Appendix

Our Agenda and the Washington Consensus

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The editors of this volume were both deeply involved in the development of what became known as the "Washington Consensus," a phrase that we have endeavored to avoid repeating ad nauseam in the main text of this book. But in view of our past, as well as the title of the volume, there are bound to be some readers who will be curious about how we conceive the relationship between the proposals that have been developed in this volume and the Washington Consensus. The purposes of this appendix are to spell out this relationship, and to explain why we have chosen to title the volume *After the Washington Consensus*.

Origin of the Term

The story starts with a reform agenda first developed in the depths of the debt crisis in a publication of the Institute for International Economics, in which Pedro-Pablo Kuczynski, my coeditor of this volume, was one of the authors (as he recounts in chapter 1). It was entitled *Toward Renewed Economic Growth in Latin America* (Balassa et al. 1986). The agenda advocated competitive exchange rates to provide an incentive for export growth, import liberalization, the generation of adequate domestic savings to finance investment (primarily by tightening fiscal policy), and cutting back the bloated role of government to allow it to concentrate on the provision of core public services and a framework for economic activity. In the light of subsequent events, it is worth noting that the call for import liberalization was coupled with a call for competitive exchange rates; the authors were not naive enough to imagine that import liberalization alone would guarantee export growth.

This document initially had a very frosty reception in Latin America, for it did indeed call for upheaval in the region's traditional approach to economic policy. But opinion started to change quite quickly, and by the time of the Brady Plan in 1989 a number of countries were implementing the sort of reforms that *Toward Renewed Economic Growth in Latin America* had advocated. This was not widely appreciated in Washington, so to enlighten local opinion, the Institute for International Economics decided to convene a conference devoted to exploring the extent to which these reforms were being pursued in the region (Williamson 1990). To give some coherence to this conference, I made a list of ten reforms that I judged Washington could agree were widely needed in Latin America as of 1989 (see chapter 2 in Williamson 1990, now accessible at www.iie.com/jwilliamson.htm). I dubbed this agenda the "Washington Consensus." It embraced the following ten points:

1. Budget deficits . . . small enough to be financed without recourse to the inflation tax.
2. Public expenditures redirected from politically sensitive areas that receive more resources than their economic return can justify . . . toward neglected fields with high economic returns and the potential to improve income distribution, such as primary education and health, and infrastructure.
3. Tax reform . . . so as to broaden the tax base and cut marginal tax rates.
4. Financial liberalization, involving an ultimate objective of market-determined interest rates.
5. A unified exchange rate at a level sufficiently competitive to induce a rapid growth in nontraditional exports.
6. Quantitative trade restrictions to be rapidly replaced by tariffs, which would be progressively reduced until a uniform low rate in the range of 10 to 20 percent was achieved.
7. Abolition of barriers impeding the entry of foreign direct investment.
8. Privatization of state-owned enterprises.
9. Abolition of regulations that impede the entry of new firms or restrict competition.[1]
10. The provision of secure property rights, especially to the informal sector.

1. Although not explicitly stated, this applied to the labor market as well as product markets, which is why in this volume labor market liberalization is treated as an unfulfilled first-generation reform.

Ten country authors were then asked to analyze the extent to which this agenda was being implemented in their country (or countries, in the case of the smaller ones). The conference concluded that acceptance of this agenda was intellectually incomplete and that action lagged even more, but that there had nonetheless been a sea change in attitudes to economic policy within the region in the late 1980s.

Like most of the rest of the world, the countries of Latin America were aiming at macroeconomic stabilization, developing a market economy, and integrating into the global economy. They had freed themselves of the intellectual apartheid that earlier in the postwar period had divided the world into industrial countries (those belonging to the Organization for Economic Cooperation and Development), where price stability, the market economy, and open trade were good things; and developing countries, where inflation was due to structural causes, the state had to play a leading role, and import-substituting industrialization provided a royal road to growth. And there was in the following years a wave of optimism that the new agenda would succeed in putting the region firmly back on the road to modernization and catch-up growth from which it had been deflected by the debt crisis of the 1980s.

Criticisms of the Term

Right from the start, the term "Washington Consensus" evoked controversy. One of the discussants of my paper, Richard Feinberg, argued that I should have called it the "universal convergence," because (1) the change in economic thought that I was summarizing was worldwide rather than confined to Washington, and (2) the extent of agreement fell far short of consensus. Feinberg was of course correct in both these points, but it was too late to change the brand name.

The criticism that hurt me the most came from within Latin America. Many reformers felt that I had slighted them by implying that this was a reform agenda made in Washington rather than designed by them. That is certainly not what I intended or believed;[2] "Washington" reflected the fact that, insofar as the original intention was to make propaganda, the target of the propaganda was envisaged as being those Washingtonians who were skeptical of whether there was a reform process under way in Latin America. Had my intention been to make propaganda for reform in Latin America, the last city in the world that I would have associated with the cause of reform is Washington.

The reason is obvious: This was a godsend to all those unreconstructed opponents of reform who yearned for socialism or import-substituting industrialization or a state in which they could play a leading role. The term

2. See Williamson (1990, 354-58) for an account of my experiences in Bolivia in 1985 for an authentication of this denial.

fed the desire to believe that reforms were designed by the United States in its own interests and imposed by the Washington-based international financial institutions under its thumb, notably the International Monetary Fund and World Bank, and perhaps also the Inter-American Development Bank. Anyone with a smidgen of anti-Americanism could be persuaded to foam at the mouth with indignation at the idea that Washington was seeking to impose its interests, and then they would, it was hoped, be easy to recruit to the antireform cause. Before long, the term had escaped from its original meaning of a list of 10 specific reforms that most influential people in a certain city agreed would be good for a specific region of the world at a certain date in history, to mean an ideological agenda valid for all time that was supposedly being imposed on all countries.

The ideological agenda was asserted to be that of neoliberalism, meaning the set of ideas emanating from the Mont Pellerin Society and developed primarily by Milton Friedman and Friedrich von Hayek, and then to some extent implemented by Ronald Reagan and Margaret Thatcher when they were in power. There were of course important areas of overlap between my original meaning and the neoliberal interpretation of the term, for most neoliberals believe in macroeconomic discipline, privatization, a market economy, and free trade. (So do lots of non-neoliberals; that is to say that there was a consensus that these ideas make sense. Indeed, non-neoliberals seem to be much better at implementing some of them, notably fiscal discipline, at least to judge by what happens in Washington.)

But there were also fundamental differences, in that I never claimed to detect a consensus in favor of free capital movements, monetarism, minimal tax rates (whether or not rationalized by "supply-side economics"), or the minimal state that accepts no responsibility for correcting income distribution or internalizing externalities. Curiously, no one who used the term in this sense ever seems to have thought it necessary to ask whether such policies commanded a consensus in Washington before treating them as a part of the Washington Consensus. They simply used the term to mean the full conservative agenda of the Reagan and Thatcher administrations, rather than distinguishing between those things that outlasted Reagan and Thatcher (like globalization and privatization) and those that were unceremoniously ditched when their rule ended (like monetarism and supply-side economics and belief in minimalist government), as I had intended.

This neoliberal meaning appears to me to be the way most self-styled opponents of the Washington Consensus have used the term in recent years. This is the sense in which, for example, Stiglitz (2002) uses it. This allows him to inveigh against the Washington Consensus without actually disagreeing with anything much that I wrote in 1990.[3] And perhaps this usage was to some extent legitimized by the fact that at least for a period

3. I once attempted to engage Stiglitz in a debate about the Washington Consensus. He declined to participate on the ground that he and I disagree little about substance as opposed to semantics and he did not consider semantics to be worth debating.

in the 1990s some of the Washington institutions—the IMF and key agencies of the US government like the Treasury Department—did indeed urge parts of this extended agenda, most damagingly a pace of capital account liberalization that most people agree in retrospect to have been precipitate.

Did the Washington Consensus Fail?

As Naím (2002) has said, it is certainly true that the phrase "Washington Consensus" has become something of a damaged brand name. But before one can decide whether something that has been used to mean such different things to different people worked or failed, one obviously needs to be clear about the sense in which one is using the term.

If one uses the term in its neoliberal sense, then it is easy to be among the critics. One of the reasons that Chile did well in the 1990s and avoided a major crisis was precisely because it used the *encaje* to limit the entry of short-term funds as occurred in other Latin American countries when the markets were enthusiastic about emerging markets. Excessive capital inflows both discouraged investment in tradable-goods industries as currencies became overvalued, thus reducing the ability to service debt, and built up a debt overhang whose subsequent exit at the first whiff of trouble turned problems into crises.

Similarly, one of the reasons that so many people were disappointed by the outcomes of the 1990s is that the rewards from such growth as was achieved, in dimensions like expanding employment and reducing poverty, were disappointing. That is to be expected when growth is slow and the benefits to those lower down the income scale are exclusively those that result from trickle-down; better outcomes for poor people demand either faster growth or a better distribution of the fruits of growth, or preferably both. A neoliberal agenda, by precluding any concern for the distribution issue, makes it that much more likely that outcomes will disappoint.

But it would be too easy to dismiss the criticisms of the Washington Consensus as exclusively attributable to the fact that many people have used the term in a different sense than I did. The fact is that the results of the past decade have been disappointing, as already acknowledged. We need to ask why.

In acknowledging disappointment in the outcomes, let me emphasize that I am not agreeing that the Washington Consensus was responsible for the tragedy in Argentina. Argentina undertook many good reforms, but it also made two fatal errors: it nailed its mast to a currency board that resulted in its exchange rate becoming grossly uncompetitive, and it failed to follow the strict fiscal policies that would have been needed to give the currency board a chance to work. Both run directly counter to the policies recommended in what I meant by the Washington Consensus, so it is unambiguously wrong to blame the latter for Argentina's tragedy.

The present volume makes a more general attempt to diagnose the reasons for the disappointing performance of Latin America. We identify three (or four, depending on how you classify them) reasons.

The first, and surely the one that has been most damaging to economic growth, is the series of crises that emerging markets have suffered, starting with that in Mexico at the end of 1994. The second is that reform was incomplete. Some first-generation reforms were never tackled, and few countries launched much of an agenda of second-generation reforms. Third, the objectives of reform were too narrowly drawn, being restricted essentially to restoring growth without any specific concern for employment, poverty, income distribution, mobilizing the poor to contribute to growth, or the social agenda. The question is whether these failings can legitimately be attributed to the Washington Consensus.

As far as crises are concerned, it is true that my version of the Washington Consensus did not emphasize crisis avoidance. No country that took as a textbook the Consensus as I wrote it would have been *obliged* to do the sort of things that led countries into crisis—by opening up the capital account prematurely and letting money flood in and overvalue the currency, or using the exchange rate as a nominal anchor, or pursuing a procyclical fiscal policy. But neither were they warned against such foolish acts. Those were not the urgent issues in the late 1980s, so a warning against them did not get included in what I wrote at the time. Moreover, it has to be said that what became widely known as the Washington Consensus—the version preached at the time by some of the international financial institutions and US government agencies and enthusiastically endorsed by much of the Latin American elite—was indeed guilty of a reckless enthusiasm for capital account liberalization.

The second reason argues that the problem was not too much reform, but too little. We consider that the most conspicuous act of neglect regarding first-generation reforms concerns the labor market, which has remained strongly dualistic everywhere, resulting in ever-growing informality. In other key areas, reform was incomplete (e.g., with regard to fiscal reform, where the massive budget deficits were eliminated but opportunity was not taken during the good times in the first half of the decade to run budget surpluses that would provide a buffer to allow a move to deficit spending when times turned difficult). Presumably, even the most ardent critics of the Washington Consensus will not blame it for the failure to push reform far enough.

In addition, there is a whole agenda of so-called second-generation reforms, involving the strengthening of the institutions that provide the foundations for market-oriented growth. Although some countries have indeed reformed some of their institutions, most notably by the wave of decentralization in the region, institutional reforms were not in general given high priority, and even the decentralization is in many cases seriously incomplete. In this respect, it has to be conceded that the Washington Consensus was not ahead of its time; it focused on policies, not institutions. Recognition of the key role of institutions in nurturing development was the big change in development economics in the 1990s.

The third reason for disappointing performance listed above is that the objective that underlay policy was excessively narrow: it consisted in accelerating growth without worsening income distribution. This was as much as I judged official Washington would subscribe to in 1989,[4] so that is what I incorporated into the Washington Consensus. I regard the narrow focus of the Consensus as a legitimate target for criticism, if one interprets it as offering a policy manifesto. Birdsall and de la Torre (2001) wrote a tract that aims to complement the Consensus by listing a set of 10 reforms intended to improve income distribution without reducing growth (chapter 3 takes up some of those themes). That provides an admirable complement to the Consensus.

So even my version of the Washington Consensus fell short as a manifesto for guiding economic policy in the 1990s. It failed to warn countries about some of the risks that they encountered. It neglected institutional reforms. And it was too narrowly focused on growth. The successor agenda that we have developed in this volume has sought to remedy those weaknesses.

Of course, none of this argues for abandoning what I meant by the Washington Consensus. It certainly does not argue for returning to the high inflation of yesteryear. Nor does it argue for giving socialism another chance. Some want to revive industrial policy, which may not be a promising idea, or to build a national innovation system, which looks more hopeful (see chapters 7, 8, and 11), but both are a long way from ubiquitous state intervention. Nor does it argue for closing economies again. Perhaps it would be nice to go back to closed capital accounts, if we could make exchange controls work, but it would be silly to abandon export promotion in favor of a new wave of import substitution. Critics criticize, quite understandably, the hypocrisy of Western governments that urge liberalization on developing countries while maintaining trade restrictions on the specific commodities that developing countries are in a position to export to them, or that have pushed intellectual property protection into the World Trade Organization. But endorsing those criticisms does not mean returning to the intellectual apartheid of the days before the Washington Consensus.

4. Remember that the origin of the Washington Consensus was a list of policy prescriptions that would command general assent in the Washington of George H.W. Bush shortly after Ronald Reagan had left office.

The Relationship to our Agenda

Our agenda builds directly on the diagnosis that was offered in the preceding section of why outcomes in the past decade have been disappointing. We offer an extensive set of proposals designed to avoid a succession of future crises similar to those that have had such a devastating effect on growth since 1994. We discuss how to liberalize the labor market in a civilized way, not by riding roughshod over the interests of those who already have formal-sector jobs. We outline some of the institutional reforms that countries need, though our discussion in this area is admittedly not as complete as elsewhere.

We also discuss how to broaden the agenda so as to improve income distribution and increase the antipoverty impact of growth, which means mainly by focusing more on aspects of the social agenda. We argue that this is essential if the region is ever to offer living standards to its average citizens comparable to those available in advanced countries; it is simply not possible to imagine that the average person will ever catch up if the elite continues to receive the lion's share of the income. Of course, it will be far easier for the elite to acquiesce in a reduction in their *share* in the context of vigorous growth that avoids asking them also to accept losses in their *absolute* level of income.

From the standpoint of the task attempted in this book, it does not really matter whether one chooses to use the term "Washington Consensus" in my original sense or in the neoliberal sense used by Stiglitz and many others. Someone who uses the term as an economic cuss word will surely want to identify a policy agenda to succeed the Consensus. And anyone who thought that my summary of the reform agenda for Latin America in about 1989 was a reasonably accurate and enlightened description of what was then thought to be needed should also be interested in considering how the agenda needs to be updated. The main difference between the two groups is that the former will wish to present a new agenda as a repudiation of the Consensus whereas the latter group will regard it as going beyond the Consensus. Both groups can welcome an analysis of what the policy agenda should consist of after the Consensus.

The search for a new agenda did not lead us to denounce the first-generation reforms that were adumbrated in *Toward Renewed Economic Growth in Latin America* and summarized in my version of the Washington Consensus. On the contrary, we argue that an important part of the new policy agenda needs to be a completion of those reforms. But it is only a part of the new agenda: we also argue that first-generation reforms need to be complemented by second-generation reforms, that crisis proofing the economies of the region needs to become a new priority, and that growth needs to be complemented by a new concern with poverty and the distribution of income.

A new reform agenda needs to contain a third element as well as completing and complementing the reforms of the early 1990s: it needs where necessary to correct them. Several candidates appear prominently in the book. On the macroeconomic level, the major errors were failing to seek cyclical stabilization and premature liberalization of the capital account. It is much easier to avoid liberalizing than it is to close up again once liberalization has happened, and indeed it can be argued that a reimposition of administrative controls on capital outflows would amount to breach of an implicit contract by the government (chapter 6).

Nevertheless, limited and strategic departures from an open capital account may be possible and worthwhile, such as an *encaje* if the problem of excessive capital inflows ever recurs, or a requirement that foreign financial institutions must seek authorization to borrow in local currency (as was required in Singapore during the Asian crisis, which impeded foreign speculators selling the currency short). On the microeconomic level, the major errors concerned the way in which some privatizations were carried out. Every privatization must offer net advantages to the public, which implies that it must be accompanied by creation of an efficient regulatory system if the privatized enterprise is not selling into a competitive market. In some cases, it may be possible to use the act of privatization to further the strategic objective of fostering competition.[5]

Finally, with regard to trade policy, it is important to undertake import liberalization in the context of a competitive exchange rate and adequate foreign market access, and with supporting policies geared to helping any company that wishes to improve its competitiveness to do so (see chapter 7). This will allow export industries to grow and create new jobs in parallel to the expected contraction of import-competing industries, thus reaping the efficiency benefits of more trade without imposing net contractionary pressures on the economy. There is much here that parallels Ffrench-Davis's call to "reform the reforms" (2000).

In short, we do not see our agenda as a rejection of the Washington Consensus. If one wishes, one can regard it as completing, complementing, and where necessary correcting the policy program summarized in my use of the term. But if some people are fed up with the whole debate, they are welcome to treat our title as an invitation to discuss policy reform free of any ideological albatrosses from the past.

5. A less important point looking forward than it was in the past, because most of the large privatizations have already happened: privatization must also avoid any appearance of impropriety in the way the sale is conducted, especially because Latin American opinion has now become sensitized to corruption.