



# Dissenting Economists

*Benjamin M. Rowland*

---

*Globalization and its Discontents*, by Joseph E. Stiglitz. (New York: W.W. Norton, 2002). 192 pp. \$25.

*The Elusive Quest for Growth: Economists' Adventures and Misadventures in the Tropics*, by William Easterly. (Cambridge, MA: The MIT Press, 2002). 356 pp. \$18.

---

Nobel Prize winner Joseph Stiglitz has had a distinguished career as an academic and a public servant, but is possibly best known today as the renegade insider who took on the International Monetary Fund (IMF) and was “fired” from his post as World Bank chief economist. As he recounted in a recent interview, “throughout the time I had been at the Bank, there had been tremendous pressure from the U.S. Treasury, particularly from [Secretary of the Treasury] Larry Summers. Typically, it was a hierarchical thing. Summers would lean on Jim Wolfensohn, [president of the World Bank], and make Wolfensohn’s life unpleasant.” But, “No, I was never fired. Basically I was told I could stay in the Bank, but if I did I would have to circumscribe my thoughts. So I chose to resign.”<sup>1</sup>

Similarly, William Easterly, another distinguished economist with a sixteen-year career at the World Bank and more than fifty publications to his credit, also left the Bank under conditions that, to many, looked suspiciously like punishment for being outspokenly critical of the Bank’s policies. The Bank’s Office of Business Ethics and Integrity placed Easterly under investigation because he wrote a summary article of his book, *The Elusive Quest for Growth: Economists’ Adventures and Misadventures in the Tropics*, for the *Financial Times* a few weeks before it was published. Although Bank policies did not require staff members to clear books for publication, the same enlightened

---

Benjamin M. Rowland (SAIS M.A. 1970, Ph.D. 1975) took early retirement from the World Bank in 2001. He is currently a strategic advisor to senior management at the Inter-American Development Bank and is at work on a new book, *Whatever Happened to Joe Stiglitz? People, Ideas, and Interests at the World Bank*.



standard, it seems, did not apply to press releases. The Bank claims that its motivation was solely to determine whether Easterly violated any rules regarding contact with the press but some observers find it more credible that it was his critique of Bank policy that made him a target.<sup>2</sup>

---

**For Stiglitz, development economics has lost its moral compass because it has failed to put the poor first.**

---

Stiglitz's *Globalization and its Discontents*, in which he criticizes what he saw while at the Bank, is a forceful, frequently angry critique of development economics directed mainly at its leading institution, the IMF. The field as Stiglitz describes it is a poisoned chalice of bad theory, base motives, and collusion on the part of the world's richest governments and banks, as well as the multilateral institutions they dominate. For Stiglitz, development economics has lost its moral compass because it has failed to put the poor first.

Stiglitz made a successful academic career in large part by debunking the simplifying assumptions associated with the neo-classical equilibrium model of economics—the model that underlies today's "Washington Consensus" doctrine of stable macroeconomic policies, open markets, and minimalist governments. Among the many weaknesses of the neo-classical model, according to Stiglitz, are its assumption of perfect information and its inattention to institutional interests and the self-dealing behavior that frequently attends them. He sees phenomena such as "moral hazard" (taking oversized risks in the expectation of a bailout), and "adverse selection" (making wrong decisions on the basis of bias or imperfect knowledge) as too pervasive to be simply assumed away. In his view, moreover, the private sector is as susceptible to these universal flaws as the public sector. Stiglitz has said that his work, "showed that the standard theory of competitive equilibrium was not robust," adding, "my work was as much a comment on economics as it was on economies. That is, it provided a critique of the perfect information, perfect competition paradigm that had informed so much of economists' research. It showed that . . . one could not have confidence in its conclusions; slight perturbations—small imperfections in information—could have large effects."<sup>3</sup> If markets are self-equilibrating—the Washington Consensus credo—then governments should simply stand down and let markets go about their efficient business. But if, as Stiglitz believes, markets do not inherently clear



at a welfare-optimizing equilibrium level, it follows that there is a strong and positive case for frequent government intervention. Stiglitz's academic conclusions, in short, led him in a different direction than the prevailing views at the U.S. Treasury Department and the international financial institutions.

Stiglitz left academia in 1993 to be a member of the Clinton administration's Council of Economic Advisors, eventually becoming its chairman. In 1997, he moved to the World Bank as chief economist in order to dedicate himself to alleviating world poverty, only to be disillusioned:

I saw my task as three-fold: thinking through what strategies might be most effective in promoting growth and reducing poverty; working with governments in the developing countries to put these strategies in place; and doing everything I could within the developed countries to advance the interests and concerns of the developing world. . . . I knew the tasks were difficult but I never dreamed one of the major obstacles the developing countries faced was man-made, totally unnecessary, and lay right across the street – at my “sister” institution, the IMF.<sup>4</sup>

Stiglitz finds bad IMF policies at the center of virtually all the spectacular market failures of the 1990s and onwards. In his view, the IMF's greatest error was its untoward eagerness to liberalize the world's financial and capital markets. This effort, Stiglitz believes, culminated in the 1997–1999 East Asian financial crisis.<sup>5</sup> International financial liberalization, most economists agree, is theoretically desirable because it is necessary for the achievement of a welfare-maximizing global economy. The practical problem is separating “good” capital for long-term investments from “bad” capital, which can destabilize economies as it circulates around the world looking for short-term gains. In the words of Stiglitz's World Bank colleague, Gerard Caprio, the result of this unhappy experiment was not a global boom, but a “boom in busts.”<sup>6</sup> The IMF not only pushed capital market liberalization on countries that were sometimes reluctant; it also, in Stiglitz's view, compounded the problem by misdiagnosing the causes of the crises that resulted and applying the wrong medicine. For example, the IMF demanded that afflicted countries impose austerity measures during the Asian financial crisis when, according to Stiglitz, it should have been encouraging governments to adopt counter-cyclical expansionary measures.

“Hooverian austerity” might have been appropriate, Stiglitz concedes, if governments had been profligate and run up large deficits.



This was the pattern that underlay the Latin American balance-of-payments crises in the 1980s and early 1990s and in those cases the “Washington Consensus” prescriptions made sense. But for the countries of East Asia, the opposite was true: governments ran surpluses. It was the private sector that caused the crisis by responding to the blandishments of nominally cheap international credit and the dismantling of domestic financial controls. What particularly frustrates Stiglitz was not simply the incorrect assumptions underlying IMF policies but the arrogance with which those policies were administered. He writes, “The stance of the IMF . . . was clear: it was the font of wisdom, the purveyor of an orthodoxy too subtle to be grasped by those in the developing world.”<sup>7</sup> In the end, Stiglitz claims, it was the developing countries that suffered from this combination of ineptitude and arrogance as wealth evaporated, jobs disappeared, and political turmoil increased.

Stiglitz’s research suggests that liberalized markets are unlikely to reach equilibrium in the absence of effective institutions, laws that create positive incentives, and an independent judiciary. These three elements, all built on the broadest possible consensus of national interests, are not incidental to good market behavior; they are its wellspring. Thus the real task of development is not just getting some prices right, but nothing short of transforming society. Nowhere, in Stiglitz’s view, should this have been more obvious than in post-Soviet Russia, another country he focused on at the Bank.

Russia’s changeover to market capitalism was not expected to be free of disruptions. First, there would be inflation as price controls were lifted, then contraction as authorities sought to contain excess demand with high interest rates. However, no one imagined the extent of the ensuing failure. During the World War II period, 1940–1946, industrial production in the Soviet Union fell by 24 percent. From 1990–1999, the drop-off was 54 percent, while the decline in GDP was an even larger 60 percent. The problems lay not just in the nature of the reforms, but in the sequence and timing of their execution; in Stiglitz’s view, the decision to favor shock therapy over gradualism was an incorrect one. Stiglitz concedes that shock therapy might have worked had it been applied to all prices, but major exceptions like the oil price remained regulated. This meant that insiders could buy oil at the administered price and sell it internationally for huge profits, hastening a payment crisis in the process. Furthermore, the rush to privatize combined with dubious financing schemes to encourage widespread asset stripping while the removal of capital controls allowed the oligarchs to move their booty to safe havens abroad.<sup>8</sup>



For Stiglitz, the final proof of the folly of IMF policies was that while its captive clients found themselves mired in crises, countries that explicitly rejected the IMF's liberalizing prescriptions fared much better. "It is no accident that the two developing countries spared the ravages of the global economic crisis—India and China—both had capital controls. While developing countries with liberalized capital markets actually saw their incomes decline, India grew at a rate in excess of 5 percent and China at close to 8 percent." Moreover, "China achieved this by following the prescriptions of economic orthodoxy. These were not the Hooverite IMF prescriptions, but the standard prescriptions that economists have been teaching for more than half a century: when faced with an economic downturn, respond with expansionary macroeconomic policy."<sup>9</sup>

In *The Elusive Quest for Growth*, William Easterly finds that overly simple assumptions are not just a feature of current development practices; they have characterized the field from the very beginning. Like searchers for the Holy Grail, "we economists have tried to find the precious object, the key that would enable the poor tropics to become rich. We thought we had found the elixir many different times. The precious objects we offered ranged from foreign aid to investment in machines, from fostering education to controlling population growth, from giving loans conditional on reforms, to giving debt relief conditional on reforms. None has delivered as promised."<sup>10</sup>

Easterly refutes one theory after another with persuasive statistical evidence of their failings. For example, one of the earliest and still most influential theories—the Harrod-Domar growth model—is based on the premise that growth is a straightforward function of the level of investment. No matter that this premise or its applicability to developing countries had long since been disavowed by its authors, its influence survives in the so-called "financing gap analysis" still routinely used by the development institutions. To calculate the gap, start with a desired rate of growth, one high enough to increase per capita incomes, for example, by 7 percent. Then factor in the domestic rate of savings, say 3 percent. The difference between the two numbers, 4 percent, is the amount of outside resources, such as aid, needed to bring growth up to the desired level. Simplicity, convenience, and, to a large degree, politics help to explain the model's long life. Easterly observes that the most famous expression of the financing gap approach, W.W. Rostow's *The Stages of Economic Growth: a Non-Communist Manifesto*, added not only the Cold War political rationale for making these expenditures but also the highly



convenient assumption that they would not have to be made forever. Only bring investment up to a “take-off” level, 10 percent, and the higher growth rates would become self-sustaining.<sup>11</sup> Easterly notes that between 1950 and 1995, Western countries gave \$1 trillion in foreign aid (in 1985 dollars). “Since virtually all the aid advocates used the financing gap approach, this was one of the largest policy experiments based on a single economic theory.”<sup>12</sup> Unfortunately, there was little if any evidence that it worked. The model assumed, first, that all the aid or resource transfers would go into investment, and second, that the amounts invested would be connected with increases in growth. Easterly searches a sample of 138 countries for evidence of this pattern and finds it in only one: Tunisia. But, Easterly notes, “Before Tunisians throw a national celebration, I should point out that 1 success out of 138 countries is likely to have occurred by chance, even if the model made no sense, which so far the evidence says it doesn’t.”<sup>13</sup>

Education has been another of the panaceas taken up by development economists, and here too Easterly finds—to his surprise—no evidence linking levels of education to growth. In 1960, he notes, only 28 percent of the world’s countries had primary school enrollments for 100 percent of their populations, but by 1990 fully half of the world’s countries attained universal education at the primary school level “fueled by the emphasis of the World Bank and other donors on basic education.” And what was the growth response to the educational explosion: “. . . little or none.”<sup>14</sup>

Several other failed solutions receive extensive treatment from Easterly, including population control, “adjustment lending” intended to induce policy reforms, and debt forgiveness to enable the poorest countries to spend more on relieving poverty and less on servicing their outstanding loans, to name a few. Debt forgiveness, an idea in fashion today—although its origins date to at least 1979—receives a special dose of Easterly’s skeptical scrutiny. (“Alas, the head contradicts the heart,” he writes.<sup>15</sup>) Notwithstanding the endorsement of personalities like Bono, the Dalai Lama, and the Pope, and despite indications that the current version of debt relief—the so-called Highly Indebted Poor Countries (HIPC) initiative—may be more effective than its predecessors, Easterly finds no overall evidence that debt forgiveness has increased growth. To the contrary, debt levels in countries that have had their debts forgiven have simply reverted to their former unsustainable levels. In fact, by some critical “sustainability” measures, such as present value debt-to-export ratios, these countries became even more indebted than they were before.





One of the many pleasures of this book is simply that of observing a fine analytical mind at work, weighing and judging not only the mass of empirical evidence that refutes these theories, but also certain of the flawed methodological and analytical assumptions that contributed to their acceptance in the first place. Easterly also argues that random events—in effect, pure luck—may also play a greater role in development than most economists would like to concede.

Why have the panaceas failed? The unifying theme in Easterly's analysis is in many ways the same as the core argument advanced by Joseph Stiglitz: failure occurs because the incentives for behavior that favors growth are simply not there. For example, investments in education will fail if individuals conclude there is little chance that their knowledge will yield future benefits. They will conclude, rationally, that the "bird in the hand"—low-skill, low-wage employment—is safer than preparing for an implausible future. Similarly, donor policies, such as debt forgiveness, can unwittingly reinforce bad behavior. What incentive does a poor country have to deny present consumption and increase savings to support future growth if it "learns" from past experience that its debts will be forgiven?

It is, of course, easier to point out these shortcomings than to correct them. Far from being another cure, "Getting incentives right . . . is a principle that has to be implemented bit by bit, stripping away the encrusted layers of vested interests with the wrong incentives, giving entry to new people with the right incentives."<sup>16</sup> Stiglitz and Easterly both believe that societies must transform themselves.

But there are areas where the two economists differ substantially. What happens, Stiglitz asks, in the not infrequent cases when pro-growth policies are not pro-poor? He would probably not reject the notion that there are indeed times when the heart needs to rule the head. If the world's poor are ever to see the benefits of

---

Why have the panaceas failed? The unifying theme in Easterly's analysis is in many ways the same as the core argument advanced by Joseph Stiglitz: failure occurs because the incentives for behavior that favors growth are simply not there.

---



globalization, they need space and time to get there, meaning more dispensations, at least temporarily, from the growing web of rules that define the global system. Easterly, no less sympathetic to the plight of the poor, preaches a tougher kind of love. For him, there can be no growth without sacrifice. Their respective views on debt forgiveness illustrate the difference. Stiglitz supports debt forgiveness, though he believes that the current version offers too little and imposes too many conditions for eligibility. Easterly doubts its value at all because it favors consumption, discourages thrift, and conveys a mixed message to potential creditors. But, Stiglitz would argue, if the goal is really poverty alleviation, why give creditors pride of place? Why treat them differently than any other “stakeholder”? Stiglitz’s belief that central banks should be political institutions reflecting not only the anti-inflation bias of creditors, but the full range of interests in society illustrates this thinking as well. Easterly takes the opposite view.

Simple theories have advantages, especially for the institutions that have to translate those theories into practice. For several decades, however,

---

Simple theories have advantages, especially for the institutions that have to translate those theories into practice. For several decades, however, simple theories have proven incapable of alleviating poverty in the developing world.

---

simple theories have proven incapable of alleviating poverty in the developing world. One achievement of Joseph Stiglitz and William Easterly, two distinguished dissidents of the World Bank, is that they have enriched and complicated the debate about

development economics. Unfortunately, it does not speak well of their former employer that they had to leave the World Bank in order to do so.

### Notes

<sup>1</sup> Julia Llewellyn Smith, “A Beautiful Mind at the Barricades,” *Financial Times Weekend*, 13–14 July 2002.

<sup>2</sup> Joseph Kahn, “World Bank Presses Inquiry on Economist Who Dissents,” *New York Times*, 7 September 2001.

<sup>3</sup> Joseph E. Stiglitz, “Reflections on Economics and on Being and Becoming an Economist,” in *The Makers of Modern Economics*, vol. 2, ed. Arnold Heertje (London:



Harvester Wheatsheaf, 1994), 142. Stiglitz gives an extensive critique of the neo-classical equilibrium model—particularly the canonical “Arrow-Debreu Theorem”—in Joseph E. Stiglitz, *Whither Socialism?* (Cambridge, MA: MIT Press, 1994).

<sup>4</sup> Joseph E. Stiglitz, *Globalization and its Discontents* (New York: W.W. Norton, 2002), 25. There is a long tradition of IMF bashing at the World Bank, which is heartily reciprocated. These differences, however, are usually aired in private or in obscure academic journals. For a summary of earlier IMF-World Bank disputes, see Devesh Kapur, John P. Lewis, and Richard Webb, *The World Bank: Its First Half Century* (Washington, DC: The Brookings Institution, 1997), especially pages 525–531.

<sup>5</sup> A more balanced account of these events is found in Paul Blustein, *The Chastening* (New York: Public Affairs Press, 2001).

<sup>6</sup> Speech by Joseph E. Stiglitz, “Must Financial Crises be This Frequent and This Painful?” delivered at the McKay Lecture, Pittsburgh, PA, 23 September 1998.

<sup>7</sup> Stiglitz, *Globalization and its Discontents*, 41.

<sup>8</sup> A primary argument in favor of freeing international capital flows was that doing so was a necessary prerequisite for attracting international capital. However, little of this capital would have come without expectations of an IMF bailout. According to Stiglitz, “as the New York investment banks pushed loans to Russia, they whispered about how big the IMF bailout would have to be.” Stiglitz, *Globalization and its Discontents*, 147.

<sup>9</sup> *Ibid.*, 125.

<sup>10</sup> William Easterly, *The Elusive Quest for Growth: Economists’ Adventures and Misadventures in the Tropics* (Cambridge, MA: MIT Press, 2001), xi.

<sup>11</sup> See W.W. Rostow, *The Stages of Economic Growth: A Non-Communist Manifesto* (Cambridge: Cambridge University Press, 1960).

<sup>12</sup> Easterly, *The Elusive Quest for Growth*, 33.

<sup>13</sup> *Ibid.*, 39.

<sup>14</sup> *Ibid.*, 73.

<sup>15</sup> *Ibid.*, 137.

<sup>16</sup> *Ibid.*, 143.