

Is the augmented  
washington  
consensus conducive  
to development



**ASSIGN  
BUSTER**

“ Washington consensus” was still continuously argued by economists, medias, United States Government, Business Council. Its definition, successes and failures, or whether it even exists. How about Post-Washington Consensus? Many of the Washington Consensus policy components, however it’s defined, relate directly to trade policy were still debate worth following.

“ Washington consensus” is the most important achievement of the Transition Economics in 1980s, but this kind of consensus faced to such a challenge, fact in Transition, as its classical economics based component of fast privatization, marketization and liberalization. Soon after that, Post-Washington Consensus was formed in Transition Economics world. This article is based on practice of Transition Economics, to demonstrate the inner academic predicament, and elaborate what far-reaching significance did Post-Washington Consensus affect the transition on Transition Economics itself.

## **Main Text**

### **2. 1 Background of “ Washington Consensus”**

Transition economics appeared in 1980s, its aim was changing from a centrally planned economy to a free market. The transition process is usually characterized by the changing and creating of institutions, particularly private enterprises; changes in the role of the state, thereby, the creation of fundamentally different governmental institutions and the promotion of private-owned enterprises, markets and independent financial institutions.

( Falke and Mike 2009 ) The process has been applied in China, the former Soviet Union and Communist bloc countries of Europe, and many third world <https://assignbuster.com/is-the-augmented-washington-consensus-conducive-to-development/>

countries. Though the short history of Transition economics, there are massive number of essays, the issue of transition path and economic performance was debated intense and little clear agreement. In the first of transition process, economists in Western countries which based on new classic economics theories, gave a “ prescription”, Washington Consensus.

Williamson originally coined the phrase in 1990 “ to refer to the lowest common denominator of policy advice being addressed by the Washington-based institutions to Latin American countries as of 1989.” (Williamson, John 2000) These policies were:

Fiscal discipline

A redirection of public expenditure priorities toward fields offering both high economic returns and the potential to improve income distribution, such as primary health care, primary education, and infrastructure

Tax reform (to lower marginal rates and broaden the tax base)

Interest rate liberalization

A competitive exchange rate

Trade liberalization

Liberalization of inflows of foreign direct investment

Privatization

Deregulation (to abolish barriers to entry and exit)

Secure property rights

Since then, the phrase “ Washington Consensus” has become a lightning rod for dissatisfaction amongst anti-globalization protestors, developing country politicians and officials, trade negotiators, and numerous others. It is often used interchangeably with the phrase “ neoliberal policies.”

Dani Rodrik argues that there now exists an “ Augmented” Washington Consensus, which in addition to the items listed above, adds: (Rodrik, Dani 2001)

Corporate governance

Anti-corruption

Flexible labor markets

WTO agreements

Financial codes and standards

“ Prudent” capital-account opening

Non-intermediate exchange rate regimes

Independent central banks/inflation targeting

Social safety nets

Targeted poverty reduction

Joseph Stiglitz presents on the emergence of a Post Washington Consensus Consensus, arguing that the Washington Consensus has proved neither necessary nor sufficient for successful development, even if each of its policies made sense for particular countries at particular times. Any future consensus cannot be made just in Washington, and any new framework must provide better and greater adaptation to the circumstances of the countries involved, with an emphasis on the importance of equity and employment. Stiglitz also calls for a balanced role of government and markets that promotes and regulates markets, provides institutional and physical infrastructure, and promotes education, innovation, and technology. (Joseph Stiglitz, 2005)

## **Washington consensus**

Washington Consensus was the exclusive policy model accepted by developing countries in Latin America, Eastern Europe and former Soviet Union at first of Economics Transition. It's considered as the effective "prescription" to lead to continuing economic growth in these countries.

Recent experience has demonstrated conclusively that the severity of a crisis is magnified when a country has a large volume of debt denominated in foreign exchange. This is because currency depreciation, which does-and should-occur when a crisis develops, increases the real value of the debts of those who have their obligations denominated in foreign currency. If the banks took the exchange risk by borrowing in foreign currency and on-lending in local currency, then their solvency will be threatened directly. If they sought to avoid that risk by on-lending in foreign currency, then their debtors' financial position will be undermined (especially if they are in the <https://assignbuster.com/is-the-augmented-washington-consensus-conducive-to-development/>

nontradable sector), and the banks are likely to end up with a large volume of bad loans, which may also threaten their solvency. If the government contracted foreign currency debt (or allowed the private sector to shield itself by unloading its foreign currency debt when conditions turned threatening), then the effect of a currency depreciation will be to increase public-sector debt and thereby undermine confidence at a critical time. Whatever the form of such borrowing, it can intensify any difficulties that may emerge. The solution is to curb borrowing in foreign currency. The government can perfectly well just say no when deciding the currency composition of its own borrowing and issue bonds in local currency (as more and more emerging markets are now starting to do). Bank supervision can be used to discourage bank borrowing, and lending, in foreign exchange. The more difficult issue is foreign-currency borrowing by corporations. To prevent that would require the imposition of controls on the form of foreign borrowing. Perhaps it makes more sense to content oneself with discouraging, rather than completely preventing, foreign currency-denominated borrowing. That could be achieved by taxation policy, which could give less tax relief for interest payments on foreign-currency loans, and/or charge higher taxes on interest receipts on such loans. (John Williamson. 2004)

But the Growth outcomes of Washington consensus were deeply disappointing in 1990s, typically bellow the levels of the miserable 1950s and 1960s. According to the calculations of the World Bank itself, Vast swathes of humanity have continued to survive on the equivalent of a dollar a day, or less. What worse, the elimination of restrictions on domestic

finance and on domestic finance and on international capital flows resulted in huge global crises but did not succeed in enhancing volume and efficiency of productive investment. Last but not least, the transformation of Eastern bloc countries into capitalist market economies on the basis of Washington consensus can be only described as an abject failure.

The failures in Sub-Saharan Africa and Latin America have reinforced the doubts about the Washington consensus strategies. ( Stiglitz J. E. 2002)

Growth in Latin America during the 90s-the decade of reform -was just half of what it was in the 60s and 70s, the decades marked by the ' failed' policies of import substitution. Surely, there were problems with the import substitution strategy, and it would have had to evolve-as it did in East Asia-into a strategy based more on exports; but it was the debt crisis, not the shortcomings of the development strategy that brought an end to the period of high growth. Success under reform was even more short lived-less than a decade-and the end of that success was directly related to the failures of the reform strategy, e. g. the openness of capital markets exposed the countries to the volatility of international capital markets, which had such adverse consequences in the global financial crisis of 1997-1998.

Until 1997, the only part of the world that appeared to have escaped from the blight afflicting developing countries was East and South Asia, including China. For much of the 1970s, 1980s and 1990s, growth rates across the region approached double figures. However, here was an evident paradox: development success appeared to rest on conditions that contradicted several of the prescriptions at the heart of the Washington consensus. The

states of the regions were typically conservative in the fiscal sphere, but <https://assignbuster.com/is-the-augmented-washington-consensus-conducive-to-development/>

they also tightly controlled domestic finance, imposed restriction on imports, often discouraged foreign direct investment, controlled international capital flows, regulated several domestic markets and owned significant parts of the national productive capacity. That meant Asian countries manipulated in their own favour and create their own comparative advantage in the world market.

The failure of the consensus occurred at a time when information-theoretic and transactions-costs-theoretic analyses have become prominent within economic theory. This has important implications for the successor to the old consensus. It is widely accepted that though markets are by far the most efficient social mechanisms for allocating resources and maximizing social welfare, information asymmetries among market participants and inescapable transactions cost decisively limit market efficiency. Put differently, cost and information externalities result in market failure. It is concluded that institutions are pivotal to the efficient functioning of markets.

What makes different between the prosperous in East Asia and the failure in Latin America. My answer was Institutions. Such as the government and the various branches of the civil service) are now thought to play a prime role in facilitating information flows and in lessening transactions costs. Institutions make the difference between well-functioning markets and markets prone to disequilibrium. They also allow the private returns from economic activity to approximate more closely the social returns. It is now hard to come across an economist who does not pay attention to the importance of institutions.

How to construct the various institutions that are supposed to be vital to the efficient functioning of markets. Privatization is the most important reason of <https://assignbuster.com/is-the-augmented-washington-consensus-conducive-to-development/>



withering of the state required by the Washington consensus. The policy has been gaining ground since the early 1980s (Cook 1997). About 70 per cent of all structural adjustment loans made during the 1980s contained a privatization component (Cook and Kirkpatrick 1995). This has been especially true of structural adjustment loans to sub-Saharan Africa. (Berg 1994)

The essence of Privatization theory is that the process streamlines the relationship between enterprise owners and managers, thereby improves performance. Also there are two main theoretical strands: first, according to property rights theory a private owner, with the right to residual income (profit), will exercise greater monitoring effort than a public-sector counterpart with no such direct rights. Second, public-sector theory in the new political Economy tells us that privatization reduces the scope for manipulation of an enterprise for political (and inefficient) ends. Privatization simplifies the relationship between agent (an enterprise manager) and principal (shareholder in a private company or the government in a state company). This theoretical basis of privatization has been criticized extensively and will not be discussed here. Most criticisms apply equally to the post-Washington consensus. However, Stiglitz acknowledged that conditions rarely even approximate those of neo-classical assumptions and argues that, because imperfections are rife, theory gives little guidance. (Stiglitz 1997)

## **Post-Washington consensus**

Market failure and institutions played no significant role in the Washington consensus. The emergent post-Washington Consensus based itself on them. <https://assignbuster.com/is-the-augmented-washington-consensus-conducive-to-development/>

Post-Washington Consensus is still an inchoate current of thought, possessing none of the prescriptive, and profoundly misleading. But institutions are discovered, its

Joseph E. Stiglitz pointed out that the main components of Washington Consensus were: privatization, liberalization, macroeconomic stability (mainly price stability), minimize the role of government. This kind of strategy was totally in the opposite of East Asia, which government played an extremely important role in economics. And he also thought more attention should pay rather than the volume of the government, but in what role of government —and the balance between government and market.

Post Washington Consensus demonstrated the failure of Washington Consensus, were:

Economic structure was not taken into consideration or not be thought of enough, and overmuch attention was put into the narrow sense tool to achieve narrow sense aims. E. g.: As the development of the technology, market can not achieve efficiency unprompted. But this dynamic process was key issue for development, and government should make some change to respond this development. East Asia used government successfully, but not described in Washington Consensus.

Some of characteristics were ignored by Washington consensus. E. g.: Widely adopting Sharecropping policy. Factual tax rate of Sharecropping was extremely high, on the average of 50%, some place even at 66% (Joseph Stiglitz 2005), which was much higher than the other tax concerned by Washington Consensus.

<https://assignbuster.com/is-the-augmented-washington-consensus-conducive-to-development/>

Nor was the link between policies and institutions-or institutions and society-adequately recognized. Countries were told to have good institutions, examples of good institutions were exhibited, but there was little to say about how such institutions were to be created. It was easy to instruct countries on good policies-simply cut the budget deficit. But an injunction to have honest institutions didn't take one very far. Just as there was controversy about what was meant by good policies, so too there was controversy about what was meant by good institutions. Countries were told to be democratic, but there is no subject of greater concern to the citizens of most developing countries than their economic performance and they were told that one central ingredient, monetary policy, was too important to be trusted to democratic processes. As part of the conditionality imposed to get loans, countries were given short deadlines to reform social security programs or to privatize or change the charter of their central banks, to engage in reforms that the democracies of many advanced industrial countries had rejected. There was a failure to recognize that in issuing such demands, public institutions were put into an impossible bind: if they failed to comply, they lost credibility, as they were accused of not doing what was right for their country; if they acceded to the demands, they lost credibility, as they appeared to be simply following the orders of the new colonial masters. When the reforms failed to deliver on the promises-as happened in country after country-the governments again lost credibility. The weaknesses in public institutions were thus caused in part by the Washington institutions.

(Stiglitz J, E 2002)

The success of privatization and other technically possible policies depends on the political economy in which they are attempted. In other words, the success of privatization may depend on how and whether capitalism is socially accepted. Here we need to consider the role of the state, historically, in constructing institutions of private-sector transaction and production; and the role of particular political economies, or political settlements (Khan 1995), in the development of the state. The former is a far more complex matter. States have, in developing countries, made double movements both to stimulate and to regulate markets. However, the issue goes beyond this too, to the political economy within which both states and private-sector agents operate. For example Gerschenkron did not just note the possibility of reaping advantages from backwardness; nor did he just note that the institutional response to the challenges and tensions of late industrialization differed between countries. He also stressed the dramatic ideological shift that was necessary, but not inevitable or predictable, before effective social and institutional responses to these challenges could be found. (Bayliss, K. and Cramer, C. 2001)

Stiglitz offered the idea that the post-Washington consensus needs to be more sensitive to specific conditions in each country. But there are reasons that post-Washington consensus with its asymmetric information and efficient institutional development- really does not improve much on its predecessor by way of what is required for political economy analysis.

## **Conclusion**

Many of the key problems of the Washington consensus were considered by the post-Washington consensus, but only within a restricted, over-simplifying <https://assignbuster.com/is-the-augmented-washington-consensus-conducive-to-development/>

analytical framework. Other issues such as distribution were barely touched upon. The post-Washington consensus stressed the importance of legislative regulation, but this is an issue that is complicated by technical capabilities. However, beyond this and not mentioned by Stiglitz at all, privatization should be accompanied by promotion of voice regulation, and encourage the voice of employees and other affected by privatization.

## References

Falke. M (2009), Community Interests: An Insolvency Objective in Transition Economies?, No. 01/02, Frankfurter Institut für Transformationsstudien

Williamson. J (2000), " What Should the World Bank Think About the Washington Consensus?" World Bank Research Observer. Washington, DC: The International Bank for Reconstruction and Development, Vol. 15, No. 2, pp. 251-264

Rodrik. D (2001), " The Global Governance of Trade as if Development Really Mattered," New York: UNDP

Williamson. J (2004), A Short History of the Washington Consensus

Stiglitz J. E (2005), The Post Washington Consensus Consensus

Stiglitz J. E. (2002), Reforming Reform: Towards a New Agenda for Latin America, Prebisch Lecture, ECLAC, Santiago, Chile

Cook, P. (1997) ' Privatization, public enterprise reform and the World Bank: Has Bureaucrats in Business got it right?' Journal of Internation Development 9(6): 888-97

<https://assignbuster.com/is-the-augmented-washington-consensus-conducive-to-development/>

Cook, P. and C. Kirkpatrick (1995) ' The distributional impact of privatization in developing countries: Who gets what and why', in Ramandaham, V. V(ed.) Provatosition and Equity, London and New York: Routledge.

Berg, Elliot (1994) Privatization in Sub-Saharan Africa: Results, Prospects and New approache, Maryland: DAI.

Stiglitz, J. E. (1997) ' an agenda for development in the twenty-first century', speech, Washington.

Bayliss, K. and Cramer, C. (2001) Privatisation and the post-Washington Consensus.