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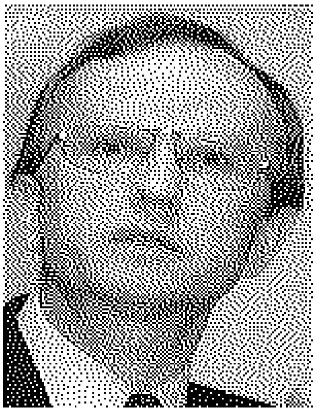
"Economic Neoliberalism Became Almost Irrelevant..."

Poland's Grzegorz W. Kolodko on New Trends in Development Strategies



New development policies are emerging after 10 years of experience with the transition process. Both theoreticians and policymakers are revising earlier theories about the market-state relationship, scrutinizing privatization processes, tackling deregulation arrangements with a fresh attitude, and attempting to deal with the far-reaching consequences of globalization. The World Bank is at the forefront of this revision process. Grzegorz W. Kolodko, Poland's first vice prime minister and finance minister between 1994 and 1997, is a visiting fellow in the Bank's Development Research Group. Having gained both theoretical underpinning from years of studies on transition issues while a professor at the Warsaw School of Economics and Yale University, and practical experience as a policymaker, he is currently working on a study titled "Transition to a Market and Sustained Growth: Implications for the Post-Washington Consensus." Revision of the Washington Consensus was a major topic of the following interview with Transition editor Richard Hirschler.

Q. There are more and more signs that we have entered the era of post-Washington Consensus. It would help to clarify what the Washington Consensus meant in the first place.

A. The transition strategies in Eastern Europe and in the states of the former Soviet Union have been based, and in some countries still are largely based, on the so-called Washington Consensus. Originally the Consensus was a response to Latin America's structural crisis in the 1980s, a kind of policy advice agreed in Washington between important organizations such as the International Monetary Fund (IMF), the World Bank, and the U.S. Treasury. It had the following message: “Liberalize as much as you can, privatize as fast as you can, and be tough in fiscal and monetary matters!” This policy advice has been applied—mainly through the IMF and the World Bank—to the transition economies. Unfortunately, little attention has been paid to their distinguising characteristics.

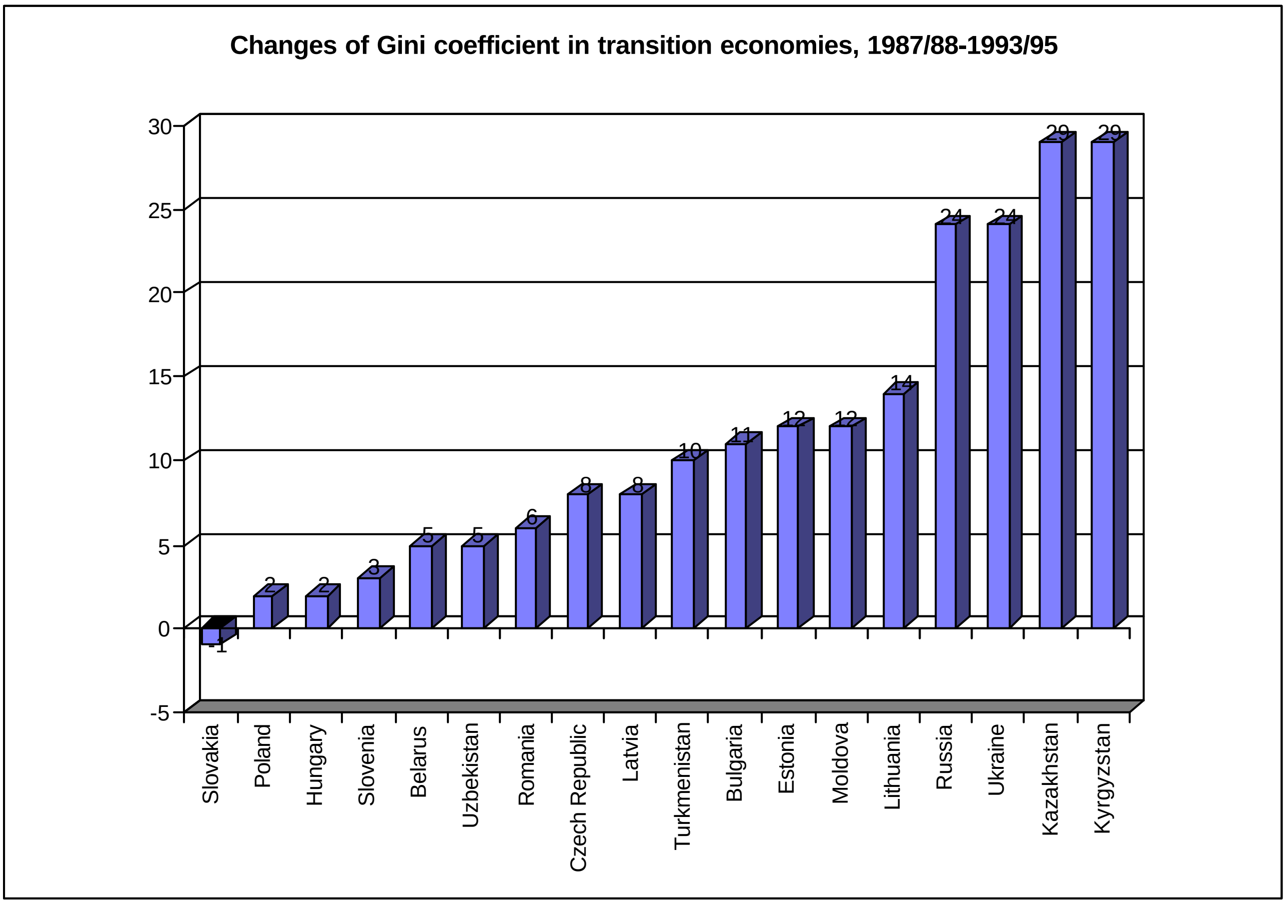
Western experts assumed that these postsocialist economies simply were affected by financial disequilibria, nonper-forming debt, and high inflation similar to the distorted economies of Latin America. But these countries had system-specific defects: these were shortage-ridden economies (in some cases 100 percent owned by the state), economies without any type of market organizations or institutions. Western advisers also preferred to believe that market institutions—even if they were unsophisticated, underdeveloped, or in any embryonic state—were present in these economies. It’s by no means a coincidence that the few countries that had some earlier experience with markets—Hungary, Poland, and Slovenia (Yugoslavia) included—were able to overcome their transition pains much faster than the others. For the other economies the erroneous advice of international institutions cost dearly in loss of national wealth, economic mismanagement, wasted resources, and social misery. It became obvious that without proper institutional arrangements, liberalization and privatization can produce problems—as is now the case in Russia and Ukraine, for example.

Q. So what should be the major features of a hopefully “gentler and kinder” post-Washington Consensus?

A. Primarily, the government’s role has to be put in its proper place. The international institutions realized that the real question is not whether a government is big or small, but whether a government is able to provide leadership, introduce right policies, or is unable to do so. Thus the state must remain active in shaping a country’s political-economic policy, not as an owner of assets or an administrator of state companies, but as an architect of institutional arrangements, as a guard of financial fundamentals, as an investor in the human capital, as a financier for infrastructure development, and as a manager of global integration. I would like to highlight three areas that need to be addressed:

- *Taking care of financial and economic fundamentals.* Here I do not differ from IMF orthodoxy or a classical mainstream liberal approach. Fiscal balance has to be restored, current account has to be sustainable, inflation has to be brought down, liberalization has to proceed vis-a-vis prices and trade, and privatization has to be completed.
- *Creating and maintaining institutions, such as antitrust agencies and laws, commercial and investment banking, social safety nets, securities exchange commissions, and re-regulation of capital markets.* The negligence of institutional arrangements has been a grave miscalculation of the orthodox approach, for example, in Russia. If the governments are unable to set up institutions that can facilitate market economies, a “neither plan nor market” situation can arise—a systemic vacuum that will be filled in by informal arrangements. It can be run by organized crime or fraudulent financial intermediaries, such as the managers of Albania’s financial pyramids. Russia’s seven tycoons—heads of the country’s seven industrial-financial-media empires—function as a “shadow government,” combining their enormous economic power with wide-scale political influence. The price is paid by the majority of the society. It also demonstrates that there is a link between the lack of proper institutional arrangements, on the one hand, and widening inequality and growing poverty, on the other hand.
- *Investing in human capital.* To assume that the market per se takes care of its education needs is wrong. Postsocialist economies have no organizations, no networks, and most important, not enough private resources for that. Many parents cannot afford to send their children to high schools, vocational schools, or universities or even to retrain and redeploy themselves if necessary, therefore, the government has to take over these tasks.

Thus the role of government, especially in the postsocialist transition economies, seems to be on the rise. It contradicts the intentions of the neoliberal approach that didn’t have much to say to the government, except that it should “liberalize everything, privatize everything, and then pull back.” However, governments can fail or succeed, but they cannot afford to pull back. What should pull back instead is neoliberalism as an economic theory and, especially, as an economic policy.



Source: The author, based on data provided by B. Milanovic (1998)
Note: The *Gini coefficient is a measure of income inequality. The higher the coefficient, the larger the inequality.

Q. Would you say then that neoliberalism, as an economic ideology and policy, has become irrelevant?

A. Almost. Not completely yet, but hopefully soon. There is good reason to expect such an outcome after the harm that this train of economic thought and policy has caused in the final decade of the twentieth century. And not only by mishandling transition issues in postsocialist economies, but also by economic mismanagement in the aftermath of the East Asia crisis.

Q. Thus the revised, enlarged role of governments is an important feature of the post-Washington arrangement. But wouldn't the East Asia crisis warrant doubts about the soundness of governments' judgement?

A. I don't think so. The message is clear: the market has failed more so than the state. I wouldn't claim that governments in Indonesia, Malaysia, Thailand, or the Republic of Korea didn't make mistakes. They have to learn the hard way that certain policies don't work. But much of the blame for the contagion of the Asia crisis can be put on the panicking markets. The problem is the lack of proper regulation of capital flow that should be re-regulated instead of being even more deregulated.

Q. Consequently, should the effects of globalization also be included in the post-Washington Consensus?

A. Absolutely. This is the most sensitive element of the post-Washington Consensus. Whether we want it or not, hardly any major decision or policy can be executed in the world—be it in Moscow or Bangkok, Budapest or Jakarta—without international backing, primarily from Washington, D.C., the location of the World Bank, the IMF, the U.S. Treasury, Congress, and other influential organizations and think tanks. Globalization reached a point where governments are not able to resist the rapid fluctuations of the international capital flows alone. Countries in East Asia watched helplessly as the market panicked and more than $100 billion left the region in a blitz. To say, "fix the fundamentals, privatize whatever has been left for privatization, overhaul the banking sector, get rid of fiscal deficit, sustain the exchange rate, and bring the inflation down," is not enough for the post-Washington Consensus we are searching for. In Malaysia it wasn't enough, so it will not work in Russia either. Thus not only weak governments but large speculative portfolio investors also threaten economic stability and sustainable development. Therefore, paramount international institutions, such as the IMF, have to step in, advising and supporting governments in their efforts to regulate capital flow, for example, through maturity requirements and taxation.

Q. You claim that as Poland's deputy prime minister and finance minister between 1994 and 1997, you were able to achieve a "therapy without shock," contrary to the "shock therapy" that characterized Poland's economic policy in the early 1990s. What were the major differences between your policy approach and your predecessor's?

A. During 1994–97 Poland's GDP grew by more than 28 percent, inflation fell by two-thirds, unemployment dropped from 3 million to 2 million, the accumulated inflow of foreign capital exceeded 16 billion dollars, and—as the *Wall Street Journal* put it—Poland had to face a new challenge: managing success. Contrary to the opinion of many observers, what really mattered was the efficiency of the policy and not the dose of radicalism or gradualism. Although it is true that, under our stewardship, lots of measures, including deregulation, destatization, and denationalization of the economy, gradually mitigated the negative social effects of these changes. We have been extremely radical if justified and quite gradual when it was necessary, depending on the challenge. Also, and that is a crucial institutional difference, we strongly opposed the approach that claimed that the best industrial policy is not having one at all. We in the government have actively and deliberately supported the restructuring of Polish enterprises. I am pleased that the succeeding Solidarity-led government has not abandoned industrial policy—for example, the restructuring of the steel and coal industries—even if they have to coordinate it with the European Union.

We have also paid great attention to institutional arrangements. Those were introduced simultaneously with further privatization and liberalization, to facilitate the emerging private capital, assist in capital formation, and help to improve efficiency without an a priori assumption that the market will do the job. A Polish joke illustrates the point well: How many experts were needed under a centrally planned economy to replace a light bulb? Three. One worked on the plan, another replaced the bulb, and the third drafted a report. How many experts do we need under the market regime? None. The market will do the job (my predecessors also believed that). I said we still needed somebody to replace the bulb. That makes a huge difference. That is what distinguishes our program, known as Strategy for Poland, implemented in 1994-–97, as "therapy without shock" from the "shock therapy," exercised in Poland at the onset of the 1990s.[1]

Q. Do you think that this reassessment of the Washington Consensus will change the attitude and approach of international finance institutions, including the World Bank?

A. Following the temper and tone of discussions in Washington, which included the Bretton Woods organizations, I am convinced that the priorities and the emphasis have been shifted. For example, a recent IMF conference on economic policy and equity, organized by Vito Tanzi and Stanley Fischer, was attended not only by distinguished experts of the IMF, the U.S. Treasury, the World Bank, and scholars from Harvard and Oxford Universities, but also by trade union representatives and archbishops, including a secretary of the Vatican Council for Justice and Peace. I said that if the Fund was going to take care of equity and the Vatican, efficiency, I preferred to keep it in the old way...

But seriously, it is clear that the Fund is paying more attention to equity, not only because it now believes that the fruits of the growing economy should be shared more fairly, but also because if they are distributed more equally it works on behalf of sustained growth. The World Bank now focuses more on how to sustain growth, with the broadest possible participation of social groups, and has been working out new, more productive relationships with the governments as well. World Bank President James Wolfensohn envis ions the Bank as an organization that disseminates knowledge worldwide, that functions as a teaching and learning institution. Senior Vice President and Chief Economist Joseph Stiglitz has provided a detailed analysis of this new policy design [see boxe on previous page].

Q. In your studies you often refer to the big mistake of confusing policy goals with policy means.

A. The Washington Consensus sometimes confused the ends and the means, as Joe Stiglitz revealed several times. While searching for a post-Washington Consensus, policymakers have to consider three major rates: interest rate, exchange rate, and tax rate, but above all, respect a fourth rate: the electorate —the people. The aim of economic policy is not fiscal prudence, or stable exchange ra tes, or low taxation, or deregulation. These are the means that should ensure the final goal: sustainable development and the well-being of the people.

Recession and growth in transition economies, 1990-97

	Number of years of GDP decline	*Did GDP fall again after recovery?*	*Average annual GDP growth*			*1997 GDP*
Countries			***1990-93***	***1994-97***	***1990-97***	***(1989=100)***
Poland	2	no	-3.1	6.3	1.6	**111.8**
Slovenia	3	no	-3.9	4.0	0.0	**99.3**
Czech R.	3	no	-4.3	3.6	-0.4	**95.8**
Slovakia	4	no	-6.8	6.3	-0.3	**95.6**
Hungary	4	no	-4.8	2.5	-1.1	**90.4**
Uzbekistan	5	no	-3.1	-0.3	-1.7	**86.7**
Romania	4	**yes**	-6.4	2.1	-2.2	**82.4**
Albania	4	**yes**	-8.8	4.9	-2.0	**79.1**
Estonia	5	no	-9.7	4.1	-2.8	**77.9**
Croatia	4	no	-9.9	3.0	-3.4	**73.3**
Belarus	6	no	-5.4	-2.6	-4.0	**70.8**
Bulgaria	6	**yes**	-7.4	-3.6	-5.5	**62.8**
Kyrgyzstan	5	no	-9.3	-2.4	-5.8	**58.7**
Kazakhstan	6	no	-6.7	-6.0	-6.3	**58.1**
Latvia	4	**yes**	-13.8	2.2	-5.8	**56.8**
Macedonia	6	no	-12.9	-0.8	-6.9	**55.3**
Russia	7	no	-10.1	-5.3	-7.7	**52.2**
Lithuania	5	no	-18.3	0.5	-8.9	**42.8**
Turkmenistan	7	no	-4.5	-15.0	-9.8	**42.6**
Armenia	4	no	-21.4	5.4	-8.0	**41.1**
Azerbaijan	6	no	-14.5	-5.7	-10.1	**40.5**
Tajikistan	7	no	-12.2	-8.4	-10.3	**40.0**
Ukraine	8	**no recovery**	-10.1	-12.1	-11.1	**38.3**
Moldova	7	no	-12.6	-10.2	-11.4	**35.1**
Georgia	5	no	-24.1	2.9	-10.6	**34.3**

Source: National statistics, international organizations and author's own calculations.

Note from page 4: [1]See also *The Polish Alternative–Old Myths, Hard Facts, and New Strategies in the Successful Transformation of the Polish Economy,* by G. W. Kolodko and D. M. Nuti, UNU/WIDER, Research for Action No. 33, 1997).