Joseph E. Stiglitz, *Globalization and its Discontents*, New York: Norton, 2002.

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Twenty-five years ago, Joseph Stiglitz helped to revolutionize the field of microeconomic theory. In a series of articles that later won him the Nobel prize, he showed how asymmetric information influences the operation of credit, insurance, and labor markets. The concepts he and his co-authors developed—"pooling" and "separating" equilibria, "efficiency wages"—now shape the way scholars think about dozens of problems. Other economists of his generation treat him with reverence, while younger ones view him with something close to awe.

In the 1990s, Stiglitz bounded into the public arena. In 1993, he was appointed first a member and then chairman of President Clinton's Council of Economic Advisers. Then, from 1997 to 2000, he served as chief economist at the World Bank. He brought to these jobs not just a brilliant analytical mind but also an acute sense of morality, a concern for the plight of the poor in developing countries, and an unshakeable confidence in his own judgment.

Globalization and its Discontents represents the climax of this venture into the policy world. Stiglitz came to Washington at a complicated time. The US economy and stock market were entering a remarkable boom. Wall Street bankers, never known for humility, were at their most expansive and expansionist. At the same time, many other countries were either suffering through severe economic crises or about to succumb to them. Africa was stagnant; the post-communist world was in freefall; and the Asian "miracle" economies were about to stumble. Within a few

years, it seemed clear to Stiglitz and many others that, as he writes in the book, “something had gone horribly wrong”.

The contrast between the soaring American markets, the globalist rhetoric of Wall Street, and the deepening squalor of parts of the Third World was one of several factors that fueled the emergence of a new international counterculture. Its members had little in common except a shared loathing for something called “globalization”. Some cared about the poor of the Third World, others mostly about keeping them from stealing First World jobs and polluting the environment. Some warned of an international elite conspiracy, others wished there was more global economic coordination. Politically, the anti-globalists came from left, right, underground, and outer space. This book is Stiglitz’s attempt to position himself at the crest of this wave. He lends his intellectual respectability to the network of activists, libertarians, anarchists, Luddites, unionists, peaceniks, environmentalists, organic farmers, and performance artists who converge on world centers periodically to defy the tear gas and smash a few windows.

The book has two main targets. Although these are related, it makes sense to consider them separately. First, Stiglitz attacks the way the international financial system has been managed in recent years. Second, he criticizes a certain strategy for economic reform chosen by some of the postcommunist countries. On both these issues, Stiglitz believes the IMF got things profoundly wrong.

Laying aside the more polemical elements, there is much in the book with which it is easy to agree. First, more should be done to help the poor in developing countries and to help their countries develop. Debt relief is urgently needed. Second, the universal prescription for trade and capital market openness needs to be studied critically (as economists such as Dani Rodrik have,

indeed, been doing for years). Third, states have a role to play in regulating markets, and ineffective and corrupt governments are among the greatest obstacles to development.

None of these points is particularly original, and many of those whom Stiglitz criticizes would surely agree with them. Several other arguments are more controversial, but I think probably correct. First, Stiglitz rightly points out how uneven a playing field the world economy is. The rich countries set the rules and then bend them in hypocritical ways. Most outrageously, Washington pressures poor countries to open their markets and then uses tariffs and anti-dumping measures to block their exports to the US. Stiglitz skewers Paul O'Neill, now treasury secretary, for lobbying the US government when he was head of Alcoa to create a global aluminum cartel to protect his company. If true, this is indeed appallingly crass. Second, he is probably also right to emphasize the dangers of liberalizing capital markets in very underdeveloped countries, a point even the IMF now concedes. Third, the IMF and World Bank—like any bureaucracies—do need transparency, outside monitoring, and impartial expert review. Until recently, they did not get enough.

It may also be true that adopting extreme targets when fighting inflation and budget deficits can be counterproductive. Although inflation above 50 percent a year devastates economies, it is often not worth sacrificing to bring the rate down from 20 percent to under 10 percent. And fiscal deficits are not always fatal to a government's macroeconomic credibility. If targeted spending helps make economic reforms *politically* credible, this can increase confidence in future growth, even if such spending is not fiscally sustainable in the long run. Advocating "user fees" for primary and secondary schools in developing countries and cutting food subsidies in order to balance the budget are, as Stiglitz suggests, generally bad ideas.

These points are scattered among the book's two main polemics. The first of these accuses the IMF of mismanaging the international financial system. In the 1990s, Stiglitz contends, the IMF exacerbated financial crises in developing countries by demanding contractionary policies—spending cuts, high interest rates—as conditions for aid. From Ethiopia to Indonesia, he argues, the IMF wrongly insisted that countries balance their budgets even as they were sinking into recession. Instead, he insists, the IMF should stick to the mission that Keynes originally envisioned for it: it should fund expansionary monetary and fiscal policies that maintain full employment. If a country's banks and firms are insolvent, the government should be encouraged to impose a stand-still on debt repayment by the banks and to organize a quick financial restructuring of the firms, often leaving the existing management in place. The IMF should not provide bailouts to help countries defend fixed exchange rates. Rather, international aid should boost aggregate demand in countries facing business-cycle related slowdowns.

This prescription seems obvious to Stiglitz, and he asserts it without the slightest doubt. He accuses the IMF officials who disagreed with him of "hubris". "They stuck to their positions," he writes, "in spite of what I viewed as overwhelming evidence of their failure" (p.129).

To give Stiglitz his due, it may well be true that the Asian crisis of 1997-8 was deepened by attempts to impose contractionary policy. When the crisis struck, the embattled governments had balanced budgets or even surpluses and low inflation. It might well have been appropriate in these cases to *soften* policy with government spending or tax cuts, much as the US does as it sinks toward recession. (In a response to Stiglitz, Kenneth Rogoff of the IMF points out that the IMF did allow for deficits in the Asian countries, and backed off from contractionary policies rapidly.)

But there are other types of financial crisis that look quite different from those that erupted in Thailand, Korea, and Indonesia. In Latin America and the post-communist countries, crises have

usually occurred in countries where governments were running large deficits and printing money to cover them. In these cases, low growth or falling output seems to have more to do with deep structural problems—the transition from central planning, inefficient labor markets—than with business cycle fluctuations. Trying to boost aggregate demand in such conditions is a sure recipe for high inflation, which would stimulate even more capital flight and reduce growth still further.

Yet Stiglitz, while criticizing the IMF for adopting a "cookie-cutter" approach to international financial crises, adopts one of his own. He seems to assume that all the crises that the IMF is called in to address are caused by inadequate demand. All economic illnesses are varieties of the Keynesian disease. If growth is stagnant, government spending must be too low and the country's interest rates must be too high. (Stiglitz might deny adopting this view: on pp.121-2, he does admit to a more sophisticated understanding; but it is a view he seems to forget throughout the rest of the book, where his conclusions and recommendations are phrased with complete generality.) While true in some cases, these assumptions are clearly way off in others. In Russia, they cause Stiglitz to see high interest rates where there were none (see below).

The oddest thing about Stiglitz's criticisms of the IMF, however, is their personal nature. He affects to think that the policies he dislikes were simply chosen by a few individuals in the top jobs. Stanley Fischer, the Fund's former deputy managing director, is singled out for a savaging. These individuals were guilty, in the Stiglitz account, of diverting the IMF from the goals he thinks it should pursue—injecting liquidity into countries in recession, funding Third World health and education systems, fighting poverty, and redistributing land from elites to share-croppers (pp.81, 87).

Why Stiglitz adopts the tone of personal denunciation is hard to understand. He implies at one point, without presenting any evidence, that Stanley Fischer was "venal" and "faithfully executed

what he was told to do" by the Wall Street bankers. Of course, there is a much simpler reason why the IMF did not adopt Stiglitz's preferred policies which has nothing to do with ideology or dubious morals. Most of the tasks he mentions were simply never part of the Fund's mandate. Whether or not Fischer or Camdessus thought them wise or desirable, they had no authority to use member countries' money to pursue these goals.

The IMF's "Articles of Agreement", which countries sign when they join, does authorize the Fund to provide aid to countries undergoing balance-of-payments crises (albeit "under adequate safeguards"). But the document says nothing about helping countries merely entering recession, as Stiglitz would have liked. Nor does it say anything about Third World health and education systems or abolishing share-cropping. As Stiglitz knows, of course, there is a division of labor between the international instititutions. Economic development and building social infrastructure fall squarely within the remit of his *own* institution, the World Bank. Why he did not push these priorities harder within his own building instead of running across the street to lecture Fischer is not easy to figure out.

Stiglitz's second complaint is about how economic reform was managed in the postcommunist world: too many countries—prodded, he believes, by the IMF—chose "shock therapy" rather than "gradualist" strategies. He contends that gradualism has in fact been proved right: "the tortoises have overtaken the hares". He also believes that, although privatization in the right circumstances is desirable, it is a mistake to privatize too early or too fast. He views Russia as the epitome of the failures of both "shock therapy" and rapid privatization.

These claims deserve to be examined separately. In order to award victory to the tortoises, Stiglitz resorts to a rather idiosyncratic classification of species. Poland—usually considered a poster child for "shock therapy"—is labeled a "gradualist". If one adopts a more objective standard, the

hares seem actually to have a comfortable lead. In 1994, the EBRD analyzed how far reform had progressed in a number of spheres—e.g., trade, small-scale privatization, large-scale privatization, the banking sector—in some 25 postcommunist countries. The countries that had reformed more by 1994—i.e., the more radical reformers—grew faster on average between 1989 and 1998 than those that implemented reform more slowly. This is true whether one focuses on price liberalization, trade reform, banking reform, or privatization, and whether one looks at the East European and former Soviet countries together or separately. Obviously, one would need a more sophisticated statistical analysis to reach firm conclusions, but the prima facie association between rapid reform and growth is positive.

The chapter on Russia could have used a fact checker. The misstatements start in the Preface, where Stiglitz writes that he was in the White House in 1993 “as Russia began its transition from communism”. Actually, he arrived a little late: the communist regime had collapsed in 1991. He complains about Russia’s “high interest rates” in the early 1990s (pp.142-3). (We know he means 1992-3, since he is talking about the after-effects of price liberalization.) In fact, during this period, real interest rates were *negative*. He singles out Novgorod as an example of a regional government that extracts rents from businesses. In fact, Novgorod is known as one of the most business-*friendly* oblasts.

Stiglitz is—quite rightly—disdainful of the “loans-for-shares” auctions of 1995-6 (for some reason, he keeps referring to these as “loans-for-*share*”), but his facts on these are also a little off. He blames privatization for letting the oligarchs strip assets. Actually, most of the future tycoons became oligarchs by stripping assets from companies *before* privatization, in cahoots with their state managers. The most notorious of these, Boris Berezovsky, grew rich by managing the cash-flow of Avtovaz and Aeroflot when they were still state-owned. According to Stiglitz, the oligarchs who got companies in the loans-for-shares auctions “left them on the verge of

bankruptcy." He cannot have read the business pages lately. To take just three cases, the market capitalizations in dollar terms of Khodorkovsky's Yukos, Berezovsky's Sibneft, and Potanin's Norilsk Nickel grew respectively by 12, 10, and more than 2 times between late 1996 and late 2001. Companies that the oligarchs got through privatization are mostly doing well these days, with output and valuation expanding, not contracting.

The book offers a contorted argument to suggest that the government let the real exchange rate appreciate in the mid-1990s to help the oligarchs afford "their Chanel handbags". In fact, the oligarchs had much to *lose* from real appreciation, which made their oil exports less competitive. (That is not to say that they desired devaluation in 1998, after they had loaded up their banks with foreign currency debt. Some did, others did not.) He also claims that high real interest rates led to the real appreciation. But much of the real appreciation occurred in 1992-3, when—as already noted—real interest rates were negative. It was only from 1994 that real rates became positive. Real appreciations occurred in almost all postcommunist countries, regardless of interest rates.

Stiglitz repeats the old canard that the Russian reformers "let ideology and simple textbook models determine policy". The only actual reformer he mentions meeting is Yegor Gaidar. Stiglitz makes it clear that he does *not* consider Gaidar to be either economically simplistic—on the contrary, "He knew his economics" (p.261)—or politically naïve. So who were all these free-market ideologues? The genuine "market fundamentalists", such as the gifted economist Andrei Illarionov, never held office in this period.

Stiglitz's favorite comparison is with China, where growth rates have indeed been phenomenal for the last two decades. The secrets of Chinese success, as he sees it, were the gradual liberalization of prices, the creation of effective regulatory institutions and a banking sector, and a lack of emphasis on privatization. Instead of privatizing, the Chinese government leased out land

and encouraged the creation of state-private partnerships like the township-village enterprises (tve's).

There are two problems with this part of the argument. First, it is quite absurd to claim that Chinese economic growth reflects the creation of effective regulatory and banking institutions. The Chinese court system is notorious for corruption and ineffective enforcement of judgements. Meanwhile, the four largest state banks are insolvent, with more than $200 billion in bad loans on their books. They are sustained only by the Chinese population's remarkably high and increasing savings rate. Hundreds of billions of dollars of the population's savings have been channeled into inefficient state enterprises with little positive result.

As for gradual price liberalization and the use of leaseholding and state-enterprise partnerships rather than privatization, Stiglitz seems unaware that this *was* actually tried in Russia and other parts of the former Soviet Union. From 1988, Gorbachev legalized small cooperative enterprises, which could set their own market prices. Larger state enterprises were allowed to go on self-financing contracts, selling part of their output at market prices, and setting up cooperatives. Local governments could also set up cooperatives like the Chinese tve's (the Moscow city government took up the opportunity with relish.) Families were permitted to lease farm-land from 1988. By 1991, the Chinese model in Russia had resulted in a disastrous economic crisis, which Yeltsin and Gaidar inherited. The reformers did not liberalize prices out of some simplistic free-market conviction; they did so because as of late 1991 the state had only a few months of grain reserves, lines for bread were lengthening in the cities, and farms were simply not marketing their crops.

But forget the Gorbachev period. A more statist, gradual approach to economic reform has been tried since then in many of the former Soviet republics. A weekend in Minsk or Tashkent would

probably be enough to see the result. One Belarusan economist tells the story—supposedly true, although it sounds too good to be—that the country's authoritarian president, Aleksandr Lukashenka, recently asked him about the views of the American economist Joseph Stiglitz. After hearing the summary, the Belarusan autocrat is said to have replied: "What this man won the Nobel prize for I have been implementing in Belarus for the last eight years."

The most lasting impression left by the crises of the 1990s is of how much economists still do not know. Does the global system today suffer from a lack of liquidity? If so, how could a Keynesian-style IMF channel liquidity to countries in recession without creating moral hazard or inflation? Are financial crises caused more often by domestic economic weaknesses or the overreactions of international investors? Have African countries stagnated because of credit constraints, market rigidities, macroeconomic imbalances, or insecure property rights? Why did unemployment rise so steeply in Argentina in the 1990s? To frame better policies, governments and international institutions need to know the answers to these questions. If only an economist of Stiglitz's brilliance would set out to study them rigorously. Unfortunately, he seems to think he already knows the answers.