The Post Keynesian Retort to the “After Washington Consensus”

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Abstract

The term “Washington Consensus”, as 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. By 2003, the policy-set had been modified to the point that the father of the term 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 set of controversial policies the “Washington Consensus” and the “After the Washington Consensus” and offer an alternative based on the Post Keynesian framework.

Keywords: Washington Consensus, Post Keynesianism, international development, Latin America.

JEL Classification: O10, O19, O54

1. Introduction

The Washington Consensus, 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 had been modified to the point that the father of the term 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. Nevertheless, the critic of the reforms has been concentrated and effectively trapped, especially by Post Keynesians, to either the original Washington Consensus or the Post-Washington Consensus developed by Stiglitz (1998). Thus, there appears to be a vacuum in the literature. Post Keynesians have to move a step forward and offer an alternative for international development to the modern conceptualization of the Washington Consensus in the form of “After the Washington Consensus”. The purpose of the paper is to develop and

1 I am grateful to Robert H. Scott III, Assistant Professor of Economics, Monmouth University for his useful comments in an earlier version of the paper.
present recommendations based on Keynes’s ideas and Post Keynesian ideals to the “After the Washington Consensus”. The paper dismisses slogans for instance “we already know what must be done” or that there is “no alternative” as inexorably and precariously mistaken and a sign of arrogance by economists (Chang and Grabel, 2004, p.1; Ocampo, 2002, p.406). The paper contributes and determines in a systematic way the alternative to current international development policy from a Post Keynesian perspective which 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 Washington Consensus, the “After the Washington Consensus” and the Post Keynesian alternative, and identify the interrelationships and disagreements between these programs. The paper is structured as follows: Section 2 presents the After the Washington Consensus and its relationship with the original Washington Consensus. Section 3, proposes the Post Keynesian retort and finally Section 4 concludes.


In fall of 1999, during a conference at Princeton University, Pedro-Pablo Kuczynski expressed his concern to John Williamson about the economic stagnation in Latin America. Kuczynski suggested, as before, convening a team of experts for a comprehensive reassessment of the situation and to make recommendations. The director of the Institute for International Economics Fred Bergsten agreed and the team was established. The group had three meetings, twice in Washington (in 2000 and 2002) and once in Montevideo (2001). 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.

As the Washington Consensus did not contain all the answers to the policy questions in 1989 and as circumstances have changed “so of course we need to go beyond it” (Williamson, 2008, p.30). Economic reform cannot be static; 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, 2004-5, 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, 2003b, p.18) with the goal of reviving the economic momentum (Kuczynski, 2003, p.31), “as to put them back on the road of catch-up growth that most people thought they had achieved before the debt crisis” (Williamson, 2003a, p.305). But this time, the objective is twofold accelerating growth and improving income distribution.

In the following I outline the policies of the After the Washington Consensus based on Kuczynski and Williamson (2003) in the order presented by the authors with the stipulation how each policy relates to the original Washington Consensus and placed in Table 1:

**PLACE AROUND HERE TABLE 1**

**New Agenda I: Crisis Proofing**: an objective of highest priority. Governments should attempt to reduce vulnerability to crises and stabilize the macro-economy “a 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 Washington Consensus); to stabilize the real economy through Keynesian policies; sub-national 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 inflation; strengthening prudential supervision and increase domestic savings. This policy is related with the original Washington Consensus and placed in Table No. 1 in the following entries of: fiscal discipline, public expenditure priorities, financial liberalization, and exchange rates.

**New Agenda II: Completing First-Generation Reforms:** completing rather than reversing the reforms of the Washington Consensus. The original formulation of the Washington Consensus was a sensible, yet an incomplete reform agenda (Williamson, 2004-5, p.196). First of all, liberalizing the labor market, so as to encourage labor back into the formal sector where labor will get at least minimal social protection; complementing import liberalization with better access to export markets in developed countries; continuing the privatization program, even though in some cases, it was carried out badly; and supplementing financial liberalization by the strengthening of prudential supervision. It is reminded that “reducing government intervention in the economy is not the same as a desire for a minimalist government” (Williamson, 2003a, p.308). This policy is related to the original Washington Consensus and placed in Table No. 1 in all 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) “second-generation reforms”2. A vital role for the state, which is perfectly consistent with mainstream economics, is creating and maintaining effective institutions, in providing public goods, internalizing externalities, correcting income distribution, 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). However, a mistake would be the initiation of industry policy, a program that requires government to “pick winners”. There is more sympathy for a “cousin” of industrial policy, the national innovation system: government policy is to create an institutional environment in which those firms that want to innovate find the necessary supporting infrastructure such as to provide technical education to promote the diffusion of technological information, to fund precompetitive research, to provide tax incentives for R&D, to encourage venture capital, to stimulate the growth of industrial clusters and so on (Williamson, 2008, p.27). Countries would be ill-advised that the state should play a leading role in the productive sector. It is true, however, that stimulating investment is a requirement to faster growth, and probably it did not get the scrutiny it deserved in the original Washington Consensus. However, “… while it may be right to leave the door slightly open for measures to subsidize investment, the fact is that I have yet to observe such measures—beyond competitive exchange rates and national innovation systems—that I would feel confident in recommending to other countries” (Williamson, 2004, p.17). There is also the recognition that the second generation of reforms would differ for each country and cannot be determined a priori from the agenda. Williamson (2008, p.27) recognizes

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2 By the way, Williamson (2003b, p.2; 2003d, p.13) acknowledges that the term “second-generation reforms” is a misnomer, inasmuch that effective institutions might be a prerequisite for liberalization, which necessitates that the second-generation reforms ought to precede the first!
that this is a departure from the Washington Consensus, which focused on policies rather than institutions. This policy would be placed in the row Institution Building as the result of the entry by the After the Washington Consensus.

New Agenda IV: Income Distribution and the Social Sector: growth is always pro-poor, as benefits trickle-down. But the poor will not benefit as much as they do not have much resources to start with, as in Latin America. Hence there is a case to be made 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 (2003b, 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; elimination of tax loopholes and taxing income earned on flight capital. An increase in tax revenue should be used to reduce inequality by expanding opportunities for the poor, spending on basic social services, social safety net, education and health. However, the strategy focuses more on measures to empower the poor to exploit potentialities (“bootstraps”) rather than a massive redistribution of income through tax (“Band-Aids”). It is a long run strategy to allow access to assets that will enable the poor to earn their way out of poverty by improved educational opportunities, programs to provide property rights to the informal sector, land reform and microcredit. “Hence, our focus is on both accelerating growth and improving income distribution. We believe that both are possible and both are necessary” (Kuczynski, 2003, p.31). Income distribution is related with the original Washington Consensus and placed in Table No. 1 in the Tax Reform entry and social sector in the public expenditure priorities.

There is significant overlap between the original Washington Consensus and the After the Washington Consensus set of policies; “but the overlap is not complete” (Williamson, 2003a, p.320). Some of the original reforms of the Washington Consensus – liberalization 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 what I meant by the Washington Consensus” (Williamson, 2003c, p.329). This time though there is less danger that the new list will be mistaken for a cookbook (Williamson, 2004-5, p.205).

3. A Post Keynesian Alternative to the “After Washington Consensus”.

The Post Keynesian development agenda rests on the following principles: a balanced form of globalization that respects diversity; macroeconomic stability based on counter-cyclical policies; 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, alike to those experienced in nineteenth century (Kregel, 2008, p.541), are the policies of the Washington Consensus based on stringent macroeconomic discipline, a free market, and unhindered openness to the world. Nevertheless, rejection of the Washington Consensus does not imply also rejection of the market system (Davidson, 2004-5, p.217). Post Keynesians criticize the pace at which reforms were/are being 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 Washington Consensus, as implemented in Latin America (Marangos, 2007; Williamson, 2007).
Williamson’s decalogue (Neto and Vernengo, 2004-5, p.334) from a Post 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, all in all, the reforms are unrealistic and unpractical (Gnos and Rochon, 2004-5a, p.190). The free market system that the economists envisioned through the Washington Consensus is not certainly the economy in which we actually live in. According to Davidson (2004-5, p.211) the Washington Consensus can only be applicable to the real world, if the three classical axioms are satisfied\(^3\). Because mainstream economists were so enthusiastic about liberalized 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 relevant as much 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, 2004, p.2; D’Arista, 2008, p.524). Post Keynesians argue that a blueprint cannot be “prêt-a-porter” (Gnos and Rochon, 2004-5a, p.190), disagree that there is a perfect and specific set of “good” policies (Chang and Grabel, 2004-5, 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, 2004, p.3).

While Latin American nations have outstanding debts, Davidson (2004-5, 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”. IMF assistance comes with “strings attached” (Chang and Grabel, 2004, p.23), as policies have been nicknamed an “inevitable straightjacket” (Bresser-Pereira and Varela, 2004-5, p.232; Friedman, 2000), because critical domestic decisions are vetted by an institution that serves the interests of the global financial community. Effectively, “the Fund has shoved the Washington Consensus down the throats of low- and middle-income countries, often with heavy conditionalities” (Hailu, 2009).

Accordingly, to prevent indebted countries in Latin America from defaulting on their loans, the IMF in turn makes 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 (2004-5) discredits the IMF and World Bank for seeking only to give aid to those countries who fully adopt the consensus reforms, when in actuality, the problems and crises arising should not be the sole burden of countries alone to bear. These nations should avoid the constraints imposed by the IMF “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, 2004-5, p.214). Post Keynesians ultimately reject the Washington Consensus for the reason that it is an attempt to apply strict free market neoclassical policies on developing

\(^3\) 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).
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 (Gnos and Rochon, 2004-5a, p.191). In this context, too
much attention was paid by the Washington Consensus in 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, 2004, p.22, 23; Kregel, 2008, p.557; Reinert,
2007).

In reality, the world is “fundamentally Keynesian,” (Gnos and Rochon, 2004-5a, p.191),
thus a new “consensus” is required that “emphasizes Keynesian aggregate demand policies,
exchange rate stability, income distribution and crisis avoidance” (Gnos and Rochon, 2004-5a,
p.190). This is not merely the “Augmented Washington Consensus”4, but rather an entirely new
set of reforms that requires “more than plumbing” (Davidson, 2003; Gnos and Rochon, 2004-5a,
p.190). As the Washington Consensus was a failure, proposals were born out such as
“Augmented Washington Consensus” or “Second Generation Washington Consensus” or “After
the Washington Consensus” by developing 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 versions are merely add-ons
to the supply-side neoclassical economic policies, essentially the same liberalization matched
with fiscal discipline, an effective difference in policy outcomes should not be expected (Chang
p.395). Notwithstanding, the best performing developing economies in the world are highly
interventionist (Chang and Grabel, 2004, 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, 2004, p.16-7).

It appears that the net effect of the Washington Consensus policies have 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
(Chang and Grabel, 2004; Stiglitz, 2002, p.20). The effect has been devastating, 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,
2004, 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). In 2003, the
year the “After the Washington Consensus” was proposed, according to the United Nations data,
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

4 By the end of the 1990s the consensus had been altered to what Rodrik (2002) named the “Augmented Washington
Consensus”, based on the need for good governance, anti-corruption measures and some limitations on international
capital flows. For the relationship between the Washington Consensus and “Augmented Washington Consensus” see
Marangos (2009a).
critical competitive advantage (Ocampo, 2004-5, p.310). Moreno-Brid, Perez-Caldently, and Ruiz-Napolez (2004, p.346) and Kregel (2008, p.554) argue that although these 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.

The main purpose of the Post Keynesian policy framework proposed in this paper is to go beyond the “After the Washington Consensus” 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. We need to be aware that 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 by Post Keynesians. What version of Keynesian economics Williamson has in mind, when he states that Keynesian economics is part of mainstream economics qualifying for a Nobel Prize and thus contributes to the formation of the Washington Consensus?

In the following I outline the policies proposed by Post Keynesians with the stipulation how each policy relates to the After the Washington Consensus and the original Washington Consensus and placed in Table 1. In particular:

3.1 Fiscal Discipline:

Fiscal discipline, rather than fiscal policy, came first and foremost 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 due to the widespread use of fiscal deficits as a macroeconomic policy tool. Meanwhile, implementing the Washington Consensus came with a commitment to maintain primary surpluses, even in periods of recession, while Keynes is known for remaining keenly aware of the limitations of fiscal policy, especially, in times of recession. Deficits are the result of recession and do not represent a reliable solution (Neto and Vernengo, 2004-5, p.335). If deficits are 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, as Keynes argued.
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 was an overemphasis on inflation targeting that damaged the economy, while diminishing output and employment stabilization; there is no clear relationship between fiscal deficits and inflation (Gnos and Rochon, 2004-5a, p.190; Ocampo, 2002, p.398; Saad-Filho, 2007, p.522). The reduction of public investment, as the result of the Washington Consensus, 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 Washington Consensus 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 R&D, and they are not always able to value externalities correctly (Chang and Grabel, 2004, p.74). Consequently, it is crucial to offer government support for these activities in the form of industry policy, in contrast to the After Washington Consensus. The present industrialized countries initiated and depended upon numerous state interventionist policies, whether they were industrial, trade or financial policies (Chang and Grabel, 2004, p.10). Japan, France, Norway, Austria and Finland used aggressive industrial policy to rebuild and modernize their economies after WWII, while at the same time they liberalized their economies. Even the USA relies upon “industrial policy” without naming it, as such in defense and pharmaceuticals with significant private-sector spillovers (Chang and Grabel, 2004, p.10-1). The successful use of selective industrial policy in East Asia countries such as Japan, South Korea and Taiwan is well-known. Industrial policy in Japan, Korea and Taiwan, set targets on export growth, increases in local content and R&D capabilities, and increases in the ability to withstand import competition (Chang and Grabel, 2004, 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 penalized (Chang and Grabel, 2004, 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, 2004, p.75). Meanwhile, there is no single cut-out approach for industrial policy across developing countries (Chang and Grabel, 2004, p.77).

Bresser-Pereira and Varela (2004-5, p.239) question the growth cum foreign savings strategy promoted of what they name the “second” Washington Consensus. It should be noted that Williamson (1997) substituted the entry “fiscal discipline” in the original Washington Consensus to “high savings” in 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. In turn, national currencies appreciated, causing artificial increases in wages and salaries.

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5 For the different versions of the Washington Consensus see Marangos (2009b).
and ultimately to increasing consumption, a fall in domestic savings, a disappointing increase of
capital accumulation, and in conclusion economies remained semi-stagnant. According to
Bresser-Pereira and Varela (2004-5), developing countries assigned an excessive priority to price
stability, a mistake that disabled them from achieving macroeconomic stability and resuming
growth after stabilizing 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, 2004-5,
p.248-9). 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). 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 that ensure that domestic firms have access to capital that is generated
domestically, increase demand and income more equitably and lessen dependence on exports for
growth (Chang and Grabel, 2004, p.124; D’Arista, 2008, p.532). Hence, the Post Keynesian
recommendation of increase in public investment targeting the optimum level of employment not
inflation, industry policy and growth financed by domestic savings contradicts the After the
Washington consensus policies of stabilizing inflation, maintaining hard budget constraints and
increasing domestic savings, as placed in Table 1.

3.2 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 poor population.
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 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 etc. (Chang and Grabel, 2004, p.191; Saad-Filho, 2007).

Hence, one of the main concerns regarding the Washington Consensus reforms is the
issue of income distribution which is not confronted, while for the After the Washington
Consensus the unequal distribution of income is the result of volatility. However, deficits have
limited impact on rates of interest; thus, income distribution is affected by the fiscal policy mix
American countries implied that the government is 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 (Neto and Vernengo,
2004-5, p.339). Therefore, the effects of fiscal deficits on the level of activity are mediated by
income distribution rather than the rate of interest (Neto and Vernengo, 2004-5, p.339). In wage-
led economies, as in the case of many Latin American countries, redistribution towards debt
holders, with lower propensity to consume, should lead to output stagnation. The IMF’s
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 ‘social safety net’ rather than on building modern welfare states, subordinates social policy as 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 “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) can promote several pro-poor objectives simultaneously (Saad-Filho, 2007, p.516, 530). “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” (Saad-Filho, 2007, p.530). Public expenditures in education, health, infrastructure “are clear pre- and co-requisites 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). In sum, the position of Post Keynesians is in establishing a modern welfare state and directing expenditure on social programs, while for the After the Washington Consensus public expenditures should be 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.

3.3 Tax reform:

For the Post Keynesians, the development of a tax system should be based not only 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.522-3). 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, there is a conscious payment of taxes by members of the society and non-compliance is not considered an alternative. Non-compliance 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 as a result of the ‘rational’ computation associated with the benefits and costs of deceiving. In addition, enforcement mechanisms for non-compliance 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 would have had to 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

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6 The reasoning for the impact of distribution on aggregate demand based on Saad-Filho (2007, p.517) rests on Kalecki (1972; 1993).
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 transition model, in which individuals were motivated not by moral duty but, rather, by self-interest and 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 After the Washington Consensus 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 or elimination of the 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.

3.4 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 counter-cyclical direction to smooth out boom-bust cycles (Ocampo, 2002, p.399). Arestis (2004) argues 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 towards the interests of the financial sector, an interest group that is mobile, politically powerful, and maintains strong international ties with the only interest 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 (Chang and Grabel, 2004, p.183). After crises occur, governments either discard policy implementation of financial liberalization, all in all, 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-spurs in the developing world – East Asia, China, India, Brazil and Mexico – did not correspond with periods of all-embracing financial liberalization inline with the Washington Consensus (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 reasons are: 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.338-9). Gnos and Rochon (2004-5a, p.188) criticize the IMF for imposing such 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” in return for aid. Because of these policies are forced on national economies when the capital flows to their emerging economies are reversed, “the complete collapse of aggregate demand ensued” (Gnos and Rochon, 2004-5a, 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). Meanwhile, the dynamic analysis of a Kaldorian pattern of growth determines productivity rather than the reverse neoclassical postulate (Kaldor, 1978; Ocamb, 2004-5, p.297).

Davidson (2004-5, p.214) suggests 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 (2004-5, 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 (Neto and Vernengo, 2004-5, p.337). In this case, the central bank should be able to set the rate of interest independently from any international pressures.

Arestis (2004-5) questions the policy implications emanated by the Washington consensus that free banking leads to stability of the financial system; financial liberalization enhances economic growth; savings cause investment; 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 liberalization policies have destabilizing effects on economies. Financial liberalization increased the demand for credit by households and firms that was not offset by a comparable increase in the saving rate (Arestis, 2004-5, p.264). Speculation has become rampant because the policies of financial liberalization increased the opportunities and incentives to speculate (Chang and Grabel, 2004, p.28). Arestis (2001) shows that the link between stock market volatility and economic growth is significantly strong and negative.

The financial liberalization thesis ignores several factors relating to the relationship between financial liberalization and economic development, and is based on an ideological commitment to markets that are grounded neither in empirical evidence or economic theory. In sum, interest rate liberalization has a negative effect on investment (Arestis, 2004-5, p.266), financial liberalization is less likely to enhance long-term growth prospects (Arestis, 2004-5, p.263), and a free banking system is unable to respond to a financial crisis (Arestis, 2004-5, p.258). The alternative is to support interest rate policies that aim at a stable and permanently low level of interest rates (Arestis, 2004-5, 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, 2004-5, p.265).

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, p.280-1). 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 and autonomous rate of interest. The After the Washington Consensus advocates maintaining the low inflation rate targeting and financial liberalization by supplementing the strengthening prudential supervision.

3.5 Exchange rate:

Davidson (2004-5, p.212) attacks the insistence of the Washington Consensus 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 nation in a process that perpetuates a world of slow growth (if not stagnation)” (Davidson, 2004-5, p.217). By chasing the competitive exchange rate with the intention of making domestic industries more competitive in the absence of capital controls, risks stability and capital flight and unemployment becomes a problem for not only the competing economies but also the trading partners of the successful export-led country. Davidson (2004-5, p.216) argues 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”. Even if the search for a competitive exchange rate were to succeed, the end result would still tend to increase the global inequality of income and likely reduce domestic living standards. Restricted currency convertibility, along with 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).

This 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, “the 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” (Davidson, 2004-5, p.216). Thus, the rich, developed countries will realize a higher growth rate of income earnings than 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” (Davidson, 2004-5, p.226). In this context, the recent experience of Argentina clearly demonstrates that currency boards do not protect developing countries from the
financial and economic collapse that is associated with speculation against their currencies (Chang and Grabel, 2004, p.173).

While the corner solution supported by the Washington Consensus presents a false dichotomy with the goal of halting inflation, neither the intermediate case of managed competitive exchange rates is an adequate answer (Kregel, 2008, p.550-1). 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) inline 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 After Washington is in favor of flexible exchange rates, while the original position was competitive exchange rates, and the minimization of the use of the dollar.

3.6 Trade Liberalization

Globalization ‘a la Washington Consensus is but one form of globalization. Different policy choices with reference to international trade and finance can create a form of globalization that would not be so damaging to living standards and growth (Chang and Grabel, 2004, p.30). It is the ‘a la Washington Consensus form of globalization and not globalization itself that is primarily responsible for the poor economic performance and the deterioration of living standards in developing countries (Chang and Grabel, 2004-5, 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 labor and capital (Chang and Grabel, 2004, 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 labor 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, 2004-5, p.213). In addition to this, trade liberalization 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 liberalization can disproportionately effect the poor, the pro-poor strategies require the regulation of the balance of payments (Saad-Filho, 2007, p.528).

Keynes’ provides a rationale for designing an international payment system that recognizes that several of the Washington Consensus reforms cause more problems than provide solutions (Davidson, 2004-5, p.218). Davidson (2004-5) and Ocampo (2002, p.397) propose an international trade reform program built on Keynes’s Bretton Woods proposals that are 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 be protected from international trade competition and that smaller countries engage in selective export promotion (Chang and Grabel, 2004, p.66, 67). The statistical correlation between the degree of openness and growth cannot legitimately be 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 (Chang and Grabel, 2004, p.64).

Keynes, especially, insisted upon the idea that movements of capital could not be left unrestricted: “we cannot hope to control rates of interest at home if movements of capital money out of the country are unrestricted” (Keynes, 1980, p.276). Meanwhile, “capital 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 it would 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). Capital controls played a critically important role during the high-growth periods in Japan and South Korea and in Brazil in the 1950-60s. 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, more importantly assuring satisfactory growth rates in comparison with other Latin American countries (Bresser-Pereira and Varela, 2004-5, p.237). The Malaysian government successfully employed stringent capital controls in 1994 and 1998, Thailand at the end of 2006. China and India continue to employ extensive capital controls 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 only ones that many supporters of the free market largely view in a positive light (Chang and Grabel, 2004, p.113-4). It appears that foreign private capital inflows follow rather than create rapid growth, as the experience of Taiwan, South Korea and China demonstrates. Thus, for Post Keynesians capital controls are the necessary complement to Keynes’ fiscal policy proposals and for the socialization of investment and it appears that a sustainable growth path is a precondition for private capital inflows (Chang and Grabel, 2004, p.19; Neto and Vernengo, 2004-5, 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 they are based on pragmatic justification (Modenesi and Modenesi, 2008, p.561, 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). At the end, inline with Keynes, Williamson (2000, p.257) and the IMF recently also advise against capital liberalization that lead to speculative bubbles and financial crises, as in the East Asian crisis (Chang and Grabel, 2004-5, p.274).

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 know of the failures of the Washington Consensus 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 have been 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 can 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 be surrendered. The creation of the ICU would require only an international agreement among its national members, preserving the core of the Keynes 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 success, fixed but adjustable exchange rates, capital flow restrictions, and surplus nations initiating the path toward the reduction of imbalances7 (Cetrini, 2008, p.516). D’Arista (2008, p.536-7) 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 effective demand is not guaranteed.

Keynes’ 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, promoting national diversity through freedom to choose were finally abandoned (Cetrini, 2008, p.517-8). As well as, the current proposed ICU plan, seriously reduces the role of the international financial institutions, as it requires the reconstitution of a public channel for balance-of-payments settlements a element that is most considered necessary to re-establish a system that can promote balance and stability around the world (D'Arista, 2008, p.537-8). Even so, “some 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 International Clearing Union (fixed but adjustable exchange rates, capital flow restrictions, and surplus nations initiating the path toward the reduction of imbalances) while the After the Washington Consensus maintains its position of import liberalization with the stipulation of ensuring better access to export markets in developed countries.

3.7 Foreign Direct Investment (FDI):

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

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7 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).
Grabel, 2004, p.23) with the goal to avoid the threat of capital flight. But not all investment by multinational corporations is equally subject to flight. This concern should not discourage governments from regulating FDI as part of a national development strategy (Chang and Grabel, 2004, p.143). This is because when making investment decisions, multinational corporations place greater emphasis on factors like a large domestic market, an educated workforce, rising incomes and economic growth, and 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 both cases of Brazil and Argetina 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 which 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, p.552-3, 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 and 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 are successful in attracting, while at the same time regulating heavily FDI (Chang and Grabel, 2004, p.142, 145). At the end, it appears that growth leads to FDI rather than the other way around (Chang and Grabel, 2004, p.143).

Gnos and Rochon (2004-5b) 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 FDI. In the end, foreign banks wind up controlling almost half of the banking activity in Latin America. By and large, Gnos and Rochon (2004-5b) argue that the multinationalization 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 with the sole purpose of all these changes to attract 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, 2004-5b, 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 recapitalize domestic banks; meanwhile foreign banks experienced in increased competition from financial deregulation in their own countries responded with pleasure. Gnos and Rochon (2004-5b) 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 recapitalization (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 Post 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 Post 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, which may eventually turn to foreign ownership as a possible way of salvaging what is left. Thus, multinational banks lead to more multinational banks (Gnos and Rochon, 2004-5b, p.327). “Hence, it appears as if the ‘globalization of banking’ has contributed to make the world financial markets more fragile, not less so” (Gnos and Rochon, 2004-5b, p.317).

The proper policy response from a Post 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, 2004-5b, 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 behavior of banks is the same in all markets, both developed and developing markets: loans create deposits. What needs to be done, from a Post Keynesian perspective, is to improve the prospects that all borrowers will be able to reimburse banks (Gnos and Rochon, 2004-5b, p.328). This involves ensuring a proper “macro-financial environment”, to use Keynes’ expression (Gnos and Rochon, 2004-5b, p.327), and place the emphasis on the need for government to ensure sufficient growth in effective demand to allow borrowers to reimburse their bank loans. In sum, for the Post Keynesian FDI should be linked with national development or industry policy, and foreign banks should be regulated to ensure fair competition. The After the Washington Consensus maintains the abolishment of barriers to entry for foreign firms.

3.8 Privatization:

In several countries, many state-owned firms became a source of inefficiency and budget deficits, but this is by no means a universal feature. Indeed, even reform-minded countries kept some public-sector firms, and some of them were quite successful (Ocampo, 2004-5, p.311). As it may be easier to control state-owned firms as compared to private firms, the experience of France, Austria, Finland, Norway and Italy, had 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 in Latin American economies with all the consequences that emanating from this characteristic (Chang and Grabel, 2004, 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,
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) argue 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 was because ownership, as such, was 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 After the Washington Consensus persists in favor of privatization despite the fact that it accepts that it was carried out badly.

3.9 Deregulation:

The mainstream Keynesians explain unemployment to short-term maladjustments due to wage and price rigidities, or in an open economy to non-competitive exchange rates (Davidson, 2004-5, p.210); supposedly, this justifies liberalization of the labor market, as recommended by the After the Washington consensus. However, labor market liberalization has contributed to the worsening income distribution in 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 by a reducing “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, p.403-4).

The main goal of the regulation of labor market within the Post Keynesian framework in contrast to the deregulation recommendation by the After the Washington consensus 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).

3.10 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 After the Washington Consensus. However, property rights are only one part of the general institutional framework for a “successful” market economy; the disregard of institutions in the original Washington Consensus was harmful to economic development (Ocampo, 2004-5, p.309). Meanwhile, “… we can claim that the period of state-led industrialization was superior in Latin America in terms of institutional development” (Ocampo, 2004-5, p.308).

3.11 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 only be reconciled 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 of historical determinants; so as institutions fulfill the capacity 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 After the Washington Consensus to impose a dominant model of economic and social organization (Ocampo, 2004-5, p.312). The After the Washington Consensus specifies with respect to the institutional structure a role for the state as outlined in Table 1, in contradistinction the Post Keynesians argue that institutions are endogenous to each society so as to guarantee social cohesion and manage conflict.

We should not make the same mistakes, as Williamson and the supporters of the After the Washington Consensus. 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 the 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 Washington Consensus argue that their policies are founded objectively; nevertheless, they are instigated by values, social influences and closed-mindedness of its creator and policymakers who adopt these policies. Bresser-Pereira and Varela (2004-5, p.233) remind us that “…there are many varieties of capitalism”.

The worldview of the Washington Consensus 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, p.89-90). Based on a cross-disciplinary social science approach, researchers and policymakers should make explicit their predispositions when providing policy advice. Gay (2007, p.84) argues 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 (Gay, 2007, p.84).

Hence, with caution, I am presenting the general Post Keynesian propositions with the stipulation that development is a common endeavor and 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.
National autonomy to determine economic and social development strategies by deciding, adapting and executing policies, with the international institutions in a supporting role “by the intimate involvement of development economists in the everyday lives of their target audience” promotes democracy on an international scale (Gay, 2007, p.91, 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, p.99-100). In the end, Ocampo (2002, p.405) and Chang and Grabel (2004-5, p.274) state that the economic system must be subordinate to broader social objectives as per Polanyi (1975 [1944]) because institutions, governance, and distribution always matter.

4. Conclusion

The paper reveals the Post Keynesian alternative to the “After Washington Consensus” as a means “to counter the argument that the [After] Washington Consensus is effectively the only game in town, these critiques need to be supplemented by suggestions for alternative macroeconometrics 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 current 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 reveal in Table 1, in sum: public investment directed to the optimum level of employment; industry policy; growth financed with domestic savings; modern welfare state; social programs; modern tax system, expanded tax base, increasing tax revenues and redistributing income; prudent 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 or industry policy; regulation of foreign banks; maintaining state owned enterprises; regulation of the labor market; and institutions that guarantee social cohesion and manage conflict. Of course, these policies are not the only preconditions for economic prosperity, only because the paper is merely a reaction to the After the Washington Consensus; thus, by definition the paper is limited in its scope. Nevertheless, all in all, these policies are in contract to the After Washington Consensus which does not dismiss the original reforms associated with the Washington Consensus, 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 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 current financial crisis affecting the world today.

References


Hailu, D., (2009), "Is the Washington Consensus Dead?", International Policy One Pager, Centre for Inclusive Growth, No.82.


Table 1: After the Washington Consensus, Washington Consensus and the Post Keynesian Alternative

<table>
<thead>
<tr>
<th>After the Washington Consensus</th>
<th>Policies</th>
<th>Original Washington Consensus</th>
<th>Post Keynesian Alternative</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stabilizing inflation, sub-national governments subject to hard budget constraints, increase domestic savings.</td>
<td>Fiscal Discipline</td>
<td>Small Budget Deficit financed without resource to inflation tax</td>
<td>Public investment directed to the optimum level of employment. Industry policy. Growth financed with domestic savings.</td>
</tr>
<tr>
<td>Stabilize the real economy through Keynesian policies, establish a stabilization fund</td>
<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>
<td>Modern welfare state. Social programs: 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.</td>
</tr>
<tr>
<td>Monetary policy targeting a low rate of inflation; strengthening prudential supervision.</td>
<td>Financial Liberalization</td>
<td>Market determined interest rates.</td>
<td>Prudential regulation and capital controls. Dependent central 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. Development banks</td>
</tr>
<tr>
<td>Flexible exchange rates minimize the use of the dollar.</td>
<td>Exchange Rates</td>
<td>A unified competitive exchange rate.</td>
<td>Adjustable pegged exchange rate. Exchange rate anchor as part of domestic price stabilization policy</td>
</tr>
<tr>
<td>After the Washington Consensus</td>
<td>Policies</td>
<td>Original Washington Consensus</td>
<td>Post Keynesian Alternative</td>
</tr>
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<tr>
<td>As the original Washington Consensus</td>
<td>Fiscal Discipline</td>
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</tr>
<tr>
<td>As the original Washington Consensus</td>
<td>Tax Reform</td>
<td>Broadening Tax base and cutting marginal tax rates</td>
<td>Increasing tax revenues and redistributing income. Strong enforcement of the existing tax laws; the reduction or elimination of the 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. Modern tax system and an expanded tax base.</td>
</tr>
<tr>
<td>Supplementing financial liberalization by the strengthening of prudential supervision</td>
<td>Financial Liberalization</td>
<td>Market determined interest rates.</td>
<td>Prudential regulation and capital controls. Dependent central 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. Development banks</td>
</tr>
<tr>
<td>Complementing import liberalization with better access to export markets in developed countries.</td>
<td>Trade Liberalization</td>
<td>Replace quantitative trade restrictions with tariffs of around 10-20%.</td>
<td>International Clearing Union (fixed but adjustable exchange rates, capital flow restrictions, and surplus nations initiating the path toward the reduction of imbalances).</td>
</tr>
<tr>
<td>As the original Washington Consensus</td>
<td>Foreign Direct Investment</td>
<td>Abolish barriers to entry for foreign firms</td>
<td>Joined to national development or industry policy. Regulation of foreign banks and to ensure fair competition</td>
</tr>
<tr>
<td>Continuing the privatization program, even though in some cases, it was carried out badly</td>
<td>Privatization</td>
<td>State enterprises should be privatized.</td>
<td>Maintaining state owned enterprises.</td>
</tr>
<tr>
<td>New Agenda II: Completing First-Generation Reforms</td>
<td>Liberalizing the labor market</td>
<td>Deregulation</td>
<td>Abolition of regulations that impede entry of new firms or restrict competition.</td>
</tr>
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</tr>
<tr>
<td>As the original Washington Consensus, provide property rights to the informal sector, land reform</td>
<td>Property Rights</td>
<td>Secure property rights which are also available to the informal sector.</td>
<td>Recognizing the importance of property rights for an entrepreneurial market economy. Reform of land tenure.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>New Agenda III: Second-Generation Reforms:</th>
<th>A role for the state: maintaining effective institutions, in providing public goods, internalizing 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, modernizing the market institutional structure and institutional reform in the financial sector</th>
<th>Institution Building</th>
<th>Not a concern.</th>
<th>Endogenous to each society. Guarantee social cohesion and manage conflict</th>
</tr>
</thead>
<tbody>
<tr>
<td>Establishing property taxation as the major source of revenue; elimination of tax loopholes and taxing income earned on flight capital</td>
<td>Tax Reform</td>
<td>Broadening Tax base and cutting marginal tax rates</td>
<td>Increasing tax revenues and redistributing income. Strong enforcement of the existing tax laws; the reduction or elimination of the 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. Modern tax system and an expanded tax base.</td>
<td></td>
</tr>
<tr>
<td>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</td>
<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>
<td>Modern welfare state. Social programs: 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.</td>
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</tbody>
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