
Challenging the Washington Consensus

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Joseph Stiglitz is Professor of Economics and Finance at Columbia University. After serving as Chairman of President Clinton's Council of Economic Advisers from 1993 to 1997, he was Chief Economist of the World Bank from 1997 to 2000. In 2001, he was awarded the Nobel Prize in Economics for his work on the analysis of markets with asymmetric information. Over the course of his career he has taught at Stanford, Oxford, Princeton, and Yale. Professor Stiglitz is also the recipient of the prestigious John Bates Clark Medal, awarded every two years to the American economist under the age of 40 who has made the most significant contributions to the subject. Among more than 300 papers in the premier journals of the field, as well as a dozen books in his 35-year career, he is author of Globalization and its Discontents. Joseph Stiglitz obtained his B.A. from Amherst College and his Ph.D. from the Massachusetts Institute of Technology.

Stiglitz is one of the most authoritative and controversial figures in the globalization debate. His criticisms have added a new dimension to discussions of international economic policy by questioning neoliberal economics as applied by World Bank and the International Monetary Fund. On matters of development, trade, and international stability, Stiglitz challenges the conventional operations of international financial institutions.

Journal: During and since your term as chief economist of the World Bank, you have advocated major reform of international financial institutions. Has real reform taken place?

Stiglitz: Real reform has taken place at the World Bank. Less reform has taken place at the International Monetary Fund (IMF), small amounts of reform have even happened at the World Trade Organization (WTO). There have been changes, more in rhetoric than in reality, but even in reality there have been changes.

Journal: What and where have those impacts been?

Stiglitz: The orientation of the World Bank has changed very dramatically, especially in the way that it deals with developing countries. It has approached the problems of development from a much more comprehensive perspective. In many countries, it has committed to placing the country in a central role in decision-making, putting the country in the driver's seat.

The IMF, at the rhetorical level, has admitted that capital market liberalization has contributed to an enormous amount of risk in the developing countries, and they have therefore stopped trying to make it a central point of their agenda, though their overall policy stance has not changed much. They talk a lot more about poverty, but it isn't yet clear how much more their policies are oriented towards poverty.

During the East Asia crisis, I and many others said that there should be more reliance on bankruptcy, work-ups, and standstills, and that the big bailouts were a failure. After Argentina, the IMF seems to be saying that they agree the big bailouts are a failure and that an alternative is necessary, and they have said that we ought to explore bankruptcies, workouts, and standstills. The fact that they are willing to talk about it is a major step forward compared to where they were five years ago.

Journal: One of your other principle critiques of the IMF has been its lack of transparency and accountability. What role does democratic participation play in the formation of appropriate economic policy, and how might the IMF incorporate such participation?

Stiglitz: More than the voices of finance ministers, central bank governors, and those who reflect the viewpoint of the financial community ought to be heard during the formation of economic policy. Such perspectives have overrun the IMF, endorsing a viewpoint of market fundamentalism—the idea that the markets by themselves always work well—suggesting a minimal list role for

government. Creditor countries, specifically the G7, dominate the IMF. They control voting power and they overwhelm the decision-making.

The challenge then is to incorporate a broader range of the views of the developing countries and the borrower countries. It would be best if this were done at the institutional level itself, but it's equally important that interests outside of the financial community are heard. The decisions made by the institution have such an impact on those outside of the institution. If they decide to pursue policies that lead to higher unemployment, the workers are going to be very badly affected, and if they decide to pursue policies that are going to lead to higher interest rates or tighter credit, then small businesses are going to be very affected. These other interests—which are very different from the interests of the financial community—must be heard. That's why I've argued so much for transparency, so that others may see what is going on and if they disagree, they can at least explain why they feel what is going on is not reflective of the broader concerns of society.

Finally, I think that there needs to be more accountability. In the past, when the IMF developed a program, it didn't have to reveal its model, and it didn't have to reveal what its program was going to do to the unemployment rate or any other aspect of society. It should be made to provide an assessment of those impacts, and then if those impacts are different from what it anticipated, it should be held accountable.

Journal: Are social safety nets such as food subsidies for the poorest of the poor more geopolitically possible now than they have been in past crises, such as those in Indonesia and Ethiopia?

Stiglitz: They've always been possible. The amount of money that went to bail out the banks' western creditors was humongous compared to the amounts of money required for the social safety net. In the wake of the Indonesian riots, the financial community found the money, but only after the damage had been done. Today, in many people's minds there is recognition that there will be social consequences if social safety nets are not provided and the social consequences will overwhelm the short-run economic consequences. Indonesia was far more hurt from the riots that resulted from cutting off those subsidies than it would have possibly been helped by a slight improvement in budgetary position. The IMF did not recognize that. Today, it should recognize that, but it doesn't seem to in the policies that it has pursued, for instance, in Argentina.

Journal: You've stressed the need for appropriate and thorough financial regulations in order to prevent crises like the Korean banking crash and the

Enron accounting scandal. What sort of institutional support is necessary for such regulation, and how might developing countries create such institutions?

Stiglitz: A whole range of institutions is necessary, from financial supervisory boards to independent accounting standard boards to a good strong accounting profession. Many countries have already begun to create the principles of oversight and regulation. The principles of good accounting standards are well known, and a recognition of how standards might need to differ from developing to developed countries. Developing countries do not need to create their own accounting standards, they can borrow them. Developing countries could get together and decide appropriate and inappropriate deviations from the standards that are used in the more developed countries. I think several of the countries are well along the way to having good supervisory boards and good standards.

The problem, of course, is that no matter how good your standards are, there will be shocks to the system that put your system to the test. For instance, Malaysia actually did have fairly good financial regulation and did insist that the banks put aside significant amounts of money for reserves for bad loans. That was one of the reasons that they managed to have as short of a downturn as they did.

Journal: Clearly, trade is a necessary part of any developing county's growth strategy, but are there necessary prerequisites to trade liberalization, and what obstacles do you currently see that exist in the first and third worlds?

Stiglitz: The most important obstacle for most developing countries is that the First World is not open to the goods less developed countries can naturally produce. The comparative advantage in developing countries lies in areas like agriculture and textiles, and those goods remain protected and subsidized in the north. That is the major obstacle to their becoming strong trading countries.

The North has recognized the importance of time for adjustment and the need for safeguards. The United States, for instance, in its negotiations with China, proposed that the adjustment of its apparel industry would require four more years beyond the time ordinarily allowed by the WTO. If the United States—the richest country with the least unemployment—takes 15 years to adjust, then the developing countries need time as well, particularly if they have high unemployment. To make trade work, there must be a macro-economic environment and a set of conditions that result in job creation to parallel the job destruction that comes from trade liberalization.

Journal: That said, what role do you feel infant industry protection and targeted subsidies play in growth strategies in the developing world, and specifically,

what role did such measures play in the post-war “Asian miracle,” and what lessons may be extrapolated from such strategies by developing countries today, especially in light of the current administration’s plans for a free trade area of the Americas?

Stiglitz: In the United States, enormous use was made of protective tariffs during the period of industrialization—it was a source of great conflict between the North and the South. Those tariffs were essentially infant industry protection. In East Asia, the government didn’t so much increase tariffs as they promoted new industries through the provision of special credits at only slightly subsidized rates, as well as helping to create and transfer technology. Policy wasn’t oriented towards the creation of tariffs, but towards a slow reduction of old tariffs. Help came through credit rather than large direct subsidies.

Journal: How do you feel such lessons could be applied to new countries?

Stiglitz: It is more difficult in today’s environment for developing countries to imitate the policies of the past, given the strictures that were put into the WTO. Still, countries can provide the basic infrastructure to help certain industries grow: they can provide the education that trains personnel, they can create industrial and science parks, they can assist in improving the financial institutions, and particularly in doing a certain amount of directed credit. Many of those instruments must be used very carefully. Other countries have taken similar measures but money wasn’t directed at creating new enterprises but at subsidizing old friends.

Journal: Do you feel that current WTO regulations prevent some countries in some situations from achieving the most sustainable levels of growth?

Stiglitz: WTO provisions probably do circumscribe what developing countries can do. Some of the measures more developed countries took when they were industrializing are not easily taken by developing countries today, putting them at a disadvantage. The policy instruments that are available, however, can go a long way towards achieving their objectives. In addition, the advantages gained when the North’s markets are more open will compensate for such losses. Such circumstances have not been fully realized, but if they were it would be a major advantage.

Journal: What is the relationship between U.S. interests and the prescriptions of international financial institutions, particularly the IMF and the WTO?

Stiglitz: That's a very interesting question. In both the IMF and the WTO, U.S. positions play a central role. The United States has veto power within the IMF, so nothing can be done that the United States is strongly against. The United States enjoys a similar position at the WTO. Moreover, actions are taken not in the interests of the United States as a whole, but in the special interests of the financial community rather than the broader concerns of the American people. When the IMF pushed for capital market liberalization, such policies benefited Wall Street but not the American people. The American people do not want policies that would risk global economic instability; we lose from that instability, but Wall Street gains through the new opportunities opened by capital market liberalization.

Similarly, in the WTO, drug companies might gain from the stronger protection of intellectual property rights. Such measures enable drug companies in poorest countries to insist that drug prices be so high that people dying for those drugs couldn't afford them. Yet that was not consonant with the interests of the American people, and when the American people saw that people were being deprived of life-saving drugs, in South Africa and elsewhere, their voices were heard very strongly and policy was reversed. I do think American voices are heard, but which of our voices? Often, the voices of special interests drown out what most Americans actually believe.

Journal: When international financial institutions do advocate policies that are contrary to the interests of developing countries they ostensibly help, how might developing countries resist such policies?

Stiglitz: Developing countries should be learning by now that the aid they get in the form of short-term loans is of very little benefit, except under very unusual circumstances. Becoming indebted is not the basis on which you build factories or create jobs. The additional finance may make you feel a little bit better for a little while, but is almost inevitably followed by a crisis sometime down the line, and what you lose during the crisis is far, far greater than what you gain during the brief period of capital inflow. When it comes to the moment of crisis, for example in Argentina, most of the money that flows into Argentina—if not all of it—will be going to pay back international financial institutions and the Western banks. Russia was smart enough to realize this. Russia knew that because all the money the IMF was offering was going directly back to the IMF to pay back other loans, the IMF would make the loan whether or not Russia agreed to any conditions. So Russia followed more of a course of its own, and two years after it reneged on its debt it was back in the capital markets.

The lesson: it was able to get back into capital markets because its economy had grown. Its economy had grown in part because it had devalued,

and that devaluation finally started the economy. The IMF had resisted devaluation for years, and it was only when Russia broke away from the IMF that it began to grow. Countries have to realize that the IMF is not the fountain of wisdom, and that many of the policies the IMF has advocated have been both bad in the short-run and bad in the long-run. They must craft their own policies, realizing the money that the IMF uses to entice countries to follow their positions is money of little long-term value.

Journal: Do you think that has something to do with the behavior of the Argentinean government this past winter?

Stiglitz: I think the Argentinean government has been vacillating. There are those who recognize what I have just said, but there are those who are really intimidated by breaking with the international community. They are worried about losing the approval and aid of the IMF. They have been so afraid that they keep coming up with new programs. The joke in Buenos Aires is that the IMF is saying, “we can’t accept ‘yes’ for an answer,” which means that every time the IMF makes a proposal and Argentina agrees, they say, “obviously we weren’t demanding enough,” and they raise the bar.

Journal: Has globalization—and by that I mean the emphasis on free trade, the increased mobility of capital, and the interconnected nature of financial markets—undermined state sovereignty or interrupted democratic consolidation in the developing world?

Stiglitz: I think the way it has been implemented has done that. One can have an economic agenda and still do things voluntarily, with strong popular support and broad consultation.

Yet different countries have tied their hands in a manner of ways, and each tying of hands represents a reduction of what will be done in the short run. For example, whenever you create an independent agency, a whole set of decisions can no longer be made on an individual basis. Also, once you don’t sign an international treaty you have tied your hands. But what is disturbing to me is not that such decisions have been made, but that in many countries they have been made without adequate democratic debate. They feel they have to do this “or else,” and the “or else” is that you won’t receive aid, which they’re so desperate for, or we will say that you’re a terrible country and foreign investors will never come in. Through carrots and sticks, they’ve been forced, and that is a derogation of their sovereignty.

Journal: How do you feel U.S. foreign aid should be directed to best promote equitable growth?

Stiglitz: There is no simple answer to that question. The answer depends very much on the country involved—the stage of development, the stage of governance, and the quality of the public sector. There needs to be recognition that NGOs might be a more effective delivery mechanism of getting aid to the people than the governments would be, and so there needs to be more use of NGOs in some countries. The importance of health and education has been recognized, and many of the best health and education delivery mechanisms have been through NGOs. The World Bank has emphasized a comprehensive approach to development. A shift in funding from loans to grants ought to occur, but in a way that leads to an increase in aid flow. The shift from loans to grants should not be an excuse for cutting the amount that goes to developing countries.

Journal: How do you feel that your ideas compare with the current strategies of the Bush administration?

Stiglitz: There are important congruences and important differences. The administration was right to recognize that the big bailout strategy of the past was a dismal failure. But right now, under the Taylor proposal, they seem to be arguing that markets by themselves, with slight changes in contracts for collective action clauses, will suffice to resolve the issue. Anyone who understands the evolution of bankruptcy laws within our country understands that resolving bankruptcy disputes that go across borders and involve sovereigns will require more than market mechanisms. The IMF is wrong to think that an institution in which creditors and creditor interests dominate can ever play a central role. 