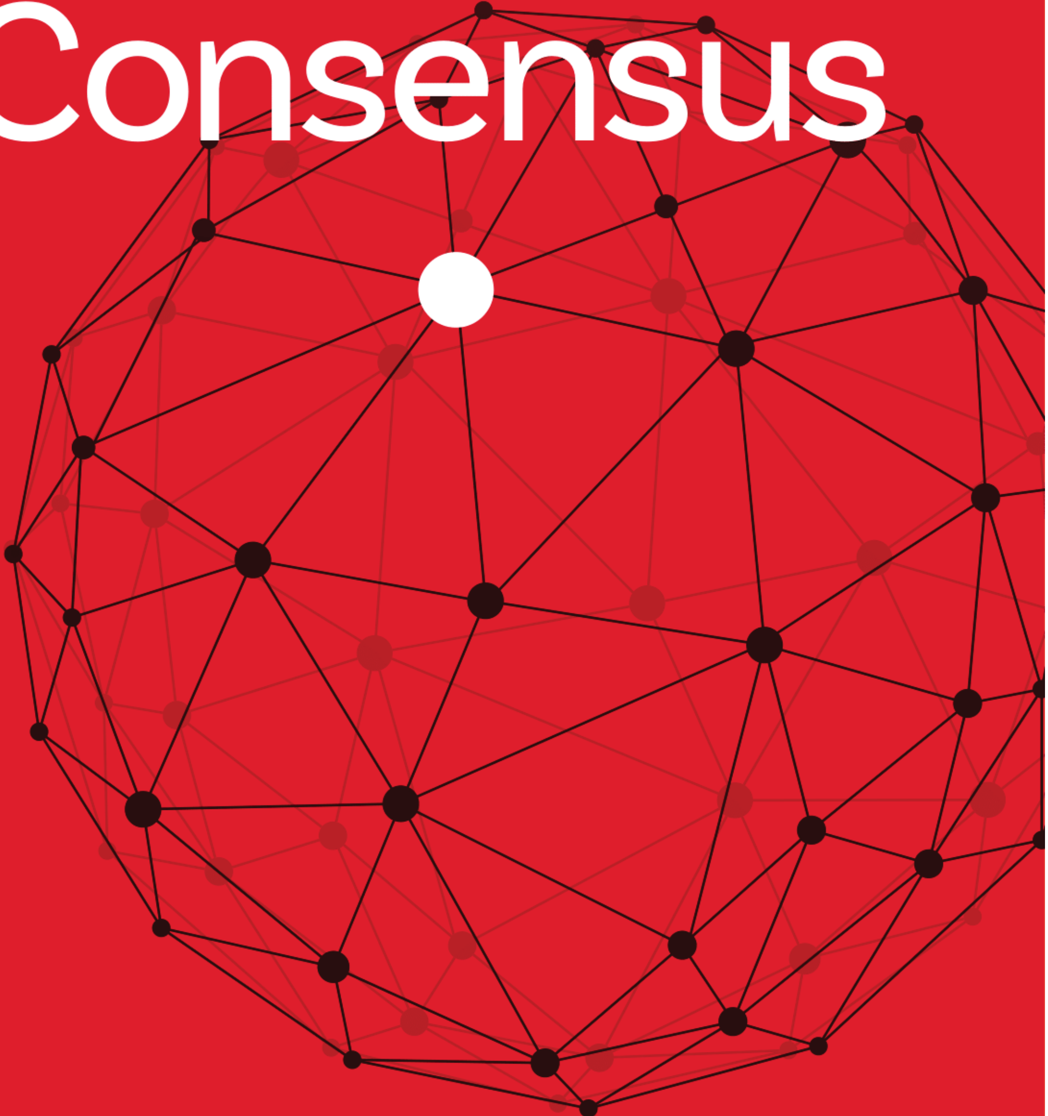
The London Consensus



ECONOMIC PRINCIPLES FOR THE 21st CENTURY

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I. Introduction

John Maynard Keynes' well-known epigram that '(i)t is ideas, not vested interests, which are dangerous for good or evil' has special relevance when reflecting on the role of policy approaches and paradigms in shaping the world we live in. New ideas about economic policy are only partly evidence based, because they try to shape a world not yet created and therefore rely on a combination of logic, evidence, and imagination. There is no 'grand designer' charting the evolutionary course of the world, where trial and error shape change. So does luck: societies have yet to prevent happenstance from determining their destiny.

Today the new challenges are easy to list: climate change, loss of biodiversity, pandemics, assorted inequalities, the unwanted effects of tech, a fragmenting world economy, populism and polarisation, war on the European continent, waning support for liberal democracy in many countries. Much harder is to identify the set of *new* ideas that will guide us through those challenges.

Any such exercise is inevitably in the shadow of similar efforts in the past. Many intellectual historians identify a post-WWII consensus that stressed a role for state-owned businesses, market regulation, welfare state institutions, and Keynesian demand management.[1] Transferred to the developing world, this consensus meant a heavy role for state support (and sometimes ownership) of infant industries, behind trade barriers and controlled exchanged rates. The approach had its critics but until the 1970s went largely unchallenged as the development model of choice, promoted by the International Monetary Fund (IMF) and World Bank.[2] It paid dividends in Japan, Singapore, Taiwan, and South Korea but the record elsewhere was mixed. In Latin America, growth petered out after a period of 'easy' import-substituting industrialisation.[3]

The 1970s were a turbulent decade. The period of stagflation in Western democracies led to critical questions being asked about the prevailing paradigm. The mixed record of the model in the developing world became increasingly clear. Thinkers, such as Anne Krueger, soon to become the Chief Economist of the World Bank, pointed to the rent-seeking opportunities

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that regulation and protection brought, and the mood started to shift.[4] The election of Thatcher and Reagan led to a different approach (although in the United States some of the shift had begun under Carter). Deregulation and trade liberalisation became mainstream.

A potted intellectual history of the last century would claim that Keynesianism held sway in the industrialised world after the Great Depression, only to be replaced by so-called neo-liberalism in the late 1970s or early 1980s. And neo-liberal ideas found their pithiest expression in the Ten Commandments that another English economist, John Williamson, published under the label *The Washington Consensus* in 1990.[5]

This simplistic history of shifting economic paradigms is somewhat misleading. On the standard account, Keynesianism was progressive and neo-liberalism, conservative —focused on the benefits of markets to the detriment of everything else. But Keynesianism was mostly about macro-management. It coexisted with free markets in the US and highly regulated markets in Europe. Neo-liberalism, to the extent that it was a coherent paradigm, was mostly about microeconomic deregulation.[6] It coexisted with expansionary policies and large fiscal deficits in the US under Reagan, and with fiscal austerity in the UK under Mrs Thatcher.

Those caveats aside, there is no doubt that Williamson's Washington Consensus was hugely influential. By the early 1990s it constituted the predominant view of effective policy for development. Fuelled by support from the IMF and World Bank, which by then had turned their back on the post-war consensus, fiscal consolidation, tariff reduction and deregulation became preconditions for adjustment assistance. The fall of the Berlin Wall brought additional willing participants to the policy experiment.

The Washington Consensus did lay down many important ideas, some of which have stood the test of time. It contributed to the spread of globalisation, creating many opportunities along the way: it is hard to argue against the proposition that the huge drops in global poverty that followed were due, at least in part, to greater economic openness. The fall in world inflation that took hold until recently also owed a great deal to the view – well captured by Williamson – that monetary policy should be used to fine-tune aggregate demand (ideally under the aegis of an independent central bank), not to finance large budget deficits. Those were important achievements. But the Washington Consensus also left us with a plethora of important, unanswered questions about the kind of society that would follow. And those questions have become more urgent with the passage of time.

To explore those questions, in May of 2023 we convened a group of authors and discussants and asked them to give their take on what would constitute a new economic consensus for the 21st century. Because the group met at the London School of Economics (LSE), the working label of our project was the London Consensus. We imposed no pre-determined approach or paradigm on this venture, but we hoped some general principles and lessons would emerge. The papers and comments from that 2023 meeting are contained in this volume.

In the time between the Washington Consensus and the London Consensus meetings, the world has changed in fundamental ways. The collapse of the Soviet Union and its area of influence, the rise of China as an economic power, and the increasing recognition of anthropogenic climate change are just three important examples. Today we have the advantage of being able to judge which prescriptions in the Washington Consensus have stood the test of time and which have proven incomplete or just plain wrong.

The discipline of economics has changed too, most notably in its embrace of political economy, and its engagement with psychology to create richer models of individual behaviour and of collective decision-making. The availability of data and new methods have also allowed for a wealth of innovative empirical studies, both micro and macro, that practitioners can draw upon to understand the consequences of alternative policies. Many of the authors and discussants in this volume have lived through this transformation and have played major roles in reshaping the discipline of economics.

II. Are paradigms useful?

In appraising the lessons from the contributions to this volume, we will steer clear from trying to create a supermarket list of reforms that a country needs to complete before it can improve the lot of its citizens. To democratic leaders with limited terms of office, fragmented parliaments, and limited resources, such lists are not particularly useful. An approach that emphasises everything ends up prioritising nothing and can easily become a recipe for policy paralysis.

Nor are we seeking one-size-fits-all recipes. The binding constraints that hold back economic growth and social progress differ across countries with local history, culture, and politics varying widely. Thus, each nation should develop its own bespoke policy priorities. The very notion of international 'best practice' that can be applied across the board can do more harm than good.

Given these caveats, sceptics might question the idea of trying to build a new consensus at all, whether conceived of in London or anywhere else. And given the mixed record of development models or *paradigms*, which can easily become too rigid or too ideological, perhaps one should stay away from them. Dani Rodrik, in his paper in this volume, rightly counsels policymakers to 'beware of economists bearing paradigms'. Earlier, Albert Hirschman titled his influential essay 'The Search for Paradigms as a Hindrance to Understanding'.[7]

But the fact that local circumstances matter, and that countries ought to have differing policy priorities, does not mean that nations cannot seek common lessons from others' experiences, or from the findings of policy-oriented research. There are at least four reasons why a new consensus can assemble useful knowledge for policymakers to use.

The first is the importance of identifying what does not work. We know from experience there are policy approaches that yield disastrous results pretty much regardless of setting or circumstance. Identifying those failed approaches and placing them on a list of policies *to-be-avoided-at-all-costs* can save a lot of time and trouble.

Second, is the difference between principles and policies. Politico-economic analysis can yield general principles – perhaps amounting to a paradigm – that help understand development challenges and organise the search for solutions. Using those principles, each nation can decide which policies are best, given its unique history and circumstances. As Jean Pisani-Ferry agues in his contribution to this volume, 'A great advantage of policy paradigms is that they are directional. Whenever new policy directions are to be explored, governments go through a discovery process where they learn from the successes and failures of other governments'.

Third, and to avoid the one-size-fits-all temptation, useful advice can come in conditional propositions, of the form 'if this is your set of circumstances, do this' and if 'that is your set of circumstances, do something else'. This approach must have a diagnostic technique for identifying the relevant set of circumstances and a prescriptive taxonomy that lists the policies that are appropriate for different circumstances.[8]

Fourth is the importance of narratives in political and economic debates. Psychologists have long argued that human reasoning is predisposed to processing information via narratives.[9] Among social scientists there is increasing interest in the power of narratives to shape policy. And paradigms are a kind of narrative: they help structure thinking about appropriate policies. Plus, in democracies voters must be persuaded of the advantage of this or that policy approach. And those debates take place not over the technical advantages of a given policy, but over the paradigm of which it is part and the values it embodies. Policymakers going into political battle without a paradigm do so with an arm tied behind their backs.

In this introduction we focus on the central elements that, we believe, can form the basis of a new policymaking consensus that could displace the Washington Consensus. We begin with some core principles that shape policy and then, drawing on the contributions in the volume, show how they can be combined to form a coherent intellectual framework for a new approach.

III. Five core principles

1. *It's not just the money*

There is an idea with a long history in economic thinking, going back at least, to J.S. Mill: the market should take care of what to produce and how to produce it, while the state addresses market failures and redistribution using taxes and transfers.[10] In modern public economics this view is associated with the seminal work of Diamond and Mirrlees, who laid down the argument for production efficiency in a rigorous way.[11]

Out of this grew the idea of the separation of efficiency and distribution. Optimal taxes and transfers to households can redistribute, while businesses operate in a largely undistorted way as long as their profits can be taxed. The implication is that, even economists who care about equity should strive to build an efficient market economy. This conclusion brings together the views of advocates of egalitarianism and of a market-based economy, justifying efforts to make the size of the pie as large as possible before deciding how best to divide it.

This way of thinking is also quite consistent with the thrust of the Washington Consensus, even if the latter was largely silent on matters of distribution. The separation of efficiency and distribution was implicit in the prescription that public expenditure was to focus on infrastructure, security, health, and education, while the use of industrial policy was suspect, regulations were to be lifted, and state-owned enterprises were to be privatised.

This intellectual framework also had a political corollary: if achieving a just distribution could be separated from the pursuit of efficiency, failure to respect the interests of the poor was largely at the door of individual countries rather an indictment of the Washington Consensus *per se*. The *Third Way* advocated by politicians, such as Bill Clinton and Tony Blair, could also be justified using this core model, with the implication that there was no fundamental trade-off between the pursuit of efficiency and equity if there existed a fiscal response in the form of redistributive taxation and transfer programmes.

The approach still has much to commend itself. Relying on the market for most allocation decisions is often right when considering private production. But in the years since the Washington Consensus, we have had to relearn an old lesson: *what* you produce, *how* you produce it (e.g. via what kinds of jobs), and *where* you produce it, matters. Not all economic and social ills can or should be corrected by post-production redistribution. Some need to be corrected before or during production, in what some are now calling 'pre-distribution'.[12]

Why does the Mill-Diamond-Mirrlees principle fail sometimes? First, because one of its key premises, that all rents (pure profits) can be taxed, is problematic. There are technical issues around identifying and measuring rents rather than normal returns. The task is especially difficult in a world of creative destruction, where profits motivate innovation. An extra layer of complication arises in a globalised world where transfer pricing is used to shift profits to low tax jurisdictions. Finally, many rents are shifted to labour earnings in ways that make it harder to separate productivity from rents. Taxing labour rents separately from standard labour earnings is almost impossible.

Another difficulty for the separation of equity and efficiency is that modern economies are rife with externalities, which in turn may require intervention directly into the productive process. Of course, externalities were not discovered yesterday, nor was the use of policy to correct them. What is new is the emergence of very large externalities, which span economics, politics, and society. An example is the negative multiplier that affects local communities, destroying social capital and undermining cohesion, when large numbers of well-paying jobs are destroyed. The result is not only unemployment, but increases in drug addiction, crime, broken families, etc.

Those large externalities can also be positive. An example is provided by Ricardo Hausmann in his contribution to this volume: there is substantial evidence suggesting that countries that export more grow faster (and more than proportionately so) because they adopt innovative technology with greater speed and because, in doing so, they learn about additional export opportunities at the extensive margin. These benefits are not all internalised by the exporting firms themselves – the very definition of an externality.

The separation of efficiency and distribution requires that governments be able to extract sufficient revenues through broad-based taxation. But there is an active debate about where the limits to taxation lie, now that many countries in Europe raise 40% or more of national income in taxes. So, while there can be significant expansion of taxation in lower- and middle-income countries (LMICs), it may well be that the limit is near – or it has been reached already – in several high-income nations. If so, as Olivier Blanchard claims in his contribution to the volume, 'it may be that more direct intervention in the market process, rather than the redistribution process, is needed'.

Some economists advocate wealth taxes as a way out of this conundrum. But wealth is hard to measure and often portable across borders. Without a level of global cooperation that is unrealistic today, wealth taxes are unlikely to raise much larger revenues. And while taxes could be levied on fixed assets, such as housing, those higher property taxes would have to be phased in over gradually, so as not to punish people who bought their homes recently.

A more subtle but also more fundamental issue with the Washington Consensus (and the Mill-Diamond-Mirrlees principle that underpinned it) is its conception of welfare. In a utilitarian world everything is commensurable, and can be put on a single dimension. Transfers can then be used to compensate losers. Yet, as Francisco H. G. Ferreira stresses in his chapter on inequality in this volume, what matters for human flourishing is not simply the distribution of monetary income (even when that includes compensation). The distribution of self-worth, respect, social status, and public recognition matter a great deal, too.[13] They are intrinsically important and cannot simply be written off by a materialist conception of wellbeing.

We agree with Ravi Kanbur, who in this book stresses that recognising the importance of these multi-dimensional inequalities should not be used as cover for forgetting about what can (and ought to) be done with taxes and transfers. But we also believe that taking a wider perspective on the definition of wellbeing and its distribution does point to issues that matter in concrete situations policymakers frequently confront. For example, in a town where coalmining has been the mainstay for a generation, a 50-year-old miner will understandably be unhappy if forced to swap his job for that of hotel waiter or telephone operator, even if these new jobs pay better. And the jobless resident of an area suffering from high unemployment will not be eager to hear that there are jobs to be had hundreds of miles away, in places where she has no family, friends or links to the local community.

We conclude there is need for an approach that thinks harder about the kinds of reward structures embedded in an economic system. A system that allows people to protect their rents, limiting competition, may also undermine faith in the market system, especially when government lacks the capacity to tax those rents. When markets function imperfectly there is a case for labour market interventions via, for instance, minimum wages.[14]

Corporate governance arrangements also determine how different groups are rewarded. Crucially, people care about distribution not just after the state has intervened, but instead look at market rewards as a reflection of opportunities – and often conclude that these are unfairly distorted by the distribution of economic and political power.

It is also relevant whether goods are produced, and jobs generated, *in situ*. Geographical areas are often identified with the production of distinctive varieties of goods. When comparative advantage shifts, the loss of social structures that were associated with those goods can undermine workers' sense of identity. This means paying greater attention to the 'place-based policies', which we elaborate on below.

2. *Growth still matters*

Even though Williamson's text is often described as a 'neoliberal' (i.e., conservative) manifesto, it is striking that economic growth does not get star billing as a major goal of policy reforms.[15] The lack of emphasis on growth is not unique to the Washington Consensus, nor to so-called neoliberal approaches. Over the last quarter-century, 'progressive' approaches to development have tended to emphasise other policy goals (for instance, distribution) to the detriment of growth. Even in institutions like the World Bank, growth has not received the priority it enjoyed in the post-WWII consensus. This owes more to shifting intellectual fads in the United States and Europe than to changed circumstances in developing and emerging nations. As Timo Boppart stresses in his contribution to this volume that 'economic growth as measured by average gross domestic product (GDP) per capita is still a proxy of success of first-order importance and will remain so for the years to come – in particular for developing countries'.

In the Washington Consensus, the focus was on static allocative efficiency: liberalisation, deregulation and privatisation were supposed to ensure that 'prices are right' and private agents can respond to those price signals. The implicit assumption seems to have been that if the market was allowed to do its work, economic growth would naturally follow.

Thanks to the modern approach to growth, we understand much better than economists did back then that static allocative efficiency is very different from dynamic efficiency, and that getting prices 'right' is neither a necessary nor a sufficient condition to ignite economic growth. In 1989 the endogenous growth academic revolution was just getting under way; the 'creative destruction' growth paradigm that Aghion and Van Reenen stress in their contribution to this volume would not be formalised until the following decade.[16]

In this Schumpeterian 'creative destruction' paradigm, innovation rents motivate investments in innovation, so doing away with all rents via liberaliSation and competition can, in fact, be bad for growth. But those rents cannot be allowed to get too big, because yesterday's innovators are tempted to use their rents to prevent subsequent innovations, since they do not want to be the victims of creative destruction themselves. This all suggests a subtle and complex interaction among the policies, incentives, and decisions governing innovation, which was very much absent from economic analysis in Williamson's time, as discussed in Philippe Aghion and John VanReenen's contribution to this volume.

The factors that create an enabling environment for growth are consequently much richer and more nuanced than in the static-efficiency-only approach. Innovation decisions are rife with externalities and market failures, which can benefit from judicious government policy. For example, knowledge spills over in ways that do not benefit the original owners of that knowledge, frameworks have to be found for safeguarding intellectual property, some innovations are not fully patentable so rents may accrue to imitators who did not invest, coordination failures may prevent needed investments in innovation from taking place, etc.

The case for an activist innovation policy is strong, in advanced and developing economies alike, since the state can both expand the technology frontier and ensure that firms get support to adopt and adapt the most appropriate technologies. Beyond having a strong legal system that protects intellectual property rights, the state can help train the required human capital. Policy can also spur innovation by ensuring that the financial system works effectively to channel capital towards firms with growth potential. This is a particular challenge when lack of collateral or other financial market failures prevents the private sector from doing so.

Growth has positive effects that go far beyond higher incomes, wages, and consumption. One example is that growth enlarges government revenues and relaxes budget constraints, making it possible for governments to spend more on health, education, and pensions. That is one reason why, as Lant Pritchett has stressed, indicators of human development, such as those measured by the United Nations Development Programme (UNDP) (lower poverty, higher life expectancy, lower child mortality, enhanced literacy and numeracy, etc.) are closely correlated with economic growth.[17]

At a time of generalised distrust of politicians and of democratic politics, it is remarkable that growth is a reliable predictor of empirical measures of political trust. Citizens seem to trust their politicians more when politicians are able to deliver a growing economy. Interestingly, growth matters more for trust than other economic outcomes, such as low inflation.[18]

3. *The need to build resilience*

Most people prefer their lives to be serene, their jobs to be stable, and their consumption to be smooth. That is why countering volatility and stabilising economic outcomes has long been a goal of policy. Volatility comes in many varieties, but the Washington Consensus focused on only one: macroeconomic volatility resulting from irresponsible monetary and fiscal policies. That emphasis turned out to be insufficient. Policymakers must put countering volatility of all kinds at the centre of their concerns and must design policies explicitly targeted at volatility. There are political and social reasons, in addition to standard economic ones, for this change.

The focus of the Washington Consensus made sense at the time. It was conceived of at a conference on Latin America, a region which in 1989 was coming out of the biggest debt crisis in its history, with deep recessions and high unemployment. In most countries, budget deficits financed via external borrowing accounted for the sizeable debt burden. When borrowing was no longer possible, governments turned to money creation to finance fiscal deficits, which under-fixed exchange rates, caused a loss of reserves, and an eventual balance of payments crisis. The lesson that Williamson extracted was simple: fix monetary and fiscal policies and macroeconomic volatility will go away.

Today economists understand much better than they did in the late 1980s that unsound monetary and fiscal policies are one important cause of volatility, but certainly not the only one. Policymakers do not always heed this lesson, as the Great Financial Crisis of 2007–09 showed. The benign economic circumstances that preceded it allowed the build-up of imbalances in the financial sector – a phenomenon that illustrates how the financial sector can itself be an important source of shocks, and how proper financial regulation is an essential component of policies to keep the economy stable. (Williamson was aware of this: he excluded free capital mobility from his 10 commandments precisely because it could be destabilising, but he did not make this explicit in the original paper).[19] Today, economists and central bankers are busy developing micro and macroeconomic prudential regulation, and institutions like the IMF include capital controls as one more tool in governments' toolkits to fight instability, as Hélène Rey explains in her contribution to this book.

Economists also understand better, as Ricardo Reis and Andrés Velasco stress in this volume, that some financial markets never develop (e.g. markets for certain kinds of insurance) and that other markets disappear at times of financial stress, creating an essential role for government. Part of the job can be taken over by monetary policy (think of Mario Draghi's we will do 'whatever it takes' to prop up the Euro), but monetary policy inevitably must be backed by the taxing and borrowing powers of the state. There is much justification for an activist fiscal policy that goes far beyond the Keynesian role.

Crucially, volatility is not only macroeconomic, and the Washington Consensus paid almost no attention to other sources of volatility. A case in point is the volatility individuals face due to largely uninsurable idiosyncratic shocks: they might lose their jobs, become sick or disabled, live longer than expected and run out of retirement savings, etc. Not only does this volatility result in people's consumption not being smooth. It is also a source of anxiety and stress, with serious consequences for health and wellbeing.

Furthermore, such volatility can have political consequences: a citizen who is unable to find a job or secure healthcare for a sick child will naturally become angry, become disenchanted with mainstream politics, and may be drawn towards extremist or populist alternatives. A properly functioning welfare state should provide insurance against these contingencies, as Nicholas Barr stresses in his contribution to this book.

Last, but certainly not least, recent events have underscored the risks associated with yet other kinds of volatility. As discussed by Alistair McGuire, Joan Costa-i-Font and Ranjeeta Thomas in this volume, the pandemic reminded us how costly it can be to run healthcare systems that are not prepared for a sudden and large surge in the demand for their services. But many healthcare systems, including those of many advanced nations, lacked the spare capacity to deal with sudden surges in demand, with insufficient supplies of essential equipment, such as respirators, to cope with an emergency.

Recent years also revealed how fragile global supply chains are and how vulnerable they are to both economic and geopolitical shocks. The Russian invasion of Ukraine showed that food supply and prices can respond in extreme ways to an adverse shock in one large grain producer. And climate change, of course, will produce ever more volatile weather conditions, with all the attendant (and harmful) economic and social consequences. We agree with Diane Coyle when she underscores in this volume that a 'malfunction of the innovation machine is the economy's lack of resilience or security of supply, demonstrated by the multiple shocks occurring since 2008'. The inescapable conclusion is that the resilience of economic and social arrangements should be a central goal of policy. That objective was completely absent from the Washington Consensus.

Because the environment is likely to become an even more important source of shocks, the world will need to come together to engage in carbon-reducing mitigation efforts. But for many countries, adaptation will be the only option in the near term, building structures that are resilient to shocks. This is a point that both Elizabeth Robinson and Chukwumerije Okereke, and Robin Burgess and Tim Doberman, make in their respective papers in this book. Many nations, for example, will have to revisit the standards used for flood resilience and make the necessary investments. Governments will have to re-engineer public infrastructure to respond to the heightened risk. The way in which states provide social insurance will also need to be reconsidered, with tricky questions arising along the way on how to relocate certain populations as part of the adaptation process.

4. *It's the politics, stupid*

In Bill Clinton's campaign, James Carville's well-known dictum was *it's the economy, stupid!* The Washington Consensus shared that premise. There is no single mention of the political economy of reform in Williamson's original manifesto. In the background, politics was far from absent: Ronald Reagan and Margaret Thatcher had obtained the political mandate to reshape their countries' economies, while in countries such as Brazil, Argentina, and Chile autocratic generals were applying Washington Consensus-like policies. But in 1989 the underlying premise seemed simple: fix the economy and politics will get sorted along the way. Three decades of experience have taught us that reforms imposed by either local authoritarian rulers or external lenders, however potentially beneficial, often lack legitimacy and 'local ownership', and get overturned once political or financial circumstances change. Plus, policies that are perceived as temporary and therefore lack credibility can have many undesirable effects, as Guillermo Calvo has long argued.[20]

Economic reformers in the 1980s may have overlooked the importance of politics, but it would be unwise to repeat that mistake today. Look around the world today, and the opposite of Carville's dictum seems to apply: now *it's the politics, stupid!* From the end of the democratic dream in Russia to hardening autocracy in China, from democratic backsliding in Hungary and Turkey to the return of dictatorship in Venezuela and Nicaragua, to the recent succession of coups in Sub-Saharan Africa, from chaotic political gyrations in the United States to growing disenchantment with democracy in many long-established democracies in the West, the catalogue of political ills is long and worrying.

One concern is that, increasingly, shocks to the economy will have their roots in politics or will be exacerbated by politics. Of course, this is nothing new; in history, wars have been an enormous source of economic shocks, something we have been reminded of by recent global events. And many countries have fluctuated between periods of dictatorship and democracy in ways that have been a source of economic instability. These dangers are still with us, but today they are not the only sources of instability. As societies cope with the fallout from globalisation, technological change and climate change, and deal with the reality of populism and polarisation, there is a growing risk that politics will be *the* source of economic shocks.

A case in point is the recent Brexit experience of the UK. Whatever stance one takes on the merits of the decision, it created an enormously volatile political environment in a country famed for stability. How politicians in a range of countries choose to respond to dissatisfaction over immigration will have important spillovers to the economy. In many established democracies, populist parties are gaining popularity on the back of this issue. In other places, such as the United States, this cleavage is, sadly, now mainstream.

Politics obviously influences economic outcomes, but economic policies and outcomes also have political consequences – a causal link that was largely absent from Washington Consensus thinking. As Daron Acemoglu and Jim Robinson have argued, many economists long assumed that 'good economics is good politics', meaning that good economic policies necessarily relax political constraints, making it possible to implement even better policies in the future. But both theory and recent experience suggest this need not be the case.

What may seem myopically like 'desirable' policies today may well shift the distribution of incomes and rents in ways that make politics more challenging in the future.[21] For instance, it is hard not to ponder the recent rise of authoritarian populism across the world without reference to wage stagnation and growing inequality in the US and the UK, the left-behind regions caused by the decline in industrial employment, and the massive human suffering triggered by job losses and family bankruptcies during the Great Financial Crisis 2007–09.[22]

Economists often mistakenly think of politics as *the great constraint* whereby survival-obsessed and special interest-influenced politicians keep benevolent technocrats from implementing the 'right' economic policies. Even though politics does come with its own structure of incentives, we prefer to flip this approach around and think about politics as *the great enabler*: when the politics goes well, then many other good things follow. Plus, the main alternative to politics is conflict and violence, which are unambiguously worse outcomes.

Politics is about creating an environment for policy choice and implementation that rests on voluntary compliance with laws and regulations, facilitated by citizens' perception that they have a stake in the system and are not simply dependent on the whim of a dictator. Democratic values include consent and respect for the agency of citizens –not only as economic actors in the marketplace, but as political actors with the right to play a role in choosing policies and to use their voice in influencing outcomes.

Moreover, the goals of politics include status, respect and dignity, not just monetary rewards. Political equality is also a core value that can never be attained by systems of government that deny political rights to their citizens. Such rights have intrinsic value, not just instrumental value. They are so important that societies might reasonably tolerate paying a pecuniary price for the sake of having a more engaged and empowered citizenry.

Yet these reflections come with a warning: optimism about the potential of democratic politics is not the same as naïveté regarding the risk that politics can take the wrong turn. Put in academic jargon, there is no guarantee that decentralised political interactions among large numbers of people will produce Pareto-efficient outcomes. And even if the outcome is efficient, the associated distribution of economic and non-economic rewards may be hard to square with our preferred notions of justice.

The modern political economy view is that institutions for decision-making are a key building block of an enabling environment for economic policy. As stressed by Leonard Wantchekon in his contribution to this volume, describing the project as finding 'optimal' institutional arrangements is not particularly helpful. Experience from successful polities suggest that transplanting institutions without regard to diversity of history and culture is problematic. At the same time, there are dos and don'ts to be learned from the empirical literature. Polities that invest leaders with power that lacks accountability put both economic and political stability at risk. And a failure to build broad-based political coalitions makes it hard to implement policies that share benefits of economic success widely.

In their contribution to the volume, Besley and Persson emphasise the importance of a liberal political consensus built around a cohesive society as a basis for political and economic development. But Margaret Levi rightly stresses in her comments that this is a mammoth project for political economists, with lots of details to be filled in. Understanding how that consensus is built will require research in many disciplines, along with a plurality of methods. Political economy is increasingly connecting politics and economics with insights from psychology and sociology, which suggest that the roots of cohesion lie as much in informal norms and values as in formal rules. One important lesson for economic policymakers is to be mindful of whether a given policy helps or hinders the building of social cohesion, a consideration that is absent from a purely economic approach.

Embracing politics is central to our new policy consensus, and this stands in stark contrast to the Washington Consensus. We need to appreciate better how politics can make policy inclusive and sustainable – as well as being sensitive to its own political consequences. This will be crucial to the way in which we discuss specific policies below.

5. *A capable state is the keystone*

Because the state was supposed to be confined to providing policing, defence, and basic education and health, there was no discussion of state capacity in the original Washington Consensus. By contrast, today we understand that even for these allegedly 'simple' tasks the quality of the state matters tremendously. As Lant Pritchett stresses in his paper for this volume, a number of low-income nations have succeeded in teaching basic reading and writing, while others have failed miserably. There is huge variation in state capabilities, even among nations at similar levels of income. Some of those differences reflect conscious decisions by governments not to invest in state capacity. Investing in the state is a key form of infrastructure investment, which goes far beyond bricks and mortar. The 'right' organisational structures of the state do not emerge spontaneously. They have to be *built*.

State capacities are relevant to almost every area of policy. Even behind the narrow vision of the state that maximises the efficiency of production and redistributes its fruits, lie strong assumptions about what the state can do. Contrary to the mythical libertarian ideal of the small state, creating a functional market economy requires an array of market-supporting institutions, both legal and regulatory. A market does not develop in many countries because the state is too incompetent and weak. Product safety rules, employment contracts that ensure employers fulfil their obligations, or loan contracts that guarantee debtors pay back their debts, are infeasible without state capacity. And just as important, providing adequate public services without broad-based consumption and income taxes often proves impossible.

Nowadays, it is broadly understood that at least three kinds of state capacity are crucial: revenue-raising capacity to pay, without excessive recourse to debt, for the things government does; legal-administrative capacity, to provide a stable framework in which private agents can take decisions – especially investment decisions, which involve parting with resources today in exchange for an uncertain return in the future; and delivery-capacity – not just to design policies, but to implement them effectively.

State capacity is also key for the choice of appropriate policies. Depending on the capacity of a given government to raise revenue, train and employ able professionals, resist short-term political pressures and avoid corruption, a given policy may be highly appropriate or a complete mistake. During the pandemic, for instance, policies to provide households with emergency income succeeded depending on whether government had the required databases, could make electronic cash transfers, etc.

In contrast to the late 1980s, today scholars can draw on an extensive literature on how and why states invest (or fail to invest) in their own capacity, as Besley and Persson explain in their contribution to this volume. And we also have abundant empirical evidence on which bureaucratic arrangements (i.e. hiring and remuneration schemes), with varying degrees of centralisation or local control, work better to motivate bureaucrats and get the business of government done. The chapter by Dan Honig, Adnan Kahn and Joana Naritomi surveys this evidence and provides preliminary lessons. And as their discussant Matt Andrews notes, the idea that such capacities are just a 'copy-paste' process from elsewhere is dangerous. He makes a convincing plea for an adaptive and iterative process to build such capacities.

Politics again is key. States that operate like the private fiefdoms of narrow ruling elites have little incentive to create broad-based taxation, because those elites can simply expropriate the successful. But this very fact destroys incentives to invest in prosperity. Worse still, the lack of constraints on executive power turns politics into a 'smash-and-grab' game where those who hold power think not about the future, let alone the interests of their citizens, but their own short-term interests alone. Staying in power often is their lexicographic priority. This form of fragility can quickly descend into civil conflict, further compromising the task of building an effective market economy.[23]

Industrial policy (also known in some quarters as productive development policy) and competition policy, we will argue, have a great deal going for them. But without state capacity, the idea of an activist state that can conduct industrial policy and competition policy is pie in the sky. These kinds of policies are state capacity-intensive. In those countries where they have been effective, it is largely because they already had such state capacities or because they were built alongside the implementation of the policies. Moreover, such investments in state capacity can lead to persistence in economic success beyond the life of rotating politicians. To function, the state no longer needs to rely on a specific leader, however competent or benevolent. And this, in turn, creates confidence among those who put private capital at risk, spurring investment.

Another dangerous view is that the state can be substituted for by well-meaning outsiders, either from multilateral or non-governmental organisations (NGOs). This can become quite a conundrum when, as is true in a number of low-income countries, the latter are mostly overseas NGOs. Of course, as a palliative when the state lacks capacity, their role can be vital. But though these NGOs are frequently well-meaning, their accountability to local populations is not guaranteed. There is the risk that, bypassing state actors while performing government-like functions, they will diminish the capacities of the state. There is also the risk that by recruiting talented staff who might otherwise work for the government, NGOs unwittingly perpetuate state weakness. Useful international aid policy means thinking about the dynamic consequences of delivering vitally needed goods and services, not just about the outcomes that are achieved in the short run.

IV. From principles to policy

We now explore the implications of our principles for the conduct of policy. In illustrating them we will draw on the papers in the volume. Rather than proposing a neat compartmentalisation of policies and principles, we view our principles as running through all of the policy approaches that we consider.

1. *Macroeconomic policy*

Not surprisingly given its origins, many of the most memorable policy prescriptions of the Washington Consensus concerned the underpinnings of macroeconomic stability. These included fiscal, monetary, financial and exchange rate policy. Of course, guaranteeing macro stability and getting those crucial policies right is a priority of the London Consensus, too. But we stress new elements that reflect the principles we have outlined.

While the Washington Consensus emphasised fiscal discipline to reduce the need for government borrowing, our new proposed consensus encourages fiscal activism, especially in response to crises. The point Reis and Velasco make in their paper is that fiscal policy has a key role in reducing volatility, and that role goes beyond standard aggregate demand management of the Keynesian variety.

There are at least two new fiscal policies governments have been pursuing in recent years (for instance, during the Great Financial Crisis 2007–09 and during the COVID-19 pandemic), and which can be justified by solid economic analysis. One is to use targeted transfers to help people offset uninsurable shocks, such as the loss of a job during a recession. Here government plays the role of insurer of last resort, given that private markets cannot provide insurance. The second policy is for government to become a market-maker of last resort, helping to prop up financial markets that freeze at times of macroeconomic stress. During the Great Financial Crisis 2007–09, public institutions provided emergency credit, subsidies, public guarantees, asset purchases, and capital injections to replace the financial markets that had disappeared or to keep markets operating and secure the flow of credit.

Now, government can perform both functions if and only if it can keep borrowing at times of macroeconomic stress, when the private sector cannot because it is largely shut out from financial markets. This means that to make activism possible in bad times, fiscal policy must be prudent (and reduce net debt) in good times. So, the new activism is far from a call for 'anything goes' when it comes to fiscal policy. On the contrary, it requires substantial fiscal prudence, and the institutions that make that prudence possible: many countries, both rich and middle income, have found that fiscal rules and the autonomous fiscal councils that administer them can play a crucial role. At the same time, as Chryssi Giannitsarou stresses in her comment in this volume, to be credible those fiscal rules have to be sufficiently flexible. The European experience with overly simple and rigid rules makes this point abundantly clear.

The Washington Consensus stressed the importance of market-determined interest rates, with financial markets determining the allocation of credit. This recommendation was a product of its times, given that many systems of government credit allocation had resulted in cronyism and served neither equity nor efficiency objectives. Market-determined credit allocation remains a goal in the London Consensus. But we place a great deal more emphasis on regulation to prevent lending booms and busts. Creating an institutional environment for micro and macroprudential regulation is now the name of the game, for central bankers and banking supervisors across the world. This means recognising political realities and working with a system that has a judicious mix of technocracy and political accountability.

These financial market policies help reduce volatility and create a system of credit allocation that allows small- and medium-size enterprises to flourish. The past 30 years have also witnessed experimentation with innovative forms of credit supply, sometimes in the form of micro-finance, in order to mitigate incentive problems in financial markets and to widen the scope of borrowing, given that most poor borrowers lack collateral. Providing reliable and secure savings opportunities is also important, particularly as individuals try to manage volatility over the life cycle.

Creating better credit market opportunities has both equity and efficiency objectives. In the absence of financial inclusion, only those with wealth can start new businesses, and those businesses that wish to grow must rely exclusively on retained earnings. This limits who can become an entrepreneur and distorts the firm-size distribution – and it also leads to lower wages by lowering labour demand. So financial inclusion plays a key role in building a more productive and more equitable economy.

Competition in financial markets is important, too. Many countries have concentrated banking sectors, which are a source of rents. These rents can translate into political power. In many countries, such rents are in the hands of foreign banks, so they accrue to foreign shareholders. Moreover, there has been growing suspicion that some financial products have become a means of perpetuating rents rather than mitigating risk. Behavioural economics interpretations of the global financial crisis stress that many market participants were easily misled, which accentuated the misallocation of capital. The resulting government support during the crisis was indispensable, but it created political discontent when it seemed to protect the wealth of rich financiers. The lesson from all of this is a renewed emphasis on both macroprudential and competition policy in finance, both to reduce volatility and to create fairer economic structures.

The Washington Consensus stressed low inflation as a priority, and we of course share that goal. In the years since, and in developed and emerging nations alike, policies to control inflation have converged on a broadly used formula, which can be labelled flexible inflation targeting.[24] It consists of controlling the short-term interest rate to target some agreed-upon measure of inflation, while the exchange rate floats.[25] There are, of course, many operational issues that continue to be discussed: which price index to target, whether the short interest rate should be the only tool used (or, rather, be complemented by 'quantitative policies'), whether the exchange rate float should be clean or dirty, and so on. But those important points aside, the overall approach clearly has been successful. Inflation rates declined worldwide after the adoption of inflation targeting and remained there for more than two decades. And when inflation spiked after the pandemic, in part because of unforeseen supply shocks, central banks managed to bring down headline inflation rates without provoking a recession – although, as Paul Tucker points out in this volume, the combination of large fiscal and monetary stimulus turned out to be excessive in several advanced countries.

We have little to add to this conventional wisdom. But we do want to highlight two additional and important points. One has to do with the global financial cycle (GFC) and its implication for exchange rates and monetary policies, particularly in emerging markets (EMs). The other has to do with the link between exchange rates and exports.

Thanks to the pioneering work of Hélène Rey and co-authors, summarised in her contribution to this volume, today we understand much better than a quarter of a century ago that there is such a thing as a GFC. Asset prices and capital flows to EMs are highly correlated with measures of global risk appetite. And given the important share of the dollar in international funding, US monetary policy is the main driver of the risk cycle. Periods of loose monetary policy in the United States coincide with a weaker dollar, higher risk-taking, larger capital flows, rising asset prices, and increasing leverage in EMs. The opposite happens when the United States tightens monetary policy: investors run for the exits, and capital flows, asset prices, and leverage move in the opposite direction.

In addition, Şebnem Kalemli-Özcan underscores in her contribution to this volume, the GFC often induces a local interest rate disconnect: when the Federal Reserve moves rates in one direction, emerging country market rates tend to move in the same direction even when the local policy rate moves in the other, as the local central bank tries to offset the shock coming from the US.

This has important implications for the conduct of exchange rate policy. Allowing the currency to float does not do away with the dominance of the dollar and the difficulties it brings. As Rey puts it: 'There is no "divine coincidence" that guarantees international financial conditions align with the objectives of domestic monetary authorities.' Central banks in EMs can find themselves facing a boom in capital inflows at a time when they are trying to tighten to reduce inflation, and vice versa.

So, the reality of flexible exchange rates is less rosy than suggested by Milton Friedman, the Mundell-Fleming tradition, and the Washington Consensus. Does that mean that, as a general rule, fixed exchange rates are better? Not at all. Rey persuasively argues, as do other recent papers, that even in the presence of GFCs, flexible rates can play a useful stabilising role.[26]

But it does mean, however, that policymakers should be pragmatic, and not be shy about using occasional exchange market intervention, macroprudential regulation, and even exchange controls, to prevent destabilising short-term capital flows. At the same time, whenever there is an attempt to manage exchange rates, there are institutional challenges as to who will conduct the intervention and with what objective. Having competent management of this aspect of macro policy is a key part of state capacity.

Ricardo Hausmann's contribution to this volume makes a persuasive case for a positive and crucial role of exports in the growth and development process. This means that exchange rate policy cannot be conducted while turning a blind eye to the implications of the real exchange rate for export growth – and for overall economic growth. On the contrary, as Hausmann and co-authors Lant Pritchett and Dani Rodrik show in their earlier paper, growth accelerations are associated with periods of persistently undervalued real exchange rates.[27] The conventional wisdom is that exchange rate policy cannot control the long-run real exchange rate, which is driven by real factors.

But the long run can be *very* far into the future. Over shorter horizons, exchange rate and regulatory policy matter. This is an additional reason to be pragmatic and keep a dirty float, prudential regulation, and disincentives to speculative capital inflows, in the policymaker's toolkit.

As well as paying attention to the need to create conditions for stability and to support growth, macroeconomic policy must also recognise that different policies have very different distributional consequences. As Nora Lustig notes in this volume, the Washington Consensus was frequently blind to the distributional consequences of its prescriptions, especially in countries with weak social safety nets. This had political consequences, for instance when public expenditure cuts were seen as the product of externally driven technocratic interventions by actors such as the World Bank and IMF. Our principle that politics matters stresses that policy ownership by countries is of intrinsic importance and that responsive political systems should be sensitive to the distributional effects of macroeconomic policies.

2. *Structural policies*

Our principles stress the importance of the underlying structure of the economy for both equity and efficiency. We saw earlier that the Washington Consensus focused on static efficiency, with little attention paid to both dynamic efficiency (for generating growth) and to distribution. The London Consensus approaches these issues very differently. We have stressed that *what* you produce, *how* you produce it, and *where* you produce it matter. This gives way to a suite of policies that we will loosely label *supply side progressivism* (in his comment on Rodrik, Pierre-Olivier Gourinchas also argues that what is central to these policies is the emphasis on the supply side, in contrast to the focus on the demand side typical of more traditional progressive approaches). *Supply side progressivism* assigns a central role to productive development policies – such as industrial, competition and technology policies – to promote inclusive growth.

One of the key debates at the time of the Washington Consensus concerned the role of public ownership in sectors of the economy, i.e. whether it matters which goods are produced by the public or private sectors. Privatisation of state-owned enterprises to increase the efficiency and profitability of businesses and to minimise subsidies to state-owned enterprises was a widely used policy, which received fresh impetus following the fall of the Berlin Wall. There can be no doubt that running state-owned enterprises created large governance challenges. Without the right political incentives, in most countries it has proven extremely hard to manage those challenges and avoid inefficiency.

Although there is close-to-a-consensus on ownership in sectors such as consumer goods and services, which are best located in private hands, debates remain about the case for public ownership of natural monopolies and some kinds of core infrastructure. When it comes to natural monopolies, many countries have embraced independent regulation with mandates that focus on price regulation rather than rate-of-return regulation. But it has proven difficult to incorporate social and environmental goals into such systems. And there are questions of whether investments in green technologies should be paid for by higher prices or funded from general taxation. Plus, some systems have also struggled in managing volatility, such as the price shocks in energy markets after the invasion of Ukraine. Reliability of energy supply is certainly now back on the agenda, with the promise that renewables can play a greater role in many countries in reducing dependence on suppliers based in potentially hostile countries.

The London Consensus is not prescriptive about the way that a country chooses to organise these important sectors. Instead, we give primacy to three of our core principles in approaching this issue. First, access to core infrastructure involves a case for a universal service obligation to limit the domain of inequality, with pricing (including subsidies for low-income users) that respects this mandate. So, equity as well as efficiency objectives matter.

Second, environmental goals are central to these ambitions. Infrastructure investment can be an important driver of clean growth, creating new industries but also allowing other industries to benefit from less volatile access to key inputs.

Third, state capacity is key. Without a joined-up approach that combines technocracy and politics, there is little chance that an inclusive and environmentally sound approach will be achieved that supports growth. Politics affects *how* these key goods are produced and whether these industries are run in the public interest.

The Washington Consensus was famously hostile to state activism in industrial policy – though this preference was often rhetorical, with governments that subscribed to the consensus often continuing to use state-owned enterprises for strategic ends. The success of several East Asian economies, styled a 'miracle', was also attributable to state activism.

Today there is now much greater acceptance of activist state policies to solve market failures and to coordinate decisions across sectors of the economy. Indeed, these are now frequently seen as the *sine qua non* of an approach to productive development that can support inclusive and sustainable growth. That said, there are large differences of opinion when it comes to the form such policies should take and what the (measurable) objectives should be.

When it comes to industrial policy, for example, some think that a focus on broad non-selective horizontal policies will suffice, while others see merits in a more vertical approach, even one in which government decides *ex ante* which sectors should be given priority. The climate imperative has somewhat lessened the scope for disagreement, since there is (almost) a consensus that state action that makes both production and consumption greener is needed. Many nations are also having to make judgements on where they stand on advanced technology sectors, and whether they will become so strategically important that some home production capacity should be supported.

Globalisation has also reignited debates about cultural industries and whether preservation of the production of unique culturally specific public goods ought to be part of that strategy.

Our core principles do provide some useful guidance in shaping a London Consensus approach to productive development policies (we prefer this label to the conventional 'industrial policy', since many of the activities to be promoted need not be industrial – they could be services, high-value added agriculture, etc.). First, many of the past failures of industrial policy can be avoided by building state capacity that increases the competence of the state in supporting productive development. Legal and regulatory structures are now also thought of as a source of comparative advantage.

Second, politics is key, since there is no obvious way to agree on national priorities and the resources that they require without debate and accountability for success and failure. Even though China lacks conventionally democratic institutions, it created frameworks for learning from success and failure, and decentralisation allowed some kinds of yardstick competition to evolve.[28] The state also supported technological upskilling through education and training.

Third, the objectives of industrial strategy, although debatable, could include important non-efficiency-oriented objectives. These include place-based policies to support a regionally equitable distribution of prosperity (this is connected to the issue of *where* goods and services are produced), or encouraging labour-intensive sectors to expand to reduce unemployment, especially among low-skill workers. If the objectives are clear and state capacity is present, then it is perfectly reasonable to go beyond narrow notions of static efficiency.

Fourth, productive development policy should be used to promote growth, not just static efficiency. It is reasonable for policymakers to be concerned if production is locked into sectors with low growth potential, such as traditional agriculture or old-style manufacturing. A forward-looking strategy that tries to support growth through state activism is perfectly reasonable if the structures are in place to deliver. But alongside state intervention, an enabling environment for both job creation and destruction is important. As we stressed in our principles, designing a transition for workers whose dignity and status comes from their work presents difficult challenges. Good politics can support this process without allowing vested interests to form a blocking coalition.

All of these ideas surface in Dani Rodrik's essay on productivism for this volume. He departs from the thinking that dominated the Washington Consensus by assigning a greater role to government and civil society, along with less of a blind faith in markets. This vision also stresses the need to invest in local communities and create good jobs for all. To do so requires new modes of industrial policy and the capacity to build a political consensus around policy objectives. In their contribution, which has many overlaps with Rodrik's, Philippe Aghion and John Van Reenen frame the challenge in terms of a renewed appreciation of Schumpeterian growth theory. They, too, embrace new forms of state activism to achieve inclusive and sustainable growth, through productive development policy and activist competition policy.

Related to these two is technology policy. Our first principle, that economic structures matter, is of first order importance when considering the consequences of technology. At a country level, there is a strong case for government support to help firms adopt frontier technologies. In his contribution to the volume, Ricardo Hausmann links this to export-led growth, arguing that countries that grow exhibit more than proportional export growth, in a way that changes the composition of exports towards new, more complex products. Hausmann frames the challenge in terms of organising a costly search process for growth opportunities, both at the intensive and extensive margins of production, with government playing an activist role in that process. In addition, Isabela Manelici stresses in this volume, exporting itself may contribute to technology adoption, as exporters learn from sophisticated foreign buyers.

Technological innovation has the potential to dramatically improve productivity and raise living standards. But the fact that many technologies hold great promise does not mean that all of their social and economic consequences will be desirable. A case in point is the advent of social media, which has created new economic opportunities but has also changed the nature of social relations, and not necessarily for the better. The rise of artificial intelligence (AI) will be similarly transformative, and along with its huge potential benefits lie distributional and social effects we do not yet fully understand. There are also potential negative externalities that need to be taken into account. One crucial area of concern is the development of technologies that simply replace labour instead of serving as complements for labour productivity.

Democratic societies have been reluctant to regulate technology. Much less reluctance has been evident among dictatorships, which have embraced the potential of tech for citizen surveillance. This contrast has fuelled the perception that free societies should follow a Wild West approach to technology. But the principles we are proposing caution against this stance.

The economy we create, and the inequalities it displays, will depend on the way that technologies are used. Governments will have to develop capacities to do the job of regulating technology better – especially in the case of new technologies whose economic and social consequences are not fully understood.[29]

There is also a respectable case for recognising that the internet is effectively a public utility, where pricing and production decisions require greater state involvement. Here our principle that politics matters re-emerges, but in a different guise, not as a counterpoint but to stress that without adequate contexts for public debate and discussion, states could easily weaken public trust further when they appear to restrict technological opportunities.

Concerns about volatility should also have a more salient role. So far, we have seen only tremors from software glitches and cyber-attacks. But it is plausible to think that the next global crisis will have its origins in cyberspace. State capacity to comprehend the nature of these risk and minimise them *ex-ante* is essential, since mopping up after the event could prove extremely damaging and expensive.

Skills and labour market policies are another important class of structural policies that received scant attention from the Washington Consensus, but are a central part of the London Consensus. Access to 'good jobs, at good wages' is an important policy goal along with growing awareness of the importance of the quality of jobs (formal versus informal, with or without benefits, etc.) and of the need to fight discrimination in the labour market. This issue is central to Christopher Pissarides's contribution to this volume, and it also surfaces in the papers by Dani Rodrik and by Oriana Bandiera and Barbara Petrongolo, and the comment by Kirsten Sehnbruch. It is an issue which, in addition to its crucial economic implications, will also have deep and lasting political repercussions. Without 'good jobs, at good wages' it is hard to imagine how politics will remain peaceful and stable in many countries.

The endogenous growth approach has put human capital at centre stage. And to the extent that educational attainment is broad-based, human capital accumulation can be an important source of inclusivity. Delivering education requires systems of finance that recognise that capital market frictions are important, but also that many of the gains from education accrue to those who receive it, as the contribution by Nicholas Barr to this volume stresses. Thus, easy-to-access and flexible loan schemes allow for more skills acquisition. This requires new kinds of lending, some of which may involve state support.

Externalities are important too, and there are good arguments for subsidising strategically important forms of education. This is often taken as code for STEM subjects, but not only that. Good management plays a key role in business success, and requires understanding of organisational behaviour, economics and human psychology. In addition, cultural industries are the lifeblood of thriving societies and communities.

In accordance with our principles, the approach of the London Consensus stresses a wide interpretation of wellbeing and a central role to values and ethics that promote cohesive polities. Creating a public sphere for establishing common ground is a priority – something that social media have made more difficult by coarsening public discourse. We do not regard seeking such common ground as utopian, and shared experiences like living through a global pandemic ought to create new opportunities.

3. *Openness to trade*

The Washington Consensus was fashioned on the eve of a vast wave of globalisation that saw the widespread integration of the global economy, including two countries of continental scale, China and India. The Washington Consensus was optimistic about the potential of trade to spur development – which made sense given the focus of the initial conference on Latin America, a pretty closed region where one did not have to be an ideologue to think that some trade liberalisation could be beneficial. Consequently, Williamson and his colleagues were suspicious of attempts to protect industries using tariffs and quotas. Protection was seen as a source of political as well as economic distortions, as entrepreneurs were driven to rent-seeking rather than focusing on making their firms more productive.

Three-and-a-half decades later, what have we learned about the benefits and costs of international trade? (We focus on capital mobility and migration later.) Dave Donaldson's paper in this volume tackles the question head on, and provides very clear answers.

A long time ago, David Ricardo started us thinking about the 'gains from trade'. Donaldson's first big conclusion is that modern econometric techniques have revealed that in 'most countries and in most circumstances, the aggregate efficiency gains from being open to foreign trade are substantial'. He adds:

> While it is challenging to quantify the aggregate effects of trade, I believe that we can be more confident than ever in the broad view invoked in the Washington Consensus: that trade openness raises aggregate living standards. In fact, given changes to the global economy since 1989, the size of the aggregate gains available to most countries may also be greater....

In their comments on Donaldson, both Tony Venables and Thomas Sampson agree that recent evidence shows that gains from trade are large (though Sampson stresses that *how* large depends on country size, with smaller economies benefiting a great deal more from liberalisation).

That is an optimistic conclusion, and one that would seem to chime with the general impression that globalisation and trade are at least partly responsible for pulling tens and even hundreds of millions of people out of poverty in the last decades, most notably in China and India but also in a host of other countries in East and South Asia and Latin America. The conclusion also fits the enormous consumer benefits from globalisation. Products that could barely have been dreamed of 30 years ago, such as smartphones and inexpensive portable computers and tablets, today are widely available. They were not created by globalisation, but the increase in the size of the market has been an important force for innovation and lower costs. The poor, in particular, have been beneficiaries of the increased affordability of basic manufactured goods, such as clothing and footwear.

As part of this trend, the digital world has also been opened up to a wide population. Despite creeping concerns about digital addiction, especially in a world of social media, improved access to digital communications has been largely beneficial. And it has the potential to generate even larger gains in education and also in health, as these technologies are harnessed for treatment and diagnosis. Of course, access to digital technology is by no means universal, and some countries limit the use of global digital brands – as when China chooses to ban content providers, such as Google.

But that is not end of the story. With trade liberalisation occurring at a world scale, the global distribution of production has shifted – most notably with China's entry into the world economy, initially on the back of low-cost manufacturing, and then increasingly by moving up the value chain. This massive shift has produced winners, but also losers. Hence the second main conclusion in Donaldson's paper: 'The uneven effects of globalisation cannot be ignored. Changes in the size and composition of trade flows have markedly unequal effects on earnings across individuals'. Of course, he emphasises, this was never in dispute. Over 80 years ago, the Stolper-Samuelson theorem described how income distribution would shift as the result of trade between rich and poor countries. What is new is the size of the changes involved: '… recent empirical work has shown just how unequal these effects can be – and how they can show up in ways that may have surprised economists from Stolper and Samuelson to those behind the [Washington] Consensus in 1989'.

Now, it is important to be clear about who the losers are and where they live. The Stolper-Samuelson theorem shows that, under plausible conditions, trade between a capital-abundant country and a labour-abundant country will shift the distribution of income in favour of workers in the labour-abundant country and in favour of rentiers in the capital-abundant nation. This proposition largely seems to have been borne out in reality, with the losers being low-skilled workers in rich countries.[30] (That said, in his contribution to this volume Danny Quah does outline a mechanism whereby poor countries, too, can lose from trade.)

This distribution of gains and losses helps explain why one observes growing scepticism toward free trade and rising concern over large-scale manufacturing job losses in the US and, to a lesser extent, in the UK and continental Europe. But for many labour-abundant countries, trade liberalisation has been close to an unmitigated benefit, both in terms of equity and efficiency. Granted, there were reallocation and adjustment costs in poor countries, but those are mostly behind them. And, as both Dave Donaldson and Thomas Sampson emphasise in this book, undoing trade liberalisation there would amount to an additional shock, involving new costs of adjustment. That is why – except for lobbies in remaining monopoly sectors – you will not find many leaders in the so-called Global South pushing to raise trade barriers. This crucial distinction in the distributional effect of trade between rich and poor countries is not always captured in international debates, dominated as they are by developments in the advanced world and, particularly, in the Anglosphere.

Another insufficiently appreciated aspect of globalization is how rents are distributed. Those with intellectual property are able to increase their rents by outsourcing manufacturing. Even though tech giants such as Apple produce little in the US, rents from their products accrue to the Apple Corporation where it chooses to declare them. This has enriched the (successful) entrepreneurial classes whose returns are larger when they can drive down production costs. It also has created new sources of inequality within countries.

Where does the London Consensus stand on all of this? First of all, it is in tune with these developments by emphasising the benefits of exports and an export orientation for growth, especially in developing and emerging nations. Now, an export-orientation is not the same as a laissez-faire attitude, as we stressed in the previous section. On the contrary, a successful export performance may require an activist productive development policy. This is part of a more general theme: growth does not just happen when government steps aside and lets the private sector do its job. Economic growth requires an enabling environment, the lion's share of which is created by deliberate government policy.

In the countries of the North there is a drift towards protectionism – first with the tariffs on Chinese electric auto manufacturers in Canada, Europe and the USA and, more recently, with the tariff escalation initiated by Donald Trump. These policies rest in part on the accusation that there is no level playing field. In Europe and North America there is also increasing acceptance of security arguments to restrict trade, especially in high-tech products that go into weapon systems.

Our principles do not rule out all certain protection measures categorically since, as we have argued, economic structures matter. We also stressed the flaws in the argument that the downside from trade openness can always be dealt with by financial compensation. The political system cannot be relied on to deliver financial compensation, much less compensation for the loss of status and dignity that many have endured. But this certainly does not mean that any old protectionist policy is justified. The risk, or course, is that protectionist vested interests will hide behind security arguments, which are vague and hard to evidence.

One important caveat is that concern over the loss of jobs in certain areas, and the social and political consequences this might have, need not feed straight into protectionist policies – that is, into policies that discriminate between foreign- and domestically produced goods, and between national and foreign firms. What we have learned in the years since the Washington Consensus is that the negative multiplier, that goes from the loss of jobs to the weakening of whole communities, operates at the local level (the level of a city or a region) and hence is often best dealt with through local policies – or what is known nowadays as policies of place. Instead of tariffs and quotas, Tony Venables argues in this volume, that policies should involve 'both [local] labour supply – the training and skill development polices traditionally suggested – and labour demand, through active policy to support lagging areas and attract investment'. The aim is often to start a local 'Big Push' of the kind first described by Rosenstein-Rodan and later by Murphy, Shleifer, and Vishny.[31]

Another way of dealing with the issue of local job losses is to stimulate inward foreign investment, as when European, Japanese, or Korean firms build auto plants in the United States. More generally, the growth of foreign direct investment (FDI) is another dimension of openness that has grown in importance since the years of the Washington Consensus. Williamson stressed its benefits as a source of capital, job creation, and building skills, while exposing domestic firms to greater competition. Back then they were greeted with scepticism in some quarters, but the arguments still stand. FDI can have plenty of beneficial effects, especially for developing nations. The London Consensus puts greater stress than the Washington Consensus on the importance of technology transfer as a benefit from FDI and calls on policymakers to create an environment where such transfers will actually take place.

The London Consensus is sceptical, however, on the benefits (or lack thereof) of a completely open capital account, which can lead to large (and potentially destabilising) short-term capital movements. In line with our discussion in the macro section of this essay, and in the paper by Hélène Rey, there are many circumstances where a clash can arise between the objectives of domestic macroeconomic stability (including export growth and full employment) and the pressures of the global capital market. Policymakers should not be shy about using their entire policy toolkit to deal with such situations. This might include serving as lender of last resort and market-maker of last resort, as stressed by Reis and Velasco in their paper.

Prudence is also in order when it comes to the ever-contentious issue of migration. There is a strong global equality case to be made in favour of international migration, as people flow to countries where jobs are plentiful and pay better. This both pushes up wages in the source country and enables the families of the migrants to receive remittances, which is helpful to reduce poverty and improve income distribution. Even when looked at exclusively from the point of view of rich, capital-abundant countries, and given current demographic trends, it is hard to envision how those countries will keep the tax base growing and be able to provide social services to their ageing populations, without substantial migration flows.

But our emphasis on the political effects of economic policies leads us to counsel care and gradualism. Even if migration does not hold down wages in certain recipient-country sectors, there are political consequences of immigration due to the mixing of cultures and difficulties with integration into local communities. It seems fair to say that such difficulties have been larger and more disruptive than most observers anticipated. This is not a case for doing away with migration – in fact, despite evident political stress, so far, no rich country has moved decisively in that direction, and in many nations migration flows are at all-time highs. Rather, it is an argument for being careful and creative regarding the mechanisms that regulate the movement of people across borders – whether by using a point system that prioritises skills that are high in demand, or by creating mechanisms for temporary migration (some call it rotational labour mobility), which can be less politically disruptive.[32]

4. *Taxation and public spending*

The vision of a state funded by broad-based taxation, and spending on programmes with universal benefits, such as health, education, infrastructure, and the environment, is a point of convergence between the Washington Consensus and the London Consensus. But the underlying principles are quite different, and so are some of the policy implications.

Creating broad-based taxation requires investment in state capacities, which in turn include systems of compliance and measurement. Research in this area has grown fast in the past 30 years, as economists have come to understand that computing the optimal choice of tax rates and tax bases is an empty exercise unless there is scope for implementing and enforcing tax policy. The Panglossian view that delivering quality public programmes is only a matter of political will is not much help – on the contrary, it can be quite destructive. And of course, the ability of states to get their hands on the needed resources varies widely: several advanced economies manage to raise 40% of GDP or more in tax revenue, while many countries in the world struggle to get 20% or even 15%.

Similar considerations apply to public spending. Being able to deliver even the most basic health and education services requires attention to organisational design and the standard of training. The chapter on education by Lant Pritchett, and the very good comments it elicited, all emphasise that there are plenty of examples where spending has increased without concomitant improvements in educational attainment. In his contribution, Pritchett stresses that with near universal access achieved, the priority now is to improve on learning outcomes, which requires realigning educational systems but not necessarily higher spending. We may never have a consensus on the granular details that will drive sustained gains in improving learning outcomes, but points of agreement include commitment to universal foundational learning and supporting and rewarding quality teachers. Pritchett also stresses the need for an adaptive and iterative learning process, rather than a universal blueprint for success.

The study of educational provision is part of a new organisational economics of the provision of key public services. This includes pragmatic debates about the role of private schools, as Pedro Carneiro discusses in his response to Pritchett – although both he and Miguel Urquiola stress that private provision can play a useful role but is no panacea. Urquiola also underscores that system design is key. A running theme is that the provision of education relies on state capacity for designing, evaluating, and implementing whichever system is in place. And without a system of political accountability to drive success, often at the local level, the needed changes may fail to materialise. This aligns with a more general theme in Ernesto Dal Bó's contribution to the volume, stressing the role of accountability and decentralisation in building state capacities.

An important lesson is that taxation and public service access should be designed to distort labour market decisions, and the choice by small firms to be formal or informal, as little as possible. As Santiago Levy's research has long shown – the point also comes up in his comment in this volume – well-meaning but mis-designed welfare systems can push workers and firms into informality, with deleterious effects on productivity and equity. An example is the policy of making certain individual social benefits contingent on employment status, so that informal workers lose access to them if they take a formal job.

In keeping with our theme that policy ought to attempt to reduce the volatility citizens are exposed to, state institutions and expenditure programmes ought to be designed for resilience. This implies that the delivery of public services should not add to volatility, instead being as smooth and reliable as possible over time, even in the face of financial and real shocks. This can be challenging, as the chapter by Alistair McGuire, Joan Costa-i-Font, and Ranjeeta Thomas shows. The COVID-19 pandemic revealed that many healthcare systems, including those of many advanced nations, did not have enough spare capacity to deal with sudden surges in demand, and lacked sufficient supplies of essential equipment, such as respirators, to cope with an emergency. Moreover, the global community had not agreed on a cooperative system to allocate scarce vaccines and medicines during a pandemic, with weaker and poorer nations predictably paying the price. Now we understand better than we did a few years ago the risks associated with pandemics. Climate change and the degradation of the natural environment will increase the prevalence of natural emergencies. So, we need to incorporate resilience into public service delivery. This means not just increasing spending, but also building the kind of state capacity needed to identify risks and develop strategies for adaptation and mitigation.

Spending and taxation should be viewed not as separable functions of the state, but instead as part of an integrated component of a social contract based on norms of responsibility – and of reciprocity between the state and citizens. People who believe that the government is serving their interests will feel a stronger obligation to pay their taxes.[33] As Margaret Levi has stressed, governments that are credible and trusted in this sense become less reliant on coercion to get things done and therefore are also more efficient.[34]

The implication is that we should build institutions that create such confidence, including the demonstrable use of public resources for collective ends. But building state capacity is far from a technocratic exercise that can be carried out by external experts and consultants who preach the best global practice. State reforms are unavoidably shaped by domestic politics and by the local political culture. As underscored by political scientists, such as Robert Putnam, when civic norms are strong, the state emerges stronger.[35]

Even though state intervention is key in areas such as health and education, inequalities in endowments and circumstances are a constraint on health and educational attainment, something that in this volume Michael Marmot stresses in relation to health. Such inequalities are important for many reasons, not the least of which is that they have a direct impact on the distribution of wellbeing in a way not easily quantified in conventional economic terms.

Hence, reducing the domain of inequalities in health and education is an end in itself. But the goal is likely to be elusive for many reasons, one of which is that inequalities interact in ways that can multiply the resulting harms. For instance, as Carol Propper underscores in her comments, inequality in health outcomes depend not just on differential access to healthcare, but also on inequality of incomes, education, and the places where people work and live.

Pragmatism is also required. We agree with Paul Johnson, who writes in this volume that good economics 'do not support simply minimising state involvement, nor ruling out the private sector. It is much more complicated than that'. That is why recent research has paid a great deal of attention to incentives and organisational design issues. Ideas like school vouchers and competition among providers, once dismissed by some as neoliberal ideology, are now sometimes embraced in pursuit of a system that is both equitable and efficient.

In a modern welfare state, and depending on the public goods and services involved, there should exist a mixture of public and private provision, with varying proportions of redistribution and insurance, and with more or less centralisation in delivery, as Nicholas Barr argues in his chapter for this volume. The devil, as ever, is in the details. The chapters on health and education suggest similar conclusions. In this and other policy domains, the London Consensus is not prescriptive about the balance of public finance and provision, and the methods through which that provision occurs. Instead, the focus is on building the capacity and structures to deliver, based on rigorously evaluating what works.

5. *Empowerment*

The London Consensus stresses the role of policies (and politics) as a source of empowerment. It is also a theme Pranab Bardhan emphasises in his closing comments. Labour market flexibility was part of the mantra of the Washington Consensus era. While the consensus was not openly hostile to trade unions, there was an undercurrent at the time that saw them as part of the problem, not the solution. Yet, labour market flexibility and strong unions are by no means contradictory. For instance, the Scandinavian 'flexicurity system' combines flexibility (in the form of low and predictable hiring and firing costs) with a central role for unions in negotiating features of the workplace that matter for productivity (hours, shifts, worker training, and worker voice among them). Similarly, the London Consensus envisions empowered unions playing a role that goes far beyond the traditional role of bargaining over wages.

There is a related issue of great importance today on which the Washington Consensus was silent: policies to promote gender parity in social and economic life. In their essay in this volume, Oriana Bandiera and Barbara Petrongolo stress that, although economic development often leads to convergence in formal rights, this does not necessarily translate into gender parity in the labour market. Direct policies are needed to achieve equality.

Today, Bandiera and Petrongolo show, the bulk of the labour market differential between men and women is driven by differential experiences upon childbirth – what the literature terms the 'motherhood penalty'. While the state has a role to play in correcting this gap, nowadays there is also growing attention to what firms can do, for instance, by adopting family-friendly policies, such as parental leave, childcare support, and flexible work arrangements. This will require a sharp break from the current prevalence of 'greedy jobs' (jobs where there is little substitution between workers), which pose particular problems for women workers, as Almudena Sevilla stresses in her contribution.[36]

Bandiera and Petrongolo argue persuasively that gender inequality is a waste of talent. Therefore, progress toward gender parity can enhance economic efficiency and growth. But the case for parity should not be based on instrumental efficiency grounds alone, Ashwini Deshpande argues in her contribution. Dignity and social justice are at stake.

Now, the extent to which the voices of female workers will be heard and valued depends on the nature of the workplace. This is an issue of wider concern since, in modern societies, many of our waking hours are spent at work. We hope to have our voices heard on this crucial sphere of our lives, but this is frequently not the case. This reduces economic efficiency, since frontline workers often know better than anyone else how to improve productive practices. But it also matters crucially for people's sense of dignity and self-esteem, and therefore for the politics of a nation, which is more often than not driven by citizens' frustration and desire for change. Political philosopher Elizabeth Anderson, well known for her work on equality in social relations, describes company management as a 'private government', and calls for that government to be more democratic.[37] We sympathise with that call.

Earlier in this introduction we have stressed the importance of political democracy as a source of empowerment. Without delegating authority to citizens as the ultimate stakeholders, it is hard to see how there can be any guarantee to protect the economic, political, and social rights of all citizens. Citizen voice and influence matter because they are directly constitutive of human agency, and not just because they can secure greater access to goods and services.

Crucially, people identify with their local communities, and those identities are a crucial component of who they are as human beings. For most of history we lived in tribal societies and communities that were a key source of identity. Some have seen the advent of a globalised cosmopolitan society as a natural evolution that will allow humans to leave such archaic structures behind. We believe that is a mistaken interpretation. The forms of social organisation and identity might change, but communal identities have a way or reasserting themselves in politics and social life even as they are wished away. A key challenge today is to enlarge this human circle of identity and trust, and to build enlarged communities of fate, as Margaret Levi has long argued.[38] These are communities in which people come to believe 'they are in it together' and are willing to act on the interests of anonymous strangers because of this perceived shared collective interest. Even in a globalised world there are overlapping communities – like the one that came together to produce this book.

V. Concluding comments

This introductory chapter has attempted to draw lessons from the contributions in this volume. While we have not done full justice to the richness of these, which must be read to be appreciated, we have tried to delineate some common threads and ideas. But they are *our* interpretation and *our* views; we cannot even be sure that our proposals will elicit a consensus among our authors, let alone the global policymaking community. But we do think that now is a good time to try to foster a consensus grounded in sound economic principles.

Each author in this volume was tasked with looking for consensus in a specific policy area. There was no attempt to prescribe any core principles of policymaking that could underpin the task. But, as we have emphasised, principles have emerged, which do allow for a clear departure from the Washington Consensus. Some are clear shifts of direction while others attempt to correct blind spots in the underlying economic model. These principles also reflect fundamental changes in the discipline of economics, toward less monolithic conceptual foundations – a flexibility that has also informed new empirical approaches.

Economics has embraced political economy and has also brought in ideas from other social sciences. Economists' measurement frameworks now try to transcend a narrow focus on the implications of policies for consumption and incomes – without losing sight, of course, that these remain core indicators of economic success and failure. We argue for an approach that has its core in economics, but an economics that also thinks about *who* gets *what* and *why* that matters.

We have also stressed that *what* you produce, *how* you produce it, and *where* you produce it is important. The *what* and *how* allow us to discuss the choice of technology and the role of directed technical innovation, and the consequent impact on the quantity and quality of jobs. The *where* opens the door to a discussion of 'place-based policies' – or 'levelling up', as it has been called in the UK. This approach integrates the local and the global. It is also more attentive to the challenges we now face from climate change and the depletion of nature.

The Washington Consensus did lay down many important ideas, some of which have stood the test of time. The framework it proposed contributed to the spread of globalisation, creating many opportunities along the way: it is hard to argue against the view that the sizeable reductions in global poverty that followed were not in significant part the fruit of embracing greater economic openness. But the Washington Consensus also left us with a plethora of important unanswered questions about the kind of society that would follow.

Some of the failings of the Washington Consensus are understandable. In 1989 economics had yet to re-engage seriously with political economy and with the more nuanced psychological models of human behaviour. And welfare economics as practiced then found it easier to argue for efficiency rather than engaging with apparently more difficult issues of distribution. There was also much less appreciation of the importance of state capacities and institutional structures in shaping policy effectiveness. The climate crisis was much less salient, as were some of the social and political downsides of globalisation. These new factors are all prominent in the contributions to this volume and should become central to shaping a new approach.

Because the London Consensus is reflective of where economics, as a discipline, is today, it is best thought of as an *economic* consensus rather than a *policy* consensus. The approach we suggest is not a prescriptive list of policies but a set of principles that assist policymakers when choosing among alternatives. We believe that social science is at its best when used as guidance for seeking solutions, while leaving it up to empowered communities to find the appropriate policies to meet the manifold challenges they face.

Notes

1 See, for example, Gerstle (2022).

2 For example, Bauer (1976).

3 The classic reference is Hirschman (1968).

4 Krueger (1974).

5 Williamson (1990).

6 In the UK, the Conservative-Lib Dem coalition that governed in 2010–15 was never particularly keen on deregulation. Most of that was already done by Margaret Thatcher and largely maintained by Tony Blair.

7 See Hirschman (1970). Distrust of big ideas and general solutions is also a key theme of Banerjee and Duflo (2011).

8 Rodrik et al. (2008).

9 For example, Sarbin (1986), or Schank and Abelson (1977).

10 This sentiment is neatly encapsulated in the following quote from Mill: 'The laws and conditions of the Production of Wealth partake of the character of physical truths. There is nothing optional or arbitrary in them. It is not so with the Distribution of Wealth. That is a matter of human institution solely. The things once there, mankind, individually

or collectively, can do with them as they like. They can place them at the disposal of whomsoever they please, and on whatever terms. The Distribution of Wealth depends on the laws and customs of society. The rules by which it is determined are what the opinions and feelings of the ruling portion of the community make them, and are very different in different ages and countries; and might be still more different, if mankind so chose.' Mill (1848/2004).

11 Diamond and Mirrlees (1971).

12 Hacker (2011).

13 These are core ideas in moral and political philosophy that go back, at least to Aristotle and have modern statements in works such as Rawls (1971), Sen (1999), and Nussbaum (2011).

14 Manning (2013).

15 Output growth, as opposed to growth of population or exports, merits only a few passing mentions.

16 Aghion and Howitt (1992).

17 Pritchett (2022).

18 See Besley et al. (2025).

19 See Williamson (2009).

20 Calvo (1986a; 1986b).

21 Acemoglu and Robinson (2013a)

22 Now, these links should not be interpreted mechanically nor generalised too much. If economic frustration and income inequality were its only sources, then populism would not be affecting egalitarian Sweden or fast-growing India – and the rising populism would be of the left-wing, redistributive variety, not of the right-wing, lower-taxes-on-the-rich kind.

23 Acemoglu and Robinson (2013b) delineate an important distinction between inclusive and extractive institutions as core drivers of state success and failure.

24 Svensson (2011).

25 With regard to the exchange rate, the Washington Consensus was often characterised as favouring market-determined exchange rates. This resulted from the fear that managed exchange rates often became overvalued, and required current and capital account restrictions to be sustained. Floating seemed like a ready fix for this problem, even if it added a new source of volatility. But many others who argued for the

Washington Consensus favoured fixed rates. Some for technical reasons (they feared a floating exchange rate was not uniquely determined). Others for political economy reasons, since fixed rates would presumably induce fiscal discipline.

26 Obstfeld and Zhou (2023).

27 Hausmann et al. (2005).

28 See Wang and Yang (2021).

29 For an illuminating discussion of these issues, see Johnson and Acemoglu (2023).

30 There are caveats. Think of Stolper-Samuelson in the context of two factors of production (skilled and unskilled labour) and many countries. It could be that one country (e.g. Mexico) is relatively abundant in unskilled labour vis à vis one trading partner (the United States) and relatively abundant in skilled labour vis à vis another partner (China). Then, multilateral trade liberalisation could either raise or reduce the wage skill premium in Mexico. In practice it seems to have raised it, increasing wage inequality in Mexico. See Hanson and Harrison (1999).

31 Rosenstein-Rodan (1943), and Murphy et al. (1989).

32 On this last point, see Pritchett (2024).

33 For example, Besley (2020).

34 See Levi (1997).

35 Putnam (1994).

36 The term was coined by Claudia Goldin (2021).

37 See Anderson (2019).

38 Levi (2020).

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