



Spence Christens a New Washington Consensus

BY DANI RODRIK

Two and a half years ago, senior staff members of the World Bank asked Nobel laureate Michael Spence to lead a high-powered commission on economic growth. The question at hand could not have been more important. The “Washington consensus”—the infamous list of do’s and don’ts for policymakers in developing countries—had largely dissipated. But what would replace it?

Spence was not sure he was the man for the job. After all, his research had focused on theoretical issues in advanced economies; he had been

dean of a business school; and he did not have much experience in economic development. However, he was intrigued by the task and he was encouraged by the enthusiastic and positive response he received from the commission’s prospective members. Thus was born the Spence Commission on Growth and Development, a star-studded group of policymakers—including another Nobelist—whose final report was issued at the end of May.

The Spence report represents a watershed for development policy—as much for what it says as for what it leaves out. Gone are confident assertions about the virtues of liberalization, deregulation, privatization, and free markets. Gone are the cookie cutter policy recommendations unaffected by contextual differences. The Spence report recognizes that context matters and appreciates the limits of what we know. It

emphasizes pragmatism and gradualism, and encourages governments to be experimental.

Yes, successful economies have many things in common: they all engage in the global economy, maintain macroeconomic stability, stimulate saving and investment, provide market-oriented incentives, and are reasonably well governed. It is useful to keep an eye on these commonalities, because they frame the conduct of appropriate economic policies. Saying that context matters does not mean that anything goes. But there is no universal rule-book; different countries achieve these ends differently.

The Spence report reflects a broader intellectual shift within the development profession, a shift that encompasses not just growth strategies but also health, education, and other social policies. The traditional policy framework,

Dani Rodrik, Professor of International Political Economy at Harvard University’s John F. Kennedy School of Government, is the first recipient of the Social Science Research Council’s Albert O. Hirschman Prize. His latest book is One Economics, Many Recipes: Globalization, Institutions, and Economic Growth.

which the new thinking is gradually replacing, is *presumptive* rather than *diagnostic*.

THE PRESUMPTIVE APPROACH OF THE OLD WASHINGTON CONSENSUS

The presumptive approach starts with strong preconceptions about the nature of the problem: too much (or too little) government regulation, too poor governance, too little public spending on health and education, and so on. Its recommendations take the form of the proverbial “laundry list” of reforms, and emphasize their complementary nature—the imperative to undertake them all simultaneously—rather than their sequencing and prioritization. It is biased toward universal recipes—“model” institutional arrangements, “best practices,” rules of thumb, and so forth.

The original Washington consensus and the newer governance agenda both fit this mold. The former enunciated a simple and universal list of policy reforms: liberalize trade, privatize public enterprises, deregulate prices, bring down inflation through monetary and fiscal retrenchment, and so on. However, the recipe failed to generate much growth in those countries in Latin America and Africa which

adopted the reforms. Today’s governance reform agenda is in part a response to this failure, and encompasses deeper institutional reforms: fight corruption, improve courts, enhance public administration, improve regulation, and so on. The trouble with this list, in turn, is that it flies in the face of the empirical record on how successful countries achieve high growth: India, China, Vietnam and many other countries before them became growth superstars despite monumental failings with regard to these institutional prerequisites.

THE DIAGNOSTIC APPROACH

By contrast, the new policy mindset starts with relative agnosticism about what works. Its hypothesis is that there is a great deal of “slack” in poor countries, so simple changes can make a big difference. As a result, it is explicitly diagnostic and focuses on the most significant economic bottlenecks and constraints. Rather than comprehensive reform, it emphasizes policy experimentation and relatively narrowly targeted initiatives in order to discover local solutions, and it calls for monitoring and evaluation in order to learn which experiments work.

For example, an economy where investment is constrained by lack of private profitability needs a different approach than one where the binding constraint is a shortage of domestic saving. In the first case, priority needs to be given to relieving the profitability constraint, even if that has some adverse implications for, say, public finances. In the latter case, by contrast, improving public finances may be the most effective remedy for enhancing the investment environment, while usual remedies such as improving property rights and contract enforcement are likely to prove ineffective.

The new approach is suspicious of universal fixes. Instead, it searches for policy innovations that provide a shortcut around local economic or political complications. This approach is greatly influenced by China’s experimental gradualism since 1978—the most spectacular episode of economic growth and poverty reduction the world has ever seen.

The Spence report is a consensus document, and therefore an easy target for cheap shots. It has no “big ideas” of its own, and at times it tries too hard to please everyone and cover all possible angles. However, as Spence puts it with regard to economic reform itself, you

need to take small steps in order to make a big difference in the long run. It is quite a feat to have achieved the degree of consensus he has around a set of ideas that departs in places so markedly from the traditional approach.

It is to Spence's credit that the report manages to avoid both market fundamentalism and institutional fundamentalism. Rather than offering facile answers such as "just let markets work" or "just get governance right," it rightly emphasizes that each country must devise its own mix of remedies. Foreign economists and aid agencies can supply some of the ingredients, but only the country itself can provide the recipe.

If there is a new Washington consensus, it is that the rulebook must be written at home, not in Washington. And that is real progress.

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REFERENCES AND FURTHER READING

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