

**ECONOMIC REFORM:  
CONTENT, PROGRESS, PROSPECTS**



**John Williamson**  
Senior Fellow, Institute for International Economics

November 23, 1999



**Indian Council for Research on  
International Economic Relations  
&  
The Maharaja Sayajirao University of Baroda**

## **Foreword**

**I am very happy to make available for wider dissemination the lecture on “Economic Reform: Content, Progress, Prospects” by Prof. John Williamson, Senior Fellow, Institute for International Economics, Washington, D.C. The lecture was delivered at a joint session organised by the M.S. University of Baroda and ICRIER at Vadodara India, on November 23, 1999. The session was part of the Golden Jubilee celebrations of the Economics Department of the M.S. University of Baroda during November 22-26. The lecture begins with an insightful review of policy reform in the past half century. This is followed by a discussion of the contemporary reform priorities. The originator of the term Washington Consensus ends his lecture by attempting to answer the question as to whether Washington Consensus is dead today. I have no doubt that this tour de force will enrich our appreciation of the complex process of economic reform across time and space.**

**Isher Judge Ahluwalia  
Director & Chief Executive  
ICRIER  
November, 1999**

## **Introduction**

**One of the hallmarks of a modern, as opposed to a traditional, society, is that it is constantly seeking to improve the way it functions. One thing this often implies is the creation of new institutions, such as that which your forebears whom we are saluting today created 50 years ago. At other times it seeks to change the way its existing institutions function, i.e. to reform. But the concept of what constitutes reform is not static. Nowhere is this more obvious than with regard to economic policy. When I was young, nationalization and planning would have been classified as reforms in my country. I suspect that I.G. Patel, whose illustrious career we are also celebrating today, would have agreed with the dominant opinion in India at that time in considering the introduction of import protection and small-scale industry reservation to constitute reform. Today, in contrast, when India's new government declares its intention of pursuing an agenda of economic reform, the phrase suggests policies like privatization, trade liberalization, and the removal of barriers to competition, policies with which I suspect I.G. nowadays has some sympathy.**

The debate on economic reform is one in which I became engaged almost by accident ten years ago, when I invented the now notorious

phrase “the Washington Consensus” to describe the set of reforms (which can be summarized as macroeconomic stabilization, microeconomic liberalization, and opening to the outside world) that official Washington was then urging on Latin America. That term has since taken on a rather different, and far more ideological, tone than I had intended it to signify.

---

The author acknowledges with gratitude comments on a previous draft by Devesh Kapur, Sanjay Kathuria, and Jayshree Watal, but absolves them of any responsibility for opinions expressed in the paper.

seeking to explain the success of my term when he discussed Williamson (1999), Moises Naim argues that people need an ideology as a thought-economizing device, and that “Washington Consensus” filled a vacuum by providing an appealing title for the economic ideology of the victor of the Cold War, the world’s only remaining superpower. Those who were opposed to that ideology then sought to turn the phrase to their advantage, by portraying the reforms it described in extreme terms (e.g. minimalist government, rather than government cut back to the tasks that can be rationalized by economic theory; or monetarism, rather than macroeconomic

discipline), and by implying that Washington imposed reforms on other countries. This has made me distinctly uncomfortable, because I do not regard myself as an ideologue (I define an ideologue as someone who knows the answer before he has heard the circumstances of a question), let alone an apostle for American imperialism.

I want to take advantage of this lecture today to go back to first principles and explain what I see as the intellectual foundations for the economic system toward which economic reform has increasingly been directed. I will then take you on a rather rapid historical survey of the way in which development thinking and practice has evolved from 1949 to the present day, emphasizing how the concept of reform developed its current meaning. That will then set the stage for a discussion of what a contemporary reform agenda for India might look like. In concluding I will reflect briefly on whether the Washington Consensus is dead, suffering a backlash, being superseded by a post-Washington Consensus, or alive and well.

***Foundations: What Is Reform Seeking to Achieve?***

At this point in time, both mainstream economic theory and the lessons of history appear to suggest that the system that makes the best use of an

economy's human<sup>1</sup> and natural resources in terms of generating economic output is a competitive, open, market economy. By “mainstream economic theory” I mean both the neoclassical core of theory, which is based on recognition that the market economy has the advantage over alternatives that it harnesses rather than fights the widespread human instinct of self-interest, and also understanding that the neoclassical assumptions are not universally valid but quite often need to be modified. Thus I include within the mainstream the theory of public goods, and externalities, and Keynesian economics, and public choice theory: anything, say, for which the Nobel Committee has seen fit to award the Nobel Prize.

Such an economy does not arise spontaneously, it needs social organization. The prime economic purpose of government is to provide such organization, implying a need to nurture those institutions – notably laws regulating property rights, contracts, the operation of corporations and banks, and bankruptcy, a judicial system capable of enforcing those laws impartially and efficiently, and a system of prudential supervision of financial institutions – that are central to the operation of a market economy. One may term this the institutional infrastructure of a market economy. An efficient economy also requires government to preserve a stable

---

<sup>1</sup> The fact that this is the system that best allows individuals to realize their potential should be counted as a benefit in its own right and not just a means to increase output.

macroeconomic environment, within which enterprises can make decisions without unreasonable uncertainty about circumstances beyond their control, and to provide public goods. Moreover, there are three classic circumstances in which market failures may usefully be addressed by government, if the latter is up to its job and not failing even more than the market: where externalities are present, where a market is monopolized, and in regard to income distribution (there is no theorem that says that the market will generate a distribution of income with any attractive ethical properties). In the absence of one of those conditions, activities are best left to the private sector.

You will realize that I am trying to limit discussion to the economic issues. This is because I believe in the division of labour and comparative advantage, and I doubt my ability to say anything very interesting about issues of national security or sovereignty or gender or human rights or crime. It does not imply that I am so stupid or so insensitive as to doubt the importance of these issues, some of which (like national security) are also preconditions for economic prosperity, and others of which (like gender) demand their own reform agenda.

### ***The Progress of Policy Reform, 1949-99***

Let us take the year when the University of Baroda was founded as the starting point for a brief survey

of the history of economic thought about appropriate development policy. Jean Waelbroek (1998) has characterized thought at that time as dominated by what he called the “Indian Congress Consensus”, a set of ideas set out by Jawaharwal Nehru during his period in jail in 1944-45. His concern was how India in particular, and the developing world in general, could modernize so as to catch up with the industrial world that had shot ahead during the preceding 150 years, and he argued that this required the acquisition of modern technology, rapid industrialization, and the transfer of large numbers of workers to the cities. So far, so good: those ideas have aged well, much better than Gandhi’s competitive program based on the promotion of small-scale industry. But when Nehru came to the means of achieving those objectives, he argued for collective action rather than the acquisitiveness of capitalist society, for using state enterprises and cooperatives rather than big business to realize economies of scale, for state ownership of the leading heights of the economy, for the use of heavy import protection to foster a rapid buildup of the domestic manufacturing sector, and for the use of planning rather than the price mechanism as the main guide to resource allocation. Planning and autarchy became even more tightly fused together in the 1950s as the closed-economy model of Mahalanobis provided the basis for Indian planning. This was the dominant set of ideas in India, supplemented by a nod to Gandhi in the form of small-scale industry reservation, and also in the rest of South Asia.

The other area of the world that generated its own ideas about development policy was Latin America. The ideas of autarchy and import substitution evolved on parallel lines in both regions, although with an additional rationalization, in terms of the supposed secular deterioration of the terms of trade of primary products, that was developed at CEPAL (the Spanish acronym for the Economic Commission for Latin America, based in Santiago).<sup>2</sup> State ownership had a somewhat less ideological base than in India, being used as a way of building up domestic industry when the private sector failed to move in, rather than because of a preference for the public over the private sector based on a suspicion of acquisitiveness as a motivation. Planning had a much lower profile: ironically, indeed, some countries introduced 5-year plans only reluctantly in the early 1960s, driven by a concern to access US aid under the Alliance for Progress, for which a national plan was virtually a prerequisite. There was one major additional element to thought in Latin America, the theory that inflation was a result of structural imbalances and rigidities rather than excess demand. This served to rationalize policies of deficit financing as beneficial to growth, which duly led on to a large accumulation of external debt when the banks started international lending to recycle the oil

---

<sup>2</sup> Although the issue is still debated, my own reading of the evidence is that such a tendency exists, but I do not see this as having the strong implications that the CEPAL economists inferred.

surplus in the 1970s, and thence to the debt crisis and hyperinflation in the 1980s. India was spared these macroeconomic traumas.

Africa imported the preponderant developmentalist ideology of import substitution, state enterprises, and (with a longer lag) structuralism, after it achieved independence in the early 1960s. These ideas were particularly damaging in the African context of tiny national states that had resulted from the pattern of competitive colonization followed by decolonization on the basis of unchanged boundaries. In conjunction with the venality of many African leaders and severe ethnic tensions, this laid the basis for the economic tragedy that has befallen that continent in the past 20 years. Sub-Saharan Africa has now slipped behind South Asia to become the poorest region in the world.

China is another region that imported its ideology, though in its case from Karl Marx and the Soviet Union rather than other parts of the developing world. For almost 30 years after the Communist government came to power in 1949 it pursued a policy based on collective ownership of both industry and agriculture. We were periodically told how China was forging ahead and leaving India far behind, and then learned with a long lag of the disasters of the Great Leap Forward and the Cultural Revolution.

Neither did the rest of East Asia develop any strong indigenous developmentalist theory. In the early postwar years it imported many of the same policy attitudes that were dominant in India and Latin America, notably the doctrine of import substitution. But it was here, perhaps because of the lack of any indigenous intellectual basis for that doctrine (and perhaps also because of the nearby example of Japan, which had resumed development very nicely in the 1950s with a more outward-oriented strategy), that the reaction against it, that is to say “reform” in the modern sense, first took root in the developing world. Admittedly some of the region’s intellectuals have in recent years been trying to compensate for its earlier lack of any indigenous developmentalist theory, by seeking to invent some East Asian Model that is distinctively non-neoclassical (an intellectual undertaking that I have always felt to be condemned to failure by the fact that one of the highly successful East Asian economies, namely Hong Kong, pursued the most laissez-faire development strategy of any economy in history). My reading of history is that those economies prospered because they embraced many modern economic reforms, specially with regard to macro stability and outward orientation and investment in human capital, though admittedly less so in the sphere of market liberalization. I do not have a strong view as to whether they would have done even better had they been a bit more “orthodox” with regard to micro policy: it is conceivable that industrial policy brought net benefits in certain

countries like Korea, where the civil service was relatively uncorrupt and competent, where the prior evolution of industry in Japan provided a model for the planners to follow, and where protection was made contingent on success in penetrating export markets rather than being made to measure. What I cannot believe is that Korea's success was primarily due to its industrial policy.

Taiwan was first off the mark in reform. The first timid move to encourage manufactured exports, by rebating duties on imported intermediate goods used in the production of exports, was made as early as 1955. This was followed the next year by the adoption of a suggestion of S.C. Tsiang, then an IMF economist who consulted with the government in Taiwan and whose policy positions were far more market-oriented than was the intellectual fashion at the time, to allow exporters to retain a part of their earnings in tradable exchange certificates that could be used to buy imports. In response manufactured exports jumped from under \$4 million in 1954 to nearly \$15 million in 1958, still a tiny sum but a far larger response than the predominant export pessimism of the time, which held that the developed countries would immediately throttle any incipient expansion of manufactured exports by a developing country, would have judged conceivable. A government reorganization in 1958 brought to power K.Y. Yin, who had been converted by S.C. Tsiang to a belief that a market-oriented approach would be the most

effective road to rapid industrialization, which soon led to a program of major trade liberalization accompanied by devaluation (indeed, an effective floating of the exchange rate).

The process of abandoning the strategy of saving foreign exchange by import substitution for that of earning foreign exchange by creating favourable conditions for the growth of manufactured exports was essentially completed in January 1960, when the third Four-Year Plan was accompanied by a 19-Point Program of Economic Reforms. This bears a family resemblance to a structural adjustment program as sponsored by the World Bank for the past 20 years: it sought to encourage savings and investment, develop the capital market, privatize, raise electricity prices, limit the military budget, reform the tax system and tax administration, set up a central bank to control monetary policy, liberalize imports, and unify the exchange rate. Unlike the original moves toward outward orientation and a market economy, in which the only foreign influence was the agreement of the IMF to release S.C. Tsiang to visit as a consultant, the U.S. government had a hand in helping design the 19-Point Reform Program. This arose because in 1959 ECA (the Economic Cooperation Administration, the forerunner of US AID) was pressing President Eisenhower to reorient the focus of foreign aid away from security and toward development. Eisenhower was sympathetic but argued that he would need Republican support in Congress, and

to build that he would need a show case: a country that would appeal to Republicans and that was adopting policies of which they would approve, not the statism and import substitution that was then standard in developing countries. An official called Bill Ellis suggested that Taiwan would fit the bill, and that with a reform program it would be able to dispense with US aid within 5 years. This suggestion was initially met with incredulity because Taiwan was then regarded as a basket case, but Ellis persisted and eventually carried the day. A team of around 10 ECA officials duly went to Taipei, led by Jim Grant, then Deputy Director in charge of Planning at ECA and subsequently an outstanding Director of UNICEF until his death in 1994.<sup>3</sup> Their initial 8 proposals were endorsed by Yin and ultimately supplemented by another 11 to make the famous 19 points. Yin actually urged the Americans to be tough in imposing conditionality, notably in demanding limits on military expenditure, so as to help him to overcome the opposition from the military that he knew was inevitable. In the end the deal was done: the US provided increased aid in the short run that would be tapered out over a 5-year period, which it was. Taiwan has never looked back.

The second country to embrace economic reform was Korea, which made its first step toward encouraging the export of manufactures rather than

---

<sup>3</sup> The research underlying this account was inspired by, and in part based on, an interview I was granted by Jim Grant a few weeks before his death.

relying on import substitution in 1959, and then gradually developed the policy of export promotion after President Park Chung Hee had established his rule in the early 1960s. But there are two interesting contrasts to the experience in Taiwan. There was no conscious decision to promote exports rather than pursue import substitution: indeed, the two were pursued in parallel, at the expense of nontradables, for many years. Exporters were allied with the planners as the modernizing element, in contrast to the Taiwanese situation where exporting was a market-oriented activity and the liberalizers were the modernizing element. In that sense it was Taiwan rather than Korea that anticipated the major ideological shift in the West during the 1980s. Once again, however, the policy changes were essentially the outcome of domestic decisions, with foreign advice from the IMF, the World Bank, and the US aid mission being technical and low-key.

Excluding Hong Kong, where the local elite took advantage of the classical policy framework (“defence, and law and order”) provided by Britain and welcomed by the local citizenry as a protection against China, the next country to reform was Singapore, which backed away from the import protection that had developed during its brief period of union with Malaysia soon after it achieved independence in 1965. It decided to plump for a policy of all-out export promotion after it learned of Britain’s intention to withdraw

from the naval base that had hitherto been the mainstay of the economy in 1967, and this involved the progressive dismantling of virtually all protection except for a small and largely uniform tariff of 5%. But this policy of near free trade was complemented by a highly interventionist stance in many other areas, notably in stimulating savings, attracting foreign investors, giving tax incentives to reduce the cost of capital, providing training and technical education, maintaining industrial peace, developing infrastructure, providing overseas marketing services, and planning the transport system and the physical environment. Singapore provides an interesting case of an activist and efficient government committed to modernization that was neither laissez-faire nor anti-market. Its planners aimed to provide an environment that would attract and support a vibrant private sector, rather than to issue regulations to prevent enterprises doing what they saw as in their interest.

The other S. E. Asian countries -- Indonesia, Malaysia, Thailand, and the Philippines -- also moved toward more outwardly-oriented economies in the late 1960s and early 1970s, at about the same time that in the West the battle against ISI (import substituting industrialization) as a development strategy was first joined, with the classic analyses of Balassa (1970) and Little, Scitovsky, and Scott (1970). Both of these focused primarily on external liberalization (or what would today be called globalization), which was the first

of the three main thrusts of my “Washington Consensus” to become a target for reformers. Before long the conspicuous success of what Jagdish Bhagwati first characterized as the “Gang of Four” (meaning Hong Kong, Korea, Singapore, and Taiwan) became the prime exhibit of those urging a more outward-oriented trade policy on developing countries. Of course, the terminology was soon changed to something more politically correct, and the Gang of 4 became the “four dragons”, or the “little dragons”, or “the four tigers”, or the “East Asian NICs”, or (the ultimate in political correctness, yawn) the “East Asian NIEs”.

Disappointingly to we scholars who would like to believe that it is our analysis that persuades policymakers of what they should be doing, the intellectually persuasive case for trade liberalization made by Balassa and Little/Scitovsky/Scott did not result in a sudden surge of other countries to adopt more outward-oriented strategies. In fact, after the policy switches in S.E. Asia around 1970, it was only in China, Sri Lanka, the Southern Cone of South America (Argentina, Chile, and Uruguay), and Turkey, that there were any pronounced moves toward economic reform as that term is now understood until the mid-1980s.

Far and away the most successful of these was China. In 1978 China abandoned the commune system for agricultural production and

effectively allowed the resumption of peasant agriculture. It employed a dual price system to manage the transition, where producers had to fulfill a quota that was paid for at a low, fixed price, while excess production could be sold on a free market. It permitted the establishment of enterprises with more capitalist characteristics, although some of the most successful were “town and village enterprises” that exploited the former communes to create industrial units that were managed collectively at the local level, that sold their output on free markets, and that used their profits to buy local public goods.<sup>4</sup> Foreign direct investment was encouraged. Exports were promoted. The results of these policy changes were dramatic, with Chinese growth over the following 20 years averaging almost 10% per annum, resulting in over 200 million people being raised above the World Bank’s “dollar a day” line for absolute poverty.

Sri Lanka also undertook a major liberalization of its economy in the late 1970s. Unlike China, the basic institutional infrastructure of a market economy had survived the two decades of more or less socialist rule, but the economy had

---

<sup>4</sup> When I was working on South Asia in the World Bank I several times asked those familiar with the Chinese town and village enterprises whether their experience might be replicable in South Asia. I was always told no, and eventually concluded that the effective constraint was the limited tradition of collective action at the local level in South Asia (with the milk cooperatives at Anand, and more recently watershed management and forestry, providing the leading but still isolated examples of such action).

been almost strangled by a combination of state enterprises and the exchange restrictions that had been created to offset the effects of an overvalued exchange rate. The November 1977 policy package therefore “included a significant trade liberalization, new incentives for foreign investment, significant liberalization of financial markets, limits on public sector participation in the economy, and exchange rate realignment [i.e. devaluation in conjunction with a unification of the exchange rate and a more flexible exchange rate policy for the future]” (Athukorala in Shand, 1999, p.273). Fiscal policy was also tightened. The result was clearly beneficial in terms of the growth rate of manufacturing, which had dropped to 3% per annum in the period 1970-76 and averaged almost 7% per annum over the following ten years. Unfortunately the outbreak of ethnic conflict in 1982 has so far limited the gains that Sri Lanka has been able to reap from economic reform.

I will refrain from discussing Turkey’s important external liberalization in 1980 (unfortunately not accompanied by a thorough macro stabilization), but I do want to say something about the liberalization in the Southern Cone of South America in the late 1970s. Argentina, Chile, and Uruguay all had military governments at the time, they were all suffering from high inflation as well as inward orientation, and they all chose a highly ideological Chicago-inspired form of reform quite unlike the Asian approach. Chile dismantled the socialist system

that Pinochet had inherited from Allende, including by privatizing many of the socialized enterprises. Trade and capital movements were liberalized in all three countries, while exchange rates were devalued and then put on a preannounced, decelerating crawling peg that was supposed to induce a slow disinflation in accordance with the monetary approach to the balance of payments. Chile, but not Argentina or Uruguay, established fiscal discipline. All three enjoyed a short-lived boom, which quickly turned to bust even before the Mexican moratorium in August 1982 initiated the debt crisis. Incidentally, the Chilean crisis of 1982-83 provides something of a precedent for the East Asian crisis of 1997, in that this was a crisis caused by market euphoria over economic reforms which led to excessive capital inflows that fed an exchange-rate overvaluation and financed the resulting large current account deficit which developed despite a fiscal surplus.

The debt crisis became the dominant international economic issue of the 1980s. Unlike Chile, the rest of Latin America (except Colombia) had been experiencing large fiscal deficits, associated with high inflation, and most analyses blamed these as the ultimate cause of the crisis.<sup>5</sup> Accordingly economic reform came to embrace

---

<sup>5</sup> My own view is that a large fiscal deficit is a sufficient but not a necessary condition for a debt crisis as experienced in Latin America. As just noted, Chile managed to have a full-blown crisis without a fiscal deficit.

macroeconomic stabilization, involving fiscal and monetary discipline and a realistic exchange rate, as well as a move toward outward orientation. Both elements were present in the World Bank's early structural adjustment programs in the first half of the 1980s.

One can date the full development of my version of the Washington Consensus, which embraced microeconomic liberalization as well as macro stabilization and outward orientation, to two events in mid-1985. The first of these was a stabilization program in the small, poverty-stricken, Andean country of Bolivia in August of that year. This was designed by a visionary team of six Bolivians, with very limited outside participation (although they did draw on some work on stopping the ongoing hyperinflation that Jeffrey Sachs had done for the losing candidate in the presidential race earlier that year, and they talked to missions from the IMF and AID). The program combined big tax increases (and tax reform) with the abolition of large subsidies to produce a dramatic improvement in the public finances; a drastic devaluation and the maintenance thereafter of a depoliticized and realistic exchange rate; trade liberalization in the form of an immediate move to a single uniform tariff and the elimination of all other trade restrictions; interest rate liberalization; and the elimination of price controls. The team exploited the macro crisis to make a decisive move toward a market economy and open up to the outside world,

at the same time that they undertook the necessary stabilization measures. This was the original Big Bang program of economic reform, from which Jeffrey Sachs (who a few months *after* the program was announced became an advisor to the government) drew the inspiration that he took to Poland at the beginning of the transition in 1989.

The other key development of 1985 was the speech of the new US Secretary of the Treasury, James Baker, to the Annual Meetings of the IMF and World Bank in Seoul. This speech contained the first official recognition that the initial debt strategy, which had focused on persuading the commercial banks to continue concerted “new lending” to permit the debtors to maintain full debt service until macroeconomic adjustment by the debtor countries made involuntary actions by the banks unnecessary, was breaking down. It urged the banks to continue new lending, in parallel to increased lending by the multilateral development banks, to countries that tackled “structural reforms”, meaning liberalization and, an addition to the roster of internationally approved reforms, privatization. Hitherto the question of public versus private ownership had been considered a preserve of national sovereignty, something about which it was impolite for one nation to urge another to change its policies. But by 1985 the evidence of five years of positive results of the privatization program of the Thatcher government in Britain was making it hard to maintain official neutrality on something that seemed to offer such

significant benefits, and privatization entered the reform program. This was Mrs. Thatcher's legacy to the cause of economic reform.

In the second half of the 1980s attitudes to economic reform in Latin America underwent something of a revolution, as one country after another switched to the path pioneered by Chile (which, unlike Argentina and Uruguay, maintained its main reforms after 1982) and Bolivia. We had a dramatic illustration of the change at the Institute for International Economics. In 1986 we published a manifesto for reform entitled *Toward Renewed Economic Growth in Latin America*, co-authored by Bela Balassa and three Latin economists, which encountered a lot of hostility in the region and seemed to have fallen on deaf ears. Three years later I organized a conference under the title "Latin American Adjustment: How Much Has Happened?", which documented the widespread character of the reform movement at that time. The main complaint this engendered was that my term "Washington Consensus" for the reform agenda of the region slighted the Latin reformers by suggesting that the initiative lay in Washington. But my identification of the reform agenda of the time, as consisting of fiscal discipline, reorientation of public expenditure toward fields promising high returns such as primary education and primary health care, tax reform, financial liberalization, a competitive exchange rate, trade liberalization, liberalization of foreign direct investment (FDI) inflows,

deregulation (in the sense of eliminating barriers to exit and entry), privatization, and secure property rights, evoked rather little controversy, beyond Stanley Fischer's suggestion that I had missed some of the World Bank's priorities, like poverty reduction, and some emerging issues, such as the environment and institutional development.<sup>6</sup> (In retrospect, I have concluded that I allowed wishful thinking to cloud my judgment on the exchange-rate issue: indeed, there now seems a near-consensus, from which I am one of the few dissenters, that countries should choose between firmly fixed and freely floating exchange rates, and ignore whether the chosen policy is consistent with maintenance of a competitive exchange rate.)

The weeks while I was editing the resulting conference volume, at the end of 1989, witnessed the end of the Iron Curtain and the beginning of the transition to a market economy by the countries of East and Central Europe. Jeffrey Sachs convinced the Poles that a Big Bang as pioneered in Bolivia was the right approach for a transition economy. I never found the debate on gradualism versus shock therapy to be very enlightening, perhaps because it so often seemed to be posed in terms of the speed of price decontrol, whereas I

---

<sup>6</sup> One of Fischer's remarks in his Comment on my paper is of particular interest in the light of subsequent events: "I am less sure than Williamson that Washington regards the freeing up of capital flows as less urgent than the freeing up of goods flows. I fear rather that much of Washington does believe strongly that financial capital flows should not be constrained, but that it simply has not yet focused on the problem."

suspect that the real issue was whether new institutions could be implanted overnight or whether they needed to be allowed to adapt gradually. One thing that we can surely say with the benefit of hindsight is that we did not show proper urgency in building the institutional infrastructure of a market economy in the early years of the transition: perhaps the principal intellectual development in development economics over the past decade has been recognition of the key importance of the institutional environment, a realization stimulated at least in part by the difficulties encountered during the transition (particularly in the former Soviet Union where the institutions of a market economy had been most thoroughly eradicated). On the other hand, there was surely excessive urgency in attempting to privatize large-scale corporations overnight (Stiglitz 1999). But my purpose today is not to tell you how the transition should have been handled, but to draw your attention to the fact that the governments of 400 million odd people which had spent decades trying to implant an alternative to capitalism finally acknowledged that the quest had been misguided. All of a sudden there was no alternative paradigm. Reformers simply had to concentrate on making capitalism work in the social interest.

By the beginning of 1991 there were only three regions of the world which lacked a serious movement for economic reform, namely Africa, the Middle East, and South Asia. In Africa and the

Middle East reforming countries are still somewhat scattered. But the situation in South Asia was transformed overnight in August 1991 when the incoming Indian government had to face a balance of payments crisis and decided to use the opportunity to liberalize the economy rather than simply to fix the immediate crisis. There had of course been a number of reform initiatives in India before 1991, but these always seemed to be in the nature of marginal adjustments to enable the tightly controlled regime to work better, rather than signifying an abandonment of the “license raj”. Similarly, there were scattered reforms in other South Asian countries before 1991, but (apart from the measures adopted in Sri Lanka in 1977 that were discussed above, and a subsequent second-wave liberalization program in 1990) these were modest in scope and indecisively implemented. One suspects that the reason things were different in 1991 was that those who had been itching to introduce these reforms, out of a conviction that they would give India a chance to begin catching up with East Asia and the industrial countries, realized that the collapse of Communism gave them at last the opportunity they had been seeking.

The Indian reforms of 1991 were wide-ranging. They included a measure of fiscal adjustment, domestic liberalization, and opening up the economy to the outside world, although in none of these areas could one say that reform is anything like complete. The fiscal adjustment was

quite significant in the first year but never made much subsequent progress, leaving India in recent years with an overall budget deficit (including state governments, state enterprises, and the oil account) close to 10% of GDP. Domestic liberalization started off with a veritable bonfire, eliminating most of the myriad controls over domestic production and investment. But little further progress was made on this front during the later years of the Congress government or during the subsequent United Front or BJP governments, although the easing of inward FDI that started under Congress was extended. Many trade controls, other than those on consumer goods and agricultural products, were abolished, and tariffs were lowered a lot, though they remained way above those almost anywhere else in the world, even in neighbouring South Asian countries. The United Front made further progress on external liberalization, and although the BJP government raised rather than lowered tariffs, this seemed to be done reluctantly and in response to fiscal pressures more than in furtherance of its traditional ideology of swadeshi. Disinvestment, meaning the sale of a minority of the shares in state enterprises, was started in industry and parts of the financial sector, and was gradually made somewhat more extensive. So India's reform program was definitely a gradualist one, in the Asian tradition, but it was pointed in the direction of what had become the international mainstream.

### *Contemporary Reform Priorities*

If one accepts that India's reforms to date are seriously incomplete, then a critical question is: what should come next? To suggest an answer, let me go back to my description of the intellectual foundations of what reform is seeking to achieve. I stressed first the role of government in building the institutional infrastructure of a market economy. The two big weaknesses in India in this regard appear to be the absence of a proper bankruptcy law and the weakness in the administration of justice, especially the lengthy delays in reaching decisions. I went on to speak of the macroeconomic environment, where India has traditionally performed relatively well, but today the size of the fiscal deficit poses a real threat to the maintenance of its past record. I mentioned public goods: there are notorious inadequacies in both the road system and the provision of basic education (a merit good rather than a pure public good, but one with strong positive implications for income distribution as well as economic growth). In regard to externalities, one immediately thinks of the environment. So far as competition is concerned, the principal issue is surely the continued existence of small-scale industry reservation. Finally, there is still a large public sector that is impossible to rationalize by the sort of logic that I have suggested underlies contemporary reform movements.

That gives a list of eight issues that strike me as likely priorities for the reform agenda in India at the present time. Please do not interpret me as claiming to offer a comprehensive agenda, and certainly not as claiming to make a definitive judgment that these are the eight most important issues; I suspect that some of those I have chosen to focus on are less urgent than completing reforms in more familiar areas like trade liberalization (specially liberalization of trade in agricultural products) or power sector reform. But I have chosen these issues to illustrate the range of concerns that arise in a country that is trying to modernize in accordance with prevailing views on best practice.

Let me now offer a brief discussion of each of the reform areas identified above.

*Bankruptcy.* In 1985 India adopted a Sick Industries Company Act that was intended to substitute for bankruptcy proceedings, by creating a Bureau for Industrial and Financial Restructuring that would give special treatment to “sick industries”. The intention was to revive them, under the existing management, which was normally sought by extending privileges such as access to cheap credit. This is contrary to normal practice elsewhere in the world, which takes the failure of an enterprise to operate at a profit as a sign that resources are being misused by the existing management and should be redeployed to those able to make better use of them, not as a

reason to provide additional resources to be wasted. The purpose of bankruptcy proceedings is primarily to determine who should obtain command of the resources in place of the existing managers, and secondarily to resolve the rival claims of the enterprise's creditors to such net worth as it still has.

The reason for the sick industry policy was a reluctance to allow jobs and firms to be destroyed. There is indeed a danger that a creditor grab race may lead to a firm being destroyed, and one of the considerations in designing a bankruptcy law is that this be prevented from happening. However, there is now pretty persuasive evidence from around the world that arrangements designed to protect employment, of which India has an extreme form, have the net result of destroying jobs in the formal sector: employers hesitate to take on new employees in response to what may prove a temporary increase in demand if they know they will be unable to reduce their labour force subsequently should demand decline in the future. It is now also widely understood that the effect of a well-designed bankruptcy law is not to result in the assets employed by a bankrupt firm going to waste, but rather to allow them to be redeployed into more productive uses. If the weakest tier of firms is enabled to stay in the same business, this may jeopardize the next weakest tier rather than add to industry output. None of this is to claim that that no one suffers in a typical bankruptcy proceeding. There will normally be

some of the incumbent managers whose services will be dispensed with, and it is also entirely possible that at least some of the employees will lose their jobs or only be rehired at substantially lower wages, but the losses of the losers are less than the gains of the winners.<sup>7</sup> Preventing change in these circumstances is a recipe for stagnation.

To argue that India desperately needs a proper bankruptcy law is not at all to say that it would be well-advised to copy the existing law of some other country. There are difficult issues in designing a law that will avoid a creditor grab race, that could indeed destroy the value of a company as a going concern, while also respecting the legitimate rights of creditors. Interesting new ideas have been advanced by economists in the past decade as to how bankruptcy law should be written. In particular, Aghion, Hart, and Moore

---

<sup>7</sup> The fact that the losers could be compensated by the winners implies that the Compensation Principle can be invoked to suggest that it is desirable to enforce bankruptcy. Of course, the idea that the Compensation Principle proved that a change was desirable, unless compensation were actually paid, has long since been discredited, but it is still a test that we habitually use, while also asking whether compensation should actually be paid. To my mind there are two reasons for actually paying compensation. One is if the losers have a veto on the change. The other is if the losers are particularly badly off, as compared to the rest of the society that will be paying the compensation. There is a lot to be said for putting a safety net under the losers, but very often the losers are actually among the labour aristocracy, and compensating them, unless they can veto the change, is perverse. One can think of one of the purposes of bankruptcy law as being to deprive them of their veto power, so as to facilitate change and avoid the necessity of having to pay perverse compensation.

(1992) suggest a procedure in which the firm's creditors are first converted into equity-holders, who then vote to choose between a series of reorganization plans developed by alternative potential managers (who may include the current management team) under the supervision of some neutral figure like a judge. It is high time some country tried to develop a law based on their proposal, and I can think of no better candidate than India, with its tradition of appointing weighty commissions to make careful evaluations of proposed changes before it legislates.<sup>8</sup>

*The Administration of Justice.* A survey undertaken earlier this year by the CII in conjunction with the World Bank asked business leaders for their appraisal of the efficiency of the Indian court system in resolving business disputes (World Bank 1999 forthcoming). In a number of dimensions the results were far from depressing. For example, 83% of respondents expressed some measure of confidence that the legal system would uphold contracts and property rights in business disputes; 78% agreed, or tended to agree, that justice would be fair and impartial; and 70% expressed a similar degree of conviction that justice would be impartial and uncorrupt. This suggests that the legal system has so far withstood

---

<sup>8</sup> One of the issues with which such a commission would need to grapple is the problem caused by so many of the likely creditors being state-owned financial institutions, and whether the Aghion-Hart-Moore proposals would make sense before those institutions have been privatized.

the advance of corruption far better than has happened in some of India's neighbours. At the other extreme, however, 64% of respondents disagreed with the proposition that justice is affordable, and no less than 88% think it is slow. This merely provides statistical underpinning for the anecdotes about cases needing decades to work their way through the courts with which every visitor to India is regaled soon after their arrival.

An old English proverb asserts that justice delayed is justice denied. One can surely never expect to have an efficient banking system until willful defaulters are dealt with promptly, so as to provide the incentive to service loans that is key to the banking system channeling resources to the borrowers able to make the best use of them. A National Task Force on Judicial Reforms reported in 1996 on the measures needed to ease supply bottlenecks in the judicial system (such as appointing more judges), and on changes in fee structures that would provide lawyers with an incentive to bring cases to a prompt conclusion (such as payment by results rather than by the hour). It is time this report was acted on.

*Fiscal Discipline.* India's non-financial public sector deficit (which includes state governments, public enterprises, and the oil pool account as well as the central government) is running at over 9% of GDP. The revenue deficit is over 6% of GDP, higher than in the crisis year of 1990-91, signifying that such fiscal adjustment as has

occurred was all achieved by cutting capital expenditure. Since inflation is low, very little of this can be dismissed as a consequence of inflation that should be deducted in order to get a figure for the operational (inflation-adjusted) deficit. Few countries have larger fiscal deficits than this: indeed, over the decade 1987-97, only Brazil, Pakistan, and Nigeria had larger fiscal deficits (among countries with a population of over 20 million). Most countries that have had fiscal deficits as large as this for any length of time have suffered severe macroeconomic problems in consequence, either in the form of inflation (vide the Brazilian hyperinflation), or of a balance of payments crisis (as in Pakistan and Nigeria), or in the form of a buildup of foreign debt, or some combination of these. The urgency of correcting the fiscal deficit has often been emphasized by the Minister of Finance. In its 1999 *Indian Development Report*, the Indira Gandhi Institute has called for a 10-year program to eliminate the fiscal deficit, on the model of what the United States has achieved over the past decade. I can only echo that call.

Why has the Indian polity found it so difficult to tackle the fiscal deficit in recent years? A 1997 report from the Ministry of Finance (Government of India, 1997) on subsidies estimated these at some 15% of GDP in 1994-95,<sup>9</sup>

---

<sup>9</sup> One might argue that is an underestimate, inasmuch as it excludes the high (for a non-inflationary era) 12% interest rate paid on small savings, which holds up the whole structure of interest rates.

of which the bulk (no less than 11% of GDP) did not qualify as merit subsidies, where a merit subsidy is defined as one that can be rationalized either on the ground that it corrects an externality or that it can be expected to improve income distribution. These are subsidies to the consumption of power, irrigation water, diesel fuel, and so on. In many cases the effect of these subsidies is utterly perverse: for example, farmers have an incentive to pump up excessive quantities of water for the cultivation of paddy in semi-arid zones, wasting electricity (and adding to greenhouse gas emissions) while depleting the water table and/or causing water-logging. The farmers who benefit (and even they may benefit only temporarily, where the environmental effects in terms of depletion of the water table or water-logging are cumulating over time) are almost inevitably the richer ones, since it is they who have the access to electricity and have installed the tubewells that enable them to exploit the subsidies. So these are not just non-merit subsidies, they might be described as anti-merit subsidies, that are damaging both environmentally and economically as well as being distributionally perverse. Moreover, estimates of the impact of liberalizing trade in agricultural products conclude that the benefits this would bring to the farming community would outweigh the costs of totally eliminating the subsidies, suggesting a rather attractive reform package.

When one points this out, one is typically met by an assertion that abolishing the subsidies would be political suicide, even if farmers were more than compensated by export liberalization. In fact, such econometric evidence as there is on this point does not substantiate the widespread political belief that economic reform is electorally unpopular: on the contrary, one study found that economic reform was the second most potent vote-winner in Latin America over the period 1982-95, second only to stopping a civil conflict (Gervasoni 1995). Perhaps Mr. Naidu's recent electoral victory in Andhra Pradesh, where he triumphed over an opposition party that wallowed in populist promises of increased subsidies, and the contrast with the electoral outcome in Punjab, will at last convince Indian politicians that good economics can also be good politics.

*Roads.* Any visitor to India soon realizes that the country's road system is seriously deficient by international standards. In contrast, telecoms have improved significantly in recent years, even if not as markedly as happened in Sri Lanka following full privatization, and the new privatized ports show promise of vastly improving performance in that sector, provided at least that they are given a free hand in out-competing the old public sector ports. However, although privatization has a lot to contribute in telecoms and ports, I worry that India is expecting too much from the private sector in modernizing its road system.

An uncongested road is a classic case of a public good, that is, a good whose consumption has the key property of non-rivalry (additional use at the margin by one person imposes no cost on others), and to some extent also the property of non-excludability (it is costly to charge for using it, by levying a toll). It is therefore a good that is most efficiently provided through the public sector, without charging. Economic efficiency suggests that, if tolls are to be levied, they should be charged on congested rather than uncongested roads, so as to discourage marginal users from imposing costs on other road users by rationing the available road space to those who value it most highly. Where alternative routes exist (better still, where there are alternative lanes on the same highway), there is a case for levying a toll on one route (or lane) and not on the other(s), so as to allow users to sort themselves into those who value time more highly than the toll charge and those who are prepared to sacrifice time in order to save money, but even this presupposes a system that would be congested in the absence of tolls. And when it comes to urban areas, the avoidance of gridlock demands a system of area tolling, on the model pioneered by Singapore, that one could hardly place in the private sector. Moreover, such tolls can be expected to be acceptable to the public only if there is a decent system of public transport as an alternative to private motor transport, which again presupposes an active public sector role.

None of this suggests that simply inviting private contractors to build new roads in return for the right to levy a toll on them is likely to be an efficient way of modernizing the road system. This is not to deny that there are some circumstances in which private provision of roads, motivated by a right to collect tolls on the new or improved road, may be a reasonable policy. Where the new facility has an effective monopoly, as is often the case with bridges and tunnels, then there will be no significant efficiency loss, although a regulator will be needed to set tolls in order to prevent monopolistic exploitation of road users (especially to avoid undue burdens being placed on those who live close to the toll-point). More generally, where cost recovery is possible without tolls so high as to divert a substantial portion of traffic back on to the old congested roads, this solution may be acceptable. But my feeling is that India is expecting too much from getting the private sector into road provision. There are some public goods that are best provided straightforwardly through the public sector, and the road system is one of them. Another reason for wanting to get rid of the panoply of non-merit subsidies is that this would give the public sector the financial resources to enable it to provide true public goods on the scale needed by a growing economy, without all the elaborate exercises that are necessary to persuade the private sector to provide public goods in an economically efficient way.

*Education.* Economic theory has recognized since the 1950s that capital consists not just of structures and machines, but also of human capital, that is, the highly educated and trained persons needed to run a modern economy and, in particular, to innovate. Economists have since then devoted much effort to trying to measure the returns to education, to see whether it is as profitable as physical investment, and which types of education yield the highest rates of return. The evidence is somewhat mixed, but the bulk of it suggests that education is a competitive field for investment, even if one regards increased earning capacity as the only benefit of education, and allows nothing for the enrichment of human life that learning brings. The conventional wisdom also holds that primary education, and the education of girls, yield the highest social returns.

India, with the honourable exception of some of the southern states, most notably Kerala, has not invested as those findings would suggest it should have done. Even in 1997 literacy was only 62%, and the figure for women was well below 50%. India has done rather better in regard to higher education, compared to the average of developing countries, although one hears that standards in public universities have been deteriorating in recent years. The relatively strong past performance in higher education provides the foundation for the country's success in having become the world's leading exporter of software, the context in which India has at last established

itself as a significant force in the world economy. However, this pattern of investment in education has the effect of increasing inequality in the distribution of income: it is overwhelmingly the poor whose children do not get even a primary education, while it is the better off whose offspring mainly go on to university, so that income inequalities in one generation are magnified in the next. The solution is not to cut back on higher education, which is of key importance in sustaining economic growth, but partly to increase expenditure on education and partly to make students, or their parents, pay for their education (by charging cost-recovering tuition fees while allowing students to pay for these through loans), and using the resulting financial savings to make primary education universal. I know that this is never a popular proposal to make to a student audience, but it seems to me that there is an overwhelming case in equity for those whose earning power is going to be enhanced by receiving a higher education to pay at least a substantial part of the cost, specially since on past form a significant proportion of the beneficiaries will spend the bulk of their working lives outside India and thus not even repay society via their taxes. I will believe that the current generation of students is more altruistic than my generation only when I observe a groundswell of support for this proposal!

*The Environment.* I have already referred to the importance of environmental spillovers in the

context of the choice between road and rail. There are numerous other fields in which environmental externalities (meaning spillover effects of actions on parties other than the immediate decision-maker) are important: air pollution caused by power stations and factories as well as cars<sup>10</sup>; water pollution, salinity, and the lowering of water tables; acid rain; toxic poisoning of the human population; loss of biodiversity; and so on. Such a complex range of problems does not admit of any simple solution, but it does demand recognition by the government that it has a duty to seek to identify each of the major threats and then introduce some appropriate compensatory action which will face decision-makers with a set of incentives that will give them a roughly appropriate motivation to avoid harming third parties. This may sometimes best involve regulation, but is frequently best done by the use of economic incentives like emission charges. There is not much sign of any such initiative at the present time.

One important question of principle, as well as a host of difficult questions of practice, arises in designing such an approach. The question of principle is: Who are the third parties whose interests should be taken into account in seeking to

---

<sup>10</sup> Ironically, the most damaging form of air pollution of all, the indoor air pollution caused by the use of traditional cooking methods, involves the least externalities, or at least the minimum extra-family externalities. Perhaps the obvious need for government action to address this major health hazard is best rationalized in terms of furthering the Gender Agenda rather correcting externalities.

make decision-makers weigh the external effects of their actions? Should these be confined to other Indians, should they also include the citizens of neighbouring countries, or should they include all effects worldwide? The important case of neighbourhood effects is the acid rain from Indian power stations that falls on Bangladesh; the “polluter pays” principle suggests that it should be India that pays for limiting emissions, if one recognizes Bangladesh as a party whose interests in this subject are legitimate. But would one then extend the same principle to greenhouse gas emissions, where the potential beneficiaries of limitation include the developed countries? If one accepts the less alarmist estimates of the likely impact of global warming, the cost imposed on the rest of the world by greenhouse gas emissions is not particularly large compared to the damage imposed on Indians by air pollution, but the issue is nonetheless a potentially important one for the future, in part because there is still such a wide range of uncertainty about the damage that is being imposed by global warming. Of course, India suffers from the emissions of other countries too: I take it as axiomatic that India would accept “polluter pays” obligations with regard to greenhouse gas emissions only in the context of an international agreement that imposed reciprocal obligations on other countries, and where obligations are based on the absolute level of emissions per capita rather than their change relative to some base level. It is the developed-country proposal to base such obligations on

changes from existing emissions levels, which are still very low in India, that threatens an unfair burden on India and deserves to be resisted. But that is no reason for resisting application of the polluter pays principle, if it were fairly structured to impose charges relative to the total level of emissions per capita.

*Dereservation.* The effect of the policy of import-substituting industrialization was to encourage industry to be capital-intensive. But there was also an understanding in India that the country needed to generate productive employment for a large number of people, as well as a second school of economic thought, due to Gandhi, that idealized small-scale industry. An attempt was therefore made to stimulate small-scale industry, which took two main forms: exemption from a range of taxes, and the legal reservation of certain industries for production by small-scale firms (a form of entry restriction that is unique to India). Even those who regard small as beautiful, and (for example) support policies to discourage the takeover mania that is currently afflicting the developed world, surely have to admit that the reservation policy has become so encrusted by anomalies as to be counterproductive by this point in time, if indeed it ever made much sense. Indian companies can evade it by relocating to Nepal. Imports are already allowed duty-free in 722 of the 1040 items reserved for small-scale industry, meaning that small Indian businesses have to compete with large foreign firms able to bring in imports (and this

number will increase as trade is liberalized in accord with India's WTO obligations). Exports are hampered in some of the sectors, notably clothing, in which India almost certainly has a comparative advantage. According to Joshi and Little (1996, p.201), product reservation has seriously damaged the engineering industries, by precluding "large firms producing the final product using many components bought in from other smaller firms". The large excess costs of processing oilseeds as a result of small-scale industry reservation are borne partly by consumers, and partly by the peasant producers of oilseeds (World Bank 1997). It is surely time that small-scale industry reservation was abandoned, lock, stock, and barrel.

*Privatization.* India built up a substantial group of state enterprises in the industrial and financial sectors during its period of flirting with socialism. So far it has been extremely timid in selling these off to the private sector, with policy limited to disinvestment of a proportion of the shares, a policy whose effect on incentives, and therefore on efficiency, is questionable. Only recently has the possibility of majority private ownership been entertained.

It is difficult to see good reasons for this reticence. Private ownership normally raises the efficiency of the privatized enterprise, because of the sharper incentives confronting the managers. It may also have an invigorating effect on

competitive firms, as the playing field is leveled (a private firm confronted by a state competitor can never be sure that competitive success will not be nullified by a state bailout of its competitor). Its fiscal impact is normally positive: Domingo Cavallo, when he was Finance Minister of Argentina in the first half of the 1990s, used to say that he benefited three times over when an enterprise was privatized -- by the cash that he received from the sale, by the subsidies that he no longer had to give to finance the enterprise's losses and/or its capital expenditure, and by the taxes that he received on its profits. About the only negative effect is the reduction of employment that will happen if the induced increase in output is less than the increase in labour productivity (and this is not axiomatic, as experience in Sri Lanka telecoms shows). One may hope that India will be a lot bolder on this front in future, and may even begin to use the P-word rather than insist it is only disinvesting.

It might be worth emulating Mexican practice by placing privatization receipts in a trust fund whose revenues were then used for social expenditure, on education or health or rural water supplies. In a sense this is window-dressing, but it is not just motivated by a desire to improve the public image of privatization. It is dressing the window to tell what one hopes is the truth, namely, that privatization reflects an intention to redirect the activities of the state away from building industry toward building social assets, an activity

which falls within its natural remit. And it may even be that by spelling out the intention in this way one will have some effect in ensuring that this does actually happen. Incidentally, not only is it the social sectors where the Indian public sector has been shirking its responsibilities, but also in its neglect of urban planning, a field where there is no Invisible Hand to guide the explosive urban growth to be expected in India over the next half century.

### ***Is the Washington Consensus Dead?***

Let me conclude by giving you my take on a debate that sputters in and around Washington, about whether the Washington Consensus to which I introduced you earlier is confronting a backlash, being superceded by a new consensus, dead, or what.

I am not persuaded by the evidence usually cited to support the notion that there is a backlash against reform. For example, it is common to cite the doubts about capital account convertibility that have been expressed in the wake of the Asian crisis, or the failure of the US Congress to support fast-track procedures for trade liberalization, or the disasters of the transition in the former Soviet Union, to make the case for backlash. I would respond (1) that traditional analysis (such as McKinnon 1973, 1991) argues that capital account liberalization should come at the end of the process of economic liberalization (and certainly after the

development of an effective system of prudential supervision), rather than be pushed early as it was in East Asia; (2) that the problems of trade legislation in the US Congress are primarily a result of the post-Monica political deadlock in the United States, and that we may have to reconcile ourselves to trade policy standing still for a couple of years; and (3) that while it is difficult today to argue that the details of the reform programmes adopted in the FSU were optimal, the nature of the reforms being sought remains obstinately unchanged. So I see no persuasive evidence for the backlash thesis.

In fact I expect reform to continue. I say this because I do not believe there is any remotely plausible paradigm that might inspire an alternative agenda. Socialism was tried and failed. The costs of autarchy are becoming increasingly prohibitive. The consequences of sloppy macro policies were unambiguously disastrous. There is simply no alternative to the general direction which reform has recently been taking. The mere fact that the word reform is now universally used to describe changes in those directions suggests to me that opposition to reform is likely to continue to be a protest movement rather than a new wave. India is a good example of a country where the political support for reform has been consolidated rather than undermined by every new election. So I am quite hopeful that the sort of reform agenda that I laid out above will in due course get implemented, though doubtless not as fast as I would prefer or with all the nuances that I would choose.

Indeed, in my more optimistic moments I still dare to hope that the broad objectives of the reform movement will come to enjoy the same general acceptance that human rights and democracy do, as things about which there is no need to do battle because the battle has been won and almost everyone is content with the outcome. But this is not at all the same thing as to agree with Joe Stiglitz (1998) that there is some new Post-Washington Consensus in the making. I am not quite sure that it was legitimate to speak of a policy consensus (within Washington or anywhere else) in 1989, but it is certainly arguable that we were then, as the Cold War wound down, closer to a consensus on the identity of the set of leading reforms needed at that time than we ever were before or are ever likely to be again. I see absolutely no sign that we are on the verge of a consensus on how to deal with environmental issues: on the contrary, the Senate of the only superpower has rejected a treaty intended to limit carbon emissions that many of us regarded as pathetically inadequate, particularly in the obligations it placed on the heaviest carbon-emitting countries like the one whose Senate rejected the treaty. The old and necessarily divisive question of income distribution is back on the table (some of us think it was scandalous that it was ever off the table, but the fact is that, at least in Washington, it practically disappeared as an issue in the 1980s). Capital account convertibility for emerging market countries is a major policy issue of the day on which opinions are sharply divided.

So I think the idea that we are on the verge of a breakthrough to some new consensus on the main issues of the day is pie-in-the-sky.

Does that mean that the Washington Consensus is dead? I submit that depends crucially on how one chooses to interpret what the Washington Consensus is. If one interprets it to mean consensus on the main issues of the day, then I have just argued that consensus may have been alive in 1989 but is dead today. If one interprets the Washington Consensus as I think Stiglitz does, to mean the collective view of the policymakers who call the shots in Washington (today, in alphabetical order, Fischer, Greenspan, and Summers), then it is very much alive and possibly more enlightened than at any time in history, if (as I suspect) experience has disabused those talented gentlemen of misplaced past enthusiasm for rapid opening of the capital account and privatization at all costs. If one interprets it to mean the parody of my list that has been hawked around by left-wing journalists, then I would say that it never did command a consensus in Washington (the nearest Washington got to subscribing to such views was under the first Reagan administration, way before I got around to trying to distill which of the Reagan/Thatcher grab-bag of ideas had survived the return of professional policymaking to Washington), for which we may all be truly thankful. If one interprets it to mean my initial agenda of 10 reform areas on which I claimed wide agreement (as relevant to Latin America in 1989), then my current judgment is that

about half of them do and should command wide agreement, and the others need significant qualification in one way or another (Williamson 1999).

But in this lecture I have been interpreting the Washington Consensus in yet another way, to mean three rather general ideas as to what constitutes reform: macro discipline, a liberal market economy, and globalization, supplemented by a concern to build the institutions that foster such an economy (what the Latin Americans refer to as second-generation reforms). I have argued that there is increasing acceptance that there is no real alternative but to try and make those general approaches work. One of the great benefits of admitting that we agree about the general direction that we wish reform to take is that this will liberate us for much-needed debate about the details of reform. I hope that I have been able to show you in this lecture that agreement on the generalities that have inspired so many polemics in the past leaves a host of important and fascinating issues for debate and analysis. Everyone in this room could subscribe to this general version of the Washington Consensus without the slightest danger of our lacking topics for future controversy. I believe, however, that our controversies would become much more constructive. We economists might even begin to be the “humble, useful people, like dentists” that Keynes (1931) argued we should aspire to become. If we did, then my successor in 2049 might well find it less fun to look back on the

coming half century than I have found it today to take you back over the last 50 years; but people will find the times better to live through, which strikes me as altogether more important.

### ***References***

Aghion, Philippe, Oliver Hart, and John Moore (1992), “The Economics of Bankruptcy Reform”, *Journal of Law, Economics, and Organization* (8,3).

Balassa, Bela (1970), “Growth Strategies in Semi-Industrial Countries”, *Quarterly Journal of Economics*, 84.

Balassa, Bela, Gerardo M. Bueno, Pedro-Pablo Kuczynski, and Mario-Henrique Simonsen (1986), *Toward Renewed Economic Growth in Latin America* (Washington: Institute for International Economics).

Gervasoni, Carlos (1995), *Economic Policy and Electoral Performance in Latin America, 1982-1995*, M.A. thesis, Center for Latin American Studies, Stanford University.

Government of India (1997), *Government Subsidies in India*. (New Delhi: Ministry of Finance).

Indira Gandhi Institute (1999), *India Development Report* (Mumbai).

Joshi, Vijay, and I.M.D. Little (1996), *India's Economic Reforms 1991-2001* (Oxford: Clarendon Press).

Keynes, John Maynard (1931), "Economic Possibilities for our Grandchildren", in his *Essays in Persuasion* (London: Macmillan, reprinted as vol. IX in D. Moggridge, ed., *The Collected Writings of John Maynard Keynes* (London: Macmillan for the Royal Economic Society).

Little, I.M.D., Tibor Scitovsky, and Maurice Scott (1970), *Industry and Trade in Some Developing Countries* (Oxford: Oxford University Press).

McKinnon, Ronald I. (1973), *Money and Capital in Economic Development* (Washington: Brookings Institution).

\_\_\_\_\_ (1991), *The Order of Economic Liberalization* (Baltimore: Johns Hopkins University Press).

Shand, Ric (1999), ed., *Economic Liberalisation in South Asia* (Delhi: Macmillan India).

Stiglitz, Joseph E. (1998), "More Instruments and Broader Goals: Moving Toward the Post-Washington Consensus", WIDER, Helsinki.

\_\_\_\_\_ (1999), "Whither Reform?", Annual Bank Conference on Development Economics, World Bank, Washington.

Waelbroeck, Jean (1998), “Half a Century of Development Economics: A Review Based on the Handbook of Development Economics”, *World Bank Economic Review* (12,2; May).

Williamson, John (1990), “What Washington Means by Policy Reform”, in J. Williamson, ed., *Latin American Adjustment: How Much Has Happened?* (Washington: Institute for International Economics).

\_\_\_\_ (1999), “What Should the [World] Bank Think About the Washington Consensus?”, paper presented to PREM Week of the World Bank, July, shortly to be available on <http://www.iie.com/TESTMONY/bankwc.htm>.

World Bank (1997), *The Indian Oilseed Complex: Capturing Market Opportunities* (Washington: World Bank).

\_\_\_\_ (1999 forthcoming), *India: Comprehensive Development Review of Policies to Reduce Poverty and Accelerate Development* (Washington: World Bank).

### **About the Author**

**DR. JOHN WILLIAMSON is a Senior Fellow at the Institute for International Economics since**

**1981. He was on leave as Chief Economist for South Asia at the World Bank during 1996-99, economics professor at Pontifica Universidade Católica do Rio de Janeiro (1978-81), University of Warwick (1970-77), Massachusetts Institute of Technology (1967, 1980), University of York (1963-68), and Princeton University (1962-63); Adviser to the International Monetary Fund (1972-74); and Economic Consultant to the UK Treasury (1968-70). He is author or editor of numerous studies on international monetary and developing world debt issues, including The Crawling Band as an Exchange Rate Regime (1996), What Role for Currency Boards? (1995), Estimating Equilibrium Exchange Rates (1994), The Political Economy of Policy Reform (1993), Economic Consequences of Soviet Disintegration (1993), Trade and Payments After Soviet Disintegration (1992), From Soviet Disunion to Eastern Economic Community? with Oleh Havrylyshyn (1991), Currency Convertibility in Eastern Europe (1991), Latin American Adjustment: How Much Has Happened? (1990), and Targets and Indicators: A Blueprint for the International Coordination of Economic Policy with Marcus Miller (1987).**



**ECONOMIC REFORM:  
CONTENT, PROGRESS, PROSPECTS**



**John Williamson**

**November 23, 1999**

---

Printed by :

**INDIAN COUNCIL FOR RESEARCH  
ON  
INTERNATIONAL ECONOMIC  
RELATIONS**

Core-6A, Fourth Floor, India Habitat Centre,  
Lodi Road, New Delhi – 110 003  
India