In what way did the Washington Consensus affect poverty in Latin America?

There is a wealth of qualitative evidence that links the increase in poverty seen in Latin America between 1980 and 2002 to the free-market reforms undertaken in that period. There is a particularly strong association between poverty and the negative effects on employment of sudden exposure to external competition. Empirically however, the causal underpinning of this correlation is somewhat more controversial. Characteristic of the debate is the differing stance taken by Huber & Solt as against Walton. The former conclude that there is a clear statistical link between poverty and the reforms whereas the latter maintains that once other macro level variables are controlled for there is no statistically significant relationship. These contradictory stances are evidence of the chronic endogeneity and omitted variable problems that plague macro level empirical analysis of this sort, and whilst it is prudent to be sensitive to these different debates, this paper starts from the non-controversial assumption that the policies of the Washington Consensus at best did very little to address the problem of poverty in Latin America, and at worst failed to prevent a large scale increase in the number of people living in poverty. This essay argues that this failure sprung from an internal inconsistency between the initial concept of the Washington Consensus as a short term plan for macroeconomic stabilization, and the policy tools recommended. Whilst certain of the policy tools were pertinent for addressing the severe hyperinflation and balance of payments problems faced by Latin American economies (particularly reducing fiscal deficits, and ensuring a competitive exchange rate), others (particularly trade liberalization) should have been part of a more comprehensive development strategy. This conceptual confusion led to implementation of long-term development strategy policies as though they were short-term macroeconomic policy programmes and this kept poverty extremely high in Latin America.

By 1992 all the major economies of Latin America had embarked upon free market reforms. During the reform period there was a concurrent and significant increase in poverty in the region: In 1980 the percentage of the population living in poverty stood at 40.5%. By 1990 this had risen to 48.3%. In 2002 the figure was 44%, a slight decrease from a decade earlier, but still higher than the 1980 level. Moreover the absolute number of people living in poverty rose consistently throughout this time period, from 136 million in 1980 to 221 million in 2002. That poverty should not be addressed by the reforms is perhaps not entirely surprising. The original document in

5 ECLAC Social Panorama of Latin America (2010)
which John Williamson coined the term “Washington Consensus” was concerned with how to “deal with the debt crisis”, not about how to reduce poverty. Jeffrey Sachs, one of the architects of the Bolivian adjustment commented that Bolivia had a “miserable, poor economy with hyperinflation”, and that if it followed the adjustment programme, it would be left “a miserable, poor economy with stable prices”. Conceptually then, the Washington Consensus was not a programme for development, or indeed growth, it was merely concerned with the stabilization of economies that were in free-fall.

However, despite these arguments, when returning to the policy tools that were recommended as part of the Washington Consensus one can distinguish between those policies which might reasonably form part of short term stabilization plans and those which are inherently part of longer-term strategies for development. I argue that fiscal deficit reduction and maintaining a competitive exchange rate belong to the former group, whilst trade liberalization belongs firmly in the latter.

Fiscal deficits were thought to be a key source of macroeconomic disequilibrium, inflation and capital flight and thus dealing with such deficits was a key policy recommendation for the Latin American economies in crisis. Similarly a competitive exchange rate was recommended to redress seriously overvalued currencies in Latin America thus promoting exports, discouraging imports, and dealing with huge current account deficits that stood at around 20% GDP for Brazil, Peru and Chile in 1980. At this level of generality these policies seem to fit naturally into a toolbox of policies that can be implemented to encourage macroeconomic stability. The spending cuts and devaluation these policies implied were simple and easily implementable partial solutions to what were very grave problems. Although the reduced government spending implied by the deficit reduction and the rising prices and fall in domestic demand implied by the devaluation would undoubtedly cause recessionary pain, particularly at the bottom end of the income distribution, it would be a temporary cost to pay for increased stability and a return to an economic environment where growth could resume. Additionally, from the point of view of the poor, a prospect theory perspective claims that the losses these policies implied were preferred to the continued enormous losses sustained due to the hyperinflation that was characteristic of the pre-reform period.

The same argument cannot be made regarding trade policy even at a high level of generality, meaning that means of implementation are not taken into account. Shifting toward an outward oriented economy when the explicit development discourse and practice in Latin America had been centred on import substitution and inward orientation does not seem to occupy same policy space as the quick fix fiscal policies outlined above. Rather, a liberal trade policy is at the heart of the choices states

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7 Quoted in Duncan Green The Silent Revolution: The Rise and Crisis of Market Economics in Latin America (2003) pg. 74
11 Kurt Weyland The Politics of Market Reform in Fragile Democracies: Argentina, Brazil, Peru, and Venezuela (2003) pg. 96
make about paths toward development, just as the illiberal trade policy Latin America pursued in the middle decades of the twentieth century was due to its choice of developmental path.

Seen thus, there is an inconsistency within the core policies of the Washington Consensus between those that can be thought of as legitimate tools for the stated goal of economic stabilization (deficit reduction and a competitive exchange rate) and those that seem to belong to different set of long term development strategy policies. The most important of these is the trade liberalization policy, although also of great importance are the privatization and capital account liberalization policies. John Williamson has expressed disapproval that his policy recommendations were adopted into a broader neo-liberal framework\(^\text{13}\). However, given that policies relating to trade and state owned companies are at the heart of any development strategy, I would suggest that this this neo-liberal co-option is not a great surprise. In other words, the Washington Consensus was not as narrowly defined in practice as perhaps it was intended conceptually.

This conceptual confusion in turn spilled over into the way in which the policies were implemented. Trade liberalization was treated as a quick fix to economic malaise, and this has had serious consequences for domestic industry, employment and thus poverty. This is reflected in the speed in which liberalization occurred. Argentina, Bolivia, Brazil, Peru and Mexico, amongst others, all liberalized their trade regimes in a period of 2-3 years,\(^\text{14}\) with the main instrument of reform being across the board liberalization of imports. In many places this lead to a large scale deindustrialization. In Mexico, in 2000 only 25% of the productive firms that existed in 1982 were still extant.\(^\text{15}\) Similar stories are told in Argentina and Ecuador as firms supported by the import substitution regime were exposed to the world markets as uncompetitive and thus went out of business. This had a large impact on unemployment which rose to 66% in Ecuador by 1990\(^\text{16}\) and could partially explain both the rising numbers of those living in poverty across the region, the high levels of participation in the informal sector which can exacerbate poverty due to the lack of inclusion of informal workers in social security programmes.

As Agosin and Ffrench-Davis illustrate this model of liberalization was by no means the only one available to Latin American policy makers. An alternative would have been an export-lead strategy such as those implemented by the East Asian miracle states, whereby producers benefit from reduced input prices due to lower import tariffs, but are given continuing protection from competing imports such that they have the necessary time to restructure. A strict timeline is set in which producers must innovate and become globally competitive before being exposed to the vicissitudes of the world markets unprotected.\(^\text{17}\) This model implies a gradual increase in domestic efficiency, and thus a much lesser loss of productive capacity and domestic jobs, when markets are liberalized. Such a strategy is however necessarily a much longer term view

\(^{13}\) J. Williamson *Economic Reform: Content, Progress, Prospects*. A lecture delivered to Indian Council for Research on International Economic Relations (Nov. 23 1999)

\(^{14}\) M Agosin and R. Ffrench-Davis *Trade Liberalization and Growth: Recent Experiences in Latin America* Journal of Interamerican Studies and World Affairs, Vol. 37, No.3 (1995) pg. 17


\(^{16}\) *Ibid.*

\(^{17}\) M Agosin and R. Ffrench-Davis *Trade Liberalization and Growth: Recent Experiences in Latin America* Journal of Interamerican Studies and World Affairs, Vol. 37, No.3 (1995) pg. 17-20
than the model favoured in Latin America that saw a massive and near instantaneous reduction in the volume and use of productive resources including labour. It seems plausible that such a long-term strategy would have had a much lesser impact on bankruptcies, unemployment and thus poverty than the short-term strategies actually implemented. However such long-term thinking did not fit within the rubric of short-term stabilization promulgated by the Washington Consensus.

Similar evidence of short-term thinking can be found in the social policies that accompanied trade liberalization. Most of the liberalizing economies chose the “pure” form of trade liberalization, labeled the “standard model” by J. Sheahan\textsuperscript{18} whereby private capital flows are the determinant of competitive advantage and the structures of production. This was the model chosen by Chile in the first years of the 1980s, as well as Mexico and Peru.\textsuperscript{19} The model was accompanied in Chile by large increases in poverty and inequality\textsuperscript{20} and was thus subsequently modified to encompass what Sheahan calls the “competitive model” which aims to build up the capacity of domestic production and factors of production to compete on a global level. The accompanying social policies these two models imply are vastly different. The standard model puts an emphasis on emergency relief from the extreme poverty that adjustment causes. The competitive model focuses on providing sufficient education, healthcare and improving opportunities for the abundant factors in society, in Latin America’s case, unskilled labour. This model is infinitely more nuanced than the standard model and it recognizes that pressures from competitive advantage are not sufficient generate new industries in a short time frame. The ability of nations to restructure following an opening to trade depend heavily on promoting internal mobility, creating infrastructure and, perhaps most critically, increasing levels of human capital that allow workers to move with minimal friction through the labour market. As such a successful trade policy is comprised of much more than merely import liberalization and is inherently more long-term than the original conception of the Washington Consensus.

Starting as it did from a position of relative underdevelopment, the crushing blow that liberalization dealt to those working in import protected industries in Latin America, was aggravated by the concurrent cuts in government spending on education and healthcare pursuant to the goal of reducing deficits. Mexico saw a 40.8% reduction in state spending on education in 1983\textsuperscript{21} greatly reducing quality at the same time that access to education fell as more families fell into unemployment related poverty. It is clear therefore that the necessary investments in social expenditure that could have led to increased opportunities for the poor from trade liberalization, were in fact being scaled back. Thus we see that the marriage of trade and social policy was not viewed as a long-term developmental strategy, but rather a short-term corrective measures to end macroeconomic instability and as such trade liberalization had at best no power to improve the region’s level of poverty, and at worst significant power to add new families to the roll call of the poor.

The Washington Consensus was conceptualized as set of policies designed to stabilize the turbulent Latin American economies. It was not conceived as a programme

\textsuperscript{18}J. Sheahan \textit{The Effects of Liberalization Programs on Poverty and Inequality} Latin American Research review, Vol. 32, No.3 (1997) pg. 10
\textsuperscript{19}Ibid.
\textsuperscript{20}Ibid.
\textsuperscript{21}SAPRIN \textit{The Policy Roots of Economic Crisis and Poverty} (2002) pg. 151
for development. However, the policies enshrined in the doctrine belong both to the tools used for macroeconomic adjustment, and to long term development strategies. I have argued that there is therefore an internal inconsistency between the Washington Consensus’ conception, and its policy recommendations. This is because, even absent information about implementation, dealing with deficits and the exchange rate are a natural part of the macroeconomists’ toolbox whereas the same cannot be said for privatization, capital account liberalization, and most importantly as I have shown, trade liberalization. These policies are at the heart of any development strategy, and are inherently long-term and based on conceptions of, and paths toward development. This internal inconsistency or confusion played out in the manner in which the policies were implemented in Latin America. Long-term strategies were treated as quick short-term fixes. In the area of trade this led to deindustrialization, huge unemployment and I would suggest, poverty. This trend was exacerbated by cuts in social spending on human capital investment which could have smoothed the transition pains of the poor. Ultimately what was in practice the most destructive of the Washington Consensus policies had the potential to be the most welfare improving; there is no better way to lift the poor out of poverty than by the opportunities afforded them by trade. However, in order to capitalize on these welfare enhancing properties of trade, a long-term strategy for managing liberalization combined with real investment in improving human capabilities is needed. Sadly, such long-term visions were not part of the short-term stabilization programme offered by the Washington consensus.