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The "Washington Consensus" and Development Economics

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Introduction

The disappearance of development economics, and replacement of economic development strategy with a simple code for liberalizing international trade and capital flows, has undoubtedly contributed to the economic failure experienced by the vast majority of low to middle income countries over the last two decades. Thandika Mkandawire and others have summarized some of the analytical capacity and tools that were lost in this neo-classical and neo-liberal resurgence. In many ways it is similar to the loss of knowledge in the natural sciences due to clerical influence during the Middle Ages; so it is a great thing that the UNRISD has taken up this project not only to recover lost knowledge but to lay the foundation for real progress in both practice and theory.

I would like to reverse the natural order of such a discussion and begin with the specific rather than the general, to focus first on the political and strategic aspects of reviving Development Economics. To move away from the extremist position that now dominates economic thinking and practice on these subjects will require simultaneous battles on a number of fronts. We will need to create the political, intellectual, and media space for a more honest discussion of very crucial economic issues -- a discussion that barely exists, in the most prominent forums, at present. This could take a long time, but some of it can be done piece-by-piece: there are certain strategic reforms that may be winnable in the near future, that could bring us much closer to these goals.

Creating the Political Space for the Practice of Development Economics

One of these concerns the most important Multilateral Economic Institutions (MEIs): the IMF, the World Bank, and the WTO. The IMF is by far the most powerful of these organizations. Together with the Bank, which is subordinate to it, the Fund controls a creditors' cartel that can deny to dozens of countries access to not only to Fund and Bank credit, but the credit of other multi-lateral lenders (e.g. the Inter-American Development Bank), governments, and often most of the private sector, unless the borrowing

country meets their conditions. Since these conditions generally preclude the pursuit of an economic development strategy, the weakening and breaking up of this cartel must be an urgent priority. For even if some governments were to embrace a new Development Economics and wish to implement the best possible programs, they will not necessarily be able to make any positive changes when they are confronted by such concentrated power.

This power is even more concentrated than it appears on paper, where the United States has about 18 percent of the voting shares. In practice, the US Treasury Department has much more control than that, and the other high-income countries, who could outvote the United States, have never chosen to do so. The *New York Times* has referred to the IMF as "a proxy for the United States," and this is a reasonably fair description. Last year witnessed the first public disagreement over between the US and Europe -- over who would succeed Michel Camdessus as managing director. Europe eventually backed down and supported a candidate acceptable to Treasury.

The power of the IMF to decide the most important macroeconomic policies for dozens of countries is not written in its charter or anywhere else. Rather it is the result of an informal arrangement between the IMF, the World Bank, the G-7 governments, and other creditors, which puts the IMF at the head of a creditors' cartel. This arrangement can be broken down, and in fact it is beginning to break down.

During the Asian financial crisis, the government of Malaysia rejected IMF loans and conditions, and opted for the unorthodox measure of currency controls (rather than using exorbitant interest rates, as high as 80 percent in Indonesia, to attempt to stop the depreciation of the local currency). Neither the bond markets nor the Fund were pleased with this policy. But Malaysia suffered less of an economic contraction than the other affected countries, and it appears that the currency controls helped.

More recently, Putin's economic adviser Andrei Illarionov declared "We didn't need IMF money before, and we don't need it now. It causes nothing but harm." There are other countries, similarly situated -- in the sense that there is no real punishment that could be visited upon them that would cause more harm than the Fund's current policies -- who could reject IMF loans and conditions. There is currently debate in Brazil over whether to accept the Fund's offer of a $15 billion line of credit, with austerity conditions (again in the midst of an economic slowdown) attached. It is not difficult to imagine that in the near future, the cartel will weaken to the point where many countries can reject IMF advice and loans without taking the risk that they will be economically strangled.

In fact, we were perhaps momentarily not far from that point in 1998, when the US House of Representatives failed on three votes to appropriate an $18 billion quota increase for the IMF. (It became $90 billion, a 50% increase in the Fund's capital base, when matched by other member countries). The money was eventually attached in a House-Senate conference committee. But a loss of confidence in the Fund within the United States would have far-reaching consequences, since it is the political power of the US that allows the Fund to play its "gatekeeper," or cartel organizer, role.

The top leadership of the Fund is reportedly demoralized (ref. to Economist) by the decline in support within the Treasury department under Secretary Paul O'Neill, who has publicly criticized the Fund. By contrast, O'Neill's predecessor, Larry Summers, was a leading advocate for the Fund and its policies throughout the world, giving it unqualified support and fighting for access to the maximum possible resources.

The IMF has also been subject to increasing criticism as a result of growing protests by NGOs in the developed countries (large scale protests and demonstrations against structural adjustment have occurred throughout poorer countries for decades). The Fund and Bank have just cancelled most of their Fall meeting schedule in Washington DC, originally set for September 26- October 4, in response to expected protests. Among other groups, the 13 million member AFL-CIO has called upon its membership to join the demonstrations, demanding that the IMF and World Bank cancel the debts owed to them by poor countries, from these institutions' own resources, and without any structural adjustment conditions attached to debt cancellation. The AFL-CIO's participation is particularly noteworthy: it is probably the first central labor federation of a major developed country to take a strong stance against the Fund and the Bank. It also shows the strong potential for solidarity between organized labor and other NGOs in the high-income countries, and the interests of underdeveloped countries in pursuing independent development strategies, at a time when the press has focused on potential conflicts of interest (e.g. protectionism vs. access to developed country markets, and disagreements within the WTO over labor and environmental standards).

These political developments within the United States are particularly important, because Treasury is the overwhelmingly predominant force within the IMF. But movements within other developed countries, especially in Europe and Japan, could play a much larger role than they have so far. At present, the governments of these countries cede authority in these institutions to Washington, despite the fact that -- for various historical and domestic political reasons -- they do not necessarily agree in principle with the extreme version of neo-liberalism that Washington advocates for developing countries. This also rests on an informal arrangement, mostly dating back to the creation of the Bretton Woods organizations at a time when, in the rubble of World War II, the United States was practically the only industrial power in the world.[1] The arrangement will not last forever, and there is much that could be done to hasten its demise.

At the beginning of the Asian financial crisis, in September of 1997, Japan proposed creating an Asian Monetary Fund to stem the panicked selling of local currencies that was soon to spread from Thailand to South Korea, Indonesia, Malaysia, and the Philippines. There were pledges of support for a $100 billion fund from governments throughout the region, including China and Taiwan. But the United States insisted that any support for these economies had to go through the IMF. Japan yielded, and the rest, as they

1 It is often said that if the Fund did not exist it would have to be created, but if it were it would be very different from the IMF of today. This can be seen by comparison with the WTO, which was born nearly six years ago: within the WTO the developed countries have serious disagreements over major policies, and although the G-7 countries still dominate, decision-making is formally by consensus.

say, is history. As is now well known, the Fund failed to provide the necessary liquidity to contain the financial crisis, and then exacerbated the ensuing regional recession with monetary and fiscal austerity, and a host of unnecessary and sometimes counter-productive conditions attached to the loan package that was eventually approved.

In this case Japan's proposal was probably a result of its greater stake in the regional economy (the major recipient of its exports and direct investment), but also -- based on its own experience as a relatively late-industrializing country -- a less rigidly neo-liberal view of the parameters of economic and development policy. Europe is also different from the United States in at least some aspects of its foreign commercial policy; yet within the IMF and the Bank, their representatives consistently defer to Washington. This is something that can and must be changed, if we are to open up space for the practice of development economics in low-income countries.

In particular, the participation of NGOs from other OECD countries in some of the "harm reduction" strategies that have so far been put forth within the United States, and the pressuring of their governments to push for changes within the IMF and the Bank, could have a considerable impact. For example, as a result of efforts by more than 120 NGOs in the United States, the US Congress last October passed a law requiring the US Executive Director at the IMF, World Bank, and other multilateral lending agencies to oppose any loan or debt relief agreement that imposed user fees on primary health care and education for poor people. These fees, which had been a condition of World Bank lending for years, had resulted in millions of children in Africa being pulled out of school, and denial of previously free health care services. Efforts are currently under way to stop the Bank and IMF's promotion of the privatization of water resources (especially the Bank's "full cost recovery" policies that prohibit subsidies for poor consumers).

These "harm reduction" strategies create an avenue for dismantling structural adjustment piece by piece, while actually reducing some of the harm caused by the IMF and the World Bank at the same time. They also highlight for the public some of the worst abuses committed by unaccountable institutions. Organizations from the Global South are a significant part of this effort; the increased participation of NGOs from developed countries other than the US would give these efforts a higher profile. The movement for debt relief, in which European organizations played a major role, forced the IMF and WB to adopt the HIPC initiative in 1996. Although the ensuing debt relief has been quite limited, and economically and socially destructive conditions have often been attached, the power of such organized and public opposition has been demonstrated. The major NGOs are now calling for 100 percent cancellation of poor countries' debts, from the resources of the IMF and the World Bank, and Jubilee South is working to persuade poor country governments to form a debtors' cartel with which to confront the creditors' cartel led by the IMF. Debt cancellation, too, is a strategic reform, since it would lessen the hold of the IMF and the World Bank over poor countries.

Ultimately, of course, it is the low and middle-income countries themselves who will have to decide on the implementation of development strategies. But the punishment that comes with rejecting the current neoliberal orthodoxy is often formidable at present; in the near future we have to change this by limiting the enforcement capabilities of the IMF-led creditors' cartel.

One of the most promising strategies to date for bringing pressure to bear on the creditors' cartel is the international boycott of World Bank bonds, launched by NGOs and social movements from 35 countries in April of last year. In the United States it has quickly gathered steam, joined by city governments of Oakland and San Francisco, major unions such as the Communications Workers, churches, and socially responsible investment funds. It is modeled after the world-wide anti-apartheid movement (one of its founders and main leaders is Dennis Brutus) and provides similar opportunities for activists to bring these issues to their local governments, unions, churches, universities and communities. The Bank raises about 80% of the funds it lends to middle income countries through these bonds, and they are common enough throughout the portfolios of institutional investors so that it makes sense for almost any institution with an endowment or a pension fund to pass a resolution not to buy them. Just as massive international pressure was built against the apartheid state before the boycott affected the stock prices of companies doing business there, this movement can have enormous impact well before the Bank loses its AAA bond rating. The most important and immediate effect of such a boycott is to enable activists throughout the world to organize and raise awareness of the workings of the IMF/World Bank's cartel.

Creating a More Honest Debate

The power of the IMF and World Bank, along with the US Treasury Department, to decide economic policy in developing nations rests not only on their monopoly over credit, or other economic and political influence, but also the legitimacy and even dominance of their ideas. Their ideas hold sway throughout the dominant news media and academia. The Fund itself is widely seen as a lender of last resort, playing the role of a central bank in the global economy, and requiring borrowing countries to adopt "sound macroeconomic policies" (a common description in the US press).

Furthermore, most of the neoliberal principles that have replaced the discipline of development economics -- most importantly, the idea that simply opening up to international trade and investment constitutes a development strategy -- enjoy widespread acceptance in educated circles. This is true in spite of the fact that the last 20 years of the experiment in applying these principles, during which most low and middle income countries significantly opened their economies and followed Washington's economic advice, have been an unquestionable economic failure. In Latin America, GDP per capita has grown by about 7 percent over the last two decades; from 1960-1980 it grew by 75 per cent. In Africa, income per capita grew by about 34 per cent from 1960-80; it has since *declined* by more than 15 percent. This decline in growth has occurred throughout the vast majority of developing countries. The major exceptions are China and India, but neither can be pointed to as an example of success in adopting neoliberal policies. China, which recorded some the highest growth rates in

world history over the last 20 years, maintains strict currency controls, considerable protection of its domestic consumer markets, and its financial system is dominated by state-owned banks.

If we group countries by their starting level of per capita income, rather than by region, the growth slowdown is very pronounced. The lowest quintile went from a per capita GDP growth rate of 1.9 percent annually in 1960-80, to a *decline* of 0.5 percent per year (1980-2000). For the middle quintile (which includes mostly poor countries), there was a sharp decline from an annual per capita growth rate of 3.6 percent to just less than 1 percent. These declines in growth represent an enormous difference in living standards as compared to what was considered normal and feasible in the past, and there were declines across all groups of countries.

The failure of the last two decades also shows up in a substantial decline in the major social indicators (again dividing the countries into quintiles according to their initial level at the beginning of the period). For almost all groups of countries, there was considerably reduced progress in life expectancy, infant and child mortality, measures of education, and literacy in the past two decades, as compared with the period from 1960-1980.[2]

If these basic facts were well known -- especially the failure regarding economic growth -- there would be a much different public debate about the last 20 years. The main question would be: what has gone wrong? What are the structural and policy changes that have led to this wide-ranging failure?

A change in the debate of this nature would help to create political space for a renewed practice of development economics. There are many paths to development, as Keith Griffin has argued, but the problem is that almost all of them are currently blocked by the reigning neo-liberal orthodoxy. And now we have the WTO throwing further obstacles in the way, for example, through its TRIPS (Trade Related Aspects of Intellectual Property Rights). By tightening the enforcement of patents and copyrights, the TRIPS agreement will make it much more difficult, if not impossible, for developing countries to industrialize in the way that countries such as South Korea and Taiwan did, on the basis of borrowed technology; while at the same time draining tens of billions of dollars of scarce capital from South to North, for royalties and other intellectual property payments.

Economists and policy analysts from throughout the world can play an important role in changing the public debate, and making it more honest. In the last year or two the World Bank has for the first time begun to respond to its critics on the economic arguments. These efforts have mostly taken the form of econometric analysis purporting to show that countries that have "globalized" more rapidly have experienced higher growth.[3] Dani Rodrik[4] has shown that such results derive from such faulty reasoning as using imports/GDP -- an outcome rather than a policy variable -- to measure

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[2] The above data and sources on growth and social indicators can be found in "The Scorecard on Globalization: Twenty Years of Declining Progress, 1960-1980" at www.cepr.net.

[3] See e.g., "Trade, Growth, and Poverty" by David Dollar and Aart Kraay, 2001, www.worldbank.org

[4] Rodrik, Dani, “Comments on ‘Trade, Growth, and Poverty,’ by D. Dollar and A. Kraay, ”October 2000

openness, as well as other arbitrary and inappropriate selection of countries that biases their results.[5] Another examination (Rodriguez and Rodrik[6]) of the leading economic papers purporting to show a positive relationship between openness and growth revealed similarly fatal econometric flaws.

Research of this type can be extremely valuable in creating a more honest debate about development. It can be done in any academic setting, and much of it can be done by graduate students. Research that documents the continuing failure of IMF and neoliberal policies can play a similarly vital role. One of the great problems we face in opening up the debate over economic development is that the journalists who report on these issues are get their analysis primarily from one side; if it were not for the vocal dissent (and papers) of Joseph Stiglitz, Jeffrey Sachs and Steve Radelet during the Asian economic crisis, it is very possible that the IMF's role in creating and exacerbating that crisis would have passed almost unnoticed in the Western press. As a result of the debate that ensued, the IMF's plans to amend its charter to in order to promote capital account liberalization have at least been put on hold.

The Fund's current intervention in Argentina should be thoroughly discredited by now. It has arranged loans amounting to more than14% of Argentina's GDP in just the last year, which together with fiscal austerity and high interest rates in the midst of a prolonged recession, have imposed enormous costs simply to prop up an overvalued currency. Yet these same efforts failed completely in both Russia and Brazil in 1998-99, where both currencies collapsed and, contrary to the arguments and predictions of the IMF that this would be an economic disaster, both economies responded positively to the devaluation -- with Russia registering its most rapid growth in two decades.

These are the kinds of gross errors and malpractices that should not be allowed to go unchallenged in the public debate, and hence repeated indefinitely. (The history of the Asian economic crisis is already being rewritten as an example of successful intervention by the IMF). An organized public presence of economists could make journalists and policy-makers more aware of these failures, and demonstrate that there is widespread expert opinion, based on sound economic reasoning and data, that seriously challenges these and other failed policies. In the current crisis in Argentina, for example, the idea that "there is no alternative" to the present policies prevails, however implausible that sounds, because there are hardly any credible voices offering alternatives represented in the press.

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[5] A CEPR review of Dollar and Kraay's earlier and widely publicized (in the press) paper (Growth *Is* Good for the Poor, 2000) showed that the authors' data and regressions could not support most of their main conclusions: e.g. that "globalization is good for the poor (p.22)," and that "anyone who cares about the poor should favor the growth-enhancing policies of good rule of law, fiscal discipline, and openness to international trade." (p27). See "Growth May Be Good For the Poor, But Are IMF and World Bank Policies Good for Growth?" www.cepr.net

[6] See Rodriguez, Francisco, and Dani Rodrik, "Trade Policy and Economic Growth: A Skeptic's Guide to the Cross-National Evidence," in B. Bernanke and K. Rogoff, NBER Macroeconomics Annual 2000, Cambridge, MA, MIT Press, 2000

On the broader issues of creating a new Development Economics as an academic discipline, Lance Taylor has summarized some of the openings that currently exist within academia. I would only like to add that some of his own country studies, and those of Ricardo Ffrench Davis and others, have provided a valuable and ongoing contribution to a literature that provides not only a critique of the present orthodoxy, but also a means of examining the practical problems of what policies might work and under what conditions, which will be vital to the revival of Development Economics in practice.

As for a paradigm shift of the kind that "disappeared" Development Economics in the 1970s and 80s, this is a much longer project. When Development Economics emerged in the 1940's and 50s, methodological individualism -- in particular the derivation of macroeconomic theory from methodological individualist micro-foundations -- had not yet become the norm in economics. Even so, W. Arthur Lewis had to seek refuge in the classical paradigm, with institutionally determined wages and a revival of the classical concept of the surplus. In so doing he re-established the classical link between the surplus, social classes, and income distribution -- a conceptual framework that could at least relate the problems of capital formation to the actual resources from which it might come. Others -- e.g. Nurkse, Myrdal, Rosenstein-Rodan -- drew on Keynes and even Schumpeter to get outside of the ideological and methodological constraints of neoclassical economics, in order to try to understand some of the problems of economic development.

Economics has traveled a long way since the early development economists made their case for development planning or dealt with crucial questions such as balanced growth or the role of the state in late industrialization. In 1956 Gunnar Myrdal observed that no developed country had ever left so much of its development policy to market forces as the underdeveloped countries were then encouraged to do; and yet this is many more times true today as it was then. Myrdal also recognized that market forces, if left to themselves, tended to exacerbate inequalities in development -- hence his theory of "cumulative causation," and the observation that there are real, structural impediments to development that are embodied in the international economic order. Looking back from the vantage point of today, it is difficult to imagine that these ideas found their way into the mainstream of economic theory, which now rejects the idea that it even needs a discipline of development economics.

There were a number of historical factors outside of the discipline that allowed for these departures from neoclassical economics. The process of de-colonization in the context of post-war reconstruction, in which newly independent countries had an interest in economic growth and development that could no longer be ignored by the developed countries; the recent experience of wartime planning, and the Cold War all played a role. It is worth remembering, too, that for the United States in the 1960s development policy was merged at the highest levels with counter-insurgency, military and political strategies that constituted some of the worst abuses in the history of US foreign policy. These strategies were directly antagonistic to independent economic development in underdeveloped countries, and this tension played an important role in the demise of development economics.

I have focused here on the role that economists and policy analysts can play in shaping the parameters of the current debate because this appears to be an urgent need at present. The creditors' cartel of the IMF and the World Bank, and the dominance of neoliberal policies and ideas are maintained today through a combination of secrecy, unaccountability, and a lack of public debate and understanding. Nonetheless, in the last few years these institutions and policies have faced growing scrutiny and political opposition. A concerted effort to bring about certain strategic reforms at this time can help to create the necessary space for the practice, and spread, of a new development economics.