

Université Stendhal Grenoble3, UFR d'Etudes Anglophones

**JEFFREY SACHS, THE EVOLUTION OF AN
AMERICAN ECONOMIST**

by

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INTRODUCTION

The purpose of this thesis is by comparing social realities in countries such as Russia and some Latin American countries, with economic theories propounded by Harvard economist Jeffrey Sachs, we'll attempt to explain the evolution of his thinking concerning America's role in the world.

In **Part I** I will briefly outline the history and motivations of American economic and social thoughts and theories from the 1920s to the present. Then I'll analyze in depth Milton Friedman's theories and the spreading of Neo-liberal movement he launched.

In **Part II** I will analyze the economic and teaching career of one of the most famous of Milton Friedman's disciples, economic adviser and professor Jeffrey Sachs. Then we will see how faithful the IMF and the World Bank policies are to the Friedman's – Sachs's ideas.

In **Part III** I'll closely analyze the effects and consequences of Neo-liberal reforms. I'll compare the case histories of Chile, Bolivia and Russia.

By way of conclusion I will attempt to explain the significance of my finding in this research, by emphasizing the disasters that Neo-liberal economics bring wherever they are applied.

It is important to know that the supremacy of the institutions as the IMF and the World Bank is not eternal and the people begin to realize what is hidden behind their "democratic" policies. In recent years the IMF and the World Bank have been dramatically losing their popularity among the Third World countries and this is evidence that the resistance to Neo-liberalism is possible and it is the first step to meaningful change.

Part I

Early Economic Theories Adopted by U.S. Government History of Economic and Social Theories in the USA from 1920s to the Present

Chapter 1

From Social Darwinism to Reagan's Counter-revolution

1.1 Social Darwinism

At the end of the 19th century there was a theory of social selection that enjoyed special popularity among European and American conservative cycles. The theory of Social Darwinism was inspired by Charles Darwin's recent work *Origins of Species* (1859). The idea was promoted by an English philosopher Herbert Spencer, who had been equally influenced by the works of Thomas Malthus,(1766-1834). The latter as well as H. Spencer were concerned about the growing population and the problems of subsistence. Malthus' idea was that once the growing population doesn't have enough food, only the strongest would be able to survive and the weakest would die of starvation¹. H. Spencer developed further this theory, adding some more conditions for survival such as skill, intelligence, self-control and capacity to adapt through technological innovation. This way the progress of human race is achieved and the next generation is fitter for survival. Those ideas were expressed some six years before the publishing of *Origins of Species*. Using a term "Darwinism" made the theory more "fashionable", especially in the United States. Herbert Spencer generalized the law of evolution by natural selection to society: "struggle for existence" and "survival of the fittest", applied to human beings, meant that the nature itself took care of its best competitors until the perfection is reached. As for the unfit ones, (stupid and lazy or full of vices, which was equal to physical inferiority) the world should be cleared of them, they should make room for better: "If they are not sufficiently complete to live, they die and it is best they should die".² Wealth was considered as a sign of natural superiority, and poverty a sign of unfitness.

There was only one explanation for poverty: bad genes (idleness, stupidity etc) and nothing could cure it, so no compulsory poor laws or state measures could help. Herbert Spencer believed that the state intervention would only slow down the evolution, thus he was

¹ Thomas Malthus, *Essay on a Principle of Population* (London : W. Pickering, 1986)

² Richard Hofstadter, *Social Darwinism in American Thought* (Philadelphia: University of Pennsylvania Press,1965) 41.

against fixing neither minimal workers' salaries nor the maximum working hours. As for the charity, it would only make the social problems worse.

He was equally opposed to state-supported education, sanitary supervision, regulation of housing conditions, as well as to tariffs, state banking and government postal systems. That was exactly the kind of ideology the USA conservative cycles needed at that time and that was why Herbert Spencer, as well as Charles Darwin, became much more popular in America than in their home country.

In America the ideas of social evolution were developed by a sociologist William Graham Sumner after being inspired by the ideas of Social Darwinism.

Social Darwinism was particularly welcome in the US because the conservatives were looking for the scientifically explained theory that could explain their superiority, excuse the exploitation of the workers (as their less fit fellows); make them reconcile to the hardships of life and in short, defend the laissez-faire capitalism. American society was in full industrial growth, there were vast unexploited resources that needed mastered labor and capital. And thus it needed urgently appropriate economic ethics. In order to let capitalism and society evolve naturally, there should be no regulation for private enterprises, or income taxation. Most of taxations were considered by Spencer as a confiscation and contrary to the principles of capitalism progress.

The years from 1870 to 1900 were the years of laissez-faire capitalism, called The Gilded Age. The ideas of Social Darwinism made these times ideal for industrialists: without minimum wages for workers or income taxes, they rapidly made their fortunes. For example, such famous tycoons as John Rockefeller and Andrew Carnegie owe their wealth to that period.

Still, the numerous strikes (the most important one happened in 1894 by the employees of The Pullman Company, which resulted in extreme violence and deaths of workers with Chicago federal troops involved) and criticism of the Social Darwinism, made the Gilded Age come to its end and the administration began taking measures to improve the life of the workers and of the poor.

For example, Woodrow Wilson, the president of the USA from 1913 to 1921 promoted several reforms against laissez-faire capitalism as well as some for defending human rights.

He introduced legislation that curbed “indefensible and intolerable” private monopoly, and prevented unfair methods of business competition, made strikes legal, regulated working conditions for seamen and fixed an eight-hour working day for railroad employees, (which prevented a national railroad strike in 1916) and prohibited child labor. W. Wilson equally made possible low-cost long-term mortgages for farmers and legalized women’s right to vote.³

Social Darwinism together with its by-product, Eugenics(a philosophy about ways of human genes improvement), loses completely its attraction with the WWII and with Nazism distorting its ideas and using them as a justification and explanation for existence of superior Aryan race, ethnic cleansing (Holocaust), forced sterilization of people with mental diseases, human experimentation, etc

1.2 Great Depression and The New Deal

The Black Tuesday of the American Economy happened on October 24, 1929. The stock market crashed, bringing with it ten years of high unemployment (of over one forth of labor force), poverty and hunger. The Great Depression started in the USA and followed in Europe. German economy suffered the most from it, thus allowing Adolf Hitler enjoy the confidence and popularity amongst the poor, i.e. majority of the population.

Its origins are numerous and still being discussed. A natural catastrophe, a draught called the Dust Bowl was one of the reasons. It caused huge migration of season workers and their families, which destabilized the cost of labor. One of other reasons is speculation.

At that time, the president of the USA was Herbert Hoover, a Republican supporting a traditional strategy of government non-intervention in the social spheres of life. “Good government” was considered to be “minimal government”, which was neither to deal with social and economic problems, nor to offer direct assistance to people.

The basic known social protections as old age pension system, security from unemployment, minimum wage, aid to dependent children, federal housing support and many others did not exist then. There were no banking or stock market regulations either. All this permitted

³Dr Eric Mayer, *Lectures on History of the U.S from 1870*, taken from internet site:
<http://www.emayzine.com/lectures/Gilded%7E1.htm>, visited on August 3, 2008.

malfeasance of bankers and industrialists. Speculation on stock market was getting enormous but President Hoover would not discuss this issue in Congress, limiting himself to privately asking financiers to stop manipulating securities, which was with no success. Wild speculation would not be curbed and by summer of 1929 the rate of consumer spending dropped by 400 percent. The Stock Market crash that followed is considered as a logical end of a period of intense speculation. As a consequence the economy went down, taking away people's saving and confidence.⁴

President Hoover took some measures to prevent the spread of Depression but first they were too late and second, they only helped the business class (the Tariff Act and the tax bill of 1930), and the situation of the poor and middle class, who were most badly hurt by the Depression, continued to deteriorate. He thought that businessmen would re-invest in the economy and the situation would stabilize. So he would not spend any more of the Federal Budget. In May of 1930 Hoover declared that "we have now passed the worst" but following events proved him wrong: the banks continued to fail, enterprises went bankrupt. Millions of people became homeless, losing their savings and mortgages. The population was stricken with unprecedented gloom and "fathomless pessimism", in the words of one contemporary observer. Hunger strikes, marches and riots happened all around the country with police cruelly dispersing and injuring strikers. One of the most notorious marches happened in summer of 1932, when the veterans of the First World War came to Washington and demanded to be paid at once on the bonus certificates. The bill did not pass the Senate, but most of the demonstrators stayed. President Hoover ordered four troops of cavalry, four companies of infantry, a machine gun squadron and six tanks to evict the veterans. The demonstration ended in bloodshed, with several people dead and a thousand injured.⁵

All these events had a devastating effect on Hoover's popularity and on the election of November 1932. Democrats held a campaign against Hoover. Their candidate Franklin Roosevelt won the elections by a landslide.

The Great Depression marked the beginning of the welfare state. All this prepared a ground for a new kind of government with totally different approach: it was the "Roosevelt Revolution". He supported a totally different theory, (that of the Progressive movement),

⁴ *Ibid.*

⁵ Howard Zinn, *A People's History of the United States*, (New York: Harper Perennial, 2005), 391-392.

quite a phenomenon for those days: that the government should play the most important role in the country's economy and society and that the private enterprises should be controlled for the sake of social and economical system. During his presidency, the federal government's size increased several times and its role continued to grow.

Franklin Roosevelt proposed a New Deal to the citizens of US, a series of reforms aimed at the country's recovery. There were two major issues Roosevelt had to deal with: restore the economic and social stability, i.e. regain people's confidence in capitalism by checking it through reforms and regulations. The second issue was to calm down and prevent still ongoing spontaneous strikes and rebellions. When taking office, he was sure that "if another President failed as Hoover has failed" there would be a great risk of violent revolution of the Left or Right. According to Howard Zinn, administration gave financial aid to lower classes "to keep them from turning a rebellion into a revolution."⁶

Naomi Klein sees the New Deal as a concession Industrialists had to accept "grudgingly" in order to save the future of capitalism: softening the edges of the market with public sector jobs so that no one went hungry.⁷

One of the first major laws that passed was the National Recovery Act in 1933, aimed at controlling the economy by fixing prices and wages, limiting competition in the hope this would create new jobs. This Act served big businesses' interests and was dominated by them. Still, according to Roosevelt and his Brain Trust, big business should share its power with government and "distribute wealth more equitably"⁸, in President's words.

The following Acts stabilized farm prices through limiting the crops. Private banking became regulated through closer supervision and individuals' savings were insured. The nation's Stock Market enjoyed government supervision; people received loans to pay their mortgages. The private sector received loans to prevent it from going bankrupt and to conserve jobs. The workers were granted the right to resemble in unions and to bargain with employers. The Social Security Act of 1935 marked for the first time the interest the government took in the destiny of poor and unemployed. According to the Act, old age pensions, unemployment insurance, aid to dependent children, to invalids and to blind were administered.

⁶ *Ibid.*, 393.

⁷ Naomi Klein, *The Shock Doctrine: The Rise of Disaster Capitalism*, (London: Allen Lane, 2007), 251.

⁸ Schaller, *The Present Tense: The United States since 1945*, (Boston: Houghton Mifflin Company, 1996), 4.

Though the payments differed from state to state and were insufficient, the government was beginning to take responsibility to ease the hardships of destitute people. To assist the unemployed there were created numerous programs, a host of agencies who received grants for employing the poor in federal work projects.

All these reforms were inspired and justified by the theories of the famous British economist John Maynard Keynes. He advocated strong government intervention as the only means of securing the success of mature capitalism. Investing public money into the economy could help to increase consumer demand. Millions of Americans drew real benefits out of New Deal programs, but there were many people who fell through the gaps and didn't receive aid. For example, racial prejudices were still strong in the US. By 1938 Roosevelt's influence with the Congress begins to wane and it hardly accepts the Fair Labor Standards Act, which limited working hours to 40, prohibited child labor, and fixed a minimum wage. Unluckily domestic jobs were not concerned, these posts largely held by women and racial minorities.

With conservative bloc becoming more powerful and the beginning of the WWII the progress of social reforms stopped.

1.3 WWII. War Economy : Military Production

America's involvement in the war lead to its progressive military spending and production and laid the foundation for a new economy, based on military production.

In the mid-1930s, in front of the growing German, Japan and Italian military power and their aggressiveness the general mood in America was to stay neutral. After the negative experience of the WWI, feeling exploited by European and American warmongers and arms merchants, they did not want to have anything to do with the foreign wars. In 1937 the Congress passed neutrality acts which restricted American economic assistance to the belligerents. America limited its foreign intervention to appeasement of Hitler by accepting his demands about the partition of Czechoslovakia.

But in September 1939 when Britain and France, declared war on Germany, Congress approved Roosevelt's demand to help their European friends by selling arms.

Several weeks later, Roosevelt received an alarming letter from the prominent physicist Albert Einstein. He warned the President of a coming nuclear threat: German scientists were working on creation of atomic weapons, atomic bomb would be a decisive advantage in the outcome of the war.

From this moment it became clear that a rapid creation of atomic bomb was needed, the Manhattan Project cost \$2 billion from American budget.

The USA had a vivid interest in supporting the nations who resisted Germany and Japan. In March 1941 Congress accepted unanimously an aid of \$7 billion to England and China.

On December 7, 1941 U.S. naval base, Pearl Harbor was bombed by Japan, causing more than 2400 deaths. After this attack, America could no longer keep out of the war.

In 1940, the size of the American army was comparable to that of Bulgaria – about 185.000 men. A short time after the Pearl Harbor attack, military production provided the army with more ships and planes per month than the total that were lost in Pearl Harbor. The government encouraged industrial conversion from civilian to military by creating privileged conditions, which contributed to big business prosperity: their profits soared from \$6.4 billion in 1940 to \$10.8 billion in 1944. Thus motivated, military industries produced so many planes, tanks, ships, bombs, trucks and ammunition that by the end of war, Allied soldiers had three-to-one advantage over their enemies.

Scientific research was also significantly financed, thus employing much more people; universities updated their facilities, counted new students-officers. Private research laboratories multiplied their staff by two. The government itself largely increased its staff: its size tripled by the end of the war.

Intense military production brought surprisingly positive economic and social changes. Unemployment practically disappeared, ordinary American citizens regained confidence as the Great Depression finally became a part of the past. Individual savings, thanks to adjustment for inflation and growing salaries, increased steadily and by the end of the war were of \$29 billion annually, which is ten times more than in the beginning of the WWII.

The American economy took quite a different turn during the war years and became prosperous as never before. The horrors of Great Depression were at last forgotten.

On one hand, America emerged from the war victorious and wealthy: with the smallest human casualties and the strongest economy and army in the world.

On the other hand, military production not only helped to fight the enemy and stabilize the economy, but dangerously, it also proved to be extremely lucrative and so attractive business. When the war was over and the enemy was defeated, big military industrialists did not want to give up their gain so easily. Rather than reconverting plants into civil production, it was much easier and more profitable to find a new enemy, even amidst one's own recent allies.

1.4 Postwar Years: Cold War Economy, Marshall Plan

By the end of the WWII, Europe is devastated, millions of people are killed or injured, the biggest cities have been bombarded, leaving millions of people homeless. Major roads and railroads are out of service, causing the isolation of cities and villages. Economy is in the severest decline, and people are starving, as Eastern Europe, their greatest food exporter, is behind the Iron Curtain. At the same time, America's economy is prospering; the country is experiencing a consumer boom: having saved their earning during the war (about \$140 billion since 1941), people began buying cars, domestic electric appliances, houses etc.

The Europe was recovering too slowly from the impact of war, and their collapse was not in the interests of the US government. First, because the USA needed foreign markets to export their goods to, and secondly, as John Maynard Keynes warned in "*Economic Consequences of the Peace*", (1919), poor and desperate people can be easily manipulated by Nazi or Communists. At this time, government began to realize, on Fascist Germany example, that market economies "had to guarantee enough basic dignity"⁹ so that disillusioned citizens don't turn to more attractive ideologies as fascism or Communism. With already growing Soviet influence in Eastern Europe, American government was deeply suspicious of USSR actions. European capitalism had to be saved and rapidly. In order to assist European industrial recovery and trade in Europe, a European Recovery Plan was proposed, lately known

⁹ Klein,54.

as Marshall Plan. It lasted from 1947 to 1953 and cost about \$12 million to American Budget. In assisting European economic recovery, Keynes' principles were respected. For example, a moratorium was imposed on foreign investment in Germany so that their companies don't compete before recovering. Forty years later, while "assisting" economic transition in Russia, the methods will turn out to be quite different.

President Truman tried to promote a pack of social reforms under the name of Fair Deal, but he wasn't completely approved by Congress and only a small part had a vote. Still it influenced later politicians.

In 1949, when it becomes known that the USSR had created and tested an atomic bomb, a period of "the Red Scare" begins: senator McCarthy gets known for his chasing Reds, scaring ordinary American citizens with stories about communist spies everywhere, bringing with them subversion of American society. This seemed to be a perfect justification for not only continuing intense military production but for even increasing it, as well as defense spending.

In 1950 the government decides to create a hydrogen bomb, thousand times stronger than the precedent one. Paul Nitze, a head of policy planning, advocated increase in defense spending from \$ 13 billion to \$50 billion per year. This proposal was approved by high officials, as they believed that with larger industrial output, employment would soar. Later Dean Acheson, the secretary of state and Paul Nitze both accepted the exaggeration of the threat the Soviets represented, but a scare campaign aimed at shocking the public was needed in order to justify their demands.

President Truman was hesitating about accepting this demands but the outbreak of Korean War made these expenditures real.

By the end of the 1950s there were some important positive changes in the life of Americans.

Higher education became more democratic. Demobilized soldiers received free access to college, which was nearly unaffordable for people with modest means. Colleges and universities received a better financing.

In 1957 after successful launching of Sputnik, President Eisenhower increased funding for the National Science Foundation, supported grants for schools and universities, together with Congress created National Aeronautics and Space Administration (NASA) with a budget of \$340 million.

1950s were the years of baby and housing boom, the time of big hope for American people.

The government tradition brought by Roosevelt was respected, federal government stayed as large and active as before.

In spite of continuing demands of increasing incentives to accelerate the arms race against the Soviet Union, President Eisenhower made important efforts to decrease military production and defense spending. He saw a threat to democracy in the huge military-industrial complex and didn't consider military production as a guarantee of stable economy, but on the contrary responsible for economic recession of 1958.

1.5 1960s -1970s Vietnam War

When J.F. Kennedy takes office in 1960, he continued the policy of containing the communism and particularly its spreading influence in Vietnam. Moreover, after the huge resources of oil were discovered in Indonesia, the territory represented additional economic interest for the U.S. The number of military advisers sent to the pro-American government in South Vietnam increased.

In 1964 Lyndon B. Johnson, a Democrats candidate, won the elections by a landslide. The general mood was against nuclear war and in the famous commercial "*Daisy Ad*" he declared his convictions against the use of nuclear weapons in Vietnam. He continued J.F Kennedy's politics towards Vietnam, sending military advisers. But in 1967 the USA had about 500.000 soldiers fighting in Vietnam. The unpopularity of war kept raising, especially after the Tet-offensive, a surprise-attack by the North Vietnamese. Numerous anti-war demonstrations were held. The U.S. commander General W. Westmoreland claimed for more troops, but with the growing social unrest and increased casualties among American soldiers, Johnson had to refuse.

In 1968 a Republicans' nominee Richard Nixon won the election promising American people "peace with honor". He began a process of "vietnamization" – progressive withdrawal of American troops which ended only by 1973, costing the lives of more than 58.000 Americans and almost 6 million Vietnamese, Cambodians and Laotians.

These years were the times of growing social movement, especially among students. Well educated and well informed students, joined by Vietnam War veterans, were horrified by the conflict in Vietnam and in general angry at the American economy based on military production. The civilian protests are frequent and they are violently dispersed. In May of 1970, during one of student demonstrations against the U.S. invasion of Cambodia, four students were killed by National Guard Troops. In total about 500 campuses participated in strikes during that period.

The 1960s were the times of the progress of social democracy.

In 1965 president Lyndon Johnson passes successfully through the Congress a pact of social reforms called “Great Society”, aimed at financing public education, medical research, antipoverty activities, housing and urban renewal, enlarging voting rights, healthcare for the old.

Taking office in 1969, Richard Nixon, a candidate from Republicans, sought to limit the power of federal government and reduce government expenditures in order to control inflation that had been developing during the 1960s. However, during two years, he rejected proposals for freezing wages and prices. Huge military expenditures created the lack of financing for domestic programs, and as the Vietnam War went on, prices went on spiraling. Many people started blaming war for the increasing inflation.

In July 1971 it became known that the country imported more goods than it would export. National budget deficit represented \$20 million. American economy faced a slump, high level of unemployment and inflation soared.

This was the time when Milton Friedman experienced one of his greatest disappointments. Being a close friend of the president and having his followers, George Shultz and Donald Rumsfeld, at the key economic posts in the government, he was quite confident that his laissez-faire free market ideas were about to come true. But he felt betrayed by his disciples, as they embraced Keynesian principles instead. Nixon did not dare to put Friedman’s ideas into practice, he was sure a revolt would outbreak then and he wouldn’t keep his post for long.

Nixon administration froze prices on oil and rent, installed a wage-and-price control program, suspended dollars redemption in gold and imposed a 10% overcharge on imported goods. In

spite of infuriated Friedman's predictions, these measures worked, reducing inflation and making the economy grow.

Nixon's next step was to control industry by installing environmental and safety standards, proclaiming totally Keynesian government.

Thanks to these reforms, Nixon merited the name of "the most socialist American president of the 20th century" in the words of Milton Friedman.¹⁰

1.6 1980s Reagan's Counter – Revolution

In 1981 a Republican candidate Ronald Reagan took presidential functions. During the election campaign, he played a note of national pride and promised Americans more powerful, happier and less divided nation. He did not mention his convictions about social security programs. He declared that the cause of the country's economic problem was excessive government spending and too high taxes.

Reagan found some social programs wasteful, advocated tax cuts. Being himself a well-to-do man, he regarded income taxes as a "punishment" for fortune, whereas he believed that people should be rewarded for working "hard". On the contrary, people who didn't work and received aids, should receive less so that they want to work. He believed stories about "welfare queens" who drove Cadillacs thanks to unemployment compensation and other social programs payments. As the national debt was approaching \$1 trillion, he believed that social spending had to be cut, so that people would be motivated to work harder and better.

Most of his planned changes successfully passed Congress: many social programs were moved from the federal budget to the local, many welfare programs were cancelled as well as regulations on business, environment and public health. Personal and business income taxes were cut by 25%. Reagan managed to convince Democrats in Arthur Laffer's theory according to which tax cuts would let people earn more and would motivate them to work more, so that the economy would soar. But, on the contrary, economy continued to go down

¹⁰ Klein,133.

by the end of 1981. The wages of the poor and middle class stagnated, whereas tax policies were beneficial to the wealthy. This economics was called “trickle-down economics”.

The 1980s was a Gilded Age for wealthy owners: the number of millionaires increased from 574,000 in 1980 to 1.3 million in 1988.

The business deregulation incited creation of numerous sweatshops with hard exploitation, including child labor.

Shortly after Reagan's taking office, 11,400 striking air-traffic controllers paid dearly for their strike: President Reagan ordered them to be fired if they didn't return to work in 48 hours. Two days later, he kept his threat. That was the first significant mark of Friedman's counter-revolution. Air-traffic controllers' union would never completely recover after this blow and twenty years later the whole air transit system would be privatized. Low paid and badly trained employees would assure the security of flights.¹¹ This action could be considered by private employers as a declaration of war on trade unions. Indeed, employers privileged temporary labor in supermarket chains, offices and airlines, which was cheaper.

Chicago School policies of free market and free prices enjoyed high influence in Washington. That period is also called “Reaganomics”.

During the 1980s and 1990s the “privatization mania” in the words of Naomi Klein, sold off several state companies from electricity and water to highway maintenance and garbage collection.¹²

Still, in spite of Friedman's influence, Ronald Reagan wouldn't risk deploying shock therapy in the U.S. (The risk G.W. Bush wasn't afraid of: in 2001 after 9/11 attack, he launched the security, warfare and reconstruction privatization, as well as using taxpayers' money to finance private companies under the guise of "New Deal")¹³

During Reagan administration the military production became the leading growth industry in the United States. Any decrease in defense expenditures was considered as a dangerous for national security. Increased government military spending played an important role in

¹¹ Klein, 296.

¹² William Pfaff, “The Privatization of Public Utilities Can Be a Disaster,” *International Herald Tribune*, published on February 22, 2001, taken from internet site <http://www.commondreams.org/views01/0222-04.htm>, visited on July 2, 2008.

¹³ Klein, 298.

economic recovery of the country. American military plants were allowed to sell arms at the highest level ever known. The nation was armed to an unprecedented proportion.

By 1984 the economy began to stabilize, inflation had practically disappeared. During Reagan's presidency capitalistic values were significantly reinforced and a blueprint of Neoliberal ideology was formed. Financially secure individuals like those working in Wall Street or "yuppies" (young urban professionals) found the Reagan era fantastic, as they managed to multiply their wealth by stock manipulations. A new American morality had been created, motivated by personal greed and glory, and it became a part of national values. Still, never before the social inequality gap widened that much.

The Berlin Wall was crushed in 1989, marking the end of the Cold War and the collapse of the Soviet Union. The U.S. government congratulated its citizens with the victory. But the cost of the Cold War policies to the American people was horrible. In the words of George Kennan, former U.S. ambassador to the USSR, it cost "forty years of enormous and otherwise unnecessary military expenditures... where vast and useless nuclear arsenal had become a danger to the very environment of the planet." The huge military production justified by the Cold War policies, was a really lucrative business to big industrialists and arms merchants. Looking for more gain, there were some who views the possibility of nuclear war as an even more lucrative field. Henry Wallace, a former Secretary of Defense during Truman presidency, who criticized arms race (and was accused for sympathizing with the Communists) witnessed this mood and was horrified at the prospect on nuclear war.

Nevertheless, the U.S. economic situation and level of life didn't resemble those of victors. If national wealth was rising, it didn't mean it was equally distributed.

As George Bush became president in 1989, the new economic recession was threatening the nation. The federal budget would go down \$267 billion in 1991, the highest in history. The national transportation system was in decay, highways and bridges needed reparations, new airports were needed urgently. The health care system existed only for the wealthy. Poor working class could afford paying insurance. As a result health care costs were soaring and pharmaceutical companies were profiteering from the situation, artificially raising prices on high-demanded drugs. All these poor-and-middle class problems didn't seem to bother president Bush. When foreign creditors express their worries about the value of U.S. dollar, Bush's administration decided to increase taxes and to reduce social spending. Conservative

Republicans were infuriated at Bush for not keeping his “no new taxes” promise and when at the end of 1990s the economy faced a new recession, conservatives accused G. Bush for not following Reagan’s policy.

The arms race continued, and only in 1993 president Clinton initiated a program of nuclear disarmament together with Russian president Boris Yeltsin.

CONCLUSION

The link between the 19th - century economic theory and the present one is obvious: Social Darwinism resembles much to the ideology of the free market. According to its defenders, both society and free market are natural organisms, where the State should not intervene and which should be let evolve according to their own natural laws. Free market will evolve to the economic stabilization and as for the Social Darwinism; evolution meant the amelioration of the human kind to ideal individuals through the survival of the economically fittest.

Otherwise, interfering with “the wisdom of the nature” can only lead to degeneration.¹⁴ Looking back on Spencer’s ultra-conservative view points, it is surprising to see that one hundred and fifty years later his ideas have been realized: privatization of the most vital spheres of life (like the privatization of the USA’s postal system), flourishing of private schools and universities, poor condition of public health care (good health insurance is affordable only to the well-to-do people), housing conditions and state banking are in poor state also. Survival of the fittest is more actual than ever: a good example to it (and extremely tragic too) is the inundation of New Orleans in 2005. The victims were those who could not afford to escape the city, the poorest and most destitute people.

We can also see the analogies between the housing crisis during the time of Great Depression and today’s credit crisis in the USA (caused again by accounting manipulations by US banks), when thousands of people turned out to be at a deadlock and lost their homes.

As Naomi Klein puts it, all the social protections we have now came as a concession made by powerful industrialists facing the growing power of the Left.

¹⁴ Hofstadter,7.

Chapter 2

Influence of M. Friedman on Chicago School

2.1 Biography and the creation of Chicago School of Thought

Milton Friedman was born in 1912, in a family of Jewish emigrants to New York. When he was one year old, the family moved to Rahway, a small town in New Jersey. His parents owned a sweetshop and worked hard. He was a gifted student and graduated from high school before he was 16. His father died a year ago and if Milton Friedman wanted to go to college, he would have to sustain himself. He received a competitive scholarship for the Rahway University. There he was influenced by two economics professors, Arthur F. Burns and Homer Jones, they became his guides in economics and shaped his visions about modern economics as a solution to Great Depression. In 1932 he graduated, with both majors in economics and mathematics. Thanks to their recommendations, Friedman received a tuition scholarship for Chicago's Economic Department. After obtaining his M.A. degree in the University of Chicago, his privileged relations with economics professors assured him a fellowship in Columbia University. The next year he worked as a research assistant to Henry Schulz, his former professor.

In 1935 he joined a New Deal team, a harbor for many unemployed young economists. He worked for the National Resources Committee, designing consumer budget survey. His next job consisted in the studies of professional income, at the end of which he had come to the conclusion that physicians had greater income than dentists, because of monopoly created among medical professions. From 1941 to 1943 he worked in the US Treasury department, designing war time taxation. In order to collect taxes faster, easier and without a risk of tax avoidance, Milton Friedman promoted withholding tax system, which he later regretted. From 1943 he devoted his career to the scientific research, first in Columbia and Minnesota Universities and then in the University of Chicago, that became his “intellectual home”,¹⁵ where for more than thirty years he would be considered as a creator and leader of Chicago School of Thought.

¹⁵ Milton Friedman, “Autobiography” in *Nobel Lectures: Economic Sciences 1969-1980*, ed. by Assar Lindbeck, (Singapore: World Scientific Publishing Co., 1992).

Actually the Chicago School of Thought existed since 1920 but it was under the leadership of Stigler and Friedman that it became famous and polemical. Chicago School stayed faithful to Neoclassical economics and to spreading Neoclassical price theory.

During his work for the government, Milton Friedman supported Keynes' economics of high taxation which he would regret later. During New Deal year and all through the 1950s, the war against poverty was declared, Chicago school was in disgrace, as Keynes's ideas were popular and worked well.

2.2 The economic theories

In 1960 s Milton Friedman developed a different theory, which made him famous and Chicago University Economics Department too. The money playing the crucial role, the theory received the name of monetarism. The government should keep the money supply steady, expanding it slightly each year only to allow for the natural growth of the economy and a few other basic factors. Thanks to market forces inflation, unemployment and production would adjust themselves automatically around this fixed money supply.

In monetary economics the quantity of money served as an important instrument of government policy and as a determinant of business cycles and inflation. He insisted that there existed a natural rate of unemployment. Friedman contradicted Keynes' theory about the causes of the Great Depression of 1930, that it wasn't the lack of investment but a shrunk supply of money. He insisted that supply of money does affect the amount of spending in an economy and the equilibrium between the supply and demand of money should be respected by banks. The only wise policy is the extension of the money supply. And on the contrary, if expending extensively it would cause inflation.

The School advocated non-intervention of the government and minimizing its role in favor of the private sector, as well as deregulation and free market system.

In his book *Capitalism and Freedom* (1982), which became a bestseller and a “Bible” of the Neoconservatives, Friedman revealed to his followers the principle of shock doctrine: that the best ground for his measure to be applied without any resistance is a country in crisis. It did

not matter whether the crisis was real or not. The policies should be prepared and wait for an appropriate moment.¹⁶ The policies prepared were as follows: total deregulation (for profits protection and their faster accumulation), selling off all state assets, that is privatization (so that corporations could profiteer) and limiting social programs. Besides, it included low taxes (at equal rate to rich and poor), cancelled any protection for local producers, gave unlimited freedom to corporations, wages and the price of labor should be determined by the market. As for the state properties to go in private hands, it concerned health care, post office, education, retirement payments and national parks. Friedman called for total eradication of New Deal and of all the social progress (that was achieved and financed by tax-payers with such a difficulty).

2.3 Nobel Prize Controversy

In 1976 Milton Friedman won a Nobel Prize in Economics “for his achievements in the fields of consumption analysis, monetary history and theory and for his demonstration of the complexity of stabilization policy”.

Pierre Rinfret, a former economic adviser to three American presidents (Kennedy, Johnson and Nixon) assures that there never was such a thing as Nobel Prize in Economics. The prize was actually created (and funded) by the Bank of Sweden in memory of Alfred Nobel, but Milton Friedman claims all the same that it was Nobel Prize that he won, thus deserving a name of a “liar” by Rinfret, who adds that in general “he lies frequently about most things.”¹⁷ There is a controversy about these prizes as the most of them were awarded to monetarists. To Rinfret’s viewpoint, that is totally logical as the Bank of Sweden supports monetarism as an economic theory.

¹⁶ Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1982) ix.

¹⁷ Pierre Rinfret, “Milton Friedman: Conceited, Lying, Egotistical and Disastrous”, published on November 25, 2000. Taken from internet site <<http://www.rinfret.com/mf.html>>, date of visit August 10, 2008.

2.4 The times of Chicago School and Rising Star of Milton Friedman

1930s- 1950s were the “dark days” for the University of Chicago’s Economic Department. Keynesian ideas proved efficacious not only in the U.S., during the New Deal years and the war effort, but also abroad.

By 1950s Keynesians’ and Developmentalists’ efforts began to fructify: there’s a series of impressive success stories about the Southern Cone. For example by this time Argentina had the largest middle class on the continent and as for Uruguay, its literacy rate went up to 95 percent, including free health care for all its citizens. This success didn’t contribute to the glory of the Chicago’s University Economic Department. Almost no one was interested in Friedman’s ideal about freer markets.

Although Friedman was not popular by then, the heads of multinational corporations saw in his speeches and theories a perfect scientific justification for their policies. Since the beginning of New Deal program, they had been losing a great deal of money through corporate taxes and minimum wages. Their original “robber baron” policies coming out of Friedman’s mouth will have a disguise of economic impartial science, thus obtaining a legal right to exist. Chicago School had much to win from this kind of collaboration: significant donations and world-spread network, forming right-wing neoconservative specialists, all this in the glory of Chicago School of Thought. According to Naomi Klein, behind the language of math of science, Friedman simply hid the same interests as those of large multinationals, with the final goal of re-colonizing the state by selling its public services for a trifle.

The first blows against Developmentalists began abroad in 1953: CIA – sponsored coups d’états in Iran and Guatemala. In 1956 began “The Chile Project” aimed at producing ideological warriors – Chilean students indoctrinated by University of Chicago’s Economics Department. These students were supposed to become leaders in economic affairs of their country. But the money invested in the indoctrination of Chilean students didn’t bring dividends: the Project turned out to be “an expensive bust”¹⁸ The elections of 1970s proved that Chicago Boys were beaten by their left-wing ideological enemies.

¹⁸ Klein, 63.

By this time, Chile held about 20% of American investments. Although Allende proposed compensations, the multinationals didn't want to lose their annual profits. For example, Chile's copper mining industry covered 7 times the original sum of investments. (From \$1 billion to \$7.2 billion in fifty years)¹⁹

When it became known that Allende, the elected president of Chile, was going to nationalize all the multinational corporations and properties, including many U.S. firms, President Nixon declared economic war on Chile. He ordered the CIA director to "make the economy scream"²⁰. Those "dirty tricks", as Naomi Klein calls them, constituted the following: from blocking U.S. loans to Chile and inciting foreign banks to do the same, to boycotting Chilean copper. Yet these "dirty tricks" didn't reach their goal- the economic collapse. The next step was much more violent – a coup d'état, sponsored by CIA and multinational corporations.

In order to "save" "freedom in Chile and the existence of private enterprise"²¹ Allende and his supporters were to be exterminated, as well as their economic ideas.

In 1981, after Allende was overthrown, *Fortune* magazine was lavishing praises upon a new capitalist state of Chile, with shops full of luxuries and new Japanese cars, omitting to mention the explosion of shantytowns and repressed citizens.²²

2.5 Limited versions of "shock therapy" in the U.S.A and the Great Britain

In the end of 1960s when his predicted "stagflation" arrived in the U.S. (high unemployment and low growth), Milton Friedman's popularity began to rise. He was offered to work as economic advisor for Richard Nixon and Ronald Reagan.

During Nixon presidency, Friedman had big hopes. A member of a committee of economic advisers , with his two followers detaining economic posts in the government ,Donald

¹⁹ Sue Branford and Bernardo Kucinski, *Debt Squads: The U.S. ,the Banks and the Latin America*(London: Zed Books,1988),40,51-52.

²⁰ CIA, *Notes on the meeting with the president on Chile*, September 15, 1970,www.gwu.edu/~nsarchiv.

²¹ Juan Valdés, *Pinochets's economists: The Chicago School in Chile* (Cambridge: Cambridge University Press,1995),251.

²² Peter Dworkin, "Chile's Brave New World of Reagonomics", *Fortune*, November 2, 1981.

Rumsfeld and George Shultz, they didn't apply his ideas but those of Keynes, which was equal to a crime against economy in Friedman's eyes.

Although President Nixon helped Friedman to promote his Chicago Boys in Chile, he was more cautious at domestic policies, causing Friedman's enormous disappointment.

It was during Reagan presidency, that Friedman's star began to rise. Shortly after Reagan was elected, Friedman finally took his "revenge", when 11.400 striking air traffic controllers were fired after president's order. This marked a beginning of Neoliberal era in the U.S., smothering the following resistance of unions and intimidating people. Then followed cuts of taxes and all through the 80s and 90s, huge privatization of public services and maintenance, letting more than half a million people enrich themselves so well as to become millionaires.

In the end of the 1990s the governor of Texas, George Bush, made private prisons proliferate in the state, making contracts with private companies to supply guards for the prison.

As Milton Friedman stated in *Capitalism and Freedom*, the policies are prepared and awaiting an appropriate moment to step in – a country in crisis. Recent tragic events that happened in the U.S., prove that this statement is still actual: after the terrorist attack in 2001, president George Bush launched, under the name of War on Terror, a transfer of hundreds of billions of public dollars into the hands of private firms. These firms received state contracts for dealing with such normally public functions as security, invasion, occupation and reconstruction. Besides, using the "emergency state" George Bush allowed surveillance, policing and detention.

Another developed country also experienced "a limited version of shock therapy", in Naomi Klein's words. It was the case of the Great Britain.

In 1981 Friedrich Hayek, Milton Friedman's mentor and "patron saint" of the Chicago School, after visiting Chile, wrote to his close friend Margaret Thatcher that she should use that country's model to transform the Great Britain's Economy (from Keynesian to that of free-market, via shock therapy policies). He received a disappointing answer, where she explained that these types of measures would be unacceptable in a country with such democratic institutions as in the U.K. A year later, the opportunity occurred with the Falklands war. The victory restored her popularity, making her a "war hero." When coal

mine workers went on strike in 1984, she took advantage of her popularity and of recent war. The strikers were declared “enemies within”, their labor union was infiltrated with informers, the telephones and workers’ homes were bugged. The workers’ demonstration was violently dispersed by horse-back police causing about 700 injuries. The strike ended the next year, with 966 people fired.²³ Coal mines workers’ union, the most powerful union in The Great Britain, received a devastating blow, which brought a sad message for the other, weaker unions. What followed next is called “a limited version of shock therapy” by Naomi Klein: 1984 to 1988 were privatization years, when British Telecom, British Gas, British Airways, British Airport Authority and British Steel.

While employing shock therapy policies, developed countries’ leaders couldn’t push it further, restrained by more or less stable democratic institutions, the shock doctrine was much easier to be promoted in the countries with dictatorships, like Chile, which became a first huge experimental laboratory for Milton Friedman and Chicago Boys.

Chicago School’s influence is so great in the economic world that any country that decides to become its protégé, actually becomes its hostage. If the country doesn’t abide by Chicago School rules, it is immediately punished: American and British traders declare war on the “offender’s” currency, provoking even deeper crisis, followed by the need for even more loans with more conditions. This kind of trap was experienced by Nelson Mandela, the first black president of South Africa. In 1997 he had to acknowledge to the African National Congress that the globalization of markets and of the capital prevent the country from choosing freely their domestic policy.

²³ *Coal War: Thatcher against Scargill*, director Liam O’Rinn, episode 8093 of the series *Turning Points of History*, telecast June 16, 2005.

2.6 Criticism

In 1971, Murray N. Rothbard, the founder of modern libertarianism and the dean of the Austrian School of economics, wrote an article for *The Individualist*, where he criticized several viewpoints of Milton Friedman and called him a totalitarian and statist:

Friedman's theoretical concessions to the egregious ideal of "perfect competition" would permit a great deal of governmental trust-busting, and his neighborhood-effect concession to a government intervention could permit a virtual totalitarian state.²⁴

In October 1998, Milton Friedman organized a conference on the privatization of public education. Just before George Shultz, a former Secretary of State, was about to present the conference under the title "School Choice and Corporate America", Al Decker, a co-founder of Biotic Baking Brigade, threw a pie into Milton Friedman's face with the words "Mr. Friedman, it's a good day to pie!" As he later explained, Milton Friedman was committing a crime against people by advocating the privatization of public education. His Neo-liberal policies of free-trade caused only world poverty and starvation, whereas a private capital grew so powerful that it "grossly undermines the power of the people to determine their country's future."²⁵

On "online memoirs" that Pierre Rinfret created in 2000, he calls Friedman "a lousy economist with dangerously simplistic visions and explanations of the economic world." As Rinfret assures, it was thanks to those oversimplified explanations of the economy that Friedman became so popular among business media. But for the same reason that he is popular, he is dangerous as he deliberately misinforms people, making them "swallow nonsense" and thus delaying real progress²⁶.

²⁴ Murray Rothbard , "Milton Friedman Unraveled". Originally printed 1971 in *The Individualist*. Reprinted in *the Journal of Libertarian Studies*, Fall 2002.taken from internet site <http://www.lewrockwell.com/rothbard/rothbard43.html>.

²⁵ "Milton Friedman Gets Pieed", published on October 21, 1998, taken from an internet forum for anti-authoritarian political opinion, research and humor <<http://eatthestate.org/03-07/MiltonFriedmanGets.htm>>. date of visit July 3, 2008.

²⁶ Rinfret.

CONCLUSION

What is shocking is that in demanding a privatization of public education, he deprives poor and middle class youth, no matter how bright they could be, from their last chance to a decent existence in the future. Just the kind of comfortable life Milton Friedman, a son of poor immigrants, could enjoy thanks to public education and numerous scholarships.

PART II

The life and times of Jeffrey Sachs

Chapter 3

Early intellectual formation of Jeffrey Sachs

3.1 Biography and studies

Jeffrey Sachs is one of the most famous and influential American economists.

He was born in 1954 in Detroit and made brilliant studies in Harvard University, obtaining a Ph.D. He was 29 when he was offered a post of Economics Professor at Harvard, becoming one of youngest tenured professors. He is mostly famous for shock therapy and Millennium Villages Project. He worked as a Professor of International Trade, the Director of the Harvard Institute for International Development, and the Director of the Center for International Development. In 2002 he became the Director of the Earth Institute at Columbia University in New York City. He is also a professor of Sustainable Development.

In the 1980s-1990s he worked as an economic adviser in some countries of Latin America, in Poland and in Russia. His mission consisted in “helping” the country to make transition to the “normalcy”, that is the capitalism. In January 1994 he resigned from his post in Russia and put an end to his free-market promotion.

Since 2002 he has been actively involved in humanitarian aid to the Third-World countries, working on such global issues as poverty eradication, economical development, global health and environmental sustainability. He is a founder of Millennium Villages Project, a global approach to achieve Millennium Development Goals, concerning sub-Saharan Africa – a United Nations project to reduce extreme poverty by half, as well as child mortality, disease and epidemics by 2015. He worked as a Special Advisor to UN Secretary General Kofi Annan on Millennium Development Goals and he kept his post with a new UN Secretary General Ban Ki-moon.

In *The End of Poverty*, published in 2005, Sachs searches to increase people’s awareness about extreme poverty in the countries of the Third World and appeals to people’s generosity, so that the financial aid triples by 2015.

In his recent book, *The Common Wealth*, published in 2008, Jeffrey Sachs speaks about the evolution of the economics – taking into consideration all the global changes the planet is facing now, economics should be global.

3.2 His economic theory regarding Milton Friedman and John Maynard Keynes

In June of 2000, when giving an interview for *Commanding Heights*, he speaks admiringly of his two greatest inspirers, John Maynard Keynes and Milton Friedman.

At the beginning of his studies in Harvard, he remembers the battle of ideas between macroeconomics and monetarism. He assures being raised as a Keynesian and being told not to trust Milton Friedman and not to listen to him. But with time, as he began working on economic advising, he came to a conclusion that much of what Friedman said about specific monetary questions was right.

Jeffrey Sachs positions himself between the two theories, “not at either extreme”²⁷ of Friedman-Keynes’ debate.

He profoundly respects Friedman for insisting on his theory of markets’ power and efficacy and he himself says to rely on the strength of market institutions, whenever there’s a possibility, but adds that they can’t solve all the poverty problems.

He admires Keynes for understanding the necessity of such institutions like the IMF and the World Bank for the postwar world, calling him “the greatest clinical economist”.

He has enormous admiration for Milton Friedman for having helped to “restore a balance” but he says that he can’t agree with all the details and assures not being a free market economist “in all its glory”, as he considers that a government should play an important role in many areas.

²⁷ Interview with Jeffrey Sachs conducted June 15, 2000, for *Commanding Heights : Jeffrey Sachs on Keynes and Friedman*, www.pbs.org.

After reading the interview, one is tempted to conclude that Jeffrey Sachs had found the golden mean, a perfect equilibrium between the two completely opposite economic theories. Actually, it looks more like polishing image of “wise economic adviser”.

His experiences of economic advising prove to be rather rough, and he has not brought any country’s economy (with a slight exception for Poland) to a happy end.

No matter how many praises he showers on Keynes, he still stays a “product of Reagan America”, as Naomi Klein argues, giving him the nick-name of “The New Doctor Shock”. He couldn’t stay immune to the influence of Friedman’s theory of free-market supremacy, which spread among Ivy League universities in 1980s.

His only disagreement with Chicago School was that shock-therapy policies (the term he denies actually) should be accompanied by debt relief and financial aid. Gradually he’ll work only on procuring help. But before that he would help installing savage capitalism with his shock –therapy methods.

3.3 His theories in application

Jeffrey Sachs compares economy to an ecosystem, which is capable of self-regulating. So when giving complete freedom, without any government intervention, the market would stabilize itself, after a short period of decline.

The usual set of reforms promoted by Sachs included: no more state planning, no fixed prices, promote private competition with state-owned industry, and sell off state industry as fast as possible.

The first country where Jeffrey Sachs had the opportunity to see his theory in practice was Bolivia. Even though he was only thirty years old, he managed to impress Bolivian politicians so much with his confident speech about how he could stop hyperinflation in just one day that they invited him to work as an economic advisor for the government. Although he had no experience and knew “next to nothing about Bolivia”, as Naomi Klein writes, he readily accepted the offer, thinking that he knew all about inflation. During seventeen days, secretly created emergency economic team worked out the steps of radical restructuring of economy, i.e. shock therapy, according to Sachs’ advice. The entire state-planned economic system had

to be dismantled, food subsidies eliminated, oil price tripled, already low wages frozen, prices “given freedom”. Besides, there should be a complete freedom for imports, cuts in government spending and state companies’ staff should be reduced.

What is interesting to note that during the preparation of this “capitalist manifesto”, its developers kept the project in high secret. For Bolivian President, the more surprising and fast were the reforms, more chances they had to prevent a resistance. And he was right: people were so abashed that they did not have the time to organize.

3.4 Russia

In December 1991, president Yeltsin and his economic advisor, Yegor Gaidar, had a meeting with seven foreign economic advisors. They found Yegor Gaigar’s program for restructuring Russia, too gradualist. In exchange for a shock therapy approach to transition, Jeffrey Sachs, the leader of the advisory group, promised to get \$15 to \$20 billion per year as an international support. As a result, Gaidar’s program turned out to be a mostly a copy of the IMF’s reform model (i.e. of Chicago School) in order to gain IMF’s trust.

Famous for successfully advising on capitalist transition of Poland, Jeffrey Sachs was invited to advice on the transition in Russia.

Shock therapy was introduced on January 2, 1992, several days after the debacle of the Soviet Union. We see here the best traditions of Milton Friedman – only the country in crisis is the best patient. A gravity of shock that Soviet people experienced at the dissolution can be understandable for the peoples’ national proud was raised on the basis of “Indestructible Union of Soviet Republics...” – the words Soviet Anthem began with. All their life was based on the principle of stability of Soviet Union. This shock, destructing the roots of the Russians’ vision of the world, made the country a perfect ground for free-market experiments.

It was the end of the central planning system, that existed more than 70 years. Jeffrey Sachs stayed faithful to his principles: As seven years ago in Bolivia, prices were unleashed, government spending cut and the frontiers open to foreign imports and capital. In order to

fight inflation government austerity was advocated, together with rapid privatization of enterprises and the fast opening of the international trade.

3.5 Criticism

Nancy Holmstrom and Richard Smith, co-authors of the article named “*The Necessity of Gangster Capitalism: Primitive Accumulation in Russia and China*”, published in 2000 in an independent Marxist journal *Monthly Review*, criticize Jeffrey Sachs for using Neoliberal approach to the economy. Nancy Holmstrom, a professor of philosophy, specializing in Marxist and feminist theory, and Richard Smith, a history professor, specializing in China’s transition to capitalism, are accusing Jeffrey Sachs and his Chicago Boys of not knowing the history of capitalism in Europe. If they learned better the history, they would be able to predict the consequences of relying on Neo-liberal model of capitalism.

3.6 Conclusion

As the only thing that differentiates Sachs’ approach to economics from that of Friedmanites, is getting foreign help, it can be surely stated that Russia “enjoyed” a pure shock-theory treatment, as the much needed help didn’t come up during the first two “shocking” years, the most crucial of the economy. When the treatment came, ‘the patient’ was already lost.

Chapter 4

Applied economics – austerity plans, IMF, World Bank

4.1 The History of Creation

When in 1919 John Maynard Keynes published his book “*The Economic Consequences of the Peace*”, it rapidly became a bestseller on both sides of the Atlantic. He claimed that the conditions of the Versailles Treaty were too humiliating for Germany and the demanded reparations too heavy. The country was facing the severest economic crisis. He actually warned the world about the approaching catastrophe (the rise of Fascism) if the Versailles Treaty was not reconsidered.

After the World War II the West learned very well the lesson – a nation in economic crisis shouldn't be left on its own, otherwise it becomes a fertile ground for communism or fascism.

In 1944 in order to prevent the repetition of the World War II causes the World Bank and International Monetary Fund were created. Forty-four UN representatives of different countries assembled in Bretton Woods, New Hampshire to decide on a framework for international economic cooperation. John Maynard Keynes was the leader of the U.K. delegation. The Bretton Woods Agreement suggested a monetary system very similar to the one Keynes described in “*The Economic Consequences of the Peace*”. The purpose of the IMF and the World Bank was fighting poverty worldwide, preventing economic collapses like in Germany of 1930s. More precisely, the World Bank function was to make long-term investments in order to foster the country's development. The IMF's agenda was to provide loans and grants as well as recommending stabilizing economic policies. The IMF and the World Bank should coordinate their actions, so their headquarters are close to each other. Current 185 countries- members finance the institutions through quotas, which in their turn come from taxpayers.

4.2 Transformation of International Funding Institutions

In the 1980s with the Reagan and Thatcher counter-revolution, these institutions change completely their ideology. Based on the belief that the markets needed to be controlled, they advocate now free market supremacy. Their main goal has become “corporatist crusade”.²⁸

²⁸ Klein, 163.

Chicago School economists begin slowly and silently to “colonize” the IMF and the World Bank. By 1989 it became official that there existed “the Washington Consensus” – an agreement between The IMF, The World Bank and the U.S. Treasury about the right kind of policies for developing countries. The list of policies necessary for economical recovery of the “protégé”, included privatization of state assets, free trade, deregulation and cuts to government spending – Neoliberal “recipe” from Milton Friedman. As Joseph Stiglitz, the author of *Globalization and its Discontents*, 2002, wrote that “Keynes would be rolling over in his grave were he to see what has happened to his child.”²⁹

In the early 1980s there happened an ideological purge in the World Bank. With a new conservative government, William Clausen was appointed the World Bank’s president and Ann Krueger as chief economist. The group of economists, appointed by former World Bank president Robert McNamara, had been working on helping the governments of developing countries to reduce poverty. The new president and chief economist saw the situation differently – the government was a source of problem and free-markets were solution. Because of this split of ideologies many first rate economists left the World Bank.

If before Chicago School “Colonization” of the World Bank gave loans and recommended policies, then from the 1980s, radical free-market policies became the essential condition to having these loans. The poor countries faced ultimatum and being in desperate need of aid, accepted whatever policies the IMF advocated. The IMF still claimed acting in the interest of stabilization and prevention of crisis. But in reality, the governments were misled through “a combination of false pretenses and bold extortion”³⁰ as the economists knew that the free trade and privatization had nothing to do with creating stability.

4.3 Austerity plans: fiscal austerity, privatization, market liberalization

Joseph Stiglitz, a former Senior Vice President and Chief Economist of the World Bank, criticizes its actual polices. In his book *Globalization and Its Discontents*, he explains “that three pillars of Washington Consensus” – fiscal austerity, privatization and market liberalization became “ends in themselves” and they don’t serve a goal of sustainable development. While privatization and free trade, when they are done “in the right way and the

²⁹ Joseph Stiglitz, *Globalization and Its Discontents* (New York: W.W.Norton & Company, 2002), 13.

³⁰ Klein, 165.

right place”, can have sense and create new jobs, these policies were pushed too far and too fast, following a narrow ideological perspective.

In advocating rapid privatization there is a danger of vested interest as it brings much revenue to the government and much more if the monopoly is not regulated. This leads to corruption of the government high officials, who sell state enterprises at ridiculously low price and have a large portion of asset value for themselves.

The privatization in Russia can be a good example of “briberization”. In spite of free-market ideology that claimed that the economy would self-regulate itself, the privatization didn’t contribute to the economic growth but proved to have contrary effects. New owners instead of investing in the country’s industry placed their new gained wealth in western banks, as there hasn’t been yet any appropriate legal structure for protecting free-market.

Liberalization means no government interference in financial markets and removal of barriers to trade. Trade liberalization was the most popular among countries with multinational corporations. IMF claims that their aim is to eliminate the old inefficient jobs and create the new and more productive ones. It results in even greater unemployment as inefficient and old enterprises are getting closed and the new ones aren’t easy to create because of the lack of specialists and lack of bank financing. IMF austerity programs bring high interest rates – 20%, 50% or sometimes even 100%, making it impossible to create new firms and jobs, even in the economically healthy country.

The situation is aggravated by the Western countries’ hypocrisy: they push hard for exporting their goods to developing countries but at the same time, they protect their economy through subsidizing their agricultural sector and keeping their markets closed for the agricultural goods and textile where developing countries could have advantage.

These double standards, inequity and hypocrisy have been existing since the 19th century, when China was forced to open its markets to opium and to export the goods the West wanted at low prices. No wonder that developing countries have grown so hostile towards IMF and World Bank.

One of IMF policy requirements is abolishing subsidies on basic necessities, like prices for food, water, transport and energy. These austerity policies provoked “IMF riots” in more than two dozen countries, resulting in the loss of lives and civil freedom.

One of these riots happened in Malaysia in 1998. The IMF ignored the warnings about the danger of social and political unrest that was growing since food and fuel subsidies for poor were cut back. When riots exploded, Indonesian businessmen and their families became the victims. When food subsidies were restored, business confidence as not to be restored and capital was driven out of the country.

According to Joseph Stiglitz, risking social and political turmoil is one of the “most grievous mistakes” of the IMF.

Even high IMF officials acknowledge policy failure of IMF and World Bank. Mohsin S. Khan, the Director of the Middle East and Central Asia Department of the IMF expressed his doubts in 1990s:

Although there have been a number of studies on the subject over the past decade, one cannot say with certainty whether programs have “worked” or not... On the basis of existing studies, one certainly cannot say whether the adoption of programs supported by the Fund led to an improvement in inflation and growth performance. In fact it is often found that programs are associated with a rise in inflation and a fall in the growth rate.³¹

4.4 IMF- World Bank and military dictatorships

IMF and World Bank’s support of military dictatorships since the 1980s is one of the most controversial topics. Eric Toussaint, president of the Committee for the Cancellation of the Third World Debt, a Belgian historian and political scientist claim that IMF opposes the human rights protection, labor rights, democracy and supports military dictatorships that are friendly to western corporations. In his 2004 article, written for the sixtieth anniversary of Bretton Woods Agreement, he denounces IMF-World Bank strong political involvement in order to reduce the progress of movements that could jeopardize “the domination of major

³¹ Mohsin Khan, “The Macroeconomic Effects of Fund Supported Adjustment Programs”, IMF Staff Papers, Vol.37, No.2, 1990,196

capitalist powers".³² These institutions don't respect one of the most important resolutions of the charter about objectivity concerning country's economy and politics. The political partiality can be easily proved by IMF's financing the dictatorships in Chile, Brazil, Nicaragua, Congo-Kinshasa and Romania.

Eric Toussaint claims that IMF – World Bank political and economical involvement began as early as in 1950s, when The World Bank installed its agencies in its client countries. It was its first step in controlling the client's internal affairs.

In 1956 the World Bank, with the financial help of Rockefeller and Ford Funds, created Economic Development Institute, which was to train during 6 months delegates from the member countries. Those policies proved to be efficient as The New-York based Center for International Legal Studies discovered that these agencies seriously undermined political party system and heavily influenced political structure and social development in Colombia from 1949 to 1972.

The political situation of the future debtor is crucial to the World Bank decision to give a loan, although that is contrary to the Bretton Woods Agreement, where in Section 10 political activity is clearly prohibited:

The Bank and its officers shall not interfere in the political affairs of any member; nor shall they be influenced in their decisions by the political character of the member or members concerned. Only economic considerations shall be relevant to their decisions, and these considerations shall be weighed impartially in order to achieve the purposes stated in Article I.³³

Eric Toussaint writes that the Bank many times circumvented this prohibition. France was given a loan only in 1947, the day after the Communists left the government. Until then France's request for the loan stayed blocked. And on the contrary, IFI didn't hesitate to give help to a country under military dictatorship, as long as it was in U.S. and Western shareholders' interests.

³² Eric Toussaint, "World Bank-IMF support to dictatorship," 28 September 2004. Taken from the internet site: <<http://www.cadtm.org/spip.php?article809>>. date of visit August 12,2008.

³³ IBRD Article IV: Operations of the World Bank, Section 10. Taken from the internet site of the World Bank: <<http://web.worldbank.org/WBSITE/EXTERNAL/EXTABOUTUS/0,,contentMDK:20049603~pagePK:43912~piPK:36602,00.html#I11>>. Date of visit August 9,2008.

One of these countries was Chile. When Allende was democratically elected president in 1970 and was developing the projects of nationalization, the country was not considered as credible and did not receive any loans from IFI. But it suddenly merited loans in 1973, when the country fell under Pinochet dictatorship. This help was not in the interests of the people, as a Bretton Woods charter says, but in the interests of few people, the heads of multinational corporations, who had much money to lose from Allende's nationalization.

Another example can be 1960s Brazil. When Brazilian president Goulart announced nationalization of oil refineries, he was military overthrown on April 1964. On the next day the United States recognized the regime in Brazil and the IMF unblocked the loans. The recognized regime was that of severe repression, torture, violation of human and labor rights.

The history repeats with Nicaragua under Somoza's dictatorship, Zaire under Mobutu dictatorship and with Ceausescu dictatorship in Romania.

During the Cold War, IFI's policies corresponded to Truman Doctrine: they financially helped the countries to withdraw themselves from the Soviet influence (as Yugoslavia and Romania) and in order to distance the USSR and the Third World countries, China and Indonesia received IMF loans.

4.5 Lost Reputation of the IMF and the World Bank

The former Vice president of the World Bank, Joseph Stiglitz, is sure that the IMF "has failed in its mission"³⁴. The Fund couldn't meet its most important engagement – to help the country in need to restore its employment and promote its global stability.

Looking back on the past quarter century, almost hundred countries had experienced crises, more frequent and deeper than before (except the Great Depression). But all the IMF could contribute to- turned out to be global instability, and global impoverishment.

³⁴ Stiglitz,15.

As for another mission – guiding countries’ transition from communism to a market economy, it was not more successful.

Jeffrey Sachs, a Russian “guide” into transition, also blames the IMF. In 1998, when giving an interview on PBS to Charlie Rose, his general criticism of the IMF is founded on assertion that “the IMF programs are not working”³⁵, not only in Russia, but all throughout Asia and Africa. He declares that the IMF “has missed every single target that it set by a mile” as Asian countries have negative growth as a result of the IMF interventions. In his view, the IMF is so wrong because they preach extraordinary monetary tightness which, together with private capital outflow, results in a “vastly deeper recession”. When the IMF officials decide to renegotiate as each time the situation turns out worse than they thought, it’s because “there are working on a wrong model”. Jeffrey Sachs sees their problem in being protected from competition, as an official community instrument. That is the advantage that allows them to “go in and continue to make the same mistakes year after year”.

He makes the Fund responsible for the awry transition in Russia, as they delayed the aids.

As a result of its policies, the IMF faces now a crisis of credibility. With high oil prices, Venezuela managed to emerge from the crisis and is now lending to other developing countries. The results are dramatic for the IMF- it’s losing its clients: Brazil, Nicaragua, Venezuela and Argentina. The IMF’s influence is disappearing: three years ago it was lending \$81 billion and now the sum has shrunk to \$11.8 billion³⁶

The World Bank is sinking too: in 2007 Rafael Correa, Ecuador’s president, planning the nationalization of oil resources, declared the World Bank’s representative persona non grata in the country and suspended all loans from the Bank. Ecuador’s foreign Minister Maria Fernanda Espinosa accused the World Bank court for investment disputes for “ruling in favor of U.S. interests”.³⁷ By the end of the year, Ecuador withdrew from the court. The ICSID

³⁵ Interview with Jeffrey Sachs conducted on July 13, 1998, available on the internet site: <<http://www.charlierose.com/shows/1998/07/13/2/a-conversation-with-economist-jeffrey-sachs>>, visited on August 12, 2008.

³⁶ Klein, 457.

³⁷ “Ecuador withdraws from World Bank Court for Investment Disputes,” *International Herald Tribune*, December 14, 2007. Taken from internet site : <<http://www.iht.com/articles/ap/2007/12/14/business/LA-FIN-Ecuador-World-Bank-Court.php>>, visited on September 2, 2008.

makes it possible for the corporations to sue poor countries for measures that cost them profits.

Ecuador would be followed by Bolivia: Evo Morales took a bold step and announced the country's withdrawal from the World Bank arbitration court and nationalization of state resources.

CONCLUSION

We see that the IMF and the World Bank give loans with only one goal – to influence the countries' policies (Although that is radically different from initial IFI engagements). The main decisive factor stays strategic and politic interests of major western corporations.

Part III

Effects and Consequences of Neoliberal Reforms

Chapter 5

Russia. Causes and Consequences of Neo-liberal Reforms

5.1 Historical Context

During the 1980s, American government was more and more unwilling to spend on foreign affairs. While during Reagan years the military expenditures increased, the expenditures on foreign aid dropped from \$12.7 billion in 1981 to \$10.5 billion in 1988³⁸. When George Bush took the office in 1989, U.S. was beginning to have financial problems, which was one more reason for reducing financial help to developing countries.

The Soviet Union, at the same time, was facing economic collapse as the prices on oil plummeted. It was impossible to continue to assist its friends in the Third World. The struggle for the world influence was over, as well as the arms race. The Bush administration welcomed the end of the arms race as it was looking to reduce the defense budget. The USSR in its turn wasn't a rival any more, on the contrary, Gorbachev looked to the U.S. for loans.

In November 1990 George Bush announced the America's victory in the Cold War. The policy towards Russia had to be reconsidered, though many in the U.S. government were reluctant to help, still seeing in Russia its ancient rival and potential enemy.

When Gorbachev was forced to resign in August ,1991 and after Yeltsin's decision to dissolve the Soviet Union in the end of the year, Yeltsin turned to the U.S for credits and investment. All that Bush's administration agreed to give was food. (One of these products, chicken legs – so called “Bush legs” continue to flood Russian market, making it the world's largest importer of American chickens. They are often blamed to be responsible for “killing off Russian poultry farming”³⁹)

³⁸ Stephen E. Ambrose & Douglas G. Brinkley, *Rise to Globalism: American Foreign Policy since 1938*, 8th edition, (New York: Penguin Books, 1997),370.

³⁹, “Russia's U.S Chicken Ban in Force”, BBC News, March 10,2002, taken from internet site: <<http://news.bbc.co.uk/2/hi/europe/1864844.stm>>, visited on September 4, 2008.

5.2 “Grabification”

In 1991, at the G7 summit it was made clear to Gorbachev that if Russia wanted to get any loans, it had to apply radical economic shock therapy immediately. The message of the IMF and the World Bank was the same – rapid transition to free-market economy. Russia had to open its frontiers to free trade and undergo fast privatization of about 225.000 state-owned companies.⁴⁰

In the end of 1991 Jeffrey Sachs was invited by president Yeltsin to advise on the transition. But there was something that Yeltsin needed even more than advice – he wanted Jeffrey Sachs to repeat the same successful fund-raising as for Poland.

The result of the IMF-promoted reform was as usual: much deeper economic crisis, mass impoverishment, and privatization transforming into vulgar pillaging, corruption, grow of criminality, no social protection and dramatic decrease in life expectancy.

According to Marshall Pomer Russian transition had so disappointing results because it was “poorly conceived, hastily executed and corruptly managed”.⁴¹

“Rapid-fire” privatization caused the most damages to the Russian economy and the well-being of Russian citizens, creating so-called oligarchs.

When speaking about disappointing result of the Russian “reform”, Jeffrey Sachs likes to blame corruption and indecent government behavior.

In the interview he gave to Charlie Rose, an American journalist on PBS in 1998, he complains about high corruption in Russian government, which had been abusing of the western aid during 6 years or of a sum of \$22 billion.

He also explains that the Russian great mistake was pushing out billions of dollars of natural resources wealth to “Yeltsin’s insiders”.⁴² He acknowledges his mistake (he uses plural

⁴⁰ David McClintick, “How Harvard Lost Russia”, *Institutional Investor*, published on January 1, 2006. Available at internet site <<http://www.uvm.edu/~wgibson/How%20Harvard%20Lost%20Russia.pdf>>, date of visit September 2, 2008.

⁴¹ Marshall Pomer, Demise of the Command Economy, in *The New Russia: Transition Gone Awry*, eds. Lawrence R. Klein and Marshall Pomer (Stanford: Stanford University Press: 2001),140.

⁴² Interview with Jeffrey Sachs on July 13, 1998.

pronoun here) of ignoring the savage character of privatization. They (apparently, he means the team of economic advisers he headed) should have said to the Russian government that they didn't like that "all of a sudden Gas Prom finds private owners who paid absolutely nothing to get those shares or oil companies that were just given away to Yeltsin's friends, with the money turned around to help financing reelection". Jeffrey Sachs is sure that could have made their behavior better and the crisis of 1998 would have been less painful.

Instead they "turned their eyes away", pretended that there were no problems and that the government behaved according to rules of law.

But Sachs doesn't say anything about what gave birth to this corruption and bad behavior. It was exactly the shock therapy prescribed to Russian economy that made all these horrors possible, and which policies he himself promoted.

In 2000, Nancy Holmstrom, philosophy professor and Richard Smith, a historian, argue that the reason Western economists were so disappointed in Russia is that they used Neoliberal model of capitalism," historical-fantasy-world". Western economists were horrified at "the viciousness and rapaciousness" of Russia's new Mafiosi capitalists.⁴³

But the main reason of it is not Russian communist past and mentality, as Jeffrey Sachs insists, but as Holmstrom and Smith explain, a lack of proper capitalist class. Jeffrey Sachs, faithful to self-regulating free-market theory, thought that once free-market policies were launched, the capitalist class would form itself rapidly. But they did not.

Until the collapse of the USSR, all the assets were state-owned, the capitalist class did not simply exist, no one was wealthy enough to afford to buy factories, oil companies, forests, the mines etc. Because of the extreme rapidity of privatization the capitalist class didn't have the time to form itself so it was "hot housed", "side-by-side with growing millions of unemployed and starving". As nobody could buy rapidly 225.000 state properties, then there was no way of doing privatization legally. So they were people close to Yeltsin entourage who got the loot: from top managers of industries and relatives to elements of mafia. Two scholars are directly blaming Jeffrey Sachs and his Harvard Institute for International Development as

⁴³ Nancy Holmstrom, Richard Smith, "The Necessity of Gangster Capitalism: Primitive Accumulation in Russia and China," *The Monthly Review*, February 2000. Available at the internet site: <www.monthlyreview.org/200holm.htm>. Date of visit August 10, 2008.

being responsible for the creation of gangster capitalists, as it was under the leadership of Sachs that the privatization framework was developed.

Secondly, as there weren't definite laws protecting private property, Russian capitalists were afraid to invest at home, preferring putting their money into safe foreign banks.

Bertell Ollman, a professor of politics in New York University, who specializes in Marxist theory wrote in 1993 that building capitalism in Russia was idealist mistake. He reminds that the basis for creation of capitalism is lacking in Russia : first, there's no wealthy capitalist class and "mafia and managers with some savings"⁴⁴ don't count; second the working class isn't desperately poor, "malleable" and "ready to do anything to survive" and Soviet goods are not competitive for foreign markets.

Ollman characterizes transition as a counterrevolution against the working class. He was sure that this attempt to build capitalism would fail, and he was right. It was another sort of capitalism that turned out – a savage gangster capitalism.

5.3 Consequences

Free-market policies killed Russian industry: without government subsidies, with "liberalized" prices on raw materials and with a huge flow of foreign goods, many enterprises rapidly became insolvent. Moreover, Russian industry lacked technology in order to be competitive on foreign markets.

The transition to "normalcy" actually transformed the country from one extreme to the other : from Stalinist bureaucracy to a dominance of gangster capitalists.

Shock treatment, that bitter but necessary medicine for recovery the Russian economy turned out to be poison. Naomi Klein compares it to the war, with 100.000 casualties – Yeltsin's October coup and the war in Chechnya – the "little victorious war" designed to restore Yeltsin's popularity.

The economic experiments in the middle of the 1990s plunged about 74 million Russian people into extreme poverty, the suicide rate increased by 50%, life expectancy declined from

⁴⁴ Bertell Ollman, *Dialectical Investigations*, (New York: Routledge, 1993), 117.

64 years in 1988 to 56 in 1994.⁴⁵ With 50.000 annual deaths caused by alcohol poisoning, Russian men appear to be on a mission of destroying themselves with alcohol, drugs and cigarettes.⁴⁶

In present times, the patient has not yet recovered: in 2006 according to UNICEF, there are 3.5 million homeless children in Russia.⁴⁷

The shock therapy was more a shock than anything else – a huge blow on human psyche. With mass unemployment, healthcare and social services destroyed, no wonder people didn't see the light in the end of the tunnel and found the reality unbearable.

It proves the dramatic rise in alcohol consumption – more than twice under communism, the number of heroin addicts attained 4 million people in 2004, which is followed by AIDS epidemics - by 2005 UNAIDS counted about a million of HIV-positive.⁴⁸

5.4 Economists' viewpoints

William Easterly, Professor of Economics at New York University, who worked on 1990s' Russia with the World Bank confesses that he believed in shock therapy and it took him and some other economists "a decade of failure" to see that enforced free-market policies did not work. He and a group of experts had to acknowledge that "overnight transformation to a market economy"⁴⁹ is utopia.

When Charlie Rose asked Jeffrey Sachs where was he wrong with Russia, he couldn't give a direct answer, he just said that he was too optimistic about the Western Aid.

Naomi Klein, one of his major critics, would interpret this "optimism" as fatal for Russian economy, as he assured president Yeltsin than the help was coming, when actually, it came only two years later.

⁴⁵ UNDP, Russia Human Development Report, 2005. available at internet site <<http://www.undp.ru/index.phtml?iso=RU&lid=1&cmd=publications1&id=48>>.

⁴⁶ Anna Smolchenko & Staff Writer." UN Pleads for a Change in Behavior". Taken from internet site <<http://www.undp.ru/index.phtml?iso=RU&lid=1&pid=1&cmd=text&id=129>>. Date of visit July 15, 2008.

⁴⁷ Carel De Rooy, UNICEF, *Children in the Russian Federation*, November 16, 2004, 5 available at internet site: <www.unicef.org>.

⁴⁸ UNAIDS, "Annex 1: Russian Federation," 2006 Global Report on the AIDS epidemic, May 2006, 437. Available on the internet site: <www.unaids.org>.

⁴⁹ William Easterly, *The White Man's Burden: Why the West's Efforts to Aid the Rest Have Done So Much Ill and So Little Good*, (New York: Penguin Books, 2006), 61.

Jeffrey Sachs in his book *The End of Poverty*, published in 2005, gives his viewpoint on Russian reform.

First he calls Russia “a world apart” for its numerous “staggering” differences. He depicts a really horrible picture, which makes it look like a condemned country, extremely difficult to be changed. The author especially compares Russia with Poland and China, the countries where, to his mind, his reforms went on rather successfully.

According to J. Sachs, everything was wrong in Russia for its successful conversion: first, its past, that had never been “normal”—“the thousand years of autocracy”, “seventy-five years of central planning”, centuries of serfdom with peasants without freedom as majority of the population. Second, its population: “four times as large as Poland’s”. Then come geography and demography (“a huge landmass” with “often forbidding climate”, few and far-located cities that didn’t favor international trade development). Speaking about China, he assures that the reforms worked out thanks to its “very different [from Russia] geography, geopolitics and demography”.⁵⁰ And finally, he speaks about cultural and even linguistic differences.

The mentioning of the linguistic differences between Poland and Russia seems especially unjustified, as both languages belong to the Slavic family and resemble very much.

Another difficulty for well conducted reforms, according to J. Sachs was that Russian leadership was badly educated and had no experience of market economy. The most experienced of them was E. Gaidar, who had spent a few weeks in the West.

All it looks like a real challenge, but that doesn’t make it impossible for a well-educated and experienced economist (especially when it is a case of “the leading international economic advisor of his generation”⁵¹ and “probably the most important economist in the world”⁵²) to transmit his knowledge, advise and control useful (if that’s what they really were) economic reforms.

It is interesting to see that those explications go before the description of his work, as if it was a warning to the readers (and thus excusing the author beforehand) that the reforms were not

⁵⁰ Jeffrey D. Sachs, *The End of Poverty: Economic Possibilities for Our Time* (New York: Penguin Books, 2005), 147.

⁵¹ “Prof. Jeffrey Sachs, Director,” Internet site of The Earth Institute at Columbia university <<http://www.earth.columbia.edu/articles/view/1804>>. Date of visit July 3, 2008.

⁵² Peter Passell, “Dr. Jeffrey Sachs, Shock Therapist”, *New York Times*, June 27, 1993. Available at internet site <<http://query.nytimes.com/gst/fullpage.html?res=9F0CE7D7143EF934A15755C0A965958260>>. Date of visit July 2, 2008.

going to work out well and the conversion would be “the hardest in modern history” and apparently not the most successful one.

So, whose fault was it (except Russian abnormal realities) that the reforms degenerated?

According to the author of *The End of Poverty*, his own work mostly consisted in providing financial help from the West. But his attempts turned out to be unsuccessful because of “Western obtuseness”(including one of many mistakes made by IMF analysts) and the change in American foreign policy (the secretary of Defense Richard Cheney and his deputy Paul Wolfowitz saw Russia as a “continuing threat”) and the G7, who obliged Russia to pay the Soviet-era debts. He acknowledges that he wouldn’t have been so optimistic about foreign aid, if he knew that beforehand. But as Naomi Klein, the author of *Shock Doctrine*, says, his fault was not only in being so optimistic about getting \$15 billion per year, but of having assured president Yeltsin of the coming help: “Sachs had pushed hard for shock therapy before he had any guarantee”⁵³ He took an enormous risk in being so over-confident and it cost dearly to millions of Russian people.

As for the “shameless, criminal and phony” privatization process that followed in 1995 and 1996, it had nothing to do with Jeffrey Sachs, according to his words: “the worst occurred when I was watching from the sidelines”⁵⁴. But just the fact that he left Russia by this time cannot excuse him of the reforms that continue the same policy framework, established during his presence.

Concluding his chapter on Russia, Jeffrey Sachs looks back on the reforms and doesn’t regret them for the most part: “the reforms needed to be made” and “the changes made sense” even without foreign help. Moreover, he saw his help as extremely necessary for the destiny of this country as well as for the rest of the world: otherwise Russia would have turned into an anarchist state, would have fallen into the hands of a new tyrant, the civil war could have broken out or a new state would be a menace for the West security.⁵⁵

(Speaking about menacing anarchy for Russia, it is interesting to note that, according to William Easterly’s view point, recent cases of anarchy are preceded by nothing else but the

⁵³ Klein, 249.

⁵⁴ Sachs, 143.

⁵⁵ Ibid.,135.

IMF and World Bank involvement, which although indirect causes, don't have a positive long-run effect on a country's economy.)⁵⁶

As noted by Naomi Klein during her interview with Jeffrey Sachs, there were some aspects which he "glossed over" repeatedly, such as his demands for quick privatization and large cutbacks, which are nothing less than shock therapy itself. It is quite the same case in the book: he totally concentrates on his activity of fund-raising, leaving the subjects above nearly untouched, including the putsch of 1991! For him it was rather a good sign, which predicted more power for Boris Yeltsin.

As a result of his activity, J. Sachs has certainly "saved" the Russian people from civil war or a possible tyrant communist leader, but as a result the people now are living under another sort of tyranny: that of rich business people (including oligarchs) over the poor.

CONCLUSION

The modern times are the times of the search for the new territories to colonize. With neoliberal reforms it becomes possible, as they produce Neocolonialism.

Free-market policies oblige poor countries to rely on the export of raw resources, such as coffee, wheat, copper or oil. The country becomes particularly vulnerable then. If a price of one of these resources suddenly goes down, its entire economy collapses. Not being able to pay back loans, the government has to take more loans to cover its debts, with more interests. The vicious circle begins then when one crisis is followed by another. And the country has no other choice but to accept "structural adjustment" from the IMF.

One of Russia's main functions actually is a source of raw materials, and a market for imported goods. This process undermines Russia's technological potential and is called by Marshall Pomer a process of "de facto colonization".⁵⁷

⁵⁶Easterly,67.

⁵⁷Pomer,10.

Chapter 6

Latin America – Restricted Freedom

Historical Context

Latin America is one of the regions where IMF-World Bank involvement had disappointing results. A period of state intervention from 1950 to 1980 ended in a debt crisis and the countries had to turn to the IMF and World Bank for help. As usual, they could get the loans only with condition of undergoing structural adjustment or the shock therapy. But the IMF intervention didn't bring economic growth, actually the best growth the Latin America had was before the IMF stepped in. In 2003 per capita income hardly doubled in comparison with the level the Latin America had 50 years ago. According to William Easterly's prognosis, it should have tripled without the IMF help. It's no wonder that actually there is a strong negative reaction against free markets in Latin America, with "free markets tarnished by the utopian expectations of structural adjustment."⁵⁸ But the most astonishing in all these IFI policies is the West's response to their repeated failures – to continue structural adjustment loans, only changing their name to "poverty reduction loans". Naomi Klein indignantly writes that instead of questioning and overhauling their laissez-faire theories, they apply a "junkie's logic: Where is the next fix?"⁵⁹

The disastrous effects of shock therapy, as well as the U.S. interests in applying it can be well illustrated by examples taken from the recent history of Chile and Bolivia.

6.1 Chile, a Chicago School pattern for changing the world

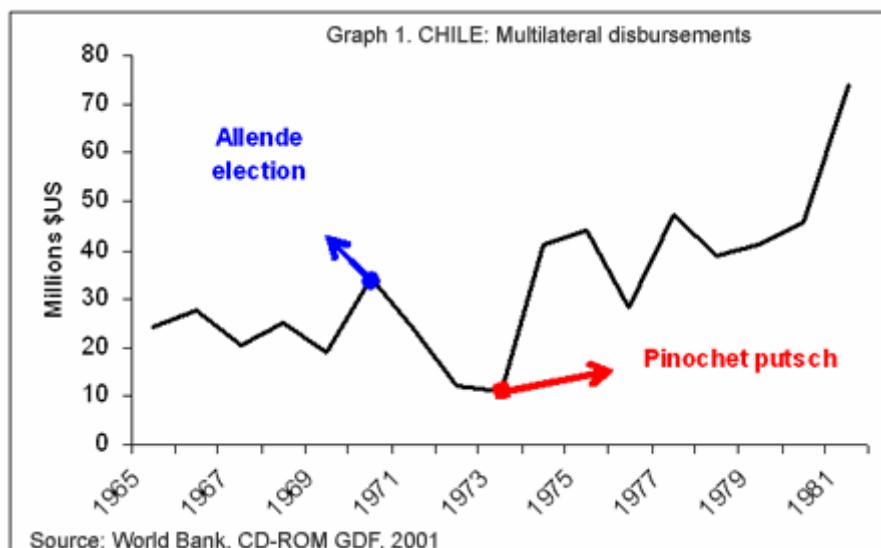
By the end of 1960s the USA had huge investments in Chile, which constituted about 20% of all its foreign investments. The profits the corporations were receiving were staggering. For example, Chile's copper mining industry brought \$7.2 billion to its investors, with only \$1

⁵⁸ Easterly,71.

⁵⁹ Klein,87.

billion invested.⁶⁰ The ITT, International Telephone and Telegraph Company, owned 70% of shares of Chile's phone company.

In 1970 Chilean people elected a socialist Salvador Allende. He froze prices on necessities and raised wages to improve the life of the poor. When he declared the nationalization of private industries and copper companies, including phone company, corporate America declared war on his administration. Its aim was to make Allende resign by provoking economic collapse in the country by cancelling all the loans and boycotting Chile's copper. They went even further and financed Allende's overthrow by general Augusto Pinochet in September 1973. The overthrow, which Pinochet preferred calling a war, actually was the slaughter of Allende and his supporters. The presidential palace was bombed and his colleagues tortured and executed in a football stadium. Although these atrocities as well as dictatorship regime of Pinochet were widely known, the country somehow became trustworthy for getting IMF loans.



The loans came together with the help of the Chicago Boys, who developed "The Brick" – a new economics program, faithful to that proposed in Milton Friedman's *Capitalism and Freedom*: privatization, deregulation and reducing of social expenditures. The Chicago Boys

⁶⁰ Sue Branford and Bernardo Kucinski, *Debt Squads : The U.S., the Banks, and The Latin America*(London: Zed Books,1988),51-52.

hoped that once these measures applied, economy as a natural self-regulating organism would stabilize. But they were mistaken: next year, the inflation grew to 375%.⁶¹

In order to stay in power, Augusto Pinochet promoted terror – 13.500 civilians imprisoned, resistant or suspected people executed in the football stadiums, their bodies thrown outside so that population get frightened and understand what would happen to them if they resist. Terrified country is the best ground for administering Friedman's free-market reforms. Indeed Friedman's most extreme proposals were realized: privatization of public schools, health care, kindergartens, social security system and even cemeteries.

As it would happen twenty years later in Russia, local businesses were closing for lack of competitiveness, as cheap foreign goods invaded the Chilean market. As enterprises were closing, people were being thrown out of work and hunger was spreading fast.

The western media praise Pinochet for producing Chilean economic miracle, but in reality they had nothing to do with market reforms. A steady economic growth began only in the middle of 1980s, when Pinochet had to make some radical concessions facing Chile's economy crashing with debts, hyperinflation and mass unemployment – he nationalized many companies.

A Chicago Boy Jeffrey Sachs also believes in miraculous recovery thanks to market reforms. In his interview for *Commanding Heights*, he says: "So by 1985 Chile was just starting to recover in the context of those market reforms."⁶²

So we see that William Easterly was right when speaking about eternal IMF mistakes, that IMF officials don't learn from them and continue the same policy. Or maybe, as Naomi Klein suggests, these disastrous effects the shock therapy provokes each time don't happen by accident but "perhaps it was meant to do exactly what it did – hoover wealth up to the top and shock much of the middle class out of existence."⁶³ Finally it all comes down to the war of the rich against the poor, disguised into sophisticated scientific theories. This war had terrible casualties – about 3.200 executed, 80.000 jailed and 200.000 that exiled.

⁶¹ André Gunder Frank, *Economic Genocide in Chile : Monetarist Theory versus Humanity* (Nottingham, UK: Spokesman Books, 1976), 81.

⁶² interview with Jeffrey Sachs on June 15, 2000.

⁶³ Klein, 86.

The pattern of corruption was laid in Chile also: corrupted privatization when huge public wealth goes into private hands and as for the huge private (in Chile's case, military) debts, they are paid out of taxpayers' pockets. That will be exactly Russia's case when IMF's loans were embezzled during 6 years and paid recently back out of stabilization fund – money for increasing pensions, teachers' salaries etc.

As William Easterly notes, during all the history wealthy elite was making concessions to the poor in order to prevent the revolution. In 1990 the Chilean military oligarchy had to make concessions too. But before accepting democracy and ceding the power to a new elected government, they put conditions: to protect private-property and free-market reformers they had earlier installed. To Naomi Klein's view, it was a lost battle: the Chicago Boys "rigged the constitution and the courts"⁶⁴ so as the shock doctrine reforms were actually strengthened and irreversible. That was what they called "technified" or protected democracy.

6.2 Bolivia – the first experimental ground for Jeffrey Sachs

Bolivia was the first country where a "fledgling" advisor Jeffrey Sachs tested his capacities and saw his theories in action.

Since being colonized by Spain, Bolivia was heavily exporting silver and gold. After having independence in 1825, its state wasn't much different from a colony: Indigenous people had to pay rents for the land to wealthy European landlords. The revolution of 1952 took a conservative turn and up to 1981 there happened eight coup d'état. When democratic government took finally power, the country was seriously indebted, with hyperinflation reaching 25.000% in 1985.

When Bolivian politicians visited Harvard and listened to Jeffrey Sachs propositions to stop inflation in one day, they invited him to work as an economic advisor. Although Jeffrey Sachs was young and never "operated" his shock treatment on such difficult cases as in Bolivia, he was confident enough. He believed in Friedman's free-market supremacy, that a country needed a sudden policy shock which would reanimate its economy to normalcy. The economy needed radical restructuring, which included destroying state-centered economic model: cancellation of food subsidies, cuts in government spending, liberalization of trade,

⁶⁴Klein,204.

significant lowering of tariffs on imported goods, liberalizing prices and reducing state companies. So that the people wouldn't have the time to organize a revolt, these policies were conducted extremely fast, in the first hundred days. Nevertheless people reacted by a general strike, and on the tenth day the union leaders declared a hunger strike. The government took advantage of it and declared a state of emergency, with tanks driving on the streets of the capital. Demonstrations were dispersed with tear gas, more than one thousand of demonstrators arrested. Police didn't hesitate to open fire on strikers, later explaining that they were attacked. The most influential union leaders were sent to jails in the Amazon. They were released only after the unions abandoned their claims. The state mining union was crashed and about 24.000 lost their jobs and populated shantytowns surrounding La Paz. At the national level, there were about 50.000 public workers who lost their job. The same story repeated a year later when tin mining strikers were finally forced to give in as their leaders were kidnapped.⁶⁵

Thanks to these drastic measures, the inflation was tamed and it was one of the most popular success-stories of Jeffrey Sachs who told it in *Commanding Heights* interview: "No question, Bolivia made a fundamental turn towards stable, constitutional rule... And it made a fundamental turn towards economic growth, all of which one can date quite clearly to the period." But he doesn't mention what it cost to Bolivian People and what repressions were needed to introduce his shock therapy. As Naomi Klein names those measures "quasi-fascist" which were needed for enforcement of Jeffrey Sachs' "normalcy".

One of results of shock therapy is that people turned to coca growing, as its profits were ten times higher than growing other crops. Two years after applying shock therapy, Bolivian illegal drug export exceeded all its legal exports combined.

The western media of those times were all telling a Bolivian "success story" which made Jeffrey Sachs a star economist and launched his career as an advisor to crisis-struck economies. According to Boston Magazine, Jeffrey Sachs was a hero who "salvaged the inflation-wracked economy of Bolivia".⁶⁶

At the present, structural adjustment programs are still extremely unpopular in Bolivia, as well as in the other countries of Latin America. In 2000 there were demonstrations against

⁶⁵ Catherine Conaghan and James Malloy, *Unsettling Statecraft: Democracy and Neoliberalism in the Central Andes*(Pittsburgh, PA : University of Pittsburgh Press,1994),149.

⁶⁶ John Sedgwick, "The World of Doctor Debt", *Boston Magazine*, May 1991.

IMF programs in Argentina, Bolivia, Brazil, Colombia, Costa Rica and Honduras. They also provoked a strong movement of anti-Americanism in Latin America.

6.3 Conclusion

The reality is much different from Jeffrey Sachs' success stories. What it certainly proved one more time was that shock therapy cannot be imposed democratically and without repression on resisting social groups and democratic institutions. And what is worse that these drastic economic measures are conducted in the name of democracy and freedom, in the name of Bretton Woods Agreement – saving people from poverty.

GENERAL CONCLUSION

From a free-market prophet Jeffrey Sachs has transformed himself into an anti-poverty activist and charity collector.

The real reason for this evolution of thinking only Jeffrey Sachs knows.

Maybe it was “the colossal failure of shock-therapy in Russia that contributed in no small part to Sachs’ transformation from a Friedmanite crusader into an aid and development do-gooder.”, as one Russian journalist supposes.⁶⁷

But the progress in his thinking is clear: he criticizes IMF programs, and recently as adviser to UN secretary-general, he asked for changes in food aid programs. He said that just sending food couldn’t resolve poverty and suffering, that the solution was in helping poor countries grow their own food: “If you help them to grow more food rather than shipping food aid, you’ll produce an escape from poverty”⁶⁸

⁶⁷ Alexander Zaitchik, “Naomi Klein Takes Downs The Shock Therapy Quacks”, taken from internet site <http://www.exile.ru/articles/detail.php?ARTICLE_ID=15607&IBLOCK_ID=35&phrase_id=8076>, December 25, 2007.

⁶⁸ “UN Adviser Calls for Overhaul of Food Aid System,” *Democracy Now!*, headlines for May, 6, 2008. Taken from the internet site <<http://www.democracynow.org/2008/5/6/headlines#8>>, date of visit June 20, 2008.

This of course, is not a new idea, and it does not explain why Jeffrey Sachs engaged in Neo liberal economics for so many years.

As far as I know, he hasn't yet asked Russian people for a pardon or publicly repented. (If he did, actually, maybe he would direct his charity programs to his former experimental victims).

We cannot help but ask if Jeffrey Sachs is cynical in this posture of a new reincarnation.

Boris Yeltsin is one of his favorite scapegoats, which is rather convenient, taking into consideration that Jeffrey Sachs's favorite "culprit" has left this world.

From an ordinary Russian's point of view (I was born in Russia in 1983), Yeltsin certainly has a part of responsibility for the hardships which together with terror in Chechnya, we had to face. But my research has led me to conclude that Yeltsin was a creation of Sachs' policies. If it had not been Yeltsin, it would surely have been someone else who would have committed the same crimes or even worse, for as long as the "shock therapy" policies made it possible.

His reasons for abandoning the free-market dogma which he had so distinctively promoted in Russia and everywhere for so many years and for suddenly converting to poverty-fighting crusader might be explained by a secret remorse for the promotion of the "shock therapy" or it might be simply, just like some politicians (Albert Gore) and celebrities (L. Dicaprio, Angelina Jolie, Bono etc), he is following a more fashionable path advocating environmental protection and humanitarian activities.

In any case, after many months of researching and writing this mémoire, there is one thing above all that became very clear for me: I know who to thank for my materially impoverished childhood, when I was a teenager. I saw my father lose the job he loved the most, working as an airplane pilot in Siberia and my mom's constant stress and anxiety during several years, as her colleagues were being fired one after another. She waited for her turn. It did not fail to come. With both parents unemployed, my father had to work as a clandestine taxi-driver in order to sustain our family. This became dangerous work as the level of criminality sharply increased, along with alcoholism and drug-addiction.

In my memory as a teenager this was a really eerie period: I remember also seeing older people looking for food in the garbage (which can be still seen today), or quarrelling about an

empty glass bottle that could be redeemed for a few kopecks (their pensions, if paid, were ridiculous). I recall our school teachers not receiving their meager salaries for several months but still not abandoning their responsibilities to their pupils (for which most of us students were deeply grateful). My memories are vivid and I could continue “painting this picture” for a long time, and I’m sure it would be recognized by all Russians, as well as people of Latin America, who also found themselves victims of American “shock therapy.”

The general mood of ordinary people between 1992 and 1998 was that of growing despair and pessimism. Another mood, amoral and often violent, was the excited state of mind in anticipation of many marvelous opportunities opening from the “incentives of the free-market”, in other words – the chance to get rich quick.

As I see it, Milton Friedman, Jeffrey Sachs and other supporters of free-market theory observed their reforms realization with a totally detached scientific interest. They appear to have been totally alienated, mistaking society for an experimental laboratory and human beings for objects of experiments. Would Milton Friedman become Milton Friedman and Jeffrey Sachs – that famous brilliant scientist that the entire world seems to worship, if they had found themselves in the same situation that they have created? If for example, as a ten year-old children they had not received state support for their impoverished families, like many of their victims from Russia to Bolivia and places in between.

No matter how “brilliant” their studies have been and how many awards they have received, people like Friedman and Sachs share many of the character traits of tyrants, responsible for the death and misery of millions of people all over the world.

Similar to the medieval tortures and public killings of the Inquisition in the name of Jesus, the Neo-liberal economists speak of the necessary pain of “shocks” in the name of Democracy.

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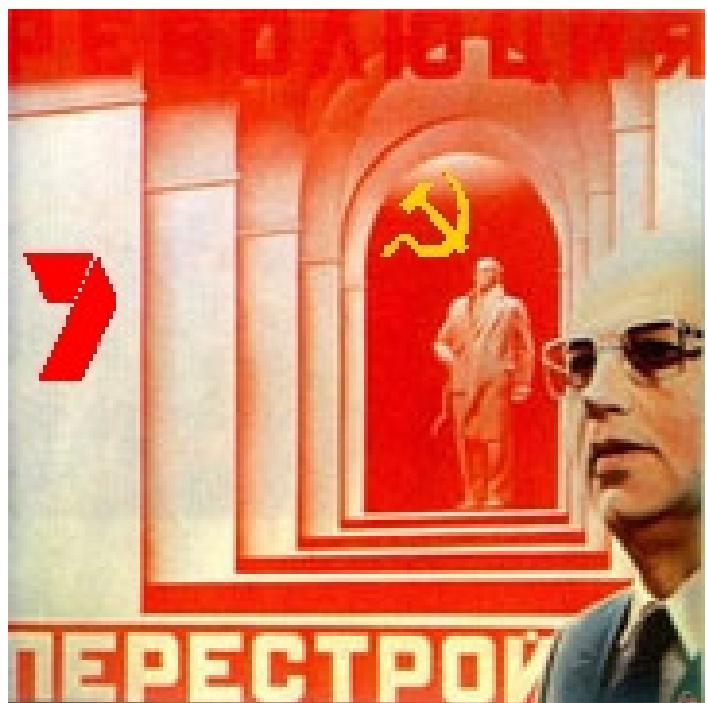
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APPENDIX

Propaganda poster for perestroika with Mikhail Gorbachev



Picture taken from organizational site: <<http://images.evrazia.org/images/perestroika-1-1.jpg>>, September 1, 2008.

Andrei Sdobnikov, USSR stamp, Propaganda for Perestroika, 1988, 5 kop.



“Perestroika – continuing October’s work.”

Three mottos of transition – Acceleration, Democratization and Glasnost (Openness)

Taken from internet site <<http://ru.wikipedia.org/wiki/Перестройка>>, September 1, 2008.



“Grabification” in Ukraine

Image taken from the internet site of the communist party in Ukraine:

<<http://www.komunist.com.ua/article/23/6836.htm>>, September 1, 2008.



Andrei Sdobnikov, USSR stamp, Propaganda for Perestroika, 1988, 5 kop.

“Transition relies on creative work of people”

Taken from internet site

<http://commons.wikimedia.org/wiki/Image:USSR_stamp_Perestroyka1_1988_5k.jpg>,

September 1, 2008.



1998, at the Conference for privatization of public education, Milton Friedman gets a coconut-cream pie in the face from the Biotic Baking Brigade, a group of left-wing activists, as a form of protest against neoliberal economics.

Taken from internet sites: <<http://eattheestate.org/03-07/MiltonFriedmanGets.htm>> and <<http://cruel.org/econthought/profiles/friedman.html>>, September 1, 2008.