References


Is there a Post-Washington Consensus Consensus?

Joseph E. Stiglitz

If there is a consensus today about what strategies are most likely to promote the development of the poorest countries in the world, it is this: there is no consensus except that the Washington Consensus did not provide the answer. Its recipes were neither necessary nor sufficient for successful growth, though each of its policies made sense for particular countries at particular times.

By the Washington Consensus I mean, of course, the oversimplified rendition of policies recommended by international financial institutions and the US Treasury, especially during the period of the 1980s and early 1990s, before they became such a subject of vilification in both the north and the south—not the more subtle work of John Williamson, who actually coined the term (Williamson 1990, 1999). Whatever its original content and intent, the term ‘Washington Consensus’, in the minds of most people around the world, has come to refer to development strategies that focus on privatization, liberalization, and macro stability (meaning, mostly, price stability). (The policies are often referred to as ‘neoliberal’ policies, because of the emphasis on liberalization, and because like nineteenth century liberalism, they emphasized the importance of a minimal role for the state.) To most people, the Washington Consensus represents a set of policies predicated upon a strong faith—stronger than warranted either by economic theory or historical experience—in unfettered markets and aimed at reducing, or even minimizing, the role of government.² This development strategy stands in

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² How the term 'Washington Consensus' is widely understood is then an important difference between this chapter/paper and John Williamson's paper presented at the same
marked contrast to the successful strategies pursued in East Asia, where the development state took an active role.

The Consensus on the Failures of the Washington Consensus

The post-Washington Consensus consensus goes further in detailing the nature of the failures of the Washington Consensus. There was a failure in understanding economic structures within developing countries, in focusing on too narrow a set of objectives, and on too limited a set of instruments.

The Limits of Market Fundamentalism: Theory

For instance, markets by themselves do not produce efficient outcomes when information is imperfect and markets are incomplete (true in all countries, but especially in developing countries) or when technology is changing as a result of R&D expenditures or learning, or more generally, when there is learning, for instance, about markets.

The intellectual foundations of the Washington Consensus had been badly eroded even before its doctrines became widely accepted. The fundamental theorems of welfare economics provided the rigorous interpretation of Adam Smith's invisible hand, the conditions under which and the sense in which markets lead to efficient outcomes. Under these theorems, it turned out, markets were efficient only if capital markets were impossibly perfect—at least in the sense that there be no missing risk or intertemporal markets. There could be no externalities (no problems of air or water pollution), no public goods, no issues of learning, and no advances in technology that were the result either of learning or expenditures on R&D. Greenwald and Stiglitz (1986) went further and showed that there also could not be any imperfections of information, changes in the information structure, or asymmetries of information. These problems are serious in any economy, but are at the heart of development.

There are important externalities in these dynamic processes, which give rise to an important role for government. The successful East Asian countries recognized this role; the Washington Consensus policies did not. In short, there is no theoretical underpinning to believe that in early stages of development, markets by themselves will lead to efficient outcomes.

The Limits of Market Fundamentalism: History

Historical experience also provided little support to the belief that markets, by themselves, would lead to rapid development. While there is an active debate about the particular role of each of the industrial policies undertaken by each of the East Asian countries, there is a clear link between the policies and the successes. The township and village enterprises in China (publicly owned at the local level) were central to China's success in the 1980s and early 1990s. The individual responsibility system, which was far short of full privatization of land (which market fundamentalists claimed was necessary), was responsible for the enormous increase in agriculture productivity. And it is hard to conceive that Korea or Taiwan would have become the industrial players of today without having undertaken active industrial policies. All of the countries in East Asia had high savings rates, and it is at least plausible that the government policies designed to stimulate savings actually did what they were intended to do. While firms in the rest of the world complain about a shortage of capital, the governments of East Asia provided capital to those firms that were proving their mettle by exporting, especially in technology sectors where there were likely spillovers to the rest of the economy. To be sure, all of this could have been an accident; it is even possible that, as some critics of these policies claim, the East Asian countries might have grown even faster in the absence of industrial policies. Anything is possible, but there is no reason to believe that this is the case, and the weight of the evidence points in the other direction.

If the success of East Asia suggests the desirability of a larger role for government in successful development than was traditionally emphasized in the Washington Consensus policies, the failures in sub-Saharan Africa and Latin America have reinforced the doubts about the Washington Consensus strategies (Stiglitz 2002a). Growth in Latin America during the 1990s—the decade of reform—was just half of what it was in the 1960s and 1970s, the decades marked by the 'failed' policies of import substitution. Surely, there were problems with the import substitution strategy and it would have had to evolve, as it did in East Asia, into a strategy based more on exports. It was the debt crisis, however, and not the shortcomings of the development strategy that brought an end to the period of high growth. Success under reform

3 See, for instance, Stiglitz (1998). This chapter extends and updates the arguments I made in that paper.

4 See, for instance, World Bank 1993; Wade 2003.

5 The general theory for why such policies may be desirable is set forth in Greenwald and Stiglitz (2006).
was even more short lived (less than a decade), and the end of that success (beginning in 1997) was directly related to the failures of the reform strategy. The openness of capital markets exposed the countries to the volatility of international capital markets, which had adverse consequences in the global financial crisis of 1997–98.

In Africa, the costs of a simple-minded belief in the magic of the market were palpable and huge. For example, policy conditionalities imposed on the region’s countries too often focused much too narrowly on liberalization of agricultural prices without adequate attention to the prerequisites to make such liberalization effective, for example, functioning markets for inputs and outputs, credit availability, and infrastructure (especially roads). The insistence on static comparative advantage foreclosed the kind of dynamic changes that underlay the successes in East Asia—had Korea stuck with its static comparative advantage, it would still be growing rice. But there were a further set of problems, illustrating the fallacy of composition, whereby increasing exports of commodities by many countries with similar comparative advantages led to a collapse in their prices. Financial sector reforms focused excessively on making interest rates market-determined in very thin and rudimentary markets, which often led to prolonged periods of very high interest rates without improving the availability of credit.

If there were fruits of the Washington Consensus, they are yet to be enjoyed, at least by the average citizens of many developing countries. Early followers of the Consensus, such as Bolivia, still ask: “We have felt the pain, when do we get the gain?” If Consensus reforms exposed countries to greater risk, the policies did not provide the citizens of their countries with adequate protections, with the kinds of safety nets that could even partially insulate them from the consequences; nor did they provide these countries with the strength for a rapid recovery; in Latin America as a whole, there followed almost a half decade of declining per capita income.

The fact that countries that followed the Washington Consensus policies grew more slowly than those that did not, by itself, have been enough to lead countries to abandon these strategies. But the International Monetary Fund (IMF) urged patience developing countries were told that growth was just around the corner. They were told that if they abandoned the Washington Consensus policies, all the pain and suffering that they had experienced would be for naught.6

It was the crises, especially in countries like Argentina that had received an A+ grade from the IMF, that finally resulted in global disillusion with the Washington Consensus, as marked by the Barcelona conference.

But even before this, there was growing awareness that several of the policies that they had pushed seemed flawed: privatizations marred by corruption,

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6 The reluctance to abandon failed strategies is a well-documented phenomenon in all bureaucratic institutions (sometimes referred to as the principle of escalating commitment).
to governments that are ‘published’ (and adopting other measures of the extractive industries transparency initiative).

- IMF accounting practices continue to put a roadblock in the way of market-based land redistribution.

While the IMF talked about the need for greater safety nets, it did not focus squarely on the factors that contributed to economic volatility, including capital market liberalization. Instead, it continued to advocate capital market liberalization, long after the adverse effects on stability became clear and evidence mounted that it did not contribute to economic growth. The IMF continued to focus on the inadequacies in the developing countries and not those in the Washington Consensus policies; blame was squarely placed on the developing countries for their problems, especially those related to lack of transparency and poor governance.

A Balanced Role for Markets and Government

The political agenda was most evident in the Washington Consensus’ reliance on market fundamentalism—the belief that markets by themselves lead to economic efficiency, that economic policies should focus on efficiency, and that distributional concerns could and should be taken care of elsewhere in the political process. The policies pursued by the international financial institutions that came to be called ‘Washington Consensus policies’ or ‘neoliberalism’ entailed a much more circumscribed role for the state than was embraced by most of the East Asian countries, a set of policies that (in another simplification) came to be called the ‘development state.’

To be sure, governments can make matters worse. No doubt, the Washington Consensus represented, in part, a reaction to failures of the state in attempting to correct failures of the market. But the pendulum swung too far in the other direction and for too long. The Washington Consensus policies often assumed the worst about the nature and capability of all governments, and, in its quest to find a ‘one-size-fits-all’ policy, gave up on trying to improve governments, arguing that it was better simply to rely on markets by themselves. This resulted in a strong bias against basing policy advice on an analysis of what interventions are appropriate in what contexts, or building the institutions or capacity of states to intervene effectively.

What is at issue then is not just the size of government, but its role—what activities should it undertake—and the balance between government

7 Finally, in March of 2003, even the IMF recognized these problems—almost six years after it had tried to change its charter to force developing countries to liberalize their capital markets. It remains uncertain, however, the extent to which these findings have altered the policy prescriptions that it gives at the country level. See, for instance, Prasad et al. (2003).
and efficiency and equity were inextricably interlinked. Interestingly, several sources of these interlinkages (e.g., associated with agency problems) had been analyzed in the context of developing countries 15 years before the formulation of the Washington Consensus (see, e.g., Stiglitz 1974).

Ignoring distributional concerns meant that sometimes even improvements in efficiency were compromised. For instance, land reform, which would have reduced the scope for (and inefficiencies associated with) agency problems in tenancy, would have simultaneously improved equity and efficiency. Sharecropping, a prevalent form of land tenancy in developing countries, has resulted in an effective tax rate of 50 percent, and in some cases 66 percent, on some of the poorest people. It is ironic that while the IMF and the advocates of the Washington Consensus often railed against the distortions arising from high tax rates, land reform, which should have been even more important, was seemingly not high on the agenda. While the international financial institutions talked a great deal about ‘getting incentives right,’ they never addressed this incentive problem.

Confusing Ends with Means

Even worse than the formulation of too narrow a set of objectives was the fact that, too often, the IMF confused means with objectives—privatization and liberalization, for instance, became not means to an end, but ends in themselves. Sometimes privatization makes sense. But it matters how privatization is done; if done in the wrong way, growth can be reduced and societal welfare lowered. The pursuit of rapid privatization in the former Soviet Union contributed to the enormous increase in inequality, compromising the legitimacy of private rights, at least those acquired in the privatization process, and perhaps even of the market system. Low inflation was seen as an objective in itself; excessively tight monetary policy led to the growth of barter, which undermined market efficiency as equally as inflation. Capital market liberalization did not lead to faster economic growth, but did lead to more instability.

The Evolving Washington Consensus

As the failures of the Washington Consensus became increasingly evident—especially after the crises, beginning with the Mexican crisis and followed by the East Asian crises, the Russian crisis, and the Argentine crisis—it has evolved, to what is sometimes called the ‘Washington Consensus Plus.’ The advocates of the Washington Consensus successively tried to modify the prescription. But even as it changed, the underlying problems, based on a flawed understanding of market economics and a too narrow set of objectives (even if those objectives did expand slightly), persisted.

From Resources to Policies

The Washington Consensus represented an advance in one respect over earlier approaches to development, which saw developed and less developed countries differing largely in their resources. Thus to make more resources available, a ‘bank’ was put at the center of the world’s efforts to promote development. Interestingly, the creation of the World Bank (as well as the IMF) reflected recognition of the importance of market failures. If the neoclassical model were correct, the shortage of capital would be reflected in higher returns to capital, and private markets would ensure the flow of capital from the capital-rich advanced industrial countries to the capital-poor developing world. But particularly at the time of the founding of the World Bank, such flows were limited; and even in the temporary heyday of capital flows, the mid-1990s, before the global financial crisis, the funds went mostly to a limited number of countries, and for limited types of investment. Many countries seemingly faced credit constraints (see, e.g., Eaton and Gerzovitz 1981). (It was in this sense ironic that international institutions founded in recognition of a market failure should premise so much of their analysis on models that paid insufficient attention to these failures.)

By the early 1980s, however, it was recognized that projects were not enough. The Washington Consensus thus focused on policies—policies of privatization, liberalization, and stability (which meant, in practice price stability).

From the Washington Consensus to the Washington Consensus Plus

When these policies failed to produce the hoped-for results, the diagnosis changed, and it was argued that these policies needed to be supplemented with additional policies: the Washington Consensus Plus. What was added depended on the criticism that was being leveled and on the nature of the failure that was being recognized.

When growth failed to materialize, ‘second generation reforms,’ including competition policies to accompany privatizations of natural monopolies, were added. When problems of equity were noted, the ‘Plus’ included female education or improved safety nets.
Mexico showed that even if a country got its own fiscal house in order and kept inflation in check, it could have a crisis. The problem, supposedly, was a lack of domestic savings. But when East Asian countries faced crisis—countries with the highest rates of savings in the world—a new explanation was sought. Now, it was lack of transparency (they seemingly forgot that the last set of crises were in the Nordic countries, which were among the most transparent in the world). Weak financial institutions were to blame, but if such weak institutions were found in the United States and other advanced industrial countries (which had banking crises in the late 1980s and early 1990s), what hope did the developing countries have? By this point, the IMF/US Treasury/Washington Consensus advice rang hollow: ex post, they could always find something that was wrong, and add something to the increasingly long laundry list of what countries should do.\footnote{11}

From the Washington Consensus Plus to the Washington Consensus Plus Plus

When all of these versions of the Washington Consensus Plus also failed to do the trick, a new layer of reforms was added: one had to go beyond projects and policies to the reform of institutions, including public institutions, and their governance.

In some ways, this represented a more fundamental change in perspectives, but in other ways it was a continuation of the same mindset. Government had long been viewed as the problem and markets as the solution. The questions should have been: what can we do to improve the efficiency of both markets and the government? What is the right balance between the market and government and how should that balance change over time, as markets improve and the competencies of governments change? Rather than asking these questions, the Washington Consensus had ignored market failures, viewed government as the problem, assumed that governments could not be reformed, and proposed massive scalebacks in government. Belatedly, it recognized the need to improve government, and that many of the countries where development was not proceeding suffered not from too much government but from too little. But there remained a lack of balance. For instance, rather than asking if public pension systems could be strengthened, the Washington Consensus continued to focus its attention on privatization.

\footnote{10} I deliberately drop the World Bank from the trilogy, because by this point, it had joined the critics on many of the elements of the Washington Consensus.

\footnote{11} Jason Furman and I tried to do a somewhat serious job of ascertaining what might be meant by a country having policies or institutions that made it “vulnerable” to a crisis, by looking across countries to see what, if any, characteristics were systematically associated with an increased likelihood of having a crisis. Not surprisingly, the East Asian countries that the IMF had suggested were particularly vulnerable do not appear to be so in our analysis. See Stiglitz and Furman (1998).

When deficiencies in private pension schemes were noted (e.g., their higher administrative costs, problems of adverse selection, the failure to insulate old age pensioners against risks of market volatility or inflation, and the difficulty of preventing fraud), the problems were ignored or attempts were made to address the market failures, but it was simply assumed that it would be easier to make markets work than to make public institutions work.

Neither was the link between policies and institutions, or between institutions and society, adequately recognized. The IMF told countries to have good institutions, and examples of good institutions were exhibited, but there was little to say about how to create such institutions. It was easy to instruct countries on good economic policies: simply cut the budget deficit. But an injunction to have honest institutions was much more complicated.

Just as there was controversy about what constituted good policies, so too was there controversy about what was meant by good institutions. Countries were told to be democratic, but there is no subject of greater concern to the citizens of most developing countries than economic performance. To make matters more confusing, developing countries were told that one central ingredient, monetary policy, was too important to be trusted to democratic processes. As part of the conditionality imposed to obtain loans, countries were given short deadlines to reform social security programs or to privatize or to change the charter of their central banks, to engage in reforms that the democracies of many advanced industrial countries had rejected. There was a failure to recognize that the issuance of such demands put public institutions into an impossible bind: if governments failed to comply, they lost credibility, as they were accused of not doing what was right for their country. If governments acceded to the demands, they also lost credibility, as they appeared to be simply following the orders of the new colonial masters. When the reforms failed to deliver on the promises, which happened in country after country, the governments again lost credibility. The weaknesses in public institutions were thus caused in part by the Washington institutions.

There were other important instances of policies interacting with institutions in ways that were adverse to economic performance. High interest rate policies in Russia (and the failure to create viable financial institutions to supply credit to new and expanding enterprises) made asset stripping more attractive than wealth creation; and weakened support for the creation of the kind of rule of law that would have facilitated wealth creation (see, e.g., Hoff and Stiglitz 2004).

Thus, even as the Washington Consensus began to expand the list of what was to be done, its perspectives remained too narrow. Broader goals and still more instruments were required. A more fundamental change in mindset was needed.

But the criticism now went further. One of the longstanding criticisms of the Washington Consensus and the IMF was not just the failure to understand
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It was argued that they failed to take into account adequately politics and political processes, and how they are intertwined with economics. But governance entails political processes, and while the attention newly focused on governance was welcome, these limitations—and the imperfections in the international institutions’ own governance itself—meant that the IMF and the Washington Consensus had less to contribute on the subject than one might have hoped. Even when what they said may have had more than a grain of truth, the international economic institutions lacked the credibility required for their messages to have the desired impact.

Institutional Failures at the International Level

The focus on institutions had one salutary effect: it shifted attention to the problems in the international economic institutions themselves. One of the problems, the ‘democratic deficit,’ and the lack of political legitimacy, is discussed at greater length in Chapter 14, on ‘The Future of Global Governance’ (as well as elsewhere, e.g., Stiglitz 2002a). Close links with financial markets (not just its governance structure, which is directed accountable to finance ministers and governors of central banks, both typically from financial markets, but also through a ‘revolving door,’ through which staff go from and return to financial markets) contribute to its seeing the world through a lens similar to those that predominate there (accounting for greater faith in markets than either theory or evidence warrants)—and taking actions that reflect their interests (the interests of foreign creditors) more than the interests of the developing countries, which was so evident during the East Asian crisis. But institutional imperatives even account for one of the aspects for which the IMF has been so roundly criticized, its one-size-fits-all prescriptions, also evident during the East Asia crisis, when it tried prescriptions that might have been appropriate during the Latin American crisis, on the countries in the region. There was no subtlety of diagnosis—an attempt to recognize the defining characteristics of East Asian economies, that had contributed to their success over a period of more than three decades—that one might have hoped for. But in defense of the institution, countries that call upon the IMF have to receive the same treatment, the same advice, no matter who the institution sends to the country; it is far easier to accomplish this if there is a strong doctrine, a simple recipe, which can mechanically be followed in the analysis of each country’s problem. Moreover, IMF staffers have to be replaceable parts, and this in turn makes it a place less attractive to those with the capacities and drive to understand the subtle but often important ways in which countries differ.

Some Elements of an Emerging Consensus

So far, I have described several elements of an emerging consensus—or, at least, a broadly shared view—about the inadequacies of the Washington Consensus and its excessive belief in market fundamentalism. There is also a broad consensus that the international economic institutions have created unfair rules of the game (most evident in the case of trade, see, e.g., Stiglitz and Charlton 2005) and have foisted failed policies on developing countries that are dependent on these institutions and on donors for assistance. While many of the policies of the developing countries have themselves contributed to their own failure, the difficulties of development need to be recognized: tilting the playing board against developing countries makes their task all the more difficult, even for an honest and committed government.

I have written extensively elsewhere on what accounted for these failures: the role of historical experiences and honest differences in economic analysis and in the interpretation of statistical evidence, versus the role of ideology and special interests. In recent years, the economics profession has paid more attention to institutions, the incentives confronting the institutions and those within the institutions, and the relationships between governance, organization design, and organization behavior. Such analyses have provided insights into the behavior of the IMF and the WTO (see, e.g., Stiglitz 2001). Of concern is not only what has been done, but what has not been done—for instance, the failure to address the problems posed by the international reserve system, sovereign defaults, and the inadequacy of the system of sharing the risks of interest rate and exchange rate fluctuations between developed and less developed countries.

There are several more elements of a post-Washington Consensus. The first is that a post-Washington Consensus consensus cannot be arrived at simply within the confines of Washington. The development of a successful development strategy will have to involve those in the developing world in an important and meaningful way.

The second is that one-size-fits-all policies are doomed to fail. Policies that work in one country may not work in others. The contrast between the success of the East Asian economies, which did not follow the Washington Consensus, and those that did has become increasingly clear. However, the question remains, to what extent can the policies that worked so well in East Asia be transferred to other countries?

A third is that there are some areas in which economic science has not yet provided sufficient evidence, sufficiently strong theory, or empirical evidence, to result in a broad consensus about what countries should do. There may be a broad consensus against ‘excessive protectionism’ that only serves the interests of special interests, but there is no consensus that rapid liberalization, especially in a country with high unemployment, will lead

12 A subject I have written about extensively, e.g., in Stiglitz (2002a).
to faster economic growth. It may only lead to more unemployment. The usual argument that liberalization frees resources to move from unproductive, protected sectors into more productive export sectors is unconvincing when there are ample unutilized resources already available. In these cases, there is an emerging consensus: countries should be given room to experiment, to use their own judgment, and to explore what might work best for them.

A fourth is that successful development requires not the minimal role assigned to the state by the Washington Consensus, but a balanced role. The exact role may differ from country to country, depending on the stage of development of market and public institutions. In every successful country, government plays a critical complementary role with markets, for example in regulating financial institutions. In the most successful countries, government has taken on the broader set of roles associated with the developmental state.

A fifth point of consensus is that development requires strengthening of both market and state institutions.

And a final point of consensus is that success is to be measured not just by an increase in GDP, but by a broader set of measures—including those that assess environmental and social sustainability. Greater attention must be paid too to issues of distribution; a development strategy that leads to increases in GDP with most citizens not sharing in the fruits of that growth is not a success; and such a development strategy will almost surely not be sustainable over the long run.

Though it may not be possible to formulate simple prescriptions applicable to all countries, there may still be some principles and a range of instruments to be adapted to the circumstances of each country. The Barcelona Conference provided us an opportunity to explore some of the possible principles and some of the possible reforms, both in the policies pursued by individual countries and by the global community.

We addressed two broad sets of issues: first, what can each country, on its own, do to enhance sustainable, stable, equitable, and democratic development? As the developing countries approach this problem, they must take the world as it is, with the inequities in the global trading system and the instabilities in the global financial system. But that brings us to the second question: How should the global economic architecture be changed, to make the global economy more stable, to promote equity among countries, and to enhance the ability of developing countries to pursue their objectives—especially the goals of sustainable, stable, equitable, and democratic development? While it is difficult to touch upon all the facets of this question, we can discuss, or at least touch upon, a few of the central reforms, including, or especially, reforms in global governance.

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References


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The Barcelona Development Agenda

We*, a group of economists from developing and developed countries, met in
Barcelona on September 24 and 25, 2004 to consider the prospects for growth
and development around the world. We discussed the effects of economic
reforms adopted by many developing nations over the last two decades, the
lessons for economic policymaking that emerge from this experience, and
the performance of the international economic system into which poor and
middle-income countries are increasingly integrated.

We noted three encouraging trends:

- The gains made in human rights, democracy, and the rule of law in many—but regrettably not all—developing nations.

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