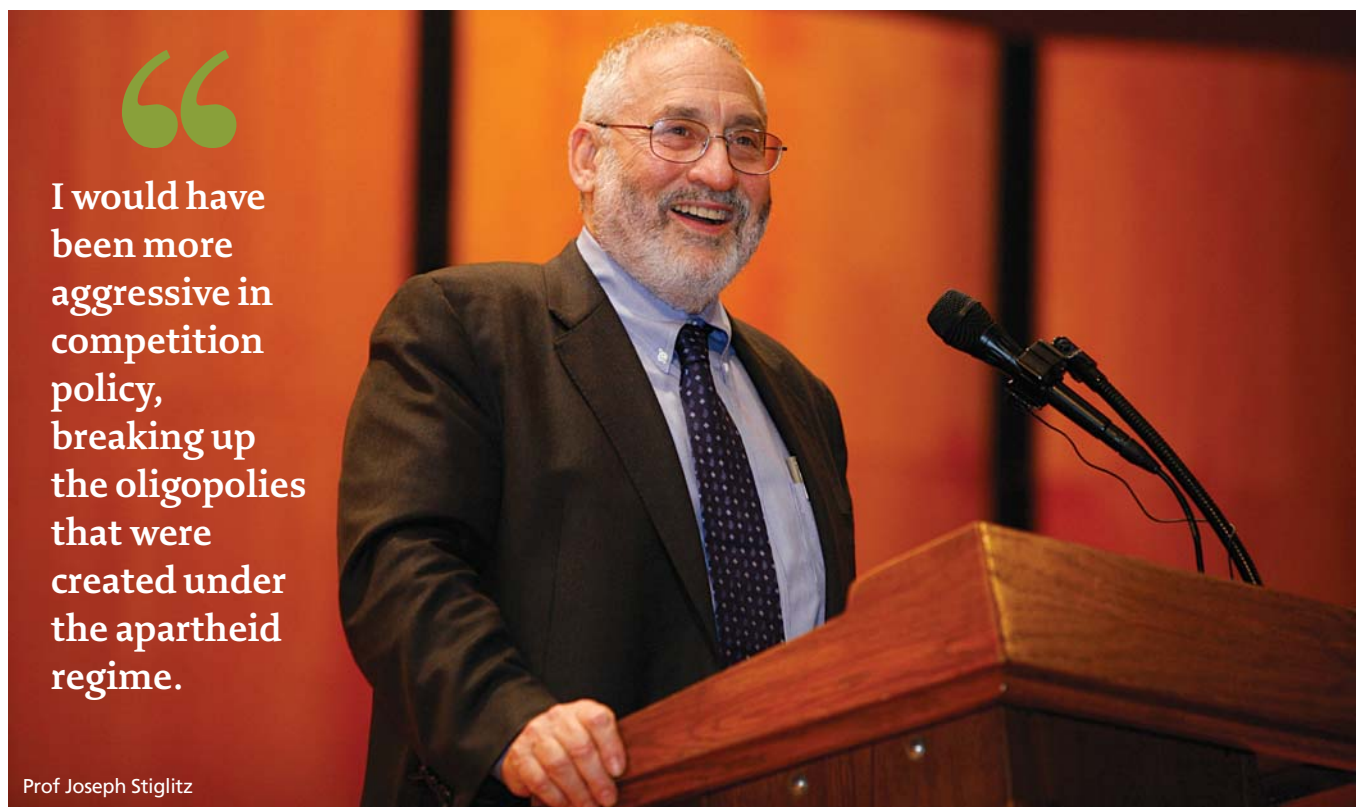


THE GLOBAL MARKET ECONOMY IS NOT WORKING

An interview with Joseph Stiglitz



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Prof Joseph Stiglitz

One of the world's foremost economists, Joseph Stiglitz is a Nobel laureate, former chief economist of the World Bank and former chair of the US Presidential Council of Economic Advisors. Ben Turok interviewed him at the BRICS conference in Durban in November 2015. They spoke about US responses to the financial crisis, startling new thinking at the IMF, and options for South Africa's economic future.

USA 2008: BIG MISTAKES

Ben Turok: You are known to be critical of the measures taken by the United States government in response to the international financial crisis of 2008.

Joseph Stiglitz: The main mistakes we made were, first, we bailed out the banks – or more accurately, we bailed out the bankers, the shareholders and the bondholders – rather than focussing on just making sure that lending

continued. In fact, lending stopped.

It created, from a political economy point of view, the most disastrous effect because ordinary Americans believed the government, both Republicans and Democrats, was out to save the bankers, not to save ordinary Americans. They lost their jobs. They lost their homes. It was an economic and a political and a social mistake. They could have done it in ways that would have been better for >>

the government's treasury and would have provided more money.

The second big mistake was that they underestimated the depth of the downturn, and therefore they underestimated what needed to be done. They stimulated the economy for a short while, but it was too little, too short, and not as effectively designed as it could have been and should have been. They say it was the best they could do politically, but I think that's totally wrong. I think they could have asked for more. The Democrats controlled the Congress, the Senate, the House. They were just too timid.

Two years later, you had a Republican-controlled Congress and you're not going to get any stimulus. The United States went into a mild form of austerity. Today, six years after the crisis, we have 500 000 fewer public sector employees. At normal growth, we would have had 2 million more public sector employees. So we have austerity of 2.5 million jobs. That's significant. Those were my two main criticisms.

BT: What were the mechanisms of the bailout?

JS: The main mechanism was providing funds to the banks in return for what were called "preferred shares". The government was basically underwriting the banks totally.

BT: Was this the central bank?

JS: No, it was from the Treasury – \$700 billion. It was effectively a loan, but they wanted to be on the equity side of the balance sheet, just for accounting reasons, so they called it "preferred shares". They were basically the owners of the firms, but they said, "We're not going to interfere. You can continue manipulating markets, manipulating Libor [the benchmark international inter-bank lending rate], abusive credit card practices, predatory lending. Do all the bad things that you've done to make money before, because we want you to make money so that you could

be strong." The banks just continued doing that. In fact, some of the worst practices occurred after the government had bailed them out.

To me, it was unconscionable. The government, as owner, was complicit in some of the worst practices of the banks. They were throwing people out of homes who didn't owe any money. The banks were signing affidavits saying that they've looked at the records and the guy owes money when they had not looked at the records. They were just lying. By the thousands, by the tens of thousands, people who didn't owe any money were thrown out of their homes in America.



My view is very strongly that a combination of monetary tools could probably allow you to invest more, even with your debt.

BT: It was a bailout, not nationalisation.

JS: No. It should have been nationalisation: we owned it. But we decided not to take control, using the preferred-shares gimmick. Obama explicitly said that Sweden had done otherwise and done it very well, but that's "not the American way". My response was that the American way is not to just suspend the rules of capitalism.

We're supposed to be playing by the rules. If a bank can't pay what is owed, it goes bankrupt and the government, through the Federal Deposit Insurance Corporation (FDIC), takes over the bank. In banking, you call it conservatorship not bankruptcy, but that's the rule. Geithner and Paulson [secretaries of the Treasury under Barack Obama and George W Bush respectively] and Obama and Bush decided to suspend the rules of capitalism for the benefit of the big banks.

BT: What was "quantitative easing" as a mode of intervention?

JS: Quantitative easing is part of monetary policy, intended to stimulate the economy. After interest rates went down to zero and it didn't have a very big effect, they saw they had to do something more. They wanted to try to bring down the long-term interest rate, and that's what quantitative easing is about. It worked a little bit but not very much. My cynical view was that the Federal Reserve felt guilty because it caused the crisis – through deregulation, etc. – so it felt it ought to do something. But I don't think that's what was really going on.

BT: Is that policy continuing?

JS: No, it's stopped. Interest rates have been at zero since 2008 and now they're discussing this miniscule move: whether they should increase the short-term interest rates by a quarter-point.

IMF U-TURN

BT: What do you think of statements by the head of the IMF [International Monetary Fund] recently about inequality, about avoiding austerity? There seems to be a big debate going on.

JS: This is a major change in the position of the IMF. There are three major changes that are very, very dramatic. The first is the recognition that *austerity doesn't work*.

BT: Is it really so? That's a reversal of their position.

JS: It's a total reversal! That's the first major change. The second is the recognition that *inequality is really bad for economic performance, growth and stability*. The third is that *capital controls may be an important instrument for economic policy*.

These are three things that I fought the IMF very vigorously on in the late 1990s when I was chief economist at the World Bank. They called me a snake-oil salesman then, and now they've changed. So I feel a little bit of, at least at the intellectual level, a kind of victory.

BT: But doesn't the US dictate policy in the end?

JS: No. But it tries, and there are things the IMF cannot do. For instance, the G20 agreed that there ought to be a change in [IMF] governance. The US Congress refused, so there's no change in the [voting participation] of the developing countries and emerging markets. The IMF was supportive of the criticism of the US court decision about Argentina's debt, which was outrageous, but the US Treasury put pressure on the IMF and they had to back off – even though, subsequently, the UN came out and said we need a better way of restructuring debt. The IMF has repeatedly said that we need a better way of restructuring. The US said: we don't.

BT: What about Greece?

JS: If it were up to the US government, I think there would be more support for Greece, less austerity. I do know that the US government was very concerned about what the troika [European Central Bank, European Commission and the IMF] was doing in Greece. But in the end, it's European policy.

SOUTH AFRICA'S OPTIONS

BT: "Prudence" is the favourite word of our National Treasury, and we've been pursuing it for twenty years, through Gear [Growth, Employment and Redistribution] and other austerity policies. Now the economy is at zero growth. Change is needed, and we don't know what. Would you be willing to say anything about South Africa's trajectory?

JS: I can say a couple of things. First, in 1994, there was a concern about establishing credibility in the financial market for the new government – a challenge that very few governments have had to face. I think they succeeded in doing that. Gear was intended to both do that and promote economic growth. I think we can say, twenty years later, it succeeded in the first but it failed in promoting growth. The numbers say that. It's a fact.

BT: It's conceded.

JS: Would I have done something different? Yes, I think I would have. I would have taken a more proactive policy of promoting employment, promoting inclusion. When I see unemployed labour and huge needs in housing and infrastructure, I get deeply upset. It's a market failure; something is deeply, deeply flawed in the economic system. Just like in America, where we've had homeless people and empty homes. We all have to recognise that: at the global level, the economy is not working. Going from there to the question of "what do we do?" is a big step. But if you don't first recognise that the system is not working, you're not going to make that step.

I have some things that I would have liked to try. I would have been a little more aggressive in exchange rate policy, keeping the exchange rate more competitive. The industrial sector, export sector, could have grown a bit more robustly. I would have been more aggressive in competition policy, breaking up the oligopolies that were created under the apartheid regime. I would have recognised there was a legacy of a non-competitive economy and asked how we would deal with this legacy. I would have wanted – but I don't know if I could have – to have dealt more aggressively with the housing problem, where you have inadequate housing and relatively unskilled people who could have been put to work – and could gain skills as they were working – to create some of the housing. These are, you might say, on my dream list.

BT: Would you do it the same now, given that we are in big trouble?

JS: Yes, I think I would. Last year, when I was here, I talked about trying to create a more competitive real exchange rate. You know, all the natural resource-based economies are now regretting that they didn't use the opportunity of the resource boom to reinvest in their economy. One of the consequences of

that were higher exchange rates. They should have used that moment to invest in their future.

BT: So you would have taxed the mines more?

JS: Very much so.

BT: But they object! [laughter]

JS: Of course they're going to object. But you have some very difficult problems, because you have some very high-cost gold mines, so you can't be insensitive to the cost of production.

BT: South Africa has high debt and the repayments are now very high. And yet, we need to boost the economy; we are stagnant in mining, industry and agriculture. What determines the choice that you make between reducing debt because repayments are high and/or stimulating the economy?

JS: What is your debt-to-GDP ratio now?

BT: About 45 percent.

JS: But that's not high. At the end of World War II – which was the period of our fastest economic growth – the US had about 100 to 120 percent [debt-to-GDP], and the UK had 240.

BT: And Japan now has over 200 percent. The problem is that the interest rate in South Africa is 5 percent, while Europe and the US is zero.

JS: You could try to engineer a monetary policy that sets interest rates lower. The naïve view that that would be inflationary is, I think, wrong. What causes inflationary pressure is the pace of creation of credit, not just the interest rate. There was this naïve view that the only instrument you should use is the interest rate. That's been totally discredited. A monetary authority has a range of instruments. It may be that you have to impose capital controls.

BT: We need inflows because of our balance of payments.

JS: Then it may entail the use of other >>

instruments. In the United States, Warren Buffett – hardly left-wing – has proposed that whenever you export something you get a chit; you want to import something, you have to use a chit. Balance of trade.

The Washington Consensus was wedded to too narrow a set of instruments, based on the ideological position that markets work perfectly. My view is very strongly that a combination of tools could probably allow you to invest more, even with your debt.

There is another set of ideas, which I have pushed very strongly for, called the “balanced budget multiplier”: if you increase taxes on natural resources and increase spending continuously, it actually stimulates the economy, creates jobs, and improves the balance sheet of the country.

GLOBAL TRADE, NATIONAL INTEREST

BT: Can we talk about South Africa’s integration into the world economy? We are now told that we are very deeply integrated, partly because the mining companies are now listed offshore, in London. Is there nothing we can do as a country in the national interest?

JS: A country’s natural resources always belong to the people. Some foreign company may currently have management responsibility, but you always view that as a fiduciary responsibility. If they don’t exercise that responsibility in an appropriate way, they should lose it.

BT: You are very bold! [laughter]

JS: I should say, just to be a little less bold, there has to be a legal framework with which one does that. But the legal and regulatory framework should be such as to ensure that whoever is the owner is pursuing the national interest. Problems have been created in some bilateral investment treaties, which is why South Africa tore those treaties up. They have to be rethought. They’re oppressive: they represent the interests of the corporate

world against the ordinary citizens. That fact has now been recognised – even in the United States, with all the Democratic Party candidates for president coming out against these provisions.



A country’s natural resources always belong to the people.

BT: This discussion is raging in South Africa at the moment. Our producers suffer enormously from cheap imports, not only from China. The United States wants to export cheap chickens. Our minister of trade and industry says, “If we can’t produce chickens, what can we produce?” People say that import-substitution industrialisation (ISI) has run its limit, that protectionism is not possible in the new order. What is your view?

JS: A central aspect of US trade policy is not based on free trade: it’s “managed” trade. And it’s managed for our corporate interests. We make sure that other countries don’t dump their goods on us – while we’re sure that we have the right to dump our goods on other countries. It’s an anti-symmetric policy. What maximises profits for American companies is what we care about. It’s a producer-oriented trade policy. We don’t care about our consumers, only about the campaign contributions, to put it bluntly.

So in the case of chickens, you should also worry about sanitary conditions, because our chickens are not produced under good conditions. There are “organic” chickens that are not safe to eat.

BT: Non-tariff barriers?

JS: I wouldn’t call from “nontariff barriers”; I’d call them “ensuring the health and safety of your citizens”. That should be the first priority of all policy. I think you should at least look at that: the conditions under which chickens are raised, the

kind of drugs they’re given, real concerns about the use of pharmaceuticals, where we know drug resistance can set in. It’s actually a global concern. Clearly, our corporate interests have put aside the general interest, and even the national interest, in order to profit.

South Africa obviously has to recognise that the US is the big gorilla in this burly world. The question is: how do you adapt? The US will use rhetoric about how we don’t believe in protectionism. But what do you think all of our agriculture subsidies are about? There’s a whole set of subsidies that go into so many of our industries. We believe in protectionism of a kind, according to our rules. The bottom line is not the rhetoric of principle: it’s the reality of power. I’m not sure the United States even grasps how hypocritical it is about its free trade rhetoric and massive subsidies.

The view of import-substitution industrialisation is, I think, wrong. There have been failures because of excessive protection, but at the same time, many successful countries used those strategies. Many of the successful countries in East Asia used export oriented policies, but that was in a particular period where exports were growing rapidly. The challenge facing Africa is that manufacturing employment will be going down around the world, and there will be an intense competition for those scarce jobs. It will not be possible for all countries to use an export-oriented growth strategy like East Asia did.

BT: You can turn to internal markets as a substitute.

JS: Large countries clearly can, and will have to. That’s not going to be possible for South Africa. That’s where South Africa’s policies to promote African integration and integration with other emerging markets become important. I’m more hopeful of South-South cooperation, where the abuse of power is probably less prevalent than in North-South relationships where abuses of power and hypocrisy are pervasive. **NA**