A Keynesian alternative to the Washington consensus policies for international development

John Marangos

Department of Economics,
University of Crete,
Rethymno 74100, Crete, Greece
Email: marangosjohn@gmail.com

Abstract: The Washington consensus was identified as a neoliberal manifesto and received a vast amount of criticism. In response, lately, John Williamson has offered a new set of policies in the ‘After the Washington Consensus’. The aim of this paper is to determine whether there has been any substantial change in the recommended policies, and to offer a Keynesian proposal. Due to space limitations, the Keynesian perspective developed concentrates on: the state interventionist policies used by the industrialised countries; the excessive priority given to price stability instead of full employment; recycling the country’s savings back into the domestic economy in coordination with industrial policy and domestic financial regulation; supporting interest rate policies that aim at a stable and permanently low level of interest rates and to direct credit to specific parts of the economy; regulation of foreign banks and reinforcement of fair competition; and the role of globalisation in development and capital controls.

Keywords: Washington consensus; Keynes; international development; global markets; economic development.


Biographical notes: John Marangos is an Associate Professor at the Department of Economics at the University of Crete and visiting research scholar at the Department of Economics and Finance at the Winston-Salem State University. Focal points of his research include economic transition processes in Russia, Eastern Europe and the former Soviet Union and Asia, international development, and innovative methodologies for teaching economics. His latest publication is a three volume set on comparative economic systems published by Palgrave with the titles: Consistency and Viability of Capitalist Economic Systems; Consistency and Viability of Socialist Economic Systems; and Consistency and Viability of Islamic Economic Systems and the Transition Process.

1 Introduction

Williamson (1990) coined the term ‘Washington consensus’ to describe the consensus between the US Executive Branch of government and the main financiers of development in the world: the International Monetary Fund (IMF) and the World Bank
Initially, the term was associated with the set of policies and conditionalities imposed by the international financiers upon the development strategy in Latin America. In time, the term became associated with the policies and conditionalities by “Washington” to fund development around the world: “…the Washington consensus focuses on the promotion of GDP growth, and has been implemented through a top-down, donor conditionality driven and outside-expert-led approach” (Gore, 2000, p.795).

Williamson (2004a, p.1) admits that by incorporating ‘Washington’ in the term, it suggested to the ‘conspiratorially minded’ that the consensus was a list of policies that Washington was imposing on the world; in this way, ‘Washington’ was seeking to take credit for government-originated reforms. The criticisms that distressed Williamson were produced, by and large, from within Latin America, as the term implied that the reform agenda was supplied externally rather than designed from within Latin America. He states that this outcome was not his objective. His original purpose was to make ‘Washington’ the target, because ‘Washington’ was sceptical about the occurrence of reform in Latin America. “Had my intention been to make propaganda for reform in Latin America, the last city in the world that I would have associated with the cause of reform is Washington” (Williamson, 2003a, p.325). Nevertheless, it is quite obvious who forms and imposes policies in the developing world, as funds needed for development come with strings attached. Those strings are the neoliberal policies associated with the Washington consensus, analogous to the domestic policies in the USA.

The Washington consensus received wide criticism as the policy set. The Washington consensus has been identified as a neoliberal manifesto as those who opposed the policies of the consensus argue that social equity, safety nets, and institutional development were overlooked in the original consensus. Even so, after subsequent interpretations and misinterpretations, expansions and contractions, agreements and disagreements, and lastly in attempting to maintain originality or offering alternatives, the Washington consensus evolved as an attempt to react to the ever-changing economic conditions. Nevertheless, the changing character of the Washington consensus requires meticulous studying to reveal the underlying assumptions and the nature of reforms. While the fundamental assumptions remain intact, we still need to study its changing character in order to respond effectively. In identifying the updated version of the neoliberal manifesto, the purpose of the paper is to offer an alternative and to determine any change in policies associated with the New Agenda of the “After the Washington Consensus”. As a result, we can move away from the original Washington consensus and follow the evolution of the set of policies in order to offer an effective alternative. I propose in this paper, an alternative strategy based on Keynesian principles. The Keynesian economic analysis used in this paper refers to the original work of Keynes and does not denote the modern version of the neoclassical synthesis in the form of New Keynesian economics as sustained by Mankiw and Rommer (1991). The dominant paradigm in mainstream macroeconomics is a synthesis of new Keynesian and new endogenous growth models, revising the Washington consensus based on new classical and monetarist neoliberal macroeconomics (Niggle, 2006, p.405).

Keynesians ultimately reject the Washington consensus for the reason that it is an attempt to apply strict free market neoclassical policies on developing countries. The reforms are unrealistic and unpractical; the ‘one-size-fits-all’ Washington consensus has proven inappropriate. Due to space limitations the Keynesian perspective proposed concentrates only on the following policies: the state interventionist policies used by the
industrialised countries; the excessive priority given to price stability instead of full employment; the recycling of the country’s savings back into the domestic economy in coordination with industrial policy and domestic financial regulation; a stable and permanently low level of interest rates and directing credit to specific parts of the economy; regulation of foreign banks and reinforcement of fair competition; and the role of globalisation in development and capital controls. Students of international development would benefit from these findings as they would be able to determine and compare the differences between recent international development programmes as imposed by the international financial institutions, and be offered an alternative based on the Keynesian perception of international development.

The paper is structured as follows: Section 2 presents a critical perspective of the Washington consensus and the ‘After the Washington Consensus’, Section 3 provides a cognitive framework of the Keynesian alternative for international development and Section 4 concludes.

2 The original and the ‘After the Washington Consensus’: a critical perspective

2.1 The original Washington consensus

In November 1989, the Institute for International Economics convened a conference to investigate the progress of economic reforms in Latin America. At that time, there was a general misconception, based on Williamson’s assessment, that Latin America countries were unwilling to undertake significant reforms to avoid the debt crisis. In this conference, Williamson found the opportunity for the first time to reveal his new-found term Washington consensus, in a paper entitled What Washington Means by Policy Reform. The papers presented at the conference were subsequently edited by Williamson (1990), published in a book and as a result the term ‘Washington consensus’ became well-known. As a matter of fact, the Washington consensus was initially “…what most people in Washington believed Latin America (not all countries) ought to be undertaking as of 1989 (not all times)” (Williamson, 2002a, p.1) and the “Washington consensus was originally used to describe a list of ten reforms that I [Williamson] argued were practically universally agreed in Washington to be desirable in most Latin American countries” (Williamson, 2004b, p.195). In spite of this declaration, the ten policy recommendations were converted into “the Ten Commandments” for international development policy (Williamson, 2004a, p.3). The Washington consensus is presented in Table 1.

Williamson (1999, p.2) was aware that he is restricting the debate only on economic issues. His excuse was that his comparative advantage is on economic issues, while he “doubts my [Williamson] ability to say anything very interesting about issues of national security or sovereignty or gender or human rights or crime. It does not imply that I am so stupid and so insensitive as to doubt the importance of these issues, some of which (like national security) are also preconditions for economic prosperity and others which (like gender) demand their own reform agenda” (Williamson, 1999, p.2). Nevertheless, the goal of founding the Washington consensus was that “indeed, in my more optimistic moments I still dare to hope that the broad objectives of the reform movement will come to enjoy the same general acceptance that human rights and democracy do, as things about which there is no need to do battle because the battle has been won and almost
everyone is content with the outcome” (Williamson, 1999, p.16). By agreeing about the general direction of reform, in the form of the Washington consensus, we will ideally not get bogged down nor be confused anymore with the details (Williamson, 1999, p.20).

Table 1  The Washington consensus

<table>
<thead>
<tr>
<th>Policies</th>
<th>Washington consensus</th>
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<tbody>
<tr>
<td>Fiscal discipline</td>
<td>Small budget deficit financed without resource to inflation tax.</td>
</tr>
<tr>
<td>Public expenditure priorities</td>
<td>Redirect expenditure from politically sensitive areas to fields with the potential to improve income distribution, such as primary education, health care and infrastructure.</td>
</tr>
<tr>
<td>Tax reform</td>
<td>Broadening tax base and cutting marginal tax rates.</td>
</tr>
<tr>
<td>Financial liberalisation</td>
<td>Market determined interest rates.</td>
</tr>
<tr>
<td>Exchange rates</td>
<td>A unified competitive exchange rate.</td>
</tr>
<tr>
<td>Trade liberalisation</td>
<td>Replace quantitative trade restrictions with tariffs of around 10–20%.</td>
</tr>
<tr>
<td>Foreign direct investment</td>
<td>Abolish barriers to entry for foreign firms.</td>
</tr>
<tr>
<td>Privatisation</td>
<td>State enterprises should be privatised.</td>
</tr>
<tr>
<td>Deregulation</td>
<td>Abolition of regulations that impede entry of new firms or restrict competition.</td>
</tr>
<tr>
<td>Property rights</td>
<td>Secure property rights which are also available to the informal sector.</td>
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2.2 The new agenda: ‘After the Washington Consensus

In fall of 1999, the Institute for International Economics, due to the stagnation in Latin America, again established a team of experts for a comprehensive reassessment of the economic situation and to make recommendations. A book was produced as a result, edited by Pedro-Pablo Kuczynski and John Williamson (2003) titled: After the Washington Consensus: Restarting Growth and Reform in Latin America. This new agenda, though it promised to correct the flaws of the past, nevertheless maintained faith in the original set of reform policies. The Washington consensus cannot be blamed for the region’s disconcerting economic and social outcomes from the view of the authors of the book.

The Washington consensus did not contain all the answers to the policy questions in 1989 and circumstances have changed, “so of course we need to go beyond it” (Williamson, 2008, p.30). Economic reform cannot be static; even more so regarding economic policy (Williamson, 1999, p.1). “So the proposition that there is a need to supplement what I laid out as the Washington consensus seems to me unobjectionable, indeed compelling” (Williamson, 2004b, p.11). Thus, the agenda for development requires updating in the light of changing times, but this time with no responsibility to maintain consensus (Williamson, 2008, p.23). After the Washington Consensus is a policy agenda for Latin America from 2002 onwards (Williamson, 2003c, p.18) with the goal of reviving the economic momentum (Kuczynski, 2003, p.31). But this time, the objective is twofold: accelerating growth and improving income distribution.

The editors of this book made an effort of not “repeating ad nauseam” the phrase “Washington consensus” in the text. “When a term has come to acquire such different meanings, it is time to drop it from the vocabulary” (Williamson, 2003d, p.12). Williamson has consistently maintained that the term Washington consensus has been
often wrongly labelled ‘neoliberalism’ or ‘market fundamentalism’, something different from what he had assigned to the term. As often happens, Williamson did not have intellectual property rights to control its meaning. Keynes, for example, could not stop the development of the neoclassical synthesis and what New-Keynesians assigned to Keynesian macroeconomics (Davidson, 2004, p.207). In much the same way, the per Williamson (1999, p.1) defined mainstream theory incorporates public goods and externalities, public choice theory, and most importantly for our analysis, Keynesian economics: “Anything, say, for which the Nobel Committee has seen fit to award the Nobel Prize” (Williamson, 1999, p.2). For Williamson, Keynesian economics is part of mainstream economics; nevertheless it is quite questionable whether Williamson will accept the policies recommended in this paper by Keynesians. What version of Keynesian economics did Williamson have in mind, when he stated that Keynesian economics is part of mainstream economics qualifying for a Nobel Prize and thus contributes to the formation of the Washington consensus? Conceivably, Williamson had in mind the misleading meaning of Keynesian economics in the form of the neoclassical synthesis and new Keynesian economics.

The naming of the new agenda of policies ‘After the Washington Consensus’ was a conscious act by the authors to call attention to “our belief that it is high time the world moved on from tendentious ideological debates in which the Washington consensus is caricatured as a neoliberal manifesto to serious discussion of the new wave of reform the region needs to restart growth and make it more equitable than it has been in the past” (Bergsten, 2003, p.8). There is no attempt to establish a consensus again; the set of policies offered are those that the authors of the book believe are considered necessary (Williamson, 2003a, p.330) and “...it [After the Washington Consensus] is not presented as ultimate truth” (Williamson, 2003b, p.321). The new set of policies, do not need to command a consensus and incorporate the policies that Williamson believes deserve to be implemented because time has passed and new ideas have developed (Williamson, 2008, p.23). In Table 2, I outline the policies of the New Agenda the ‘After the Washington Consensus’ based on Kuczynski and Williamson (2003).

Williamson (2004b, p.198) argues that he never had the intention for the list of policies to be used as a cookbook. “My review of the ten policy prescriptions that composed my version of the Washington consensus has not, I trust, given the impression I believe they embodied all the truth and nothing but the truth, any more that I think there was a lot that needs retracting in the light of experience” (Williamson, 2004a, p.12). In conclusion, it is clear that countries ought not to have adopted the Washington consensus as an ideology as there will always be other things that matter that are not included in the general set of policy guidelines, “and for a policymaker to imagine that s/he can stop thinking and simply follow a set of policies that someone else has concocted is irresponsible” (Williamson, 2002a, p.3).

Even in the case of Argentina, widely regarded as the poster child for the Washington consensus, whilst in 2001–2002 the country was embroiled in the deepest crisis that has been experienced in Latin America at least since the 1980s, Williamson (2003c, p.2) argues that the Washington consensus cannot be held responsible as well. Argentina implemented many ‘good’ reforms, according to Williamson. But, in 1991, Argentina adopted a currency board that was successful in eliminating hyperinflation; nonetheless, being such a rigid system, it overvalued the currency to excessive uncompetitive levels. At the same time, Argentina failed to implement the strict fiscal policies required for the currency board to succeed. Both these policies were not consistent with the Washington
consensus; thus, it is unwarranted to blame the consensus for Argentina’s disaster (Williamson, 2002a, pp.3–4; Williamson, 2004a, p.8; Williamson, 2004b, p.199). To this argument, Williamson adds that any new set of policy guidelines, as of 2002, must also include recommendations regarding as crisis avoidance.

Table 2 The new agenda

<table>
<thead>
<tr>
<th>Policies</th>
<th>New agenda</th>
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<tbody>
<tr>
<td>Fiscal discipline</td>
<td>Stabilising inflation, sub-national governments subject to hard budget constraints, increase domestic savings.</td>
</tr>
<tr>
<td>Public expenditure</td>
<td>Stabilise the real economy through Keynesian policies, establish a stabilisation fund, improved educational opportunities.</td>
</tr>
<tr>
<td>priorities</td>
<td></td>
</tr>
<tr>
<td>Tax reform</td>
<td>Establishing property taxation as the major source of revenue, elimination of tax loopholes and taxing income earned on flight capital.</td>
</tr>
<tr>
<td>Financial liberalisation</td>
<td>Monetary policy targeting a low rate of inflation, strengthening prudential supervision.</td>
</tr>
<tr>
<td>Exchange rates</td>
<td>Flexible exchange rates, minimise the use of the dollar.</td>
</tr>
<tr>
<td>Trade liberalisation</td>
<td>Complementing import liberalisation with better access to export markets in developed countries.</td>
</tr>
<tr>
<td>Foreign direct investment</td>
<td>As the original Washington Consensus.</td>
</tr>
<tr>
<td>Privatisation</td>
<td>Continuing the privatisation programme, even though in some cases, it was carried out badly.</td>
</tr>
<tr>
<td>Deregulation</td>
<td>Liberalising the labour market.</td>
</tr>
<tr>
<td>Property rights</td>
<td>Programmes to provide property rights to the informal sector, land reform and microcredit.</td>
</tr>
<tr>
<td>Institution building</td>
<td>A role for the state: maintaining effective institutions, in providing public goods, internalising externalities, correcting income distribution, 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, modernising the market institutional structure and institutional reform in the financial sector.</td>
</tr>
</tbody>
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Williamson (2003c, pp.18–19) admits that the new strategy, as in the past, ignores or touches only briefly on some issues, in this case on democracy, social progress, illegal drugs, environmental issues, how Argentina and Brazil can escape the crisis of 2002, policies of the rest of the world, and sequencing. It is clear that what the region needs is not an immediate boom, but rather sustainable growth that encourages the private sector, multinationals and micro-entrepreneurs to invest. It is clear that “Latin America will never break out of the crisis syndrome unless it pays more attention to long-term issues” (Williamson, 2003b, p.321). Thus, “the way forward is to complete, correct, and complement the reforms of a decade ago, not to reverse them” (Williamson, 2003c, p.18). This is consistent with “reforming the reforms” (Williamson, 2004b, p.199) or ‘reform the reforms’ as the Inter-American Development Bank programme adopted in its 2002 annual meeting. It was hoped that the number of economists who would reject the
new agenda would be substantially lower from those who objected to the original Washington consensus and the new list would not be mistaken for a cookbook (Williamson, 2004b, p.205).

There is significant overlap between the original Washington consensus and the New Agenda of the “After the Washington Consensus” set of policies; “but the overlap is not complete” (Williamson, 2003b, p.320). Some of the original reforms of the Washington consensus – liberalisation of foreign direct investment and interest rates – have been achieved. New reforms have been 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 abandonment [of] what I meant by the Washington consensus” (Williamson, 2003a, p.329).

As far as Stiglitz’s post-Washington consensus is concerned, the new agenda includes all the crucial issues; hence the disagreement has become semantic and “whether we think it [Washington consensus] is a Bad Thing” (Williamson, 2004a, p.14). Critics, such as Stiglitz, based on Williamson’s assessment, have distorted the Washington consensus and presented the list as a neoliberal manifesto. However, Williamson (2004b, p.201) “… regard[es this] as a thoroughly objectionable perversion of the original meaning”. Joseph Stiglitz presented the 1998 Annual Lecture of the World Institute for Development Economic Research (WIDER) of the University of the United Nations, where the set of policies of the Post-Washington consensus was originated. Stiglitz (1998) in his lecture presented for the first time his new concept of a ‘post-Washington consensus’, as an antithesis to Williamson’s ‘Washington consensus’. Stiglitz (1998, p.34) presented a set of policies that “… are the basis for what [he] see[s] as an emerging consensus, a post-Washington consensus”. The context for the Post-Washington consensus is East Asia, not Latin America as for Williamson. East Asian countries had not closely followed the Washington consensus recommendations, but had by some means managed the most successful development in history.

Those who opposed the policies of the Washington consensus proposed policies emphasising social equity, safety nets and institutional development which, they argued, were overlooked in the original Washington consensus. Although, Williamson (2004a, p.2) argues that “an odd feature of this literature is that almost never does it include any citations to substantiate the charge that the International Financial Institutions (IFIs) actually hold the views that the author attributes to them”. By definition, the word “consensus” implies a wide measure of agreement. This implies that Stiglitz and others have to demonstrate that the policies that they name “Washington consensus” are indeed adopted in Washington. Certainly, based on Williamson’s evaluation, Stiglitz and others fail to do so, as the policies they described as a neoliberal manifesto are not in fact widely endorsed, even by the IMF or the World Bank. “Accordingly, I [Williamson] regard this usage of the term as mischievous” (Williamson, 2004a, p.2).

Stiglitz, by using the East Asian experience, demonstrated the inapplicability of the Washington consensus as a development strategy. Notwithstanding, “I have no complaints about his [Stiglitz] handling of evidence, but his frequent resort to polemical language is only one degree less unscientific” (Williamson, 2002b, p.5). Williamson’s (1999, p.4; 2008, p.19) explanation for the fast growth of East Asian economies concentrates on what these economies had in common, such as macro stability and outward orientation, fiscal prudence, high savings rates, work ethic, competitive exchange rates, and investment in human capital, rather than on what they did differently,
such as industry policy, directed credit, import protection and less so in market liberalisation. However, “what I cannot believe is that Korea’s success was primarily due to its industrial policy” (Williamson, 1999, p.4).

Based on Williamson’s (2002b, pp.4–5) ruling, “… there never was a consensus that the set of policies he [Stiglitz] defines as characterising the Washington consensus – fiscal austerity, privatisation and market liberalisation – would provide any sort of panacea for the problems of developing countries”. In reality, Stiglitz, who endorses gradual trade liberalisation and carefully done privatisation, does not object so much to Williamson’s Washington consensus but rather to neoliberalism that the Washington consensus was branded that it was implying (Williamson, 2002a, p.2). Based on Williamson’s assessment, the real motivation behind Stiglitz’s repeated attacks on the IMF, by taking advantage of his Nobel Prize, was to win the anti-globalisation protesters to his side so that they will endorse the “sensible” positions he advocates (Williamson, 2002a, p.5; Williamson, 2002b, p.1). As such, “I [Williamson] once attempted to engage Stiglitz in a debate about the Washington consensus. He declined to participate on the ground that he and I disagree little about substance as opposed to semantics and he did not consider semantics to be worth debating” (Williamson, 2003a, p.326). As a result, “if the battles are essentially semantic, why don’t we all jump on its grave and get on with the serious work of pursuing an updated policy agenda?” (Williamson, 2008, p.29)

Williamson, hence, rejects the accusation, as he never intended the term to imply the aforementioned policies such as monetarism, supply side economics, minimalist government (getting the state out of welfare provision and income redistribution) and therefore minimal taxes, nor capital account convertibility. “The vast majority of those who have launched venomous attacks on the Washington consensus have not read my account of what I [Williamson] meant by the term” (Williamson, 2008, p.20), as “…those using the term this way [are] apparently unconcerned with the need to establish that there actually was a consensus in favour of the policies they love to hate” (Williamson, 2008, p.22). Unfortunately, Williamson (2002b, p.1) cannot deny that the term “is a damaged brand name”, as argued by Naim (2003), realising that “there are people who cannot utter the term without foaming at the mouth” (Williamson, 2002a, p.1).

2.3 A critical perspective of the Washington consensus

Effectively, through the Washington consensus, Williamson attempted to introduce a paradigm for economic policy, reform, and development. Paradigms result from people’s need to understand and attempt to control their environment by fitting observations into some pattern to assist with the development of thought. Paradigms necessarily abstract from details so as to develop a framework for understanding the complexities of the real world and attempting to reflect actual practices and processes (Marangos, 2009b, p.380). In this context, with the establishment of the Washington consensus there was a swing to a market-oriented development paradigm, justified due to globalisation of development policy analysis and a shift from historicism to a historical performance assessment (Gore, 2000, p.790). Consequently, there was a rejection of long-term government direction of the economy and a shift to decentralised decision-making in the form of *laissez-faire*. “Everything has been made subject to the rules and discipline of the market” (Gore, 2000, p.795).
Nevertheless, the Washington consensus necessarily evolved due to major events and/or intellectual changes from the original Washington consensus, as the lowest common denominator of the economic reforms in Latin America, to the “After the Washington Consensus” as a policy agenda reviving economic growth in Latin America. The Washington consensus was questioned by dissident social scientists, governments in the developing countries, and civil society organisations across the developed world (Bird, 2001; Beeson and Islam, 2005, pp.198–199). They questioned both the logic and the empirical validity of the Washington consensus, and whether an abstract universalistic neoliberal set of policies is appropriate to invigorate growth in the crisis-affected economies. Sandbrook (2005, p.1124) states that the Washington consensus lacks an acute sense of socio-political realities of the African region, while Gore (2000, p.799) highlights the discrepancy between Washington consensus recommendations and East Asian development practices. “In sum, it is difficult to argue that the empirical foundation of global neoliberalism is so robust that one can confidently prescribe a ‘one-size-fits-all’ policy agenda for East Asia as well as other developing regions of the world” (Beeson and Islam, 2005, p.207).

Consequently, there was a demise of the original Washington consensus due to more worldwide socially responsive economic policy in favour of pragmatic developmentalism (Gore, 2000), and in particular on suspension of financial liberalisation in support of global financial security (Hubbard, 2001; Mosley, 2001, p.309). Thus, the Washington consensus had to change (Mosley, 2001, p.310), which explains the shift in the Washington consensus from laissez-faire liberalisation to the market-friendly approach (Gore, 2000, p.799) of the “After the Washington Consensus”.

The latest set of policies, in the form of the “After the Washington Consensus,” should be viewed as the result of the natural historically evolutionary process in international development policy (Marangos, 2009a, p.208). With the proposal of the “After the Washington Consensus,” Williamson added new policies without dismissing the original ones, to resume growth in Latin America, but this time, as he argues, in a more equitable way. Effectively, the old agenda remained in an updated form.

Nevertheless, “what matters at the end is not how these shifts are labelled but how much they reduced poverty” (Mosley, 2001, p.313). International development policies that facilitate a pro-poor employment-friendly development agenda at the national level require a major paradigm shift in the dominant development discourse. In addition, the policies of the rich countries of the industrialised nations will need to change too (Beeson and Islam, 2005, p.213). Consequently, if the developing world is to create an environment in which continuing economic development is feasible, they may have to pursue nationally or regionally based strategies that reject the “After the Washington Consensus”. It is in this context that a cognitive framework of the Keynesian alternative for international development is proposed in the following section.

3 A cognitive framework of the Keynesian alternative for international development

While Latin American nations have outstanding debts, Davidson (2004, p.214) declares that the problem is not theirs, and that they “should not let pressure from their international bankers force them to adopt those reforms that will further depress their economies”. Assistance comes with “strings attached” (Chang and Grabel, 2004a, p.23),
as policies have been nicknamed an “inevitable straightjacket” (Friedman, 2000; Bresser-Pereira and Varela, 2004, p.232), because critical domestic decisions are vetted by institutions that serve the interests of the global financial community. Effectively, the international financiers have “… shoved the Washington consensus down the throats of low-income and middle-income countries, often with heavy conditionalities” (Hailu, 2009).

Accordingly, to prevent indebted countries in Latin America from defaulting on their loans, the international financiers in turn make additional loans, usually contingent on pursuing the adoption of all ten reforms, which only saddles the countries with larger and difficult to sustain international debt. International financial institutions undermine pluralism and policy independence in developing countries, as the conditionalities are paternalistic (Hailu, 2009). Davidson (2004) discredits the US Executive Branch of government, the IMF and World Bank for seeking only to give aid to those countries that fully adopt the consensus reforms, when in actuality, the problems and crises arising should not be the sole burden of these countries to bear alone. These nations should avoid the constraints imposed “and pursue an independent full employment policy while negotiating the restarting of debt service payments after the domestic economy is showing significant signs of improvement” (Davidson, 2004, p.214).

Keynesians ultimately reject the Washington consensus for the reason that it is an attempt to apply strict free market neoclassical policies on developing countries, and as Keynes warned, policies based on wrong economic theory can only be catastrophic. The world will have a more stable international environment only when domestic full employment policies are adopted (Ginos and Rochon, 2004a, p.191). In this context, too much attention was paid by the Washington consensus to the “destruction” of inefficient domestic industry, without providing support for “creation” through higher investment and technological innovation (Kregel, 2008, p.553). Overall, the policy framework of the Washington consensus undermines accountability, pluralism and national autonomy, and threatens democracy, while at the same time it is a deviation from the tradition established in the history of development policy (Chang and Grabel, 2004a, pp.22–23; Reinert, 2007; Kregel, 2008, p.557).

It appears that the net effect of the Washington consensus policies has all too often been to the benefit of the wealthy minority, while the human cost of financial crises are disproportionately borne by the majority of the population, the working class and the poor (Stiglitz, 2002, p.20; Chang and Grabel, 2004a; Chang and Grabel, 2004b). The effect has been devastating as there is extraordinary misery, inequality and despair, a sharp and widening divide between the haves and the have-nots in the region and between developed and developing countries (Chang and Grabel, 2004b, p.205; Moreno-Brid et al., 2004, p.355). Growth can only be pro-poor, when it reduces relative, as well as, absolute poverty (McKinley, 2003; Saad-Filho, 2007, p.516). According to the United Nations data, in 2003 (the year the “After the Washington Consensus” was proposed), 225 million Latin Americans were poor, and among them, 100 million lived in conditions of extreme poverty (Moreno-Brid et al., 2004, p.354). In addition, inequalities are a major constraint to economic growth in developing countries, as social cohesion can be considered a critical competitive advantage (Ocampo, 2004, p.310). Although the Washington consensus policies helped to lower inflation and led to an export boom, they failed to increase domestic investment. They also failed to remove the balance-of-payment constraint on the region’s long term growth prospects, because of the difficulty
of producing competitive exchange rates. In sum, there is no such obvious link between the depth of macroeconomic reforms and economic growth (Moreno-Brid et al., 2004, p.346; Kregel, 2008, p.554).

Williamson’s decalogue (Neto and Vernengo, 2004, p.334) from a Keynesian perspective is a blueprint which ignores “specific historical and institutional conditions prevailing in developing countries” and completely abandons the “Keynesian notion of aggregate demand and income distribution set within a nonergodic world” and, hence, ultimately the reforms are unrealistic and unpractical (Gnos and Rochon, 2004a, p.190). The free market system that the economists envisioned through the Washington consensus is not certainly the economy in which we actually live. According to Davidson (2004, p.211) the Washington consensus can only be applicable to the real world, if the three classical axioms are satisfied. Because mainstream economists were so enthusiastic about liberalised international financial markets and the export-led economic miracles, apparently this justified the Washington consensus’s validity to be implemented in developing countries. The supporters of the Washington consensus try hard to render their approach as scientific and as relevant as possible to any situation. However, successful economic and social development is the result of diverse types of economic policies and the “one-size-fits-all” Washington consensus has proven inappropriate (Chang and Grabel, 2004a, p.2; D’Arista, 2008, p.524). Keynesians argue that a blueprint cannot be “prêt-a-porter” (Gnos and Rochon, 2004a, p.190), and disagree that there is a perfect and specific set of “good” policies (Chang and Grabel, 2004b, p.276) made applicable to all situations and circumstances in all times. Quite the reverse; policy reform must be tailor-made to take into account the specific tribulations inherent to each individual country and policies must also be dynamic to account for nonergodicity. “We do not share the hubris of neoliberals, and therefore do not argue that there is an ideal, single approach to ‘good’ policy” (Chang and Grabel, 2004a, p.3).

In reality, the world is “fundamentally Keynesian,” (Gnos and Rochon, 2004a, p.191), that requires a new “consensus”, “more than plumbing” (Davidson, 2003; Gnos and Rochon, 2004a, p.190) that “emphasises Keynesian aggregate demand policies, exchange rate stability, income distribution and crisis avoidance” (Gnos and Rochon, 2004a, p.190). As the Washington consensus was a failure, the “After the Washington Consensus” was developed as a socially oriented version, via the addition of a social agenda including poverty reduction and softening the strict reliance on market forces, and also adding the concept of “institutions” without properly acknowledging their role or function. In the meantime, “attempts by international financial institutions to harness subjective knowledge have often made little practical difference to policy and have conflicted with the overall universalist approach” (Gay, 2007, p.93). Given that the new version is merely an add-on to the supply side neoclassical economic policies, essentially the same liberalisation matched with fiscal discipline, an effective difference in policy outcomes should not be expected (Ocampo, 2002, p.395; Chang and Grabel, 2004a, pp.23–24; Gnos and Rochon, 2004a, p.190; Gnos and Rochon, 2004b, p.316). Notwithstanding, the best performing developing economies in the world are highly interventionist (Chang and Grabel, 2004a, p.18). The Chilean achievements can be explained by reference to “non-orthodox” policies: government subsidies to certain export industries and rigid capital controls during much of the 1990s (Chang and Grabel, 2004a, pp.16–17).
The present industrialised countries initiated and depended upon numerous state interventionist policies, whether they were industrial, trade or financial policies (Chang and Grabel, 2004a, p.10). Japan, France, Norway, Austria and Finland used aggressive industrial policy to rebuild and modernise their economies after WWII, while at the same time they liberalised their economies. Even the USA relies upon ‘industrial policy’ without naming it, as such in defence and pharmaceuticals with significant private-sector spillovers (Chang and Grabel, 2004a, pp.10–11). The successful use of selective industrial policy in East Asian countries such as Japan, South Korea and Taiwan is well-known. Industrial policy in Japan, Korea, and Taiwan, sets targets on export growth, increases in local content and R&D capabilities, and increases in the ability to withstand import competition (Chang and Grabel, 2004a, p.79). In Korea and Japan, firms had to prove that they were using state support to increase productivity and/or exports; if they failed to do so, they were penalised (Chang and Grabel, 2004a, p.76). Industrial policies in East Asia and Europe were never anti-market. Their industrial policies involved the selective control of market forces. The control of market forces was designed to enhance the ability of national firms to compete in the world market (Chang and Grabel, 2004a, p.75).

According to Bresser-Pereira and Varela (2004), developing countries assigned an excessive priority to price stability, a mistake that disabled them from achieving macroeconomic stability and resuming growth after stabilising inflation. “According to Celso Amorin, the foreign minister of Brazil since 2003, the difference between Asian and the Latin American countries is the fact that the former grow with domestic savings and foreign markets, whereas the latter expect to grow with foreign savings and domestic market. In this paper, we argued that the second alternative is self-defeating. Growth must be financed with domestic savings” (Bresser-Pereira and Varela, 2004, pp.248–249). Foreign savings and investment tend to be volatile, difficult to target, and they are often detrimental to pro-poor objectives; for example, foreign investors in poor countries often produce luxury goods and services rather than basic consumer goods and manufacturing inputs (Saad-Filho, 2007, p.521).

Bresser-Pereira and Varela (2004, p.239) question the growth cum foreign savings strategy promoted by what they name the “second” Washington consensus. They point out the disastrous consequences and argue that growth should instead be financed with domestic savings. This strategy, they believe, led countries to lose control over their respective exchange rates. As a consequence, national currencies appreciated, causing an increase in wages and consumption, and a fall in domestic savings, all with no increase in capital accumulation, resulting in semi-stagnant economies. The goal is to recycle the country’s savings back into the domestic economy, with the coordination of industrial policy and domestic financial regulation in support of development strategies ensuring access of domestic firms to capital that is generated domestically, increasing demand and income more equitably and lessening dependence on exports for growth (Chang and Grabel, 2004a, p.124; D’Arista, 2008, p.532).

Arestis (2004) questions the following policy implications of the Washington consensus: that free banking leads to stability of the financial system; that financial liberalisation enhances economic growth; that savings cause investment; that there is an absence of serious distributional effects as interest rates change; and that stock markets and speculation enhance economic growth. Meanwhile, empirical evidence ultimately concludes that in entirety, financial liberalisation policies have destabilising effects on economies. Financial liberalisation increased the demand for credit by households and
firms that was not offset by a comparable increase in the domestic savings rate (Arestis, 2004, p.264). Speculation has become rampant because the policies of financial liberalisation increased the opportunities and incentives to speculate (Chang and Grabel, 2004a, p.28). Arestis et al. (2001) shows that the link between stock market volatility and economic growth is significantly strong and negative.

The financial liberalisation thesis ignores several factors relating to the relationship between financial liberalisation and economic development, and is based on an ideological commitment to markets that are grounded neither in empirical evidence nor economic theory. In sum, interest rate liberalisation has a negative effect on investment (Arestis, 2004, p.266), financial liberalisation is less likely to enhance long-term growth prospects (Arestis, 2004, p.263), and a free banking system is unable to respond to a financial crisis (Arestis, 2004, p.258). The alternative is to support interest rate policies that aim at a stable and permanently low level of interest rates (Arestis, 2004, p.262), and to direct credit to specific parts of the economy, as the East Asian experience demonstrates, rather than allowing the market mechanism to allocate credit (Arestis, 2004, p.265). Meanwhile, based on Kaldor, it is growth that determines productivity rather than the reverse neoclassical proposition. Unlike the “total factor productivity” concept of neoclassical economics, which is entirely based on the supply side, Kaldor’s model considered both the demand and supply sides. As demand and supply conditions differ between sectors, Kaldor believed that it was not adequate to formulate a theory of economic growth based on a single product economy. As a consequence, Kaldor derived generalisations concerning the relationship between the growth of output, employment and productivity (Kaldor, 1978; Ocampo, 2004, p.297; Dasgupta and Singh, 2006, p.3).

Gnos and Rochon (2004b) critique the Washington consensus policies from the perspective of the increased presence of foreign national banks in local economies as the result of the removal of barriers to the free flow of foreign direct investment (FDI). In the end, foreign banks wound up controlling almost half of the banking activity in Latin America. By and large, Gnos and Rochon (2004b) argue that the multinationalisation of the banking system in developing economies tends to increase, rather than decrease, the fragility of the overall system. Latin American countries and many emerging economies have eliminated barriers to entry to their financial markets in the form of eliminating restrictions in the number of branches, controls over permissible activities, and strict limits to the percentage of foreign ownership of domestic banks, all with the sole purpose of attracting foreign capital and banks. This increase in foreign ownership of emerging banking systems is problematic because it exports to developing countries one of the most problematic elements of developed countries: the unequal influence of financial interest (Gnos and Rochon, 2004b, p.318).

Initially, it was believed that following financial crises, allowing foreign banks to enter the market was a better and cheaper way to quickly restructure and recapitalise domestic banks; meanwhile foreign banks experiencing increased competition from financial deregulation in their own countries responded with pleasure. Gnos and Rochon (2004b) discuss several benefits of allowing foreign banks into the domestic economy, but ultimately conclude that the presentation of these so-called benefits “miss the boat completely”. These benefits include capital restructuring and recapitalisation (foreign banks will bring much-needed capital that quickly reestablishes sound market fundamentals, making banks better able to withstand certain shocks), the
consensus/stereotype that banks that tend to enter into emerging economies are “solid and respectable” (bringing a degree of expertise, and thus respectability and credibility to the emerging banking system through spillover effects), and that foreign banks come with their own lender-of-last-resort. One would think that these benefits would lead to not only better banks, but to better pricing, better lending practices and more credit through an increased supply. Most mainstream economists would agree that the entry of multinational banks generally increases the stability of the local banking system, but not for Keynesians. Accordingly, developing countries did not have sufficient time to properly evaluate the effect of multinational banks. The immediate effect only created an illusion of stability, which is why Keynesians maintain that the spread of global banking has contributed to the financial instability of many nations, and has led to the disruption of domestic credit markets. Foreign banks are more susceptible to withdrawing funds and tightening credit in times of crisis, which would only contribute to increased instability, putting pressure on domestic banks to consider foreign ownership as a possible alternative. Thus, multinational banks lead to more multinational banks (Gnos and Rochon, 2004b, p.327). “Hence, it appears as if the ‘globalisation of banking’ has contributed to make the world financial markets more fragile, not less so” (Gnos and Rochon, 2004b, p.317).

The proper policy response from a Keynesian perspective is to advocate regulation of foreign banks, and advocate and reinforce fair competition. Foreign banks benefit from some oligopolistic power resulting from their relationship with foreign companies and because of their reputation (Gnos and Rochon, 2004b, p.329). Governments must have in place established rules of conduct and controls that will direct foreign banks to allocate a given percentage of their loan portfolio to smaller and local borrowers and give local banks the opportunity to supply credit to “good” borrowers. The fundamental behaviour of banks is the same in all markets, both developed and developing markets: loans create deposits. What needs to be done, from a Keynesian perspective, is to improve the prospects that all borrowers will be able to reimburse banks (Gnos and Rochon, 2004b, p.328). This involves ensuring a proper “macro-financial environment”, to use Keynes’ expression (Gnos and Rochon, 2004b, p.327), and place emphasis on the need for government to ensure sufficient growth in effective demand to allow borrowers to reimburse their bank loans.

Globalisation à la the Washington consensus is but one form of globalisation. Different policy choices with reference to international trade and finance can create a form of globalisation that would not be so damaging to living standards and growth (Chang and Grabel, 2004a, p.30). It is the Washington consensus form of globalisation and not globalisation itself that is primarily responsible for the poor economic performance and the deterioration of living standards in developing countries (Chang and Grabel, 2004b, p.278). The theory of comparative advantage rests on a host of specific and unrealistic assumptions about technology, industrial structure, macroeconomic conditions, and the mobility of labour and capital (Chang and Grabel, 2004a, p.60). In this context, any attempt by many nations to obtain competitive gains by implementing policies that will reduce the domestic monetary costs of labour or the exchange rate can only foster further global stagnation and recession. Each nation that attempts to regain a competitive edge induces similar depressionary policies in other economies (Davidson, 2004, p.213). In addition to this, trade liberalisation around the world is partial, biased, and unfair, as products produced in developing countries are subject to the highest
levels of protection in developed economies. Seeing that trade liberalisation can disproportionately affect the poor, the pro-poor strategies require the regulation of the balance of payments (Saad-Filho, 2007, p.528).

Capital controls played a critically important role during the high-growth periods in Japan, South Korea, and Brazil in the 1950–1960s. Chile and Colombia successfully used capital controls during the 1990s. Chile was the only Latin American country able to impose controls on capital inflows, therefore not only avoiding balance-of-payment crises, but also (and more importantly) assuring satisfactory growth rates in comparison with other Latin American countries (Bresser-Pereira and Varela, 2004, p.237). The Malaysian government successfully employed stringent capital controls in 1994 and 1998, as did Thailand at the end of 2006. China and India continue to employ extensive capital controls and did not bend to pressure from the IMF (Modenesi and Modenesi, 2008, p.574).

Among these experiences, the capital controls in Chile and Colombia are the only ones that many supporters of the free market largely view in a positive light (Chang and Grabel, 2004a, pp.113–114). It appears that foreign private capital inflows follow rather than create rapid growth, as the experiences of Taiwan, South Korea and China demonstrate. Thus, for Keynesians capital controls are the necessary complement to Keynes’ fiscal policy proposals and for the socialisation of investment (socialising investment through the creation of a new kind of capitalist culture of cooperation between private and public authorities), and it appears that a sustainable growth path is a precondition for private capital inflows (Chang and Grabel, 2004a, p.19; Neto and Vernengo, 2004, p.337). “The experience of the twentieth century thus leads to the conclusion that opening to external capital inflows has been one of the major causes of the demise of both import substitution and the Washington consensus policies…” (Kregel, 2008, p.555). Capital controls are adopted not because of political leanings and ideology but rather based on pragmatic justification (Modenesi and Modenesi, 2008, p.561, p.563). A Tobin tax is not a substitute for capital controls, as it would increase exchange rate volatility (Davidson, 2002; Modenesi and Modenesi, 2008, p.572). Ultimately, in line with Keynesians, Williamson (2000, p.257) and the IMF recently also advised against capital liberalisation that leads to speculative bubbles and financial crises, as in the East Asian crisis (Chang and Grabel, 2004b, p.274).

4 Conclusions and policy implications

The investigation of the New Agenda of the “After the Washington Consensus” and the comparison with the original Washington consensus provides us with a new context to uncover the policies implemented and imposed on developing countries by the US Executive Branch of government, the IMF and the World Bank. This new policy context for international development creates the responsibility for social scientists to offer an effective response to the new situation; in this way, social scientists will not be accused of being outdated. It appears that the New Agenda of the “After the Washington Consensus” consists of the addition of new policies (for example, taking institutions into account) without dismissing rather demanding the completion of the original policies. It appears that the new sets of policies actually entail tinkering, as there is no substantial
change in the fundamentals of the original consensus. It is clear that the underlying principles of the consensus remain the same, consistent with the free market approach of orthodox economics. Nonetheless, this cannot be an excuse to be unaware of any changes that have taken place in the set of policy reforms.

The paper offers an alternative to the Washington consensus and the “After the Washington Consensus” based on Keynesian propositions. Because of limited space only a few important issues of international development were tested. These include: the state interventionist policies used by the industrialised countries; the excessive priority given to price stability instead of full employment; the recycling of the country’s savings back into the domestic economy in coordination with industrial policy and domestic financial regulation; a stable and permanently low level of interest rates and directing credit to specific parts of the economy; regulation of foreign banks and reinforcement of fair competition; and the role of globalisation in development and capital controls. The solution to the underdevelopment problem around the world does not appear to be adding more reforms to fill in the gaps in the consensus by identifying “successful” reference points and imposing them upon countries with different historical and cultural foundation, but rather “… to sweep away ‘reform fetishism’” (Ocampo, 2004, p.294). Diversifying institutions, effective demand policies, equity, income distribution, and understanding the “context-specific” dynamics of the real world are required for successful growth policies (Gnos and Rochon, 2004b, p.316). Most importantly, social and economic interests, either domestic or international, influence the choice of policies. Using or imposing a foreign approach which is not self-reflexive – “the idea of being reflexive simply means having an open mind and looking at your own project” (Gay, 2007, p.95) – can result in goals which may be inappropriate to the domestic situation. The imposition of foreign values and beliefs on economic policy proposals within the context-specific dynamics of customs and culture is likely to be simply wrong. Ultimately, global recession does not need to happen again as long as policies are designed for the real world and not for some theoretical configuration that is only valid on paper. The economic system must be subordinate to extensive social objectives, as per Polanyi (1975 [1944]), because institutions, governance, and distribution continually shape social outcomes.

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References


A Keynesian alternative to the Washington consensus policies


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Notes

1 The neutrality of money (changes in money cannot influence real economic variables), gross substitution (everything is substitutable for everything else) and that the economic environment is ergodic (the future can be estimated from past statistical information).