeconomics, trade, multilateral corporations, intellectual property rights, regulatory and privatization policies, debt and institutional issues. It is a strong indictment. (We take up these issues in the next section of the essay as they relate mostly to policies at the country level: see Section 3 below). He targets the IMF for the strongest criticism. And, he argues for a different paradigm of economic relationships in the world. Mainstream economists agree that when a country is in macroeconomic imbalance and reaches an inevitable crisis point, the IMF should work like an emergency ward in a hospital. That is, it diagnoses the problem and gives emergency assistance and helps to restore the country back to macroeconomic balance. This diagnosis is not very different for a specified number of cases. Countries seek IMF assistance when they have an unsustainable balance of payments situation, an over-valued exchange rate, rising debt at a faster rate than receipts from exports and capital inflows from other sources. The charge by Stiglitz that these institutions use a one-size- fits-all model comes from this observation that emergency assistance follows a standard approach. In most cases, this "emergency medicine" is administered to cut down aggregate demand, mostly arising from fiscal deficits and adjust relative prices, particularly the exchange rate. This is not rocket science. It is standard well-understood text-book macroeconomics. The quantities, timing and sequencing can differ for different country contexts, but the approach has to be similar. It has received much acceptance among the policy makers. If a country were to deal with this emergency problem on its own or from assistance from other countries, the approach would not be much different.

The IMF has made its mistakes, even though the Stiglitz criticism is overdrawn and he strains credibility by the stridency of his attack against it, in both books on globalization. First, he is right in saying the IMF got it wrong in the 1997-98 East Asian financial crisis. The crisis had a tremendous adverse impact on that region, particularly on South Korea, Thailand and Indonesia. Its analysis of the crisis as largely a fiscal problem was wrong. It was in fact a private sector savings-investment gap problem that was associated with real estate booms financed by over-extended commercial banks, appreciated real exchange rates and fallen foreign demand. In supporting these countries to come out of

[6] This is now contested. In fact China saw the fastest reduction in poverty rates (head-count rate or number of persons living below the poverty line of $ 1.00 day) during the last two decades and India similarly reduced poverty rate fastest with respect to its own economic history. In sum, nearly 500 million persons were lifted out of poverty, a remarkable achievement. It happened when these countries were able to raise their output growth to 9 and 6 percent respectively since the early 1990s, when they began to liberalize their economies. This is not to say that poverty does not persist in India (some 25 per cent of the world's poor still live there). When poverty rates are examined at the level of each country, they have shown dramatic reductions. So globalization did not impoverish countries when they made use of the opportunities offered by globalization. See Bhalla (2003).

the crisis, IMF went beyond its brief to insist on stringent measures outside the monetary-financial field. However, it must also be said that these reforms of the incentive structure were to stand in good stead for these countries in the more recent and severe financial crisis that began in the United States in late 2007. Second, there is no penalty to the IMF for abandoning a program which it has helped to develop. It can always say it tried but the country failed. It will get paid first in a country's repayment crisis as it has seniority in debt obligations of member countries. Stiglitz cites case of Argentina in ("Making Globalization Work") which she defaulted against private banks but not the IMF. Instead Argentina was able to re-negotiate an easier repayment plan to the IMF and received more emergency funds to help its adjustment. Stiglitz notes that debt crisis arise not only due to the mistakes of the borrow but the lender too, as the world has clearly noted in the recent US and European financial crisis. Third, at the same time, the IMF cannot be relied upon to support growth efforts particularly with respect to efficiency issues. Nevertheless, it has attempted to get into this area with its Poverty Reduction and Growth Facility working in tandem (or some would say in competition) with the World Bank. Another mistake that the IMF made is with its approach to Stand-by programs. In that approach as long as the books balance it is okay with them. But books can balance at different levels of income and rates of economic growth. The greatest support it can provide is to help countries' through a balance of payments adjustment with funds and expertise. This, it has done well in most cases.

While the international financial institutions are disparaged by Stiglitz, he gives developing countries wide latitude and does not hold them ultimately responsible for their own economic fates. There is a tinge of paternalism in his stance towards these countries. Stiglitz sees them rather as victims of the rapacious rich countries and faulty policy frameworks of the international financial institutions. No wonder, he appeals to the left intellectuals in the West and left of center economists, everywhere. It comes from his credentials and probably their conjecture that he must be in the know, as a quintessential insider[7]. Ideas about the rapacious rich and the irresponsible international financial institutions are not new. What is new is that they are being articulated by a first-rate academic and an apparent Washington insider.

3. Sri Lanka's development challenges and implications of Stiglitz's views.

Stiglitz's core global views provide a backdrop to national challenges. Sri Lanka's development challenges operate principally at the national level. If his global views were to be realized, it may or may not ease the task for the country to meet its national challenges. However, without a national effort the

[7] Fifty years ago, one heard these views from Marxists parties in Sri Lanka as one hears from the JVP more recently.

opportunities provided by the global economy cannot be utilized. With this background it is useful to explore what these challenges are and to ask what Stiglitz's views mean for Sri Lanka.

Sri Lanka is uniquely positioned to meet these challenges in today's context for several reasons. First, after a three decade long civil war that held the attention of the national leadership and led to the direction of resources away from development to defense, is finally over. There is now the opportunity to concentrate on meeting these challenges. Second, she begins with better initial conditions than most other developing countries, given the high level of adult education or human capital stock, fairly good but yet inadequate infrastructure particularly in the North and the East and functioning institutions which need improvement but do not need to be started from scratch. Third, national amity is within reach, if political wisdom and commitment are there to address the issues that led to the civil war in the first place. Finally, Sri Lanka has in the past responded well to reforms and attempts to meet these challenges. She is at the cusp of becoming more securely placed within middle income country category.

Relating these challenges to their specifics, one notes that the Government plans to double per capita income from $ 2000 to $ 4000 in six to ten years, depending on who speaks for the Government. The Mahinda Chintana document envisages a doubling of per capita income by 2015. This implies a real annual GDP growth rate of 13.2 per cent (namely 12 per cent GDP growth and a population growth of 1.2 per cent) for a six year period and 7. 2 per cent annually (or 6.0 per cent GDP growth and a 1.2 per cent population growth) for a ten year period[8]. An attempt to reach the doubling of income in the six year horizon carries the danger of misallocation of resources, higher inflation, higher debt and larger balance of payments deficits. In fact, the acceleration of the Mahaweli program in the early 1980s led to this situation but it was partly ameliorated by huge inflows of concessionary assistance. Even so, the appreciation of the rupee due these large capital inflows (sometimes called the "Dutch disease") reduced gains from the 1977 liberalization. For this reason, the ten year time horizon is more realistic to double per capita income, and poses less of a macroeconomic risk. But it would require an additional effort compared to the economic performance of Sri Lanka in the past six years.

Assuming a capital- output ratio of 5:1 (five units of capital to produce one unit of output in one year, based on Sri Lankan GDP and investment data in the last six years), to achieve a 7.2 growth rate requires a saving rate of 36 per cent of GDP, when the present rate of saving is around 25 per cent. This means an additional effort has to be made to raise the savings rate by 11 per cent (both national savings

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[8] These are for illustrative purposes. Strictly speaking , the capital output ratio is more a physical relationship than a measure of efficiency. The two key variables used here, the marginal capita-output ratio and the marginal savings rate, that are assumed to determine GDP growth rate, will vary over a range. So when we present a point estimate, it is to be thought of as a central value, as is the outcome- per capita GDP growth rate.

and foreign savings i.e. the latter from foreign aid, borrowing and foreign direct investment). A lower saving effort would be required if the capital output- ratio can be reduced to say 4:1. In this case, the saving rate required would be 29 per cent of GDP and the savings effort would be lower, to raise it by 4 per cent of GDP over the present rate.

But raising the savings rate and lowering the capital-output ratio need a substantial effort. Both are not easily amenable to short run policy manipulation. Towards increasing the saving rate, the most important policy the Government could do is to reduce the fiscal deficit by cutting down wasteful expenditures in the public sector and selling off some of the public corporations that are a drain on the budget and are well-known to be inefficient. Equally, a high fiscal deficit reduces the savings and investment in the private sector. It causes uncertainty in the economy since decisions about the future in the private sector are going to be affected by it expecting taxation to go up to meet the long term fiscal deficit. Meanwhile, the avoidance of inflation creates strong an incentive to save. With inflation, savers will find that the real value of their savings fall over time and the interest paid on their savings deposits in the banking sector turn negative in real terms. Thus a high fiscal deficit is a signal to the private sector that their taxes will go up, interest rates will go up (as the Government bids away private saving by selling bonds) and there is the likelihood of an appreciation of the exchange rate as was seen in the three years to 2009. With stable prices, a budget saving of 2-3 per cent is possible in the short run.

In addition to raising savings, the reduction of the fiscal deficit will also have an effect on the capital- output ratio, since in general terms, the rate of return to private investment is higher than that of the public sector in a wide spectrum of activities, where there are no clear externalities (or where private returns are not lower than social returns). Thus, giving greater head-room to the private sector will help in raising the GDP growth rate. At the point where the returns to public investment equal the return to private investment, the rate of investment is optimized. This is what public policy should attempt to do. Nowhere in the three books does Stiglitz refer to the proper allocation of investment between the private sector and the public sector or the rules that should determine an optimal balance.

Incentive policies determine efficiency. In order to reduce the capital output ratio, (a marker of efficiency or called the reciprocal of the marginal productivity of capital in economic jargon), would require a strong, credible and sustained reform program[9]. In fact, there has not been a reform program of that type since the mid-1990s. This task relates to incentive reforms principally in three areas: trade, regulatory and institutional reform.

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[9] A reduction of the capital output ratio from 5:1 to 4:1 is after all a twenty percent decrease and not a small change, suggesting the need for a substantial effort.

Incentive Reforms

Trade Policy Issues: Sri Lanka undertook a major liberalization of the trade regime in 1977 within a substantive reform program including a devaluation of the rupee. There was some back sliding that was partially rectified in 1989 when some duty rates were reduced. But the country has become more protective since then, with ad hoc measures to meet some international price changes. There has not been an attempt to maintain the reform program due to a number of factors. The new Governments that came into power in 2004 and 2009 were less inclined to liberalize the trade regime, due mostly to ideological reasons, given their erroneous interpretation that the 1977 and 1989 liberalizations were failures and that the trade regime was already more open than Sri Lanka's neighbors[10]. Of course the on-going civil conflict distracted Governments since the late 1990s from pursuing a substantive liberalization agenda.

Meanwhile, Sri Lanka's competitiveness lost ground due to the liberalization of competitor countries exporting similar products (India, Vietnam, Bangladesh, Thailand and many other garment manufacturers), appreciation of the Sri Lanka rupee particularly after 2007, reduced access to credit for exporters due to the Government taking a lion's share of funds that could have gone to the private sector during 2006-2009. There has been some respite after 2009 mostly due to the IMF Standby negotiated in 2009. The withdrawal of duty free access to the European Union market that was available under GSP Plus since August 2010 was a shock to the garments industry. It faces much strong competition since its competitors like Bangladesh would continue to get duty free access.

Recent analysis of the trade regime shows a greater tightening. The total protective rate has increased from 13.4 per cent in 2004 to 27.9 per cent in 2009 when both customs duties and para-tariffs (including ports and airport levies) are taken into account. Sri Lanka has at present a complex import tariff schedule with ten different taxes in addition to customs duties that can be applied to imports. This is an unnecessarily complicated system. The signing of the India-Sri Lanka Free Trade Agreement with India has led to some decline in tariffs for specific items. However, it is not clear whether there is a net trade creation from this agreement. A broader Comprehensive Economic Partnership Agreement (CEPA) that goes beyond trade to investment and regulatory harmonization is mooted with India but it is under further negotiation.

Going by 'Fair Trade for All' (2005) Stiglitz is clearly not a supporter of trade liberalization even though as an economist he sees the validity of the theory of comparative advantage. He would have not

[10] The 1977 liberalization was not a failure with respect to the trade regime. But the bad management of the macroeconomic situation led to an appreciation of the exchange rate that prevented the country from realizing the full competitiveness benefit of the liberalization. See Lal and Rajapatirana (1989)

supported the 1977 Sri Lanka trade liberalization on a number of grounds. First, he does not seem to support unilateral liberalizations, others must liberalize if a country were to liberalize. Second, he would have said that the liberalization was done too fast. Third, he would have provided some cushion to those that were going to be adversely affected by the liberalization. Finally, he is for selective liberalization of the trade regime while the 1977 liberalization was neutral or across the board.

On account of Sri Lanka's 1977 liberalization and the 1989 reforms being unilateral, Stiglitz would have objected to it. It is true that if everyone else also liberalized, then the gains would be higher. But still there would be gains to unilateral liberalization even if the rest of world does not liberalize. Stiglitz and his co-author Andrew Charlton do not see the gains from re-allocation of domestic resources so that the same level of resources can bring higher output or returns. To tell the least, their position is Mercantilist and mistaken. It is not what the East Asians did to become such successful exporters. In the period 1960-70, they liberalized their trade regime in the sense they provided free trade status to imports of raw materials and once the exports began to grow, they liberalized imports. Basically, they did not follow the Stiglitz-Charlton recommendation. Of course they could have liberalized their imports as the same time they promoted exports and got even a better allocation of resources (by reducing the bias against exports arising from general import duties) , but they did not. By maintaining import controls for some time, East Asian countries allowed a bias against the exports to continue. Also, their trade system had a highly competent, committed and incorruptible bureaucracy that had to provide various rebates, credit subsidies and depreciation allowances, firm by firm. How many countries have that kind of beauracracy to match South Korea, Taiwan and Singapore? On the other hand, there were no trade barriers in Hong Kong and she did not use any of these promotional devices. It was able to match the success of others who used these specific interventions. Moreover, such special targeted promotion measures would be WTO illegal today, others would challenge these devices. Also, it is not clear whether these countries would have done even better without such promotion measures by more general non-selective measures. Today, many countries have very open and liberalized economies in the developing world such as Chile, South and Eastern parts of the Republic of China, South Korea and Uganda and Botswana. In contrast, Sri Lanka, despite the strong liberalization in 1977 and its follow up in 1989, has one of the most complicated, unpredictable and bribe-ridden import regimes today.

Stiglitz and Carlton favor industrial policy and picking winners by the Government. There is a rich literature on industrial policy that has looked at the issue and concluded that it does not pay to pick winners. Rather winners pick their own activities and the Government provides support. It is the more accurate interpretation of the reasons for East Asia success in trade in the mid to late 1960s. The choice is not made by bureaucrats. Where the bureaucrats made the choices and gave subsidies, studies show that the promoted industries had low productivity compared to those not promoted[11].

Where Stiglitz is right is that some cushion could be provided to activities that are going to lose out in a trade liberalization. This could be done through adjustment assistance. The other way to undertake a trade liberalization is to announce the reform program in advance and stick to it, so that those who want to leave the activity or enter it could have a good idea as to what to do. Moreover, such adjustment become easier when the economy is growing and supply responses are facilitated with the availability of credit, access to inputs and other facilities like services for expansion of the activity. Complementary polices are necessary to make a reform program successful as Stiglitz and Charlton note. It is difficult to believe that a dynamic garment industry could have emerged in Sri Lanka without the liberalization of the economy in 1977 and a return to the path in 1989, even for a short period. Equally, the attempt to set up two hundred garment factories under Government auspices by President Premadasa had to fail. It was not based on entrepreneur choice but an attempt to create an industry by the Government in a highly competitive world garments market.

Regulatory Reforms: These reforms must enable firms to operate efficiently by facing competitive input and output markets. If they operate in the tradable sector, a trade opening supports the regulatory environment to promote efficiency and competitiveness. In the non-tradable sector, where firms do not directly face competition, an additional effort has to be made to prevent the growth of monopolies that will raise costs and damage competitiveness. In Sri Lanka, the regulatory environment is not well developed because of the large size of public corporations in the economy who receive budget subsidies; easier access to credit compared to the private sector and have become repositories of political patronage. Despite the 1977 reforms of the economy, public corporations continue to function as before, by and large. Later, they assumed greater support from the newly elected governments due the ideological difference from the past and even greater politicization by appointing managers from the winning political party. The Governments that came into power in 2004 were not well disposed towards privatization for the reason that earlier privatizations have not been conducted well.

Reform of the regulatory environment to make free entry and exit from activities possible and promote competitive behavior to create a level playing field is essential for efficiency. Otherwise, Sri Lanka will be at a disadvantage with respect to her competitors and also the resultant inefficiency will lead to high prices and reduce both consumer welfare and profitability of enterprises that use products and services of these firm's inputs. Public sector reform to bring this about is long overdue. It is not clear,

[11] Beeson and Wienstein (1996), Rajapatirana (2003)

whether this issue would be resolved in the near future, given recent amendments to the constitution that could reduce the independence of bodies that oversee these corporations.

Reading Stiglitz in the three works gives one the impression that he is better disposed towards public rather than private ownership. He has expressed concern about the rush with which public enterprises were privatized in some countries. That is a genuine concern. However, one cannot object to privatization under a well-designed and functioning regulatory regime. At shown above, an over-extended public sector can be inefficient for a number of reasons. First, incentives to maximize profits take a back seat to the security of public ownership. Second, most of these enterprises in Sri Lanka have become politicized and their management is given to political appointees who have neither the expertise nor the interest in the efficient running of these enterprises. Finally, Stiglitz seems to ignore the large amount of empirical work done in South Asia, Latin America and Sub-Saharan Africa where public enterprises have performed very poorly and have been a drain on Government budgets. As shown above, even reforming governments (such as the UNP Government in 1977) have been reluctant to reduce their size in the economy as they provide sinecure for parking political supporters, who most of the time have no idea of running a business. Even if competent managers are appointed they will find it hard to turn around a culture of inefficiency and lethargy so characteristic of public enterprises in Sri Lanka. It is hard to imagine that Stiglitz could support such a situation despite his disposition towards public ownership.

Another aspect of regulatory reform that Stiglitz deals with in the two books on globalization is the treatment of multinational corporations. He is very critical of them. His main complaint is that they operate with impunity in the developing world and that they locate in countries that have loose labor and environmental standards that cause a race to the bottom in international investment. His views show a stark contrast between publicly owned corporations and privately owned ones. He feels that multinational corporations promote corruption and influence host government policies to such an extent that their value is doubted by Stiglitz in no uncertain terms. As far as Sri Lanka is concerned it is hard to contend that multinational corporations have so much power in this country. With the departure of agency houses in the 1970s, the power of multinational corporations have declined, even if they had any power before. The same agency houses were responsible for leaving behind one of the best run and profitable plantations enterprises in the developing world.

Contrary to what Stiglitz contends multinational corporations could be useful to Sri Lanka in a number of ways. They can provide additional resources needed to increase overall savings and investment rates (more preferable to foreign borrowing), can act as a conduit for foreign technology and management know-how and give access to foreign markets. Sri Lanka needs to look to them actively seek them out benefit from foreign direct investments. Ideally, they should have national status, namely the same regulatory and tax regimes as the national enterprises. Most of the successful developing countries have depended on them to support their development. China has received the largest amount of foreign investment for any developing country in the world. Others like Vietnam, Thailand, Indonesia and Philippines are actively looking for these corporations to expand their operations in their countries. These corporation have been the vehicles that have spread the effects of globalization. On balance they provide net benefits, contrary to what Stiglitz claims. Developing countries need to have sound regulatory environments to avoid some harmful effects that Stiglitz talks about. This could be done by instilling corporate responsibility, limiting their power to pursue anti-competitive behavior and adopting global laws that Stiglitz says must be put in place. If such laws are promulgated Sri Lanka should also adopt them to the extent they become universal, but not otherwise.

Institutional change: In a modern economy like Sri Lanka, institutions must be robust, neutral and be the anchor to which reforms are attached to provide continuity and credibility. A modern competitive market cannot function well without these anchors. Among them the rule of law, commercial codes and a clear definition of rights and duties of contracting parties have to be specified and enforced for efficient transactions to take place. These property rights or the rules of the game that determine the transactions costs which firms have to bear in conducting their businesses. Less clear these rules are, higher the transactions costs and lower the efficiency.

Among important property right Stiglitz discusses in the three books are those relating to patent law and intellectual property rights? Industrial countries are pushing for trade related intellectual property rights (TRIPs) to protect patents particularly in the areas of pharmaceuticals, information technology and similar patent protected products. Their negotiations on trade emphasize these aspects in exchange for reducing their own barriers on agriculture and traditional manufactures of interest to developing countries. More recently, there have been attempts by these countries and their corporations to appropriate intellectual property rights with respect to traditional medicine from developing countries. These attempts need to be resisted. Such cases have come up when some United States' firms have tried to get patents for turmeric, basmati rice and indigenous medicines. Patents create monopolies over and above what is needed to create incentives for innovation and invention. Stiglitz warns developing countries to be careful about protecting their traditional medicines and practices from encroachment by foreign firms which would like to appropriate these rights for themselves and hold monopoly power over them.

Together with the regulatory environment, institutions define the business environment. Sri Lanka has a lower ranking on global studies done on the business environment or the cost of doing business in the country. Out of some 181 countries, Sri Lanka has the rank of 102nd, a position it cannot ill afford if it were to grow rapidly and reach the doubling of per capita income in ten years. These high costs would discourage both domestic and foreign investors who are looking for business friendly and conducive environments.

Among the institutions in the country, the Central Bank assumes a key role. This is not only because of its role in formulating monetary policy, but also being the economic adviser to the Government and as the institution charged with the responsibility of maintaining price stability and competitive and stable exchange rates. It has been the interlocutor for the Stand-by Agreement with the IMF since July 2009 and has now (September 2010) been instrumental in meeting performance criteria to get the third tranche out of the eight tranches of the Stand-by agreement. After a period of nearly three years of poor exchange rate, foreign borrowing and monetary policies, it went to the IMF reluctantly, but have since maintained a good standing up to now. Due to more restrictive and appropriate monetary policy, and with the decline in international prices, the inflation rate has fallen to around five per cent. It would be most important to maintain this stability beyond the IMF Stand-By that will be effective until 2011, if nothing untoward happens to suspend it as was the case in the 1974 Stand-by.

Given his strong criticism of the IMF, it is clear that Stiglitz would not have favored Sri Lanka seeking support from it. But events and developments have shown that it was a wise decision to have gone to the IMF. Without it, Sri Lanka would have been in dire straits in 2009 with an unsustainable balance of payments, the highest inflation rate in the region and large debt service obligations and was downgraded by two sovereign debt rating agencies. Meanwhile, world demand has fallen and Sri Lanka has lost its duty- free access to the European market when the European Union withdrew the GSP Plus concession. The conditions of the Stand-by are not onerous and the IMF has revised its fiscal deficits and other performance criteria to accommodate developments in the country from the national elections to the need to build infrastructure and facilities in the North and the East. One wonders, what Stiglitz’s advice would have led to, if Sri Lanka did not have the Stand-by Agreement.

4. Conclusions

While Stiglitz’s views on globalization and trade are interesting and provocative, they would not be easily adopted by the world community, particularly among the industrial countries and large developing countries. To the extent that they are not, they are Utopian. But some of the ideas he has espoused have already been worked upon, such as reforming the governance of international financial institutions albeit at the margin, to give larger quotas to three or four large developing countries to China, India, Brazil, and probably South Africa, the leading countries in their own regions. But others have proposed these reforms, even earlier. Sri Lanka should support this effort in the various international forums. However, it is unlikely that the governance in these institutions would follow a one country one vote basis. Nor would that be beneficial to separate the power of decision making from financial contributions. The United Nations provide a good example of the need to avoid that principle as it bestows power without responsibility, particularly harmful to small countries.

As far as his criticisms of 'market fundamentalism' and ' Washington consensus' are concerned, it is not an issue of concern to Sri Lanka as she must follow her own interest in using ideas that are market friendly, that is a choice only this country could make. First, his criticisms of these institutions and the US Treasury are over-drawn and unnecessarily strident. Going to the IMF was not a bad thing for Sri Lanka. It would have been worse to have tried to do it alone with the high level of debt, large external deficits and the need to have fiscal discipline. The macroeconomic situation was becoming increasingly unsustainable, despite the views expressed by the Government and the Central Bank in 2006 and 2007, that Sri Lanka would not seek assistance from the IMF. Of course one must face up to the fact, that if the Stand-by were to fail (there is no reason it should, with correct policies), there is no penalty to the IMF.

With respect to more specific country issues that Stiglitz discusses, Sri Lanka did well with trade reform in the past. His views on trade liberalization are somewhat discouraging and need not be taken to heart. When one looks around the world, faster growth is in countries are that have more open economies and trade regimes. Without reform the of the trade regime it would be difficult to achieve the doubling of per capita income and raising welfare of the people across the board. One word that seem to be conspicuously understated in the three books is "reform". And, that is a disservice to poor countries. One agrees with Stiglitz that trade reforms must be accompanied by complementary policies relating to regulation and the reform of institutions.

One must also heed his warning about "bio-piracy" to protect Sri Lanka's property rights from those firms that attempt to acquire property rights on traditional medicines and exclude others from using them without paying a licensing fee. Imagine, if basmati rice were given a US patent, those Pakistani and Indian farmers would have had to pay licensing fees to the US patent holder! His suggestion that foreign drug companies should sell their drugs at low prices in the developing world and practice price discrimination is not an unsound idea. But from a world welfare point of view if drug companies should not encouraged to do research on new drugs, everybody, everywhere will lose.

There are three areas in which Stiglitz's views are particularly deficient and questionable. First, his characterization of the international trading system as inherently unfair is not valid because under the "Escape Clause" introduced in 1979 in GATT, developing countries can seek and receive "special and differential treatment", so they have an exemption from reciprocity. However, that is a two-edged sword. By using this clause developing countries can keep their countries protected and pay a price for it in low growth and welfare in general. Second, his criticism of multinational corporations is over drawn. On balance they do much good than harm, which is why developing countries go out of their way to invite them to locate in their countries. Besides, by having a good regulatory regime, developing countries can avoid and minimize any adverse effects of these corporations. Finally, and importantly, he gives developing countries wide latitude to avoid reform and treats them as victims of the international economic arrangements. However, there were many factors that have led to the poor performance of developing countries; they range from sheer neglect of the economy by non-democratic governments who are not dependent on votes from the public, economic uncertainty that discouraged investment, corruption and very poor initial conditions, as found in low income countries.

Stiglitz could have underscored more the political economy factors operating at the global and the country level. At the global level, rich countries want hold on the status quo and avoid reform of international institutions. But centers of world power are changing and these reforms will have to come when powerful coalitions are formed among the richer developing countries. He favors world government over national states when he writes about world regulatory regimes, and world bodies to monitor international institutions. Such arrangements would be unnecessarily intrusive of developing countries including Sri Lanka, as it has recently discovered. At the country level, it must have coalitions that support reforms in different aspects of the economy and are prepared to take risks to move forward with reform.

Nevertheless, Stiglitz's work is a good read for policy makers and the students alike. But it must be read, understood and digested with a critical eye. As brilliant as Einstein was, he could not have run the tram system in Berne where he lived before emigrating to the United States. Stiglitz should stick to his theoretical work. All can benefit from that effort.

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