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CREATING KNOWLEDGE TO END POVERTY

THE GLOBAL CRISIS, SOCIAL PROTECTION AND JOBS

Joseph Stiglitz

The current crisis is touching every country in the world, including the developing countries. Globalisation has meant that the world economy has become integrated, that there cannot be a major downturn in the world's richest country without implications for every other country.

There are multiple channels through which this crisis is affecting all the countries of the world. The most direct channel through which it began was, of course, financial markets. Financial flows, which were so strong in good years, are now reversing, meaning that access to finance is becoming a problem in many developing countries. A dramatic fall in the flows to developing countries is projected; in some cases, there may actually be reverse capital flows. Another channel is the unprecedented fall in exports. The declines are of a magnitude that no one ever expected to see. Furthermore, there are impacts through remittances and labour flows. Inevitably, when employment goes down, immigrant labourers are among those first hurt.

It is a truly global crisis, and within a globally integrated economy, a crisis of this kind can only be addressed globally.

There is agreement that we need to have a global stimulus, but countries in the developing world do not have the resources to finance a stimulus package. Unless they receive substantial assistance, these countries will not be able to engage in counter-cyclical policies, and there will thus not be a quick, robust recovery in a large part of the world that is being most affected by the crisis.

However, there is another problem, in addition to the lack of resources: the lack of policy space. Markets are at the core of a well-functioning economy, but, by themselves, they are not enough. There

needs to be a balance between the role of the market and the role of the government. Understanding when markets work and when they do not, and the limitations of markets as well as the limitations of government, is an essential part of developing appropriate policy frameworks.

The nature of the problem that we face today can be put in the following way. The people in the global economy have the same skills as before the crisis, and the machines and real resources are the same as before the crisis. The problem is that there is an organisational failure, a coordination failure, and a macroeconomic failure. We are failing to put to work these human and physical resources to produce output.

What this highlights is the importance of economic policy and organisation. It is not our resources that have disappeared. It is the way we organise those resources to create jobs and to create value. The challenge, in going forward, is to try to create the aggregate demand that will put those resources back to work.

The question is: what kinds of policies and reforms are likely to do that? If we start asking that question, we realise that many of our policy frameworks in recent decades have been making things worse. We have weakened our automatic stabilisers by weakening social protection, and we have destabilised the economy by making wages



more flexible rather than providing job security. We have created greater anxiety, which, in times like this, increases savings rates and weakens consumption. All of these so-called reforms have made our economic system less stable and less able to weather a storm.

As we approach the problems posed by the current crisis, it is imperative to keep in mind the importance of maintaining the automatic stabilisers and the social protections. For a robust and sustained recovery, we must also address the underlying problem of insufficiency of aggregate demand, caused by global inequality as well as inequality within countries, and the build-up of excessive reserves, which is related to the global imbalances that have been a cause of growing concern in recent years.

Unless the problems in developing countries are addressed in a more effective way than they have been in the past, the inequality will increase and the demand for excessive reserves will grow even greater.

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