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Review

Neo-liberalism's fatal flaws

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Joseph Stiglitz is the author of dozens of seminal papers in the most prestigious journals of mainstream economics. He has been a cabinet member in the Clinton administration, chair of the President's Council of Advisors, and senior vice president and chief economist of the World Bank. And, oh yes, he won the Nobel Prize. It is a remarkable development indeed when an economist of Stiglitz's stature proclaims that in many ways the critics of neo-liberalism have a deeper understanding of the global economy than elite policy makers: "Globalisation today is not working for many of the world's poor. It is not working for much of the environment. It is not working for the stability of the global economy" (p 214).

[https://internationalviewpoint.org/IMG/jpg/31_Stiglitz.jpg] Joseph Stiglitz

It is not surprising that most reviews of Stiglitz's book in progressive publications have been quite enthusiastic. Nonetheless, it is as important to comprehend the limits of his perspective as it is to appreciate the force of his criticisms.

Stiglitz's arguments can be grouped under three main headings. He exposes a series of profound flaws in the theoretical framework of neo-liberalism. He provides considerable empirical documentation of the practical failures of neo-liberal policies. And he attempts to explain why the neo-liberal agenda continues to be pursued, despite its fairly obvious shortcomings.

The theoretical foundation for neo-liberalism is the dogmatic belief that markets automatically lead to optimal results whenever they are allowed to operate without interference. Government ownership of enterprises, and restrictions on trade and investment, are taken to be paradigmatic instances of external obstructions undermining this remarkable property of markets. The policy implications follow at once: publicly owned state enterprises must be privatised, trade barriers must be removed, capital markets must be deregulated, government spending must be kept within strict limits, and so on, and all of these transformations should be undertaken as rapidly as possible.

Stiglitz, in contrast, insists that markets function properly if and only if a suitable set of background institutions is already in place. In the absence of adequate laws enforcing competition, privatisation will result in oligopolies and monopolies that harm the interests of consumers. The unemployment that inevitably follows the dismantling of protectionist trade barriers will generate immense social suffering if adequate safety nets and job creation programs have not been established. While wealthy economies can handle stampedes of capital inflows and outflows, these stampedes will wreck havoc on smaller developing economies. When economic downswings occur, their duration and harmfulness cannot be minimised unless the state is capable of undertaking expenditures to stimulate the economy. The main policy implication that follows from Stiglitz's alternative theoretical framework is the need for sequencing. Privatisation should only occur after an effective set of antitrust laws been put into place. Openness to trade should only be instituted after an apparatus addressing the social costs of free trade has been established. And capital controls should only be dismantled after a national economy has attained a critical mass.

In Stiglitz's view the empirical evidence clearly supports his perspective. He provides a comprehensive account of the International Monetary Fund's interventions in response to financial crises in East Asia and Eastern Europe in the late 1990's. The Fund encouraged the premature deregulation of capital markets in these regions, which often led to stampedes of speculative capital into already overheated stock and real estate markets. When the all but inevitable crashes and reverse stampedes of capital outflows occurred, austerity programs were then imposed by the Fund (pp 98 ff.). Governments were forced to restrict credit and spending, despite the fact that downswings are precisely the time when access to credit and government spending are most needed.

Motivated by the fear that currency devaluation would raise the cost of imports and lead to inflation, the IMF also provided funds to troubled economies to help them maintain the given exchange rate. As Stiglitz notes, these funds in effect bailed out international investors, while granting local elites an opportunity time to protect their financial assets by capital flight on a massive level (95). Soon enough the exchange rates were devalued anyway. The subsequent burden of paying back these IMF loans then fell on the very group that benefited least from them, working men and women.

Finally, privatisation programs were vigorously pursued in Russia and elsewhere despite the fact that only local gangster capitalists had funds available for the purchase of privatised assets, and despite the fact that the on-going economic slowdown enabled these gangsters to buy privatised enterprises and natural resources for a song.

Why were neo-liberal policies pursed (and continue to be pursed today with only minor modifications) when they are so obviously inadequate from the standpoint of both theory and historical experience? Stiglitz's main explanation invokes the overwhelming power of ideology. Defenders of the 'Washington Consensus' are so convinced by the tenets of market fundamentalism that they literally cannot conceive of any alternative or accept any negative evidence. They apply its precepts in any and all circumstances, however inappropriate they might be in the particular circumstances at hand, and however dismal their past record of success.

Stiglitz, however, also draws our attention to the numerous ex-IMF and US Treasury Department officials who have taken ludicrously lucrative positions in the very financial firms that profited most from their policies. One would have to be naÃ¯ve indeed, he implies, to think that this 'revolving door' between government and Wall Street has absolutely no effects on policy making. To my knowledge no 'insider' has ever come closer to conceding that Marx's dictum that the state is the executive committee of the ruling class just might have a grain of truth to it. Stiglitz extends Marx's point to include the international agencies such as the IMF as well:

"Many of its key personnel came from the financial community, and many of its key personnel, having served these interests well, left to well-paying jobs in the financial community. Stan Fischer, the deputy managing director who played such a role in the episodes described in this book, went directly from the IMF to become a vice chairman at Citigroup, the vast financial firm that includes Citibank. A chairman of Citigroup (chairman of the Executive Committee) was Robert Rubin, who, as secretary of Treasury, had had a central role in IMF policies. One could only ask: 'Was Fischer being richly rewarded for having faithfully executed what he was told to do?'" (pp 208)

Stiglitz's analysis echoes that presented by Theodore Veblen in the beginning of the twentieth century. In Veblen's account of the capitalism of his day, the most significant social division was that between producers (industrialist entrepreneurs and the workers they employed), on the one hand, and financial speculators, on the other. While the actions of the former bring about long-term technological progress, the latter are primarily concerned with short-term profits from trades in financial assets. The more power and prestige claimed by financiers relative to producers, the less likely it is that society will undertake the long-term investments in fixed capital necessary for social dynamism. Veblen's central thesis, in brief, was that there can be a tension between what is rational from the standpoint of financial capital and what is rational from the standpoint of society as a whole. Institutional reforms must be undertaken to ensure that the operations of financial capital are strictly subordinate to industrial development.

In an exactly parallel fashion Stiglitz argues that the neo-liberal policies pursed by the U.S. Treasury Department and the I.M.F. have furthered the interests of financial capital to the detriment of the overall social rationality of the global economy:

"Trade liberalization accompanied by high interest rates is an almost certain recipe for job destruction and unemployment creation - at the expense of the poor. Financial market liberalization unaccompanied by an appropriate regulatory structure is an almost certain recipe for economic instability - and may well lead to higher, not lower, interest rates, making it harder for poor farmers to buy the seeds and fertilizer that can raise them above subsistence. Privatisation, unaccompanied by competition policies and oversight to ensure that monopoly powers are not abused, can lead to higher, not lower, prices for consumers. Fiscal austerity, pursued blindly, in the wrong circumstances, can lead to high unemployment and a shredding of the social contract." (p 84).

Institutional reforms must be undertaken restricting the financial sphere. His suggestions include:

- Standstills on debt repayment when financial crises occur, giving otherwise healthy firms an opportunity to recover from financial crises (p 130).
- Special bankruptcy provisions that kick in when exceptional macroeconomic disturbances break out, providing management a chance to restructure ailing companies (p 130).
- Greater reluctance by the IMF to lend billions in bail out packages.
- Improved regulation of banking, including, for example, restrictions on speculative real estate lending.
- The use of short-term capital controls and "exit taxes" to protect countries against "the ravages of speculators" (p 211).
- Granting more seats at the I.M.F. to countries from poor regions in the global economy.
- More open discourse at the I.M.F., the World Trade Organisation, and other international agencies.
- A narrowing of focus at the I.M.F. to managing crises, leaving policies of development and transition to other institutions such as the World Bank
- The developed countries and international financial institutions should provide loans enabling developing countries to buy insurance against fluctuations in the international capital markets.
- Improved safety nets.
- Debt relief and a more balanced trade agenda.

Many of these policy proposals are deserving of support. But I believe that the 'institutionalist' critiques of Veblen and Stiglitz are beset by a series of profound difficulties. A first point to note is the manner in which institutionalists, no less than the market fundamentalists they oppose, use fundamental categories such as 'money' and 'capital' in an uncritical fashion. Neither Veblen nor Stiglitz comprehend that money is the alien form of appearance of abstract labour, or that capital is the alien form of appearance of collective social labour. And so neither calls into question the reign of the money fetish and the capital fetish over human life.

Even if we put this absolutely crucial point to the side, it is still astounding that Veblen categorises 'producers' as a homogenous group, failing to appreciate the immense class divide between industrial capital and wage labour. In Stiglitz's account class divisions within the industrial sector of the global economy are occluded as well. It is true, of course, that global financial markets and international agencies often harm the interests of industrial capital and their workers simultaneously. IMF austerity programs, for instance, force otherwise profitable firms into bankruptcy and wage labourers into unemployment.

But one of the most profound historical developments associated with globalisation today is the formation of cross-border production chains. These chains were established by trans-national capital in the hope of implementing a 'divide and conquer' strategy vis-Ã -vis the global workforce. General Motors workers in Michigan for example, face a plausible threat of production being shifted to plants in Mexico; workers in these Mexican plants face the threat of capital flight to Guatemala, or now even Vietnam or China. In the absence of effective organizing on the international level, the balance of power in the capital/wage labour relations tends to shift in favour of capital, with increased economic insecurity and a higher rate of exploitation resulting. From a class perspective Stiglitz's ultimate policy objective can be described as the systematic reproduction of the capital/wage labour relation on the global level, freed from the irrational disruptions imposed by the financial sector. This is equivalent to the systematic reproduction of exploitation on the global level.

It must also be emphasized that even if for the sake of the argument we imagine a capitalist world market purged of financial excesses, it would still be characterised by uneven development. A systematic exploration of this topic is not possible here. A brief discussion must suffice.

The heart of inter-capital competition is the drive to appropriate surplus profits through temporary monopolies from product or process innovations. The research and development process is obviously a crucial element in innovation. Units of capital with access to advanced (publicly or privately funded) R&D are best positioned to win this form of surplus profits. They are thus also best positioned to establish a virtuous circle in which surplus profits enable a high level of future R&D funding, which provides important preconditions for the appropriation of future surplus profits, and so on. In contrast, units of capital without initial access to advanced R&D tend to be trapped in a vicious circle. The resulting inability to introduce significant innovations prevents the appropriation of surplus profits, which in turn tends to limit participation in advanced R&D in the succeeding period. This then limits future innovations and future profit opportunities.

This fundamental dynamic of capitalist property relations has profound implications. Units of capital with the greatest access to advanced R&D almost by definition tend to be clustered in wealthy regions of the global economy. Units without such access tend to be clustered in poorer regions. The former are in a far better position to establish and maintain the virtuous circle described above, while the latter have immense difficulty avoiding the vicious circle. When units of capital in poorer regions engage in economic transactions with units of capital enjoying temporary monopolies on process and product innovations, they thus necessarily tend to suffer disadvantageous terms of trade. In other words, there is a redistribution of the value produced in the production and distribution chain from the periphery of the global economy to the centre. In this manner the drive to appropriate surplus profits through technological innovation - an inherent feature of capitalist property relations - tends to systematically reproduce and exacerbate tremendous economic disparities in the world market over time.

In Stiglitz's account of the world market there is no hint of a systematic tendency to uneven development. At crucial places in the book he refers to the historically unprecedented rates of economic growth and increases in per capita income attained in a number of East Asian countries in recent decades. He clearly implies that this 'East Asian miracle', based on the ability of industries in these countries to compete successfully in global export markets, provides a devastating refutation of the uneven development thesis. The heart of Stiglitz's position is the claim that in principle all poor countries can enjoy success in the world market, if only they follow intelligent policies and are not impeded by the dogmas of neo-liberalism.

A first difficulty Stiglitz must address has to with the fact that the relative handful of countries that have escaped from poverty in the last decades did so through 'the development state' model, which is characterised by three main features. First, savings in the national economy are 'intermediated' - that is, deposited in the national banking system. Second, the allocation of capital to the non-financial sector of the economy is determined in a process of formal and informal negotiations between banks, state agencies, and industrial corporations. Third, the banks hold a high portion of the equity of the corporations to which they lend. The problem is that this model is now in the process of being dismantled.

Stiglitz fully comprehends the extent to which this model is under now attack by the policy elites in the US and the IMF, who hope to force the countries that have implemented it to open their financial sectors to Wall Street. But he both underestimates and overestimates this factor. He underestimates it in the sense that he fails to comprehend just how central the dismantling of the developmental state model is to the United States, the hegemonic power in the global system. Peter Gowan correctly places this development in the context of the 'great global counteroffensive' by the US in response to the demands for a New International Economic Order articulated by third world states in the late 1960's and 1970's. The debt crunch of 1982 provided the opportunity to launch the counter-offensive in much of Latin America and Africa, aiming at the following two objectives:

- To replace a national industrial strategy for development through import substitution, and the development of the internal market, with a strategy based upon western MNC direct investment and exports from the target country to the world market.
- To replace a state-centred financial and industrial system within the country with private financial markets, ownership of economic assets in the hands of private capital, deregulated labour markets and a strong role for western FDI [Foreign Direct Investment] and portfolio investment.

In East Asia, the continuing Cold War motivated the US government to accept high levels of exports from countries that allowed neither imports from US manufacturers (unless they were needed by their exporting firms) nor portfolio capital investments from the US. With the end of the Cold War this arrangement ceased being acceptable to US political and economic elites.

From this standpoint the neo-liberal project does not merely reflect the temporary power of one faction of capital in the state apparatus. It represents the fundamental interest of the hegemonic power in the world market. And from this standpoint it is not sufficient to complain that the US.- controlled IMF has imposed policies that had the unanticipated consequence of leading to slump rather than growth, for "the IMF approach requires slumps rather than growth as the favoured context for restructuring since the slump provides powerful pressures on key economic actors and it destroys the social power of labour in economic and political life."

Lacking a theory of hegemony and hegemonic interests in the global economy, Stiglitz underestimates the force of US/IMF pressure to dissolve the developmental state model. But he also overestimates it in other respects. He implies that if only this pressure could somehow be neutralised all would be well, and the 'miracle' could recommence in East Asia and elsewhere. This drastically downplays the extent to which the transition away from the bank-centred financial systems of the developmental state model is a general trend of the present historical epoch. It is supported by most leading sections of both industrial and financial capital in almost all regions of the world market, quite apart from the machination of US and IMF policy makers. Wealthy depositors throughout the global economy now seek better rates of return from international capital markets than they can attain from deposits in national savings systems. The biggest corporations prefer reliance on impersonal markets to the much more intrusive oversight that arises when they are dependent on a specific bank for credit. The biggest banks in the global economy wish be freed from long-term ties to corporations, in order to avoid being brought down when those corporations have difficulty adjusting to rapidly changing technological and economic environments. The increasing number and scope of cross border production chains and cross border mergers and acquisitions also make the developmental state model less feasible in the global economy. And the promise of profitable opportunities to extend extending cross-border production chains and participate in cross border mergers and acquisitions in the future makes this model less attractive to more and more units of capital.

Another crucial consideration when attempting to assess the claim that the successes of the developmental state model in East Asia refute the theory of uneven development is the systematic tendency to over-accumulation crises in the world market. This issue is also far too complex to discuss adequately here. For our purposes it must suffice to note that while the drive to appropriate surplus profits necessarily tends to lead more efficient plants and firms to enter a given sector, established firms and plants do not all automatically withdraw when this occurs. Their fixed capital costs are already 'sunk', and so they may be happy to receive the average rate of profit on their circulating capital. They also may have established relations with suppliers and customers impossible or prohibitively expensive to duplicate elsewhere in any relevant time frame.

Further, their management and labour force may have industry-specific skills. Or governments may provide subsidies for training, infrastructure, or R&D that would not be available to them if they were to shift sectors. When a sufficient number of firms and plants do not withdraw as a result of these factors, the result is an over-accumulation of capital, manifested in excess capacity and declining rates of profit. In more traditional Marxist terms, insufficient surplus value is produced to valorise the investments that have been made in fixed capital. In certain circumstances this dynamic may lead to an economy-wide fall in profit rates for an extended historical period.

When over-accumulation crises break out, previous investments in fixed capital must be devalued. At this point the entire system becomes convulsed in endeavours to shift the costs of devaluation elsewhere. Each unit, network, and region of capital attempts to shift the costs of devaluation onto other units, networks, and regions. And those who control capital mobilise the vast economic, political, and ideological weapons at their disposal in an attempt to shift as many of the costs of devaluation as possible onto wage labourers through increased unemployment, lower wages, and worsened work conditions. As the concentration and centralisation of capital proceeds in the course of capitalist development, both over-accumulation and the resulting need for devaluation necessarily tend to occur on an ever-more massive scale. Global turbulence and generalised economic insecurity increasingly become the normal state of affairs.

These considerations strongly reinforce the thesis that the so-called 'East Asian Miracle' does not refute the theory of uneven development. While it may be true that at some points in time some developing countries may enjoy great success in certain export markets, it does not follow that all developing countries can do so at any time in nay market. As more and more developing countries enter into global export markets, excess supplies necessarily tend to arise. In other words, the more the developmental state model succeeds, the closer it is to failing.

Also, the East Asian miracle was at least partially premised on exports to the United States that could be absorbed due to a historically unprecedented rate of credit expansion. The limits of this credit expansion - that is, the failure of this credit expansion to remove over-accumulation difficulties - have revealed the limits of the ability of US markets to absorb exports from East Asia.

Stiglitz does not once refer to the overcapacity problems that afflict almost every major sector of the global economy today, or to the fact that only massive devaluations of capital on the global level can resolve these problems. As a result he fails to appreciate the extent to which the policies of the IMF are rational from the standpoint of the dominant capitals and states. The devaluation of capital occurs through processes such as firms going out of business and being bought up by competitors. When the IMF imposes conditions forcing corporations to fold and countries to open their economies to outside investors, this is part of a rational strategy to shift the costs of devaluation to these vulnerable corporations and countries. To ask leading capitals and states - and the international agencies they control - to act otherwise is to ask the capitalist world market to not be the capitalist world market.

Thus far I have been arguing that capitalist rationality would still conflict with social rationality, even if we assume for the sake of the argument that financial crises can be avoided. Even then the systematic tendencies to uneven development and over-accumulation crises would continue to beset the capitalist world market. But there are good reasons to believe that Stiglitz's hope is a fantasy that will never be fulfilled. Financial crises, like uneven development and over-accumulation crises, are not contingent occurrences in the capitalist global market. They are not due to the power of ideology over economists and public policy experts, nor are they adequately explained by the revolving door connecting the IMF and the US Treasury Department to Wall Street. They are instead rooted in the logic of capitalist property and production relations.

The financial sector is intimately implicated in both the formation of over-accumulation crises. Flows of financial capital from across the world market tend to be centralised in a few points at the centre of a global financial order, and then allocated across borders. With credit money and fictitious capital the provision of funds can be a multiple of the temporarily idle profits, depreciation funds, and precautionary reserves pooled in the finance sector. In this manner financial capital "appears as the principal lever of overproduction and excessive speculation in commerce."

Once an over-accumulation crisis commences, the rate of investment in sectors suffering overcapacity problems slows significantly. A large pool of investment capital is formed once again, now seeking new sectors with a potential for high future rates of growth (that is, with an expectation of being able to appropriate future surplus value for an extended period of time in the future). When such sectors are found, financial capital from throughout the world market tends to flow in their direction. If the flows of investment capital to these new sectors are high enough, a systematic tendency to capital asset inflation results. Expectations of future earnings eventually become a secondary matter, as financial assets are purchased in the hope of profits from later sales of these assets. This tendency is then reinforced as previous (paper) gains in capital assets are used as collateral for borrowings to fund further purchases of capital assets, setting off yet more rapid capital asset inflation. Throughout the course of this speculative bubble it remains the case that financial assets are in essence nothing but claims on the future production of surplus value. When it becomes overwhelmingly clear that the ever-increasing prices of these assets are ever less likely to be redeemed by future profits, the speculative bubble collapses, and a financial crisis ensues.

The intertwining of the tendencies to over-accumulation crises and financial crises implies that the impact of concentration and centralisation on the former extends to the latter as well. The devaluation of loans and fictitious capital following in the wake of financial crises necessarily tends to occur on an ever-more massive scale. The pressure on units, networks, and regions of capital to shift the costs of this devaluation on to other units, networks, and regions thereby increases as well. Most of all, capital's attempts to shift as much of the cost as possible onto wage labourers and their communities intensify.

Now let us reconsider the list of Stiglitz's policy proposals given earlier.

Would they transform the financial sector so that it would not play a role in the formation of over-accumulation crises? No.

Would they rule out speculative bubbles in the financial sector? No - many of the measures Stiglitz calls for were already in place in the US, and they did not present one of the greatest speculative bubbles in history from arising.

Would any of these measures prevent the greatest burdens of financial crises from being inflicted on the very groups that benefited the least from financial excesses, working men and women and their communities? No.

Finally, and most importantly perhaps, is there any item on this list that would reverse the structural mechanisms generating uneven development? No.

These problems are all rooted in the system of property and production relations that defines capitalism. To recognise this is to recognise the limits of Stiglitz's framework, however admirable and even courageous his break from neo-liberalism has been.

