

Book Review: *Globalization and Its Discontents*

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Joseph E Stiglitz, *Globalization and Its Discontents*: WW Norton and Company 2002, New York, London, XXII + 282 pages. 24.95\$ hardcover 15.95\$ paperback

*Globalization and its discontents* is a book of remarkable insight. The author draws upon his experiences as chief economist at the World Bank to explain major events in the global economy of the 1990s. The primary episodes that this book analyzes are the Asian Crisis and Russia's post Soviet reforms. Empirical analysis by economists typically relies on formal statistics. Professor Stiglitz avoids this in his book, and much to his credit. Written history helps fill out the empirical record and enhances our understanding of economic processes. The author took full advantage of his position to write about important changes in the global economy.

Professor Stiglitz also has much to say about how political factors affected policy at the IMF, US Treasury, and the World Trade Organization. He claims (p XIII) that ideology and bad economics thinly veiled the actions of special interests. Private interests lobbied successfully for alleged privatization and liberalization, resulting in crises. Free market ideology served as intellectual cover for these interests in efforts to justify alleged misadventures in privatization. Professor Stiglitz claims that experience with these policies refute the case for rapid privatization, and indicate a need for stronger and more open international governance.

The examples in this book do support important theoretical arguments regarding political economy, but not as its author intends. The primary deficiency of this book is in its understanding of Public Choice concepts. Professor Stiglitz refers specifically to Rent Seeking, which he describes as a theory of "how Special interests use tariffs and other protectionist measures to increase their incomes at the expense of others" (p. 13). He associates this theory with ideological fervor and claims that market failure arguments better

explain problems in developing countries. This attitude towards Rent Seeking is peculiar for two reasons. First, what he describes is more like the collective action problem of Mancur Olson than Rent Seeking. Second, the author supplies numerous examples of collective action problems in the global economy of the 1990's<sup>1</sup>.

On page 19, Stiglitz asserts that trade ministers and the WTO and finance ministers and central bank governors align themselves with members of the business and financial community. Stiglitz claims that privatization in Russia led to greater rent seeking, which he describes as briberization (p58). This 'privatization' worked to enrich government ministers rather than to fill treasury coffers. He also mentions (p71) a World Bank sponsored and US backed electricity deal in Pakistan, where narrow private interests earned profits from pre-arranged and exorbitant prices.

Stiglitz also refers to 'Trickle Down' economics (pp78, 208). This he describes as the notion that economic growth will eventually reach the poor, as the rich spend their increased income. Instead, wealth trickled up to members of narrow interests. Stiglitz describes how Boris Yeltsin created a powerful class of oligarchs and businessmen. The IMF loaned billions to Russia, while political elites benefited from special tax privileges and looted public coffers. Local government officials squeezed private firms so hard that they had no incentive to invest (p190).

Professor Stiglitz complains that the IMF provided billions to bail out banks, but little in food subsidies to the poor masses (pp 130, 216). He condemns the Treasury and IMF for its 30 billion\$ deal with Japan. This money went to American and other foreign banks, rather than to help with Japan's economic situation (p113). He also recounts 23 billion\$ to bail out financial interests during the Asian crisis (p119). This is, as Stiglitz described it, corporate welfare.

Stiglitz explicitly blames the narrow economic view of the IMF (i.e. its ostensible free market ideology) for opposition to food and other subsidies to poor (p77). Their 'outworn presumption' that markets lead to efficient results caused discontent with globalization. Yet he supplies extensive evidence of IMF willingness to supply subsidies to narrow financial and business interests. What he overlooks are Public Choice arguments concerning the ability of concentrated interests to gain at the expense of broader interests. Rather than blaming free market ideology, Professor Stiglitz should have considered Public Choice explanations for how concentrated interests gain at public expense.

Professor Stiglitz also overlooks the 'comparative institutions' approach taken by critics of market failure arguments. He refers to the Coase theorem (p164). This he dismisses as depending upon questionable assumptions. He claims that that free market fundamentalists formed policies based on naïve faith in markets (p32). This derived from the standard competitive model where supply always equals demand (p35). Professor Stiglitz argues that markets require perfect competition and perfect information (p74). Since agents in markets lack perfect information and face transaction costs, markets will fail to deliver efficient results, and government can, in principle, improve upon market outcomes. Professor Stiglitz commits the Nirvana Fallacy by assuming that government can, in principle, always improve upon market imperfection (Demsetz 1969). Considering that his book points to many examples of government failure, his failure to avoid this fallacy is particularly odd.

Professor Stiglitz gives much credit to the intellectual progenitor of the IMF, John Maynard Keynes, for explaining why markets need government intervention to work. Unfortunately, he does nothing to prove this claim. Keynes argued that markets fail due to a lack of total private spending<sup>2</sup>. Yet he describes (pp116-8) how the IMF triggered a financial meltdown in Asia with its banking and monetary policies. IMF insistence on the tightening

of monetary policy and bank closures in Asia caused a collapse of banking in Asia, and denied businessmen access to credit. This example is reminiscent of the work of Milton Friedman and Anna Schwartz in showing how policy-induced monetary and financial collapse cause economic downturns, rather than of sudden shortfalls in private aggregate spending (Friedman and Schwartz 1993 (1963)).

Professor Stiglitz also has a strange take on free trade. He rightly accuses many industrialized nations of hypocrisy, in pushing free trade on developing nations while practicing protectionism. He condemns Western agricultural subsidies and the protection of the US aluminum and uranium producers. He also recognizes that international trade has led to high growth rates and a reduction of poverty (p4). Yet he endorses infant industry arguments (p16). The Principle of Comparative Advantage alone should have prevented the author from making such an argument. Also, the author's examples of special interests shaping policy indicate that tariffs may instead protect established industries from competition.

The author identifies inconsistencies in his belief that free market thinking pervaded the IMF. He claims that IMF logic implies that markets know best (p101). Yet, he indicates repeatedly that the IMF officials thought that the market was wrong and they knew better than anyone else how to plan production (pp 24, 127, 147). He also admits that the IMF's exchange rate policy ran counter to free market thinking (p107). He also claims that IMF economists believe that markets can exhibit excessive pessimism (p198).

Professor Stiglitz recounts an experience where the IMF insisted on bank closures (p116). He also mentions (p118) that the IMF interfered with "nuts-and-bolts decisions: what the firm should produce, how it should produce its output, and how it should be organized". He also complains that the IMF forced bank restructuring on Indonesia (p128).

These examples hardly indicate free market ideological fervor. They directly contradict his claim (on p 115) that IMF economists believed in Darwinian competition. They instead indicate a conceit on the part of IMF officials that they were knowledgeable enough to engage in such detailed regulation<sup>3</sup>.

The author derides claims that privatization failed because it did not go far enough. He points out that the Czech government opened the door to corruption by privatizing corporations while leaving banks in state hands (p159). Is this not an example of insufficient privatization? It would seem that the problem here is that the state should have privatized banks as well. Given the scenario he describes, it would at least seem possible that privatization should have gone further. Professor Stiglitz then claims “no country has succeeded in privatizing everything overnight”. The well-known example of German deregulation in the summer of 1948 contradicts this claim. Rather than failure and discontent, this resulted in the German economic miracle (Wallich 1976).

Stranger still, he refers to actual IMF policies as promoting crony/mafia capitalism or ersatz capitalism in Russia (p188-9). Yet he also complains (p189) about how many Russians adopted the ‘religion of free markets’. Are we to blame the idea of free market capitalism for IMF policies that promoted a different form of this system?

In passages reminiscent of *The Great Transformation* Professor Stiglitz argues that rapid privatization and liberalization led to discontent because these measures lacked a sound institutional basis for newly emerging markets<sup>4</sup>. He, like Polanyi, sees liberalization as causing economic failure and as not accounting for cultural values. This triggers social unrest and hostility towards globalization. Stiglitz claims that gradual and limited privatization, implemented in the right sequence and accounting for local concerns, can lead to the realization of benefits from globalization. Thus, he favors ‘prioritization’ over privatization.

The priorities that the author favors are public policies aimed towards maintaining employment, rather than preventing inflation. He also prefers debt restructuring and financial reorganization to liquidation (p130-1). He disdains fiscal austerity and bailouts, but instead wants fiscal policy to stimulate the economy through broad based subsidies. He also favors capital controls and some protective tariffs.

The charge that Stiglitz levels against IMF officials that they wrongly assumed to know best how to manage economies throughout the world is fitting and correct. However, Stiglitz himself commits the same kind of error. His preference for prioritization over privatization depends upon his knowing how best to implement reforms. He claims to know both which reforms are best and the right sequence for implementing them. This is an immodest claim, one that assumes on his part tremendous knowledge of local economic conditions the world over. Why should we believe that he is any better at outguessing markets than officials at the IMF?

Professor Stiglitz also ignores problems with special interests that he himself identifies. There is no reason to believe that the policies he recommends, if correct, would win out over special interests which would no doubt attempt to rig any sequenced or partial effort to deregulate any national economy. Stiglitz himself admits that existing international agencies are political (pp 166, 196), and gives us no reason to expect anything different from any future alternative agencies.

Professor Stiglitz sees world government as desirable in attaining his goals (pp 20-22). He insists that democratic global governance can work (p88). Yet, he provides evidence and ignores arguments to the contrary. The contents of his book point clearly to Public Choice arguments for serious collective action problems in global governance. Yet the author adheres to romantic notions of an ideal world government correcting market failure.

A better title for this book might have been “Centralization and its Discontents”. It is rife with examples of how central control by the IMF and WTO benefited well-connected special interests, at great expense to ordinary people throughout the world. These agencies rejected privatization and deregulation, and instead attempted to implement partial central planning over a number of different countries. Public Choice scholars interested in global political economy should read *Globalization and its Discontents*. It excels as a chronicle of recent events. Readers should, however, substitute Public Choice reasoning for the authors’ market failure analysis.

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#### Notes

<sup>1</sup> Oddly, Professor Stiglitz claims that his experience with the Clinton administration left him with a more jaundiced view of government (Stiglitz 1998). Yet, in *Globalization and its Discontents* he fails to recognize numerous examples of government failure as such.

<sup>2</sup> Keynes [1965 (1936)] argues that shortfalls of investment, relative to savings reduce total spending and employment.

<sup>3</sup> Hayek (1988) argues that deliberate efforts by authorities to restructure society fail due to informational problems.

<sup>4</sup> It is surely the case that Professor Stiglitz knows this book, as he authored the foreword to the 2001 edition.

See Polanyi, Karl *The Great Transformation* [2001(1944)] Beacon Press

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