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The Post Keynesian retort to "After the Washington Consensus"

Abstract: *The term "Washington Consensus," as John Williamson, the father of the term conceived it, in 1989, was a set of reforms for economic development that he judged the international financial organizations could agree were required in Latin America. Meanwhile, the Washington Consensus received a vast amount of criticism. The policy set was modified, by 2003, to the point that Williamson substituted the original name with a new label "after the Washington Consensus." The "after the Washington Consensus" designated a "new" set of policy reforms for Latin America and developing countries. The aim of this paper is to compare the two sets of controversial policies, the "Washington Consensus" and "after the Washington Consensus," and offer an alternative based on the Post Keynesian framework.*

Key words: *international development, Latin America, Post Keynesianism, Washington Consensus.*

The Washington Consensus (WC), developed in 1989, has been evolving as a prescription for international development under the pressure of criticism, evaluation, and the dynamic nature of economic conditions. By 2003, the policy set was modified to the point that John Williamson, the father of the term, substituted the original name with a new label, "after the Washington Consensus" (AWC). The AWC designated a "new" set of policy reforms for Latin America and developing countries. Nevertheless, the critique of the reforms has been concentrated, especially by Post Keynesians, to either the original WC or the post-WC developed by Stiglitz (1998). Thus, there appears to be a vacuum in the literature. Post Keynesians have to offer an alternative for international development to

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the modern conceptualization of the WC in the form of the AWC. The purpose of this paper is to develop and present recommendations based on Keynes's ideas and Post Keynesian ideals contrasting the AWC. The paper dismisses slogans "we already know what must be done" or the common phrase "TINA" (there is "no alternative") as inexorably and precariously mistaken (Chang and Grabel, 2004, p. 1; Ocampo, 2002, p. 406). The paper contributes and determines in a systematic way an alternative to current international development policy from a Post Keynesian perspective that, to my knowledge, has not been attempted before. Students of international development would benefit from these findings, as they would be able to distinguish between the alternative set of development programs, the original WC, the AWC, and the Post Keynesian alternative, and identify the interrelationships and disagreements between these programs. The structure of the paper is as follows: the next section presents the AWC and its relationship with the original WC. The third section proposes the Post Keynesian retort, and the fourth section concludes.

After the Washington consensus

In fall 1999, during a conference at Princeton University, Pedro-Pablo Kuczynski expressed his concern to Williamson about the economic stagnation in Latin America. Kuczynski suggested, as had been done before, convening a team of experts for a comprehensive reassessment of the situation in Latin America and make recommendations. A team was established and a book was produced as a result, edited by Kuczynski and Williamson (2003) titled *After the Washington Consensus: Restarting Growth and Reform in Latin America*. In the following, I outline the policies of the AWC based on Kuczynski and Williamson (ibid.) in the order presented by them with the stipulation how each policy relates to the original WC and placed in Table 1.

New agenda I: crisis proofing

Crisis proofing is an objective of highest priority. Governments should attempt to reduce vulnerability to crises and stabilize the macroeconomy "à la Keynes" (Williamson, 2004–5, p. 202). Volatility also explains the high unequal distribution of income. This policy requires stabilizing inflation (consistent with the original WC), stabilize the real economy through Keynesian policies, subnational governments subject to hard budget constraints, establish a stabilization fund, flexible exchange rates, minimize the use of the dollar, monetary policy targeting a low rate of

Table 1
After the Washington Consensus, the Washington Consensus, and the Post Keynesian alternative

After the Washington Consensus	Policies	Original Washington Consensus	Post Keynesian alternative
New agenda I: Crisis proofing			
Stabilizing inflation, subnational governments subject to hard budget constraints, increasing domestic savings.	Fiscal discipline	Small budget deficit financed without resource to inflation tax.	Public investment directed to the optimum level of employment, not inflation. Industry policy.
Stabilize the real economy through Keynesian policies, establish a stabilization fund.	Public expenditure priorities	Redirect expenditure from politically sensitive areas to fields with the potential to improve income distribution, such as primary education, health care, and infrastructure.	Modern welfare state and expenditure on social programs, including the provision of public education, training, public health, housing, water and sanitation, parks and public amenities, environmental preservation, food security, affordable clothing and shoes, and public transportation, can have relatively low managerial costs, and they improve the standard of living of the poor directly.
Maintaining the low inflation rate targeting and financial liberalization by supplementing the strengthening prudential supervision.	Financial liberalization	Market-determined interest rates.	Prudential regulation and capital controls, dependent central banks and development banks, provision of long-term finance, financing projects essential to development, such as investment in infrastructure and the promotion of infant industries, autonomous rate of interest, and the establishment of development banks.
Flexible exchange rates minimize the use of the dollar.	Exchange rates	A unified competitive exchange rate.	Adjustable pegged exchange rate. Exchange rate anchor as part of domestic price stabilization policy.

(continues)

Table 1
Continued

After the Washington Consensus	Policies	Original Washington Consensus	Post Keynesian alternative
New agenda II: Completing first-generation reforms			
As the original Washington Consensus. Stabilizing inflation, subnational governments subject to hard budget constraints, increasing domestic savings.	Fiscal discipline	Small budget deficit financed without resource to inflation tax.	Public investment directed to the optimum level of employment, not inflation. Industry policy.
As the original Washington Consensus. Stabilize the real economy through Keynesian policies, establish a stabilization fund.	Public expenditure priorities	Redirect expenditure from politically sensitive areas to fields with the potential to improve income distribution, such as primary education, health care, and infrastructure.	Modern welfare state and expenditure on social programs.
As the original Washington Consensus. Establishing property taxation as the major source of revenue, elimination of tax loopholes, and taxing income earned on flight capital.	Tax reform	Broadening the tax base and cutting marginal tax rates.	Establishing a modern tax system; expanding the tax base; increasing tax revenues; redistributing income; strong enforcement of the existing tax laws; the reduction, preferably the elimination, of deductions, exemptions, and loopholes favoring the well-off; increase in the tax rates; taxing wealth and large or second properties in rural and urban areas; and taxing interest income, capital gains, financial transactions, and international capital flows.

As the original Washington Consensus. Maintaining the low inflation rate targeting and financial liberalization by supplementing the strengthening prudential supervision.	Financial liberalization	Market-determined interest rates.	Prudential regulation and capital controls, dependent central banks and development banks, provision of long-term finance, financing projects essential to development, such as investment in infrastructure and the promotion of infant industries, autonomous rate of interest, and the establishment of development banks.
As the original Washington Consensus. Flexible exchange rates minimize the use of the dollar.	Exchange rates	A unified competitive exchange rate.	Adjustable pegged exchange rate. Exchange rate anchor as part of domestic price stabilization policy.
As the original Washington Consensus. Complementing import liberalization with better access to export markets in developed countries.	Trade liberalization	Replace quantitative trade restrictions with tariffs of around 10 percent to 20 percent.	Establishment of the International Clearing Union, involving fixed but adjustable exchange rates, capital flow restrictions, and surplus nations initiating the path toward the reduction of imbalances.
As the original Washington Consensus.	Foreign direct investment	Abolish barriers to entry for foreign firms.	Joint with national development and/or industry policy.
As the original Washington Consensus. Continuing the privatization program, even though in some cases it was carried out badly.	Privatization	State enterprises should be privatized.	Maintaining state-owned enterprises.

(continues)

Table 1
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After the Washington Consensus	Policies	Original Washington Consensus	Post Keynesian alternative
As the original Washington Consensus. Liberalizing the labor market.	Deregulation	Abolish regulations that impede entry of new firms or restrict competition.	Make it trying for firms to increase profitability by reducing wages, extending the working day, or reducing working conditions. Productivity growth and better working conditions can also be encouraged by legislation increasing the minimum wage and reducing wage dispersion, supporting trade unions, and offering tax and other incentives for firms investing in priority sectors that introduce new technologies and pay high wages.
As the original Washington Consensus. Provide property rights to the informal sector, land reform.	Property rights	Secure property rights that are also available to the informal sector.	Recognizing the importance of property rights for an entrepreneurial market economy. Reform of land tenure.

New agenda III: Second-generation reforms			
A role for the state: maintaining effective institutions, in providing public goods; internalizing externalities; correcting income distribution; providing decent infrastructure, a stable and predictable macroeconomic, legal, and political environment, and a strong human resource base. Reforming the judiciary, education, and civil services; building a national innovation system; modernizing the market institutional structure; and institutional reform in the financial sector.	Institution building	Not a concern.	Institutions are endogenous to each society to guarantee social cohesion and manage conflict.

(continues)

Table 1
Continued

After the Washington Consensus	Policies	Original Washington Consensus	Post Keynesian alternative
New agenda IV: Income distribution and the social sector			
Establishing property taxation as the major source of revenue, elimination of tax loopholes, and taxing income earned on flight capital.	Tax reform	Broadening tax base and cutting marginal tax rates.	Establishing a modern tax system, expanding the tax base, increasing tax revenues, redistributing income, strong enforcement of the existing tax laws, the reduction preferably the elimination of deductions, exemptions and loopholes favoring the well-off, increase in the tax rates, taxing wealth and large or second properties in rural and urban areas, and taxing interest income, capital gains, financial transactions and international capital flows.
Expanding opportunities for the poor, spending on basic social services, social safety net, education and health, provide property rights to the informal sector, land reform and microcredit.	Public expenditure priorities	Redirect expenditure from politically sensitive areas to fields with the potential to improve income distribution, such as primary education, health care, and infrastructure.	Modern welfare state and expenditure on social programs, including the provision of public education, training, public health, housing, water and sanitation, parks and public amenities, environmental preservation, food security, and affordable clothing and shoes, and public transportation can have relatively low managerial costs and they improve the standard of living of the poor directly.

inflation, strengthening prudential supervision, and increasing domestic savings. This policy is related with the original WC and is placed in Table 1 in the entries of fiscal discipline, public expenditure priorities, financial liberalization, and exchange rates.

New agenda II: completing first-generation reforms

The reforms of the WC should be completed rather than reversed. This policy is related to the original WC and is placed in Table 1 in all the entries.

New agenda III: second-generation reforms

In the 1990s a key innovation in development economics was the recognition of the crucial importance of institutions in ensuring that the economy functions effectively, termed by Naim (1994) as "second-generation reforms." A vital role for the state, which is perfectly consistent with mainstream economics, as the father of the term argues, is creating and maintaining effective institutions, in providing public goods; internalizing externalities; correcting income distribution; providing decent infrastructure, a stable and predictable macroeconomic, legal, and political environment, and a strong human resource base. The second generation of reforms involves, in addition to the above, reforming the judiciary, education, and civil services; building a national innovation system (to promote the diffusion of technological information, fund precompetitive research, providing tax incentives, encouraging venture capital and industrial clusters); modernizing the market institutional structure (property rights and bankruptcy laws); and institutional reform in the financial sector (strengthening prudential supervision). This policy is placed in a new row in Table 1, institution building.

New agenda IV: income distribution and the social sector

The father of the term argues that growth is always pro-poor, as benefits trickle down; however, the poor will not benefit as much because they do not have many resources to start with, as in Latin America. Hence, there is a need for supplementing the gains of growth with a degree of income distribution. Progressive taxes are the traditional means for income redistribution, namely, levying heavier taxes on the wealthy. While tax reforms have been implemented to broaden the tax base in Latin America by shifting from direct to indirect taxation, Williamson (2003a, p. 16) now is in favor of reversing the process and increasing direct tax revenue by establishing property taxation as the major source of revenue, eliminating tax loopholes, and taxing income earned on flight capital. To reduce inequality, the increase in tax revenue should expand opportunities for the poor and fund basic social services, the social safety net, education, and health. Income distribution is related with the original WC and placed in Table 1 in the tax reform entry; the social sector is placed in the public expenditure priorities entry.

There is significant overlap between the original WC and the AWC set of policies; "but the overlap is not complete" (Williamson, 2003c, p. 320). Some of the original reforms of the WC—liberalization of foreign direct investment and interest rates—were achieved. New reforms were added, such as empowering the poor and crisis proofing. This is quite expected; as time passed, the relevance of the original reforms and research and events modified what was professed as urgent. "Of course, none of this argues for abandoning what I meant by the Washington Consensus" (Williamson, 2003b, p. 329). This time though there is less danger that the new list will be mistaken for a cookbook, as Williamson has argued (2004–5, p. 205).

A Post Keynesian alternative to "after the Washington consensus"

The Post Keynesian development agenda rests on the following principles: a balanced form of globalization that respects diversity; macroeconomic stability based on countercyclical policies and on human, social, and productive development (Ocampo, 2002, p. 393). At the same time, Post Keynesians argue that at the root of the economic crises striking developing economies, similar to those experienced in the nineteenth century (Kregel, 2008, p. 541), are the policies of the WC based on stringent macroeconomic discipline, a free market, and unhindered openness to the world. Nevertheless, rejection of the WC does not imply also rejection of the market system (Davidson, 2004–5, p. 217). Post Keynesians criticize the pace at which reforms were/are implemented as well as the reforms themselves. Meanwhile, regarding the debate about the pace of reform, there is a line of reasoning that shock therapy, as implemented in Russia and Eastern Europe, is not consistent with the WC, as implemented in Latin America (Marangos, 2007; Williamson, 2007).

The main purpose of the Post Keynesian policy framework proposed in this paper is to go beyond the AWC by emphasizing the importance of a possible new direction for economic policy for developing countries. These policies should deal with the string of economic crises occurring among developing countries and propose a new approach to help developing countries grow and prosper. In this context, "crises are usually catalysts for change, and debt crises are no different" (Neto and

Vernengo, 2004–5, p. 333); thus, it is time for change in international development policy. I offer below a comprehensive overview of the policy reforms and present recommendations based on Keynes's ideas and Post Keynesian ideals on how to essentially "reform the reforms" or, even better, "form new reforms" to bring Latin America and developing countries out of their current demoralized miserable state. While I label the policies "Post Keynesian," it is possible that economists whose ideas and policy prescriptions I am using may not be comfortable with the label "Post Keynesian." Nevertheless, I would argue that the recommended policies are consistent with the Post Keynesian propositions. In the following, I outline the policies proposed by Post Keynesians with the stipulation how each policy relates to the AWC and the original WC and placed in Table 1.

Fiscal discipline

Fiscal discipline, rather than fiscal policy, came first on Williamson's wish list because there was concern that the high fiscal deficits were to blame for macroeconomic instability, generating inflation on one hand and fears of default on the other, leading to balance-of-payments problems. Fiscal discipline in general is associated with nominal fiscal results; in other words, discipline hinges on whether the government on all its levels has a surplus or not over its expenses. Thus, fiscal discipline caused a major dilemma for Latin America because of the widespread use of fiscal deficits as a macroeconomic policy tool. Meanwhile, implementing the WC came with a commitment to maintain primary surpluses, even in periods of recession. In contrast, Keynes is known for remaining keenly aware of the limitations of fiscal policy, especially in times of recession. Deficits are the result of recession, not the cause of a recession (ibid., p. 335). If deficits were the result of recession, then the best way to avoid them would be to stabilize the cycle by ultimately stabilizing investment; public investment is the stabilizing factor.

Davidson (2004–5, p. 214), referring to Keynes, suggests that each nation be required to adopt a national investment program directed to the optimum level of employment. Private investments are not necessarily superior to public investments (Chang and Grabel, 2004, p. 195). There has been an overemphasis on inflation targeting that damages the economy while diminishing output and employment; there is no clear relationship between fiscal deficits and inflation (Gnos and Rochon, 2004–5, p. 190; Ocampo, 2002, p. 398; Saad-Filho, 2007, p. 522). The reduction of public investment, as the result of the WC, had an adverse effect on investment as "crowding-in" effects have been more prevalent than the "crowding-out" effects (Neto and Vernengo, 2004–5, p. 341; Saad-Filho, 2007, p. 521). Moreover, the elimination of industrial policies and sectoral incentives had a negative effect on manufacturing investment, a sector that had been traditionally heavily protected and subsidized, during the import substitution and state-led industrialization phase in Latin America (Moreno-Brid et al., 2004, p. 353). In the end, fiscal policy should target economic stabilization, investment programs, and incentives for the private sector to support the government's pro-poor goals (Saad-Filho, 2007, p. 524).

In this context, the rejection of industry policy by the WC contradicts the history of development. Industrial policy refers to policies that favor the development of certain industries or sectors over others with a view to enhancing national economic welfare in the long run (Chang and Grabel, 2004, p. 70). Market actors tend to underestimate the long-term gains of particular activities, such as research and development, and they are not always able to value externalities correctly (ibid., p. 74). Consequently, it is crucial to offer government support for these activities in the form of industry policy, in contrast to the AWC. Meanwhile, there is no single cutout approach for industrial policy across developing countries (ibid., p. 77).

Hence, the Post Keynesian recommendation of increasing public investment by targeting the optimum level of employment, not inflation, and industry policy contradicts the AWC policies of stabilizing inflation, maintaining hard budget constraints, and increasing domestic savings, as placed in Table 1.

Public expenditure priorities

The uninspiring performance of economic growth in Latin America is echoed through social indicators, the most dramatic being the steep increase in the proportion of the poor. Failing to keep pace with the expansion of the labor force, unemployment caused wage gaps to widen further. As a whole, Latin America experienced a reduction in its gross domestic product (GDP) in the start of the new century. It is not surprising that a significant proportion of total expenditure reduction falls upon those groups with the least political and economic power, the poor, the unemployed, the sick, and so forth (Chang and Grabel, 2004, p. 191; Saad-Filho, 2007). Hence, one of the main concerns regarding the WC reforms is the issue of income distribution that is not confronted; for the AWC the unequal distribution of income is the result of volatility. However, deficits have a limited effect on rates of interest; thus, income distribution is affected by the fiscal policy mix (Neto and Vernengo, 2004–5, p. 339). A primary surplus paired with a nominal deficit in Latin American countries implied that the government was paying the difference to debt holders, the difference being interest payments. Since debt holders are usually banks, corporations, or wealthy individuals, income distribution is affected greatly by this policy mix in that the transfer of resources from society as a whole is relocated to wealthy debt holders (ibid., p. 339). Therefore, the effects of fiscal deficits on the level of activity are mediated by income distribution rather than the rate of interest (ibid., p. 339). In wage-led economies, as in the case of many Latin American countries, redistribution toward debt holders, with lower propensity to consume, should lead to output stagnation. The International Monetary Fund's (IMF) prescription of fiscal austerity therefore restricts economic growth and social expenditures, thus harming the poor—the very people who can least afford it. "Cross-country and historical experience show that strategic, well-designed and well-managed programmes of public expenditure are critical to the promotion of economic growth, investment and the alleviation of social ills" (Chang and Grabel, 2004, p. 197).

Meanwhile, the emphasis on a "social safety net," rather than on building a modern welfare state, subordinates social policy to market-based reforms (Ocampo, 2004–5, p. 310). Cash transfers are generally less desirable than public and wage goods programs except for emergency support to very poor groups (Saad-Filho, 2007, p. 531). Instead of the "safety net," improvements in income and wealth distribution and social welfare should be pursued directly, through universal social programs (such as land reform, universal basic education, and training and pensions and other entitlements funded by progressive taxation) that can promote several pro-poor objectives simultaneously. "Social programs including the provision of public education, training, public health, housing, water and sanitation, parks and public amenities, environmental preservation, food security, and affordable clothing, shoes and public transportation can have relatively low managerial costs and they improve the standard of living of the poor directly" (ibid., p. 530). Public expenditures in education, health, and infrastructure "are clear pre- and co-requisities for private investment," expected to *crowd-in* private investment (Chang and Grabel, 2004, p. 183). Retraining unemployed workers with public funds will assist to raise productivity, increase labor flexibility, and reduce structural unemployment while creating incentives for exports and for long-term productivity growth of the economy (Saad-Filho, 2007, p. 525).

Regarding public expenditures, the Post Keynesians favor the establishment of a modern welfare state and directing expenditure toward social programs. For the AWC, public expenditure is directed in stabilizing the economy through "Keynesian" policies financed by a stabilization fund and expanding opportunities for the poor by spending on basic social services, social safety net, education and health, and microcredit; in other words, the minimum on social expenditure.

Tax reform

For the Post Keynesians, the development of a tax system is not only based on revenue considerations but also on the social and cultural background of the society. Preventing tax evasion is at least as important as expenditure reduction in the face of budget deficits (Chang and Grabel, 2004–5, p. 288). Meanwhile, the expansionary fiscal policies in the Post Keynesian framework requires a modern tax system and an expanded tax base (Saad-Filho, 2007, p. 522–523). There is a definite link between tax compliance and civic values (Davidson and Davidson, 1996, pp. 91, 92). In a civilized society of a Post Keynesian mold (Davidson and Davidson, 1996; Marangos, 2000), there is a conscious payment of taxes by members of the society and noncompliance is not considered an alternative. Noncompliance is the result of the diminishing role of civic values in a society. In these circumstances, the decision whether to pay taxes or not comes under scrutiny because of "rational" computation associated with the benefits and costs of deceiving. In addition, enforcement mechanisms for noncompliance will be ineffective as long as there is an imbalance between self-interest and civic values. Simplicity of the tax system encourages compliance. The development of a civilized society encourages tax-paying norms consistent with civic values, whereby individuals pay their taxes as part of their moral duty. "In a civilized society where civic values and self-interest flourish, the citizens must be willing not only to die for their country but also to pay for it" (Davidson and Davidson, 1996, p. 217). This perception of tax-paying norms was in contrast to the neoclassical approach of the AWC, in which individuals were motivated not by moral duty but, rather, by self-interest, according to which it would have been impossible to increase tax compliance. Nevertheless, "the constraint [to tax reforms] is primarily political" (Saad-Filho, 2007, p. 523).

The AWC recommendation is to establish property taxation as a major source of revenue, elimination of tax loopholes, and taxing income on capital flight. Whereas the Post Keynesians propose establishing a modern tax system; expanding the tax base; increasing tax revenues; redistributing income; strong enforcement of the existing tax laws; the reduction, preferably the elimination of, deductions, exemptions, and loopholes favoring the well-off; increase in the tax rates; taxing wealth and large or second properties in rural and urban areas; and taxing interest income, capital gains, financial transactions, and international capital flows.

Financial liberalization

Financial liberalization, defined as freeing financial markets from any intervention and letting the market determine the allocation of credit, is the root of many recent cases of financial fragility and crises. "The appalling performance of financial liberalization policies should not be surprising. It can be readily explained by its problematic theoretical nature and its poor performance at the empirical level" (Arestis, 2004–5, p. 256). In this context, Post Keynesians emphasize the need for greater regulation of financial markets together with a more or less closed capital account that will allow for lower interest payments, lower debt servicing spending, and more space for public investment. Strict prudential regulation and supervision is required, matched with countercyclical direction to smooth out boom–bust cycles (Ocampo, 2002, p. 399).

Arestis (2004–5) argued that before reforms could even be contemplated, much less implemented, certain preconditions must be met and satisfied. His prerequisites include gradual financial liberalization (also known as "sequencing"), achievement of macroeconomic stability, and achievement of adequate banking supervision. Independent central banks are structurally biased toward the interests of the financial sector, an interest group that is mobile, politically powerful, and maintains strong international ties whose only interest is in maintaining low inflation (Chang and Grabel, 2004, p. 182). Monetary policy has such profound distributional and macroeconomic effects, making independent central banks incompatible with democracy (ibid., p. 183). After crises occur, governments either discard policy implementation of financial liberalization, overall, or are forced to intervene by nationalizing banks and guaranteeing deposits. Latin American countries that implemented financial liberalization reforms each suffered banking system meltdowns. Meanwhile, the experience of growth spurts in the developing world—East Asia, China, India, Brazil, and Mexico—did not correspond with periods of all-embracing financial liberalization, in line with the WC (Ocampo, 2002, p. 400). Hence, from a Post Keynesian perspective, the financial system should work for economic development through the provision of long-term finance, financing projects essential to development, such as investment in infrastructure and the promotion of infant industries (Chang and Grabel, 2004–5, p. 280).

There is little evidence that deficits affect the rate of interest. Further, the Latin American experience suggests that the causality between interest rate and fiscal deficit is reversed, that is, a higher interest rate will lead to higher interest payments on debt and higher nominal deficits. The reason is that central banks tend to maintain high short-term interest rates to avoid capital flight, and part of the public debt is indexed to the short-term interest rate. As a result, monetary policy translates into high debt servicing (Neto and Vernengo, 2004–5, p. 338–339). Gnos and Rochon criticize the IMF for imposing policies such as "eliminating budget deficits and adopting highly restrictive fiscal stances, severely cutting current account deficits by forcing recessions, and currency depreciations to cutting back on imports" (2004–5, p. 188) in return for aid. Because these policies are forced on national economies when the capital flows to their emerging economies are reversed, "the complete collapse of aggregate demand ensued" (ibid., p. 188). The interest differentials that produce large capital inflows and currency overvaluation at the same time favor financial assets rather than domestic corporate restructuring to increase productivity to counterbalance the decline in competitiveness caused by the overvaluation of the exchange rate (Kregel, 2008, p. 554).

Davidson (2004–5, p. 214) suggests that a policy of an autonomous rate of interest, unimpeded by international preoccupations, and a national investment program directed to an optimum level of employment, is consistent with Keynes's perception. Hence, international financial reform is the necessary complement to sound fiscal policy (Neto and Vernengo, 2004–5, p. 342). The euthanasia of the rentier is a necessary supplement to the socialization of investment recommended by Keynes, as argued by Neto and Vernengo (ibid., p. 333). The euthanasia of the rentier would imply low rates of interest, which not only would provide a better environment for private investment and full employment but would also make debt servicing and, hence, public investment cost-effective (ibid., p. 337). In this case, the central bank should be able to set the rate of interest independently from any international pressures.

To provide stable and long-term finance to particular sectors and firms of the economy is to create development banks that specialize in long-term financing, as in Brazil, Korea, and Germany. Development banks that can be managed and regulated effectively complement industrial policies and public investment programs. "The challenges of effectively managing these institutions are neither greater nor less than those associated with managing private banks in a liberalized environment" (Chang and Grabel, 2004–5, pp. 280–281).

In the end, the Post Keynesian proposal rests on prudential regulation and capital controls, dependent central banks and development banks, provision of long-term finance, financing projects essential to development, such as investment in infrastructure and the promotion of infant industries, autonomous rate of interest, and the establishment of development banks. The AWC advocates maintaining the low inflation rate targeting and financial liberalization by supplementing the strengthening prudential supervision.

Exchange rate

Davidson (2004–5, p. 212) attacked the insistence of the WC to encourage export-led growth because it is liable to involve an equal disadvantage to some other country. Effectively, "the Washington Consensus has created perverse incentives that set nations against nations in a process that perpetuates a world of slow growth (if not stagnation)" (ibid., p. 217). Chasing the competitive exchange rate with the intention of making domestic industries more competitive in the absence of capital controls risks stability, capital flight, and unemployment becoming a problem for not only the competing economies but also the trading partners of the successful export-led country. Davidson argued that Williamson "still fails to recognize that a policy of changing to a flexible competitive exchange rate can adversely affect the distribution of income in Latin American countries, as the wealthy have means to move their assets to nations with exchange rates that will rise relative to domestic rates—access not readily available to most workers in these Latin American nations" (ibid., p. 216). Even if the search for a competitive exchange rate were to succeed, the result would still tend to increase the global inequality of income and likely reduce domestic living standards. Restricted currency convertibility, along with a managed exchange rate and other financial controls, contributed to South Korea's strong economic performance and financial stability during its rapid growth era (Chang and Grabel, 2004, p. 173).

The growing income inequality that Davidson talks about comes from the differences in the income elasticity of demand for imports and exports. Typically, a Latin American nation has a comparative advantage in exports with an income elasticity of demand that is exhibited by the rest of the world to be lower than the Latin American nation's income elasticity of demand for imports from the rest of the world (Davidson, 2004–5, p. 216). Therefore, even if the goal of securing a competitive exchange rate is ultimately achieved, "[t]he demand for the Latin American nation's exports will tend to grow at a slower rate than their domestic market's demand for imports from the rest of the world" (ibid., p. 216). Thus, the rich developed countries will realize a higher growth rate of income earnings than the Latin American nations. These results do not even take into account population growth, which could further depress the income per capita in Latin America relative to developed nations. In sum, there is a great need to establish a safeguard that "prevents any nation from engaging in a beggar-thy-neighbor, export-thy-unemployment policy by pursuing a real exchange rate devaluation that does not reflect changes in efficiency wages" (ibid., p. 226). In this context, the experience of Argentina with the currency board (1991–2002) clearly demonstrates that currency boards do not protect developing countries from the financial and economic collapse, as it is associated with speculation against currencies (Chang and Grabel, 2004, p. 176).

While the corner solution, either fixed or flexible exchange rates, supported by the WC presents a false dichotomy with the goal of halting inflation, the intermediate solution of managed competitive exchange rates is also not recommended (Kregel, 2008, pp. 550–551). Chang and Grabel (2004, p. 179) support an adjustable pegged exchange rate regime validated by the historical achievements of pegged rates in developing and industrialized countries, but the sustainability of any pegged exchange rate system depends on the presence of capital controls. Kregel (2008, p. 551), in line with the architects of the Bretton Woods system, recommends an exchange rate anchor as part of domestic price stabilization policy. In other words, "whatever the exchange rate regime, it must be managed carefully" (Saad-Filho, 2007, p. 529). However, the AWC is in favor of flexible exchange rates, while the original position was competitive exchange rates and the minimization of the use of the dollar.

Trade liberalization

Keynes provides a rationale for designing an international payment system that foresees that several of the WC reforms cause more problems than provide solutions (Davidson, 2004–5, p. 218). Davidson (ibid.) and Ocampo (2002, p. 397) propose an international trade reform program built on Keynes's Bretton Woods proposals that is essentially aimed at obtaining an international agreement that does not require surrendering monetary policy, domestic banking systems, or fiscal policies and allows a sufficient degree of freedom to governments to pursue their goals. It is essential to long-term development that certain industries are protected from competition of international trade and that smaller countries engage in selective export promotion (Chang and Grabel, 2004, pp. 66–67). The statistical correlation between the degree of openness and growth is not legitimately interpreted as that more open trade causes faster growth. It may be exactly the opposite: faster growth and increased productivity may allow countries to open their trade more rapidly, as the growth in productivity may allow them to compete more successfully in the international market, reducing the need for infant industry protections (ibid., p. 64).

Keynes, especially, insisted on the idea that movements of capital could not be left unrestricted: "[w]e cannot hope to control rates of interest at home if movements of capital moneys out of the country are unrestricted" (1980, p. 276). Meanwhile, "[c]apital controls are not an infringement of the freedom of economic agents' right to move their wealth between countries whenever the spirit moves them any more than making it illegal to shout 'fire' in a crowded theater is an infringement of the individual's right to free speech" (Davidson, 2004–5, p. 218). Controls over capital movements contributed significantly to the strong economic performance of many East and Southeast Asian countries during the 1970s and 1980s (Chang and Grabel, 2004, p. 130).

The balance of payments is probably the most important barrier to sustainable growth in poor countries. It can trigger exchange rate crises, inflation, unemployment, and other destabilizing processes, with serious consequences for the poor (Saad-Filho, 2007, p. 523). In the known failures of economic crisis and recession it is sensible to reexamine Keynes's plan for the international order (Cetrini, 2008, p. 518). Keynes called for an international central bank under a fixed exchange rate system, an international reserve bank being a lender of last resort. The international central bank would have had the power to create an international currency, and its supply would be determined by future growth needs and potential. Keynes insisted on the creation of an International Clearing Union (ICU) based on a bancor unit of account. He helped to devise the Bretton Woods Agreement to encourage intervention, fix exchange rates, and control financial capital (Davidson, 1994, p. 252). In this scheme, creditor nations would have shared the burden of adjustment of payments imbalances with the freedom of deficit nations to choose corrective economic policy. The goal is to encourage economic development in the international economy by creating a system with a built-in expansionary bias for a fundamentally "Keynesian" world that rejects the financial market efficiency hypothesis (Cetrini, 2008, p. 516; D'Arista, 2008, p. 535; Davidson, 1996, p. 503; Wray, 1996, p. 144). The fostering of export growth requires a competitive and stable real exchange rate matched with coordinated industrial policy to develop the country's competitive advantages (Saad-Filho, 2007, p. 527), goals that could be achieved through the ICU. The ICU excluded the private sector from the payments system. Balance-of-payments surpluses and debits would be settled by central banks through the Clearing Union, and the proposal required the imposition of both fixed exchange rates and capital controls to enhance stability and prevent speculative flows (D'Arista, 2008, p. 536).

Davidson updates Keynes proposal, as it does not require that national control of both local banking system and macroeconomic domestic policies to be surrendered. The creation of the ICU would require only an international agreement among its national members, preserving the core of Keynes's plan (Modenesi and Modenesi, 2008, p. 572). Davidson's reform plan for international trade takes into account those systemic features that are at the basis of Bretton Woods's success, fixed but adjustable exchange rates, capital flow restrictions, and surplus nations initiating the path toward the reduction of imbalances (Cetrini, 2008, p. 516).[1] D'Arista (2008, pp. 536–537) also adds the need for creating the institutional capacity to implement countercyclical policy initiatives at an international level as a stable general level of money wages to ensure that effective demand is not guaranteed.

Keynes's original Bretton Woods proposals of increased international liquidity, exchange rates adjustable in case of structural variations of the economies, neutral rather than political character of the new international institutions, and promoting national diversity through freedom to choose were finally abandoned (Cetrini, 2008, pp. 517–518). As well, the current proposed ICU plan has been abandoned because it seriously reduces the role of the international financial institutions, as it requires the reconstitution of a public channel for balance-of-payments settlements, initiating a path that is considered most necessary to reestablish a system that can promote balance and stability around the world (D'Arista, 2008, pp. 537–538). Even so, "[s]ome think that this clearing union plan, like Keynes's bancor plan a half century earlier, is utopian. But if we start with the defeatist attitude that it is too difficult to change the awkward system in which we are trapped, then no progress will be made. Global depression does not have to happen again if our policy-makers have sufficient vision to develop this Post Keynesian approach. The health of the world's economic system will simply not permit us to muddle through" (Davidson, 2004–5, p. 227). Thus, the Post Keynesian position on international trade rests on the establishment of the ICU, involving fixed but adjustable exchange rates, capital flow restrictions, and surplus nations initiating the path toward the reduction of imbalances. In contrast, the

[1] For the application of Davidson's plan for international trade in Eastern Europe in the form of an Eastern European Clearing Union, see Marangos (2001).

AWC maintains its position of complete import liberalization with the stipulation of ensuring better access to export markets for developing countries in developed economies.

Foreign direct investment

Competition for international investors serves as a powerful deterrent to expansionary or redistributive economic and social policies, and to policies that promote labor rights (Chang and Grabel, 2004, p. 23) with the goal to avoid the threat of capital flight. However, not all investment by multinational corporations is equally subject to flight. This concern should not discourage governments from regulating foreign direct investment (FDI) as part of a national development strategy (ibid., p. 143). This is because when making investment decisions, multinational corporations place greater emphasis on factors such as a large domestic market, an educated workforce, rising incomes and economic growth, and a sound infrastructure rather than on a liberal regulatory regime.

FDI policy stands the best chance of achieving developmental objectives if it is decisively joined to national development or industry policy, as "cash cow industries tend to be 'dead ends' in the long run" (Chang and Grabel, 2004–5, pp. 283–284). However, in the cases of Brazil and Argentina, the 1990s stabilizations based on the Brady Plan were to attract foreign capital inflows as a result of privatization of state-owned firms, deregulation, and speculation that were more than sufficient to cover the rising trade deficits, leading to nominal and real appreciation of exchange rates; such a process is not sustainable. In addition, there is little empirical evidence that foreign capital inflows increase domestic investment (Kregel, 2008, pp. 552–553, 556). Instead, foreign investment flows should be stable, in amounts appropriate to the size of a country's economy and directed toward the goals of development rather than solely toward short-term profits (D'Arista, 2008, p. 533).

Meanwhile, there is no single appropriate strategy for all types of FDI for all types of countries. Policies toward FDI must be tailored to the particular conditions of each industry and dynamic as each industry serves different functions in industrial development of each country (Chang and Grabel, 2004–5, p. 285). China, Korea, Taiwan, and Vietnam are examples of countries that have been successful in attracting while at the same time strictly regulating FDI (Chang and Grabel, 2004, pp. 142, 145). At the end, it appears that growth leads to FDI rather than the other way around (ibid., p. 143). In sum, for the Post Keynesians, FDI must be linked with national development and/or industry policy. The AWC maintains the abolishment of barriers to entry for foreign firms.

Privatization

In several countries, many state-owned firms have become a source of inefficiency and budget deficits, but this is by no means a universal feature. Indeed, even reform-minded countries have kept some public-sector firms, and some of them have been quite successful (Ocampo, 2004–5, p. 311). Because it may be easier to control state-owned firms as compared to private firms, the experience of France, Austria, Finland, Norway, and Italy, with a large state-owned sector performing very well after World War II, demonstrates a dynamic state-owned sector that played a key role in industrial development (Chang and Grabel, 2004, p. 87). Comparing Asia with Latin America, the successful economies in Asia have a larger state-owned sector than the Latin American economies with all the consequences emanating from this characteristic (ibid., p. 87). Meanwhile, the experience of privatization reveals badly designed privatization processes, rent-seeking in the regulation of privatized enterprises, and the transfer of resources from one group of insiders to another (Chang and Grabel, 2004–5, p. 288; Ocampo, 2004–5, p. 312). It has proven nearly impossible to establish an unambiguous causal empirical link between the size of the state-owned enterprises sector and economic growth. Chang and Grabel (2004, p. 88) argued that there is no evidence that a larger state-owned enterprises sector necessarily causes countries to perform poorly. Economic development does not require a substantial change in property ownership. This is because ownership, as such, is less important than competition, the incentive structure, and the nature of regulatory policies (Marangos, 2002). Thus, the policy recommendation from the Post Keynesians is to maintain state-owned enterprises to be used as an engine of economic growth. Of course, "this does not imply that the state should 'take over' the economy" (Saad-Filho, 2007, p. 533). Meanwhile, the AWC persists in favor of privatization despite the fact that it accepts that it was carried out badly.

Deregulation

The mainstream "Keynesians" explain unemployment to short-term maladjustments due to wage and price rigidities, or in an open economy to noncompetitive exchange rates (Davidson, 2004–5, p. 210); supposedly, this justifies liberalization of the labor market, as recommended by the AWC. However, labor market liberalization has contributed to the worsening income distribution around the world, while the centralized wage bargaining has been a defense against such trends. Meanwhile, "flexibility should never be seen as a substitute for adequate macroeconomic policies" (Ocampo, 2004–5, p. 311). In an unstable macroeconomic environment, additional flexibility increases uncertainty and firms respond with a reduction in "formal" labor employment and/or in the deterioration of the working conditions. In other words, flexibility has negative externalities as it undermines jobs that would otherwise be stable (Ocampo, 2002, pp. 403–404).

The main goal of the regulation of the labor market within the Post Keynesian framework, in contrast to the deregulation recommendation by the AWC, is to make it trying for firms to increase profitability by reducing wages, extending the working day, or reducing working conditions. Productivity growth and better working conditions can also be encouraged by legislation increasing the minimum wage and reducing wage dispersion, supporting trade unions, and offering tax and other incentives for firms investing in priority sectors that introduce new technologies and pay high wages (Saad-Filho, 2007, p. 525).

Property rights

The importance of property rights for an entrepreneurial market economy cannot be refuted (Davidson, 2004–5, p. 209). Hence, it is necessary from a Post Keynesian perspective to reform the land tenure systems in some developing countries (Saad-Filho, 2007, p. 526), which is also consistent with the AWC. However, property rights are only one part of the general institutional framework for a "successful" market economy; the disregard of institutions in the original WC was harmful to economic development (Ocampo, 2004–5, p. 309). Meanwhile, "[w]e can claim that the period of state-led industrialization was superior in Latin America in terms of institutional development" (ibid., p. 308).

Institution building

Economic and social institutions must be subject to a democratic political process. This is because disagreements on the effectiveness of different economic institutions are deeply rooted in ideological debates that can be reconciled only through a democratic process. This reflects the fact that there is no such thing as a unique design of a market economy not only in terms of economic dynamism and stability but also in income distribution and social cohesion. "The institutional heterogeneity is apparent among wealthy countries today; but we also find it in the developing world" (Chang and Grabel, 2004–5, p. 278). Furthermore, institutional development is essentially endogenous to each society and depends on a learning process and numerous historical determinants; the goal of institutions is to guarantee social cohesion and manage conflict (Ocampo, 2004–5, p. 312). Indeed, the success of the Anglo-American model of capitalism depends on specific institutional and regulatory preconditions; in the absence of these fundamentals, the Anglo-American model of capitalism cannot function properly (Chang and Grabel, 2004–5, p. 279). Hence, it is not the role of international financial institutions advanced by the AWC to impose a dominant model of economic and social organization (Ocampo, 2004–5, p. 312). The AWC specifies with respect to the institutional structure a precise role for the state as outlined in Table 1. In contradistinction, the Post Keynesians argue that institutions are endogenous to each society to guarantee social cohesion and manage conflict.

We should not make the same mistakes as Williamson and the supporters of the AWC. The Post Keynesian framework highlights the role of the particular versus the universal, the limits of human knowledge, and the social origins of knowledge within a social science framework in method and way of thinking. Accordingly, a Post Keynesian program dismisses discipline and intolerance for diversity (D'Arista, 2008, p. 525) for all developing economies. While supporters of the WC argue that their policies are founded objectively, nevertheless, they are instigated by values, social influences, and closed-mindedness of its creator and the policymakers who adopt these policies. Bresser-Pereira and Varela remind us that "there are many varieties of capitalism" (2004–5, p. 233).

The worldview of the WC may not be applicable to all societies. The scientific techniques of the outsider can aid to "see things with fresh eyes," but at the same time it is not easy to gain the tacit knowledge of the insider, it is not easy to fully comprehend the experience of someone else, to "put yourself in their shoes" (Gay, 2007, pp. 89–90). Based on a cross-disciplinary social science approach, researchers and policymakers should make explicit their predispositions when providing policy advice. Gay (ibid., p. 84) argued that reflexive research combines the objectivism of the outsider with the attention to the locally embedded experience of the insider. The entanglement of subjectivism and objectivism requires recognizing the distinctiveness of each country as well as the limitations of economic proposals. There is a need for a balance between generalization and specificity; otherwise, the results of policy advice are undermined. Such an approach would benefit development economics, helping to take into account subjective differences between countries, but at the same time retaining scope for generalist analysis (ibid., p. 84).

Hence, with caution, I am presenting the general Post Keynesian propositions with the stipulation that development is a common endeavor and that participants, outsiders and insiders, should work in partnership on equal terms. Our guide is again Keynes's plan for an international order inspired by a consensus on freedom, enhancing rather than opposing freedom to choose the appropriate policies, as insiders are perfectly capable of generating objective knowledge (Cetrini, 2008, pp. 499–500; Gay, 2007, p. 93). National autonomy to determine economic and social development strategies by deciding, adapting, and executing policies, with international institutions in a supporting role "by the intimate involvement of development economists in the everyday lives of their target audience" (Gay, 2007, p. 98), promotes democracy on an international scale (Gay, 2007, p. 98; Ocampo, 2002, p. 397). As well, the dynamic nature of the world requires policy tools that are also dynamic, as the once-successful policies might become antiquated (Gay, 2007, pp. 99–100). In the end, Chang and Grabel (2004–5, p. 274) and Ocampo (2002, p. 405) have stated that the economic system must be subordinate to broader social objectives, as per Polanyi (1975), because institutions, governance, and distribution always matter.

Conclusion

The paper has revealed the Post Keynesian alternative to the AWC as a means "to counter the argument that the [after the] Washington Consensus is effectively the only game in town, these critiques need to be supplemented by suggestions for alternative macroeconomics policies" (Saad-Filho, 2007, p. 514). The goal of the Post Keynesian framework is the promotion of sensible prudent economic and social development that is equitable, stable, and sustainable. The recent economic crisis requires a new direction in international development policy as the human cost of financial crises, as always, are disproportionately borne by the poor. Post Keynesians emphasized, as revealed in Table 1, in sum: public investment directed to the optimum level of employment; industry policy; modern welfare state; social programs; modern tax system, expanded tax base, increasing tax revenues, and redistributing income; prudential regulation and capital controls; dependent central banks; autonomous rate of interest; development banks; adjustable pegged exchange rate; International Clearing Union; FDI linked with national development and/or industry policy; maintaining state-owned enterprises; regulation of the labor market; and endogenous produced institutions that guarantee social cohesion and manage conflict.

Of course, these policies are not the only preconditions for economic prosperity, only because this paper is merely a reaction to the AWC; thus, by definition, this paper is limited in its scope. All in all, these policies are in contrast to the AWC, which does not dismiss the original reforms associated with the WC, rather it emphasizes the completion of these reforms by adding mainly policies on institutions and social policy in the form of a safety net. In the end, "we emphasize at the outset that we present these policy alternatives in the spirit of pluralism and humility. . . . We hope that our work serves as an antidote to the defeatism and fatalism found among many opponents of neoliberalism who find it difficult to challenge these policies, believing that there are no credible alternatives" (Chang and Grabel, 2004–5, p. 276). This need for alternatives is especially underscored in the financial crisis affecting the world today.

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