Professor Stiglitz has visited today the city of A Coruña to give a conference on 'Can capitalism be saved from itself?' at Fundación Barrié. Before the conference, a group of people from the Faculty of Business and Economics of Universidade da Coruña were invited to participate in a private meeting with the 2001 Nobel Prize winning economist, and I had the immense pleasure to be one of them.

Here it follows a summary of our conversation with Professor Stiglitz **-but please note this is NOT a literal, word-by-word transcription of Stiglitz's words**. Hope you enjoy it as much as we did!

Question.- In your article 'Moving beyond market fundamentalism to a more balanced economy' you predict the end of market fundamentalism. That was back in 2008. Do you still believe the same?

Joseph Stiglitz.- I would answer that question at two levels. On one hand, most people at the street knows market fundamentalism undermined, they know markets did not work. But I do find striking that most people seems unaffected by the market failure; some even keep talking about market wonders!! On the other hand, in Economics profession is the same. At Columbia, for example, at macro courses we have an eclectic approach: one semester we teach rational expectations and that stuff, the other we teach 'other kind of models'. Then, at the end of the course, our students tell us "why do we waste our time with the first type of models? ...they are clearly wrong!!". That's a good start. However, most Universities and economists seem totally unaffected by the failure. Not all of them, the Institutional Economic thinking is seeking a new paradigm. There are movements indeed, but -going back to your question- probably I was too optimistic at that time!

Q.- Do you think Corporate Social Responsibility (CSR) could be a useful concept in western countries to 'move market fundamentalism to a more balanced economy'? Also because it could help reducing information assymetries.

J.S.- I do agree CSR info disclosure affects behavior. And I do believe it is important. But I don't think we should rely just on it because many firms will not behave responsibly. We need a 'level field' where all firms are bounded to play the same game, not just those who believe they should behave in an ethic manner. And I know people from business that agree with this view, they say "I wanna behave in an ethic way, but my competitors would have a competitive advantage because they do not, I wanna a level field!"

Q.- And do you think a solution could be for example setting executive compensation based on long term marks in the company's CSR reports?

J.S.- Anything that calls attention to that is good, but it will always be exposed to the same problem like with accounting standards: the firms' reaction would probably be to issue CSR reports saying they are always behaving good!

Q.- Next question is about public banking. People in Spain tend to say "we are not getting out of this crisis because banks don't give credit", and so there is a growing feeling supporting public banking. But when I look to your papers to see your opinion on the topic, I find it somewhat confusing. For example, on one hand in your 2003 article 'Globalization and the economic role of the state in the new millenium' you say "governments should not be involved in allocating credit or deciding who should get loans". But on the other, in several papers before that one you advocated in favor of directed credit, specially in emerging markets. So... do you think there is a role for public banking?

J.S.- Well, let me first explain my point of view because I understand it could have confused people. I said that in well-functioning markets resource allocation should be done by the private sector. Applied to financial markets (FM), that holds if FM work reasonably... but they have shown they work awfully!! FM are too shortsighted sometimes. And there is empirical evidence that public banking works: in Brazil the public banking sector is bigger than the World Bank, and they are doing a great job. The European Investment Bank (EIB) too. There is a record of very successful development banks. So they work, and FM failures show there is a need for public lending, too. Particularly in two areas: SME lending and lending to the poor. This crisis has shown markets are very good at exploiting common people...

Q.- But how could a public bank be implemented to avoid corruption and political interests?

J.S.- It would be less than in the private sector!! This crisis has shown that. For example, the only mortgage lender in the US that was public (non-profit) was the US Housing Authority, and it was the only one not to be bailed out! We have a real problem of corruption in the private sector, not that much in the public.

Q.- In Europe academics are working on topics like 'responsible lending'... don't you see the possibility for private lending to behave responsibly?

J.S.- The problem with the private sector is not the 'responsible lending'... it is the 'predatory lending'!! It's banks lending beyond people's ability to borrow. Most banks use scoring, when they granted those credits they should know it was irresponsible lending. Banks should be monitorized by authorities and, in a statistical sense, we should be able to measure whether a bank is giving credit to people that can repay or not.

Q.- Much criticism to your recommendations to enhance regulation is related to the question of how can we manage regulatory risk due to changes in the regulation structure. What can you tell us about that?

J.S.- First, in democracy you can't stop changes in the regulations just like you can't stop changes in prices. And second, I find it much worst regulation uncertainty, they never claim against that! The truth is that when banks and firms claim against regulatory risk, they truly mean they do not want to be regulated.

Q.- Next question is about energy. In your opinion, which role should the Spanish and European Authorities play in promoting renewable technologies in the future? Do you think Governments will be able to play that role, or is it the power of big oil and gas multinationals what really matters?

J.S.- This is a good example of a multiple market failure. First, it is an environmental failure (gas emissions to atmosphere, etc.). Second, it is related to innovation, and innovation is a public good, in the sense that it is to be enjoyed by the whole society. That is why governments support research in this area. Third, it exhibits a discounting problem, because for us the distant future is important, but for firms it is the short term what matters. And fourth, big companies in the energy sector have perverse incentives to innovate in renewable technologies: if a new technology appears, that goes against their own market share. So yes, it is absolutely essential for Governments to intervene in this sector.

Q.- In Universities students are tought efficiency and equality are contraries. That means, for example, that imposing a tax to get resources to grant a scholarship to a future Albert Einstein is inefficient. What do you think about efficiency and equality, and the role of states in this area?

J.S.- Two things. First, nobody should take seriously neoclassical economy when it separates efficiency and distribution. There is a growing literature on Pareto-efficient taxation, but beyond that, what matters is who benefits and who losses when we set a tax structure, that is what we must care. And second, this view that there is a trade-off between efficiency and equality is discredited today for several reasons. Two examples are human capital and sharecropping. If there is too much inequality in our societies, most people won't reach their potential, so human capital would not be working efficiently!! And in developing countries sharecropping represents a 50% tax, but it works!

Q.- Now about the Euro crisis. Germany says they accept more fiscal coordination, but in the short term they don't accept eurobonds. But we are in a hurry! Any solutions?

J.S.- The Euro can't survive without eurobonds and a mandate to ECB to pursue growth stability. And even if they do both, I am not sure that Euro would survive!! I mean, the costs of splitting the Eurozone are very large and it shows that probably the Euro was a mistake, so only if EU creates a fiscal union... then I would say it is 'worth to gamble' (but still I see difficulties!). In my opinion, the Euro is like the gold standard among several countries, and it was the gold standard what made the Great Depression worst. Europe has paid a high price. Look at Argentina, it once pegged to the dollar, then depegged, and after one year they came back to growth. Iceland too, they had a terrible banking crisis but they didn't applied the austerity meassures they require in the EU to be in the euro, and they are much better now.

Q.- Then you agree ECB should be empowered just like Fed and other Central Banks are? And do you think we should depreciate the euro?

J.S.- You should have done what Argentina did. I don't want to minimize the problem Argentina had at that time, but devaluation helps. Devaluation affects your situation compared to the abroad, but internally you don't feel it. And about ECB, sure it has to buy debt of Spain, Italy, etc. Otherwise it is not working as a Central Bank! But whether they do it (buying debt) directly or indirectly through the EFSF is just cosmetics. What matters is who bears the risk.

Q.- Do you think creating a 'bad bank' is the solution?

J.S.- In general there is no magic in this bad banking approach. What matters is how you do it. This goes back to the question of public banking I answered before. Sweden in the 1990s realized that if you split banks in good and bad banks then you have to answer a question: who bears the bad one? The solution is to nationalize both. If you nationalize them, you have one side of the union (the good banks) thinking on giving credit to the economy, while the other side (the bad banks) is trying to solve the toxic assets. But if you don't do like Sweden did, and you do like Ireland did in this crisis, you end up with the public sector owning the bad assets and paying the bill, while private banks and their shareholders, being responsible of their situation, are bailed out.

Q.- Finally, our last question for you, Professor. We teach Economics to our students, but now much Economic models are under question, and so the role of mathematics in those models. Which Economics should we teach to them?

J.S.- The problem is not with the mathematics, the problem is the wrong models. The mathematics are bad when you only care on mathematics and not on Economics, and the quality of your models. For example, I am not convinced of several assumptions they use in those models regarding elasticity, utility maximization, etc. In those models they don't consider credit rationing, for example. And when it comes to banking system, those models are completely wrong! Why Bernanke etc did so badly? Because they assumed strong assumptions of perfect markets: they thought things like "the more diversified the risk, the best", so they really thought there was nothing to worry about securitization. However, if you consider bankruptcy costs, you introduce a convexity in the model, and then risk sharing increases risk, not decrease it. Or when you consider contagion... how do we respond to contagion disease? We don't want to diversify risk, isolation is the right solution -just like we do with electric networks. So it is because they don't understand mathematics that they failed. They only know one mathematical model!!

Thank you Professor.