From the Washington Consensus Towards a 21st Century Consensus on Development

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Stockholm
September, 2016

I. Two Preliminary Remarks

- Washington Consensus as it is generally understood was broader, more market oriented, than Williamson—and Williamson himself recognized some reservations
  - Fiscally sound—operational budget deficit less than 1 to 2% of GNP
    - Williamson noted that one should exempt investment, but not include privatization revenues, but should include increase in Social Security obligations
    - Noted value in countercyclical policy design—but not included in "consensus"
  - Market oriented (free market capitalism)—including privatizations, market determined exchange rates and interest rates, no subsidies, deregulation, property rights—and downsizing government
    - Are circumstances in which carefully targeted subsidies work—including aimed at distribution
    - Redirecting expenditures towards education, especially primary
      - But in practice, balanced concerns by imposing cost recovery
    - Recognizes value of infrastructure
    - Williamson: "not persuaded that public service is always inferior to private acquisitiveness as a motivating force."
  - Outward orientation—welcoming FDI, no tariffs
    - But should set competitive exchange rate (lower than market rate)—unlike standard prescriptions
    - Zero tariff discussion focuses on intermediate goods
- Williamson asks: they may be necessary, but are they sufficient to restore growth?

Based on classical economics—with a mild (very mild) dose of Keynesian economics

- Based on presumption that markets work well
  - Williamson noted little note was made of insights of development economics
  - We will note that little was made of insights of *modern* economics, providing alternative understanding of how economic systems work
    - Presumption that markets are not efficient, may not promote growth, and often lead to highly inequality outcomes
- Ideology held very strongly—typically unaffected by evidence to the contrary
  - Ignored theory and evidence *available at the time*
  - To a large extent, has continued to do so

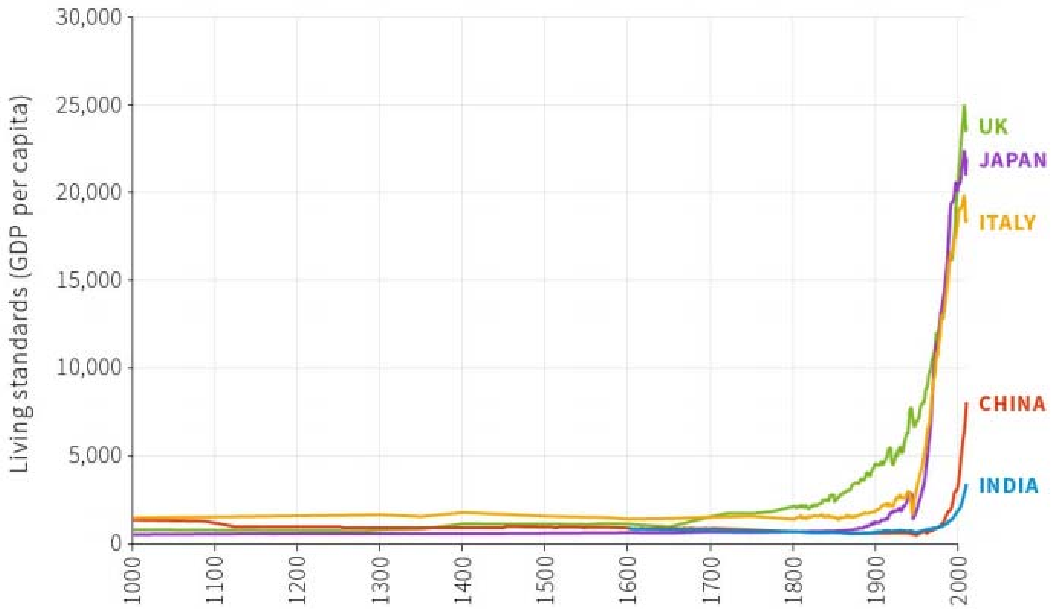
II. Reconceptualizing the meaning of development

- Not just closing the gap in resources
- Not just the *development* of markets
- Not just the development of certain institutions
- Not just an increase in GDP per capita

That, but much more

- Closing the gap in knowledge
- The structural transformation of the economy
- And, most importantly, the change in *mindsets*
  - *Change is possible*
  - *And the country, collectively, has the power to bring about that change*
- The enlightenment mindset—which brought the world out of the stagnation in which it had been mired for centuries

Historical living standards



Source: INET

Real wages of London craftsmen, 1200-2000

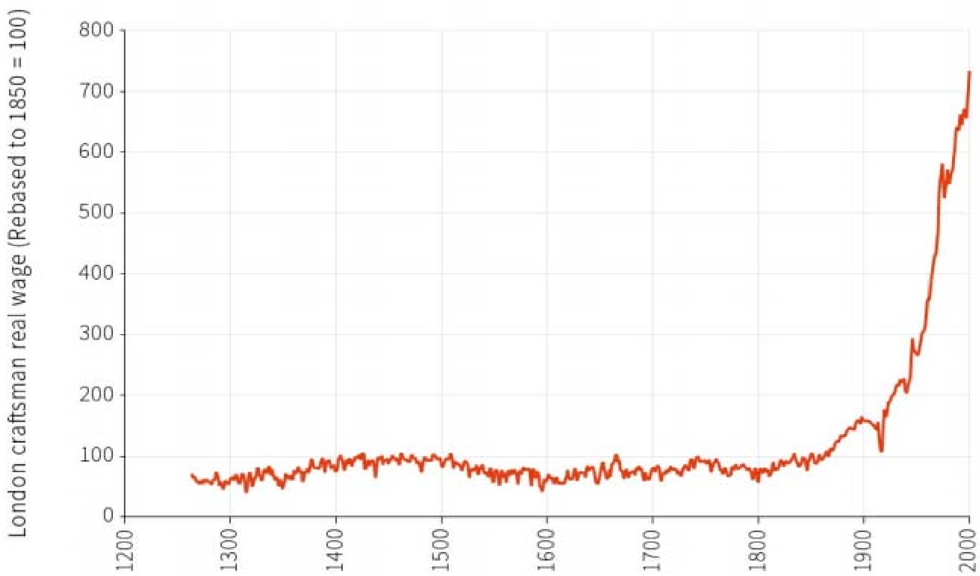
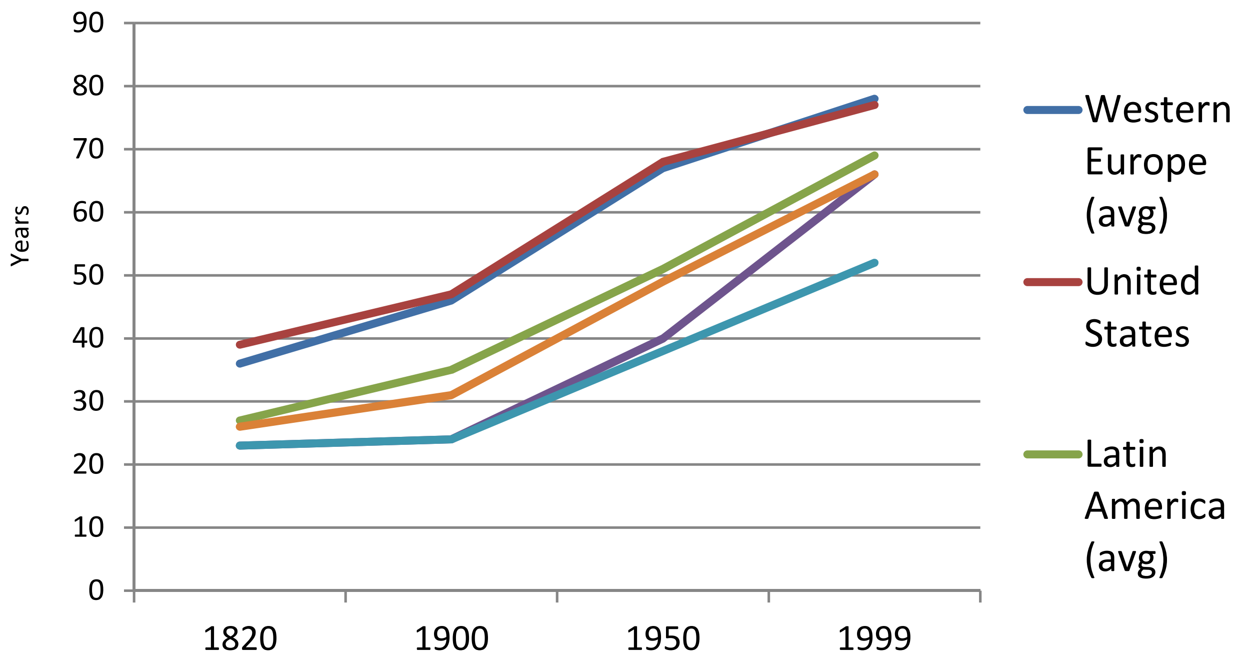


Figure 3. *Real wages over seven centuries: craftsman (skilled worker) in London (1264-2001).*

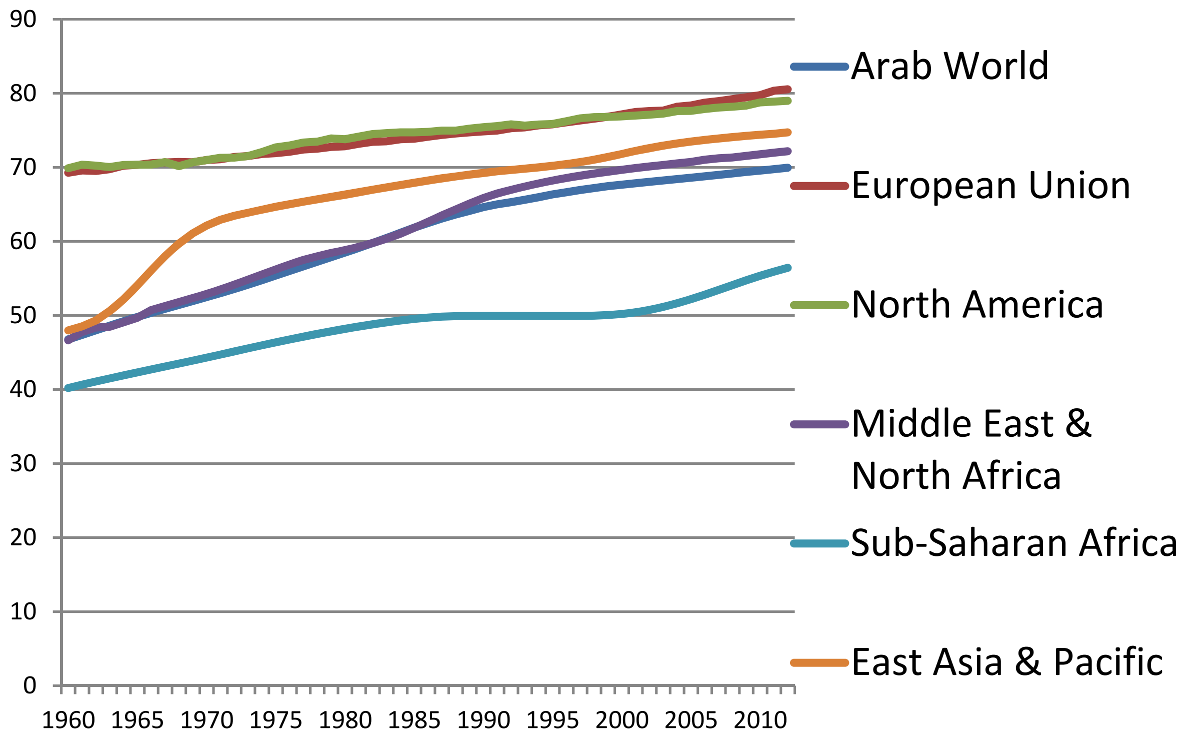
Source: INET

Improvements in life expectancy since 1820



Data are estimates from A. Maddison, 2001, "The World Economy: A Millennial Perspective," OECD.

Improvements in life expectancy since 1960



Source: World Bank DataBank

III. The failure of the WC

- Countries that broadly followed dictates didn’t do well
- Structural adjustment in Africa was a disaster
- A lost quarter century
  - per capita income in 2000 was barely at the level of the mid-1970s
- Even today, industrialization is lower than it was before structural adjustment started
  - Africa’s manufacturing value added in GDP has fallen from nearly 12 per cent in the 1970s to just over 9 per cent in the 2010s
- In Latin America too WC associated with lower growth, more volatility
  - Though some controversy about the explanation of the lost decade

Basic framework failed in providing guidance for countries in transition

- Except in China and Vietnam and the countries joining the EU, that transition has been a real disappointment
- Had expected move to market economy—end of central planning, use of prices, restoration of incentives, establishment of property rights—would lead to faster growth
  - Shock therapy didn’t work
  - Reliance on WC policies arguably contributed to failures

Countries that didn't follow dictates did well

- East Asia Miracle—multiple countries
- Development/growth beyond anything that had been thought possible
  - And contrary to what others (Myrdal) had thought would occur
  - Hundreds of millions moved out of poverty
- Based on government assuming a major role in the economy
  - But using markets
- Major debate about what it was that the government did that led to success
  - Different countries did different things, policies and strategies changed over time
  - but none had policies shaped by WC

Africa has started to grow after it left WC policies

- Ethiopia and Rwanda, two war-torn countries, adopted development state model, and became among the fastest growing countries around the world
- So too for Mauritius and Botswana
- The other fast growing countries in Africa have been based on natural resources, and have continued traditional neo-colonial model, growth without structural transformation

But elsewhere in Africa, even countries following more restrictive WC policies have not done well

- Have not been able to close gap
- Even when they have achieved macro-stability and "good governance"
- What growth there has been has been (a) result of oil and other natural resource bonanza, often spreading to neighbors; and (b) Chinese engagement, including in infrastructure
  - Will it be sustained as natural resource prices fall and Chinese economy slows.

Critical failures of policies (both of WC and of neo-liberalism in advanced countries, broadly defined)

- Failure to produce growth
  - What growth there was, was not equitably shared—Most of benefits went to those at the top and most saw their incomes basically stagnated
    - But some countries managed even to reduce inequality
  - Showed that trickle-down economics didn't work
    - And implied that GDP was not a good measure of economic performance
  - Differences among countries showed that it was not just a matter of economies, but of policies
- High levels of instability
  - No crises for forty years after Great Depression
  - Repeated crises under new policies
- Failures related
  - Crises are bad for growth
  - Poor suffer most from crisis
  - Inequality bad for both growth and stability

Lingering effect of WC beliefs

- While the Washington Consensus policies and the theories on which they have been based have been widely discredited, their influence still lingers, often masqueraded using different language
- Consistent with Keynes' quote
  - "Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually slaves of some defunct economist"
  - Though in this case, ideology underlying WC policies is far from dead

IV. Viewing WC in historical context

- Many of development policies combined with international economic arrangements pushed by WB (including some of WC) after end of colonialism are consistent with maintaining neo-colonial "extractive" relationship
  - Tariff structures marked by escalating tariffs
  - Global reserve system meant that there were flows of money from developing to developed countries
  - Investment treaties designed to restrict ability to tax and impose regulations
  - Refusal to develop Sovereign debt restructuring mechanism (even when developing countries overwhelming endorsed set of principles) left bargaining power with developed countries
  - Transfer price mechanism encouraged race to bottom and limited developing countries from extracting much tax revenues from MNE—even after they had been encouraged to let them in
  - Focus on primary education encouraged primary production—adapting colonial tradition in minimal way
  - Worked hard to ensure that voice of developing countries remained limited in international organizations—limiting change

WC ideas arose in 80’s

- At time of political dominance of Reagan-Thatcher
  - Can be seen as extending that ideology to emerging world
  - Framework to combat Communism—alternative “program” to Communism/socialism
- But in West ideas quickly became discredited
  - Supply side predictions did not come true
  - Voters quickly voted out extreme holders of Thatcherism
  - But ideas still lingered
- Even before that ideas had been discredited by economics

The dominance of WC

- WC came into dominance in period after fall of Iron Curtain
- West took away wrong lesson: thought it was success of market economy, not the failure of Communist model
- Milder versions of Reagan-Thatcherism continued on both sides of Atlantic—Blair-Clinton-Schroeder
  - Financial sector deregulation, so call free trade agreements (really managed trade agreements, managed for interests of corporations)
  - Growth of corporate and financial economic and political power
- Period in which there was no contest for Africa, other developing countries—end of Cold War
  - Countries had no choice of sources of funds
  - West could get away with conditionalities that would not otherwise have been acceptable
    - But with end of cold war, increasingly, the idea of aid came increasingly into question

The attack on WC from within the developed countries

- Development and environmentally oriented NGO's pointed out hypocrisy of West, deficiencies in global governance, in WC policies (as they continued to be elaborated by WB and IMF)
- Markedly different from what, e.g. democratic administrations pushed within their own countries
  - E.g. in the design of pension policies
- Emphasizing that underlying theory had been attacked decades ago and the policies had not worked ("The emperor has no clothes")
- Events reinforced these conclusions: East Asia Miracle, "failed" transition, 2008 global financial crisis, euro-crisis (with Euro constructed on neo-liberal principles), and the failure of the US economy—with stagnation for the bottom 90% for a quarter century
  - The 2008 crisis showed that markets on their own were neither efficient nor stable
    - Huge losses from inadequate regulation
    - Economy only saved through massive government intervention
      - Irony: attempt to reduce role of government led to increased role
    - Major deficiencies in "governance" even in US

The attack on WC from within the developing world

- The new geo-political reality—the growth of the emerging markets
    - Based in part on the opening up of markets by the West
    - But with development strategies markedly different from the WC
- The inability of the advanced countries to adapt quickly
    - Reluctant to include emerging markets in global discussion—finally, in 2009, creating G-20
    - But lack of trust, divergent interests hard to forge global consensus on key issues
- Agree to change governance of international institutions
    - Takes years for minor voting rights changes
    - And Obama insists on appointing president of WB

New geo-political realities

- China has now become major provider of development assistance
  - Especially in infrastructure
  - But even in production activities
- Often following some aspects of neo-colonial model—focused more on taking out resources than development
  - But with stronger policies of non-intervention—implying fewer conditionalities
- US once again trying policy of containment
  - New development banks—US unsuccessfully tried to bloc one of new development banks (AIIB)
  - Through TTP, but corporate driven trade policy unlikely to be passed because of new politics in US

V. Even before these failures, economics had come to question underlying premises of WC

- Limits of markets
  - Including pervasiveness of imperfections of information and competition
    - Game theory and information economicshad provided tools to analyze
- Importance of institutions
- Importance of distribution
- Endogeneity of technology
- Model of individual “wrong”
  - Behavioral economics
  - Endogeneity of preferences
- Macro-economic failures

All of these elements were left out of standard model underlying WC

The fact that they were ignored by WC is suggestive

A. Limits of markets

- Arrow and Debreu showed that competitive markets were efficient only under highly restrictive conditions
  - 2nd welfare theorem also of limited applicability
  - Provided sufficient conditions
- Greenwald-Stiglitz (1986) showed that essentially whenever there was imperfect information/incomplete risk markets (that is, always), even competitive markets were not constrained Pareto efficient
  - Reversing presumption about the efficiency of markets
  - Not just a few isolated market failures (like environmental externalities)
  - These imperfections often manifest themselves as pecuniary externalities that matter
  - Even a little bit of information imperfection could have large effect (Diamond, 1971, Rothschild-Stiglitz)
- Deep policy implications: Free trade and capital market liberalization could be (often would be) welfare reducing
  - Theory of 2nd best meant that with imperfect risk markets, no presumption that trade liberalization would improve welfare

Reconceptualizing markets

- Markets don't exist in a vacuum
- Have to be structured
- Structured through public policy
- Affects distribution of "power"
- But how they are structured is affected by political power
- There had been a process of rewriting the rules of the market economy beginning a third of a century ago in ways which led to more corporate power, more inequality, lower growth
- WC was part of that process—as was deregulation and as are proposed new trade agreements
- 21st century Development Consensus has to be part of *rewriting the rules* once again
  - There are alternatives which can promote development and equality

A. Most markets imperfectly competitive

- Growing concentration of market power
- Related to changes in structure of economy (growth of services) and technology (low marginal costs)
- Competitive model provided poor description of economy
- Growing monopoly rents consistent with growth of wealth (-income ratio) and decline in capital (-income ratio)
- Policies to reduce scope for monopoly rents can lead to more equality and greater efficiency/growth

Game theory has provided us new tools

- Now understood that perfect markets model not robust
  - Slight imperfections have large consequences
- Most markets are characterized by some degree of market imperfections, with market participants striving to increase their market power
- Limiting case of perfect competition provides poor description and poor policy guidance
- Because of theory of second best, moving toward theoretical ideal may lower welfare
  - Another reason that the WC policies failed so badly

B. Institutions

- Older theories paid little attention to many things that we now know are important
  - Held that institutions don't matter: what drives the economy are underlying economic forces (supply and demand)
- But institutions *do* matter—such as sharecropping
- Sometimes, these institutions can be *explained* (e.g. responses to imperfections of information)
- But there is no presumption that these institutional responses are efficient (Arnott-Stiglitz, 1991)
- And institutions often persist when circumstances change, leaving dysfunctional institutions in place
- Many institutions exist to preserve power structures (North II)
- Markets are a particular institution—and when they are designed in particular ways, they help preserve certain power structures

Rule of law and the functioning of markets/society

- Importance has rightly been emphasized in modern discussions of development
- But there has often been confusion about meaning
- What matters is what kind of "rule of law"
- The wrong kind of rule of law can be used by the powerful to take advantage of ordinary citizens and maintain and extend inequalities
  - US bankruptcy law/many other aspects of US legal system evidenced in aftermath of 2008 crisis
  - International law: absence enables powerful to dominate weak (sovereign debt restructuring)
- What most mean by a rule of law is a legal system that protects ordinary citizens against the powerful

A variety of institutional arrangements

- Not just for-profit institutions and government
- In US, some of the most successful institutions are not-for-profit foundations (e.g. universities)
- Many examples of successful cooperatives
- TVE's were among important institutional *innovations* in China

C. Equality and Economic Performance

- Older theories paid little attention to inequality
- Second welfare theorem said that efficiency and distribution could be separated
  - Led to view that economists should focus on efficiency, leaving issues of distribution to “politics”
  - But modern economics explained why, in general, the Second Welfare Theorem did not hold
- Now, wealth of theory and evidence that the distribution of income affects economic performance

Equality and Economic Performance

- But *no one* ever claimed that markets generated a socially desirable distribution, let alone one that maximized, in some sense, economic performance
  - Further reinforcing the importance of the role of the state in promoting equality and equality of opportunity
- Policies that lead to more instability (like CML) can lead to more inequality, hurting economic performance *both* because of the instability (which discourages investment) and because of the impact on inequality

D. Endogenous technology

- Most of advances in standards of living associated with learning and improvements in technology
- What separates developing from developed countries is more a gap in knowledge than a gap in resources
  - Changed viewed of World Bank: a knowledge bank
- But markets are not efficient in promoting learning, innovation
  - Pervasive market failures associated with competition, externalities, risk, capital markets
  - Important role of government
- Convergence may not occur on its own (and may never occur) (See Stiglitz, 2015, *JPubEc)*

- And policies based on standard model (e.g. WC) may actually retard learning, counterproductive to learning and increases in standard of living
- A new and different role of the state
  - Argument for industrial policies, exchange rate management, and carefully designed trade policies
  - Argument against excessive financial sector liberalization (excessive opening to foreign banks)
  - Argument for well-designed intellectual property regimes (*not* TRIPS)

Large literature on endogenous growth/technology, going back to 60's (Arrow, Uzawa, Atkinson-Stiglitz, Shell-Nordhaus, David) and put on stronger micro-foundations in late 70's/early 80's (Dasgupta-Stiglitz). More general theory developed in Greenwald and Stiglitz *Creating a Learning Society,* 2014/2015

E. Model of individual wrong: behavioral economics

- Standard model based on “wrong” view of individuals
- Psychological literature: lack of rationality, systematic biases (confirmatory bias) equilibrium “fictions”
- Sociological literature: beliefs largely determined by those around us
  - At the center of development is a societal transformation
  - Including changes in mindsets about change
  - Design of institutional arrangements (including markets) affects nature of society and individuals
- New instruments
- New questions about how to assess societal improvements
- Standard welfare analysis does not apply
  - Raising questions about prescriptions based on models assuming fixed preferences
- New interpretations of successes and failures, e.g. of micro-credit schemes

F. Macro-economic failures

- Not just caused by government profligacy or failure to control inflation
- Not just caused by price and wage rigidities: with imperfect capital markets market flexibility can worsen economic performance (debt-deflation)
- Greenwald-Stiglitz had shown that whenever there was imperfect/asymmetric information and imperfect risk markets (that is, always), markets are not Pareto efficient
- We now know they have pervasive macroeconomic consequences—and macroeconomic policy has to be designed to take them into account

Important implications for the role of the state

- Market, on its own, will lead to excessive borrowing, especially in foreign-denominated debt
- Market on its own will lead to too big and too intertwined financial institutions
- Need for strong financial sector regulations
  - Including macro-prudential regulations
  - Including regulations on cross border flows (capital controls)

VI. Beyond the Washington Consensus:

- Broader goals
  - Not just growth, but sustainable (economically, environmentally, socially, and politically), inclusive, and democratic growth
- More instruments and policy frameworks
  - Quantities as well as prices
  - Government production as well as regulation
- New actors
  - Now recognize importance of civil society
    - The provision of the public good is a public good, and will normally be "undersupplied"
  - New institutions and institutional arrangements
    - New development banks

New and broader roles of state

- Reflected in the concept of the *developmental state*
  - At the center of the successes in East Asia and Africa
- More generally, broad set of roles it plays, taking into account market failures, limitations in entrepreneurship, etc.
  - Entrepreneurial State
    - Emphasizing catalytic role
  - Regulatory role
  - Controlling externalities
  - Social Protection Role
  - Provider of public goods
  - Coordinating role (price system doesn't always work)
- New and complex relations with other societal actors
  - E.g. public sector preventing abuses of private in finance, education, etc
  - Public/private partnership—but too often, public takes risks, private takes rewards
  - Government financing civil society to implement programs

Institutional innovation is important

- Micro-credit
- Income contingent loans (not just for education)
- Provident funds
- Conditional cash transfers
- Public options in mortgages, retirement, health
- Inflation indexed bonds
- Using technology, e.g. for peer lending (?)

Also in macro-economics

- Design of macro-prudential regulations

Questioning “earlier” institutional designs

- Independent central banks
- Tinbergen “assignment” of instruments and objectives
    - Valid only under highly simplified and unrealistic assumptions

Examples of broader instruments

- Macro-policy: automatic stabilizers, balanced budget multipliers, investment tax credits, social welfare system
  - Recognizing, for instance, that “reforms” like move towards defined contribution retirement schemes from defined benefits schemes affect stability of economy
  - Recognizing that CML and FML may increase economy’s exposure to risk, and so too for a shift from quotas to tariffs
  - Range of capital account management tools
    - Tax deductibility of foreign denominated loans, restrictions on derivatives
    - Inflow and outflow controls and taxes
    - Unremunerated reserve requirements
    - Banking regulations

Monetary policy

- Change in theory
  - Credit rationing pervasive
    - Problems of liquidity (access to funds) at center of crisis
  - Behavioral economics: individuals' savings behavior not well described by standard utility maximizing model
  - Importance of non-convexities, interlinkages, contagion
    - Excessive diversification, rather than diversifying risk, can enhance instability

Reforming monetary policy: broader objectives, more instruments

- Single-minded focus on inflation was worse than was realized 20 years ago—it contributed to the global financial crisis. Broader mandate: inflation, unemployment, growth, financial stability—with an eye to other hard-to-correct consequences, inequality, misallocation of capital
  - Even then, inflation target should have been higher
- Single-minded focus on interest rate is wrong—many more instruments
  - And not just short-term interest rate (QE)
- Simplistic rules, e.g. “monetarism” and “inflation targeting” don’t work
- Central banks need to *simultaneously use* all the instruments at their disposal
  - Both conventional instruments ***and*** regulatory instruments; macro- and micro- prudential
  - Can’t and shouldn’t separate the two—need to be coordinated

Limits of monetary policy

- Moved from pedestal—distorts the economy, and affects distribution of income and wealth
- May have limited capacity to restore economy to full employment
  - Increased liquidity can lead to asset price bubbles, more speculation
  - Especially problematic in open economy

Competition policy

Broader objectives:

- Origins: limitations in agglomeration of political power, not just distortions affecting consumer welfare narrowly defined
- Developmental impacts—may not be measured by traditional approaches
- Not just monopoly power but monopsony power (Walmart cases)
- So to for impacts in media concentration of market place for ideas
- Special problems posed by too big too fail banks

More instruments

- Not just standard anti-trust policy (forbidding mergers, forcing break-ups, restricting anti-competitive practices)
- But regulatory policy
- And public option—public sector providing an alternative to the private sector, e.g. in mortgages, health insurance, retirement security

Industrial policies

Broader objectives

- Not just GDP, but employment, “greening” economy, structural transformation, *learning—especially important when there are learning spillovers*– critical in creating a learning society
- Not just “industry” and exports but modernizing economy—move towards advanced service sector
  - Important because old export led growth model may be coming to its end
    - As global employment in manufacturing declines both absolutely and even more as percentage of global labor force (productivity increasing faster than demand)
    - There will be intense competition for those jobs

Industrial policies

More instruments

- Not just subsidies and targeted tariffs
- Competitive exchange rates
- Access to credit (e.g. through development banks)
- Preferential access for government procurement
- Domestic content and domestic training provisions in FDI

VII. Ensuring that the State Promotes the Public Good

- Given the key role given to the state, ensuring that the state does what it is supposed to do, and doesn't do what it shouldn't is key
- Governance becomes a central issue
  - Developing systems of accountability, transparency
  - Right to know laws, free and diverse press
- WC tried to minimize the role of the state, undermining its capacities, limiting its ability to *learn*
  - Blamed poor performance on poor governance—but often confused cause and effect; ends and means
    - Low incomes tend to lead to poor governance

Good governance

- "Good governance" (GG) agenda that emerged as part of expanded WC focused on *restraining* government—in accordance with neo-liberal agenda—rather than *developing capacities* for transformative development

- Most successful countries were those where government took on role of **developmental state**
  - Following successful examples in East Asia
  - Recognizing the importance of **dynamic comparative advantage**
    - based on learning and dynamic efficiency

- There needs to be a dynamic strategy—choosing institutional arrangements and policies in accordance with the country's existing capacities and capabilities, but incorporating the learning and development of those capacities and capabilities (a dynamic programming problem.) There is a structural transformation of the public sector in tandem with the economy

The public good as a public good

- Key problem: The public good is a public good
- So there will be an undersupply of efforts to make sure that the public sector is run well (just as there is an undersupply of efforts to make sure large corporations with wide share ownership are run well)
- Government can subsidize the institutions that can strengthen monitoring and participation—media, think tanks, education
- Important role for civil society and other forms of voluntary collective action
- Systems of checks and balances
  - But if not well designed, and if society is too divided, can lead to gridlock, entrenching existing elites
- Democracy may not provide adequate check
  - Especially in societies marked by high inequality
  - Need to have more transparency, strong right-to-know laws
  - Restrictions on the influence of money in campaigns
  - Restrictions on revolving doors

The only real solution…

- What is needed is more than checks and balances within government, but within society—and that can only be achieved if the extent of economic inequality is limited, and if there is a break in the transmission of economic advantage across generations.

VIII. Global aspects of Washington Consensus

- Old view: trade is good, intellectual property is good, financial market integration/liberalization is good. Therefore: the more the better; the more integrated—more like a single country—the better
- New view:

(a) Most global agreements write the rules in ways which advance the interests of the North, and especially of their corporate and financial sector (and big Pharma)

(b) North has been trying a divide and conquer strategy to get more advantageous deal for themselves

(c) Developing countries should bargain together (been hard to manage)

(d) Faced with a take-it or leave-it agreement, need to carefully balance benefits and costs: in many cases, better to leave it, *especially given that existing agreements have already opened up markets extensively*

(e) Developing countries need to take full advantage of the flexibilities that the agreements provide (e.g. in intellectual property)

Basic principles

- Globalization means that what one country does affects others
  - Global externalities
- Implies there is a need for global governance
  - With voices of those affected heard
- There are some arenas in which externalities are limited—there is no need for imposing global rules
  - Principle of subsidiarity
- Global rules needs to be designed with flexibility
  - One size fits all doesn't work
- Too often, global rules have ignored these principles
  - No effective cooperation on monetary policy of big countries
  - Attempts to regulate monetary policy of small countries

What is needed: Tax and finance

- Sovereign debt restructuring framework
  - To facilitate workings in fair way of global debt markets
  - Needed: an international rule of law; strong powers believe that they will thrive in the law of the jungle
- Regulation of taxation of multinational corporations
  - To ensure that developing countries can impose taxes on the economic activity which occurs within their borders and that there is not a race to the bottom;
- Elimination of secrecy-havens
  - Which facilitate corruption, bleeding developing countries of resources

What is needed: Global financial system

- More stable global financial system
  - Developing countries are more open, more buffeted, less coping capacity
- Better global regulation of banks, more capital requirements (cost is low—MM theorem; benefit from lowering systemic risk is high)
- Shutting down, or highly restricting off shore and shadow banking systems
  - Asking—why do we tolerate circumvention
  - If desirable, should be brought into the regular system
- Structural as well as behavioral regulation
  - Recognizing how hard it is to regulate behavior
  - Need to prevent too correlated to fail as well as to big to fail
  - Breaking up too big to fail banks; imposing "size" tax to reflect greater systemic risk

What is needed: trade

- A multilateral system, not fragmenting the world into a spaghetti bowl, with hard to implement and distortionary domestic content requirements
- Development oriented—rather than the current system designed to keep developing countries producing just raw materials, through system of cascading tariffs; elimination of agricultural subsidies
  - Driving down the prices on which poor countries depend
- Restrictions on global cartels
- Trade agreements stick to trade
  - Currently proposed agreement are more about advancing corporate interests in both North and South against labor, consumers, environment than about trade
  - Tariffs are already low
  - No compelling argument for most of regulatory harmonization
  - If there were harmonization, should not be race to bottom—raising question about real objective
  - Clearest in discussions of IPR and investment (see below)

What is needed: global environment

- Global climate change policies
- Poor countries suffer the most, contribute least to the problem
- One way: allocate carbon space in atmosphere on a per capita basis as of 1992, with system of carbon trading
- More general, global compensation for good environmental policies with spillovers—paying for eco-services
  - Biodiversity

What is needed: managing the global knowledge commons

- Developmentally oriented IPR
- Preferential access to knowledge for developing countries—key to their development
- Access to generic drugs
- Not “enclosing” traditional knowledge—and if it is done, compensating developing countries appropriately
- Compensating developing countries for role in protecting genetic diversity (as proposed under bio-diversity convention)

What is *not* needed: investment agreements

- Which try to restrict ability of the state to regulate (for health, safety, environment, economic management)
  - By allowing corporations to sue for loss of expected profits
  - In private courts
  - In which they can appoint one of the arbitrators
  - Hampers the functioning of the global system
- Discriminates against domestic firms
  - Encourages inversions
- Expansion of provision into North-North agreements shows its not about protection of property, deficiencies in legal systems—these are corporate regulatory takings provisions
- What might work: (a) protection against *discrimination;* (b) enforced through a WTO style court system *after exhausting of domestic remedies;* (c) recovery limited to recovery of investment costs; and (d) ability of other parties (civil society) to sue corporations for failing to fulfill their obligations—rights have to be accompanied by responsibilities
- Key provision in TTIP, TPP

IX. Examples of key differences and similarities

- Some similarities, especially in Williamson version—below refer to later WC as LWC
- Importance of redirecting expenditures towards health and education and of infrastructure
- But too uncritical of statement that the public sector is "too large"
  - Depends on competencies of public sector, tasks assigned to it, and how important those commodities are in development strategy and preferences
- "little support for CML" (later CML became core part of LWC)
- Support for competitive stable exchange rate—but worried about "excessively" competitive because of inflation
  - China seems to have done better at lowering exchange rate than he thought possible
  - LWC argued for market determined exchange rate—though government sets interest rate which affects exchange rate

Further similarities

- Trade liberalization—emphasized intermediate inputs, allowed for infant industries, sensitive to speed
  - But not *infant economy* argument for protection
  - LWC included consumer goods, attacked infant industry protection, insensitive to speed
- Importance of property rights
  - But no analysis of what that entailed
- "…privatization can be very constructive when it results in increased competition…but I am not persuaded that public service is always inferior to private acquisitiveness as a motivating force…public ownership [may] be preferable to private enterprise."
  - But LWC emphasized privatization, almost without qualification

Major differences

WC: concern about deficits in excess of 1 to 2% GNP ("Left-wing believers in "Keynesian" stimulation via large budget deficits are almost an extinct species.")

- 21st Century view (NC): Countercyclical deficits are countenanced; contractionary policies are viewed as contractionary; effects of debt are highly contingent on what money is spent on; balanced budget multiplier means that fiscal policy can have effects even with large deficits
- There are some taxes that can stimulate spending: a carbon tax, an estate tax

Expenditures

WC: focus on primary education; LWC: cost recovery—forcing poorest kids in world to pay for primary education

NC: free education changes “culture,” has big impact; structural transformation needs adequate attention paid to secondary, tertiary

WC: respect for IPR, including drugs

NC: Promote generic industry, if necessary through compulsory licenses

On importance of Regulation/dangers of deregulation

- WC argued for as basis of enhancing competition
- Argued deregulation worked well in US
- In LA (according to WC) regulatory system promotes corruption, inefficiency, harsh on medium sized enterprises
- NC: Regulation and taxation of externalities are necessary: not just environmental externalities, but macro-externalities; ensuring competition; ensuring no-exploitation
- Many failures: in electricity in US (caused price gouging and shortages); in air (led to high prices—in many areas, limited competition); in telecom in LA (did not lead to greater efficiency except where artificial capital constraints had been imposed by government); and most dramatically in the financial sector

Most importantly, new consensus emphasizes

- Broader objectives
- Inclusive democratic participation: process matters for outcomes
- Failure of simplistic *single minded* solutions (see Easterly, *Elusive Quest for Growth)*
  - De Soto: Assignment of Property rights
  - Education
  - "rule of law," (including Charter cities—reinventing colonialism)
- Though these, along with other innovations, *may* be part of what is needed, a *comprehensive development framework.*

X. Concluding Comments: on metrics

- Metrics have become increasingly important, but wrong too focus narrowly on GDP
- The International Commission on The Measurement of Economic Performance and Social Progress emphasized deficiencies in measure

(a) what we measure affects what we do and the design of policy: metrics are important;

(b) no single number can capture something as complex as our society;

(c) accordingly, there will have to be a "dashboard of indicators;"

(d) the dashboard which is appropriate for one country may be different from that of another;

(e) but among the metrics that should be included are those that reflect distribution and environmental sustainability;

(f) there need to be improvements in the way we measure the value of government and other services;

(g) median income adjusted for inflation almost certainly reflects a better measure of what is happening to the typical individual, and therefore it should be among the numbers

Concluding Comment: from WC to Stockholm Consensus—change in theory

- Then, the neoclassical model predominated
- Now we understand its limitations, the importance of imperfections of competition, information, and markets, the lack of robustness of that model, the importance of second best
  - Now there is a focus on behavioral economics, endogenous technology, learning
  - These are all especially important for developing countries
  - Especially the endogeneity of preferences and technology
    - **Development is about a change of mindset, change in the structure of the economy, modernization, including closing the gap in technology**
    - **This opens up many new tools and changes perspectives on desirability of old tools**
  - Slight deviations from the standard assumptions can have large implications for behavior of the economy
  - In 2nd best world, one must think carefully about reform and reform process
    - Trade liberalization may be welfare decreasing, even if in first best world it was welfare increasing
    - Completing markets may be welfare decreasing, even if in first best world a complete set of markets was desirable

Concluding Comment: from WC to Stockholm Consensus—on the efficiency and stability of markets

- Then, there was a presumption that markets were efficient, with the exception of certain well-defined problems, like environmental pollution.

- Now, there is a presumption that markets are not efficient or stable

  - That there are not just environmental externalities, but also information and learning externalities and macroeconomic externalities

  - Giving rise to multiple needs for government intervention—not just macro-stabilization, but also industrial and trade policies, etc.

Concluding Comment: from WC to Stockholm Consensus—Separating distribution from efficiency

- Then, it was thought that one could separate issues of distribution from efficiency—and that economists should focus on making the pie as big as possible, leaving the distribution to the political system

- Now, we realize that the issues of distribution and efficiency cannot be separated.

Concluding Comment: from WC to Stockholm Consensus—Markets don't exist in a vacuum

- Then, we paid little attention to how markets are structured by the legal system. Economists would simply refer generally to a rule of law, with strong property rights, rigorously enforced.

- Now we realize that markets don't exist in a vacuum, that they are structured by our legal frameworks, that there are many alternative legal frameworks (rules governing bankruptcy, corporate governance, etc) and the choices a society makes make a great deal of difference, for development and distribution.
  - Inevitably, these are decisions made by the political system
  - Those seeking stronger development and greater equity have to *rewrite the rules*
  - The rules appropriate for advanced countries may not be appropriate for a developing country
  - Norms matter too, and how these are determined and can be affected may be an important part of development policy

Concluding Comment: from WC to Stockholm Consensus—Changing view of competition

- Then, the competitive model was not only taken as a benchmark, but it was *assumed* that the economy was close enough to that ideal to make that model relevant

- Now, we realize that the competitive model may be a bad benchmark
  - Power—including market power—matters
  - Helps us understand racial and gender discrimination, slavery and colonialism, rules that give rise to rents and inequality
  - Market concentration (and the role of market power) is growing in many countries

Concluding Comment: from WC to Stockholm Consensus—structuring policy

- Then, many subscribed to Tinbergen's analysis, assigning each institution a single objective and a single instrument, assuming little need for coordination

- Now we realize that there are many more instruments in the governments tool-kit than we realized 30 years ago, that even monetary authorities need to pursue multiple objectives, and that different policies need to be coordinated

Concluding Comment: from WC to Stockholm Consensus—Sources of the wealth of nations

- Then, the focus was on increasing resources, improving efficiency of markets (creating markets when none existed before), and developing the right institutions (like independent central banks)
- Now, the focus is on closing the knowledge gap and creating a learning society
  - Recognizing that there may be trade-offs between static and dynamic efficiency
  - That the WC institutional analysis was often flawed
  - And that there were major deficiencies in institutional framework of advanced countries that were held up as role models

Concluding Comment: from WC to Stockholm Consensus—the role of the state

- Then, the focus was on limiting the role of the government—getting it out of the way
- Now we realize that government is essential, and a central part of development policy is improving the performance of the public sector

Concluding Comment: from WC to Stockholm Consensus—Global Rules

- Then, it was thought good and desirable for 3 institutions located between 15th and 19th street in Washington would dictate "good" policies for the developing world (the Washington Consensus) and structure the global rules that would be of benefit to all
- Now, we realize that (a) to a large extent the WC policies were based on particular ideologies and interests within the dominant advanced countries; (b) that they were often not in the interests of the developing would; (c) any meaningful consensus for development has to be based on engagement with the South—they will be implementing them; (d) one-size-fits all policies don't work; and (e) global rules need to focus on the sources of cross border externalities

From the Washington Consensus to the Stockholm Consensus

- Much has happened over the quarter century since the WC was formulated—both in the evolution of ideas and in the events around the world
- Developments in development over the past 40 years have shown that development is possible—beyond anything imaginable before then—but not inevitable
- Not surprising that ideas that might have made sense a quarter of a century ago are "outdated"
  - But many of the ideas of the WC were outdated even at the time they were formulated and enunciated
  - Shows that it is hard to approach issues as big as societal change without an eye to ideology and interests
- Hopefully, what we have learned in the past quarter of a century provides the basis of a new consensus to guide development going forward