MASTER OF DISASTER
A leading economist says the protesters have a point about the I.M.F.

by JOHN CASSIDY

In 1998, Joseph Stiglitz, a Columbia professor who shared last year’s Nobel Prize in Economics, visited a village in rural Morocco where aid workers had been encouraging local women to raise chickens. At the time, Stiglitz was the chief economist of the World Bank, the Washington-based lending agency, which was supporting the project. It had started out well. The Moroccan government supplied the villagers with as many newly hatched chicks as they needed. But at some point, Stiglitz says, the International Monetary Fund, the World Bank’s sister organization, told the Moroccan government to leave the task of distributing chicks to private enterprise. A for-profit firm agreed to supply the villagers, but it refused to guarantee the chicks’ survival—a policy that had calamitous consequences. The impoverished peasants refused to risk what little money they had on livestock that were likely to die in large numbers in infancy, and the nascent industry withered. When Stiglitz arrived in Morocco, the chicken coops were empty. A promising attempt to alleviate poverty had failed.

It may seem like a long way from Moroccan chickens to the economic crisis in Argentina, the recent financial upheavals in Southeast Asia, the failures of post-Soviet capitalism, and anti-globalization protests on the streets of Seattle and Genoa, but in “Globalization and Its Discontents” (Norton; $24.95) Stiglitz argues that all these matters are related. In promoting private enterprise wherever it can, the I.M.F. was following the so-called Washington Consensus view of economic development, which sees the expansion of free-market capitalism as the route to prosperity. With the backing of the United States Department of the Treasury, the I.M.F. urges governments everywhere to privatize, liberalize, and retrench. In the past twenty-five years, many developing countries have followed this advice, dismantling their public-sector enterprises and opening up their economies to international trade and investment. As a result, the world has become more interconnected than ever, with the level of exports, imports, and cross-border investment all increasing sharply.

According to classic economic theory, this expansion of trade and commerce
should have made humanity a lot better off. Ever since Adam Smith, economists have generally agreed that trade is a good thing, because it allows countries to specialize in what they do best. This “division of labor” (Smith’s phrase) raises productivity, which results in more income to spend on food, health, education, and consumer goods. Although some people lose their jobs as the pattern of trade changes, the winners gain enough to compensate the losers and still have some left over for themselves.

During the nineteen-seventies and eighties, when countries like South Korea and Singapore were exporting their way out of poverty, the theory seemed to be working as advertised. Globalization, in Stiglitz’s words, “helped hundreds of millions of people attain higher standards of living, beyond what they, or most economists, thought imaginable.” During the past decade, however, something has gone wrong. Since 1990, the number of people living on less than two dollars a day has risen by more than a hundred million, to three billion. The gap between rich and poor countries has turned into a chasm. Even relatively prosperous parts of the developing world, such as Southeast Asia and Eastern Europe, have fallen into unprecedented slumps. “Globalization today is not working for many of the world’s poor,” Stiglitz declares. “It is not working for much of the environment. It is not working for the stability of the global economy.”

Why not? According to Stiglitz, the rich countries have hijacked globalization, using as weapons the I.M.F., the World Trade Organization, and other international bodies that are supposed to act in the interests of all countries. These institutions are “all too often closely aligned with the commercial and financial interests of those in the advanced industrial countries,” Stiglitz writes, and the net effect of the policies they promote is “to benefit the few at the expense of the many, the well-off at the expense of the poor.” The governments of the rich countries have pushed developing nations to open their borders to computers and banking services but continued to protect their own farmers and textile workers from the cheap food and clothes that poor countries produce. They have supported the extension of patent agreements that guarantee high profits for Western pharmaceutical companies like Pfizer and Merck while depriving African governments of the drugs they need to fight an AIDS epidemic. “The critics of globalization accuse Western countries of hypocrisy,” Stiglitz writes, “and the critics are right.”

If this argument brings to mind the young protesters who have made a business of disrupting international summits, Stiglitz is unapologetic. Until the anti-globalization movement came along, “there was little hope for change and no outlets for complaint,” he writes. “Some of the protestors went to excesses; some of the protestors were arguing for higher protectionist barriers
against the developing countries, which would have made their plight even worse. But despite these problems, it is the trade unionists, students, environmentalists-ordinary citizens-marching in the streets of Prague, Seattle, Washington, and Genoa who have put the need for reform on the agenda of the developed world.”

As this passage suggests, Stiglitz is part of a growing heterodoxy that seeks to define a middle ground between the Washington Consensus and the more radical elements of the anti-globalization movement. The financier and philanthropist George Soros is part of the dissenting movement, too, and he has written a pithy little book, “On Globalization” (Public Affairs; $20), setting out his views and his recommendations for reform. Like Stiglitz, Soros supports globalization in principle but is dismayed at the narrow focus among policymakers on expanding trade and industry. “International trade and global financial markets are very good at generating wealth, but they cannot take care of other social needs, such as the preservation of peace, alleviation of poverty, protection of the environment, labor conditions, or human rights,” he maintains.

Soros’s book is clearly written, but it doesn’t carry as much weight as Stiglitz’s. As a leading economic theorist and someone who has served in senior government positions, Stiglitz has a perspective on his subject which can hardly be ignored. Within four years of obtaining his Ph.D., from M.I.T., in 1967, he had published more than fifteen academic papers, several of which are now regarded as seminal. He has since established himself as an expert in many areas of economics, including finance, development, and the public sector.

The common theme running through Stiglitz’s academic work is that markets often don’t work in the simplistic way that is taught in Econ. 101. Because of complications like asymmetries of information between buyers and sellers, markets sometimes fail to work at all, and the government has to step in. (It was Stiglitz’s work on asymmetric information that won him a Nobel Prize.) In 1993, when Stiglitz joined the White House Council of Economic Advisers, at the start of the Clinton Administration, he naively thought he saw the chance to “forge an economic policy and philosophy that viewed the relationship between government and markets as complementary.” Instead, he found that “decisions were often made because of ideology and politics. As a result many wrong-headed actions were taken.”

Stiglitz stayed at the council for four years, eventually becoming its chairman. In 1997, he moved a few hundred yards along Pennsylvania Avenue to the World Bank. The World Bank and the I.M.F. had been founded at the
end of the Second World War to promote expansionary Keynesian policies around the globe, with the bank focussing on long-term development and the fund on short-term crisis management, but they long ago converted to the tenets of what Stiglitz calls free-market fundamentalism. The I.M.F., in particular, seems to revel in its role as enforcer of the Washington Consensus. Since countries approach the I.M.F. only when they are desperate for money, the fund has a good deal of leverage, which it uses to force governments to cut budget deficits, raise taxes, and close down or sell off state enterprises. Though these reforms are sometimes necessary, Stiglitz maintains that the I.M.F.’s representatives are often oblivious of the human suffering they cause. “Modern high-tech warfare is designed to remove physical contact: dropping bombs from 50,000 feet ensures that one does not ‘feel’ what one does,” he writes. “Modern economic management is similar: from one’s luxury hotel, one can callously impose policies about which one would think twice if one knew the people whose lives one was destroying.”

The centerpiece of “Globalization and Its Discontents” is a critical account of the I.M.F.’s role in the Asian financial crisis and the Russian transition. The Asian crisis began in July, 1997, when Thailand devalued its currency, and it quickly spread throughout Southeast Asia, plunging the region into the deepest recession it had seen for decades. Stiglitz argues that the underlying cause of the collapse was the misguided financial liberalization that Washington had urged upon the Asian countries during the previous few years. Countries like Singapore and South Korea hardly needed economic advice from anybody. Through a combination of hard work, high savings rates, and extensive government intervention, they had turned themselves into universally admired models for development. Between 1950 and 1990, South Korea raised its gross domestic product per capita from ninety dollars to forty-four hundred dollars. As part of the “Asian model” of development, governments prevented foreign investors (and domestic residents) from moving money in and out of their countries freely. These restrictions helped prevent damaging swings in exchange rates; they also kept out American financial firms, which were eager to expand in Asia. Beginning in the early nineteen-nineties, the I.M.F. and the Treasury Department encouraged the Asians to remove the restriction on capital movements. Stiglitz viewed this policy as an unnecessary sop to Wall Street, but the Treasury Department overruled his objections. By the middle of the nineteen-nineties, South Korea, Thailand, and most other Asian countries had heeded Washington’s advice and abolished controls on money flows. The result was a speculative boom, with foreign capital pouring into risky investments. For a while, the region seemed to be growing even faster than usual. But, once the Thai crisis erupted, overseas investors pulled
out their money en masse, causing financial markets to collapse.

The I.M.F. made the downturn worse by ordering the stricken countries to raise interest rates and balance their budgets in order to restore the confidence of investors. These austerity policies had been designed for profligate countries in Latin America, which ran big budget deficits and printed too much money. Most of the Asian countries, by contrast, had balanced budgets, or even surpluses, when the crisis struck. The fact that monetary policy was being tightened during a recession only spooked investors more, and the conflagration spread to other countries, including Malaysia and Indonesia. Suharto’s government was forced to cut food and fuel subsidies in order to meet the I.M.F.’s fiscal targets, and the subsequent riots ended up bringing down the dictator. Mahathir bin Mohamad, the Malaysian Prime Minister, managed to escape Suharto’s fate only by ignoring the I.M.F.’s advice. In the face of bitter opposition from Washington, he introduced laws that made it difficult for Malaysians and foreign investors to send their money abroad. Far from destroying the Malaysian economy, as some free-market economists had predicted, these “capital controls” allowed the country to recover more quickly than most of its neighbors.

The Asian financial crisis never came any closer to most Americans than the business pages. Yet it was so severe that some people in the region concluded that the I.M.F. and the American government had set out deliberately to weaken a potential economic rival. Stiglitz doesn’t go that far, but his judgment is almost as damning: “The I.M.F. was not participating in a conspiracy, but it was reflecting the interests and ideology of the Western financial community.”

Stiglitz’s analysis of what happened in Russia will be more controversial. As he details, the I.M.F. advanced the country billions of dollars in loans to support the “shock therapy” that Boris Yeltsin’s government administered after the collapse of the Soviet Union. The therapy involved freeing prices, hawking state-owned enterprises to private investors at a discount, and trying to maintain a strong currency. Stiglitz argues that these policies were misguided, and he marshals some depressing statistics to support his case. Between 1940 and 1946, a period when Hitler’s Army laid waste to Russia, total industrial production in the Soviet Union fell by about a quarter. Between 1990 and 1999, Russian industrial production fell by more than half. Though the economy has recovered somewhat in the past couple of years, the Russian gross domestic product is still well below where it was when the Berlin Wall came down. Poverty rates are much higher, life expectancy has fallen (almost unprecedented in a developed country), and much of Russia’s industry is in
the hands of former Communists and gangsters. For Stiglitz, the Russians’ attempt to build capitalism virtually overnight was reminiscent of the Bolshevicks’ failed attempt to impose Socialism after November, 1917. Just as chaos forced Lenin to retreat to the halfway station of the “New Economic Policy,” the dramatic collapse of the post-Soviet economy forced the modern-day reformers to back off. In 1998, the ruble collapsed (despite another I.M.F. loan) and the Yeltsinites were eventually replaced by a former K.G.B. agent, Vladimir Putin.

Is Stiglitz overstating the case against the I.M.F. here? The proponents of shock therapy, such as the Harvard economist Andrei Shleifer, who advised the Russian government during the mid-nineteen-nineties, argued that moving rapidly was the only way to prevent a Communist resurgence, and that the policy wasn’t enforced vigorously enough. Instead of consistently promoting radical change, Yeltsin vacillated, one moment supporting reformers like Anatoly Chubais, the next moment backing conservatives like Viktor Chernomyrdin. Whatever the merits of such political considerations, though, the strictly economic case for the shock therapy is underwhelming. Indeed, there is now a consensus among economists that it is a mistake to try to create a market economy without first developing the institutions necessary for capitalism to function properly, such as enforceable laws and a working tax system. Under Putin, the Russian government is now concentrating on building just that sort of infrastructure, and the results are encouraging. Even the I.M.F. has come to acknowledge the wisdom of this strategy; almost everyone agrees that there is no shortcut to building a modern economy.

Stiglitz commends the gradual approach that China and Poland have taken toward liberalizing their economies. In Poland, one of the best-performing economies in Eastern Europe in recent years, the government rejected a key element of the Washington Consensus: rapid privatization. Instead of rushing to sell off state enterprises, the Poles concentrated on creating a modern legal system and a social safety net. Only then did they allow private investors to take over banks and the like. In China, too, the government left most of the big state-owned firms in place, but it created new firms alongside them by allowing villages and towns to set up their own enterprises, often in partnership with foreign companies. During the nineteen-nineties, China’s G.D.P. grew at an average annual rate of about ten per cent, and its poverty rate dropped dramatically. “The contrast between what happened in China and what has happened in countries like Russia, which bowed to I.M.F. ideology, could not be starker,” Stiglitz writes. “In case after case, it seemed that China, a newcomer to market economies, was more sensitive to the incentive effects of its policy decisions than the I.M.F. was to its.”
“Globalization and Its Discontents” does have some disappointing omissions, especially concerning the author’s own experiences. In the Clinton Administration, Stiglitz clashed frequently with Lawrence Summers, the Harvard economist who served in the Treasury Department and eventually became the Secretary of the Treasury. Summers was far more sympathetic to the Washington Consensus than Stiglitz was, and he worked closely with the I.M.F. According to some people in Washington, Summers forced Stiglitz out of the World Bank by demanding his departure as the price of supporting the reappointment of James Wolfensohn as the institution’s president. Yet, apart from a few derogatory references to Summers’s role in specific policy debates, Stiglitz makes no mention of their rivalry, or of the circumstances surrounding his resignation from the World Bank.

All of this raises the inevitable question of how much of the book is score-settling. It will not escape I.M.F. officials that Stiglitz is overly reluctant to criticize the governments of developing countries for making bad policies, which have done at least as much as the I.M.F. to keep poor people poor. And he surely understates the difficulties facing the I.M.F. when it goes into a country where the stock market and the currency are both plummeting. What’s more, I.M.F.-led bailouts can sometimes work, as they did in Mexico.

Still, there is no disputing Stiglitz and Soros’s central point that global capitalism has outgrown its institutional framework. Both authors suggest reforms that might go some way toward remedying this situation. First and foremost, they advocate restructuring the international institutions, so that they are more democratic and effective. The I.M.F.’s voting structure dates back decades and makes no sense—the Netherlands has about as many votes as China has. Stiglitz also recommends improving banking supervision, changing the international bankruptcy laws, reducing the number of I.M.F. bailouts, and increasing the amount of aid and debt relief that developing countries receive, especially those in Africa. Soros, for his part, thinks international aid should be increased and that the World Trade Organization ought to take more account of issues like workers’ rights, health and safety, and the environment.

One can debate the particulars of reform but not the need for it. “Without reform, the backlash that has already started will mount and discontent with globalization will grow,” Stiglitz writes. “This will be a tragedy for all of us, and especially for the billions who might otherwise have benefited.”