The washington and post washington consensus

Abstract

The present term paper is an attempt to explore and put forth the theoretical exposition of the two major development paradigms – the market-oriented and the state-cum-market centric development models, plausibly portrayed in terms of what is often phrased as the Washington Consensus and the Post-Washington Consensus. These discourses must not be only analysed keeping in mind the benefits and costs of the implementing the policy prescriptions advocated by these two sets of development paradigms in different economies over the years, but at the same time its long-term effects on the individual economies, be at the centre or periphery, and the repercussion effects of any alteration in economic variables in one country on the other as a consequence of openness of economies, while pursuing the universal policies, granted for the fact that today we believe the world no less than a global village where the governance concept has modified radically over the last a few decades at the behest of the key Bretton Woods institutions like the World Bank and the International Monetary Fund. The development discourse must also account for the individual capability and capacity of countries to absorb the economic policies in the development agenda of individual countries in question, as put forth by these institutions. Naturally enough, the failure of the sound theoretical programs would invite criticisms, at least because it has worked unevenly in almost every country trying to employ these policies and unfortunately there are no dearth of evidences from all corners of the globe to prove that the universal policy design uniformly for all countries, in order to bring about meaningful economic development globally has actually failed or at least been partly successful.

The overall idea is to make an insight into the Washington Consensus and the Post-Washington Consensus and evaluating to what extent any scrutiny for these policies could be hence put forward.

Introduction

The economic development discourse of nations had been under constant influence of the economic ideology prevailing in particular nations at any point in time. The economic history of nations itself suggests that how we have witnessed the changing development paradigms have evolved after the Second World War in 1944-45, primarily seen as the deliberate developmental assistance to the war-affected nations. The focus used to be mainly the need to correct market failure through command and control mechanism through various state-oriented developmental strategies and economic programmes like the import substitution industrialisation policy for the promotion of indigenous industries for better comparative advantage in production and exchange, financial repression etc. But the decade of 70s precisely late 70s, apparently proved the defects and malfunctioning of the centrally planned economies. The two major oil shocks, first in 1973 and the next in 1979 put the greatest challenge before the policy makers and development economists, which completely destabilised the global economy along with many other politico-economic developments around the world. This would be clear in the following excerpts.

The 1980s were a hell of a decade. They began with the reverberations of the second OPEC oil shock. They ended with the fall of the Berlin wall. In between, we had the Reagan-Thatcher-Kohl economic policy era in North America and Europe, the Volcker interest rate shock, the Latin American debt crisis, collapse in Africa, the start of rapid growth in China and in India, and on and on. Oh, and by the way, in 1989 John Williamson coined the term Washington Consensus (Williamson, 1990: 3)

It became a questionable affair to challenge the efficacy of how far government policies can actually benefit or harm the economic environment. This tendency of statist model inevitably led to emergence of an alternative theory of development fundamentally rests on the assumptions of the neo-classical model of a free-market enterprise economy. The Washington Consensus per se is primarily affiliated to this school of economic thought, which states for the minimal role of the state in carrying out economic activity. That is governments should limit their interferences in the economy, only to maintain macroeconomic stability and to secure law and order and provision of public goods. In other words, the Washington Consensus is the market-centered strategy designed to counter the ill-effects of excessive state intervention in the economy, under the aegis of World Bank and the International Monetary Fund (IMF), which claimed to provide a universal mechanism for the efficient allocation of economic resources and promoter of economic growth world wide. However, the validity of Washington Consensus was under strict scrutiny for not fulfilling its much hyped economic policies and soon criticised for its failure. At this preliminary level, it is important to introduce the other parallel but pole opposite of Washington Consensus, that is, the emergence of the Post-Washington Consensus in mid-1990s, which advocates for a mixed-blend of interventionist and market strategy for better economic development of nations, granted a few conditions of the Washington Consensus like the trade liberalization to be continued along with deliberate state intervention in the economic affairs.

The Pros and Cons of the Washington Consensus

The Washington Consensus, sometimes synonymously used as the set of neo-liberal economic policies or a universal policy package was originally designed by the key Bretton Woods institutions like World Bank and IMF, to restore economic growth and to correct the balance of payments crises or the debt crises and hyper-inflation kind of situation facing the Latin American countries, such as Argentina and Mexico. The term ‘ Washington Consensus’ was coined and formulated by John Williamson in 1989 at the Peterson Institute of International Economics in the US.

According to Nobel Laureate in Economics in the year 2001, Joseph E. Stiglitz,

The Washington Consensus policies, however, were based on a simple model of market economy, the competitive equilibrium model, in which Adam Smith’s invisible hand works, and works perfectly. Because in this model, there is no need for the government – that is, free, unfettered, liberal markets work perfectly – the Washington Consensus policies are sometimes referred to as neo-liberal based on market fundamentalism, a resuscitation of the laissez-faire policies that were popular in some circles in the nineteenth century (Stiglitz, 2002: 74).

This neo-liberal orthodoxy prevailed over the entire global economy from the beginning of the late 1970s to the mid of 1990s irrespective of the nature and extent of economic growth parameters in different countries. The set of policy prescription was purely of market-oriented model of economic growth. This policy package eventually effectuated in what is better known as the Structural Adjustment Policy (SAP) of the World Bank and the IMF to help countries get rid of debt-crises aftermath of the oil shock of 1979 from the sharp decrease in the primary commodities prices and increasing interest rates, the World Bank and the IMF put forward ‘ conditionalities’ in order to receive credits or financial assistance from these institutions basically to the governments of the developing countries.

Therefore, stable macroeconomic policies, outward orientation, and free-market capitalism became the central instruments of the Washington Consensus. In other words, the three big ideas underlying these reforms as Williamson asserts are:

The macroeconomic discipline, a market economy, and openness to the world. The first three reforms are, so far as I am aware, widely accepted among economists (Williamson, 2000: 251).

Williamson also provided a more specific list of ten policy areas or tenets of that could be used to characterize the consensus as listed below:

(1) fiscal discipline, (2) redirection of public expenditure toward the areas of education, health, and infrastructure, (3) tax reform, (4) interest-rate liberalization, (5) competitive exchange rates, (6) trade liberalization, (7) liberalization of inflows of foreign direct investment, (8) privatization, (9) deregulation, and (10) secure property rights (Williamson 1990).

We can say that all these reforms fundamentally rest on the premises of the neo-classical paradigm that supports the laizzez-faire doctrine as panacea for all economic problems in a capitalist economy. Therefore, the whole concern was through following these policy package, the markets could be freely allowed to take its own course in order to set the prices right, which comes from the essence of free trade as a major component of the Washington Consensus. The widespread and often excessive state intervention was being seen as the making the economy weak and therefore it was contended that imperfect markets are better than imperfect states. Giving the logical corollary to prove this point, Lal (1983: 63-64) at different occasions asserted that

The cost of government failures arising from the rent-seeking and price distortions associated with excessive protectionism would always outweigh market failures associated mostly with imperfect competition an under-provision of public goods. The Washington Consensus was thus increasingly based on the understanding that imperfect markets are always superior to imperfect states.

Some scholars like Colclough and Manor (2000: 263) summarised the resurgence of the neo-liberal thinking in development discourse in following words.

The emerging neoliberal orthodoxy advocated a new development model based on the primacy of individualism, market liberalism, outward-orientation, and state contraction. The organising principle of neo-liberal political economy was the notion of a minimal state, whose primary functions were to secure law and order, ensure macroeconomic stability and provide the necessary physical infrastructure.

Further, according to Colclough and Manor (2000: 263)

Trade liberalisation and state contraction were necessary tools to curb the excessive powers enjoyed by politicians and bureaucrats, a process which was regarded as crucial for rapid and equitable economic growth.

Originally the policy reforms as envisaged in the Washington Consensus was designed and intended to cover all the Latin American countries, later it was applied to almost all countries and was intentionally penetrated into the economic policy agenda of Third World Countries. Regarding the supremacy of the Washington Consensus on all the earlier prevalent economic thoughts, different opinions came into the picture. Say for instance, much before the arrival of such an economic ideological discourse, economists like J. M. Keynes (1936), who is considered to be a pioneer of the welfare state, believed that a policy of fiscal discipline would neither avoid the current account crisis, nor it can lead to a fully employed economy where all the factors of production and economic resources are optimally employed. So J. M. Keynes basically challenged the classical axioms for the smooth functioning of the economy. Since the classical axioms are not very close to the real world phenomena of perfectly competitive markets, the essence of the Washington Consensus way of looking at the economy could be better described in the words of Keynes in the following lines:

It happens not to be those of the economic society in which we actually live; with the result that its teaching is misleading and disastrous if we attempt to apply it to the facts of experience (Keynes, 1936: 30).

Infact, it is felt that the last of the ten policy reforms, that is, securing property rights for efficient production in the economy however, cannot be refuted easily. If the state is capable to ensure that the production ownership should go in the hands of those who value it more, who has also the capability to augment resources, further there is no harm in transferring property rights to develop right entrepreneurship in the economy.

What is important here is to note that the Washington Consensus was treated like a shock therapy for the countries suffering from debt-crises of any sporadic shock like the one oil shock of 1979, because it was assumed that trade liberalisation and privatisation will take care of the economic disturbances affecting the normal working of the economic system. However, the experiences of the last 20 years or so have shown that the reforms envisioned through the Washington Consensus have actually led to disaster in many countries. This understanding of the neo-liberal orthodoxy could be better explained in the following lines of John Williamson.

I wrote a background paper in which I listed 10 policy reforms that I argued almost everyone in Washington thought were needed in Latin America as of that date. I labeled this reform agenda the Washington Consensus, never dreaming that I was coining a term that would become a war cry in ideological debates for more than a decade. Indeed, I thought the ideas I was laying out were consensual, which is why I gave them the label I did (Williamson, 1990).

The evidences we have clearly indicate that Washington Consensus as a universal policy package became a soft target of severe criticisms in recent years primarily from the countries at the periphery. The consistent episodes of criticisms labeled against the Washington Consensus pave the way for the future insights in the economic development discourse.

What's wrong with the Washington Consensus

A wide range of criticisms had been put forward as a result of the practical problems faced by the countries pursuing the reforms as recommended by the Washington Consensus since the year of its introduction. One of the criticisms which is generally labelled against the Washington Consensus is regarding the fundamental assumptions of the neo-classical model of free market ideology. In this connection, Stiglitz (2002: 73-74) maintains that:

Behind the free market ideology there is a model, often attributed to Adam Smith, which argues that market forces – the profit motive drives the economy to efficient outcomes as if by an invisible hand. It turns out that these conditions are highly restrictive. Ironically occurring precisely during the period of relentless pursuit of the Washington Consensus – have shown that whenever information is imperfect and markets incomplete, which is to say always, and especially in developing countries, then the invisible hand works most imperfectly. Significantly, there are desirable government interventions which, in principle, can improve upon the efficiency of the market.

So in this way the basic premises on which the Washington Consensus rests itself became questionable in the academia. Furthermore, Stiglitz (2002: 74) went on to criticise the theoretical validity of the neo-classical model in his following words:

Even if Adam Smith's invisible hand theory were relevant for advanced industrialised countries, the required conditions are not satisfied in developing countries. The market system requires clearly established property rights and the courts to enforce them; but these often these are absent in developing countries. The market system requires competition and perfect information. But competition is limited and information is far from perfect – and well-functioning competitive markets cannot be established overnight. The theory says that an efficient market economy requires that all of the assumption be satisfied. In some cases, reforms in one area, without accompanying reforms in others may actually make matters worse. This is issue of sequencing. Ideology ignores this matters; it says simply move as quickly to a market economy as you can. But economic theory and history show how disastrous it can be to ignore sequencing.

Apart from the theoretical loopholes in overall framework of the Washington Consensus, many other empirical evidences can be put forth for its failures. These are listed below:

The fundamental claim of the Washington Consensus that full-scale liberalisation, at all costs, is associated with superior economic performance was doubtful. For instance, it has been maintained that the highly successful story of the Newly Industrialised Countries (NICs) in East Asia such as Japan and Taiwan better known as the East Asian miracle, gave a reason for the resurgence of the neo-liberal policies. These NICs, no doubt, performed appreciably not only in making rapid and high economic growth but also progressed in terms of key social indicators paved a strong supporting pillar for the neo-liberal paradigm constituting the Washington Consensus. Many believed that these NICs are very close to the norms of the free-market economy. However, this story is partly true. What is significant at this point is to know that the institutions pertaining to industrialization and export growth were performing robustly well and these were the factors which were at the heart of success of these countries. Onis (1998: 197-216) has tried to give the valid argument in following words:

Strong growth and diversification of industrial output and exports could not be accounted for simply for the logic of the free market: interventionist strategies and an active industrial policy, dictated by considerations relating to longer-term competitiveness and dynamic comparative advantage, constituted the central elements contributing their success.

If we see the world economic growth rate, it had infact strikingly lowered, and become more unstable during the neo-liberal era. Not only this, the degree of inequality in the global economy appeared to have increased during this period of neo-liberal economic restricting (UNCTAD 1997). Even the gap between the developed and the developing countries had widened and there had been increased divergence within the Third World. For example, as compare to the hyper-growth in Asian NICs, the Latin American countries in 1980s and sub-Saharan Africa lagged far behind over the same period of time (Rock, 1993: 1787-1801). Moreover, excluding China, there is an increase of poor people and the poverty rate had declined from 28. 5 percent to 25 percent (Fischer, 2003: 8).

According to Stiglitz (2002: 76),

There is a more fundamental criticism of the IMF/Washington Consensus approach: It does not take acknowledge that development requires a transformation of society. Even it completely ignored the fairness concept.

A few more instances could be put forward to support the argument that the collapse of Washington Consensus was inevitable such as the success of Argentina in the first few years of accepting the policies and later how its economy collapsed. The case of Turkey is another example where the Washington Consensus policies totally failed.

Exposure of many middle income countries to the vagaries of financial globalization actually proved costly for them because opening of their capital accounts before taking into account the macroeconomic stability fell in the trap of the World Bank and the IMF. These high volatile capital flows and frequent financial crises, because of unregulated financial markets led to repercussion effect of one country could be easily felt in another, which we have thoroughly witnessed in the Asian Crisis of 1997 and the Russian Crisis of 1998, which had myriad socio-economic-politico impacts on different economies.

Last but not the least in the series of criticisms that had been labelled against the popular programmes of the Washington Consensus is of course a paradoxical situation when the Washington Consensus talks about minimising the bureaucratic inefficiency, rent-seeking, and other forms corruption and pervasive state failure, it had come to our observation that it had actually happened the other way round – these all social and economic evils had actually aggravated during the neo-liberal regime.

Keeping these issues in mind, during the mid-1990s there emerged a new and thought provoking policy focus of the key Bretton Woods institutions away from the hard-core neo-liberalism to a new synthesis of states and markets as emerging Post- Washington Consensus.

The Post-Washington Consensus: Is it inevitable?

The Post-Washington Consensus goes further in detailing the nature of the failures of the Washington consensus (Stiglitz, 1998: 17). Joseph E. Stiglitz who is supposed to provide the intellectual backbone to the emerging Post-Washington Consensus maintains that there was lack of understanding between the policies put forth by Washington Consensus and the contextual framework of developing countries. In the following words, Stiglitz tries to state his position:

There was a failure in understanding economic structures within developing countries, in focusing on too narrow a set of objectives, and on too limited a set of instruments. For instance, markets by themselves do not produce efficient outcomes when technology is changing or when there is learning about markets; such dynamic processes are at the heart of development; and there are important externalities in such dynamic processes, giving rise to an important role for government. The successful East Asian countries recognized this role; the Washington consensus policies did not (Stiglitz, 1998: 17-18).

Stiglitz and Greenwald (2003) further believe that the Post-Washington Consensus recognizes that

There is a role for a market; the question is to what extent the neoliberals recognize that there is a role for the state, beyond the minimal role of enforcing contracts and property rights. There is no theoretical underpinning to believe that in early stages of development, markets by themselves will lead to efficient outcomes.

Moreover, the Asian crisis of 1997 proved to be an important turning point for the rethinking about the Washington Consensus for the reason that for the first time in its history, the IMF was confronted with serious criticisms from all over. It was criticised not only for failing to predict the crisis but also to make the situation worse aftermath the crisis. To describe it more clearly in words of Stanley Fischer,

The Asian Crisis was also important in terms in producing a serious rift between the two Bretton Woods institutions – again for the first time for many decades. Following the rethinking process that has occurred, the IMF now tends to pay far more attention to regulatory reforms, notably in the context of the banking and financial system, and recognises far more than on the past the importance of strong institutions and good governance (Fischer, 2002: 385).

Stiglitz (2002: 155) further added that the IMF until the Asian Crisis used to be crititicised by the countries at the periphery or the Third World countries, but now the criticisms were also put forward by the countries at the centre or the developed countries. He maintains that:

With the onset of the Asian Crisis, the IMF especially became the object of serious criticism from the centre within the key Bretton Woods institutions themselves (Stiglitz, 2002: 155-156).

One of the key ingredients of the Post-Washington Consensus is the recognition that states have a great role to play in the economic development process. However, the Post-Washington Consensus favours the market liberalisation, the twin concepts of states and markets are considered as of complementing rather than substituting in nature. Greater role for the state institutions has been prescribed for better and efficient working of the economy. There is a clear indication about the regulation of financial markets in order to avoid any uncertainty arising out global flows of capital between countries. And the most important, it is thought that certain areas like human development, equality and to alleviate poverty, states can replace the market failures in accomplishing these issues. The question remains how to improve the state efficiency or to avoid state failure. In this regard, Stiglitz (2001: 17) highlights that:

The effectiveness of states can be improved by using market-like mechanisms. An interesting symmetry is established by noting that states are important for the effective functioning of markets but also that markets or market-like mechanisms are important for the effective functioning of states.

Conclusion

While analyzing the whole set of ideas and instruments put forward by each of these different line of thinking about the development discourse it is certain that the policies advocated by them may work in some countries and may not in others. What is important is the debate over the sufficiency conditions put forth for the pervasive development of countries primarily the Third World countries. So far nothing appreciable has been achieved since the introduction of either Washington or the Post-Washington Consensus in developing countries. What is apparent here is the fact that all policies whether its neo-liberal or structuralist in from and nature has not benefitted much from the development assistance programmes initiated by the World Bank and the IMF Post-Second World War period. While the role of the state cannot be undermined in economic progress of any country, it is also important to scrutinise its position and capability in the global scenario marked by excessive dominance of the global governance agenda before it. The irresistible wave of globalisation to a large extent undermines the possible intervention in formulating policies at least at the domestic levels for the countries. The concern in the developing countries is how to bring growth with equity. The balanced approach of the Post-Washington Consensus between states and markets along with reforming the governing institutions is far more impressible strategy than that of believing the automatic working of the economy exposed to liberalisation of markets and openness of economy. At least the gains and losses can be mutually appropriated between these two institutions of markets and states. Relying heavily on the free trade and the consequent trickle-down effect to happen automatically has become a far fetched dream for majority of the countries in the larger paradigm of global governance with varied socio, economic and political implications. What is sure is the trade-off between states and markets would to a large extent provide a new outlook for the development discourse for individual countries presuming institutions of governance are at their best of their capacity, capability and efficiency fronts.