Globalization and Its Challenges

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Andrzej K. Koźmiński: Ladies and gentlemen, we are privileged to host Professor Stanley Fischer. Professor Fischer is certainly one of the best-known contemporary economists. Professor Kolodko will introduce our speaker. Hopefully we will also have some time for discussion after the lecture.

Grzegorz W. Kolodko: Good afternoon everybody. Welcome Professor Stanley Fischer. We continue our Distinguished Lectures Series which started over two years ago with the first presentation and lecture by Professor Robert Mundell, the Chairman of the International Advisory Board of our TIGER (Transformation, Integration, Globalization Economic Research). Today we have the privilege to host Professor Stanley Fischer who, I believe, is very well known to everybody, starting with our students, as it is hardly possible to find these days a student who has not studied the famous textbook by Professors Rudiger Dornbusch and Stanley Fischer, "*Macroeconomics",* and other works of Professor Fischer.

Professor Fischer was born in Zambia. He got his degree in the United States where he later served as the head of the Department of Economics at Massachusetts Institute of Technology (MIT). He was also involved in teaching and researching at the University of Chicago, Stanford University and Hoover Institution. I think, aside from his large contribution to the theory of macroeconomics and international finance, he is very well known to all of us as the Chief Economist and Vice President for Development Economics of the World Bank and most recently as the First Deputy Managing Director of the International Monetary Fund.

It is at the IMF that Stanley and I first met. I had the privilege to work with him a couple of times, while conducting my research at the International Monetary Fund. At that time we had plenty of opportunities to discuss various issues. I must admit that while acting as the First Deputy Managing Director of the International Monetary Fund he has also assisted in the process of the post-socialist transformation to the market economy and integration of our part of emerging markets into the global economy.

I would like to quote a short point of view from the book *Economic Policy and Equity* which was edited by Vito Tanzi, another Distinguished Lecturer we hosted a year and a half ago, to which book both of us, Professor Fischer and myself, contributed respective chapters. Professor Fischer has written: "As a matter of social justice, all members of society should share in the benefits of economic growth. But, second, there is also an instrumental argument for equity. The adjustment programs that are equitable and growth that is equitable are more likely to be sustainable." I used to quote this opinion expressed by Professor Fischer while he was serving as the First Deputy Managing Director of the International Monetary Fund but I am sure that this view was not only the view of the institution which was co-chaired by Professor Fischer but also of Professor Fischer as a scholar. Therefore I would like, while giving the floor to you, Stan, to raise the question again. Do you believe that we know the way to sustain growth by making it in a contemporary world more equitable, and how much the existing international institutional order and our economic knowledge may contribute to such an end? Welcome again Stan, the floor is yours.

Stanley Fischer:

Thank you very much. It is a great pleasure to be here. I will present a shortened version of the lecture that I delivered at the American Economic Association meeting in January this year in Washington D.C., called: *Globalization and Its Challenges*. The lecture will appear in June in the American Economic Association Papers and Proceedings issue, and you will be able to find the more comprehensive version there.[1]

This lecture is an attempt to present a professional discussion of the key issues in the ongoing debate on globalization. The debate has become extremely vigorous, also extremely passionate in terms of the demonstrations that have taken place at many international meetings, and in terms of the language that is used in the debate. What I would like to do while avoiding polemics is to try to understand what the issues are and see what one can say as a professional economist about the globalization debate and about the main issues in it.

Economic globalization is the process of growing economic interdependence among countries and their citizens. It is reflected in the increase in the proportion of global output that is traded, in the increasing integration of global capital markets, and even in the

[1] The complete article has been published since I delivered the lecture in Warsaw in early May. This paper has been printed with the permission of the American Economic Association.

increasing flows of labor that are taking place internationally. When I talk to some people about the debate they say, "It is nothing to bother about. This process is technologically driven, it is a result of the improvements in computer technology, in communications technology, and it is inevitable. So do not worry about the debate." That is a good argument except that we economists know that between 1913 and 1945 globalization went into reverse. Technology, especially communications and transportation technology, continued to improve during that period. However, it was a period in which countries closed themselves off from the global economy. So there is nothing inevitable about the progress of globalization, except perhaps in the very long run in which we are all dead – and that makes it necessary to engage in the debate, because the policy consequences are extremely important.

I want to discuss four of the key economic issues in this debate. The first is the question of whether poverty and inequality are increasing or decreasing. What is actually happening at the global level to inequality and poverty, particularly poverty? Second issue: whether integration into the global economy is good for growth. Third issue: whether the international financial system is too crisis-prone. Do capital flows need to be regulated more than they are currently? Fourth, whether the global trading system is unfair and whether aid flows are insufficient.

I. Poverty Trends

The first issue - whether poverty and inequality are increasing or decreasing – is politically very important because the opponents of globalization say: "Well, this has been the era of globalization. All it has done is to make the rich richer and the poor poorer. It has not improved the lot of poor people and the poorest countries, because global poverty has been increasing. Therefore the system is bad and needs to be changed fundamentally." So the first issue is global poverty and global inequality.

If they had a view on this issue, most people probably believed that while the share of people in absolute poverty has been declining over time, the number of people living in absolute poverty has been increasing. Absolute poverty is defined here as living on an income of less than a dollar a day.[2] Now the data on the numbers of people living in poverty are controversial. Even our current measures are inaccurate, and we do not have good data for much of the past. But the best efforts that have been made to produce those data suggest,

[2] Strictly speaking, the World Bank, which estimates these data, works with a real income of $1.08 a day in 1993 dollars.

first of all, that the first assumption – that the share of people in poverty has been decreasing – is a fact.

In Figure 1 you can see data presented by Bourguignon and Morrison, published in the American Economic Review in September 2002,[3] which are very careful estimates of what happened to global poverty in the second half of the 20th century. The figure shows the share of people living under one dollar a day decreasing from over half to less than a quarter by 1992. This has been happening during a period of sharply rising population. In relative terms that represents remarkable progress in reducing global poverty.

The estimates of global poverty since 1992 have been a subject of even more controversy than those up to 1992. There are some publications by serious scholars that claim that global poverty, measured in the World Bank way – one dollar a day – is now only about five percent.

I do not want to go into that debate, because I do not know the numbers well enough, but I do want to present the World Bank numbers, which are shown in the Figure 2. These are the World Bank's estimates of total numbers of people in poverty. They show first that the share of people living in poverty was greater in 1990 than it was in 1987; that is because both China and India were in recession between 1987 and1990. The estimate is that there were nearly 1300 million people living in absolute poverty in 1990, and 1170 million people living in absolute poverty in 1999. That is a decline of 10 percent in the *number* (not proportion) living in poverty in the last decade of the 20th century. Of course the largest part of that progress has been happening in China.

So there has been progress not only relatively but also absolutely in recent years right through the global financial crises of the last decade of the 20th century. That is encouraging. Less encouraging is the fact that poverty rates went up in some regions. Not in East Asia and the Pacific, even excluding China, where the poverty rates were reduced, but in Europe and Central Asia -- which means that in the transition economies, Poland among them, the poverty rate went up very substantially in the 1990s. There was almost no change in the poverty rate in Latin America, the Caribbean and the Middle East, but there was a significant rise in Sub-Saharan Africa. And there was a significant decline in India, Bangladesh and Pakistan.

Thus the global trend conceals widely divergent behavior in different regions of the world. The development problems of Africa, of which you are already aware, are reflected in

[3] Bourguignon, Francois and Christian Morrison (2002). "Inequality Among World Citizens: 1820-1992", *American Economic Review* (Sept) 727-744.

rising poverty. There was not much progress in Latin America. The worsening of the situation in transition economies has begun to reverse and there is now an improvement in most of the former transition economies. And of course there were phenomenal improvements in China.

So far we have talked about poverty rates. What about the social indicators? You can see what has been happening in Figure 3, a complicated picture, which I would like to take you through. This adds indicators other than income. The first is *literacy*. Between 1980 and 2002 in every region of the world – in sub-Saharan Africa, in the Arab states, in South Asia, in East Asia, in Latin America, in every developing region – over the past twenty years literacy has risen substantially. If you look next at *infant mortality* in every region – Sub-Saharan Africa, the Arab states, South Asia – it has declined. Obviously it declined in some places much more than in others, but even in Sub-Saharan Africa, there was an improvement from about 230 to about 180, a decline of over 20 percent even in those adverse economic circumstances.

What about *life expectancy*? Here the story is more ambiguous. You will understand what the ambiguity is about shortly - - that will also increase your confidence in the figures. Life expectancy has been increasing in all regions but two. In the high-income countries, as in Latin America, in East Asia, in the Arab countries, and in South Asia it has been increasing. In Sub-Saharan Africa life expectancy increased up to 1990, and then from 1990 it decreased – and it decreased because of AIDS. In Central and Eastern Europe, in the transition economies life expectancy decreased in the transition process. That has now begun to reverse. But developments in Africa have been extraordinary and dismaying, as you can see from Figure 3. In Botswana, life expectancy decreased from 65 to 31 in a decade; in Zimbabwe the decline was from 52 to 27; in South Africa life expectancy decreased by 19 years and in Kenya it decreased by 17 years. What the AIDS epidemic is doing to these countries is absolutely devastating. There is something especially poignant in these numbers, which is that Botswana has for decades in many ways been the most successful Sub-Saharan African country. For about 30 years on the basis of having diamonds and managing the investment out of those proceeds very well, Botswana was the fastest growing county in the world. It is not any longer – mainly because of HIV/AIDS.

Nonetheless, overall the social indicators tell a better story than the income indicators about progress around the world. This is summed up in the Human Development Index

(HDI), published every year by the UNDP in their excellent *Human Development Report*. The HDI is an index that weights per capita real income, health, and education. The HDI has improved globally since the 1980s, except in Central and Eastern Europe between 1990 and 1995. It even improved in Sub-Saharan Africa. That is to say that on the weighted average of the three indicators, the situation in Sub-Saharan Africa, terrible as it was, was improving.

Let me mention one other important point, which is noted in the *Human Development Report*. The last decade of the 20th century was an exceptionally good decade for one other reason. If you look at the number of democracies in the world, you in Poland would not be surprised to know that the number of authoritarian regimes declined from 67 to 26 between 1985 and 2000. You know that is importantly related to the breakup of the former Soviet bloc. It also has to do with the fact that between 1985 and 2000 nearly all of Latin America became democratic.

What about global inequality? Here the picture is not simple, and the data are highly imperfect. We do know that inequality in many of the industrialized countries increased during this period, particularly in the Anglo-Saxon countries – the United States and the United Kingdom. It did not increase in continental Europe – which is probably in large part due to the impact of their comprehensive social welfare systems. Inequality did increase in some developing countries, including China, which had been uniformly poor, but where during the development process huge disparities opened up in income between the coastal regions and inland regions.

Surprisingly, inequality can increase in each country but decrease in the global economy. Just think about the China example to understand that. Suppose that inequality in every other country does not change. Suppose that Chinese per capita income was well below the global average in 1980. Suppose that half of China got much richer. That would mean that half of China is moving towards the global average, reducing the number of extremely poor people. Global inequality decreases in this process even though within China inequality has increased and it has not changed everywhere else. Something like this appears to have happened in the last decade. In a few countries inequality decreased; in some countries it increased (although the increase in inequality in the United States appears to have started to reverse in about 1995); at the global level inequality decreased.

As for the inequality between individuals in particular countries, I put some weight on the fact that inequality did not increase in parts of Europe (this is a partial answer to the question that Professor Kolodko has raised). I interpret this to mean that the social welfare system can make a difference to inequality. (By the way, this is not to say that I think the

European systems are ideal, but I do think that a well-designed social welfare system can reduce both poverty and inequality.)

Let me conclude this section by repeating why we are interested in the facts about changes in poverty rates and the HDI. The reason is that these are the facts that fuel the debate. Explicitly or implicitly one hears the argument: "OK, we have been doing what you say we should, you – the IMF, you – the Washington consensus, or whoever, and the world is getting worse, not better." Well, that is not true. The world has been getting better. That is not to say that there is not much misery in the world, nor is it to say the world cannot be made much better than it is. But it is to say we risk making major mistakes if we do not acknowledge that the age of globalization has brought enormous benefits to billions of people around the world.

II. Trade, Growth and Capital Account Liberalization

Does integration into the global economy make sense? Does it increase growth? We need to distinguish here between integration of the goods markets – about opening the economy to trade in goods and services – and integration of the financial markets – capital account liberalization.

There are relatively few disagreements about trade liberalization. We know that in the immediate post-World War II period, development economists emphasized import-substituting-industrialization – an idea that is so attractive that it is easy to understand that everybody could be seduced by it. What is simpler than to say: "We do not have these industries, industrialization is the way to grow, let us therefore give our producers some temporary protection to enable them to develop their industries."

Many of you here are studying economics. My great teacher, Paul Samuelson, said he was once challenged by an MIT physicist to name one idea in economics that is not obvious. Samuelson replied that the theory of comparative advantage is not at all obvious. The theory that even though costs seem to be lower in all goods in one country it may nevertheless pay to specialize internationally is not an obvious one. If you want to be persuaded of that, try to remember the first time the theory was explained to you – it did not seem clear then, you probably only understood it later.

The notion that being open to trade rather than protecting everything would be good for growth is difficult to accept. That must be why we started fifty years ago with the view that countries should protect their domestic industries. And protectionism worked for some time. Then it began to be noticed that the more successful countries were those that were promoting exports, rather than preventing imports. If a country pursued an export-driven strategy, it could not keep imports out, because it needed to import capital goods and raw materials. A country could try to keep out consumer goods and many countries did. Even so, it gradually began to be accepted that export promotion was the best strategy and that countries that are export promoting also needed to open up to imports.

Many empirical studies of this question were undertaken in the 1980s and 1990s. Possibly the best known is the paper by Jeffrey Sachs and Andrew Warner, published in *Brookings Papers* in 1995. It showed that countries that opened to trade on average grew significantly faster than those that did not. This and many other papers in this area were severely criticized in a paper by Rodriguez and Rodrik which points to a host of econometric problems in this set of studies.[4] Even so, Rodrik's conclusion on this issue is that "…No country has developed successfully by turning its back on international trade and long term capital flows." And this is the key conclusion one should draw from the trade and growth literature.

Saying that a policy of trade liberalization is good for growth is not to say that every country should remove all trade restrictions and open up immediately. It *is* to say that a gradual process of trade liberalization is good for growth. It is also not to say that the framework in place is irrelevant. If you open trade in a highly distorted economy you will have more problems than if you open trade in an economy that is operating more or less reasonably.

Next is the closely related and much discussed question of the impact of growth on income inequality. It is often argued that growth promotes inequality and may even increase poverty. I must confess I have never understood the underlying basis for this argument. You could take all the income in China and distribute it exactly equally and all you would have is 1200 million poor people. Or in the Chinese case you could set the growth process going and raise average income by a factor of four within 20 years, producing a lot of rich people and some people whose incomes grew very little. Inequality increases in this process.

Nonetheless there are fewer poor people than there would have been if policies had insisted on maintaining absolute equality during the growth process. And this effect only intensifies over time. I do not see any basis on which one could possibly argue that anything other than growth is the way to produce long-term declines in poverty. A willingness to give up significant amounts of growth to reduce inequality in the short run strikes me as self-

[4] Francisco Rodriguez and Dani Rodrik, "Trade Policy and Economic Growth: A Skeptic's Guide to the Evidence", *NBER Macroeconomics Annual,* 2001.

defeating to what should be the long-run goal of policy, to reduce poverty. Now that is a value judgment, and I may have the wrong values. Maybe equality is a hugely important factor on its own and shared misery is better than unequal growth – but I do not believe that.

There is no evidence that growth and inequality are inherently connected. David Dollar of the World Bank has shown that on average, across countries, the average income of the poor rises one for one with the average income of the country. But that relationship is not the same in every country – and that is because of the other policies that accompany the growth-inducing policies of the government. If at the same time as the economy begins to grow, the government invests heavily in education – especially primary education – and health, then growth will be more equal. Simon Kuznets, the great empirical economist, argued that in the growth process, inequality first increases and then decreases. This finding was based on a limited data set, and has not stood the test of time. Indeed, I do not see the evidence to support the view that growth, whether a result of trade-opening or some other factor, is inherently more likely to increase than to decrease poverty or inequality.

While I find the evidence on the impact of *trade liberalization* persuasive, that on *capital account liberalization* is more complicated. In the long run all countries will want to liberalize their capital account. The question is how fast to do it. Countries should not necessarily liberalize the capital account at the same speed as they would liberalize trade. If you liberalize the capital account before you have a strong financial system and before you have macroeconomic stability, you are heading for trouble. And even more so if you try to do it with the pegged exchange rate. So if you want to open up, get your financial system in shape, get yourself a floating exchange rate, and get your macroeconomic system in shape. Then you can open up.

There have been important instances of premature liberalization. Those are some of the countries that were in crisis in Asia in 1990s. But in those cases – particularly Thailand and Korea – it was not so much a matter of premature liberalization as simply inappropriate liberalization. The advice on liberalizing the capital account should be to open to foreign direct investment first and other long term flows first. The last element to liberalize should be short term flows, because they can come in and go out very fast, and put pressure on the exchange rate and the financial system. Korea discouraged long term foreign investment inflows, but it did allow short term inflows mainly because it wanted its banks to be able to borrow and get funding abroad. Thailand similarly opened up more to short term than to long-term foreign capital flows. That was a mistake. As is often pointed out, Chile and other countries have sought to limit short-term capital inflows in part through taxing; that can be done for some time, but all these controls eventually lose their effectiveness. Just last week *The Economist* came out, to my surprise, in support of some controls on capital inflows, such as those formerly used in Chile.

So the bottom line on integration in the global economy is yes on trade, and yes on capital account liberalization, but especially on the latter, only once you have the right conditions in place.

III. Global Financial Instability

The third issue I want to take up is whether the global financial system is too unstable. The emerging market crises of the last ten years, among them Mexico in 1994, Asia in 1997, Russia in 1998, and Turkey, Argentina and in Brazil between 1999 and 2001, constitute the prime evidence of excessive instability.

There is a significant element of instability in short term capital flows around the global system – for asset markets are subject to bouts of excessive optimism and pessimism. But the volatility of capital flows associated with the crises of the last ten years was accentuated by the fact that virtually all the crisis countries were operating with pegged exchange rates. Consider the crisis countries: Mexico in 1994; Thailand, Korea, Malaysia and Indonesia in 1997; Russia in 1998; Brazil in 1998 and 1999; Turkey in 2000; Argentina in 2001; and Brazil in 2002. Every one of these crisis countries, except Brazil last year, was operating with a formally or informally pegged exchange rate in the period leading up to the crisis.

I believe that when the history of this period comes to be written, the last decade of the 20th century will be seen as similar for the emerging market countries to the late 1960's and early 1970's among the industrialized countries – namely the period in which it became clear that a system with freely flowing international capital and a pegged exchange rate is inherently unstable, and will at some point blow up.

It is a mark of the extra shock-absorbing capacity a country gets from a flexible exchange rate that Brazil survived the period of extreme instability in bond yields and the exchange rate during the second half of the year without having a financial collapse. There is no question that Brazil would have suffered a major crisis had it started its election campaign last year with a pegged exchange rate. Despite the interest spread on Brazil last year rising above 20 percent, and with the exchange rate depreciating by over 40 percent, Brazil avoided having to default on its debt.

I believe the international financial system is much more stable now than it was a decade ago, as a result of the (largely forced) move among emerging market countries away from pegged exchange rates to flexible rates.

As an aside, let me say before any of you ask the question, that the answer is no. The question is: “If we enter EMU, does that mean that we will have a financial crisis?” The answer is no because you will not have a Polish currency to devalue once you join EMU. Being a member of a currency union is very different from having a pegged exchange rate that can be devalued – even if the government declares that will never happen.

In addition to moving to a flexible exchange rate, there are other things countries can do to reduce financial instability. In particular, countries that wish to open to international capital flows need to strengthen their macroeconomic policies and their financial systems.

There are other things to reduce instability in a global financial system, most of them having to do with strengthening the economic system and the financial system of countries that wish to play in the international system, that wish to be open to international capital flows.

I would like to make one more point in this section. During the last decade an enormous amount has been written about the volatility of international capital flows and the risks of premature capital account liberalization. Countries have suffered major recessions in most of these crises. Famous economists have advocated closing of capital accounts. Yet, ask how many countries did close their capital markets to foreign capital? One – Malaysia – for two years, and then it removed many of those controls. I find it remarkable that despite all that has happened and has been said on this issue, countries that are in the international financial system do not want to get out of it.

I did discuss this issue explicitly with some policymakers. In the midst of the crises I asked one of them: “Why don’t you impose capital controls?” One answer was: “We went through that in the 1980s, and we don’t want to do it again. Capital controls don’t work well, they bring corruption, and inefficiency, they obscure what is happening in the economy, and they complicate the tasks of economic policy. We don’t want to impose capital controls.” And I have had similar discussions with others. What does this opposition of these policymakers to capital controls mean? It means that it is up to those who can help these countries by helping them strengthen their economies and – if they come into crisis – lend to them, mainly the IMF, to help them maintain growth and minimize the cost of crises if they occur. I think the way that Brazil handled its crisis in 2002, getting significant IMF loans while sticking to the rules, was the right way to go – and they are being rewarded for that now.

IV. Trade and Aid

The final issue is the international trading system. There is no question that the international trading system has been a key source of growth for the developing countries. It remains true that those countries that decided to take advantage of the system by developing an export-led strategy, which is the countries of East Asia in particular, but will also be Poland as it goes into Europe, and South Africa, which has gone from exporting 21 percent of GDP in 1994 to exporting 33 percent in 2002, that trade is a source of growth. It is a source of growth to those who despite the restrictions are willing to take part in the system.

But the system is also in key respects unfair for the developing countries. It is unfair for reasons that you can see in the chart on tariffs that confront different products (Figure 4). These are 1995 tariffs. Item number one – tariffs on agricultural products are much higher than those on industrial products. Note that on average agricultural tariffs are not higher against imports from developing countries than from industrialized countries; rather they are high and biased against all foreign agricultural producers. But the system *is* biased against developing countries because tariffs in agriculture – in which the developing countries have the comparative advantage – are much higher than they are against industrial products. Further, as Figure 4 shows, tariffs on manufactures *are* biased against developing countries' exports relative to the exports of high-income countries. So developing countries are discriminated against both because agricultural tariffs are high, and because tariffs – and incidentally and importantly other trade restrictions – on industrial products are higher for them than for industrialized countries.

That is why the Doha Round, which is getting under way now and is called the development round for trade liberalization, is so critically important. As of today the Doha Round is said to be failing, but trade liberalization talks always go through many rounds of failure and many crises. We do not know at this stage what will happen in the Doha Round. It would be a major mistake for the industrialized countries to allow the Round to fail – in the sense of not reducing the bias against developing countries. Success in the Doha Round is one key to making the international system better and fairer.

Trade liberalization can do a lot for the incomes of developing countries. Figure 5 shows some calculations about what would happen if trade liberalization took place. The figure shows that if trade were fully liberalized – by both industrialized and developing countries – the developing countries could gain 500 billion per annum by the year 2015. That would be a 5 percent boost in incomes under the most optimistic assumptions and 1.75 percent under less optimistic assumptions. Those are very large gains. They far outweigh the benefits of aid. And there is one fascinating fact about them. About half the gains to the developing countries come from opening up to each other. There is a massive loss of income in the system as a result of developing countries discriminating against other developing counties. This is a source of unfairness and inefficiency in the global system where the ball is in the developing countries' court.

Finally, and briefly, I will talk about aid. Aid flows declined relative to GDP in the 1990s. There are many criticisms of the aid process. Aid is inefficient, it brings aid-dependence, it has sometimes been associated with corruption, it has by far not been as successful as was expected, nor as effective as it should be. Aid is nevertheless potentially an important mechanism for helping the poorest countries grow, particularly those, the poorest, that simply do not have the income to provide the necessary physical infrastructure and health and education services that are essential to growth. While I recognize all the difficulties about aid, I believe that the decline in global aid over the years, particularly as a share of GDP, has been an important negative factor for the developing countries, for the poorest, and we should reverse it.

V. Summary and Conclusion

To summarize: the global economy has brought huge benefits to many people, it has produced more growth for more people, for a greater proportion of the world's people, in the second half of the 20th century than at any previous time in history. This is a process in which countries should participate, with all the caveats I have noted. Globalization is of course imperfect because trade liberalization is not complete and because the system discriminates against the poorest countries. It is highly imperfect because the international distribution of income is unfair and aid is insufficient. But globalization is not something that we should fight, it is something we should try to make better.

At the end of my Washington lecture, I was asked by a friend why the defenders of globalization are always so apologetic and nuanced while its opponents have no doubts about their criticisms. The answer is: you have to do the best to describe the situation as you think it is, and it is not unambiguous. Globalization does have its minuses as well as the pluses. The pluses are hugely bigger than the minuses, but if we are serious, we have to discuss the minuses.

I summarize my views as follows. Winston Churchill said about democracy that "Democracy is the worst form of government except for all the others that have been tried." My views on globalization are that the pro-globalization approach to economic policy is the worst economic policy – except for all the others that have been tried.

Thank you very much.

Andrzej K. Koźmiński: Thank you very much for this fascinating lecture. We still have a couple of minutes for questions. The floor is opened for questions.

Andrzej Kurlicki, Warsaw School of Management, Warsaw University: You expressed the opinion that crises are mainly due to the pegging or fixing of the exchange rate. What about an excessively low interest rate set by the central bank and the corresponding stock market bubble? My second question is the following. Judged by the performance of the Polish economy – jump in unemployment, increasing number of people living below the poverty line and lower growth rate than in Russia – market liberalization and globalization seem to do more harm than good to the economy. What is your opinion about that?

Stanley Fischer: On the first question concerning the stock market bubble and whether keeping interest rate too low produces bubble: This is one of the toughest unresolved issues in monetary policy - - whether to react to asset prices or simply to ignore them and focus only on inflation. My belief on that issue is that most of the time, the central bank should not use monetary policy to try to affect stock prices. But there may be exceptional circumstances in which asset prices are so clearly out of line that the central bank needs to take them into account when setting monetary policy.

Now this is very easy to say in the abstract. But in practice it is very hard to be certain that asset prices are too high. What you do know is if you raise the interest rate too much and create a crash then everybody will know where to point the finger – you did it. The other way, the market did it. So, it is a very tough responsibility.

On high unemployment and the growth rate in Poland. You are growing at a slower pace now but you have a higher income level than Russia. Russia is very likely to grow at a higher rate than Poland because it lags behind. Your high unemployment, I think, has three causes. One is that there is a lot of restructuring that has still to be done in the economy. The second cause is that people reported as unemployed may not be unemployed. The third is that the rules on hiring and firing and various payments that had to be made by employers make it less attractive to hire people. Under similar circumstances, Spain made changes in the system that gradually reduced unemployment. That could be done in Poland too.

Alojzy Nowak, Leon Koźmiński Academy of Entrepreneurship and Management: I wanted to make one comment and ask you three very easy questions. First of all I would like to thank you for your excellent lecture and I wanted to confirm also what Professor Kolodko said that you are a very well known person here because most of us used your and Rudiger Dornbusch book. Even earlier, in the communist time, we also used Paul Samuelson's book, I do not remember exactly *Nine* or *Twelve lectures on Economics*.

Three very easy, one will be impolite, questions. Many years ago a lot of American economists were making jokes about the euro. One of them was your friend, Professor Rudiger Dornbusch who died a year ago. He wrote a paper on *Euro fantasy etcetera*. There were economists joking about the euro from left to right, from Franco Modigliani to Milton Friedman. Then they changed their mind, and they were wishing success to the Euro. Now the Euro is very successful in comparison to the American dollar. Some years ago we had a Nobel Prize winner, Professor Mundell who is the father of the Euro, to some extent, as you know, and who was saying, that probably one day the Euro, American dollar and yen or maybe gold will be exchanged and that there will be some kind of world currency which we can call "Global." What is the chance for it, what is your opinion, Professor Fischer, about this issue?

The second issue is very simple but it is discussed also here in this country. We have been observing some kind of instability in the world and among economists, some of them very well known, criticizing international institutions for what has been going on in the world. One of them is also Nobel Prize winner, Joseph Stiglitz who was the Vice-President of the World Bank. Another is Jeffrey Sachs who visited Warsaw University some months ago. What is your opinion on this?

The third and last question concerns the independence of the central bank. As you probably know we have some problems here. There is some disagreement concerning economic policies between the Deputy Prime Minister and Minister of Finance and the President of the National Bank of Poland. Of course the country and the economy has been suffering very much because of that. Using your experience, not only from international institutions but also from the Fed and the other central banks, what would you advise us to do in this country? Thank you very much.

Stanley Fischer: They are not impolite, they are just difficult questions. Thank you for your comments on the textbook, it is actually one of the great pleasures in my life to find people who used it and are still willing to speak to me. As you know Rudi Dornbusch died last year and working with him was one of the most enjoyable things I did.

I believe that there will be the world currency but it will be after my grandchildren and even your grandchildren have departed from the earth. That is probably the way we are heading but it will take a long, long time. I would not be surprised to see movements in the direction of fewer currencies because people understand that a pegged exchange rate is an unhappy in-between step – small countries with open capital accounts will need either to have a flexible exchange rate or get rid of the currency.

On the criticisms of Stiglitz and Sachs and others from the international financial institutions. They differ very much. I have generally found Jeff Sachs to be very constructive. He makes his points aggressively, but his analysis is usually perceptive, his points are usually interesting and sometimes right, and you can discuss them with him.

On the third point, I am in favor of the independence of the central bank. Taking control of the interest rate from the treasury and the finance ministry has in most countries led to better policies. There is, as you know from the literature, a temptation for finance ministries to want low interest rates, and this is a problem for monetary policy. So you should separate the functions.

There are many countries in which the finance ministry and the central bank disagree, I have noticed that in some countries if you want the most convincing critique of monetary policy you should go to see the finance minister, and if you want the most passionate critique of fiscal policy you should go to see the central banker. That is the way the system works, because each prefers to comment on things that someone else is responsible for. I don't think this approach is productive. Complicated as these issues are, mutual forbearance is better for a country than public disagreements between the two key economic policy agencies.

Antoni Kukliński, Warsaw University: I am looking at the *Herald Tribune* on Friday where we find a note on *Paying the Cost of Unilateralism* and I would rephrase this question. To what extent is the new unilateralism of the United States a danger for the functioning of the global economic system?

Stanley Fischer: This is a very serious issue. In practice the administration has been more multilateral in economic matters than your question implies. For instance, in dealing with both Turkey and Argentina, the administration has pursued a multilateral approach through the IMF.

What happens in the global economy looking forward? There are two possibilities. One is to allow recent disagreements to disrupt economic relations. The other is to say that we need cooperation between Europe and the United States, and that therefore we will compensate for the political difficulties by strengthening economic ties. I hope, and expect, that economic ties will remain very strong, and I hope in particular that the Doha Round will in the end be highly successful.

Andrzej K. Koźmiński: Thank you very much. I think that Q&A time is over also. Thank you very much, Professor, for your fascinating lecture and for your kind answers.