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SPECIAL ESSAY

Is the "Beijing Consensus" Now Dominant?

John Williamson

JOHN WILLIAMSON *is a Senior Fellow at the Peterson Institute for International Economics. He can be reached at <jwilliamson@piie.com>.*

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EXECUTIVE SUMMARY

This essay examines the content of the "Beijing consensus" approach to development and explores whether the emerging markets and developing countries should embrace it as a model that they should adopt.

MAIN ARGUMENT

Although China has been successful in its development approach, the West should not endorse the Chinese approach as a model for development because:

- China's advocacy of gradualism is only sometimes, not always, worth adopting.
- Though often effective, China's emphasis on innovation can be costly not only to multinational companies but also to those who have to pay for reinvention of the wheel.
- Chinese reliance on foreign demand as a supplement to domestic demand, by accumulating foreign assets with a likely negative yield, deprives the domestic economy of resources that it could be using to much greater effect.
- While state capitalism does have the underappreciated advantage of assisting the government in achieving rapid recovery from a negative demand shock, it was the increasing role of the market in China's economy that served as the foundation of China's rapid growth.
- Authoritarianism may appeal to other third-world leaders, but the espousal of national sovereignty irrespective of the merits of the regime or the policies defended may not appeal to the people.

POLICY IMPLICATIONS

The West should modify the advice it gives regarding the proper strategies for development to accomplish the following:

- Supplement export-led growth with a reserve build-up rather than replace it by inward-looking strategies.
- Accept that the world crisis has reinforced the case for prudential inflow controls on capital.
- Support activist use of fiscal policy for contra-cyclical purposes, while acknowledging that one cannot start a contra-cyclical policy in the recession.

A major impact of the recent worldwide financial crisis has been to discredit Western views of development—what I once tried to summarize under the somewhat unhappy term of the "Washington consensus"—and instead fortify what has sometimes been referred to (by Westerners rather than the Chinese) as the "Beijing consensus." This consensus has never been codified in the form of a series of propositions similar to those that I originally termed the Washington consensus,[1] but assuming that the Beijing consensus basically refers to the Chinese way of doing things, I shall argue that it would be a mistake for the West to endorse this and abandon the stance that it has now developed. Hence, the main purpose of this essay is to contrast mainstream Western and Chinese views on development policies by examining which model has delivered the goods up to now, what the differences are, and which holds more promise for the future.

Assuming that we do not propose to abandon received Western views, there are a series of issues that are worth discussing. Should the West modify the consensus that has been achieved about the virtues of export-led growth? Does it need to change its views on the limited role of capital flows in promoting development? In light of the crisis, should it favor and welcome fiscal expansion and abandon former demands for fiscal discipline? Does the West regard the international monetary system as ripe for reform, and could its reform help the cause of development? How has the Washington consensus stood up to recent developments?

HAS THE BEIJING CONSENSUS WORKED?

I am not among those who dismiss Western efforts to stimulate development since World War II as a colossal failure and who talk of trillions of dollars having gone down the drain while seeking to promote development. On the contrary, there has never been a time in history when development has proceeded so fast and on such a wide front. Whereas in the nineteenth century world per capita GDP rose at an average rate of under 0.9% (a figure itself far higher than ever before in history), this accelerated in the postwar period to about 2.1% per year.[2] Whereas this growth averaged about 1.2% per year in what were

1 See John Williamson, "Democracy and Reform in Latin America: How to Build More Competitive Economies," in *Latin American Adjustment: How Much Has Happened?* ed. John Williamson (Washington, D.C.: Institute for International Economics, 1990), chap. 2.

2 Figures are from Angus Maddison, *The World Economy: A Millennial Perspective* (Paris: OECD, 2001). This determined the choice of dates, which are 1820–1913 for the nineteenth century and 1950–98 for the postwar period.

then described as the industrialized countries, it has averaged some 2.9% in the larger group of countries today described as industrialized and over 5% in countries in the process of industrialization (those countries that were arguably at a similar stage of development). Whole swathes of the globe that were considered underdeveloped when I was young now enjoy much higher incomes than we in England did then: most of Southern Europe, Israel, the Gulf states, Japan (though not everyone would have called it underdeveloped in 1950), and the newly industrialized economies in East Asia (South Korea, Taiwan, Hong Kong, and Singapore). This dramatic progress in living standards as measured by GDP has been accompanied by growth of the population and its longevity, as well as by rising social and in many cases rising environmental standards. It is categorically untrue that growth in material standards of living has been purchased at the expense of deterioration according to all other measures of well-being.

While the record in terms of development has been on the whole good, one cannot deny that in some dimensions it has been even better in China since 1978. When I first joined the World Bank in 1996, I marveled at the impressive speed with which Suharto's Indonesia had reduced poverty from some 60% at the end of the 1960s to under 15% in 1996. I asserted that this was the fastest reduction in mass poverty as a percent of the population—implying an impressive fall in absolute numbers—that the world had ever seen. But the fact is that this impressive performance has since then been eclipsed by that of China, which has reduced poverty from 84% in 1981 to 16% in 2005, a decline in the absolute number of the poor of 627 million.[3] Growth in China has been staggering: real GDP has increased at an average annual rate of 9.7% over the last 30 years, even faster than occurred in other East Asian countries such as Japan and Korea. This rapid growth, the fall in poverty, and China's strikingly quick recovery from the Great Recession are the fundamental reasons to be impressed with the developmental record of China.

Amusingly, Joshua Cooper Ramo (2004), in the course of the paean to China in which he introduced the term "Beijing consensus," dismisses GDP growth as "black GDP growth."[4] But perhaps he was only seeking to emphasize that there have been costs of this impressive growth. One important cost (of which Ramo seems unaware) is the deterioration in income distribution: the familiar Gini coefficient seems to have risen from under 0.30 in the first

[3] See tables 3 and 4 in Shaohua Chen and Martin Ravallion, "The Developing World is Poorer than We Thought, but No Less Successful in the Fight against Poverty," *Quarterly Journal of Economics* 125, no. 4 (2010): 1577–625. The figures refer to a $1.25 per day poverty line.

[4] Joshua Cooper Ramo, *The Beijing Consensus* (London: Foreign Policy Centre, 2004), 22.

half of the 1980s to around 0.45 today, even allowing for the lower cost of living in the countryside. Another cost relates to the environment. Anyone who has visited China in recent years is aware that much of the east coast is enveloped by a practically permanent smog. These are not trivial costs. One of many interesting things that I learned in reading Ramo's work is that there are Chinese economists who have endeavored to develop a measure of "green growth" that subtracts some of these costs, and who even go one step further in deducting the costs of corruption to get "clean growth."[5] At the same time, I must admit that if my family were on the verge of starvation, I would consider the rise in income to be more important than the deterioration of the environment or the increase of corruption. In addition, note that even the poor have indubitably gained, even though they have gained proportionately less than the rich, and that absolute poverty fell by an impressive 68% in the 24 years from 1981 to 2005.

Hence, a denial that the Beijing consensus has been successful is a refusal to face the facts. China has done well. Its performance is impressive. One can understand why its success has stimulated the ambitions of other countries, particularly their desire to grow at a comparable speed.

THE CONTENT OF THE BEIJING CONSENSUS

Finding a definition of exactly what is meant by the Beijing consensus is no easy task. Many discussions of the Beijing consensus define it as an alternative to the Washington consensus without explaining the essence of the alternative. Perhaps one should therefore seek enlightenment from he who coined the term, Joshua Cooper Ramo. In his major work, he explains that the Beijing Consensus is "this [Chinese] new physics of power and development."[6] A few lines later, after presenting his view of the Washington consensus,[7] Ramo explains that the Beijing consensus "is flexible enough that it is barely classifiable as a doctrine." The model is "as much about social change as economic change." Later he defines the consensus as simply three theorems, of which the first concerns using innovations that offer the best bargain, the second promotes

5 Ramo, *The Beijing Consensus*, 23.

6 What is meant here by the term "physics" is unclear. See Ramo, *The Beijing Consensus*, 4–5.

7 There is not much similarity between Ramo's and my views of the Washington consensus, but such dissonance is hardly a novelty. See Ramo, *The Beijing Consensus*, 5.

working through chaos management,[8] and the third is that the concept of the consensus contains a theory of self-determination. The lack of any sort of list of what the Beijing consensus involves is disappointing. This author is forced to conclude that the term is being used to describe the development policies pursued by China.

What policies has China pursued? One can identify five:

1. *Incremental reform.* The Chinese (not to mention Ramo) have often repeated Deng's phrase about "groping for stones to cross the river." The import is that it is better to seek modernity by incremental change than through committing all on a "big bang" designed in abstract and imposed from above. This certainly fits with the way that China has introduced many reforms first in a particular province rather than springing them unproven on the whole society at one time. Although incremental reform makes a great deal of sense when one is dealing with a society that has not already fallen apart, this arguably was not an option available to the Soviet Union in 1991, or even 1989, or to many of the nations that emerged from the Soviet yoke about that time.

2. *Innovation and experimentation.* A derivative policy, much emphasized by Ramo, is that there is great value in constant innovation and experimentation.

3. *Export-led growth.* China has pursued export-led growth, interpreted as relying on a large current-account surplus as a source of demand to drive the economy.

4. *State capitalism.* While China has never explicitly announced its abandonment of socialism, there is no longer any pretense of central planning. Resources are now obtained via the thoroughly capitalist means of buying them at market prices.[9] But many companies remain state-owned enterprises (SOE) and maintain an advantage in bidding for resources in the so-called free market by virtue of the fact that many banks are also state-owned and prefer lending to SOEs (presumably because, as lenders, banks believe that these have the advantage of a soft budget constraint[10]). Moreover, not all the prices at which enterprises buy the resources are competitively determined.[11] Such a system has been termed, to my mind appositely, as "state capitalism."

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8 If this means anything, it sounds like an endorsement of laissez-faire economics. Or perhaps it is just a recognition that the economy is capitalist, as argued below in the discussion of the fourth development policy pursued by China.

9 There was an interim period when a dual price system held, with a basic quota having to be delivered to the state at controlled prices and the remainder being sold on a free market.

10 A soft budget constraint signifies that an enterprise is in no danger of being declared bankrupt but can rely on being bailed out in the event of encountering financial difficulties.

11 Yiping Huang and Kunyu Tao, "Causes and Remedies of China's External Imbalances," China Center for Economic Research, Working Paper, 2010.

5. *Authoritarianism*. It is hard to argue that China is a cheerleader for democratic ideals. At the same time, while the ideal may be the collective good of the community rather than a summation of individual well-being, the Chinese leadership accepts that it has responsibilities rather than aiming for its own satisfaction. These leaders may resist the installation of democracy out of a fear that the preservation of the disinterested policymaking that has up to now characterized China could be threatened by a victory for populists (not an unknown species in the West). A hallmark of Chinese policy in the international arena has been the support of national sovereignty irrespective of the content of the decisions implemented or the characteristics of the regime in power.

These seem to be the five central pillars of Chinese policy. This is a longer list than that provided by Halper, who identifies the Beijing consensus with the fourth and fifth pillars.[12] It is a more concrete list than that offered by Ramo, who mentions the first pillar but only includes the second among his three theorems that are supposed to define the Beijing consensus. I do not think one would be wrong to regard these five development policies as the content of the phrase "Beijing consensus."

PROMISE FOR THE FUTURE

How justified is enthusiasm for the Beijing consensus? Does China's model in fact hold more promise for the future than giving a central role to the free market, as advocated by the West?

The first point listed above has been intensely debated, but much of this argument seems beside the point because it assumes that the same answer applies everywhere. If a country still has a functioning economy, then incremental reform seems logical. If its economy is broken, then it needs a big bang. In practice, this approach still leaves room for debate because one must decide whether a particular economy would be capable of continuing to function, but conceding the principle narrows the scope of the discussion.

It might seem that no one could be opposed to the policy of maximum innovation and experimentation, except perhaps those who stand to lose because their intellectual property rights are corroded (foreign-based multinational corporations, in the Chinese case). Matters are not, however, so straightforward.

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12 Stefan Halper, *The Beijing Consensus: How China's Authoritarian Model Will Dominate the Twenty-first Century* (New York: Basic Books, 2010).

Innovation and experimentation cost money, and a good economist needs to ask whether this is a good use of resources. The world may well have promoted too little experimentation in the past, particularly where macroeconomic decisions were involved, but inducing widespread microeconomic innovation is a very questionable use of resources. There is no point in everyone reinventing the wheel. It remains sensible to argue that developing countries should concentrate primarily on exploiting the inventions that have already been made—that is, on imitation—rather than on adding to the stock of inventions.

The third element of the Beijing consensus refers to the fact that China has supplemented its domestic demand with foreign demand and appears to regard this as the essence of export-led growth. One can take the simplistic view that domestic demand is a given, so that the alternative would be a slower growth rate, but this is to treat a variable as a constant. The traditional view holds that a country needs to look to exports rather than import substitution to remedy balance-of-payments weakness. The nearest thing to a coherent argument for the alternative strategy of seeking a current-account surplus is provided by Dani Rodrik.[13] He argues that undervaluation increases the size of the tradable sector, which stimulates growth because tradable goods (essentially manufactures) suffer disproportionately from the government or market failures that keep poor countries from converging to higher income levels. A side effect of this strategy is the large current-account surplus that China has exhibited in recent years, which imposes serious negative effects on the rest of the world, even ignoring the fact that this surplus limits the size of Chinese demand. Currency revaluation might have no immediate effect on the level of Chinese output because the drop in foreign demand could be countered by an expansion of domestic demand, but it would tilt demand away from manufactures toward services and thereby provide an environment less conducive to growth in China. Obviously there are trade-offs at work here: even if one believes that market and government failures are concentrated in the manufacturing sector, at some point the sacrifice of living standards would not be worth the prospective increase of growth. Note that the hypothesis that these failures are concentrated in the manufacturing sector has not, at least as yet, received any strong empirical substantiation.

The fourth element in the Chinese model for development as identified above is state capitalism. The debate on this point has tended to identify the form of capitalism that prevailed in the West up until the financial crisis as

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13 Dani Rodrik, "The Real Exchange Rate and Economic Growth," *Brookings Papers on Economic Activity* (Fall 2008): 365–412.

the only alternative—it being assumed that this was free-market capitalism. Given the extent of takeover activity and the widespread unwillingness to break up banks despite the strong empirical evidence that there are no economies of scale beyond assets of roughly $100 billion,[14] one wonders whether this is a good assumption. One should surely distinguish monopoly capitalism from free-market capitalism. It is true that the Washington consensus, as first articulated by this author, endorsed privatization as a policy, and clearly this stance is as antithetical to state capitalism as to socialism. But privatizing in order to replace a nationalized industry with a private monopoly is not what I had in mind.[15] There may be a gain in efficiency, insofar as those in charge have keener incentives, but counteracting this is a greater incentive to exploit monopoly power. Which force will prove more powerful in a particular instance is an empirical question. If, on the other hand, privatization is used to increase competition, there are two positive effects and no negative effect of privatization.[16] Since the typical takeover before the financial crisis was apparently value-subtracting,[17] the presumption is that a greater emphasis on the importance of free markets than previously existed is justified.

The question, however, is not just whether the state is a good owner of productive resources: the role of the state is much broader than this. The question is also whether the state should play a more active role in the economy than it was assigned in recent years in the West. One need not believe that minimizing the role of the state was implicit in the Washington consensus in order to recognize that the thrust of policy was to enhance the role of markets (with not too much attention paid to whether they were competitive) at the expense of government. This policy was reversed during the crisis—with bailouts of banks, an insurance company, and even motor manufacturers in that center of the "free enterprise" system, the United States. But there is a big distinction between the way that this measure was undertaken in the United States and the policy of many other emerging markets besides China. In the former, it was regarded as a strictly temporary measure, one that privatization would reverse as soon as practical. (This is happening, with profits made by the U.S. Treasury being sufficiently large that the initial anticipated cost of the TARP program of $700 billion looks likely to be wholly recovered.) In the latter

14 The largest banks now have assets of over $1 trillion.

15 Admittedly, I should have but did not state this in 1989.

16 At least, there are no negative effects if one neglects the distributional effects of corruption in the privatization process. In practice, these were probably more important than the flow effects in poisoning public attitudes to privatization, but one would not anticipate any significant effect on income distribution if the privatization process were competitive.

17 See "Manufacturing Blues: Another One Bites the Dust," *Economist*, January 21, 2010.

there is a widespread desire to enhance the role of the state, not only by stopping (and possibly reversing) privatization but also by, most notably, initiating an industrial policy. Little in the record of industrial policy suggests that the state is very good at "picking winners." However, we are regularly assured that industrial policy does not in fact mean picking winners, but unfortunately we are not told exactly what it does mean.[18] Citing Korea and Taiwan to illustrate the success of industrial policy is utterly unconvincing to this author, because Hong Kong (whose approach was the closest to laissez-faire of any economic entity before the Baltic states) grew equally fast. What fast growers have in common—high savings, macroeconomic stability, good education, and a strong work ethic—seems to better explain their fast growth than what they do differently. If industrial policy means only that the state is energetic—e.g., by bailing out those threatened with bankruptcy during a severe recession or seeking to do what is necessary to nurture the growth of promising new industries, as Singapore seems to have done—then I am in favor of this policy.

It is an interesting fact that China adopted a policy of liberalizing the economic system from 1978 on. Then there was a monobank; now there is a multitude of banks (though there are still some very big banks that could be further broken up). Then agriculture was organized as a series of state-owned cooperatives; such cooperatives have long since been abandoned and agriculture run as family farms instead. Then there were no township and village enterprises (TVE); now these are actually being replaced by privately owned enterprises. Deregulation extended far beyond the easing of entry and exit restrictions that I advocated in the Washington consensus to an excessive weakening of, for example, environmental restrictions. When other countries look to China, they probably focus on the continued existence of many SOEs. But many Chinese know perfectly well that the success of China owes more to past liberalization of the economy than to the fact that the process is incomplete.

The last of the five pillars of the Beijing consensus is authoritarianism. This is sometimes held up as a great attraction to much of the developing world. I can understand that support for authoritarian government is attractive to some of the leaders of the developing world, but I am doubtful whether this is attractive to the bulk of its populace (the more so after what has occurred in North Africa over the last year). Another question is whether authoritarian government is good for development. There is a serious econometric literature on the relationship between growth and democracy. When I examined this literature

18 One can again cite Dani Rodrik as a welcome exception, although in his case the phrase seems to mean what many of us have previously referred to as internalizing externalities. See Rodrik, "The Real Exchange Rate and Economic Growth."

in the mid-1990s, my impression was that it had reached the conclusion that the two are orthogonal: that is, that there is no presumption that the form of government will have any systematic effect on the rate of growth.[19] The direct effect was estimated to be negative but insignificant, offset by an insignificant positive effect via education and physical investment. Since then, there has been a massive amount of additional work, summarized in a meta-analysis by Hristos Doucouliagos and Mehmet Ali Ulubaşoğlu.[20] Their conclusions are that there is probably a modest positive association of democracy and growth but that one can rule out definitively the contrary hypothesis, that democracy is bad for growth. The direct effect is estimated to be zero, but the positive indirect effects working through economic freedom, human capital, inflation, and political stability are estimated to outweigh the negative effects that work through the size of government and international trade.

In the previously cited article, John Helliwell repeated the finding that democracy is a positive function of the level of income. This common empirical finding apparently gave rise to a belief in Washington that being nice to China would raise Chinese living standards and would lead to China becoming more democratic and therefore less threatening to the United States.[21] Because this has not happened, those who pointed to the empirical finding have been denounced as naïve. It seems to me that a later finding of Helliwell (in association with Haifang Huang) can explain why the rise in Chinese living standards has not led to an end of U.S.-Chinese policy conflicts. They used life satisfaction measures as declared to researchers to examine which measures of a traditional index of the quality of government matter more to people at different income levels.[22] The index of government quality that they used has six equally weighted components, of which four relate to the delivery of government services (governmental effectiveness, regulatory quality, rule of law, and control of corruption) and two focus on the operation of the political process (voice and political stability). It turns out that, although the overall variable for the quality of government services was positive in the full sample of countries,

19 John F. Helliwell, "Empirical Linkages between Democracy and Economic Growth," *British Journal of Political Science* 24, no. 2 (1994): 225–48. I suspect that there might be an association between the form of government and the second moment of the probability distribution of the rate of growth, with authoritarian governments tending to be associated with both the very fastest rates of growth—e.g., China or the South Korea of Park Chung-hee—and the worst growth records—e.g., Zaire under Mobuto or the North Korea of Kim Il-sung. As far as I know, this hypothesis has not yet been empirically tested.

20 Hristos Doucouliagos and Mehmet Ali Ulubaşoğlu, "Democracy and Economic Growth: A Meta-Analysis," *American Journal of Political Science* 52, no. 1 (2008): 61–83.

21 See Halper, *The Beijing Consensus*, chap. 5.

22 John F. Helliwell and Haifang Huang, "How's Your Government? International Evidence Linking Good Government and Well-Being," *British Journal of Political Science* 38, no. 4 (2008): 595–619.

there was a large discrepancy between countries above and below the mean per capita income: countries below mean income had significantly positive coefficients on the delivery of government services, while countries above the mean had positive coefficients on the operation of the political process. In other words, the primary concern of poor people is to get government to perform its functions decently, which by and large happens as people get richer. When they can afford it, people value being part of the political process.[23] However, the finding has itself been challenged by Daron Acemoglu, Simon Johnson, James A. Robinson, and Pierre Yared, who failed to identify a positive relationship from changes in income to changes in democracy over the past century.[24] They point out that there are two ways of reconciling the strong empirical association of income and democracy with their finding: that there is such a relationship but that it operates over time periods measured in centuries rather than years, and that both are the product of a common cause. While they favor the latter interpretation, the matter is not settled. The former interpretation is consistent with the argument here, as well as with the work of Helliwell and Huang.[25]

When traveling around the Far East, even in countries that are not noted for their democratic credentials, one gets the feeling that decisions are based on genuine concern for people, very different to the concerns of populists. And then one can believe that those who govern might be motivated by a desire to perpetuate this enlightened government rather than risk the election of populists who would threaten to destroy it. Of course, there is a danger that unscrupulous dictators will exploit the absence of genuine elections to prolong their own hold on power, citing the absence of democracy in countries like China as justification. Yet the findings of Helliwell and Huang suggest that the willingness of people to trust their leaders is a temporary phenomenon. In due course, China's leaders will have to find a way to enable their people to participate in the political process, and give them an option other than a Communist party that long ago ceased to believe in Communism, or they will preside over an explosion.[26] Expecting that to happen in the 1990s may have been naïve, but it can still be expected to happen at some stage.

23 Helliwell and Huang also found that per capita income, while contributing to life satisfaction, has a lesser role than the quality of government. This finding should give pause to economists' preoccupation with the holy grail of growth, but that is not my topic here.

24 Daron Acemoglu, Simon Johnson, James A. Robinson, and Pierre Yared, "Income and Democracy," *American Economic Review* 98, no. 3 (2008): 808–42.

25 Helliwell and Huang, "How's Your Government?" 595–619.

26 In many respects, China has already become a far more democratic state than it was. An example is found in labor law: China now has a full-fledged body of labor law, a comprehensive court system, and a growing army of private lawyers. There was no similar rule of law in China ten years ago.

I conclude that such wisdom as we have accumulated over the years should not be abandoned in favor of the Beijing consensus. Contrary to the latter, there are times when a big bang is needed; innovation can be too much of a good thing; even if we agree on the virtues of export-led growth, we should not necessarily endorse a large current-account surplus; state capitalism is inferior to free-market capitalism (as many Chinese recognize), though we should not make the mistake of thinking that pre–Lehman Brothers capitalism was not contaminated by uncomfortably large elements of monopoly capitalism; and the future lies with democracy.

SHOULD THE WEST FALL BACK ON THE WASHINGTON CONSENSUS?

If the Beijing consensus, such as it is, is not the key to progress, should the West fall back on the Washington consensus?

That depends first on what one understands by the Washington consensus, for radically different meanings have been pinned on this term. There is a "neoliberal" version, according to which true believers hold all markets to be perfectly competitive so that the only policy needed is laissez-faire (the version propagated by Joe Stiglitz and most of the other critics). This version has often been pronounced dead, and the sooner this death is reflected in the version's disappearance from public discourse the better. There is the version that I initially advanced, which characterized the Washington consensus as consisting of ten propositions—fiscal discipline; changing the form of public spending *inter alia* from indiscriminate subsidies toward health, education, and infrastructure; tax reform; financial liberalization; a unified and competitive exchange rate; trade liberalization; freeing of FDI inflows; privatization; deregulation of entry and exit; and secure property rights—that were widely held in Washington to merit widespread adoption in Latin America in 1989.[27] There are other versions as well, such as the interpretation of the Washington consensus as consisting of the policies advocated by the World Bank (which were initially similar to those mentioned by me, but changed over the years to embrace a strong state that combated corruption).

But even if one interprets the Washington consensus in one of the two latter ways, it is difficult to argue that this theory covers all the topics that are needed to secure rapid growth. It made no mention of the importance of high

27 Williamson, ed., *Latin American Adjustment.*

savings, good education, or the demographic transition, despite the fact that these are three of the common factors that most people believe contributed to the success of the newly industrialized economies in East Asia. One can perfectly well acknowledge that many desirable policies were recognized in the original version of the Washington consensus without thereby implying that it was comprehensive.

One of the areas in which ideas seem to have coalesced prior to the world financial crisis of 1998 was in the advocacy of export-led growth as a strategy of development. Admittedly, there was a major difference of view as to whether export-led development does or does not require a current-account surplus. Balassa's original view[28] that the essential feature was that a country look to the export sector as a main source of supply-side growth has tended in recent years to lose out to the Chinese view that a country needs a large current-account surplus to stimulate demand. I am clearly in the former camp. The typical pattern in East Asia prior to the 1997 crisis was that Wall Street was so impressed by the growth of exports that it was willing to lend, which meant that the countries typically had high investment (and thus growth) rates and were in current-account deficit. The effect of the 1997 crisis was to cause the typical country to shift 10% of its resources from investment into the balance of payments with the objective of self-insurance, thereby causing growth to fall by about a third.

The main impact of the 2008 crisis on this set of ideas was to show that the existence of a large export component of aggregate demand creates a vulnerability to severe recession in the outside world. Note that this is true under both versions of export-led development; it is a high ratio of exports to GDP that creates this vulnerability, not whether exports are more than matched by the size of imports. Hence, we need to accept that there is a trade-off: the increase in vulnerability to world recession needs to be compared to the advantages that economists have preached ad nauseam, such as minimizing the danger that a country will be afflicted by a domestic macroeconomic crisis while the rest of the world is prospering, and maximizing the competitive forces in the economy. However, the disadvantage can be largely met by a policy of carrying a relatively large volume of reserves. Accordingly, I would still advocate adopting a policy of export-led development rather than returning to the doctrine of import substitution.

28 See, for example, Bela Balassa, *Change and Challenge in the World Economy* (London: Palgrave Macmillan, 1985).

The conventional wisdom for some years held that developing countries should abandon the policy of restricting capital flows, one reason being that capital would then flow downhill from developed to developing countries. This inflow of capital would help accelerate the process of development. Since the capital-exporting countries could expect a higher rate of return than at home, this would be a mutually advantageous process that could help developed countries prepare for an era of diminished productive opportunities as their populations age.

The flow of private capital to emerging markets and developing countries has in fact continued to increase on a secular basis, though with strong cyclical variations. But since the East Asian crisis of 1997–98, this private inflow has been more than counterbalanced by two factors. One is the increase in the outflow of private capital to developed countries. Nevertheless, the net flow of private capital continues to be toward developing countries. But the second factor more than offsets the tendency for private capital to flow to developing countries: the increase in reserve accumulation (official capital flows). Net, capital is flowing uphill.

Reserve accumulation increased as a direct result of the experiences of the East Asian crisis of 1997–98. Countries decided that borrowed reserves were no good for tiding a country over on a rainy day; they evaporated just when needed. The West is still living with the consequences of its decision to call the East Asian crisis a comeuppance for crony capitalism instead of recognizing that it was an illustration of Maurice Obstfeld's theory of multiple equilibria as a cause of crises.[29] Had the West recognized that and lent East Asian countries what they needed to offset the flight of panicky investors, the problem of global payment imbalances would not be so severe today. Instead, more and more developing countries will try to restrain capital inflows for which they have no use, especially since the advanced countries are suffering from excess supply and therefore running extremely expansionary monetary policies. At the time of the East Asian crisis, I was already among the economists who welcomed deliberate restriction of certain capital inflows, via capital controls, as rational. Since then, there appears to have been a big change of mind in the International Monetary Fund (IMF) about the acceptability of such a policy. On this issue, the West did not learn much new from the Great Recession, though it seems that the IMF did.

29 Maurice Obstefeld, "The Logic of Currency Crises," National Bureau of Economic Research (NBER), NBER Working Papers, no. 4640, September 1994.

The West used to tell developing countries that they should pursue a disciplined fiscal policy. Yet many of us welcomed the fact that many developing countries were able and willing to add their fiscal stimulus during the Great Recession. The charge has been made that this displays an inconsistency. But the Washington consensus, as I wrote it, was a list of ten propositions that most everyone in Washington considered to be necessary more or less everywhere in Latin America in 1989. Every country in Latin America, except Chile and arguably Colombia, badly needed some fiscal discipline in 1989. The Keynesian in me welcomed the announcement by the new democratic government of Chile that it intended to pursue a cyclically stabilizing fiscal policy. A major purpose of running disciplined fiscal policies during the boom was to permit fiscal stimulation when recession came. The fact that things worked out that way in so many developing countries is symptomatic of the success of the advice, not a criticism.

The previous discussion should make clear that I believe the West needs to learn from experiences during the Great Recession, as well as that not everything worth saying about the recession is in the Washington consensus.

CONCLUSION

The world came through the Great Recession without catastrophe, even if the growth outlook is now pretty dim, at least for industrial countries. While the West has not yet realized the magnitude of the challenge that it will face from China and the Beijing consensus, I have argued that this consensus is unlikely to dominate in the long run for two reasons. One is that it rests on a misinterpretation of Chinese experience as showing the importance of maintaining a large state-owned sector rather than the importance of liberalizing the economy. The other reason is that while authoritarianism may appeal strongly to some rulers, to most of the people of the developing world it will give China a bad name. If this is right, it is important that the West give good advice to developing countries and not the sort of rote advice to follow the Washington consensus that was supposedly dispensed by Washington according to a popular interpretation of the consensus. In particular, the United States should modify the advice that it gives on export-led growth (to supplement such growth with a reserve build-up rather than return to inward-looking strategies), capital mobility (where it has reinforced the case for prudential inflow controls), and fiscal policy (to support activist use of fiscal policy for contra-cyclical purposes, while acknowledging that one cannot start a contra-cyclical policy in a recession).