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Book Review

Development Policy in the Twenty-First Century: Beyond the post-Washington Consensus

Edited by Ben Fine, Costas Lapavitsas and Jonathan Pincus

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reviewed by Stelios D. Katranidis*

This book is a valuable piece of work and particularly useful for people interested in economic development, theory and policy. Its main focus is not on theory or policy as such, but rather on what lies behind them. In other words, as we read in the preface to the paperback edition, "it is more about how development and development policy are (to be) understood". All the articles included in this volume engaged in a criticism of Stiglitz's attempt to establish an alternative paradigm to mainstream economics and in particular of the aspects related to development economics and policy, what is being called Post Washington Consensus. Most of the authors' critique is derived from the angle of what, in the literature, is referred to as radical political economy. Examples from third world countries' developmental experiences are widely used, supporting the authors' views and arguments. According to these, the Post Washington Consensus does not really differ from its ideological predecessor the Washington Consensus, which was broadly used in the 80's and 90's. The basic argument of this book is that "without a much broader political economy [approach] the [new] consensus is unlikely to provide a coherent framework for successful development policies". Taking this into consideration, the aforementioned resemblance between the two approaches is not surprising. In any case, this book offers a framework for a more fruitful debate on economic development. What follows provides a brief presentation of the relevant concepts, giving also the main arguments presented in this volume.

The Washington Consensus (W.C.) formed the main approach of development theory and policy in the 80's and early 90's. The term actually stands for a series of concepts and measures that were supposed to lead Less Developed Countries (L.D.C's) to greater wealth and prosperity. The suggested measures were similar to those of the neo-liberal policy framework that influenced the economic policy of Developed Countries (D.C's.) at the same period. The global ascendancy of the W.C. was possible due to the relative disappointment with the policies of import substitution and, in general, with the government intervention that was dominant in L.D.C's in the 50's and 60's. The final blow came from the advancing crisis and final collapse of the Eastern Bloc, which moreover revealed a general dispute

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regarding the impact of state intervention and economic programming. In addition, the acceptance of the W.C. was made easier due to its support by international organizations, such as the International Monetary Fund (I.M.F.) and the World Bank (W.B.). What also made it quite compulsory was that at the same time loans by both the I.M.F. and the W.B. came to be dependent on adopting policies consistent with the W.C.
However, developments in the 90's, especially regarding growth rates and the elimination of poverty, were less satisfactory than expected. Moreover, the efforts to impose relevant approaches so as to accomplish the transformation of the East European Countries led to a complete disaster. What is even more interesting is the fact that the only countries that in the last thirty years had impressive growth rates (developing countries in East and South East Asia) were the ones that imposed policies that were incompatible with the W.C. The development of these countries was dependent on a few, but very crucial, interventions both in domestic, and in international product and financial markets.

Taking all the above into consideration, it was evident that the pre- eminence of the W.C. was short lived. This actually happened in the same cycles that had supported the above policy in the previous period. In the meantime, with Stiglitz's crucial contribution, it became evident that, even though the smooth functioning of markets is superior and the most effective way of allocating resources and maximizing social welfare, asymmetric information and high transaction costs limit the efficiency of market function. In other words, externalities in cost and information may lead markets to collapse. Despite the fact that emphasis was placed upon the existence of externalities and their importance, this cannot be regarded as a new contribution to theory. Instead what is crucial is the fact that the decisive role of institutions was acknowledged as responsible for the efficiency of the market function. Put differently, the criticism of externalities, without being new, led to an important acknowledgement of the role of institutions and other general factors that are outside the markets for their significance in economic development.

In addition, while in the W.C. the acknowledgment of the importance of externalities was absent, the Post Washington Consensus (P.W.C.) is based precisely on these externalities. It should also be noted at this point, that although the P.W.C. does not have this simplistic, but nevertheless precise formality, that the W.C. has, it contributes to the recognition of the importance of institutions and, in general, of social factors to development. It practically recognizes the social dimension of development, or, in other words, it accepts another dimension to economic development, that of social change. This difference can also be identified as a granting of space for government interventions. These are considered as crucial, since they correct market imperfections and therefore improve market efficiency. For example, the P.W.C. views the role of institutions in the financial sector as very important, since this sector is considered as one of the most prone to market failures.

One additional difference can be found in the acknowledgement of the importance of non-economic factors as the glue that holds society together. What is important in the P.W.C.

approach is the concept of social capital. Social Capital is defined as any social relation that does not directly fall within the poor view of the market and the economy. It is considered, moreover, as an important factor that influences development. The term and use of social capital is the way the P.W.C. embodies the relationship and contribution of social interactions to economic development.

It is obvious that the two points above, the importance of institutions on the one hand and of social capital on the other, constitute a crucial progress in relation to the more dogmatic and relatively simplistic view of the W.C. After a long period of treating development as a technical problem of growth in macro-economic aggregates, social science seems to have awakened to the realisation that development is a progress of profound social transformation. In this way, the importance of political economy in the explanation and analysis of the procedure of economic development is promoted.

On the other hand, the P.W.C. has much in common with its ideological predecessor: it is actually not opposed to liberalization and deregulation and is in favour of free trade and privatisation. The authors of this book, however, claim that the version of political economy deployed by the emerging consensus is lifeless and unconvincing. In particular, they state that asymmetries in information and transactional costs are not sufficient to explain the development process. Furthermore historical experience, the balance of forces among social classes, social structure etc., are not recognised as factors that crucially affect economic development. Terms that were previously used by all classical political economists for the analysis of the Western European transformation from an agricultural economy into a modern industrial society, are to a large extent ignored when it comes to L.D.C's. In other words, while classical political economists in their analysis placed emphasis upon the role of institutions, of social interactions, of forms of government interventions and in general of history as a factor, this kind of approach is absent from both the W.C. and the P.W.C. Even though the P.W.C. acknowledges the importance of social and economic context to development, it does not go into this kind of analysis.

This book comprises a selection of articles that were presented in SOAS seminars at the University of London regarding the P.W.C. Its nine chapters deal with various aspects of the P.W.C. and justify their criticism to a great extent on the basis of empirical foundation.

In the first chapter, Ben Fine first of all presents, in short, Stiglitz's approach to economics of information. He claims, inarguably, that Stiglitz's work provided the theoretical background for the P.W.C. What he criticises, is the view that the information theoretic approach provides relevant insights for various areas of economic theory, besides development economics. Likewise, Fine questions Stiglitz's view that the new approach disputes the old and mainstream neo-classical economics in general. According to Fine, the only departure from the mainstream is in allowing for imperfect information and consequently resulting in a generalisation rather than a break with the orthodoxies of a perfectly competitive economy. Put simply, Fine believes that the new approach is actually the old approach plus new microeconomics, with a general ignorance of the critical bibliography against the W.C. that has been published for some time.

Being more analytical, in terms of theory, Fine focuses his critique on two points. As a first and general point, he criticises the approach that perceives economy and society as a sum of people and in the meantime interprets social behaviour as a combination of the behaviour of individuals. As a second point, he criticises the reducing of the problem of development to a problem of coping with market imperfections. Regarding the first point of critique, he refers to its most modern version, which is based on Becker's work. He also considers Krueger's approach as the counterpart to Becker within the field of development economics. Regarding the second point of critique, he argues that according to Stiglitz's approach the idea of development itself, or the transition from one stage of development to another, is simply reduced to the alternative arrangements for dealing with informationally based market imperfections. Regarding the transition from the old to the new consensus, Fine argues that its theoretical counterpart is parallel to the transition from a Becker type rent-seeking economics to the new information–theoretic economics.

Finally, he considers this transition as a positive one, since it grants the possibility of government interventions in order to accomplish economic development. However, he does not consider the emergence of this approach as a consequence of its theoretical superiority, but rather as the outcome of the need to justify the new policies and the theoretical foundation for the choices of the Washington institutions. Finally, he claims that the rise of Japan as a donor of the W.B. could not be harmonized with the policies of the old consensus. In this perspective, the Japanese experience combined with the increased role of Japan, contributed significantly to the acceptance of the new consensus.

The role of the financial system in the development process is the topic examined by Sedat Aybar and Costas Lapavitsas in the second chapter of this book. They acknowledge the contribution of the P.W.C. in the emergence of the central role of the financial system and, in particular, the importance of its institutional structure in economic development. On the one hand, they claim that the fact that the P.W.C. views state controls over financial prices and flows as more efficacious at promoting development than liberalized market based systems, is progress in the right direction. On the other hand, they argue that both approaches – the old and the new consensus - treat financial development as an efficient cause of growth and development.

Aybar and Lapavitsas argue that lack of recognition of the social, historical and political context within which the financial system operates, is a major weakness of both approaches. Analysing the experience of Japan and Turkey supports their opinion, especially the existence of a two-way relationship between forming the financial sector and development of the real economy. They conclude that a country-specific political economy approach is superior to the information theoretic approach, which is favoured by the P.W.C.

In chapter three, Kate Bayliss and Christopher Cramer examine the problems surrounding privatisation, in the context of the W.C. and the P.W.C. They conclude that while in the W.C. privatisation, referring to the form of ownership, is of vital importance, in the P.W.C. there is no strong theoretical justification for an a priori privatisation. According to the P.W.C. privatisation is far less important than market structure. Moreover, Stiglitz claims that the wide use of privatisation in the 80's and 90's was mainly a result of political intentions, pressures and calculations and not the outcome of policies following pure economic goals. The basic difference between the P.W.C. and the W.C. is based on the true need for institutional changes so as to make privatisation more efficient. The authors criticise Stiglitz's view that privatisation can assist in creating an efficient competitive private sector that leads the economy by reducing mainly the scale and scope of rent seeking. To this end they cite empirical facts from L.D.C's that prove exactly the opposite.

According to the P.W.C., the State should match the extent of its intervention with its capability. The problem with this statement is that it implicitly assumes that the market fills in the gaps omitted by the State, something that is not often encountered since as experience has proven weak States tend to correspond with weak markets. In addition, while the authors acknowledge differences between the P.W.C. and the W.C. regarding competition policies, they state that these are not only insufficient for the design of regulation policies, but also rather limited. More specifically, the P.W.C accepts interventions only regarding utilities, the environment and the financial sector. Finally, the authors claim that when it comes to the success of privatisations, both the W.C. and the P.W.C. underestimate the significance of factors such as the historic and social context and the macro-economic environment, as well as outcomes such as the distribution of income.

Chapter four and chapter five, which both refer to the industrialisation process of Southeast Asian countries, claim also that the P.W.C. does not essentially differ from the W.C. In the first of these chapters, Sonali Deraniyagala argues, that Stiglitz's critique on W.C. is insufficient, since it is not going far beyond the need to overcome market failures, especially those related to asymmetries of information. Despite the fact that Stiglitz points out correctly that these failures are widely present in L.D.C's, according to the author, industrialization policy cannot be limited only to the discharge of these failures. On the contrary, Deraniyagala favours selective political interventions, instead of interventions limited to an institutional level. In this type of approach, the creation and not the elimination of market failures, which also find support in the context of strategic trade policy, could indeed be desirable. The author goes on to claim that state intervention cannot be limited only to the sphere of exchange as, according to his opinion, is happening both in the W.C. and in the P.W.C., but should also be extended to the sphere of production. Thus he reaches the conclusion that the approaches do not differ significantly.

In chapter five Dic Lo, judging the two approaches on the basis of the way they explain the amazing development of South East Asian countries, regards them as identical regarding their strategic pursuit in integrating L.D.C's in the global market. He mentions, however, that they differ in the mechanisms that they use in order to achieve this (common) goal. Moreover, he identifies as a new element in the P.W.C., the need to overcome market failures, which according to Stiglitz can be possible only with the establishment of appropriate, mainly state, financial institutions. In addition, Lo is focusing his work on the crisis of 1997 and based on this, he claims that the new approach is a movement, although insufficient, in the right direction. According to his heterodox approach, the coordination of the financial system of these countries with the changes in the global environment does not suffice. What is rather mandatory is the way these changes are handled on a global level.

In chapter six, Mushtaq H. Khan deals with the new political economy of corruption. After discussing various definitions of corruption and examining a number of contemporary approaches to it, he looks at the importance of class and group structure in determining its type and the time of its emergence. Since it is often claimed that more (less) state implies more (less) corruption, he argues that this relationship is rather simplistic and often wrong. The relationship between state and corruption is not dependent on the extent of state intervention, but on the history of the state's formation and its institutions, the class and group structure as well as national idiosyncrasies. For this reason, he refers to the historic experiences of Southeast Asian countries, which even though similar, also have important differences.

In chapter seven, Ben Fine discusses what is often considered as the main innovation of the P.W.C.: the emphasis it places upon the importance of social capital. This term is used in the P.W.C. in order to include factors that contribute to economic development and were of no interest to the W.C. Concrete or not, this term constitutes an important positive contribution to the discussion on economic development. Nevertheless, Ben Fine views this concept more critically, as he claims that it is an additional element of the attempt to extend economic approaches so as to analyse social phenomena. From this aspect, he states that the term social capital, as well as other new terms in economic theory such as information asymmetries, transactional costs etc., are not an attempt to open economic approaches to wider and more complete theories, but rather an attempt to extend economics and economists over other sciences and scientists in return. Moreover, Ben Fine's critique points out that the term and usage of social capital within the P.W.C. undermines other factors significant to economic development, such as issues of power and conflict, social classes etc.

In chapter eight, Ben Fine and Pauline Rose examine the way education is perceived under the P.W.C. At first, they draw the reader's attention to the evolution of the concept of human capital and its measurement using output results. They go on to criticise human capital theory as being a specific application of cost-benefit analysis, therefore having nothing to do with education. Approaching human capital in such a way has led to a situation where emphasis is placed upon extending the production function to allow for human capital, rather than addressing the specific economic and social relations surrounding schooling. Furthermore, they note that, since the early ‘80s, due to incomplete information individuals are not fully aware of either private or potential social benefits of education and therefore are not willing to finance it. All these factors interacting with each other led, according to the authors, to the absurd situation where the educational system was called upon to explain social and economic phenomena ranging from savings behaviour to fertility rates. In the end, they conclude that like social capital, human capital theory in the P.W.C. is again an attempt to allow orthodox economics to handle complex economic phenomena using tools of microeconomics, by undermining the role of the other social sciences.

Finally in chapter nine, Jonathan Pincus deals with the lending operations of the W.B. in the P.W.C. era. He describes the evolution of the W.B. from the ‘40s until today, stating basic operational imperatives in its function. These refer to operational difficulties, which prohibit the financing of small and more complex projects. Then, he goes on to the different phases in the W.B.’s evolution, especially regarding its approach to agricultural development. He actually identifies four different phases: the first one was until the end of ’50s, which actually includes the financing of non-agricultural infrastructure projects. The second one was until the early ’80s, which is a period of substantial flourishing of the W.B. and its financing of projects in the agricultural sector, especially in the context of integrated rural development. Then follows a third period, that of the W.C. until the early ’90s, which is a period of putting into action ideas of liberalization in the agricultural sector as well. Finally, he discerns a fourth period from the early ’90s until today, which he calls the P.W.C. period. He argues that during this period, the W.B. has proclaimed a decentralised community-based approach to agricultural development. Accordingly, the W.B. should concentrate on policy, research and extension, reform and privatisation of agricultural services and participatory resource management. Pincus finally argues, that the W.B. has actually completed a fifty-year period regarding the developmental approach that it practices. Like the early W.B., the W.B during the P.W.C. is once again stressing its role as a provider of public goods. However, physical capital accumulation has been relegated to a supporting role in favour of intangibles such as knowledge, governance and social capital. His main question is not related with this approach, but with whether the W.B. is capable of running such a mission, given its operational imperatives, the composition of its staff and mainly its size.

In conclusion, this is a very interesting book, which is directed towards readers who question the wide use of economics models, often leaving out national idiosyncrasies. Instead, it supports a more integrated approach, borrowing methods from all social sciences, for the analysis of the development process.