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Letter from America: International Development and the Bush Administration

from the Royal Economic Society Newsletter, October 2002

After two years, the Bush administration has revealed itself to be a good deal less confident and surefooted on economic policy than was its predecessor. No one of the same political or intellectual stature has emerged to take the place of Robert Rubin or Lawrence Summers, and the President has frequently found himself making his own economic pronouncements, often with less than entirely happy results. This uncertainty affects international, as well as domestic economic policy, and is in marked contrast with foreign policy, where self-doubt and openess to argument are not the obvious characteristics of the administration.

The key figure is Secretary of the Treasury Paul O'Neill, who has worked in both the public and private sectors, most recently as CEO of Alcoa. His BA is from Fresno State in California, and he worked his way up within the government from a computer analyst to deputy director of the Office of Management and Budget in the mid-1970s. He is an economic conservative, with a great belief in markets and in the ability of corporate America to solve almost any problem. This is combined with a concern for the poor, and especially for the health of the poor. He was widely respected (though not by the hardliners in the current Bush administration) for his attention to and success in improving occupation health among workers at Alcoa, as well as for health-related work in the community. (So that his African tour with Bono was less out of character than it may have seemed.) O'Neill is also a man of impeccable manners, courteous to a fault, and possessed of real intellectual curiosity; unusually for someone in his position, he tends to share, argue, and debate his views.

O'Neill came to Treasury determined to reverse the positions of his predecessor. There were to be no more bailouts; the market was to be allowed to do its work. Targets for development assistance in terms of shares of GDP were anathema; instead, loans were to be replaced by grants, and projects were to be judged strictly by results. These positions have taken a beating over the last two years. On development assistance, while the Treasury was still maintaining its stance against increasing aid, the White House announced substantial increases in funding. Although the Treasury will administer these funds, it was clearly unaware of the change in policy in advance of its public announcement. More battered still is the policy on bailouts. While it is unclear that it is possible for the US to stand by and do nothing about crises in Latin America, it has been worse than that. In the context of Brazil's recent difficulties, O'Neill commented that US was not going to lend money that would finish up in Swiss bank accounts. Not only did these sentiments exacerbate the crisis, but they made American assistance inevitable, if it had not been so in the first place.

Two recent books by economists have played a prominent part in these events. The first, by Bill Easterly, on economists' misadventures in the tropics, is an eminently readable account of development failures over the last few decades, interspersed by vivid and heart-rending vignettes of poverty around the world. The book is much stronger on its analysis of what has not worked than its prescriptions for what should be done ("incentives matter"), and will be much enjoyed by professional economists for its exposition in intelligent lay language of how the technique of instrumental variables solves the causality problem. (The intelligent lay public is likely to even further doubt the sanity of economists.) Easterly was for many years leader of the macroeconomics group at the World Bank, where cross-country growth regressions were his stock in trade. (He is currently at the Center for Global Development, a change of position that is supposed to have been a consequence of the book.) In the spirit of cross-country analysis, where each country is just another "sample" point, the economic successes of China and India, accounting for forty percent of the world's population, are notably absent from the book, and economic development is characterized as a uniform failure. Perhaps not surprisingly, this combination of the condemnation of development assistance, on the one hand, together with the "voices of the poor" on the other, proved irresistible to Paul O'Neill, who repeatedly used the book to justify his position on no more aid. "Have you read Bill Easterly's book?"

The other, even better-known book, is Joe Stiglitz's diatribe against the IMF, with the excellent Freudian title: "Globalization and its discontents." Although a member of the Clinton Administration as Chairman of the Council of Economic Advisors, and later Chief Economist of the World Bank, Stiglitz's targets are those who worked alongside him, Lawrence Summers, and especially Stanley Fisher, long at the IMF. Stiglitz's book has become the bible, not of the Treasury, but of the anti-globalization movement, who cite it as support for the belief that globalization has increased world poverty and inequality. (In fact, the book doesn't actually say so, if only because, if we don't count those at the top of each page, it is almost entirely free of numbers.) Stiglitz's book has provoked great resentment within the IMF, who published an open letter of denunciation written by Ken Rogoff, a newcomer to the Fund from Harvard, and one of the world's leading international economists. The World Bank, which is far from unified on the issues, responded by placing on its web site the complete video of the debate (which had originally been intended as an off-the-record session), and the video presents a much more balanced picture. Stiglitz's book is easy to attack; its self-righteous hindsight is grating, its attack on Stan Fischer's integrity is a terrible mistake, and its facts are far from properly checked. All of which is unfortunate, because the obvious flaws have allowed his detractors to avoid the enormously important issues that he has unsurpassed authority to discuss: the governance of the IMF and the World Bank, whether the IMF acts in the interests of its member countries or of Wall Street, the desirability of unlimited capital movements, and the intellectual puzzle of the proper role of the Fund for the free-market fundamentalists who now largely control it.

How all of this will work out remains unclear. There are rumors that Paul O'Neill will not survive beyond the mid-term elections in November; certainly, the right-wing of the Republican party is even less happy with him now than they were two years ago. From the outside, a most welcome development has been that issues of economic growth, world poverty and inequality, and development aid are being debated by the public, by academic economists, and by students with an intensity and commitment that has been absent for many years.

Angus Deaton's Letter from America appears every six months in the Royal Economic Society's Newsletter. For more information, visit http://www.res.org.uk/society/newsletters.asp.

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