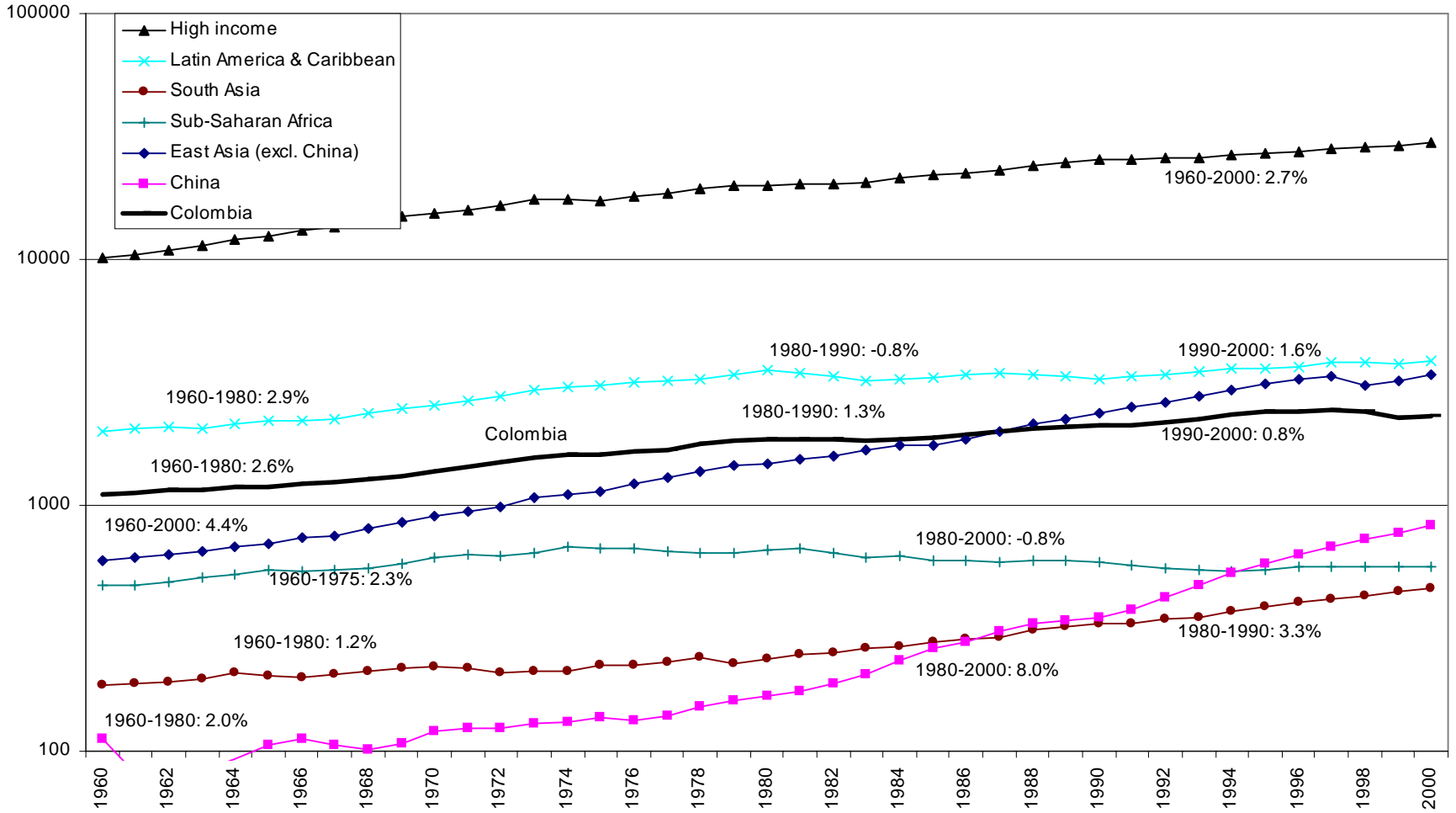


GDP per capita by country groupings (1995 US\$)



# What the growth evidence shows

Importance of:

- Macroeconomic stability
  - Low inflation and debt sustainability
- Incentives
  - Sustained increase in private profitability of production and investment, particularly in tradables and non-traditional activities
- Social protection
  - Prevention of social conflict through institutions of conflict management

## What the growth evidence does not show:

- Periods of high growth are hardly ever instigated by the adoption of Washington Consensus policies
- Periods of high growth are hardly ever instigated by policies aimed at deep integration into the world economy

# Multiplicity of desirable institutional arrangements

| OBJECTIVE  | UNIVERSAL PRINCIPLES   | INSTITUTIONAL ARRANGEMENTS   |
|--|--|--|
| <p><u>Productive efficiency</u><br/>(static and dynamic)</p> | <p><u>Property rights</u>: Ensure potential and current investors can retain the returns to their investments</p> <p><u>Incentives</u>: Align producer incentives with social costs and benefits.</p> <p><u>Rule of law</u>: Provide a transparent, stable and predictable set of rules.</p> | <p>What type of property rights?<br/>Private, public, cooperative?</p> <p>What type of legal regime?<br/>Common law? Civil law? Adopt or innovate?</p> <p>What is the right balance between decentralized market competition and public intervention?</p> <p>Which types of financial institutions/corporate governance are most appropriate for mobilizing domestic savings?</p> <p>Is there a role for “industrial policy” to stimulate investment in non-traditional areas?</p> |

## **OBJECTIVE**

Macroeconomic and  
Financial Stability

## **UNIVERSAL PRINCIPLES**

Sound money: Do not generate liquidity beyond the increase in nominal money demand at reasonable inflation.

Fiscal sustainability: Ensure public debt remains “reasonable” and stable in relation to national aggregates.

Prudential regulation: Prevent financial system from taking excessive risk.

## **INSTITUTIONAL ARRANGEMENTS**

How independent should the central bank be?

What is the appropriate exchange-rate regime? (dollarization, currency board, adjustable peg, controlled float, pure float)

Should fiscal policy be rule-bound, and if so what are the appropriate rules?

Size of the public economy.

What is the appropriate regulatory apparatus for the financial system?

What is the appropriate regulatory treatment of capital account transactions?

| <b>OBJECTIVE:</b><br><br><u>Distributive justice and poverty alleviation</u> | <b>UNIVERSAL PRINCIPLES:</b><br><br><u>Targeting:</u> Redistributive programs should be targeted as closely as possible to the intended beneficiaries.<br><br><u>Incentive compatibility:</u> Redistributive programs should minimize incentive distortions. | <b>INSTITUTIONAL ARRANGEMENTS</b><br><br>How progressive should the tax system be?<br><br>Should pension systems be public or private?<br><br>What are the appropriate points of intervention: educational system? access to health? access to credit? labor markets? tax system?<br><br>What is the role of “social funds”?<br><br>Redistribution of endowments? (land reform, endowments-at-birth)<br><br>Organization of labor markets: decentralized or institutionalized?<br><br>Modes of service delivery: NGOs, participatory arrangements., etc. |
|--|--|--|
|--|--|--|

# The logic of the Washington Consensus

## A Chinese counterfactual

### problem

Low agricultural productivity

Private incentives

Fiscal revenues

Urban wages

Monopoly

Enterprise restructuring

Unemployment

### solution

Price liberalization

Land privatization

Tax reform

Corporatization

Trade liberalization

Financial sector reform

Safety nets

And so on...

## Chinese shortcuts

- Household responsibility system and township and village enterprises obviate the need for ownership reforms
- Two-track pricing insulates public finance from the provision of supply incentives
- Federalism, “Chinese-style” generates incentives for policy competition and institutional innovation

## The empirical record and some answers

1. In practice, growth spurts are associated with a relatively narrow range of reforms; the rest comes later.

South Korea and Taiwan since early 1960s

Mauritius since early 1970s

Brazil, Mexico, Turkey others before 1980

China since 1978

India since the early 1980s

Chile since mid-1980s

## The empirical record and some answers (cont.)

2. The policy changes that initiate these growth transitions typically combine elements of orthodoxy with unconventional institutional innovations

Outward orientation combined with industrial policies in East Asia;

Partial) liberalization combined with household responsibility system and TVEs in China;

EPZ in Mauritius;

Capital controls in Chile.

## The empirical record and some answers (cont.)

### 3. Institutional innovations do not travel well.

HRS works in China, but not in SU;

ISI works in Brazil but not Argentina;

EPZs work in Mauritius, but not in most other countries;

Gradualism works well in India but not in Ukraine.

## The empirical record and some answers (cont.)

### 4. Sustaining growth is more difficult than initiating it

Few transitions to high growth are sustained in the longer run

Growth collapses in SSA, LAC

Key weakness: lack of resilience to shocks

Importance of using high growth period to build institutions that will endow the economy with resilience

## Two prongs of a growth strategy:

- An investment strategy (short-run)
- An institution-building strategy (medium-run)

## Some conclusions

- The new, refurbished Washington Consensus is not a helpful guide to promoting economic growth.
- Experimentation is an important driver of economic development (both in the institutional and productive sphere).
- Such experimentation is fully compatible with (and indeed should be based on) sound economic principles, namely property rights, incentives, hard budget constraints, etc.
- The needs of the developing world are better served within a “thin” set of rules for global economic governance (as opposed to a “thick” set of rules aimed at maximizing trade and foreign investment flows).

# Examples of successful “investment strategies”

- Import-substituting industrialization (Brazil, Mexico, Turkey)
- Outward-orientation, East Asian style (South Korea, Taiwan)
- Outward-orientation, post-1983 Chile style (large real depreciation, saving mobilization, support for non-traditional exports, discouragement of ST capital inflows)
- Two-track reform (China, Mauritius)

Key is to get domestic entrepreneurs excited about investing in the home economy. Need a two-pronged strategy

Encourage investments in non-traditional areas (carrot);

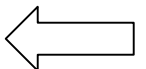
Weed out projects/investments that fail (stick)

Empirical background:

East Asia 1960-90: both incentives and discipline

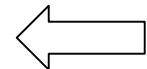
Latin America under ISI (1950-1980): incentives, but too little discipline

Latin America in the 1990s: discipline, but too little incentives

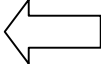


# Market-sustaining institutions

- Market-creating institutions
  - Property rights
  - Contract enforcement
- Market-regulating institutions
  - Regulatory bodies
  - Mechanisms for correcting market and coordination failures
- Market-stabilizing institutions
  - Monetary, fiscal, currency, capital-account arrangements
  - Contract enforcement
- Market-legitimizing institutions
  - Democracy
  - Social insurance



# The Augmented Washington Consensus

| Original Washington Consensus   | “Augmented” Washington Consensus<br>the previous 10 items, plus:  |
|---|---|
| <ol style="list-style-type: none"><li>1. Fiscal discipline</li><li>2. Reorientation of public expenditures</li><li>3. Tax reform</li><li>4. Financial liberalization</li><li>5. Unified and competitive exchange rates</li><li>6. Trade liberalization</li><li>7. Openness to DFI</li><li>8. Privatization</li><li>9. Deregulation</li><li>10. Secure Property Rights</li></ol> | <ol style="list-style-type: none"><li>11. Corporate governance</li><li>12. Anti-corruption</li><li>13. Flexible labor markets</li><li>14. WTO agreements</li><li>15. Financial codes and standards</li><li>16. “Prudent” capital-account opening</li><li>17. Non-intermediate exchange rate regimes</li><li>18. Independent central banks/inflation targeting</li><li>19. Social safety nets</li><li>20. Targeted poverty reduction</li></ol><br> |

## The World Bank's Star "Globalizers"\*

| Country | Growth rate in the 1990s | Trade policies   |
|---------|--------------------------|--|
| China   | 7.1                      | Average tariff rate 31.2%, NTBs; not a WTO member                      |
| Vietnam | 5.6                      | Tariffs range between 30-50%, NTBs and state trading, not a WTO member |
| India   | 3.3                      | Tariffs average 50.5% (the highest but one in the world)               |
| Uganda  | 3.0                      |  |

\*According to World Bank, Globalization, Growth, and Poverty, 2001, p. 6.

