Economic Growth and Inequality: The New Post-Washington Consensus

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The debate on economic policy has developed significantly in the past decade. The so-called Washington Consensus, which dictated most of the solutions proposed by international financial organizations, began to be questioned when a large number of emerging economies reduced their reliance on multilateral debt. The crisis of 2008 and 2009 accelerated the process of reflection on the prescriptive nature of the policy proposals advocated by monetarists, with their insistence on a uniform view as if all situations were alike. This has been termed ideology, and the ideology associated with the Washington Consensus has failed even in its methodological principles, as clearly demonstrated by the internal debate within organizations such as the International Monetary Fund and the World Bank. This article reviews the various internal arguments of the international financial organizations, and provides a critique of preconstructed models involving a return to Keynesian economics. It ends with an optimistic view of the broadening and democratization of the debate on economic policies, termed the new post-Washington Consensus.

Keywords: Washington Consensus; financial crisis; economic development; financial system; globalization.

The prefix “post” has now become a common currency spreading from philosophy to the political scene of globalization. It signals the overthrow of West-originated certainties that have long been used to explain and govern the world.

With the devastating crisis that hit most of the wealthy countries\(^1\) and the failure of the financial systems, we entered a new era, characterized by both conjunctural and structural changes. It entails a profound transformation that affects the perception and the distribution of power. Could this mean the end of the so-called Washington Consensus?

What is the Washington Consensus?

The term “Washington Consensus” comes from a simple set of ten recommendations identified by economist John Williamson in 1989: 1) fiscal discipline; 2) redirecting public expenditure; 3) tax reform; 4) financial liberalization; 5) adoption of a single, competitive

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\(^1\) In this text, the term wealthy countries refers essentially to G7 members and the European Union. Other methods of measuring economic wealth would undoubtedly produce a different list, but in common speech the term is still associated with the abovementioned group of countries.
exchange rate; 6) trade liberalization; 7) elimination of barriers to foreign direct investment; 8) privatization of state owned enterprises; 9) deregulation of market entry and competition; and 10) secure property rights. The reference to “consensus” meant that this list was premised on the ideas shared at the time by power circles in Washington, including the US Congress and Administration, on the one hand, and international institutions such as the Washington-based IMF and the World Bank, on the other, supported by a range of think tanks and influential economists.

It is important to note here that the theoretical foundations underlying these policy recommendations were nothing else but neoclassical economics espousing a firm belief in the market’s “invisible hand,” the rationality of economic actors’ choice, and a minimalistic vision of the states’ regulation of economies. The advent of this new paradigm has also marked the retreat of development economics as a distinct field, which had been long dominated by the “Dependency School” and other theories (Naim, 1999), often in sharp contrast with neoclassical economics and methodological individualism. It was development economics that had often guided policies experimented with in developing countries before the Washington Consensus era. Most independent African governments, for example, sought to promote industrialization, in an effort to develop local production and reduce imports, promote employment, raise the standard of living, and break out of the vicious circle of trade patterns epitomized in the Prebisch-Singer hypothesis (unfavorable terms of trade for commodity-exporting and manufacturer-importing countries). The Washington Consensus’ recipes, by contrast, were presented as universal, similarly applicable in the context of developed and developing countries, even if they ended up being implemented in a discriminatory and uneven fashion.

Washington Consensus policies were applied for more than two decades in such diverse contexts as Africa, Latin America and Asia, as well as in countries emerging from real socialism in Eastern Europe and Central Asia. There were usually two major stages of intervention: the first focused on macroeconomic stability and structural adjustment programs, and the second included such objectives as improving institutions, reducing corruption or dealing with infrastructure inefficiency (Naim, 1999). The conditionality exercised by the Bretton Woods institutions and wealthy countries played a crucial role in indebted countries’ decisions to push through macroeconomic stabilization reforms and structural adjustment programs. The debt crisis that first affected a number of Latin
American countries and then African and Asian countries, in the 1970s and 1980s, further increased their dependence on external loans, leaving them no other option than to follow the prescriptions that enabled them to access financing.

What Exactly Went Wrong?

Washington Consensus policies have been criticized since the 1990s by a significant number of leading economists. Most notably, Joseph Stiglitz, chief economist at the World Bank from 1997 to 2000, criticized the policies prescribed by the IMF in response to the financial crises in Russia and Asia (Stiglitz, 2003); Paul Krugman was in favor of Asian governments imposing controls on capital flows in 1997-98. The debate generated over the response to the crisis provided a good illustration of the deep divide between leading economists, who either supported or opposed the IMF. The Washington Consensus purists insisted on the importance of stabilizing exchange rates in times of crisis through public budget cuts, higher taxes and interest rates and other recessive measures. Their opponents criticized such policies, arguing that they would lead to recession (Naim, 1999). Stiglitz called attention to the fact that sharp increases in interest rates would contribute towards the deepening of the crisis (Stiglitz, 2003).

It is now commonplace to say that structural adjustment (SAP) and macroeconomic stabilization programs had a disastrous impact on social policies and poverty levels in many countries. Following the first wave of reforms undertaken by debt-affected African and Latin American countries – which included public expenditure cuts, introduction of charges for health and education, and reductions in industrial protection, leading to high unemployment, poverty rise and unequal income distribution – UNICEF published the report Adjustment with a Human Face (1987), which called for “meso-policies” to be redirected towards protecting social and economic sectors that were essential to the survival of the poor, through the introduction of social protection programs.

The period of structural adjustment programs in sub-Saharan Africa in the 1980s was characterized by poor economic performance. The GDP rose by less than 1% in Africa between 1979 and 1992, whereas East Asia and the Pacific, where the state played an active role in promoting industrial and social policies as well as in poverty alleviation, registered an average growth of 5% between 1986 and 1992. African investments declined, and the continent’s share in world exports also fell by more than one-half.
between 1975 and 1990. The share of Africa in agricultural and food exports dropped from 21 to 8.1% of developing countries’ exports, and in manufactured goods exports from 7.8% in 1980 to 1.1% in 1990. Some critics pointed out that liberalization policies, and such policies as the elimination of subsidies for fertilizers, had a negative impact on agricultural productivity and output. Price reform promoted export crops over traditional food crops. Others argued that export crops contributed to indebtedness, or that adjustment programs exacerbated unequal land distribution, promising that “efficient” land markets would replace traditional tenure systems, while encouraging deindustrialization through “wholesale privatization and unfettered markets” (Sahn, Dorosh & Younger, 1997: 1-6).

One of the major drawbacks of the policies imposed by the IMF and the World Bank was the lack of technical expertise and strategic capability on the part of the implementing countries. A structurally unequal donor–recipient relationship was established, in part due to the weakening of the public sector induced by the drastic reduction of the administrative machine. The fast and uncontrolled liberalization of small African economies presented additional dangers, such as the high volatility of capital flows, but

a larger problem for African economies is that their growth potential is directly affected by their ability to export and use export revenue to diversify production. Their ability to do so is constrained by a global trade regime inimical to the full development of African countries’ comparative advantage. Limited market access for low-cost textiles, cotton, and agricultural products and competition from heavily subsidized industrial economy exports effectively prevent growth. (Manuel, 2003: 18)

The social impact of these reforms was devastating for Sub-Saharan Africa. Many economists recognized that the difficulties associated with the promotion of economic stability and liberalization had a disproportionate impact on the poor, leading to greater poverty and unequal income distribution. International financial institutions, particularly the World Bank, displayed great intellectual arrogance in failing to acknowledge for a long time the vastly negative impact of such policies, denying the criticisms leveled at them, and limiting their response to launching compensatory programs (Sahn, Dorosh & Younger, 1997: 6).

It is thus not surprising that macroeconomic stabilization and structural adjustment policies prompted a wave of popular unrest that contributed to the recrudescence of many civil wars in the 1990s. The 1997 Asian crisis also raised some important questions
about the consequences of the deregulation of financial markets and demonstrated the limits of Washington-based policy thought.

The Structural Consequences of the Washington Consensus

The rapid economic growth registered in many regions of the South in the first decade of the 21st century, accompanied by expanding trade and investment, offset the worries of the financial markets, which ignored the signs of the impending storm. In 2008, however, the crème de la crème of the economist profession, as well as the governments of rich countries, finally had to face the inconvenient truth about the imperfection of markets. Massive and uncontrolled financial speculation has produced the worst global economic crisis since the Great Depression, suddenly revealing a number of structural “diseases” that the Washington Consensus had been hiding under the rug.

The global downturn was revealing in two major respects. First, the domination of the financial sector over the real economy had led to the creation of bubbles, to unpredictability for the future of economies, and increased vulnerability of populations, simultaneously increasing unequal income distribution and the gap between rich and poor. Second, it called into question the prevailing economic theories that served as a basis for formulating and prescribing policies, including those formulated by Bretton-Woods institutions at global level, in particular structural adjustment programs.

In reality, after three decades of Washington Consensus, we have been witnessing a confluence of crises including spikes in food and energy prices as well as financial and economic downturn, further aggravated by the impact of global climate change and growing demography. A recent article that I co-authored with Ignacy Sachs and Ladislau Dowbor stresses the striking convergence of critical tendencies, “the synergy of behaviors that [...] are destroying our fragile spaceship,” referring to the interdependence of trends in areas traditionally considered separately, such as demography, climate, industrial and agricultural production and consumption, pollution, etc. (Lopes, Sachs & Dowbor, 2010: 1, 3).

There is now more awareness of growing inequalities and the scandalous concentration of income – with the richest 20% getting 82.7% of the global income (Lopes, Sachs & Dowbor, 2010: 5). The dramatic rise in the share of poor people living in so-called emerging countries reveals how unequal income distribution is becoming, even in rapidly growing economies: 72% of the poor worldwide currently live in middle income countries,
whereas two decades ago 93% lived in low income countries (Sumner, 2011). In the current structure of power, economic growth, even when generated by technological innovation, benefits the financial intermediaries that pursue short-term maximization of profits rather than the engineers of the process (Lopes, Sachs & Dowbor, 2010: 5).

Productive inclusion as reflected in the formal sector is the exception rather than the rule. Production and consumption patterns reveal an abnormal deformation of priorities, where military budgets and luxury consumer goods dominate over access to basic services, education and health:

The planet produces almost a kilo of grain per day per inhabitant and we have more than one billion people going hungry. The ten million children who die of hunger, no access to clean water and other absurd causes constitutes an unbearable scandal. But from the private investment point of view, solving essential problems generates no profits, and the orientation of our production capacity is radically deformed. (Lopes, Sachs & Dowbor, 2010: 7)

These systemic failures are principally due to a skewed configuration of production processes, false structures of incentives, and an economic framework that externalizes social and environmental costs, relying exclusively on the “rational choice” of actors and the “natural” balance of the market – to say nothing of the way the global economy is currently run. The power imbalance within the global structures of financial and economic governance, namely the IMF and the World Bank, is evident on three levels:

- First, the prevailing ideology, entirely dominated by monetarist thought, imposed on the countries of the South and transition economies for more than 20 years, despite blatant failures and disastrous social impact;
- Second, the power structure established by voting shares within the IMF and the World Bank, which still does not reflect the size of economies, not to mention the representation of the interests of the poorest;
- Third, the strong belief that wealthy countries would never be affected by crises, something that justified discriminatory practices in terms of surveillance before 2008 (IEO, 2011) and the application of double standards during the crisis. Thus, the financial crisis that resulted from spiraling deregulation did not come as a complete surprise.

Concerning the last point, we need only compare the IMF response to the current European crisis with the policies it implemented in the 1980s and 1990s to have an idea of
those double standards. Although there has been a laudable change of attitude, favoring the social dimension instead of creditors’ interests, the fact is that these policies are only being promoted now, in Europe, hypocritically erasing the past. What is there to say of facts such as these: the total African external debt was $324.7 billion USD in 2010, meaning 20.7% of GDP, while the public debt of the United States was $14.5 trillion USD in the same year, or 98.6% of GDP?

How Did Science Become Ideology?
The ostensible belief in recipes that don’t work and yet continue to be used is somewhat of a paradox. When theoretical tools designed to help comprehend reality are used without regard to their limitations, or when findings are selectively adjusted to endorse one single view premised on wishful thinking, then science becomes ideology.

Globalization as it emerged and was perceived over the last decade of the 20th century prompted a wave of opposition. The most radical and vocal opponents of the Washington Consensus accused Bretton Woods institutions and wealthy countries of spreading a new ideology – neoliberalism. Leading economists got blinded by the myth of perfect markets, either by choice or circumstance. As Paul Krugman sarcastically put it, “the economics profession went astray because economists, as a group, mistook beauty, clad in impressive-looking mathematics, for truth” (Krugman, 2009: MM36).

The neoclassical notion of market efficiency, challenged by John Maynard Keynes, who called for active government intervention in the marketplace by printing more money and increasing public spending to boost demand during the Great Depression, is now again the focus of attention. The truth is that the blind belief in markets has enjoyed great popularity in the last two decades. Led by Milton Friedman, monetarism invaded economic thought in the 1970s, seeking to reconcile macroeconomics with neoclassical microeconomic postulates in order to bring back to center stage the idea of market efficiency. Monetarists admitted only limited forms of government intervention, linked to a very modest regulation of money supply. Famously, Milton Friedman called for the dissolution of the IMF since it interfered with the workings of the free market. Many macroeconomists completely rejected Keynesian theory regarding economic crises, and others “returned to the view of Schumpeter and other apologists for the Great
Depression, viewing recessions as a good thing, part of the economy’s adjustment to change” (Krugman, 2009: 36MM).

This debate had a strong influence on IMF postulates in particular. Without adopting monetarism wholesale, the major concepts of the Washington Consensus provided responses to the IMF’s concerns with minimizing regulation and letting markets do their work. It was this approach that led the IMF to believe that its main job was to liberalize the market in the countries of the South, and later in so-called transition economies since these represented the major obstacle to an open economy.

The report recently produced by the IMF’s Independent Evaluation Office on the failure of the IMF’s surveillance role, vehemently criticized its performance on one of its main functions — warn member countries of the risks building up in the world economy, as well as in their national contexts. Among the major impediments identified by the Evaluation Office were “a high degree of groupthink, intellectual capture, a general mindset that a major financial crisis in large advanced economies was unlikely, and inadequate analytical approaches” (IEO, 2011: 17).

A careful reading of the report’s findings reveals additional inconvenient truths. First, intellectual narrow-mindedness creates situations where the line between what we see and what we want to see is too easy to cross. Another important reason for the IMF’s failure to report accurately and produce honest analysis was the influence of the largest shareholders on surveillance and policies (IEO, 2011: 20).

The IEO drew an unflattering picture of the IMF staff, pointing to “cognitive biases,” including a homogeneous mindset (groupthink) and an “insular culture” that rarely referred to external research; the belief that economists in advanced countries were better aware of what was happening in their own countries, overlooking the importance of financial issues and the analysis of macroeconomic linkages; overreliance on models and similar tools, such as macro modeling, which practically did not include the analysis of money and asset markets; overreliance on simplistic and first-round examination techniques, such as stress testing, to determine the soundness of banking systems; and worst still, misinterpretation or dismissal of certain data for the sake of theoretical coherence (IEO, 2011: 17-19).

Intellectual honesty was further injured by the lack of reference to the limitations of data or to the existence of different analyses. The IMF epitomized the major drawbacks of
modern knowledge production and applied research, characterized by sectoral approaches and lack of holistic analysis. More specifically, it opted for economic theories, quantitative and data selection methods that sustained the coherence of its neoclassical assumptions. Dissenting views were silenced given the power chain reaction between the largest shareholder countries and senior management. The authors of the evaluation report also noted the complaints about lack of even-handedness in the treatment of different countries (IEO, 2011: 20). To put it in a nutshell, the main institution in charge of macroeconomic policy recommendations produced an analysis that was heavily influenced by its most powerful members, and promoted conformity, self-censorship, data selectivity, and one set of analytical approaches implemented in a discriminatory manner.

It is essential to engage in an honest academic dialogue and to promote intelligent systems of governance that are open to a plurality of approaches and lead to fruitful synergies between different contributions. Regrettably, however, there are too many cases of bias in the collection and interpretation of statistical data. We have a growing awareness of the multifaceted and diverse nature of our world, and of the interconnection between the various challenges that we face. This opens up new perspectives on how we can see and interpret the world around us, helping us to think outside the box. Besides the GDP, the Human Development Index (HDI), the Gini coefficient, and the Happiness Index represented important breakthroughs. The number of economic, social, and statistical indicators that can help us understand the importance of demography is growing at a fast pace. For instance, the way in which we currently measure international trade does not reflect the complexity of global production chains (Lamy, 2011).

Bearing this in mind, Robert Zoellick, the president of the World Bank, sent an important signal when he initiated the liberalization of the Bank’s information policy, granting public access to about 7000 data sets that were previously available only to subscribers, mostly governments and researchers. During the first month alone, 4.5 million individual visitors accessed the site. Since these data are used to define social and economic policies, their importance as a bargaining tool is fundamental. The data and methodology underlying the analysis and political recommendations of the World Bank are thus open to public scrutiny. Robert Zoellick described his decision as a “democratization of development economics” (Strom, 2011). Maybe this is an
exaggeration, but the truth is that after the failure of the Washington Consensus in what concerns the transparency of its methods of analysis, any progress is welcome.

**Significant Changes in Africa and Its Role**

The sets of indicators we select for our analysis and the way we collect, define and interpret data are important. The divergence between the Washington-based institutions, on the one hand, and the United Nations, on the other, in the 1990s with regard to the impact of structural adjustment reforms provides a compelling example of different recommendations based on different approaches.

The growing influence of the South, including African countries, is a factor that is going to contribute to change on many levels. At present, we cannot afford to ignore divergences, since the major players and power relations are rapidly changing dominant ideas. When Goldman Sachs coined the term BRIC (acronym for Brazil, Russia, India, China) in 2001, many did not take it seriously. The 2008-09 crisis accelerated the shift in the global balance of power, and the G20 took over the leading role from the G8. In 2010, BRICS, now including South Africa, already accounted for 25.6% of the world’s GDP, 15.5% of trade, and 42.6% of the world’s population (2,940 million).

In terms of economic relevance, African countries are still relatively marginal. However, the continent’s average growth rate increased by 5 to 6% during the last decade, and the OECD reported that the rate of return on investment there has been the world’s highest in recent years. A new study by Ernst & Young indicates that foreign direct investment (FDI) in Africa grew 87% in the last decade, and that FDI flows continued even during the crisis and may even accelerate in 2012, reaching 150 billion USD by 2015 (Ernst & Young, 2011: 7). The Boston Consulting Group has recently arrived at a similar conclusion based on somewhat different data, namely an annual growth in exports of 18% since 2000, similar to BRICS, and an annual increase of over 8% in the revenues of the 500 largest African companies since 1998. This report (produced before the Arab revolutions) points to the emergence of the so-called “African Lions” (by analogy to the “Asian Tigers”), which include Algeria, Botswana, Egypt, Libya, Mauritius, Morocco, South Africa and Tunisia (with a collective GDP per capita of 10,000 USD, exceeding that of BRICS), soon to be joined by Ghana and Nigeria (BCG, 2010: 1-2).
The population of Africa has exceeded the 1 billion mark. Demographic growth is considered a crucial element in the shift of power from North to East and South, and the fast growing middle classes both in emerging countries, such as BRICS, and in Africa seem to account for a significant part of global demand. Recent analyses indicate that the lower middle class in countries of the South represents a huge, fast growing new market, which will determine different products and services from those until now supplied to the middle classes of wealthy countries.

These recent developments, especially in Sub-Saharan Africa, coincide with a period in which the control of International Financial Institutions (IFIs) has weakened, opening up a space for the reformulation of policies. African countries are now beginning to talk of pushing industrial policies forward. The 2011 African Report of the United Nations Conference on Trade and Development (UNCTAD), entirely dedicated to industrialization in Sub-Saharan Africa, argues that the best way to confront the convergence of the food and energy crises and global economic depression is to promote industry. Economic diversification and structural transformation, involving a shift from low to high productivity activities, are expected to increase Africa’s resistance to external impacts. Industrialization, improved labor productivity in agriculture and developments in the service sector are factors that can help meet the challenges of job creation for the millions of young African people entering the labor market each year (UNCTAD, 2011: 3-4). In fact, industrialization is an integral part of the national development programs of South Africa, Egypt, Ethiopia, Kenya, Namibia, Nigeria and Uganda (Altenburg, 2011).

Some experts believe that the development of agribusiness provides an opportunity for improving the standard of living of poor populations. Currently, African agriculture has a low rate of capitalization, mechanization and added value. The value of agribusiness production in Sub-Saharan Africa is four times lower than Brazil’s, and the agricultural share of GDP in Africa exceeds that of agribusiness by 10%. As a result, less than 30% of agricultural produce is processed in Africa, as compared with 98% in high-income countries. African countries generate only $40 USD for processing 1 ton of agricultural produce, i.e. 4.5 times less than high-income countries (Korwama, 2011).

The emphasis placed on agriculture has become not only a solution for the problem of hunger, but also an attractive road to development in a period of high food prices, potentially inverting the Prebisch-Singer hypothesis. In contrast to meso level policies, some
development experts have shown a renewed interest in developing so-called inclusive businesses, whose activities are market based but geared towards generating social benefits by involving beneficiaries as suppliers and customers. A recent study by the Monitor Group identified at least 439 enterprises of this kind in nine countries in Sub-Saharan Africa (Monitor Group, 2010: 3-4).

Even the World Bank has shifted from a pessimistic stance to a generalized euphoria over the future of the continent:

Sub-Saharan Africa [...] in 2011 has an unprecedented opportunity for transformation and sustained growth. [...] Putting these factors together, the Bank concludes that Africa could be on the brink of an economic take-off, much like China was 30 years ago, and India 20 years ago. (The World Bank, 2011: 3-4)

The Impact of the Financial Crisis on the Washington Consensus

The reconfiguration of economic geography started exerting pressure on the old and inadequate governance structures of the IMF and World Bank established after the Second World War. As a result, they began a slow process of reform that included the redistribution of voting shares. First, the voting share of Sub-Saharan Africa rose by 3%, but continues to represent only 1.4% of the total. After a second round of revisions, China’s calculated quota share rose from 6.38 to 7.47%, which placed it ahead of Japan (whose calculated quota declined to 6.99%), but still behind the United States, with 17.8%.

The total share of the European Union is estimated to fall from 25% in 2000 to 18% in 2015. Similarly, as a result of the reform of the World Bank governance, only 3.3% of votes have been transferred from OECD to developing countries. China’s share rose from 2.77 to 4.42%, thus turning it into the third largest shareholder after the US and Japan. However, the US continues to be the leading player, holding 16.85% of voting shares, while more than one-third of African countries saw their shares actually decrease.

The financial downturn signaled the need for more radical transformations within the IMF. In early 2011, the IMF’s leadership suggested that SDRs (IMF’s Special Drawing Rights currently composed of the dollar, pound, euro and yen) could help stabilize the global financial system. For this to happen, their current role as a reserve currency with the Fund’s loans denominated in SDRs would need to be substantially expanded to areas such as “a potential new class of reserve assets: tradable SDR denominated securities issued by
the Fund,” or “a unit of account which could be used to price internationally traded assets (e.g., sovereign bonds) or goods (e.g., commodities.” These suggestions were presented and analyzed in a report published by the IMF in January 2011, which argues that “In order to make a difference in any of these areas, the role played by the SDR would need to be enhanced considerably from its current insignificant level. Very significant practical, political, and legal hurdles would need to be overcome in the process” (IMF, 2011: 1). Moreover, it was argued that the inclusion of currencies of emerging economies in the current SDR basket would help promote such objectives as increasing the supply of safe global assets and “reducing negative impacts of exchange rate volatility among major currencies” (ibidem). Such proposals obviously come close, if anything else, to developing an alternative to the US dollar as the global reserve currency.

The proposals for an alternative reserve currency also reflect the growing influence of emerging economies, whose central banks, particularly in China, are diversifying their foreign currency basket and moving away from the US dollar, which devalued significantly against stronger currencies in the first half of 2011. It should be noted, however, that emerging countries have a high percentage of their reserves in US treasury bonds, and thus want a stronger dollar (Addison, 2011).

The major world creditors are now countries of the South, many of which achieved success through policies that challenged the orthodoxy of the Washington Consensus. The IMF’s Chief Economist, Olivier Blanchard, recognized that “in the age-old discussion of the relative roles of markets and the state, the pendulum has swung — at least a bit — toward the state,” and that “distortions within finance are macro-relevant” (Blanchard, 2011). This implies a humble stance but not necessarily a fundamental change.

Indeed, the IMF’s recent stance on the European debt crisis was at times surprising for those used to the old style Washington Consensus. In Ireland, the IMF first appeared as defending the interests of the Irish taxpayers in the face of the European Central Bank and Ireland’s creditors by putting forward a plan to reduce “€30 billion of unguaranteed bonds by two-thirds on average” (Whitney, 2011). It later changed to a more traditional role as the Euro area crisis deepened and creditors began to exert pressure. In any case, the macroeconomic policies promoted by some Southeast Asian countries as well as Latin America’s fiscal conservatism coupled with aggressive social policies (through income transfer programs) have placed the Washington Consensus on the defensive.
The Post-Washington Consensus Era: New Hope for Economists?

While neoclassical theories are undergoing close scrutiny, economists need to remember how Keynes challenged the perfection of markets, particularly financial markets, making the case for regulation.

The return of the State onto the scene to correct market failures is inevitable. Ha-Joon Chang remarks that “industrial policy is conspicuous by its absence,” reminding us of the export-oriented industrial policy experience of South Korea: “sustainable export success over a long period of time, for which the country is justly famous, requires protection and nurturing of ‘infant industries’ through selective industrial policy, rather than free trade and deregulation.” In contrast to the “one size fits all” approach promoted by the Washington-based institutions, Koreans speak of a “dynamic iPhone model” or “a set of development apps for every occasion, drawn from successful approaches in different countries” (Chang, 2010: 27).

Dani Rodrik (2008) points to a “broader intellectual shift within the development profession, a shift that encompasses not just growth strategies but also health, education, and other social policies.” He contrasts a traditional policy framework, which is “presumptive,” starts with “strong preconceptions,” produces recommendations in the form of a “laundry list” of reforms, and is “biased toward universal recipes,” with the new policy approach, which emphasizes pragmatism and experimental gradualism. What Rodrik recommends is avoiding “both market fundamentalism and institutional fundamentalism,” and letting each country “devise its own mix of remedies.”

In a speech delivered in 2005 at a U.S. Federal Reserve event, Indian economist Raghuram Rajan, then the IMF’s Chief Economist, warned about the real possibility of a financial collapse as a result of taking risks that, most of the time, offer generous compensation, but involve a low probability of severe negative effects. However, the crucial issue was whether banks would be able to provide liquidity to financial markets. Based on financial actors’ rationality, Rajan pointed to the incentive structure of the financial sector that encouraged this kind of risk (2005: 2-3). In his 2010 best seller *Fault Lines: How Hidden Fractures Still Threaten the World Economy*, Rajan describes the world heading towards the crisis as a world marked by “deep fault lines” and excessively dependent on the indebted US consumer to power global economic growth. Easy low-
income lending and job creation policies stemmed, in his view, from the enormous political pressure exercised by growing inequalities and a weak social safety net.

Finally, Olivier Blanchard himself acknowledges the relevance of behavioral economics and behavioral finance, as well as agency theory, when he discusses the workings and incentives of the financial sector (Blanchard, 2011).

After a long period of Washington Consensus orthodoxy, the blossoming of alternatives and the variety of approaches are refreshing, all the more so since many of their proponents are part of “the system,” so to speak. It means that even the dominant schools of economic thought are ready to start revising their views. Alternative currents, including evolutionary, institutional, and neostructuralist economics, have resurfaced. We are living in exciting times marked by the demise of the ideology that has guided Western policymakers and was imposed on the rest of the world for nearly three decades. In truth, the confluence of the rise of the South and the decline of the political and ideological supremacy of the West is not accidental. In our current globalized world, the critiques of a prevailing ideology in particular – derived from post-colonial theories – may be finally expected to emerge from the theoretical isolation of philosophical cultural studies into the open field of political economy.

The unlocking of economic theory and the questioning of disciplinary divisions represent a window of opportunity for reinvigorating an integrated and ambitious sustainable development agenda. The concept of development should be reconsidered through a holistic approach, encapsulating intrinsically linked economic, social and environmental dimensions, instead of breaking them up into separate compartments. A stronger and more democratic state, supported by efficient governance mechanisms, should assume this role. This is particularly important if public policies are to provide better social protection.

Knowledge should become public in order to promote collective and global creation. The potential of emerging urban centers could also be used for fostering integrated regional development and planning, as well as endogenous participatory decision-making processes (Lopes, Sachs & Dowbor, 2010).

The first practical steps for the actual replacement of the Washington Consensus should focus on recovering the regulatory capacity of the state, aligning national accounting systems to value intangibles, including the incorporation of externalities and the
introduction of innovative indicators, guaranteeing basic income, rationalizing financial
systems of intermediation, redesigning tax systems, adopting budgets that aim at
improving the redistribution of resources according to economic, social and environmental
results, and taxing and registering speculative transactions (Lopes, Sachs & Dowbor, 2010).

A brave new world is unfolding before us.

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