Stiglitz' War Against the Wicked Fundamentalists.
A Review of Joseph E. Stiglitz: Globalization and its Discontents. New York Norton 2002

Since his ouster from the World Bank noble prize bearer Joseph Stiglitz has, maybe out of revenge, converted into a prolific popular writer, a sort of Galbraith the Second. „Globalization and its Discontents" is probably the most widely read among all of his writings. It is a book about and against a villain who bears the name IMF. We learn from the book that the villain closely cooperates with another crook, „big money", and that it has an ideology which Stiglitz refers to as market fundamentalism. He does not report much detail about this connection. Rather he occupies himself with building his case against the IMF, and attempts to support it with presenting a lot of „facts". Rogoff of the IMF replied in an open letter and proposed that these „facts" more often than not are fiction. The author of this review surely does not have the profound insights into Indonesian, Ethiopian, Argentine, Brazil, Thai etc. etc. affairs which Stiglitz claims to possess. The reviewer knows something about postcommunist transition and about German economic history and for these fields he can testify that Rogoff is right. This is not to say that Stiglitz is lying. It seems more likely that he is overextending himself. In some sense his endeavour suffers from the same defects as the activity of the IMF, but the IMF has a better excuse. It simply has the duty to involve himself in numerous countries and very different circumstances and quite often he is called upon in an emergency which requires rapid decisions. As a result the guidelines which the IMF must give to its officials – they can't be allowed to conduct their own experiments, can they ? - quite frequently do not take adequate account of the circumstances prevailing in the country to which they are applied. The IMF simply cannot possess and process all of the relevant knowledge. Stiglitz, however, is a scholar who has plenty of time for contemplation. It is entirely his responsibility if he fails to carefully check on the facts which he reports and carry out additional investigations until he has got as complete and reliable a picture as possible. His account on postcommunist transition reveals that Stiglitz has missed out on numerous relevant facts.

His basic story is that there were good reformers and bad reformers. The good reformers implemented gradual reform, the bad reformers engaged in „shock" therapy. The bad reformers frequently happened to be crooks, e.g. Yeltsin and his team in Stiglitz' black-and-white recording come out as crooks. The good reformers prevailed in China, Vietnam, Poland, Hungary and Slovenia, the bad reformers prevailed in Russia, the Czech republic and „most" of the other countries. „Most" of the other postcommunist coutries, that is what Stiglitz assures us, but he does not give a list of countries where „shock“ therapists prevailed. He does not spell out any criteria to draw the distinction between gradualists and „shock“ therapists, and it remains a mystery why he classifies one government as gradualist and the other as „shock“ therapist. When the Russian government all at once decontrolled many prices this was „shock“ therapy and a grave mistake. When the Polish government all at once decontrolled an even larger set of prices and took farreaching additional measures like abolishing most customs and subsidies this was gradualism and a great achievement. When the Chinese government after 1979 within only a few years reprivatized agriculture and allowed farmers to engage in a multitude of other private businesses this was a momentous change, because this occured in a predominantly agricultural country, but Stiglitz wishes to call it gradualism. Stiglitz somehow appears to think that the essence of gradualism and „shock“ is somehow obvious. If by „shock“ is meant that there was a major discontinuity, a rupture, a sudden change of key variables virtually all transition countries (and even the remaining communist countries Cuba and North Korea) except Slovenia experienced it and that Slovenia was the exception presumably was made possible by the specifics of Yugoslav socialism which contained important elements of the market mechanism and the fact that the Slovene economy happened to be in better shape and much more integrated with the West than all other communist economies. Stiglitz does not even mention such differences.

Referring to Russian reforms as a shock therapy is misleading. Out of the three most basic prerequisites for functioning markets, i.e. free prices, (at least some) competition and (at least approximate) monetary stability, Russian reformers managed to achieve only the first, their attempts to realize the other two were mostly thwarted by antireformers. Reforms got stuck already in 1991, a few months after prizes were liberalized. Even prize liberalization was effected only when it was nearly unavoidable because the government operated supply system had collapsed and the threat of famine was immediate in Russia’s key cities. Privatization of numerous companies in the course of the nineties was not a shock either but only concluded a gradual process towards de facto privatization which was on its way already in the mideighties. Stiglitz draws an activist picture of Russian reforms, which fails to recognize the reactive nature of much of these activities. After the mideighties the Soviet system which had long been in decline started to disintegrate so rapidly and dramatically, that compared to Russia many of the smaller communist countries appeared like real show pieces of socialism. In the midth of this chaotic and unsteerable process of disintegration reformers primarily tried to prevent the worst from happening i.e. events like famine, civil war or a return to fully-fledged dictatorship.

Stiglitz‘ measures of success resp. failure are as suspect as his distinction between gradualism and „shock“ therapy. Of course, in some cases success is obvious, e.g. in China and in Poland, and Stiglitz does not fail to recognize it. He proposes that „most“ of the other postcommunist countries were failures, catastrophic failures, worse even than Russia. To „prove“ his point, Stiglitz repeatedly refers to a single indicator of success, he compares the per capita GDP before and after transition. He does this even though he admits that measurement problems are so severe that the results may be meaningless. This may be less obvious to a Serbian reader because in Yugoslavia prices were less distorted than in Soviet type socialism. Consider the price of a Yugo car in 1989: Presumably it contained at least some information about its value for the consumer. However, the GDR price for a Trabant did not. In 1989 it was more than 12000 GDR Marks plus 10 years of waiting, it dropped to 3000 DEM in 1990, but would have dropped even further if production had not been reduced to a fraction of what it used to be. Whatever price once takes, it is arbitrary, and it is not just the Trabant but a large of GDR manufacturing output which is very difficult to price. An aggregate composed of such elements is of dubious value.

At one point Stiglitz correctly suggests that looking at a variety of social indicators is likely to be more informative. Relevant indicators may be life expectancy, child mortality, the stock of consumers‘ durables like refrigators and washing machines. In East Central Europe and the Balkans the number of registered cars is an informative indicator as well. Unfortunately, Stiglitz does not look at social indicators except for Russia and Ukraina where they deliver the result he wants to get at. Had he carried out the same sort of exercise for East Central Europe he couldn’t have helped wondering why the results are so different from Russia. In most of East Central Europe most social indicators improved nearly continuously after 1990. Even in the Baltics and large parts of the Balkan matters never got as bad as in Russia, e.g. in Bulgaria, Romania, Croatia and even in Albania most indicators for 2000 are better than they had been in the year preceding the collapse of the Communist regime. E.g. in Bulgaria, infant mortality stood at 14,4 per 1000 new born kids in 1989, in 2000 it was 13,3. Life expectancy was 69,5 in 1989 and 71,8 in 2000. The stock of passenger cars owned by 8,4 mio Bulgarian citizens was 2 mio. in 2000, in 1989 it had been 1,2 mio. Social indicators thus indicate that Stiglitz’s catastrophy proposition is unfounded. For most postcommunist countries however Stiglitz‘ mentions only their 1989 “GDP” and compares it with later values. The only reason why so many engage in this dubious exercise is that they do not want to take the time to look closer. Even worse, Stiglitz e.g. did not even notice that the Czech statistical office several times revised upwards its figures for GDP growth in the 1990s. If one takes regard of the revisions and the strong improvement of the terms of trade which has no doubt occured but is not fully reflected in GDP figures the alleged crisis of 1997/98 on which Stiglitz builds his argument simply vanishes. Thus, even a closer look at GDP figures suffices to raise doubts about the merits of his case.

Stiglitz criticizes reformers because they did not initiate their reforms in „proper order“, but he tells us little about what this „proper order“ is. He criticizes Czech reformers because they privatized manufacturing industry but kept most banks in government ownership and did not hinder banks from financing manufacturing companies on what turned out to be fairly soft terms. Clearly, they were afraid that in the absence of such funding Czech manufacturing might collapse. Obviously, there was a price to paid for this, and this price were the costs to the taxpayer who ultimately recapitalized these banks and the nepotism which invariably accompanies this sort of finance. One may even call this corruption. Stiglitz does not fail to dwell on this. However, as a result of this policy the Czech republic now has the strongest manufacturing sector in all of East and East Central Europe. In retrospect it seems less than obvious that the policy was a failure, it may have been worth the price. Stiglitz claims the opposite but fails to substantiate his proposition. He similarly missed out on the fact that according to the usual indicators the Czech republic and Slovakia, i.e. both victims of Klaus‘ „shock therapy“, have not turned into countries with a very unequal income distribution. Quite the opposite, their income distributions are about as egalitarian as in the Scandinavian countries which Stiglitz likes to point out as examples which all of us should emulate. E.g. the Czech Gini coefficient in 2001-2 was 23,4 as compared to 19,8 in 1987. The EU 15 average in 2001 was 30, indicating that the Czech republic continues to be more egalitarian than the average Western European country. Taking into account that the command economy featured a lot of hidden inequality because access to numerous consumer goods, housing, travelling opportunities etc. depended on social status, 23,4 essentially means that in terms of the Gini coefficient income inequality did not increase at all after 1989 which is even more noteworthy since among the communist countries Czechoslovakia used to be one of the most egalitarian. Thus it is fairly obvious, that Stiglitz’ claim that „market fundamentalism“ and „shock therapy“ breed enormous social inequality does not hold as universally as he proposes.

In one regard Stiglitz get’s more specific about the „proper order“. He strongly warns against fully liberalizing the capital account at an „early stage“ of reforms, but again he is vague on the details. The reader of his book ends up wondering whether the capital account should ever be liberalized. Stiglitz‘ discussion seems to suggest that markets can be trusted only if they are nearly perfect and if information is nearly perfect as well i.e. in a case which most likely will never occur. On capital account liberalization Stiglitz offers some references to economic history but once more he does not get his facts right. Contrary to his allegations not all West European countries delayed full liberalization of the capital account to the 1980‘s, West Germany and Switzerland were exceptions. The West German capital account was nearly completely liberalized by the late 1950s and it does not seem that the country suffered a lot from this „early move“. France was a late mover and it paid for it by higher interest rates. To be sure, West Germany did not liberalize in 1949, it delayed this measure for good reasons. Numerous economists whom Stiglitz would dubb „market fundamentalists“ like Ludwig Erhard or Vaclav Klaus have been well aware that premature liberalization of the capital account may be dangerous. Really, the issues involved were well-understood by 1991: then McKinnon, whom Stiglitz maybe would call a market fundamentalist as well, published a book which elaborated the issue[1] in great depth and – at least in the reviewer’s opinion – far better than Stiglitz.

Stiglitz has a persistent tendency to oversell sophisticated formal economic theorizing and correspondingly he downplays the value of traditional, more „elementary“ economics. E.g. the mathematical theory of market failure is valuable, but contrary to what Stiglitz seems to suggest it does not offer definite answers whether and how a failure should be cured except for a few cases. Arguably for many issues of economic policy „elementary“ economics is considerably more important than advanced economics. This holds even for the economics of information, Stiglitz’ specialty. It is an elementary but important insight that market prices contain a lot of information which remains inaccessible in the absence of such prices. Without this information economic decisions are nearly always misguided. Prices provide a lot of information even if competition is far from perfect. This is the reason why decontroling prices and opening markets to create some measure of competition is of such paramount importance. To be sure, Stiglitz has added some subtleties to this elementary insight. He likes to stress that the information provided by prices falls short of omniscience. This is hardly surprising. Sometimes the information conveyed by prices may be misleading and in some circumstances government regulation may actually improve the informational content of prices. One of Stiglitz‘ favourite examples for a potential role of government are bubbles in financial and real estate markets which government may seek to prevent. However, this is only a potential role. The real role of government in such events is often less than glorious. The most significant bubble of postcommunist Europe was the East German real estate boom which occured from 1993 - 1996. German government fueled this boom, it was part of the problem,

[1] The Order of Economic Liberalization. Financial Control in the Transition to a Market Economy. Baltimore: J.

not the solution. Apart from self-promotion, Stiglitz‘ tendency to oversell advanced economics and present it as a reliable theoretical underpinning for extensive government intervention serves a political purpose: Policy makers are rarely in the position to disprove this claim simply because advanced economics is often incomprehensible for nonacademics. As a result one can always criticize politicians who are less enthusiastic about interventionist government that they are not up to the latest word of economic theory.

Among Stiglitz‘ favourite topics is that he warns against privatization before the „appropriate institutions“ are in place. There is one and only case in which his argument in conclusive. Privatizing a government monopoly is rarely advisable, instead opening its market to competition should be the first step. With regard to all other „institutions“ Stiglitz‘ discussion is once more vague and misleading. In particular, he fails to distinguish between „regulation“ by civil/private law (law of contract, tort law, commercial law etc. plus the supporting law of civil procedure) and direct public control. These are two completely different systems of „regulation“ and strengthening and developing the first kind of „regulation“ in tandem with downsizing and restructuring the latter is at the very essence of postcommunist transition. Stiglitz‘ failure even to mention this distinction may be due to naivity. It seems that the Roman law tradition is something completely foreign to him. Most if not all of his remarks on legal history are plainly wrong. The 19th century witnessed an enormous development of the law of contract, tort law, the law of civil procedure etc. but little of this was a reaction to „unfettered capitalism“ as Stiglitz proposes. He somehow thinks that only legal developments occuring after 1890 are relevant. However, what occured after 1890, in particular in continental Europe, quite often was a build-up of the administrative system of direct public controls. The reviewer is not trying to argue that such direct public controls are altogether unnecessary. His point rather is that these direct public controls should be viewed as a supplement to „regulation“ by civil law, not as a substitute. „Regulation“ by civil law is what tends to be insufficient in a postcommunist environment and in urgent need of development. Thus, Stiglitz emphasis on post 1890 legal history is highly misleading. Postcommunist transition requires regaining what is in essence a pre 1890 legal heritage. Privatizing may be helpful because it increases the demand for private law. Of course, privatization is not enough, a sufficient supply of private law does not spring up easily and automatically.

In view of its many defects it may seem surprising that Stiglitz‘ book has been so warmly welcomed and so widely read. This is probably due to its „ideological“ message which is

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Hopkins University Press 1991.

welcome to many. He claims that market fundamentalism is the ideology of big money and that the IMF is its agent. The word fundamentalism suggests that what Stiglitz refers to as „ideology" is a firm set of beliefs and principles („doctrine" or „mantras" in Stiglitz' parlance) which are held with almost fanatical conviction. However the very same Stiglitz in the very same book presents lots of material which indicates the opposite and his argument thus appears as self-contradictory. Quite frequently he indicts the IMF for inconsistency which is the very opposite of acting in accordance with firm principles and religious fervor. In quite a number of cases he argues that what really happened amounted to a conspiracy against the taxpayer, and this conclusion actually is quite convincing. However, this does not square well with Stiglitz' claim about market fundamentalism that it views private property as sacred. Taxation frequently is nothing else than legalized expropriation, thus pressing for policies which amount to higher taxes surely is not in line with the lofty principle that private property should be viewed as sacred. Thus, at a closer look what Stiglitz refers to as ideology turns out to be mostly rethorics. The alleged commitment of „big money" to free enterprise most likely does not exist. Representatives of „big money" are in a rush to forget this as well as other „principles" whenever it seems to their immediate advantage. Presumably Stiglitz would not even want to dispute this sceptical view of their utterances and beliefs. However, then he has the slight problem that the core argument of this book collapses which after all asserts that globalization goes wrong because the IMF and others have adopted the „ideology" of market fundamentalism.

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