

## THE CAPITALIST ID

### RUSSIA AND THE NEW ERA OF THE BOOR MARKET

**You have made yourself the trustee for those in every country who seek to mend the evils of our condition by reasoned experiment within the framework of the existing social system. If you fail, rational change will be gravely prejudiced throughout the world, leaving orthodoxy and revolution to fight it out.**

—John Maynard Keynes in a letter to  
President Franklin D. Roosevelt, 1933<sup>1</sup>

On the day I went to visit Jeffrey Sachs in October 2006, New York City was under a damp blanket of gray drizzle punctuated, every five paces or so, by a vibrant burst of red. It was the week of the grand launch of Bono's (Product) Red brand, and the city was getting the full blitz. Red iPods and Armani sunglasses loomed from billboards overhead, every bus shelter featured Steven Spielberg or Penélope Cruz in a different red garment, every Gap outlet in the city had given itself over to the launch, and the Apple store on Fifth Avenue was emitting a rosy glow. "Can a tank top change the world?" asked one ad. Yes it can, we were assured, because a portion of the profits was going to the Global Fund to Fight AIDS, TB and malaria. "Shop till it stops!" Bono had pronounced, in the midst of a televised shopping spree with Oprah a couple of days earlier.<sup>2</sup>

I had a hunch that most of the journalists wanting to talk to Sachs that week would be looking for the superstar economist's view on this fashionable new way to raise aid money. After all, Bono refers to Sachs as "my professor," and a photo of the two men greeted me as I entered Sachs's office at Columbia

University (he left Harvard in 2002). In the midst of all this glamorous charity, I felt like a bit of a spoiler, because I wanted to talk about the professor's least favorite topic of all, one that has prompted him to threaten to hang up on reporters mid-interview. I wanted to talk about Russia and what went wrong there.

It was in Russia, after the first year of shock therapy, that Sachs began his own transition, from global shock doctor to one of the world's most outspoken campaigners for increasing aid to impoverished countries. It is a transition that, in the years since, has put him in conflict with many former colleagues and collaborators in orthodox economic circles. As far as Sachs is concerned, he isn't the one who changed—he was always committed to helping countries develop market-based economies bolstered by generous aid and debt forgiveness. For years he had found it possible to achieve these goals by working in partnership with the IMF and the U.S. Treasury. But by the time he was on the ground in Russia, the tenor of discussion had changed and he came up against a level of official indifference that shocked him and pushed him into a more confrontational stance with Washington's economic establishment.

Seen with hindsight, there is no doubt that Russia marked the beginning of a new chapter in the evolution of the Chicago School crusade. In earlier shock therapy laboratories of the seventies and eighties, there had been some desire at the U.S. Treasury and the IMF to make the experiments at least superficially successful—precisely because they were experiments, meant to serve as models for other countries to follow. The Latin American dictatorships of the seventies were rewarded for their attacks on trade unions and their open borders with steady loans, which were granted despite such departures from Chicago School orthodoxy as Chile's continued state control over the world's largest copper mines and the Argentine junta's slow action on privatizations. Bolivia, as the first democracy to adopt shock therapy in the eighties, was granted aid and had a portion of its debt erased—well before Goni moved ahead with privatization in the nineties. In Poland, the first Eastern Bloc country to impose shock therapy, Sachs had no trouble securing substantial loans, and, once again, major privatizations were slowed and staggered when the original plan encountered strong opposition.

Russia was different. "Too much shock, not enough therapy" was the widespread verdict. Western powers were totally unyielding in their demand for the most painful "reforms," at the same time as they were assiduously stingy in the amount of aid they would offer in return. Even Pinochet had

cushioned the pain of shock therapy with food programs for the poorest children; Washington lenders saw no reason to help Yeltsin do the same, pushing the country instead into its Hobbesian nightmare.

Having a substantive discussion about Russia with Sachs isn't easy. I was hoping to take the conversation beyond his initial defensiveness ("I was right and they were completely wrong," he told me. Then, "Ask Larry Summers, don't ask me; ask Bob Rubin, ask Clinton, ask Cheney how happy they were with the way Russia went"). I also wanted to get beyond the genuine despondency ("I was trying to do something at the time, which proved to be completely useless"). What I was aiming to understand better was why he was so unsuccessful in Russia, why Jeffrey Sachs's famous luck ran out at that particular juncture.

Sachs now says that he knew something was different as soon as he arrived in Moscow. "I had a sense of foreboding from the first moment . . . I was furious from the first moment." Russia was facing "a first-class macroeconomic crisis, one of the most intense and unstable I had ever seen in my life," he said. And as far as he was concerned, the way out was clear: the shock therapy measures he had prescribed for Poland "to get basic market forces working quickly—plus a heck of a lot of aid. I was thinking of \$30 billion a year, roughly divided, \$15 billion for Russia and \$15 billion for the republics, in order to be able to pull off a peaceful and democratic transition."

Sachs, it must be said, has a notoriously selective memory when it comes to the draconian policies he pushed in both Poland and Russia. In our interview, he repeatedly glossed over his own calls for swift privatization and large cutbacks (in short, shock therapy, a phrase he now disavows, claiming he was referring only to narrow pricing policies, not wholesale country makeovers). The way he remembers his role, shock therapy played a minor part, and he was almost exclusively focused on fund-raising; his plan for Poland, he says, was a "stabilization fund, debt cancellation, short-term financial help, integration with the Western European economy. . . . When I was asked by Yeltsin's team to help them, I proposed basically the same thing."\*

There is no debate about the key fact in Sachs's account: securing a major aid infusion was a central pillar of his plan for Russia—that was Yeltsin's

incentive for submitting to the entire program. Sachs based this vision, he says, on the Marshall Plan, the \$12.6 billion (\$130 billion in today's dollars) that the U.S. allotted for Europe to reconstruct its infrastructure and industry after the Second World War—a scheme widely regarded as Washington's most successful diplomatic initiative.<sup>3</sup> Sachs says the Marshall Plan showed that "when a country is in disarray, you can't just expect it to get back up on its feet in a coherent way by itself. So, for me the interesting thing about the Marshall Plan . . . is how a modest amount of monetary infusion created a base for [Europe's] economic recovery to take hold." At the start, he had been convinced that there was a similar political will in Washington to transform Russia into a successful capitalist economy, just as there had been a genuine commitment to West Germany and Japan after the Second World War.

Sachs was confident that he could shake a new Marshall Plan out of the U.S. Treasury and the IMF, and not without reason. "Probably the most important economist in the world" is how *The New York Times* described him in this period.<sup>4</sup> When he was an adviser to Poland's government, he recalled that he "raised \$1 billion in one day in the White House." But, Sachs told me, "when I suggested the same thing for Russia, there was absolutely no interest at all. None. And the IMF just stared me down like I was crazy."

Although Yeltsin and his Chicago Boys had plenty of admirers in Washington, no one was willing to come up with the kind of aid they were talking about. That meant Sachs had urged wrenching policies on Russia, and he couldn't keep up his end of the bargain. It was in this period that he came close to self-criticism: "My greatest personal mistake," Sachs said in the midst of the Russia debacle, "was to say to President Boris Yeltsin, 'Don't worry; help is on the way.' I believed deeply that the assistance was too important, and too crucial to the West, for it to be messed up as significantly and fundamentally as it has been."<sup>5</sup> But the problem wasn't only that the IMF and the Treasury hadn't listened to Sachs, it was that Sachs had pushed hard for shock therapy before he had any guarantee that they would—a gamble for which millions paid dearly.

When I revisited the question with Sachs, he reiterated that his real failing was in misreading Washington's political mood. He recalled a discussion with Lawrence Eagleburger, U.S. secretary of state under George H. W. Bush. Sachs made his case: if Russia was allowed to descend further into economic chaos, it could unleash forces no one could control—mass famine, resurgent nationalism, even fascism, surely unwise in a country where virtually the only product held in surplus was nuclear arms. "Your analysis may

\* As John Cassidy noted in a 2005 *New Yorker* profile, "The fact is that in both Poland and Russia Sachs favored large-scale social engineering over gradual change and institution-building. The disastrous privatization policy is one example. Although most of the privatization took place after Sachs left Russia, at the end of 1994, the original policy framework was put in place in 1992 and 1993, when he was still there."

be just right, but it's not going to happen," Eagleburger replied. Then he asked Sachs, "Do you know what year this is?"

It was 1992, the year of the U.S. election in which Bill Clinton was about to defeat Bush Sr. The core of Clinton's campaign was that Bush had neglected economic hardship at home to pursue glory abroad ("It's the economy, stupid"). Sachs believes that Russia was a casualty of that domestic battle. And, he says, he now sees that there was something else at work: many of Washington's power brokers were still fighting the Cold War. They saw Russia's economic collapse as a geopolitical victory, the decisive one that ensured U.S. supremacy. "I had none of that mind-set," Sachs told me, sounding, as he often does, like a Boy Scout who has stumbled into an episode of *The Sopranos*. "For me it was just, 'Great, this is the final end of this abominable regime. Now, let's really help [the Russians]. Let's throw everything into it. . . . I'm sure that in retrospect, in the minds of the policy planners, that was viewed as crazy.'"

Despite his failure, Sachs does not feel that the policy toward Russia in this period was driven by free-market ideology. It was mostly, he said, characterized by "sheer laziness." He would have welcomed a heated debate about whether to offer aid to Russia or leave it all to the market. Instead, there was a collective shrug. He said he was amazed by the absence of serious research and debate informing momentous decisions. "To me, it was just the lack of effort that was the dominant thing. Let's at least spend two days and debate this—well; we never even did that! I never saw the hard work of 'Roll up your sleeves, let's get down and solve these problems, let's figure out what's really going on.'"

When Sachs talks passionately about "hard work," he is harking back to the days of the New Deal, the Great Society and the Marshall Plan, when young men from Ivy League schools sat around commanding tables in their shirt sleeves, surrounded by empty coffee cups and piles of policy papers, having heated debates about the interest rate and the price of wheat. That is how policy makers behaved in the heyday of Keynesianism, and that is the kind of "seriousness" that Russia's catastrophe clearly deserved.

But attributing the abandonment of Russia to a bout of collective laziness in Washington offers little by way of explanation. Perhaps a better way to understand the episode is through the lens favored by free-market economists: competition in the market. When the Cold War was in full swing and the Soviet Union was intact, the people of the world could choose (at least theoretically) which ideology they wanted to consume; there were the two poles, and there was much in between. That meant capitalism had to win customers; it

needed to offer incentives; it needed a good product. Keynesianism was always an expression of that need for capitalism to compete. President Roosevelt brought in the New Deal not only to address the desperation of the Great Depression but to undercut a powerful movement of U.S. citizens who, having been dealt a savage blow by the unregulated free market, were demanding a different economic model. Some wanted a radically different one: in the 1932 presidential elections, one million Americans voted for Socialist or Communist candidates. Growing numbers of Americans were also paying close attention to Huey Long, the populist senator from Louisiana who believed that all Americans should receive a guaranteed annual income of \$2,500. Explaining why he had added more social welfare benefits to the New Deal in 1935, FDR said he wanted to "steal Long's thunder."<sup>6</sup>

It was in this context that American industrialists grudgingly accepted FDR's New Deal. The edges of the market needed to be softened with public sector jobs and by making sure no one went hungry—the very future of capitalism was at stake. During the Cold War, no country in the free world was immune to this pressure. In fact, the achievements of mid-century capitalism, or what Sachs calls "normal" capitalism—workers' protections, pensions, public health care and state support for the poorest citizens in North America—all grew out of the same pragmatic need to make major concessions in the face of a powerful left.

The Marshall Plan was the ultimate weapon deployed on this economic front. After the war, the German economy was in crisis, threatening to bring down the rest of Western Europe. Meanwhile, so many Germans were drawn to socialism that the U.S. government opted to split Germany into two parts rather than risk losing it all, either to collapse or to the left. In West Germany, the U.S. government used the Marshall Plan to build a capitalist system that was not meant to create fast and easy new markets for Ford and Sears but, rather, to be so successful on its own terms that Europe's market economy would thrive and socialism would be drained of its appeal.

By 1949, that meant tolerating from the West German government all kinds of policies that were positively uncapitalist: direct job creation by the state, huge investment in the public sector, subsidies for German firms and strong labour unions. In a move that would have been unthinkable in Russia in the 1990s or Iraq under U.S. occupation, the U.S. government infuriated its own corporate sector by imposing a moratorium on foreign investment so that war-battered German companies would not be forced to compete before they had recovered. "The feeling was that letting foreign companies

come in at that point would have been like piracy,” I was told by Carolyn Eisenberg, author of an acclaimed history of the Marshall Plan.<sup>7</sup> “The main difference between now and then is that the U.S. government did not see Germany as a cash cow. They didn’t want to antagonize people. The belief was that if you come in and start pillaging the place, you interfere with the recovery of Europe as a whole.”

This approach, Eisenberg points out, was not born of altruism. “The Soviet Union was like a loaded gun. The economy was in crisis, there was a substantial German left, and they [the West] had to win the allegiance of the German people fast. They really saw themselves battling for the soul of Germany.”

Eisenberg’s account of the battle of ideologies that created the Marshall Plan points to a persistent blind spot in Sachs’s work, including his recent laudable efforts to dramatically increase aid spending for Africa. Rarely are mass popular movements even mentioned. For Sachs, the making of history is a purely elite affair, a matter of getting the right technocrats settled on the right policies. Just as shock therapy programs are drafted in secret bunkers in La Paz and Moscow, so, apparently, should a \$30 billion aid program for the Soviet republics have materialized based solely on the commonsense arguments he was making in Washington. As Eisenberg notes, however, the original Marshall Plan came about not out of benevolence, or even reasoned argument, but fear of popular revolt.

Sachs admires Keynes, but he seems uninterested in what made Keynesianism finally possible in his own country: the messy, militant demands of trade unionists and socialists whose growing strength turned a more radical solution into a credible threat, which in turn made the New Deal look like an acceptable compromise. This unwillingness to recognize the role of mass movements in pressuring reluctant governments to embrace the very ideas he advocates has had serious ramifications. For one, it meant that Sachs could not see the most glaring political reality confronting him in Russia: there was never going to be a Marshall Plan for Russia because there was only ever a Marshall Plan *because of* Russia. When Yeltsin abolished the Soviet Union, the “loaded gun” that had forced the development of the original plan was disarmed. Without it, capitalism was suddenly free to lapse into its most savage form, not just in Russia but around the world. With the Soviet collapse, the free market now had a global monopoly, which meant all the “distortions” that had been interfering with its perfect equilibrium were no longer required.

This was the real tragedy of the promise made to the Poles and Russians—that if they followed shock therapy they would suddenly wake up in a “normal

European country.” Those normal European countries (with their strong social safety nets, workers’ protections, powerful trade unions and socialized health care) emerged as a compromise between Communism and capitalism. Now that there was no need for compromise, all those moderating social policies were under siege in Western Europe, just as they were under siege in Canada, Australia and the U.S. Such policies were not about to be introduced in Russia, certainly not subsidized with Western funds.

This liberation from all constraints is, in essence, Chicago School economics (otherwise known as neoliberalism or, in the U.S., neoconservatism): not some new invention but capitalism stripped of its Keynesian appendages, capitalism in its monopoly phase, a system that has let itself go—that no longer has to work to keep us as customers, that can be as antisocial, antidemocratic and boorish as it wants. As long as Communism was a threat, the gentlemen’s agreement that was Keynesianism would live on; once that system lost ground, all traces of compromise could finally be eradicated, thereby fulfilling the purist goal Friedman had set out for his movement a half century earlier.

That was the real point of Fukuyama’s dramatic “end of history” announcement at the University of Chicago lecture in 1989: he wasn’t actually claiming that there were no other ideas in the world, but merely that, with Communism collapsing, there were no other ideas sufficiently powerful to constitute a head-to-head competitor.

So while Sachs saw the collapse of the Soviet Union as a liberation from authoritarian rule and was ready to roll up his sleeves and start helping, his Chicago School colleagues saw it as a freedom of a different sort—as the final liberation from Keynesianism and the do-gooder ideas of men like Jeffrey Sachs. Seen in that light, the do-nothing attitude that so infuriated Sachs when it came to Russia was not “sheer laziness” but *laissez-faire* in action: let it go, do nothing. By not lifting a finger to help, all the men charged with Russian policy—from Dick Cheney, as Bush Sr.’s defense secretary, to Lawrence Summers, Treasury undersecretary, to Stanley Fischer at the IMF—were indeed doing something: they were practicing pure Chicago School ideology, letting the market do its worst. Russia, even more than Chile, was what this ideology looked like in practice, a foreshadowing of the get-rich-or-die-trying dystopia that many of these same players would create a decade later in Iraq.

The new rules of the game were on display in Washington, D.C., on January 13, 1993. The occasion was a small but important conference, by invitation only, on the tenth floor of the Carnegie Conference Center on Dupont

Circle, a seven-minute drive from the White House and a stone's throw from the headquarters of the IMF and the World Bank. John Williamson, the powerful economist known for shaping the missions of both the bank and the fund, had convened the event as a historic gathering of the neoliberal tribe. In attendance was an impressive array of the star "technopols" who were at the forefront of the campaign to spread the Chicago doctrine throughout the world. There were present and former finance ministers from Spain, Brazil and Poland, central bank heads from Turkey and Peru, the chief of staff for the president of Mexico and a former president of Panama. There was Sachs's old friend and hero, Leszek Balcerowicz, architect of Poland's shock therapy, as well as his Harvard colleague Dani Rodrik, the economist who had proven that every country that had accepted neoliberal restructuring had been in deep crisis. Anne Krueger, future first deputy managing director of the IMF, was there, and although José Piñera, Pinochet's most evangelical minister, couldn't make it because he was trailing in Chile's presidential election, he sent a detailed paper in his place. Sachs, who was still advising Yeltsin at the time, was to deliver the keynote address.

All day long, the conference participants had been indulging in that favorite economists' pastime of strategizing how to get reluctant politicians to embrace policies that are unpopular with voters. How soon after elections should shock therapy be launched? Are center-left parties more effective than right-wing ones because the attack is unexpected? Is it better to warn the public or take people by surprise with "voodoo politics"? Though the conference was called "The Political Economy of Policy Reform"—so willfully bland a title that it seemed designed to deflect media interest—one participant remarked slyly that what it was really about was "Machiavellian economics."<sup>8</sup>

Sachs listened to all this talk for several hours, and after dinner he went to the podium to give his address, titled, in true Sachsian fashion, "Life in the Economic Emergency Room."<sup>9</sup> He was visibly agitated. The crowd was ready to hear a speech from one of their idols, the man who had carried the torch of shock therapy into the democratic era. Sachs was in no mood for self-congratulation. Instead, he was determined to use the speech, he later explained to me, to try to get this powerful crowd to grasp the gravity of what was unfolding in Russia.

He reminded his audience of the infusions of aid that had gone to Europe and Japan after the Second World War, "vital for Japan's later magnificent

success." He told a story about getting a letter from an analyst at the Heritage Foundation—ground zero of Friedmanism—who "believed strongly in Russia's reforms but not in foreign aid for Russia. This is a common view of free-market ideologues—of which I am one," Sachs said. "It is plausible but it is mistaken. The market cannot do it all by itself; international help is crucial." The laissez-faire obsession was taking Russia into catastrophe, where, he said, "no matter how valiant, brilliant, and lucky are Russia's reformers, they won't make it without large-scale external assistance . . . we are close to missing a historic opportunity."

Sachs got a round of applause, of course, but the response was tepid. Why was he praising such lavish social spending? This crowd was on a global crusade to dismantle the New Deal, not to forge a new one. In the conference sessions that followed, not a single participant supported Sachs's challenge, and several spoke out against it.

What he was trying to do with the speech, Sachs told me, was "explain what a real crisis was like . . . to convey a sense of urgency." People who make policy from Washington, he said, often "don't understand what economic chaos is. They don't understand the disarray that comes." He wanted to confront them with the reality that "there's also a dynamic that things get farther and farther out of control, until you have other disasters, until Hitler comes back in power, until you have civil war, or mass famine or whatever it is. . . . You need to do emergency things to help, because an unstable situation definitely has a path of increasing instability, not just a path to normal equilibrium."

I couldn't help thinking that Sachs wasn't giving his audience enough credit. The people in that room were well versed in Milton Friedman's crisis theory, and many had applied it in their own countries. Most understood perfectly how wrenching and volatile an economic meltdown could be, but they were taking a different lesson from Russia: that a painful and disorienting political situation was forcing Yeltsin to rapidly auction off the riches of the state, a distinctly favorable outcome.

It was left to John Williamson, the host of the conference, to steer the discussion back to those pragmatic priorities. Sachs was the one with the star power at the event, but it was Williamson who was the crowd's real guru. Balding and untelegenic but thrillingly politically incorrect, Williamson was the one who coined the phrase "the Washington Consensus"—perhaps the most quoted and contentious three words in modern economics. He is

famous for his tightly structured closed-door conferences and seminars, each designed to test one of his bold hypotheses. At the conference in January, he had a pressing agenda: he wanted to test what he called the “crisis hypothesis” once and for all.<sup>10</sup>

In his lecture, Williamson offered no warnings of the imperative to save any country from crisis; in fact, he spoke rhapsodically of cataclysmic events. He reminded his audience of the indisputable evidence that only when countries are truly suffering do they agree to swallow their bitter market medicine; only when they are in shock do they lie down for shock therapy. “These worst of times give rise to the best of opportunities for those who understand the need for fundamental economic reform,” he declared.<sup>11</sup>

With his unparalleled knack for verbalizing the subconscious of the financial world, Williamson casually pointed out that this raised some intriguing questions:

One will have to ask whether it could conceivably make sense to think of deliberately provoking a crisis so as to remove the political logjam to reform. For example, it has sometimes been suggested in Brazil that it would be worthwhile stoking up a hyperinflation so as to scare everyone into accepting those changes. . . . Presumably no one with historical foresight would have advocated in the mid-1930s that Germany or Japan go to war in order to get the benefits of the supergrowth that followed their defeat. But could a lesser crisis have served the same function? Is it possible to conceive of a pseudo-crisis that could serve the same positive function without the cost of a real crisis?<sup>12</sup>

Williamson’s remarks represented a major leap forward for the shock doctrine. In a room filled with enough finance ministers and central bank chiefs to hold a major trade summit, the idea of actively creating a serious crisis so that shock therapy could be pushed through was now being openly discussed.

At least one conference participant felt obliged to distance himself in his own speech from these risqué ideas. “Williamson’s suggestion that it might be a good move to provoke an artificial crisis in order to trigger reform should best be read as an idea designed to provoke and tease,” said John Toye, a British economist from the University of Sussex.<sup>13</sup> There was no evidence that Williamson was teasing. In fact, there was plenty of evidence that his ideas were already being acted on at the highest levels of financial decision making in Washington and beyond.

The month after Williamson’s conference in Washington, we caught a glimpse of the new enthusiasm for “pseudo crisis” in my country, although few understood it as part of a global strategy at the time. In February 1993, Canada was in the midst of financial catastrophe, or so one would have concluded by reading the newspapers and watching TV. “Debt Crisis Looms,” screamed a banner front-page headline in the national newspaper, the *Globe and Mail*. A major national television special reported that “economists are predicting that sometime in the next year, maybe two years, the deputy minister of finance is going to walk into cabinet and announce that Canada’s credit has run out. . . . Our lives will change dramatically.”<sup>14</sup>

The phrase “debt wall” suddenly entered the vocabulary. What it meant was that, although life seemed comfortable and peaceful now, Canada was spending so far beyond its means that, very soon, powerful Wall Street firms like Moody’s and Standard and Poor’s would downgrade our national credit rating from its perfect Triple A status to something much lower. When that happened, hypermobile investors, liberated by the new rules of globalization and free trade, would simply pull their money from Canada and take it somewhere safer. The only solution, we were told, was to radically cut spending on such programs as unemployment insurance and health care. Sure enough, the governing Liberal Party did just that, despite having just been elected on a platform of job creation (Canada’s version of “voodoo politics”).

Two years after the deficit hysteria peaked, the investigative journalist Linda McQuaig definitively exposed that a sense of crisis had been carefully stoked and manipulated by a handful of think tanks funded by the largest banks and corporations in Canada, particularly the C. D. Howe Institute and the Fraser Institute (which Milton Friedman had always actively and strongly supported).<sup>15</sup> Canada did have a deficit problem, but it wasn’t caused by spending on unemployment insurance and other social programs. According to Statistics Canada, it was caused by high interest rates, which exploded the worth of the debt much as the Volcker Shock had ballooned the developing world’s debt in the eighties. McQuaig went to Moody’s Wall Street head office and spoke with Vincent Truglia, the senior analyst in charge of issuing Canada’s credit rating. He told her something remarkable: that he had come under constant pressure from Canadian corporate executives and bankers to issue damning reports about the country’s finances, something he refused to do because he considered Canada an excellent, stable investment. “It’s the only country that I handle where, usually, nationals from that country want

the country downgraded even more—on a regular basis. They think it's rated too highly." He said he was used to getting calls from country representatives telling him he had issued too low a rating. "But Canadians usually, if anything, disparage their country far more than foreigners do."

That's because, for the Canadian financial community, the "deficit crisis" was a critical weapon in a pitched political battle. At the time Truglia was getting those strange calls, a major campaign was afoot to push the government to lower taxes by cutting spending on social programs such as health and education. Since these programs are supported by an overwhelming majority of Canadians, the only way the cuts could be justified was if the alternative was national economic collapse—a full-blown crisis. The fact that Moody's kept giving Canada the highest possible bond rating—the equivalent of an A++—was making it extremely difficult to maintain the apocalyptic mood.

Investors, meanwhile, were getting confused by the mixed messages: Moody's was upbeat about Canada, but the Canadian press constantly presented the national finances as catastrophic. Truglia got so fed up with the politicized statistics coming out of Canada, which he felt were calling his own research into question, that he took the extraordinary step of issuing a "special commentary" clarifying that Canada's spending was "not out of control," and he even aimed some veiled shots at the dodgy math practiced by right-wing think tanks. "Several recently published reports have grossly exaggerated Canada's fiscal debt position. Some of them have double counted numbers, while others have made inappropriate international comparisons. . . . These inaccurate measurements may have played a role in exaggerated evaluations of the severity of Canada's debt problems." With Moody's special report, word was out that there was no looming "debt wall"—and Canada's business community was not pleased. Truglia says that when he put out the commentary, "one Canadian . . . from a very large financial institution in Canada called me up on the telephone screaming at me, literally screaming at me. That was unique."<sup>16</sup>

By the time Canadians learned that the "deficit crisis" had been grossly manipulated by the corporate-funded think tanks, it hardly mattered—the budget cuts had already been made and locked in. As a direct result, social programs for the country's unemployed were radically eroded and have never recovered, despite many subsequent surplus budgets. The crisis strategy was

used again and again in this period. In September 1995, a video was leaked to the Canadian press of John Snobelen, Ontario's minister of education, telling a closed-door meeting of civil servants that before cuts to education and other unpopular reforms could be announced, a climate of panic needed to be created by leaking information that painted a more dire picture than he "would be inclined to talk about." He called it "creating a useful crisis."<sup>17</sup>

### "Statistical Malpractice" in Washington

By 1995, political discourse in most Western democracies was saturated with talk of debt walls and imminent economic collapse, demanding ever-deeper cuts and more ambitious privatizations, with the Friedmanite think tanks always out front crying crisis. At Washington's most powerful financial institutions, however, there was a willingness not only to create an appearance of crisis through the media but also to take concrete measures to generate crises that were all too real. Two years after Williamson made his observations about "stoking up" crisis, Michael Bruno, chief economist of development economics at the World Bank, publicly echoed the same line, once again without attracting media scrutiny. In a lecture to the International Economic Association in Tunis in 1995, later published as a paper by the World Bank, Bruno informed five hundred assembled economists from sixty-eight countries that there was a growing consensus about "the idea that a large enough crisis may shock otherwise reluctant policymakers into instituting productivity-enhancing reforms."<sup>18</sup> Bruno pointed to Latin America as "a prime example of seemingly beneficial deep crises" and to Argentina in particular, where, he said, President Carlos Menem and his finance minister, Domingo Cavallo, were doing a fine job of "taking advantage of the emergency atmosphere" to push through deep privatization. Just in case the audience missed the point, Bruno said, "I have emphasized one major theme: the political economy of deep crises tends to yield radical reforms with positive outcomes."

In light of this fact, he argued that international agencies needed to do more than just take advantage of existing economic crises to push through the Washington Consensus—they needed to preemptively cut off aid to make those crises worse. "An adverse shock (such as a drop in government

\* It must be said that Truglia is a rarity on Wall Street—bond and credit ratings are often influenced by political pressure, and are used to increase the pressure to enact "market reforms."

\* Though Bruno did not attend the University of Chicago, he studied under and was mentored by the prominent Chicagoan Don Patinkin, quoted earlier comparing Chicago economics to Marxism for its "logical completeness."

revenue or in external transfers) may actually *increase* welfare because it shortens the delay [before reforms are adopted]. The notion that ‘things have to get worse before they can get better’ emerges naturally. . . . In fact, a high-inflation crisis may leave a country better off than if it had muddled along through less severe crises.”

Bruno conceded that deepening or creating a serious economic meltdown was frightening—government salaries would go unpaid, public infrastructure would rot—but, Chicago disciple that he was, he urged his audience to embrace this destruction as the first stage of creation. “Indeed, as the crisis deepens the *government may gradually wither away*,” Bruno said. “This development has a positive outcome; namely, at the time of reform the power of entrenched groups may have been weakened—and a leader who opts for the long-run solution over short-term expediency may win support for reform.”<sup>19</sup>

The Chicago School crisis addicts were certainly on a speedy intellectual trajectory. Only a few years earlier, they had speculated that a hyperinflation crisis could create the shocking conditions required for shock policies. Now a chief economist at the World Bank, an institution funded, by this time, with tax dollars from 178 countries and whose mandate was to rebuild and strengthen struggling economies, was advocating the creation of failed states because of the opportunities they provided to start over in the rubble.<sup>20</sup>

For years, there had been rumors that the international financial institutions had been dabbling in the art of “pseudo-crisis,” as Williamson put it, in order to bend countries to their will, but it was difficult to prove. The most extensive testimony came from Davison Budhoo, an IMF staffer turned whistleblower, who accused the organization of cooking the books in order to doom the economy of a poor but strong-willed country.

Budhoo was a Grenadian-born, London School of Economics-trained economist who stood out in Washington thanks to an unconventional approach to personal style: he let his hair stand straight on end, à la Albert Einstein, and preferred the windbreaker to the pinstripe suit. He had worked at the IMF for twelve years, where his job was designing structural adjustment programs for Africa, Latin America and his native Caribbean. After the organization took its sharp right turn during the Reagan/Thatcher era, the independent-minded Budhoo felt increasingly ill at ease in his place of work. The fund was packed with zealous Chicago Boys under the leadership of its managing director, the staunch neoliberal Michel Camdessus. When Budhoo

quit in 1988, he decided to devote himself to exposing the secrets of his former workplace. It began when he wrote a remarkable open letter to Camdessus, adopting the *j'accuse* tone of André Gunder Frank's letters to Friedman a decade earlier.

Showing an enthusiasm for language rare for senior fund economists, the letter began: “Today I resigned from the staff of the International Monetary Fund after over twelve years, and after 1000 days of official Fund work in the field, hawking your medicine and your bag of tricks to governments and to peoples in Latin America and the Caribbean and Africa. To me resignation is a priceless liberation, for with it I have taken the first big step to that place where I may hope to wash my hands of what in my mind's eye is the blood of millions of poor and starving peoples. . . . The blood is so much, you know, it runs in rivers. It dries up, too; it cakes all over me; sometimes I feel that there is not enough soap in the whole world to cleanse me from the things that I did do in your name.”<sup>21</sup>

He then went on to build his case. Budhoo accused the fund of using statistics as “lethal” weapons. He exhaustively documented how, as a fund employee in the mid-eighties, he was involved in elaborate “statistical malpractices” to exaggerate the numbers in IMF reports on oil-rich Trinidad and Tobago in order to make the country look far less stable than it actually was. Budhoo contended that the IMF had more than doubled a crucial statistic measuring the labor costs in the country, making it appear highly unproductive—even though, as he said, the fund had the correct information on hand. In another instance, he claimed that the fund “invented, literally out of the blue,” huge unpaid government debts.<sup>22</sup>

Those “gross irregularities,” which Budhoo claims were deliberate and not mere “sloppy calculations,” were taken as fact by the financial markets, which promptly classified Trinidad as a bad risk and cut off its financing. The country's economic problems—triggered by a drop in the price of oil, its primary export—quickly became calamitous, and it was forced to beg the IMF for a bailout. The fund then demanded that it accept what Budhoo described as the IMF's “deadliest medicine”: layoffs, wage cuts and the “whole gamut” of structural adjustment policies. He described the process as the “deliberate blocking of an economic lifeline to the country through subterfuge” in order to see “Trinidad and Tobago destroyed economically first, and converted thereafter.”

In his letter, Budhoo, who died in 2001, made it clear that his dispute was over more than the treatment of one country by a handful of officials. He

characterized the IMF's entire program of structural adjustment as a form of mass torture in which " 'screaming-in-pain' governments and peoples [are] forced to bend on their knees before us, broken and terrified and disintegrating, and begging for a sliver of reasonableness and decency on our part. But we laugh cruelly in their face, and the torture goes on unabated."

After the letter was published, the government of Trinidad commissioned two independent studies to investigate the allegations and found that they were correct: the IMF had inflated and fabricated numbers, with tremendously damaging results for the country.<sup>23</sup>

Even with this substantiation, however, Budhoo's explosive allegations disappeared virtually without a trace; Trinidad and Tobago is a collection of tiny islands off the coast of Venezuela, and unless its people storm the headquarters of the IMF on Nineteenth Street, its complaints are unlikely to capture world attention. The letter was, however, turned into a play in 1996 called *Mr. Budhoo's Letter of Resignation from the I.M.F. (50 Years Is Enough)*, put on in a small theater in New York's East Village. The production received a surprisingly positive review in *The New York Times*, which praised its "uncommon creativity" and "inventive props."<sup>24</sup> The short theater review was the only time Budhoo's name was ever mentioned in *The New York Times*.

## LET IT BURN

### THE LOOTING OF ASIA AND "THE FALL OF A SECOND BERLIN WALL"

**Money flows to where opportunity is, and, right now, Asia appears to be cheap.**

—Gerard Smith, a financial institutions banker at UBS Securities in New York, on the Asian economic crisis of 1997–98<sup>1</sup>

**Good times make bad policy.**

—Mohammad Sadli, economic adviser to Indonesia's General Suharto<sup>2</sup>

They seemed like simple questions. What can your salary buy? Is it enough for room and board? Is there any left over to send money back to your parents? How about transportation costs to and from the factory? But no matter how I phrased them, the answers I kept getting were "It depends." Or "I don't know."

"A few months ago," a seventeen-year-old worker who sewed Gap clothing near Manila explained, "I used to have enough money to send a little bit home to my family every month, but now I don't even make enough to buy food for myself."

"Are they lowering your wages?" I asked.

"No, I don't think so," she said, a little confused. "It just doesn't buy as much. The prices keep rising."

It was the summer of 1997, and I was in Asia researching the working conditions inside the region's booming export factories. I found workers facing a problem bigger than forced overtime or abusive supervisors: their countries