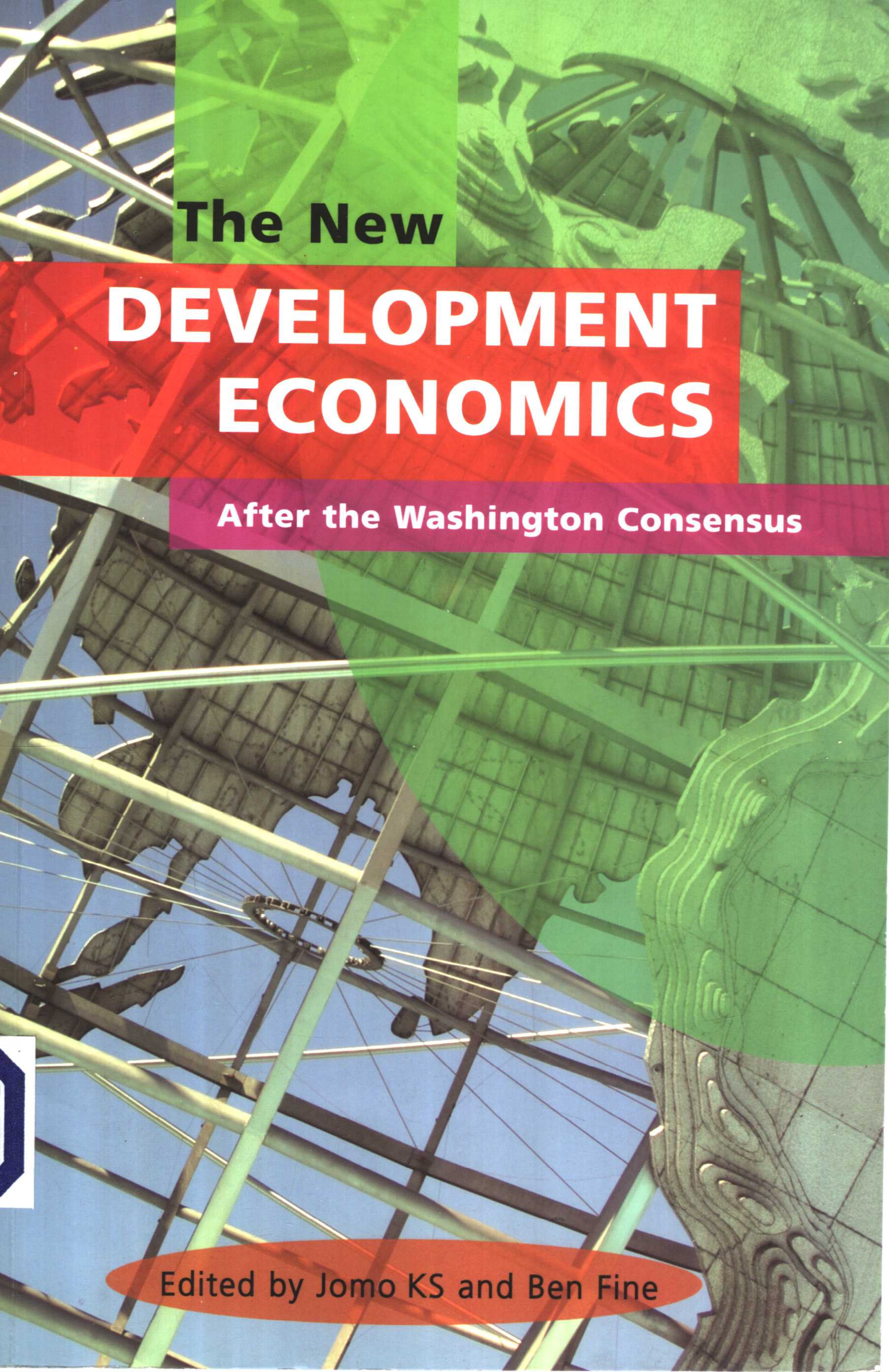

The New DEVELOPMENT ECONOMICS

After the Washington Consensus

Edited by Jomo KS and Ben Fine

The New Development Economics

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JOMO K.S.
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Preface

Development economics emerged as a distinct branch of economics after World War II, especially from the 1950s (Bardhan 1993; Hirschman 1981). Its antecedents are to be found in earlier schools of economics, for much of economic thinking over the centuries has been concerned with accelerating economic growth and transformation (Chang 2002). The emergence of development economics as a distinct field was encouraged by widespread recognition of the different economic and other conditions that prevailed in what has come to be referred to as the third world, or the South, or the developing world. Much of East Asia, then South Asia and later Southeast Asia, as well as Africa and the Caribbean, gained independence from colonial powers in the two decades after the end of World War II. The post-war ascendance of the United States of America at the expense of war-torn Europe, especially the United Kingdom, and the beginning of its Cold War with the Soviet-led 'communist bloc' provided the political motivation and intellectual space for the emergence and particular content of what is now termed old, or classical, development economics.

The experience of the Great Depression, the continuing reverberations and apparent relevance of the Keynesian revolution, and the preoccupation of pre-war Central European economists with 'catching up' and 'late industrialization' inspired and encouraged heterodox economic thinking that was distinct from the increasingly dominant mainstream, marginalist or neoclassical economics. It ranged much more widely in every respect than the limits imposed by the dominant debate in the United States between Paul Samuelson's neoclassical synthesis (US neo-Keynesianism) and free market conservatism led by Milton Friedman's 'monetarism'. Most importantly, the rationale for development economics derived from the very different economic conditions believed to prevail in Asia, Africa and Latin America. These included the generally larger significance of agriculture and primary commodity production, and the correspondingly modest role of manufacturing as well as different types of labour markets. Later, the understanding of economic development was extended beyond the conventional focus on generating economic growth (and employment) in different conditions, to include considerations of equity or distribution.

The 1980s saw a dramatic reversal in the fortunes of mainstream development economics, and an equally dramatic shift in its content and approach. With the ascendance of the Washington Consensus, there was growing official support from the Reagan and Thatcher governments for the 'counter-revolution' against development economics (Toye 1993). Often ignoring the earlier rich debates within development economics, the counter-revolution insisted on the universal relevance of its presumed notion of economic rationality, and, hence, of laws of supply and demand based on the optimizing behaviour of individuals. The apparent failure of Keynesianism after the post-war Golden Age, with the emergence of 'stagflation' (higher unemployment and inflation), contributed to greater antipathy towards state intervention generally, including towards a developmental role for government. The earlier sympathy of West European social democracy for developmental aspirations also eroded and changed in the new political conditions created by Blair's 'third way' and its continental parallels. The transitions from Soviet-led state socialism in the 1990s served to strengthen this trend.

Following the oil price hike of 1973–74 and the economic slowdown in the west, rapidly rising interest rates precipitated fiscal and sovereign debt crises in Latin America and elsewhere. Most of these heavily indebted governments had little choice but to seek emergency and other credit facilities from the Bretton Woods institutions (BWIs). This initiated a new phase of conditionality-based lending, with the International Monetary Fund (IMF) focusing on short-term macroeconomic stabilization (that is, deflationary) programmes and the World Bank on medium-term structural adjustment (that is, liberalization). (For example, see World Bank 1981. For critical assessments of the consequences of these programmes, see Cornia, Jolly and Stewart, eds 1987; Mosley, Harrigan and Toye 1991; SAPRIN 2004.) The McNamara–Chenery era of the World Bank – of 'growth with redistribution' (Chenery *et al.* 1974), 'meeting basic needs' and development finance – was set aside by Anne Krueger's (1974) efforts to roll back the state, ostensibly to eliminate rent-seeking and other governmental failures. Such policy perspectives had their intellectual counterpart in seeking to 'rubbish' a caricatured development economics, not least by appointing ideologue Deepak Lal (1983) as head of research at the World Bank (Kapur, Lewis and Webb 1997a, Kapur, Lewis and Webb, eds 1997b). More importantly, the Reagan and Thatcher administrations led western efforts to undermine the United Nations system by withdrawing from membership of those agencies they failed to 'reform' to their own advantage, while strengthening the role, profile and authority of the Bank, including its research resources and capacity. Meanwhile, recruitment to the BWIs from graduate economics departments in the United States became a matter of course as these departments increasingly treated development economics as 'ersatz', in favour of open macroeconomics, international trade and the esoterica of rational expectations. Soon, especially within the United States of America, other social sciences, led by sociology and political science, began to mimic the new fads in economics – for example, rational choice, sociometrics and other applied statistics.

These academic developments profoundly transformed the nature of development economics, and this volume seeks to identify and critically assess how academic trends since the 1980s have given rise to new approaches in the study of economic development, especially through the mainstream redefinition of development economics itself. The crude and simplistic prognostications of neoliberal market fundamentalism have enjoyed an influential but short shelf-life of a couple of decades or so. Few, however, would now openly attach themselves to the original versions and policies of the Washington Consensus (for example, see Bhagwati 1998; Feldstein 1998). And, on a higher analytical plane, commitment to the virtues of the market has made way for a more nuanced comprehension of how the market does or does not work, and of the complementary role of non-market factors. In its own technical fashion, development economics has restored some multidisciplinarity, although it is limited relative to the interdisciplinary political economy of the pre-Washington Consensus.

It was enough, however, for senior vice president and chief economist Joseph Stiglitz (2001a, 2001b), while still at the World Bank, in 1998, to announce a post-Washington Consensus, ostensibly based on a new development economics (Stiglitz 1986; also see Krugman 1999). At that time, besides opposing the unduly severe deflationary policies of the IMF, he had only sought to supplement John Williamson's (1990) original list of ten neoliberal policies with better financial regulation, competition policy, more attention to technology transfer, environmental sustainability, reduced income and asset inequality, and democratization. After being forced to resign from the Bank by the US Treasury Secretary, Laurence Summers (Wade 2001), Stiglitz's (2002) opposition to the BWIs' Washington Consensus became more explicit and total. In this sense, then, his announcement of a post-Washington Consensus was premature and, as Williamson (1990) has made clear, the Washington Consensus itself has evolved significantly over time (see Wade 1996). Hence, Stiglitz's 1998 version of the post-Washington Consensus is better characterized as a modified or updated version of the Washington Consensus rather than as its abandonment – just as subsequent generations of structural adjustment programmes (SAPs) eventually departed in substance from the early programmes.

In so far as several chapters in this volume criticize the post-Washington Consensus, they are at their strongest in referring to the post-Krueger modifications to the Washington Consensus, especially those associated with the Wolfensohn–Stiglitz leadership of the World Bank. At most, it has seen a modest retreat from Krueger's extremist neoliberal fundamentalism, although even the IMF has been forced to concede that the empirical case for its advocacy of financial liberalization has collapsed (for example, see Kaminsky and Schmukler 2003; Kose, Prasad and Terrones 2003; Prasad *et al.* 2003). While acknowledging that Stiglitz's critique of the BWIs has since gone much farther (also see Peet 2003; Pincus and Winters, eds 2002; Wade 2002), most of the contributors here still doubt that his alternative ('imperfect competition') micro-foundations approach provides an adequate critique of, let alone an alternative approach to, development studies or even development economics. Such an assessment is explored across the range of topics covered. There remain many omissions in the volume: for example, women, gender and the family; civil society (other than social capital); popular governance; environment; decentralization (also see Chang 2003; Fine, Lapavitsas and Pincus, eds 2001). These and other important subjects will, hopefully, soon belong to a more comprehensive critique of new development studies.

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Acknowledgements

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Introduction

The Economics of Development and the Development of Economics

Ben Fine

Mainstream economics as we know it today was established in broad brush as long ago as the marginalist revolution of the 1870s. It has displayed itself to be a truly remarkable, or should that be unremarkable, academic discipline. Certainly, by comparison with other subjects, its record of achievement is underwhelming. While the physical sciences have explored the nature of the universe from the Big Bang to the tiniest elements, the history of life from dinosaurs and before to DNA, other social sciences have revealed much about the human psyche, the nature of social structures, processes and agencies, and their history.

How does economics compare? Does it have an equivalent to a landing on the moon, nuclear science, penicillin, the welfare state or commitment to the values of democracy and human rights? Even as we are able to search for water and signs of life on Mars, we seem unable to design our economies in such a way that water is readily available to all here on earth. Instead of resolving such practical matters of life and death, at the heart of twentieth-century mainstream economics, in method as well as in achievement, stands general equilibrium theory: under what conditions does a perfectly competitive economy guarantee an equilibrium that is efficient in some limited sense? Even one of the leading practitioners of general equilibrium, Frank Hahn, was forced to conclude as follows in looking back over one hundred years of the United Kingdom's Royal Economic Society, and forward to the next one hundred years:

> My point has not been that twentieth-century theory sheds no light, nor indeed that its methods will not continue to provide some illumination. But it is my prediction that the latter will increasingly be found to be too faint in the search for answers to questions which have quite naturally arisen from twentieth-century theoretical developments. (Hahn 1991: 50)

Put more bluntly, Hahn is simply saying that economic theory has posed questions that it has not been able to resolve – hardly surprising, given its preoccupation with the weakest conditions that guarantee the existence of general equilibrium. And, having offered some solution to this purely *theoretical* problem, it is equally unsurprising that economics should have difficulty in dealing with *empirical* problems, the ones occupying those worlds that depart from the idealized assumptions of models, and inhabit economies as we live and experience them. While the world undoubtedly moves in mysterious ways, the connection between the esoteric theory of economics and the making of the world's economies as they are, rather than as they cannot be (perfect competition, full employment, no market imperfections, etc.), is, to say the least, elusive. Interestingly, Hahn looks to history, biology and sociology to bring economics down to earth, possibly the most explicit acknowledgement of the discipline's failure.

At times, of course, economics has engaged with the pressing problems that are posed by the inescapable departure in reality from the virtual world of general equilibrium. Keynesianism readily springs to mind, not least because of its emphasis on the idea that markets, certainly in aggregate, do not work perfectly and can generate persistent levels of unemployment. Yet, ten years after Hahn's downbeat assessment of the achievements of economics and of its prospects if not complemented by other disciplines, Robert Lucas (2000) was also offered, at the turn of the millennium, the opportunity to look forward to the future of economics. Lucas is best known as a Nobel Laureate for having launched the new classical economics in the 1970s, an explicit rejection of Keynesianism in favour of the free market (on which, see below). He treats the history and distribution of the world's economic growth as little more than a random walk to a starting line for industrialization, after which free flow of technology between those in the race increases the gap with those that are not. But no need to worry; all countries will eventually cross the starting line and more or less catch up with the others over the coming century (see the chapter on 'New Growth Theory: More Problem than Solution' in this volume).

Lucas is a leading representative of the new generation of Nobel Laureates in economics whose qualifications for prominence rest on making assumptions that depart as far as possible from realism. Such was the explicit methodological stance of his Nobel predecessor, Milton Friedman (1953). It is worth exploring further the relationship between economics and 'realism', and to suggest a regularity, if not a law, concerning them: that the worse economic performance is and the more obviously pressing economic problems are, the less, not more, realistic does economics become. At the birth of the discipline as we know it today, not least through Alfred Marshall's *Principles of Economics*, preoccupation settled on supply and demand, utility maximization, partial equilibrium, consumer surplus, and so on. Yet, this was the period, as nineteenth turned to twentieth century, that witnessed Britain's economic eclipse, when the United States of America and Germany caught up with and overtook it, leading to inter-imperialist wars. Trade unions and social democratic parties were in the process of formation. Economic and financial crises of greater or lesser duration were endemic. Only by taking history out of economics (and, to a large extent, leaving political economy out of economic history) was it possible for economics to establish itself as the science of the market, ultimately to become the science of choice (see the chapter on 'Pioneers of Economic History' in this volume). In the midst of massive unemployment in the 1930s, Lionel Robbins could infamously define economics as the allocation of scarce resources between competing ends.

Admittedly, in reaction to the Great Depression of the 1930s and to Say's Law of markets, Keynes narrowed the yawning gap between economics and reality. Keynesianism and the post-war boom prospered together. And much more besides. Mainstream economics equally displayed a degree of modesty and tolerance, both within itself as a discipline and externally towards other disciplines. Alternative schools of thought survived, even prospered, alongside the orthodoxy – post-Keynesianism, institutionalism, even Marxist political economy. And mainstream economists respected their limitations, recognizing that they took preferences, endowments and technology as fixed, whereas others did not and had much to contribute in understanding them from within the perspectives of other disciplines.

To a large extent, this enabled development economics to be captured by different scholars and traditions than those to be found within the mainstream, with the classics of development (including Nobel Laureates Myrdal and Lewis, for example) different in style and scope to fellow Laureates such as Hicks, Samuelson and Solow. By the same token, other, especially more applied, fields incorporated an empirical and policy content distinct from the preoccupations of Keynesian macroeconomics and general equilibrium microeconomics.

While the cosiness of this division of labour and approaches can be exaggerated, especially in view of the challenges from the new economic history, human capital theory and public choice theory, there can be no doubt that it was rudely shattered by the collapse of the post-war boom, and the emergence of neoliberalism and monetarism. Remarkably, this most forcible evidence of market failure ultimately led mainstream economics, through the new classical economics, to posit that markets clear instantaneously (that is, work perfectly), and that agents form rational expectations (essentially, form and work with models of the economy as good as those of economists themselves). We were also introduced to the so-called representative agent, as if the economy could be reduced to the behaviour of a single individual seeking to coordinate his or her acts of supply and demand through the market. The only reason why this economy did not remain in a state of blissful equilibrium was because of its being subject to random shocks, leading to misinformation to its representative agent. As there is very little that can be done about random shocks, and if markets and representative agent otherwise work perfectly, the dramatic conclusion drawn is that state economic intervention at the macroeconomic level is essentially rendered ineffective by the countervailing reaction of our optimizing agent. At most, the impact of state economic intervention is to introduce uncertainty and inefficient microeconomic market distortions.

It is precisely at this time that the new development economics emerges and, with the Washington Consensus, sets a developmental agenda of state versus market, while falling over heavily on the side of the market (see the chapters on 'The New Development Economics' and 'From Washington to Post-

Washington Consensus: Illusions of Development' in this volume). Much broader developments were also taking place within economics and in its relationship to the other social sciences. Lack of consideration of, and respect for, economic realities was extended to alternative schools and history of economic thought, to historical experience, to methodology and to the other social sciences. The latest model is the thing, complemented by econometric investigation through ever-more powerful computing and data-sets. With the exception of the East Asian newly industrializing countries (NICs), astonishingly interpreted against the most blatant evidence as market-conforming, the last thirty years have witnessed lost decades not only as far as development is concerned, but also for development economics itself.

Fortunately, not all was lost; the old traditions have survived and some new ones have emerged. And, over the last decade, there has been an increasing reaction against the extremes of neoliberalism and its intellectual apologists. In this respect, yet another Nobel Laureate, Joseph Stiglitz, stands out for his analytical emphasis upon the significance of the market and institutional failures, and for his principled opposition to the Washington Consensus. His own post-Washington Consensus and what has been termed (in the chapter on 'The New Development Economics' in this volume) the *newer* development economics, to which it belongs, explicitly acknowledge that institutions, history and the social more generally matter. Further, it is accepted that much can be learnt in these respects from the old classics of development economics (although those who sustained these during the period of neoliberalism are often roughly pushed aside).

Nonetheless, the newer development economics does not restore the old. In many respects, it displays continuities with the new development economics, rather than breaking with it. Although, to some extent, through its own prism of market imperfections, it returns to and retrieves the classics and the more statist approach to development that preceded the Washington Consensus, it also embraces and extends the scope of mainstream economics in understanding the nature of development. Fundamentally, the newer development economics continues to proceed on the basis of optimizing, if imperfectly informed, individuals, located within axiomatic models without social and historical content and context (as sharply revealed by the chapter on 'New Growth Theory: More Problem than Solution' in this volume). As such, it is essentially incapable of satisfactorily incorporating, at the outset, the social and historical structures, processes and agencies that comprise the key determinants and characteristics of development, and that constituted the concern of classical development economics and its predecessors in classical political economy. This not only circumscribes the extent to which the insights of earlier traditions and the other social sciences can be incorporated, but also limits the extent to which the current intellectual, ideological and policy prognoses of the World Bank and the International Monetary Fund (IMF) can be assessed and challenged, although they are subject to critique from a market imperfection perspective.

There are, then, a number of tensions in the newer development economics that endow it with a shifting and uncertain content and significance, according to the context in which it is deployed. As Byres shows (see the chapter on 'Agriculture and Development: Towards a Critique of the "Neoclassical Neopopulism"' in this volume), it can be used to rationalize radical neopopulist land redistribution. More generally, it undoubtedly departs from the Washington Consensus and neoliberalism, but it also favours reliance upon markets, seeking to make them work well through market or non-market (institutional) reform. Its method can allow for incorporation of the social and the historical, but only on the limited basis of the path-dependent outcome of individual optimizing. Its understanding of development itself shifts from one of reliance upon the market to one of correcting market and non-market imperfections.

But this remains far removed from what might be termed the pre-Washington Consensus of the McNamara era with its emphasis on structural change (summarized as modernization) and socio-economic processes, most notably that of industrialization. Symbolically the amorphous character of the post-Washington Consensus is reflected in that its most prominent exponent, Joseph Stiglitz, deploys it most effectively as a critique of the World Bank and the IMF. Yet, these institutions can adopt 'Stiglitz-speak' not only to rationalize unchanged policy as far as the nostrums of the Washington Consensus and its conditionalities are concerned, but also to extend the market-based approach from the market to the non-market arena (for the building of good governance, social capital and so on). Further, in the intellectual arena, the appropriation of the language and ideas of the old classical development economics, and of various schools of radical political economy, from dependency theory and Marxism through structuralism, is striking. As Goodacre shows (see the chapter on 'Development and Geography: Current Debates in Historical Perspective' in this volume) in the case of the new economic geography, the new development economics purports to provide a mathematical model of core–periphery development. In the clearest possible terms, leading theorists of international financial institutions claim complete compatibility between the methodological individualism of neoclassical economics and the structuralism of more radical approaches. Agénor and Montiel insist that development economics requires the same analytical principle of the rational optimizing individual, but that this principle can now not only reproduce but even advance the cause of structuralism: 'Many of the areas in which "orthodox" thinking has provided much insight [has] . . . ironically, even strengthened new structuralist arguments' (Agénor and Montiel 1996: 3). It is crucial to recognize that such structuralist arguments (and development economics and studies, more generally) are being appropriated and reinterpreted within a mainstream neoclassical microeconomic framework.

Against this background, this volume seeks to assess the new and the newer development economics critically, as a means to rescue, restore and advance alternative perspectives. It does so while recognizing that there are complex relationships among scholarship, rhetoric and policy in practice, especially within the World Bank and the IMF themselves. Consider, for example, the recent turn of these institutions to poverty. This has been extremely prominent within the development literature over a longer period, not least through the work of Amartya Sen. His intellectual trajectory has traversed social choice theory, inequality, entitlements, capabilities and freedom. In conjunction with the associated literature, poverty has been recognized to be complex and diverse. How should it be defined in relative or absolute terms? How should it be measured – by income or by consumption? What are its determinants and incidence by (un)employment, gender, race, ethnicity, age, region, rural/urban divide, and within and between household types? What about the definition and understanding of poverty by the poor themselves? And how reliable and representative are data, even if these other issues can be satisfactorily resolved?

Despite these well-established and detailed difficulties in addressing poverty, they seem to evaporate in the prognoses of the international financial institutions. Poverty itself is taken as more or less unproblematic, and is examined against individual policy issues taken in isolation from one another. In the case of IMF financial programming, for example, the assumption is made of a single, fully employed labour market, effectively precluding consideration of the causes and incidence of poverty other than as a byproduct of relative price movements (see the chapter on 'Financial Programming and the International Monetary Fund' in this volume). For the very different case of the impact of trade policy, regressions of poverty on simple (and questionable) measures of openness are deemed sufficient to crack the complex and diverse conduits between the two (as the chapter titled 'Kicking Away the Logic: Free Trade is Neither the Question Nor the Answer for Development' in this volume shows). Much the same oversimplifications are to be found in other areas of policy for which the benefits of trade openness and the free market, more generally, are declared. This is so in considering the (developmental) state's economic interventions, the purported benefits of privatization and the ways in which technological advance can accrue (as the chapters titled 'The Developmental State and the Political Economy of Development', 'Privatization Theory and Practice: A Critical Analysis of Policy Evolution in the Development Context', and 'The Analysis of Technology and Development: A Critical Review' show). In each case, scant regard is paid to the theoretical and empirical evidence to the contrary or, indeed, to pinpointing the range of factors that have to be considered.

Thus, in abstract formal terms, the international financial institutions have a predilection for taking complex issues X and Y, and, by combining them, imagining that the complexities can be set aside and the issue settled by running a simple econometric model (more often a single equation) relating the two. In a way, this is usefully summarized in the notion that, for the international financial institutions, one model fits all. Inevitably, where X is a policy variable and Y is poverty or, otherwise, a goal to be achieved, X consistently conforms to the dictates of Washington Consensus stabilization and structural adjustment, and, more recently, to the rhetoric of poverty alleviation, good governance, country ownership and so on.

Consider, for example, the conclusion to a study by a World Bank economist that includes the impact of social capital, a marker of the newer development economics (see the chapter on 'Social Capital' in this volume), on objective Y, to be revealed in a moment. To target Y, Bonnel (2000: 849) will require three sets of measures:

(i) sound macroeconomic policies,
(ii) structural policy reforms, and
(iii) modifying further the system of incentives faced by individuals.

This can only come as a surprise to the soft-boiled, but even the most cynical will surely be surprised to learn that Y is, in this case, 'reversing the spread of the HIV/AIDS epidemics and mitigating its impact'! The complexities of the epidemic, and the corresponding policy options, are reduced to a regression in which the policy stance of the Washington Consensus offers appropriate treatment. The major difference with other areas of policy is merely that lack of plausibility and connection to the issue at hand is not immediate.

Is this all a recipe for despair? For, the general law, if such it is, of growing divide between economic fortune and economics realism, is complemented within the international financial institutions by rigid policy-making and rhetorical acrobatics. Further, the weight of their influence over policy, thinking and other donors as sources of resources has been deliberately built upon the leverage gained from the limited funding that they themselves provide (see the chapter entitled 'From Washington to Post-Washington Consensus: Illusions of Development' in this volume). As a putative knowledge bank, advice is freely dispensed, but very few dissenting deposits are made, let alone withdrawn. Yet, none of this is fixed in stone. It is necessary to be both realistic and active in targeting debate around development, to oppose and expose entrenched orthodoxies and to propose alternatives. It is in this spirit that this book is offered as a selective engagement across the battleground of development economics.

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