Episode 1,249: Continually Mistaken, Chronically Admired: The Strange Case of an Establishment Economist

Guest: Gene Epstein

WOODS: Let's talk about a man, actually, who recently participated in an event at the Soho Forum, if I'm not mistaken.

EPSTEIN: That's right.

WOODS: And that's Joe Stiglitz, and we're going to talk about his career. Just start off by telling people who exactly he is and why it would be worth talking about him at all.

EPSTEIN: Well, yeah, you know, it all started I guess a while back when I was leaving *Barron's*. I had lunch with the editors at *City Journal* and Manhattan Institute, and I told them, you know, I'm a big numbers guy. I do a lot of macro stuff, and I should even segue and say that Bob Murphy does incredible stuff with the numbers, as in that book that I listen to every day that he wrote called *Contra Krugman*. I told them that, and they said, "Well, maybe do something colorful, like let's talk about a prominent economist. This Krugman — look, Krugman is hopeless. He's been done." I said, "Well, what about Joe Stiglitz?"

Joe Stiglitz is a Nobel Prize winner, and in a way, he almost is the best and the brightest of the Keynesians. Since Bob has already done Krugman, I felt that in a way I'm doing an even more important bête noire who's won a Nobel, because Stiglitz has had much more direct influence than Krugman in higher policy circles. Stiglitz was Chairman of the Council of Economic Advisers under Bill Clinton. He then went on to become chief economist with the World Bank. He's an advisor to Elizabeth Warren. And he could have a final act if Warren runs and takes the White House, so he's not going to go away. He has published over 30 books. A couple of weeks ago, he had the lead review in *The New York Times*. And so in terms of being an influential policy economist, here's a guy who has a private audience with Hugo Chavez in Venezuela in October of 2007, so he does get around in ways that Krugman has not. Here's a guy who was hired by Fannie Mae and Freddie Mac in 2002 to evaluate their mortgages and gets paid a six-figure sum to do it. And so he's sort of like the Zelig of economic policies, *Zelig* being that Woody Allen movie, the guy is everywhere in history. Joe Stiglitz is like behind the scenes. He's been there, done that, and been in a lot of places.

And you mentioned the Soho Forum. It was actually that I had lunch with William Easterly ask him for help with research on my article about Stiglitz. Easterly had been a staff economist at the World Bank when Stiglitz was made chief economist, so they've known each other for years. Easterly pointed me toward a lot of interesting sources; indeed, told me that Stiglitz' involvement with Hugo Chavez is not the first human rights abuser and economic strongman that Stiglitz gets involved with. And then through Easterly — Easterly wanted to debate Stiglitz, and through Easterly, we managed to negotiate Joseph Stiglitz' appearance at the Soho Forum, but it was a different event. His wife insisted that it not be a debate, but a conversation, and I think about the honor of having Joe Stiglitz at the Soho Forum was enough. So we didn't make it a formal Oxford-style debate, just a conversation. I'm sure you'd understand, Tom, that if Krugman wanted to appear and have a conversation with Bob Murphy, then we'd say: okay, conversation, no debate. I'm sure you'd understand that I'd give up on that requirement if I could only get him to appear with Bob. But I did get Stiglitz to appear with Easterly. It was a little bit disappointing, but at least we did have an interesting exchange at the Soho Forum.

But then most recently, my article about Stiglitz has come out and been published by the Manhattan Institute, so that's why I'm writing about him. He's a figure to be reckoned with.

WOODS: Well, given that we're talking about Easterly in connection with the Soho Forum, let's mention that it was Stiglitz who I guess in 2007 had kind words for I guess Zenawi, the Ethiopian dictator?

EPSTEIN: Yeah, Meles. You know, I was taught that he's called Meles Zenawi, that he's referred to as Meles, never by his last name. Easterly taught me that when he went over my draft. Go ahead, though, Meles Zenawi, yes.

WOODS: Okay, see, it goes to show I'm not up on my Ethiopian dictators at all, Gene. Not at all.

EPSTEIN: [laughing]

WOODS: Well, Easterly, though, what's interesting is that he put out a correction more or less in his own book —

EPSTEIN: Well, I — yeah, exactly.

WOODS: You know, implicitly correcting Stiglitz, who was fawning over the guy, saying, *Well, you know, he does have this tendency to gun people down*, things like that. So it would have been neat to see the two of them in the same room, and it would have been nice to have them debate, because if I were Easterly, you' darn well better believe I would have brought this up. *Oh, by the way, how's your Ethiopian dictator buddy doing?* I mean, I would not have pulled any punches on any of this stuff. But the key figure we really want to talk about, though, is the other dictator you mentioned. That's Hugo Chavez. Because Stiglitz was like one of these dime-a-dozen economists, progressive economists, who was praising the policies of Chavez, which he said would lead to strong economic growth.

EPSTEIN: Yes.

WOODS: And obviously, Gene, it didn't turn out that way.

EPSTEIN: No. No, but first let's discuss Meles. H did die in 20012, so we now — "How's the resting in peace?" is what Easterly could have said and should have said, but was a little bit too polite to say it. But here is Stiglitz writing in *The New York Times* about Meles Zenawi and saying that he gets showered with economic aid because people trust him to know what to do with that aid to help his own country. And Easterly wrote that two years before in 2005, even the aid groups had decided not to send money to Meles, because he had gunned down hundreds of protesters in his own country. And so Stiglitz so misinformed about Meles Zenawi, it was the exact reverse. The aid groups were actually trying to channel aid to local officials in Ethiopia. Now, that turned out to be hopeless, as Easterly points out, because anything that went to the local groups Zenawi got his hands on anyway.

However, again, this is Stiglitz. You can't even Google, can't even look the guy up, because he's cozying up to him, and he gets to meet with him, goes to Ethiopia. I mean, it's very clear. Look, we can all sort of understand that it gets you a little bit titillated to be close to power, and that was Stiglitz. So the most elementary facts about Zenawi are completely overlooked by Stiglitz, the fact that the aid groups are actually trying to shun him m at that point.

But now getting to Chavez, here too what I tried to do was make clear that I'm not trying to operate with the benefit of hindsight. It's now been widely acknowledged, even in *The New York Review of Books*, a left-leaning publication, that there's a humanitarian crisis of major proportions that's been afflicting Venezuela and the Venezuelan people. But my point is that it's easy enough to show that when Stiglitz met with Hugo Chavez in October of 2007, just the month before there was readily available information not just from the economic freedom index put out by Fraser and Cato, but by the World Bank, the Doing Business Index that the World Bank had been publishing since 2004. And they actually had a prominent discussion of their concerns about what was going on in Venezuela, I mean, that's the month before he met with Chavez, where they are talking about the chokehold that Hugo Chavez has on the economy. That's the month before he meets with Chavez, and that's the World Bank where Stiglitz had been chief economist. How is he not going to get access to that information?

Newspaper reports, *The Washington Post* had been publishing articles about the price controls on food, food prices that were driving housewives crazy in Venezuela at the time. And so the oil price was up to 80 bucks — it had been at 10 bucks — to 80 bucks a barrel. It had been at 10 bucks when Chavez took over. And what was the soundest advice — you get an audience with this guy Chavez, and do you want to tell him something? You're a Nobel Prize-winning economist> You might want to tell him: look, you're riding the wave of a high oil price. You're a major oil producer. But to be a responsible steward of your country, you can't count on oil prices continuing to go up or even continuing to stay high. You've got to loosen your chokehold on the economy. Couldn't he have said that to Chavez, if he had an ounce of sense or an ounce of responsibility? The information was plain and palpable, and that's exactly what he did not do. He endorsed Chavez' commitment to higher growth.

There was somebody from the audience, by the way, at my Soho Forum who raised this question with him. Bill Easterly, to my great dismay — I wrote Bill about this — was very, very easy on Stiglitz. But a question came up from the audience, and Stiglitz just tried to finesse it, and he said, "Well, I was hoping that things would work out at the time, and that's why I said it." But again, the major point was that it was clear that the Venezuelan economy was headed for deep trouble.

By the way, I want to mention also, as I pointed out in the article, that this idea of blaming Venezuela's troubles on the collapse in the oil price is a little overdone. I mean, for the past several years, the oil prices average $55 a barrel, relatively high in historical terms. There really was no oil price collapse. There was a brief period in which the price touched $26, $27, but the average price over two, three years, even through the period of the trough, was $55, historically quite high, a lot higher than the 1990s and a lot higher than the $10 when Chavez took office. So really, the disasters in Venezuela are certainly something that should haunt Joseph Stiglitz. Maybe at least you could have said, I had the year of this guy and I had the opportunity at least to tell him that he's got to march in the opposite direction from what he's been doing. That's exactly what he didn't do. He did the opposite. And that should be something that he lives with and struggles with and tries to overcome. But instead, he's in a state of denial.

WOODS: All right, let's talk about another big problem. I mean, Venezuela is a major one, and I can find many people who had nice things to say about the policies of Venezuela. I can also find many people, of which Stiglitz is yet again just another lemming, as far as I can see — I mean, he's supposed to be this great celebrity, but he has every fashionable wrong opinion you can imagine. So leading up to the financial crisis, well, his view was: we just need — he says — this is his profound insight: "Effective regulation requires regulators who believe in it." I mean, what is this? So he thinks that if we have enough regulators — now, and I always point out: between state and federal, we had 115 regulatory institutions in the financial sector on the eve of the financial crisis. And in the banking and financial sector, we had a threefold increase — even accounting for inflation, a threefold increase in the number of regulators, actual employees to regulate the industry. So we had plenty of regulators. We had plenty of regulations. I don't buy that there was major deregulation in any area that is relevant to the crisis.

EPSTEIN: Quite right.

WOODS: And yet, that's how he walked into 2008, with this view. And he described himself as a crisis veteran or a crisologist. But as you point out, well, he wrote a study in August of '96, "Some lessons from the East Asian miracle," which totally failed to anticipate the East Asian crisis the following year. How good of a prognosticator is he?

EPSTEIN: Yeah, no, indeed. And in '07 — I mean that's something he doesn't mention. And at that point, when he was talking about the miracle and how the miracle would be sustaining and it's attributed to the role of government, there were others who were dissenting. But the big thing is that in 2002, he was hired by Fannie Mae and Freddie Mac, along with two others, to evaluate the mortgages that Fannie Mae and Freddie Mac owned.

Now again, for background, Fannie Mae and Freddie Mac are officially called government-sponsored enterprises, so that sort of says it all. You know, it's a great crony capitalist word that the bureaucrats have thought up, and they play right into our hands. They were publicly traded on the New York Stock Exchange, but they were basically government backed. We know that we're government backed — actually look, I could a quote Tom Woods, your book *Meltdown*, Tom. Everybody knew that Fannie and Freddie's debt was protected was protected by government, and everybody was right. And the reason why everybody knew that is that they were borrowing money at barely much of a premium above the Treasury rate. And yet they were responding mostly positively and favorably to the mandates of HUD, of the Department of Housing and Urban Development, to continually buy mortgages that were being issued to people below the median income.

And year after year, it was like 50% of their mortgages had to be bought with this proviso. And very soon, very soon when you continually do that, you're going to be acquiring mortgages that are risky. You're going to have to loosen the standards on the mortgages that you do buy if it's constantly people below the median income, a policy pushed by Bill Clinton and picked up enthusiastically by George W. Bush. And so Fannie and Freddie being very political, decided that they wanted a prestigious economist to evaluate their mortgages and give them a clean bill of health. And that's what he did. And rumors are he got paid a six-figure sum for that. Hard to imagine that he didn't. They were throwing a fortune of money around.

But again, here focusing — I'm going to get to your point about regulation in a moment, Tom, but here focusing on 2002, again, I'm trying not to condemn Stiglitz with the benefit of hindsight. The American Enterprise Institute, the whole project is supervised by Peter Wallison, whom I know you've had on the show a couple of times, Tom —

WOODS: Yeah.

EPSTEIN: — and did a very good book. A lot of good books. Tom's book is one of them; Peter Wallison's book *Hidden in Plain Sigh*t is another. The Wallison project with Ed Pinto was to compile a complete universe count of all of the mortgages held by governed by the private sector. So they have a complete dossier at this point on all the mortgages held by Fannie Mae and Freddie Mac, year by year. And so I found out, well, what was held. I asked their source: give me the profile on what was held in 2001, because the 2001 book is what Stiglitz certainly would have had access to, having done this study in 2002. The 2001 book was already showing alarming tendencies for Fannie and Freddie, who are supposed to be setting the standard for quality mortgages, already showing that their mortgage book was subject to risk, that they were taking chances, that these were the down payments, other due diligence — the mortgage book was already beginning disturbing. By '02, '03, and '04, it got much worse, but the tendencies were there.

And any consultant, certainly a Nobel Prize winner, who's going to do due diligence has got to say: well, I've got to look at the book, I've got to put some research assistants on it, let's take a look. So if he had been honest, he would have released a study that would have said that you're beginning to abrogate your standards of safety and soundness. It's not serious at this point, but you're moving in the wrong direction. You've got to do a correction on this. Something's going wrong.

Now of course, he would have known and should have known that the reason it was happening was the mandates from HUD. And so it would have been plain enough; his report would have been plain enough, obvious enough. Instead, he released a report which says that the mortgages are safe and sound, there's practically zero risk of ever any default. They're given an A++, a gold star, totally contrary to the obvious facts of what was in the mortgages. It's clear enough that Stiglitz never even bothered to examine the book of mortgages, because that's not what he was being paid to do.

Now there too, who knows? If a Nobel Prize winner — this is the sort of thing that Krugman doesn't get access to, that you and I don't get access to. We didn't know — I was covering the situation. I didn't know what was going on. Fannie and Freddie were misreporting their mortgages. *Inside Mortgage Finance*, the Bible of the trade, by the way, was saying that by definition we're reporting numbers that said by definition anything that Fannie and Freddie bought had to be a low-risk mortgage. That was reporting by definition. I happen to know that, because I went to the offices of *Inside Mortgage Finance*. So we didn't know but, Stiglitz had access to it. He could have known. And yet this is what he reports. Maybe he could have made a difference, maybe not. At least he could have shaken the temple a little bit and could have done some good. Instead, he does exactly the reverse.

And then of course, then — this is of course the odd part of it, which is that Stiglitz does not list this study on his exhaustive resume. The study of Fannie and Freddie's mortgages was pulled from the website, and it was only a few indefatigable economists and researchers who downloaded it and have it, so that's why I was able to get a copy of it. But Stiglitz then has the gall to call himself a brilliant crisologist, when he's got both of these things on his record of having said that, having talked about the sustainable miracle in Asia less than 12 months before the meltdown in Asia, and then having talked about Fannie and Freddie's mortgages. And then on top of that, having a gall to say that we need regulators with PhDs, we need people who've worked for nongovernmental organizations and had experience in the government. So basically we need people like Stiglitz. And as you just said, Tom, the only thing you didn't add is that all of these regulatory agencies are pretty well stacked with people with PhDs. And those are the people we need, people like Stiglitz. So I mean it's such a colossal joke.

But actually, the other part of it is that — so clearly, we don't need these people, and actually I do quote from a book that takes an interesting Hayekian line on this whole point. Interestingly enough, they sort of go easy on Stiglitz and the scandals of his involvement with Fannie and Freddie and with the housing bubble. They go easy in that way, but they make a very good sort of abstract Hayekian point, which is that, if you leave it to the market, then there will be differing opinions. There will be a certain amount of due diligence about what's risky and what's not. Some banks, some financial institutions may be loading up on mortgages, but others might not. There will be a blend of opinion. It will be heterogeneous, because there'll be sort of Hayekian information coming in from different sources, and there'll be more of a burden on markets to evaluate the mortgages that existed.

But then when you have a one-size-fits-all regulator — and the regulators, in fact, were giving banks incentives to load up on mortgages, because they had the impression, these PhDs actually as a group had the impression that mortgages were a relatively safe investment. And so that's a kind of an abstract point correcting Stiglitz, which gets back indeed to his whole indictment of markets versus government, that markets consist of different kinds of dispersed information and are likely to make much better judgments about such things as government mortgages than regulators are likely to make.

WOODS: Now, look, I'm not saying that in order for me to take you seriously as an economist, you had to predict the 2008 crisis. But I am saying that if you're going to be a celebrity economist, then you better have something more to say than just standard platitudes all the time. You better have something to show for yourself other than cheering on dictators in the Third World. I mean, you better have something clever and interesting. And then when you're reckoning with ideas you don't agree with, at least show some familiarity with them. And you sent me a section from your article that didn't appear in the published version, where he says that: well Hayek's view that markets always act efficiently is contradicted by — where does, of all people, Hayek say that? Hayek and Mises' view was obviously not that, but that, because of an uncertain future, entrepreneurs are always adjusting and shifting resources around in light of what they anticipate future conditions to be, but they're never going to get it quite right. So that's what entrepreneurs are constantly doing. They're constantly adjusting. We don't get to some equilibrium point where we say, okay, everything is all adjusted. Now everybody go home. But so he thinks that's what we think, even though it's pretty clear — you don't have to read much Mises or Hayek to understand that.

EPSTEIN: Yeah. Well, this indeed gets into the problems with the mainstream generally. I mean, I say perhaps with a certain amount of irony and tongue in cheek that it is indeed true that, in a way, Stiglitz' claim that his information economics, his market-failure-orientation was a kind of a paradigm shift. It's a paradigm shift from the ersatz models of perfect competition perpetrated by the mainstream. And so that's really what he's addressing.

But certainly, it's fair to say that his mention of Hayek, his mentioned of James Buchanan, in fact, and even — George Stigler, the Chicago economist, had an odd kind of history, because Stigler was a kind of a perfectly-competition-oriented economist who did tend to think that markets have this abstract, pristine kind of behavior. On the other hand, Stigler also could lay claim to the idea of regulatory capture, the fact that regulators tend to be captured by the very businesses they're supposed to be running. And of course, Buchanan and his idea of public choice, as distinct from private choice, that they are applying to the government, the basic principle that they too are operating in their own self-interest. All of that, useful correctives to the standard idea that Stiglitz perpetrates, which is that markets fail and that government must step in and correct them, because after all, they consist of PhDs such as himself.

And then Hayek and Mises, who indeed — by the way, I've recently be been reading some Israel Kirzner, and I think that Kirzner to some degree has been misrepresented. I mean, Kirzner's emphasis on entrepreneurial error being rife and that markets are always in error and always being corrected by other entrepreneurs. A very, very, very, very strong emphasis on that point by Israel Kirzner, which indeed can be found in Mises and in Hayek. And so it's nothing like the idea; it's really just the point that you cannot expect human beings —I had a quote. I'm not going to click for it, Tom, because I was looking at my screen, but I did have a quote from Mises in *Human Action*, in which he talks about the expectation that these super-human beings in markets are supposedly correcting entrepreneurial error on a kind of hourly basis. And he said, of course, that never happens. Markets are always making mistakes and are in error, but their virtue is that when a market is in error, when certain goods are underpriced or overpriced — or indeed when markets are being myopic and when somebody like Jeff Bezos comes along and realizes that books can be sold online or can be shipped electronically onto a Kindle and that topples bricks and mortar bookstores — all of that is something that happens only in markets, and that government is not self-correcting and is far more prone to error. And that's the basic fallacy of Stiglitz' approach.

Indeed, the odd and almost hilarious, self-evidently hilarious part of it is that, in his writings, he's constantly focusing on something called the Arrow-Debreu model. Kenneth Arrow and an economist named Debreu, who formulated this model that he says, oh, is the real gold standard of how markets are supposed to behave, and we're so grateful to them for showing us that markets just almost never behave this way, are always falling short, and that's why we need government. Well, you'd think that even if you're just naively reading this, you might ask: well, don't you realize you've got to apply the same kind of Arrow-Debreu model to government? The same pristine perfection should be applied to government. And then when you ask yourself about all the corruption in government, their myopian government, the tendency for bureaucracies to grow and persist, all of the problems with government, then any kind of Arrow-Debreu model you apply to government has got to find them far more lacking.

And so my point, by the way, is that even from the get-go, it's very clear, should be clear that Stiglitz was marching in the wrong direction and that is whole focus was wrong. Now, he did far more harm as policymaker than we might have imagined, what with his involvement was Chavez when he should have known better and his endorsement of Fannie and Freddie when due diligence would have shown that they were in trouble. But of course, this whole mindset defines him. And of course, people who have this mindset, really, we have to get a little bit psychological on him. He certainly is attracted to power. That's why he was attracted to Meles Zenawi. And look, you know, I think you all of us can understand that. It is a little seductive to be at the tables of power. But hopefully, hopefully, we can all retain enough integrity to resist that.

And, you know, in a way, my own personal digression is that Noam Chomsky is still alive. I didn't send him this article. I would have said — I would write Noam Chomsky and say, "You know, Noam, when I read your book *American Power and the New Mandarins* when I was in my 20s back in the 1960s, you were the one who clued me in to the fact that the intellectuals in foreign policy love to sit at the tables of power and were basically celebrating power and that that's why so many of the things that they said and did were ludicrously foolish, and so I'm writing in your tradition." I only wish Chomsky could understand that, but unfortunately, he still held on to his socialism, so I can't. But in a way, this article is dedicated, ironically, to Noam Chomsky, blowing the whistle on an economic Mandarin who is never right, always wrong, and always pushing us in the wrong direction.

WOODS: All right, I want to ask you for a 60-second answer to the following question, which is: we've looked at one particular economist today, but are there any general conclusions we can draw either about progressivism or Keynesianism or the left or anything from this particular case?

EPSTEIN: Well, sure. I mean, I again, I try to argue, look, this guy won the Nobel Prize. He's written 30 books, numerous articles, peer-reviewed articles. His articles have appeared in the *American Economic Review*. And so the whole point is that it's in the Keynesian tradition — I mean, John Maynard Keynes was — oh God, you only gave me 60 seconds, Tom, but I'm going to take another 60.

WOODS: All right, go ahead.

EPSTEIN: John Maynard Keynes was in the tradition of — in 1938, John Maynard Keynes endorsed Soviet socialism, and he recommended his book to the Nazi totalitarians. This whole tradition, this whole myopic tradition that government must come to the rescue of markets is something that Stiglitz stands for, and it's the whole reason why the mainstream tradition missed out. We needed Tom Woods, a guy with a PhD in history but not an economist, to write a very good book on the meltdown. And indeed, Peter Wallison, by the way, who's a lawyer, wrote another very good book on what really happened to the housing bubble.

WOODS: Oh, and he knows an enormous amount about this stuff.

EPSTEIN: Yes, yes. And so the whole point is that I'm trying to go after the best, the best and the brightest. The guy was really up there, Joseph Stiglitz. So if Joseph Stiglitz with this mindset could miss so much that was obvious and could overlook so much that is obvious, then wouldn't you shudder to think what some of the lesser lights in in the Keynesian tradition what they miss and what they get wrong? So that's the lesson to be drawn. And then of course, in a topical sense, Joseph Stiglitz could have a final act. He is working with Elizabeth Warren. We might hear from him again. He would be 78 years old if Elizabeth Warren takes the White House, but those guys do tend to last. Greenspan was serving as Chairman of the Federal Reserve until past 80. Paul Volcker is still around. We could hear from him again.

WOODS: All right, Gene I'm going to let you go, but I want to first of all let people know that your article on Stiglitz will be available at TomWoods.com/1249. And secondly, that if they're anywhere near New York City — I mean, look, I come to New York from Florida half the time to go to Soho Forum events. If you're one subway ride away, shame on you for not attending. And with the exception of October's event, you can get a free drink by just saying, "Tom Woods," to Gene. The website there is the SohoForum.org, and it's just one of the best things about living in New York City. Gene, thanks so much for being here today.

EPSTEIN: Thanks so much.