Joseph E. Stiglitz [Ideological Profiles of the Economics Laureates]

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Abstract

Joseph E. Stiglitz is among the 71 individuals who were awarded the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel between 1969 and 2012. This ideological profile is part of the project called "The Ideological Migration of the Economics Laureates," which fills the September 2013 issue of *Econ Journal Watch*.

Keywords

Classical liberalism, economists, Nobel Prize in economics, ideology, ideological migration, intellectual biography.

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Joseph E. Stiglitz

by Daniel B. Klein, Ryan Daza, and Hannah Mead

Raised by parents that he has described as a New Deal Democrat and a Jeffersonian democrat, Joseph Stiglitz (1943–) grew up in Gary, Indiana, with somewhat mixed views of government. Early on, he was opposed to segregation and disturbed by civil rights violations. In his youth, he has said, he acquired an enduring "distrust of authority" (Stiglitz 2002a). He earned his Nobel Prize for his work on asymmetric information. Stiglitz sees market failures caused by such asymmetries, and often advocates government intervention in those areas. Stiglitz has acknowledged the problem of incentives in the political sphere, as well (Stiglitz 2002b, 523).

After earning his bachelor's from Amherst College, Stiglitz went to MIT for his Ph.D. in economics. He taught at MIT, Yale, Oxford, Princeton, and Stanford before settling at Columbia. His work has been applicable to an array of economic issues, from credit rationing to efficiency wages. Karla Hoff writes:

> His work elucidated a broad set of phenomena that had largely been ignored before 1970 because they were outside the limits of the standard paradigm: incentive contracts, bankruptcy, quantity rationing, financial structure, equilibrium price distributions, innovation, and dysfunctional institutions. This work contributed to a paradigm shift in economics. In the new paradigm, the price system only imperfectly solves the information problem of scarcity because of the many other information problems that arise in the economy. (Hoff 2008)

Stiglitz writes in his autobiographical essay: "The politics of MIT also suited me well. My teachers were mostly establishment liberals, but there were a few that were more questioning. I wonder too how I would have fared had I gone to one of the schools, like Chicago, where there is a more conservative bent. Would I have changed? Or would I have just been unhappy?" (Stiglitz 2002a).

In 1980 Stiglitz and Anthony Atkinson wrote:

> The state…has a much more basic role to play in that its first function is to establish and enforce the "rules of the economic game." … The standard justification of state intervention takes as its starting point the behaviour of the economy in the absence of the government, that is,

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> in the hypothetical situation of a free market economy. (Atkinson and Stiglitz 1980, 4-6).

They continued:

> There is indeed little reason to believe that the market could function in the way assumed in the "no-government economy": "one description of such a social order, and probably a highly realistic one, would be summarized by the word 'chaos'" (Buchanan, 1970, p. 3). As we have argued…, the state is essential to the functioning of a modern market economy—to prevent such "chaos" developing—by legitimizing property rights, by controlling monetary and financial operations, by regulating entry to economic activities, etc. (Atkinson and Stiglitz 1980, 8-9)

In 1989, Stiglitz remarked on redistribution:

> In addition to those instances where the market fails to provide a (Pareto) efficient allocation of resources, the government may have a role, either because the resulting distribution of income is objectionable, or because there are some merit goods or bads not adequately supplied by the market. (Stiglitz 1989, 39)

Stiglitz, however, seems to advise against widespread government ownership in the production of goods and services:

> The idea that private, profit-maximizing firms act in a way which is not consistent with the public interest, and that this discrepancy is especially important in certain central sectors—heavy industries, financial institutions, transportation—has been a central tenet in socialist ideology. A seeming (unproved) corollary is that if the government nationalized these enterprises, they would act in the public interest. (Stiglitz 1989, 31)

The public sector, say Stiglitz and Lyn Squire, "should focus its efforts on those areas where the private sector fails" (Stiglitz and Squire 1998, 144). "Defense, redistribution, the legal and judicial system, regulation of financial markets, and protection of the environment are all areas in which the public sector has to play the central role" (ibid., 144-145).

Stiglitz has attempted to strike a balance between the state and the market:

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> The new development agenda is informed by historical experiences and has discarded the notions of "only-Government" or "only-market" based development. This framework sees government and markets as complements rather than substitutes. It takes as dogma neither that markets by themselves will ensure desirable outcomes nor that the absence of a market, or some related market failure, will require that governments assume responsibility for the activity. It often does not even ask whether a particular activity should be in the public or private sector. Rather, in some circumstances, the new agenda sees government helping to create markets—as many of the East Asian economies did in key aspects of the financial market. In other circumstances (such as education), it sees the two working together as partners, each with its own responsibilities. In still others (such as banking), it sees government providing the essential regulatory services without which markets cannot function because investors will lack necessary confidence. The new agenda sees the State stretching beyond implementing Pigouvian taxation that corrects externalities, toward a complementary role that helps provide the information and institutional, human and physical infrastructure required for markets to exist and function well. (Stiglitz 1999, 3)

Although Stiglitz often makes general remarks about the need for markets, we have not found any calls by him for liberalization of specific restrictions. Stiglitz has signed petitions for raising the minimum wage, supporting the 2008 Federal Recovery Act, supporting augmentation of union privileges ("Employee Free Choice Act"), opposing the George W. Bush tax cuts, and endorsing John Kerry for president in 2004 (Hedengren et al. 2010).

David Henderson (2008) describes Stiglitz's faith in government actors as "tempered," possibly by his experience working with these agencies. He describes Stiglitz's involvement in policymaking:

> From 1993 to 2000, Stiglitz entered the political arena, first as a member and then as chairman of President Bill Clinton's Council of Economic Advisers, and then as the chief economist of the World Bank. In this latter role he had major conflicts with economists at the International Monetary Fund (IMF) and at the U.S. Treasury over their views of government economic policy in Indonesia and other poor countries. Stiglitz objected to their advocacy of tax increases and tight monetary policy during times of recession, a policy that he called "market fundamentalism." (Henderson 2008)

Stiglitz explains his concerns with government action: "The problem is to provide incentives for those so entrusted to act on behalf of those who they are supposed to be serving" (Stiglitz 2002b, 523). Yet, he sees a partial solution: "Democracy—contestability in political processes—provides a check on abuses of the powers that come from delegation just as it does in economic processes; but…the electoral process provides an imperfect check" (ibid.). Stiglitz also has high hopes for the effectiveness of government transparency (ibid., 524).

Stiglitz says his insights cast doubt on the conclusions of competition-based economic models: "Some of the most important conclusions of economic theory are not robust to considerations of imperfect information" (Rothschild and Stiglitz 1976, 629).

In his Nobel lecture, he said:

> We have seen how the competitive paradigm that dominated economic thinking for two centuries, not only was not robust, not only did not explain key economic phenomena, but also led to misguided policy prescriptions. (Stiglitz 2002b, 519)

Stiglitz means market-based policies, which, he contended, are "particularly inappropriate for developing countries" (ibid.).

Some of Stiglitz's work on development economics is described by Hoff as follows:

> His models were important in establishing (a) that positive feedback mechanisms can give rise to multiple equilibria and underdevelopment traps; (b) that, because the causes of market failures and constraints on growth vary greatly from setting to setting, analysis has to be done case by case; and (c) that non-market institutions need have no efficiency properties. (Hoff 2008)

With Lyn Squire, Stiglitz outlined three ingredients for growth: "a stable and credible policy environment, an open and competitive economy, and a focused public sector" (Stiglitz and Squire 1998, 142). He has criticized the trend of capital market liberalization, saying it hurts developing countries (Stiglitz 2002c, 244).

After the fall of communism, Stiglitz wrote, nations moved toward markets, and many assumed this would bring about higher incomes. "Instead, incomes plummeted, a decline confirmed not only by GDP statistics and household surveys, but also by social indicators" (Stiglitz 2002b, 519). Stiglitz blames rapid privatization that did not ensure good corporate governance: "rather than providing a basis for wealth creation, it led to asset stripping and wealth destruction" (ibid.).

With Squire, Stiglitz wrote:

> The failure of state enterprises and the success of market economies have led to strong efforts to privatize and liberalize markets. But sometimes these efforts are motivated more by ideology than economic analysis and may proceed too far, too fast. When that happens, the economy may suffer. Privatizing a natural monopoly before an effective regulatory framework is in place may lead to higher, not lower, prices and may establish a vested interest resistant to regulations that encourage competition. Striking the right balance between unfettered markets and state regulation is difficult and requires a thorough understanding of how markets work. (Stiglitz and Squire 1998, 145)

Mahmood Mamdani (2012) asks whether Stiglitz changed his mind on deregulation: "Academic reviewers of Stiglitz have often wondered when he saw the light: did Professor Stiglitz oppose deregulation at the time or change his mind when its consequences became clear? Should we understand his critique of deregulation as foresight or hindsight, foresight in 1996 or hindsight after his time as Clinton's senior policy advisor?"

By studying and exposing the costs of war, Stiglitz has to some extent positioned himself on foreign policy. In 2008, Stiglitz and Linda J. Bilmes published a book on the high cost of the war in Iraq (Stiglitz and Bilmes 2008), and he did various media events to publicize his findings, such as an interview at the website of *Foreign Policy* magazine (Stiglitz 2008). But, to our knowledge, Stiglitz does not often speak out in a more general way on foreign policy issues.

Writing on a fiscal stimulus in 2010, Stiglitz stated:

> The United States needs a stimulus, but it needs to be well designed and quick-acting (and if current trends continue, the same will be true for Europe). Any stimulus will add to the deficit, and with the deficit soaring since 2002, it is especially important to have as big as a bang for the buck as possible. The stimulus should address long-term problems—and at the very least, it should not make them worse. (Stiglitz 2010b, 79)

Stiglitz also advocated a global stimulus:

> The crisis is global in nature and countries should put in place a response that is as coordinated as possible to avoid mass unemployment and the risk of increasing social tensions. Sheer prudence requires more stimulus. The world economy needs a more global stimulus and should not tolerate free riding by some countries. This

> implies a fair sharing of the burden of the stimulus among countries, and a particular effort to help those countries that don't have the resources to lead a counter-cyclical fiscal policy. (Fitoussi and Stiglitz 2009, 3-4)

> On tax cuts:

> The Bush Administration had long taken the view that tax cuts (especially permanent tax cuts for the rich) are the solution to every problem. This is wrong. The problem with tax cuts in general is that they perpetuate the excessive consumption that has marked the US economy. … A tax rebate targeted only at lower and middle income households makes sense, especially since it would be faster acting. (Stiglitz 2010b, 79)

In recent years, Stiglitz has called for greater "equality of opportunity." "Americans are coming to realize that their cherished narrative of social and economic mobility is a myth," he wrote (Stiglitz 2013a). He explained:

> After 1980, the poor grew poorer, the middle stagnated, and the top did better and better. Disparities widened between those living in poor localities and those living in rich suburbs—or rich enough to send their kids to private schools. A result was a widening gap in educational performance—the achievement gap between rich and poor kids born in 2001 was 30 to 40 percent larger than it was for those born 25 years earlier, the Stanford sociologist Sean F. Reardon found. (Stiglitz 2013a)

In 1973, Stiglitz wrote that the United States' diverse school system was serving students well (Stiglitz 1973, 145), and added:

> Some of the complaints against the educational system are really addressed to aspects of our economic system, particularly to the degree of inequality which it engenders. Although it has been argued that the educational system is not the cause of inequality, the difficult question remains: is it possible, and/or desirable, to use the educational system to promote greater equality? (Stiglitz 1973, 145)

In 2013, however, Stiglitz cited a widening educational achievement gap, saying inequality must be addressed: "[W]e have to reverse the damaging cutbacks to preschool education…. We have to make sure that all children have adequate

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nutrition and health care—not only do we have to provide the resources, but if necessary, we have to incentivize parents, by coaching or training them or even rewarding them for being good caregivers. … Giving more money to poor schools would help. … Finally, it is unconscionable that a rich country like the United States has made access to higher education so difficult for those at the bottom and middle" (Stiglitz 2013a). Economic and educational inequality reinforce each other, Stiglitz said. He called for "substantial policy changes," concluding: "We have an economic, and not only moral, interest in saving the American dream" (ibid.).

In a book Stiglitz published in 2010, he wrote of his early hopes that the new Obama Administration "would right the flawed policies of the Bush administration, and we would make progress not only in the immediate recovery but also in addressing longer-run challenges. The country's fiscal deficit would temporarily be higher, but the money would be well spent: on helping families keep their homes, on investments that would increase the country's long-run productivity and preserve the environment, and, in return for any money that was given to the banks, there would be a claim on future returns that would compensate the public for the risk it bore" (Stiglitz 2010a, xxiii).

Regarding the financial crisis, Stiglitz said that many in the financial sector "sold [home buyers] costly mortgages and were hiding details of the fees in fine print…. The financial elite support the political campaigns with huge contributions. They buy the rules that allow them to make the money. Much of the inequality that exists today is a result of government policies" (Stiglitz 2012a).

In 2013, Stiglitz addressed an AFL-CIO convention, saying in part:

> We have become a house divided against itself—divided between the 99% and the 1%, between the workers, and those who would exploit them. We have to reunite the house, but it won't happen on its own.
>
> It will only happen if workers come together. If they organize. If they unite to fight for what they know is right, in each and every workplace, in each and every community, and in each and every state capital and in Washington.
>
> We have to restore not only democracy to Washington, but to the workplace. (Stiglitz 2013b)

He concluded the speech by saying:

> You must get others to join you, to work with you, to organize with you, to fight with you. It is only you who can raise the voice of ordinary Americans, and demand what you have worked so hard for. Together, we can grow our economy, strengthen our communities, restore the

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> American dream, and re-establish our democracy—a government not of the 1%, for the 1%, and by the 1%, but a government of all Americans, for all Americans, and by all Americans. (Stiglitz 2013b)

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Richard Stone

by Daniel B. Klein and Ryan Daza

London-born John Richard Nicholas Stone (1913–1991) followed his mother's footsteps in attending Cambridge, and initially planned to follow his father's footsteps and go into law. Halfway through his undergraduate studies, however, Stone was inspired by the Great Depression to seek solutions in the study of economics (Stone 1985). Stone eventually developed a technocratic view of economic policy (Johansen 1985, 5; Wolfe 1968, 428).

At Cambridge, Stone learned statistics, modeling, and measurement from Colin Clark (Deaton 2008). During World War II, Stone worked at the Central Economic Information Service of the Offices of the War Cabinet on national accounting with James Meade. John Maynard Keynes, then working at the Treasury, recommended their work, which was then published in 1941 as a