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THE VULNERABLE ECONOMIC MAINSTREAM

Joseph Stiglitz and the Critique of Free Market Analysis

Gerald Houseman

Why is Joseph Stiglitz ignored? Because the profession and its many business and Western government clients cannot accept the implication of his theories, argues this economist.

PROGRESS DOES OCCUR. The formidable myth of “free enterprise,” a major crutch for the belief systems of those who see market economics as a be-all and end-all, has been dead since at least 1986,¹ and a rather modest economist, Joseph E. Stiglitz, along with two fellow Nobel Prize winners in economic science, George Akerlof and Michael Spence, drove the final stake through its heart in the Stockholm Nobel Prize lecture of December 2001. Stiglitz’s acceptance speech proved to be a singular and remarkable event in which

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he effected the internment in quiet and reflective tones, a marked contrast with the shrill decibels of the defenders of this defunct idea.

The most casual observer of American culture and politics is aware of the devotion to “free enterprise.” Some people wince at its mention, for we know it well as a staple of political rhetoric, bumper stickers, manifestos, corporate advertising, stockholders’ meetings, business lunches, and chamber of commerce banquets. The term easily falls from the lips of President George W. Bush. It is the chosen topic of endless ideological “studies” by this or that tax-evading “educational” foundation. It is the religion of all, or nearly all, of the business press and television journalists. Those still failing to get the point can perhaps see it in the “chairs of free enterprise” found in a great number of universities, generously funded by persons who, on occasion, may actually believe that their riches are the result of it (though one of the holders of this title has told me that he frankly does not know what it means). Third world dictators and leaders currying favor with the West work the term into their harangues. Graduation speeches can be expected to bandy about the term, and talk show hosts, especially the law-breaking types, treat it as sacrosanct. But the ultimate “truth” of the concept may be found in Oklahoma City, where a theme park, Enterprise Square, is devoted to it.

Perspectives on “free enterprise” can, of course, vary considerably. Critical observers associate it with price-fixing, the Enron Corporation, environmental threats, consumer fraud, union-busting, anti-trust violations, deregulation, rationalizations for layoffs and for budget cuts in social welfare programs, privatization schemes, speculation, stock manipulation, chicanery, and corruption. Many of us have become weary of what is no more than a slogan that seems useful for the arsenal of those who are just plain greedy or who have divined, sometimes with assistance from On High, that “free enterprise” legitimizes keeping people in their place as a part of the holy cause of inequality. Many conversations, readings, and even the most cursory of examinations show that the term stands for hypocrisy. Those who would doubt this can look at government handouts to corporations and the rich, cost-plus and no-bid contracts, tax shelters

and write-offs, the gassing in Bhopal of several thousand Indians, the history and lawlessness of union-bashing, and the ever shifting standards of these practitioners on issues such as federalism (where they are both for and against states' rights), the fates sealed by such forces against small landholders and businesses or, more recently, a vaunted institution such as the filibuster. Europeans, by contrast, are likely to shrug at the news of the demise of "free enterprise," for they have known about it at least since the fall of Thatcher or, more likely, since the worldwide depression of the early 1930s.

And There Is Another Death to Report: The "Invisible Hand"

"Free enterprise" is probably associated most with Adam Smith, the "father of capitalism," whose two-volume tome, *The Wealth of Nations*, published in 1776, is usually cited as the authority not only for this concept but also for a concretely defined "laissez-faire" approach to markets that, according to experts like George W. Bush, Ronald Reagan, Ayn Rand, Milton Friedman, Margaret Thatcher, Dan Quayle, Ken Lay, and Gordon Liddy, stands in opposition to government and supports entrepreneurship. The two volumes, however, are a critique of monopolistic corporations rather than government, though it must be conceded that the "invisible hand" of self-interest, a mystical concept, was set out by this severe Scottish professor of moral philosophy—economics as a discipline did not exist in his day—to show that our individual wants and needs can, without any overall guidance, lead to a good result for most of us, if not all of us.

Gross misrepresentations and misinterpretations have been attached to Smith's effort, and these have unquestionably made him a folk hero of business lobbyists and Right-thinking people, elevating the professor to something like a cult figure. Reagan, Friedman, Edwin Meese III, and other prominent personalities have been known to wear Adam Smith neckties to show their fealty to *The Wealth of Nations*. But some of these people have not sufficiently familiarized themselves with the text. Smith is scathing on the subject of what was then

the closest equivalent to multinational corporations, and he calls for heavy assessments against the wealthy in the form of a steeply progressive income tax. In the case of those rich people given to the habits of “wastrel” wealth, he was so severe that he would have the government take away *all* of their money. This leaves little of Smith for a solid conservative to console himself with, though there is still the “invisible hand.” Or so we thought. For Stiglitz has destroyed the “hand” as well, proving that markets do not really work in this way.² It has been a comforting figment of many economists’ imaginations, nothing more, but now it, too, is dead, another casualty for the chamber of commerce lexicon.

So, Why Is Nothing Happening?

Four years after the Nobel address (and three decades after the appearance of Stiglitz’s landmark article), we should reasonably expect to see some changes in the way economic actors and their lobbyist representatives handle the myth of “free enterprise,” but the rhetoric is basically unchanged and has even increased in its misguided intensity. Such faith dies hard. President George W. Bush, though no scholar of economics nor even a casual observer of the discipline, continues to invoke it (or its surrogate terminology) when he talks about social security, the environment, taxes, budgets, international trade, or medical care issues. (A press conference of June 2, 2005, for example, fits this pattern.) The business press ignores Stiglitz and continues to hold that minimum-wage laws are Maoist in essence (an actual statement in a column in *Business Week* a couple of months ago), that unemployment compensation is a government-paid vacation, that public housing is a decided failure, which is hardly the case, and that privatization is the answer to everything.

Public officials are clueless on this topic. My own state representative likes to mention “free enterprise” in virtually all of his town meetings, so I e-mailed him a note about Stiglitz and a small description of what Stiglitz has said. Surprisingly, this legislator had heard of him; unfortunately, he said that he has decided to ignore

him. Most politicians both ignore him *and* have never even heard of him.

Economics texts also generally ignore Stiglitz and his cohorts. Their micro-models are unaffected and the macro-talk has proceeded in much the same vein as ever, with only slight adjustments of various kinds attached over the years. (The Stiglitz economics text is the sole exception.) "The media and everyone else seem to stiff him," according to one of my grad students, and this indeed seems to be the case. One never hears any mention of "information economics," Stiglitz's specific contribution, on CBS, CNN, or Fox News. And, yes, Enterprise Square in Oklahoma still has visitors, though probably fewer than the Disney parks. (Have any of us met a child who is excited by interest rate changes or stock option contracts?) Institutions claiming total devotion to market economics, as opposed to those that muddy this view by combining it with calls for government largesse for certain corporations or industries (as in the cases of Bush's Medicare, energy, defense, and social security measures), are also still in business, even though they have no earthly reason, by intellectual measure at least, for continuing to exist. A few examples of these purposeless ciphers are the Cato Institute propaganda mill, the Ayn Rand Institute, the Objectivist Society and its branches, the Club for Growth, and the law and economics sector of legal writing and academic work, which is headquartered at the University of Chicago and is closely associated with the eccentric Judge Richard Posner. Some of the verbal meanderings of former Federal Reserve Chair Alan Greenspan, a Randy ideologue, have and should be regarded as part of this genre, and these are equally baseless.

It can be readily appreciated that some of these people and their organizations should be given the message of information economics (for their own self-interest, if for no other reason); but there is also real cause for doubting the motives and sincerity of some of the corporations, media organizations, and various other right-wing clusters who continue to spout market economics ideology. Spreading the word must be a priority if the world of economics is ever to come to grips with itself. In the meantime, human progress must appar-

ently be patient in awaiting this new dawn. Why? I will tell you: I don't really know.

Information Economics

The sixty-eight pages of the Nobel Prize speech (available online) provide a good and informative read.³ The essence of the new economics is the understanding that bargains are rarely characterized by an equilibrium in terms of information. One side knows more about the deal and its particulars than the other can know. The typical stock purchaser who added Enron to her portfolio, for example, could not discern even the essence, to say nothing of the full truth, of her buy. And this is generally the case, whether the subject of a contract is land, a personal computer, a new or used car, or a packet of dahlia seeds. This significant lack puts a damper on the enthusiasm people may feel about any given bargain, and sharply contrasts, if one thinks about it, with all the gush and panegyrics devoted to the idea of the bargain and its role in the economy as described in the more inane *Cato*, *Orange County Register*, *Randian*, or law and economics essays and books.

Stiglitz addresses the major problem areas of economics. He avers that unemployment is the central problem of macroeconomics, but he also spends considerable time and effort in pointing out that it is usually those without connections, education, or influence—groups such as the working class, the poor, and the consumer—who are most disadvantaged by the information gaps found in the marketplace. It is quite natural, then, for Stiglitz to be intensely interested in the plights of third world peoples and the need to enhance growth and opportunity in their economies.

From the World Bank to the World's Economy

A significant three-year span of Stiglitz's career involved working for the World Bank, and it was in the assumptions and operations of this organization that he has found issues to ponder and answers that

made more sense than those adopted by the Bank. The challenges presented by this institution were of considerable moment, and his frustrations were as burdensome as they were heartfelt. Stiglitz questioned the Bank so much that he was always in the middle of one dispute or another about the purposes, goals, and efficiency of the Bank's agenda. Most galling was the insistence of policymakers upon following the same decision patterns and project goals that had already failed many times over. Stiglitz even found some of these officials conceding that his criticisms were right. But then they would proceed to act as though they had never participated in such a discussion.

Since Stiglitz is well aware of the information gaps faced by developing countries and their peoples as they deal with the World Bank and other international and bilateral arrangements, he has devoted a significant share of his writings and lectures to the basic issues of international trade and aid. But it is also fair to assume that a major part of this concern lies with the unfortunate conditions that third world nations and their peoples must face year in and year out. The tradition of obeisance to outdated and irrelevant market economics taken by the policy elites and bureaucracies dealing with trade and aid—the World Bank, the International Monetary Fund (IMF), the World Trade Organization (WTO), and certainly the U.S. Agency for International Development, among others—forced Stiglitz at a very early point in his Bank career to reject the nostrums of “free trade” which, after all, are closely tied to the old religion of “free enterprise.” Privatization and deregulation are certainly at the top of this “enterprise” diadem, but currency revaluation, sovereign debt repayment, active discouragement of labor organizing, and consumer belt-tightening are also common rules of the game.

It is this policy area, riddled with misconceptions and hazards that can lead the world to even greater chaos as well as to anti-American and anti-Western attitudes, that Stiglitz finds at the center of his concerns. The fate of the less-developed nations, as well as of the mature economies found in the West and Japan, rests heavily upon the kinds of policies, arrangements, agreements, and enforcement that will win acceptance and hold sway in the world. The political problems, much

more than the complexities of international trade and aid, must be resolved without falling back upon the solutions of the past, for these have wrought hardship and, in any event, are in no position to be justified by any more reverence for “free” markets and “free” trade. Recent political developments have underscored much of the distaste for the directives of the past: the election of a number of leftist leaders and governments in the larger countries of Latin America; a nascent “oil bloc” led by Venezuela; the continued protests that are seen at the World Economic Forum, G-8, Asia-Pacific Economic Cooperation (APEC) forum, Free Trade Area of the Americas (FTAA), and other international meetings; the rise of nongovernmental organizations (NGOs) as significant political and economic players in regional, national, and international arenas; and, most certainly, an overwhelming rejection by less-developed countries of policies pursued for the sake of mythic panaceas.

Contributions of Stiglitz and Information Economics

Stiglitz, as one might expect, sees a need for limitations on the headlong thrust toward trade arrangements encapsulated within the term “globalization.” He supports debt cancellations, the work of NGOs, aid to small farmers, encouragement of labor unions, and national as well as international controls on multinational corporations in areas such as the environment, taxes, trade practices, and protection of locally based industries and firms. His 2002 book, *Globalization and Its Discontents*, connects these issues and warns against the race to the bottom—the competitions of companies and nations to see who can find the lowest wages regardless of the social costs. It also reviews the work of the World Bank and the international financial community in dealing with serious economic meltdowns in Argentina, Asia, Russia and Eastern Europe, and elsewhere. These chronicles of crisis show, in what is essentially a milieu of routinized doctrines, how economists and policymakers, saturated with ideological attitudes and answers, have invariably gotten it wrong in trying to find a way out of the various messes. This illustrates an important point about

Stiglitz and his work: He is basically a pragmatist looking for solutions that work, and he sees ideology primarily as an obstruction. He believes that a problem presented helps to define the solution. He supports a core of political, economic, social, and moral beliefs, to be sure, but he finds his answers to problems by directly confronting them with the goal of how to get from here to there.

Further insights into the thinking of Stiglitz can be gleaned from *The Roaring Nineties*, his recently published examination of the great high-tech boom and bust in the Clinton era of American politics. He judges the Democratic administration's stewardship of the economy in harsh terms, even though he served this government as chairman of the Council of Economic Advisers. Laxity in corporate and stock market regulation, in his opinion, led to Enron, WorldCom, and many other excesses. Executive pay and stock options, combined with failures in oversight, led to what he believes can only be called "theft" of the public's resources. Deregulation of the telecommunications industry has endangered public input in the broadcasting industry and even the continued public ownership of the airwaves. But this anti-regulation mania has spread broadly through the economy, invariably working against the interests of consumers, stockholders, workers, retirees, and the less advantaged. Budget-busting tax cuts for the rich, hardly a new idea by the time the George W. Bush administration came along, added to this feeding frenzy. (These cuts, Stiglitz points out, would never be included on his list of effective fiscal stimulants.)

There is also a masterful critique of the Federal Reserve's activities during these years, showing how "irrational exuberance" in the markets was fed by Alan Greenspan's ideological notions. It is the case, of course, that presidential influence on the Fed can be limited. But Clinton and Greenspan got along famously, and all presidents have some ability to "lean" on the chairman and the Board.⁴ The North American Free Trade Agreement (NAFTA), now expanded into the FTAA, originated with the Clinton administration, and Stiglitz's criticism of its creation and focus is hardly surprising to anyone familiar with his earlier globalization book. But it is not just NAFTA that irks him. Trade policy with China, the policies of the WTO, and the con-

fusion of fair trade with “free trade” are among the many targets of the professor’s withering criticism. His critiques of the WTO closely parallel those of the International Labor Organization (ILO), the UN’s special agency, emphasizing the multinational power of corporations and the lack of any commensurate countervailing forces, such as effective international labor or environmental movements.

It is not remarkable that Stiglitz’s work appears to invariably incorporate a focus upon the dysfunctional and miserable state of the less-developed nations. These countries, after all, are situated at the very bottom rung of the economic ladder, and the unpromising prospects for their futures represent a security threat of potentially greater scope than any the world has yet seen. It does appear true that the world’s more fortunate peoples find thirst, starvation, disease, a lack of education, and privation to be not only cheerless but also boring topics. Jeffrey Sachs, an economist who does not agree with Stiglitz on all particulars of these issues, has nevertheless verified his concerns and most of his approaches in a recent tome, *The End of Poverty: Economic Possibilities for Our Time*, which sets out a prescription for these goals by proposing that the wealthier nations pledge something like 0.7 percent of GNP rather than the current 0.4, in accordance with the UN’s Millennial development goals.

For anyone wanting to find further explanations of information economics, the two recent Stiglitz books, *Globalization* and *The Roaring Nineties*, both touch upon the subject, though not as extensively as one might expect. The Nobel Prize speech of 2001 is a better source for the fundamentals of his theoretical work. The Prize effort does much more than a mere positing of a hypothesis, however, for it indicates policy connections that can be readily applied. His theoretical work thus serves Stiglitz well, for it gives him a sturdy basis from which he can set out his themes and explanations, while, not incidentally, he throws effective barbs and bombs against the dinosaurs as he delves into policy topics.

The most obvious conclusion one can make about the nonadoption of Stiglitz’s views is that there has been a massive failure within the world of politico-economic communications. It will be difficult to

set this aright. The discipline of political economy will stagger through the darkness for now, with all the relevance of biology without a theory of evolution, until the information economics revolution is acknowledged. But science has the insights, the tools, and, indeed, the power to trump ideology.

Notes

1. The landmark article initiating information economics is Joseph E. Stiglitz and Bruce Greenwald, "Externalities in Economies with Imperfect Information and Incomplete Markets," *Quarterly Journal of Economics* 101 (May 1986): 229–64.

2. Joseph E. Stiglitz, "There Is No Invisible Hand," *Guardian*, December 20, 2002.

3. An abbreviated version of the lecture can be found in *Economics for an Imperfect World: Essays in Honor of Joseph E. Stiglitz*, ed. Richard Arnott, Bruce Greenwald, Ravi Kanbur, and Barry Nalebuff (Cambridge: MIT Press, 2003), 569–639.

4. An interesting information economics design of monetary policy can be found in Joseph E. Stiglitz and Bruce Greenwald, *Towards a New Paradigm in Monetary Economics* (New York: Cambridge University Press, 2003).

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