How ‘post’ is the post-Washington Consensus?

(A Review Essay)

“Personally, like most economists, I am in fact in favor of free trade and free investment flows; but they are surely given too much credit”. ¹

The ongoing financial and economic crisis has challenged the economic and political orthodoxies that have been dominant since the 1980s. Following the financial and economic meltdown that started in 2008, voices critical of pre-crisis economic development have gained increasing prominence. Joseph Stiglitz chairs the Commission on the Measurement of Economic Performance and Social Progress (with Amartya Sen as his adviser) that was created at the beginning of 2008 under a French government initiative. Even more importantly, Stiglitz also chairs The Commission of Experts of the President of the UN General Assembly on Reforms of the International Monetary and Financial System.

Paul Krugman is similarly now one of the most influential economists, and not only in the USA – his academic papers, columns or blog posts have an impact on policy debates at the global level. Similar things can be said too about Dani Rodrik in the field of development economics.

All of these authors are known for their critique – dating back at least to the 1990s – of the international development policies of the so-called Washington Consensus, particularly as preached by the World Bank and the IMF. The Washington Consensus has come under fire for several reasons.
Krugman’s words quoted above reflect the spirit of what has become called the post-Washington Consensus, a potential corrective for the somewhat one-dimensional and heavily criticised Washington Consensus. But at the same time, and despite the fierce critique, many methodological aspects and policy implications of the post-Washington Consensus do not seem to depart so far from the previous mainstream. This review article deals primarily with the post-Washington Consensus arguments in the fields of trade, the role of states in economies, foreign direct investment and finance. There will be analysis of to what extent this relatively recent tradition in development economics differs from its predecessors, where a degree of continuity can be observed, and what this may mean for policy making.

The term post-Washington Consensus was first introduced in 1998 by the then World Bank chief economist Joseph Stiglitz. At this point, the new concept was meant simply to complete the policies advanced by the Washington Consensus that were ‘sometimes misguided’ according to Stiglitz. He called for sound financial regulation, competition policy, and policies to facilitate the technology transfer and to encourage transparency.

It can be argued that Stiglitz’s criticisms after the end of his career in the World Bank went further than the original 1998-version of the post-Washington Consensus. However, many authors are sceptical that his writings can provide an adequate critique of, let alone an alternative approach to, development economics. In the following paragraphs, I shall introduce the post-Washington Consensus
developmental arguments as presented by their authors (notably Stiglitz\(^6\)); discussion of how far these arguments differ from neoliberal dogma will follow.

The post-Washington Consensus – at least Stiglitz’s version – is built on a rejection of the previous development economics doctrines. According to Stiglitz, they focused narrowly on economics and failed to see the broader context.\(^7\) For decades, development was seen by mainstream economists both of the left and the right purely as a technical problem requiring technical solutions (better planning algorithms, pricing and trade policies, macroeconomic frameworks) – as a matter of increasing capital stock and improving the allocation of resources. This inability of early development economics, with its Washington Consensus, to see the broader and more complex development context is attributed to their lacking of a participatory approach and reluctance to take into account societies’ grassroots.\(^8\)

Stiglitz distanced himself from the early development economics as it underestimated the role of markets and rationality.\(^9\) He disagreed with the economists of the left who attributed the problems of development mostly to market failures. Unlike the early development economists, he did not think that the primary recipients of the developmental models should have been governments that were supposed to replace the absent and imperfect markets and to guide the economy towards a more efficient allocation of resources.\(^10\) He thought instead that a broader scope had to be embraced with more actors engaging in developmental efforts.

However, Stiglitz distanced himself even more from the Washington Consensus than from the early development economics. First, he pointed out that the Washington
Consensus intellectual doctrine is too simplistic, i.e. based on simple accounting frameworks and a few economic indicators, such as inflation, money supply growth, interest rates and budget and trade deficits.¹¹ Policy recommendations based on this simple logic and administered in very short periods by technocratic economists took a form of copy-paste templates applicable more or less in any developing country without regard to its specifics and stage of development.

Second, Stiglitz not only attacked the simplicity of the Washington Consensus macroeconomic policy advice, but also its content. At the level of theory, he disapproved of the assumption that competitive equilibrium theorem is universally applicable in developing countries. He refers to “a growing awareness of the limitations of the competitive paradigm, with its assumptions of perfect information, perfect competition, and complete markets, and with the correlate propositions that distribution and institutions do not matter”.¹² On the practical level, he objected for example to the excessive focus on inflation – it was not conducive to long-term economic growth, and it detracted attention from other major sources of macro-instability, namely weak financial sectors. He further claims that due to too much focus on trade liberalisation, deregulation, and privatisation, other issues necessary for an effective market economy (such as competition) were ignored.¹³ The final point that Stiglitz makes both as a critique of the Washington Consensus and as a suggestion for the new consensus is that it can no longer be derived in Washington, and that developing countries must claim ownership of policies if they are to be sustainable.¹⁴
In line with identifying himself against the previous development economics concepts, particularly against the Washington Consensus, Stiglitz then recognises a need for the post-Washington Consensus to embrace a broader set of instruments to achieve broader goals of development:

“We seek increases in living standards – including improved health and education – not just increases in measured GDP. We seek sustainable development, which includes preserving natural resources and maintaining a healthy environment. We seek equitable development, which ensures that all groups in society, not just those at the top, enjoy the fruits of development. And we seek democratic development, in which citizens participate in a variety of ways in making the decisions that affect their lives”.\(^{15}\)

As opposed to the previous mainstream development economics traditions, the post-Washington Consensus version of development thus involves and depends on the adjectives ‘sustainable’, ‘egalitarian’, and ‘democratic’.

Given the fact that the post-Washington Consensus is identified not only against the Washington Consensus, but also against earlier development economics concepts, it is notable that Stiglitz’s discussion of development sometimes resembles in many aspects the thoughts of early development thinkers. In his account, development represents a transformation of society from ‘traditional’ to ‘modern’ and ‘scientific’ relations, ways of thinking, and methods of production. An active drive for change that aims to improve the lot of individuals is a key characteristic of this transformation. Development is not an end per se, but should enrich the lives of individuals, and provide them and societies with more control over their destiny.\(^{16}\)
Stiglitz's arguments resemble those of early development structuralism in another particular aspect – Stiglitz insists that development efforts will be successful only if they manage to contribute to transforming the whole societies, not only to transferring technology via so-called development projects.\(^{17}\) The latter may end up merely adding to the process of creating dual societies in which there is little trickling (of higher productivity and returns, wealth, or – simply speaking – development) from the ‘growth poles’ or enclaves to the rest of society.

Nevertheless, the post-Washington Consensus does not restore the early development economics. According to Fine, its position vis-a-vis old development economics was rather ambiguous – the latter was acceptable only if reinterpreted through the prism of the new approach. Development then represented the emergence and correction of market and non-market imperfections.\(^{18}\) As Fine argues further, structuralist arguments were thus “appropriated and reinterpreted within a mainstream neoclassical microeconomic framework”, and the logic of core-periphery development expressed in mathematical models.\(^{19}\) This trend is most clearly represented by Krugman.\(^{20}\)

Krugman did not argue against the contents of the structuralist arguments of the early development economists. He simply thought they often lacked methodological rigour. As the core of many such arguments – the economies of scale – were difficult to express in formal models of mainstream economic theory, early development economists resorted to vague narrations. According to Krugman, however, such non-mathematical discursive style was a blind alley. Structuralist arguments, such as Rosenstein-Rodan’s Big Push, were accepted and celebrated by Krugman only after
their formalisation in economic models – as performed by Murphy, Shleifer, and Vishny in the case of Big Push.\textsuperscript{21}

Another example of the post-Washington Consensus’ ambiguity (critical rhetoric, but cautious in its implications) is Amartya Sen’s discussion of poverty and famines. In his seminal book, Sen observed that famines do not have to occur because of the lack of food, but can happen as a result of unequal changes in food distribution.\textsuperscript{22} This relatively non-orthodox conclusion is counterweighted by the limitations of his ‘entitlement approach’. He is challenged for being lost in the neoclassical fiction of the agents’ free individual choices and for neglecting the question of resource distribution between social groups, and above all that of capital ownership inequalities\textsuperscript{23}; and for “a failure to recognize individuals as socially embedded members of households, communities and states, and […] that famines are political crises as much as they are economic shocks or natural disasters”.\textsuperscript{24}

Some authors are less critical about Sen being rooted only in the neoclassical mainstream, but point out that he faces a clear tension on whether to prioritise the micro-foundations of choice theory or the macro-foundations of the theory of classes and of modes of production, that are both present in his entitlement approach.\textsuperscript{25}

Regardless of whether such strong or moderate critics of Sen are absolutely right, it seems clear that Sen – despite his indisputable original, fresh and provocative insights – does not depart radically from the economic mainstream analysis of poverty.

Jeffrey Sachs offers a similar example of how factors other than structural ones can be prioritised and highlighted when analysing the causes of poverty. In his article, Sachs
focuses on geography and climate as major factors behind countries’ potential for growth. Despite some positive reference to Prebisch, Sachs ignores the international context of growth and all his recommendations for stimulating growth and reducing poverty are internally-oriented; no reform of global order or international trade and finance architecture is ever mentioned in his piece.\textsuperscript{26}

The conclusion from the discussion presented above is that the post-Washington Consensus was able to embrace and mainstream its critique of the Washington Consensus (using the arguments resembling structuralism) without having to abandon the methodological and ideological fundamentals of standard neoclassical economic theory (far from radical policy recommendations).

The major argument of this article – that the post-Washington Consensus is critical towards its predecessor but does not depart that markedly from it in methodology and policy recommendations – is further evidenced in the area of free trade and economic openness. There are a number of economists of the post-Washington Consensus era who do not subscribe to the free trade mantra. The scope of their departure from it varies, ranging from those who are able to see the difference between the modeled free market ideal and the reality (including its market imperfections), to those who, after a series of cross-country regression, conclude that the openness of a country is an irrelevant factor in the quest for growth and development, or explicitly acknowledge that some sort of industrial or protectionist policies might be desirable.

Stiglitz is, in principle, in favour of economic openness, though for different reasons than previous economists, and with several reservations. He thought that blaming
protectionism for stifling innovation – as argued by the Washington Consensus – was confused; he rather insists that it was the lack of competition that was causing stagnation. Trade liberalisation might lead to competition, but not automatically, and therefore it is neither necessary nor sufficient for creating a competitive (both in terms of imports and exports) and innovative economy.27 Despite prioritising competition, Stiglitz remains positive about openness – he claims that retreating from it “in the developing world would unacceptably delay the development transformation”.28

Regarding the composition of trade, Stiglitz has several observations that differ from the Washington Consensus. He claims, for example, that policies that encourage mining may contribute little to development, and that when environmental degradation and resource depletion are counted, national output statistics might not look very positive either.29 Stiglitz also asserts that resources can play an important role in development, but he calls for a strategy that includes plans to preserve, use, and renew natural resources.30

As the quote at the start of this article indicates, Krugman is also generally supportive of free trade.31 He defends the complexity and validity of the original Ricardian idea of comparative advantage and argues against anti-globalisation intellectuals who fail to understand and appreciate it.32 Nevertheless, he does not try to restore the obsolete argument that free trade is optimal because markets are efficient. Krugman admits the idea that interventionist trade policies might lead to more optimal results; however, politics are as imperfect as markets, according to him.33 Pursuing strategic policies could be counterproductive and result in encouraging the wrong things; on purely
theoretical grounds, it would be difficult to formulate good interventionist policies in
the complex strategic environment prevalent in many industries.\textsuperscript{34}

The post-Washington Consensus, however, seems to be a less unified category than
its predecessor, at least when it comes to the question of whether international free
trade is beneficial for developing countries and whether there exists a case for
industrial policies. In contrast to Stiglitz, Krugman and others, Dani Rodrik, for
example, comes to the conclusion that there is little evidence that open trade policies
– in the sense of lower tariff and non-tariff barriers to trade – are significantly
associated with economic growth\textsuperscript{35}; and he also asserts that directly targeted industrial
policies are desirable.\textsuperscript{36} The interesting thing is that he comes to these conclusions
while using the same methods and analytical framework, and not from the position of
heterodox economics.

It is precisely for this reason that it is possible to classify Rodrik – despite his
different conclusions about the benefits of trade and despite the fact that he
contributes to volumes together with heterodox economists\textsuperscript{37} – under the post-Washington Consensus category. His approach, methods and tools are firmly rooted
in the mainstream neoclassical economics framework.

In probably his best known publication, Rodrik writes that
“this book is strictly grounded in neoclassical economic analysis. At the core of neoclassical economics
lies the following methodological predisposition: social phenomena can best be understood by
considering them to be an aggregation of purposeful behavior by individuals—in their roles as
consumer, producer, investor, politician, and so on—interacting with each other and acting under the
constraints that their environment imposes. This I find to be not just a powerful discipline for
organizing our thoughts on economic affairs, but the only sensible way of thinking about them. If I often depart from the consensus that ‘mainstream’ economists have reached in matters of development policy, this has less to do with different modes of analysis than with different readings of the evidence and with different evaluations of the ‘political economy’ of developing nations. The economics that the graduate student picks up in the seminar room—abstract as it is and riddled with a wide variety of market failures—admits an almost unlimited range of policy recommendations, depending on the specific assumptions the analyst is prepared to make. As I will argue in the chapters to come, the tendency of many economists to offer advice based on simple rules of thumb, regardless of context (privatize this, liberalize that), is a derogation rather than a proper application of neoclassical economic principles.”

In a similar vein to Krugman’s previous discussion of early development economics, Rodrik claims that

“neoclassical economics is fairly good […] in absorbing insights from outside perspectives and developing them in ways that their originators could not do. For my part, I have to say that I understand Schumpeter’s key insights on technological innovation a whole lot better once I see it expressed in neoclassical garb.”

It thus seems apparent that – without attending to the conclusions made by these authors – their analysis is strictly rooted in neoclassical economics including its methodological assumptions.

When it comes to the discussion on the role of the public and private sectors in development, the post-Washington Consensus allows for a significantly bigger role for the government than its predecessor. Observing the success of the East Asian economies in economic transformation, Stiglitz concludes that governments certainly contributed to it; the government of South Korea, for instance, was able to challenge the privatisation ideologues by creating the most efficient steel plants in the world.
By following some of the standard prescriptions (such as stable macroeconomic policies), while ignoring others (practicing industrial policies, intervening in trade, regulating financial markets), the East Asian miracle countries were able to create the mix of policies that – despite the open question of individual policies’ impact – worked well.\textsuperscript{41} Stiglitz criticised the neoliberal program for comparing an ideal market economy with the average or worse performing states, “with the obvious conclusion that, even where there are market failures, there is limited role for government intervention”\textsuperscript{42}, and claimed that when comparing like with like, rent seeking can be every bit as much a problem in the private as in the public sector.\textsuperscript{43} Stiglitz also admitted that states are often involved in too many things and recommended that governments should rather focus on the fundamentals (economic policies, health, education, roads, law, environment), but insisted that this was not a recipe for a minimalist government.\textsuperscript{44} He remains principally in favour of privatisation, but only if accompanied by competition and regulation\textsuperscript{45}, and maintains that public and private sector should complement each other, acting as partners in the development effort.\textsuperscript{46}

During his tenure in the World Bank, Stiglitz’s novel approach also found its expression in the \textit{World Development Report 1997}.\textsuperscript{47} According to Bayliss, this publication marked a relaxation in the Bank’s anti-statist line that had blamed the public sector for all economic problems and ills.\textsuperscript{48} In a similar vein, Fine observes that the report was a culmination of the World Bank’s developing position in which the state has been seen more positively, if cautiously so, from anti-market, through market-conforming, to market-friendly.\textsuperscript{49}
Consistent with his rather ambiguous views on openness and free trade, Rodrik believes in the ability of governments to do good and change societies for the better. He adds that governments have a positive role in stimulating economic development that goes beyond just enabling markets to function well. Rodrik claims that the important role played by the government policy of the East Asian miracle economies in stimulating private investment needs to be appreciated, and he adds that certain government interventions are necessary to transform poor countries into rich ones; that good public institutions make the task of intervention easier; and that markets and states are complements, particularly where social insurance is concerned. The later work of Sachs is also based on the assumption that market forces are generally not sufficient to produce a high flow of innovations and that government support is needed. When discussing growth prospects in Africa, Sachs calls for massive foreign investment activity (a ‘big push’) and aid, aimed both at infrastructure and disease control.

When discussing the post-Washington Consensus position vis-a-vis the state, the inspiration it takes from the ‘new institutional economics’, as presented notably by Oliver E. Williamson and Douglas C. North, should not be overlooked. This influence can be seen particularly around the turn of the century in those World Bank’s reports discussing the issues of state, institutions, corruption, and governance. In the mainstream developmental discourse, it came to be claimed that institutions and good governance are the most important requirement for long-term economic development. The state was then redefined as a provider of these institutions with the ultimate goal of facilitating an efficient market economy, in which rational individuals express their preferences by entering contracts. The
discourse of development thus did not abandon the bounds of neoclassical economic theory; the new institutional economics merely provided an elegant tool to avoid challenging previous macroeconomic reforms, and instead to focus on building or reforming institutions.\textsuperscript{56}

The post-Washington Consensus development economics current of thinking is generally supportive of foreign direct investment. Stiglitz differentiates two kinds of FDI – the old type dating from the 1960s and 1970s, and a more modern incarnation.\textsuperscript{57} The former represented an enclave phenomenon, where the attraction of investments and increasing mineral exports did little to spur development over the long term; whereas the latter not only brings management expertise, technical human capital, technologies, and overseas market channels, but also better integrates them into surrounding society. Stiglitz believes the latter type is prevalent nowadays, and therefore that FDI is something to attract, not to fear.

For his part, Sachs discusses the types of countries and their geographically determined opportunities to benefit from FDI. Those that are close to major markets have a natural advantage and can offer assembly services, whereas geographically isolated, ‘landlocked’ countries are able to attract only foreign investors interested in exploiting primary commodities with a high value per unit weight (oil, diamonds etc.). In the former case, he views the benefits of FDI optimistically: countries attract labour-intensive export oriented FDI – they generate income, modest skills, and resources to invest in improved education – that leads to upgrading of the FDI facilities – eventually the economy becomes an endogenous-growth innovator in its own right.\textsuperscript{58}
An important component of the post-Washington Consensus is the emphasis on strong but wisely regulated financial sectors. Stiglitz was critical about the Washington Consensus’s support for a complete financial and capital markets liberalisation that was based on the assumption of perfect information. 59 According to him, financial market liberalisation – often imposed from abroad – played a crucial role in contributing to the weaknesses in financial institutions and to the financial crises. 60 Stiglitz highlights the importance of the financial system for growth and development – if this ‘brain’ of the economy works well, resources are effectively allocated for the most productive use. However, he also notes that if left to themselves, financial systems will fail to fulfill this function because of incomplete information, markets, and contracts. A sound legal framework combined with regulation and oversight is therefore necessary for financial markets to work efficiently. 61

The post-Washington Consensus was able to embrace and mainstream the critique of the Washington Consensus without having to abandon the basic methodological and ideological fundamentals of standard neoclassical economic theory; nevertheless, its version of development receives adjectives sustainable, egalitarian, and democratic. To different extents, the authors listed in this development economics current depart from unconditional support for free international trade. Some admit the difference between the modeled free market ideal and the reality, including its market imperfections; the more radical ones conclude that the openness of a country is an irrelevant factor in the quest for growth and development, or explicitly acknowledge that some sort of industrial or protectionist policies may be desirable.
When it comes to the discussion on the role of the public and private sectors in development, the post-Washington Consensus allows for a significantly larger role for the government than does its predecessor. The post-Washington Consensus development economics current of thinking is generally supportive of foreign direct investment, but suggests that there is a need for differentiation between enclave FDI and genuinely beneficial FDI. An important component of the post-Washington Consensus is the emphasis on strong but wisely regulated financial sectors.

What are the implications of this discussion and the conclusions therein for the present economic (not only development-related) policy debate? Compared to the not so distant past, it is at least positive that economists who take account of economic realities can be seen to be having growing influence. Even more important is the consensus that economies should serve human development. However, it should be noted that the post-Washington Consensus – despite its harsh critique of prevalent economic policies and the model of economic development – is still some distance from proposing a more fundamental alternative. At the political level, it is definitely in favour of capitalism – a regulated one, but still capitalism. This is no novelty for many, including the reviewed authors, but should be fully taken on board by those who have the impression that Krugman’s or Stiglitz’s critiques are anti-capitalist or anti-system. They are certainly not.

At the academic level, the post-Washington Consensus analysis is still firmly rooted in neoclassical economics. In its critique, it barely refers to other currents of economic thinking. Its focus on micro-foundations prevents the post-Washington Consensus
from formulating a social theory – it is incapable of accounting for (and thus ignores) notions of class, political power, and the like.62

To conclude, the authors that broadly fall under the category of the post-Washington Consensus can be very useful to ally with in criticising the most excessive failures of prevailing economic policies. However, if one is interested to propose systemic alternatives to capitalism, sources of inspiration should be looked for elsewhere.

Notes

6 Stiglitz is the most renowned representative of the post-Washington Consensus and I will focus on his arguments in this account. However, his positions – critical but not too radical – have made it to the mainstream. As he himself puts it, what he says on development “is far from revolutionary: within the World Bank and the development community, more broadly, there has been an increasing attention” to the issues neglected by the Washington Consensus (See Stiglitz, Joseph E. 1998. “Towards a New Paradigm for Development.” vol. 9, Raúl Prebisch Lecture. Geneva: UNCTAD, p. 30.)
7 Ibid., p. 6.
8 Ibid., pp. 6-7.
14 Ibid., p. 34.
15 Ibid., p. 31.


Ibid., p. 25.

Ibid., pp. 20-24.


For an eloquent analysis and documentation of how the new institutional economics was absorbed into the World Bank’s development discourse, see Schwank, Oliver. 2003. “Staat, Markt und Demokratisierung im Entwicklungsprozess: Zur Neuorientierung der Weltbankpolitik in den 1990er Jahren.” Journal für Entwicklungspolitik XIX:52-68.


