

Globalization and the Washington Consensus

Its Influence on Democracy and Development in the South

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INTERNATIONAL MONETARY FUND: FROM STABILITY TO INSTABILITY THE WASHINGTON CONSENSUS AND STRUCTURAL REFORMS IN LATIN AMERICA

INTRODUCTION

The International Monetary Fund (IMF) was created to set a standard for development and to facilitate the exchange transactions of the International Financial System (IFS) in the framework of the established international economic order. During the last three decades, the IMF has transformed itself into an international financial organization whose main objective has been to act as a "lender of last resort" in the face of the instability generated by financial crises during this period. The Washington Consensus and the Structural Reforms in Latin America have jointly contributed to increase the instability in the region in a democratic context. It is therefore important to establish the reasons for the creation of a post war international monetary system and for the ongoing changes in the relationship between international financial institutions and the economic and political international order.

In addition, financial globalization and financial markets have fulfilled a strategic role in the performance of emerging economics, resulting from changes in the global financial system. Also, the develop-

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ment of capitalism and the economic reforms of the Washington Consensus have deepened the transformation of the economic structures of governments, which have passed from authoritarian and regulated regimes to deregulated, democratic and market-driven systems. However, democracy and its significance on the path of economic, political and social reorganization, has not given opportunities to the majority of the population, which has not seen the benefits from the reorganization of relations between countries in the process of globalization.

Decades ago, in *Capitalism, Socialism and Democracy* (1946), Schumpeter emphasized several problems of democracy, saying that

We have every reason to be on our guard against the pitfalls that lie on the path of those defenders of democracy who while accepting, under pressure of accumulating evidence, more and more of the facts of the democratic process, yet try to anoint the results that process turns out with oil taken from eighteenth-century jars (Schumpeter, 1946: 324).

That is, "we still remain under the practical necessity of attributing to the will of individual independence and a rational quality that are altogether unrealistic" (Schumpeter, 1946: 325). The significance of this quotation is that Schumpeter recognizes that defenders of democracy and of freedom of choice do not necessarily seek the benefits of economic welfare and the opportunities that society can offer all of its members. Very often democracy centralizes political and economic power in the hands of a small group.

Indeed, when one studies democracy inside the voting system of the IMF or voter equality in democratic regimes of the countries of the South, it would be difficult to speak of the benefits of democracy. Thus, Amartya Sen furthers the concept of democracy, relating it not only to the possibility of election by the majority, but also to the opportunities of satisfying human beings' needs and desires. Democracy is much more complex, as it not only relates to the majority vote but also to the respect for freedom and the right to choose within the social environment. Democracy is a system of demands on the part of social actors. Thus, democracy is related to economic development and to the economic needs of the population. These needs are also related to citizens' values and universal values, such as the right to work, to nourishment, health, housing and education.

Democracy and economic development constitute the path towards liberty; this relationship is understood as

a process of expanding real freedoms [...] that [...] focuses attention on results for which development becomes important, and not only on the means that, amongst other things, have an outstanding role in the process (Schumpeter, 2000: 19).

This author mentions five different types of freedom,

[...] from an instrumental perspective: 1) political freedoms, 2) economic facilities, 3) social opportunities, 4) transparency guarantees and 5) protective security. Each of these, distinct types of rights and opportunities, help to advance the general capability of a person (Schumpeter, 2000: 27).

Following these considerations, the main idea of this paper is to highlight the constant dispute between a financial system that seeks equilibrium in its macroeconomic variables and the persistent financial instability of capitalist development. The essay is divided into the following sections: I) the international monetary system from its creation until the post-Bretton Woods era; II) the global financial markets and the implications of financial globalization for emerging countries; III) the Washington Consensus and the transformation from regulated economies to deregulated market systems within democratic regimes; and lastly, IV) reflections on democracy and the results of the structural reforms.

THE INTERNATIONAL FINANCIAL SYSTEM IN THE POST-BRETTON WOODS ERA AND THE REFORM OF THE IMF

In general, the International Financial System is identified at present with the International Monetary Fund and to a lesser extent with the World Bank (WB), international institutions that for more than six decades have carried out financial norms established towards the end of the Second World War. This section is divided into three parts: a) the international financial system and its relationship with the IMF; b) the characteristics of the post-Bretton Woods era, and c) the reform of the IMF.

INTERNATIONAL FINANCIAL SYSTEM AND ITS RELATIONSHIP WITH THE IMF

The foundations of the IFS were established in July, 1944, to allow the economic renewal of the world's main economic actors. The objectives were

[...] the creation and control of international liquidity and the maintenance of a stable but adjustable exchange rate system, which helps countries with transitory difficulties in their balance of payments to hold stability in the exchange rate, as a contributing factor to the development of the international economy (Chapoy, 2001: 22).

As such, a system with fixed exchange rates arose, with gold as the common denominator of monetary parities, expressed at the same time in US dollars. The possession of foreign exchanges in the finan-

cial reserves of countries was fully allowed. Therefore, the rate of exchange, disequilibrium in the balance of payments, and the reserves (once in gold, now in dollars) have constituted the key considerations of a hegemonic monetary system.

With regard to exchange rates regimes, the IMF's Constitutive Agreement establishes in Article IV (Section I), corresponding to general obligations of members, that

[...] the essential purpose of the international monetary system is to provide a framework that facilitates the exchange of goods, services, and capital among countries, and that sustains sound economic growth, and that a principal objective is the continuing development of the orderly underlying conditions that are necessary for financial and economic stability, each member undertakes to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates.

More precisely, the IMF was created to facilitate the exchange order altered by the Second World War. According to authors such as Chapoy (1983), Correa, Girón and Martínez (1999), this has propitiated the expansion of corporations in Europe, as well as in Asia and Latin America.

This is due in large part to the fact that international financial organizations established the order and the management conditions of the exchange rates to facilitate the penetration and expansion of direct and indirect investments. As such, until 1971 corporate capital had a course of development beginning with its banks and companies. It is exactly in this year that the foundations of the Agreements began to crack and what would later be called the post-Bretton Woods era began.

These agreements broke down in several ways. In 1944, "[...] when the IMF was established in Bretton Woods, a fixed exchange rate system emerged around the dollar, convertible into gold at a certain standard rate" (Chapoy, 1983:7). Between 1971 and 1973, dollar devaluation took place, followed by an increase in the price of gold and the flotation of exchange rates. This situation caused not only currency instability, but it also displayed the need to deregulate financial systems. As for financial stability, Article IV of the IMF's Constitutive Agreement points out that each member shall

[...] i) endeavor to direct its economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability; [...] ii)[...] that does not tend to produce erratic disruptions; iii) avoid manipulating exchange rates or the international monetary system in order to prevent effective balance of payments adjustment or

to gain an unfair competitive advantage over other members; and iv) follow exchange policies compatible with the undertakings under this Section (IMF, 2006).

In Section 3 on Surveillance of exchange arrangements, the Fund establishes the supervision of the international monetary system and the compliance of each member to its obligations.

Due to the priority given to monetary stability through exchange rates and the balance of payments, the IMF has operated through stabilization programs. But as the IMF does not take into account that economies have periods of growth and contraction, it has imposed economic stabilization measures with orthodox leanings, and consequently pro cyclical monetary, fiscal and financial policies have been applied.

THE POST-BRETTON WOODS ERA

The results of changes in Article IV and the devaluation of the dollar in relation to gold in 1971 and 1973, have signified not only the breaking of agreements but also the beginning of the post-Bretton Woods era, characterized by 1) an international monetary system detached from a stock of external assets; 2) the creation of financial resources in excess of the rate of growth of international trade; 3) displacement of capital flows towards emerging markets; 4) chronic financial crises; 5) drastic changes in national financial systems and 6) accumulation of reserves in emerging economies (Mántey, 1988).

IMF REFORM

Recently, at the Aspen Institute in Rome, Italy, Rodrigo de Rato, managing director of the IMF, said that

[...] The world is changing and the IMF needs to change with it. Twenty-first-century globalization, with massive movements of capital and abrupt shifts in comparative advantage, is presenting all countries and the global community with new challenges. The Fund must help our members meet these challenges, and it will need to adapt to do so (IMF, 2006: 100).

On this subject, Edwin M. Truman mentions in *A Strategy for IMF Reform* (2006^a) several issues worthy of discussion, such as the voting and veto power of the members of the IMF. Countries that constitute the Group of 5 gather almost 40 percent of total votes: the United States has a share of 17.08%; Japan 6.13%; Germany 5.99%; both France and the United Kingdom 4.95%. European countries, including those recently incorporated into the European Union and those from Eastern Europe, constitute about 33.72% of votes. China rep-

resents 2.94%, Russia and Saudi Arabia 2.74 and 3.22, respectively. Africa has a 4.41% share, Latin America 12.43% and Asia 7.93%. This synthesis of voting percentages is of great importance, as developed countries, in no need of financing, have the larger number of votes. As it stands, at least a 10% of the voting power must be transferred from industrial countries to emerging economies.

A recent publication of the Institute for International Economics mentions that the IMF faces an identity crisis. It should guarantee its member countries the health and stability of the global economy and the financial system. Countless proposals are aimed at reforming the institution, not only its provisional committee but also the availability of larger amounts of resources to finance development (Truman, 2006:119).

Article IV emphasizes the stability of exchange rates, seeks coherence between countries' external and internal balances, and underlines that the Fund shall offer policies containing real guidelines for a country to develop its economy. This has determined the maintenance of a primary fiscal surplus in many countries, with the cases of Argentina, Brazil, and Mexico being of particular relevance. In Mexico, the lack of an employment policy as part of the main objectives of economic policy has contributed to the expulsion of jobs towards the United States. As such, remittances to the country have increased remarkably.

FINANCIAL GLOBALIZATION AND THE FINANCIAL MARKETS OF EMERGING COUNTRIES

The IMF, in abdicating its role at the center of the IFS and regulator of inter-bank loans, left the field open for financial intermediaries to direct the international financial market. In this new dynamic, the IMF is merely an observer of markets, an international lender of last resort, and an adviser of governments in order to restrict monetary, fiscal and financial policy in accordance with the new international order.

With the fall of the Bretton Woods agreements, financial instability has deepened and sharpened. In the past decades, financial crises have become part of Latin American, Asian and African daily life. The IMF itself points out that "[...] between 1975 and 1997, 158 episodes in which countries experienced substantial exchange market pressures and 54 banking crisis were identified" (IMF, 1998:86). A number of broad types of crises can be distinguished: currency crisis (devaluation or sharp depreciation), stock market crisis, banking crisis, balance of payments crisis, etc. Hence, it is correct to say that the decade of the nineties has not been the "decade of hope" or the "lost decade", but the "decade of the financial crisis" on a global scale.

Although stability has characterized the first decade of the XXI century, it has not been accompanied by economic growth. The world has gone through a decade of financial deepening that can be illustrated with the following figures from the Bank for International Settlements. Interbank transactions reached \$23.1 trillion as of the second quarter of 2005. This unusual growth had not been seen since the first quarter of 1988. The main activities were carried out basically by banks in the United States, the United Kingdom and Offshore Centers (Bank for International Settlements, 2005:15). According to Mántey,

[...] global financial deregulation and the detachment of the international monetary system from a reserve of external assets, has resulted in the expansion of international financial markets at rates far superior to those of world revenues and international trade (Mántey, 1998: 9).

For example, the World Trade Organization (WTO) indicates that exports exceeded \$10 trillion in 2004. In spite of the fact that there was a slowing of world trade in 2005, exports of commercial services still rose by 11% at current prices (as opposed to a growth of 29% in 2004).

Meanwhile, financial activities have maintained a sustained growth, as evidenced by capital flows. Total external credits equaled \$7.7 trillion dollars in 2005. Capital flows towards developing countries have had a sustained annual average of \$179 billion dollars between 2002 and the present. Nevertheless, Asia has received greater amounts of these private capitals than other regions, attracting \$60.9 billion dollars during the period, while the Middle East and East Europe have received \$77.4 billion dollars. On the other hand, Latin America's annual average of capital inflows has decreased by \$54.8 billion dollars from 1996 to 2001. From 2002 until today, inflows to the region have averaged \$17.9 billion dollars annually.

At the same time, the deepening of external indebtedness is noteworthy in the region, and Latin America continues to be far more indebted than other regions of the developing world. Since 2000, the region's annual average of external indebtedness has been \$760 billion dollars, as opposed to South-East Asia and the Pacific's \$512 billion dollars, and Eastern Europe and Central Asia's almost \$600 billion dollars. Expressed in other terms, Latin America represents almost a third of all developing countries' external indebtedness and more than the third of developing countries' external debt service, representing as an annual average almost \$133 billion dollars since 2000.

The players of financial globalization represent interests of considerable scope. Only the first ten commercial banks worldwide controlled 12.6 trillion dollars in 2005 (The Banker, 2005), when fifteen years before, the respective number was only around 3 million dollars.

The major non financial corporations represented 2.88 trillion dollars in 2005. They increased three times more than fourteen years before, when the total amount was \$870 billion dollars (Fortune, 2005). A significant outcome of the Financial Reforms in Latin America is that the total amount of assets, at least in Argentina, Brazil and Mexico, has reached over \$660 billion dollars and net profits \$8.7 billion dollars, more than a 10% of total assets. In addition, it is worth mentioning specific features of these countries. In Argentina, the country's largest bank, Banco de la Nación Argentina, controls over \$14 billion dollars while the Banco de la Provincia de Buenos Aires controls over \$7 billion. In total, both state owned banks control over \$21 billion dollars, more than the third of total assets. Even though Argentina was a symbol of the wave of privatizations in the nineties and of the financial and economic crises that the region has witnessed since its independence from Spain, circumstances have been different in other countries, such as Mexico. This country's main commercial banks are in private hands. The first two institutions belong to Spain's principle transnational megaconglomerates, BBVA and Banco Santander Central Hispano, which together hold a total of \$65 billion dollars in assets. In addition, Citigroup-Banamex manages \$42 billion dollars of assets in the country, and HSBC \$18 billion.

The internationalization of the Mexican financial system has been very deep in comparison with Argentina and Brazil. While Brazil's banks hold assets of over \$422 billion dollars, and the first and third largest banks in this measure are state owned, Banco do Brasil holds \$90 billion dollars, and Caixa over \$55 billion. Santander Brasil, a Spanish bank, occupies the sixth place with approximately \$26 billion dollars. Comparing the amount of Brazil's total bank assets to the amount in hands of foreign agents, it is evident that foreign banks have a limited penetration and do not significantly influence the credit decisions of the Brazilian client.

While financial reforms in Latin America were successful in some countries, in others they signified a loss of credit sovereignty. Though reforms have focused mainly on financial balances, in spite of the fact that such balances have generated stability, but not greater employment and growth, governments that have criticized the structural changes and so-called "neoliberalism", have not worked towards attaining sustained growth for their countries. The economic reports of the ECLAC (Economic Commission for Latin America and the Caribbean), of the IADB (Inter-American Development Bank), and even the annual statements of the central banks of the region, show this point clearly. There is still continual support to prioritize the neutrality of monetary policy and inflation.

THE WASHINGTON CONSENSUS AND DEMOCRACY

From an academic perspective, relating the Washington Consensus to democracy poses a challenge. Schumpeter himself warned that it was necessary to worry about the "defenders of democracy". First, the main objective of the Washington Consensus project is the deregulation of financial, productive and labor markets. Secondly, emphasis is given to the respect of private property and processes of privatization which mean a diminished role of the state so that companies, together with a free workforce, can take charge of national and international economic projects. Moreover, the restructuring of the productive bases of the economic order established since the end of the second world war, when public institutions and unions fulfilled a role in favoring a welfare state and when private and public investment coexisted in a coordinated way, has been explicitly exposed. In the eighties, deregulation and liberalization were presented as an alternative to the existing economic policy and the problems that it faced, such as the United States' economic situation and the serious difficulties of foreign debt in the Latin American countries. The deregulation and opening of markets took place gradually by way of the stabilization plans that the IMF imposed on countries after crises that led to the devaluation of their respective currencies. Therefore, movements towards more democratic markets have been based on a market in which the chief actors are the large financial and industrial conglomerates.

THE WASHINGTON CONSENSUS

The recent essay "Obstáculos al Desarrollo: el paradigma del financiamiento en América Latina" (Correa and Girón, 2006) mentions that in order to understand the financial reforms in Latin America, it is necessary to at least be familiar with the works produced by the Inter-American Development Bank (IADB), the Center for Latin American Monetary Studies (CLAMS), the Institute for International Economics and the Economic Commission for Latin America and the Caribbean (ECLAC) (Hausmann, 1997)¹. In such institutions, the ten points of the Washington Consensus and how they have been applied have been studied.

THE RESULT OF THE REFORMS

There are three fundamental books to understand the Washington Consensus and its results. The first is Correa and Girón's *Reforma*

¹ On the part of CLAMS, it published Stallings, B. (2001). It is proper to mention three other books that pose the "urgency" of the reforms: Balassa, B. (1986), Williamson, J. (1990), which coins the concept of Washington Consensus, and Kuczynsky, P. and Williamson, J. (2003).

Financiera en América Latina (Correa and Girón, 2006), which explains the process of financial deregulation and the development paradigm up until the loss of national financial systems. Secondly, in the foreword of *After the Washington Consensus* (Kuczynski and Williamson, 2003), Fred Bergsten mentions that it is time for the world to overcome the tendentious and ideological debates that have caricatured the Washington Consensus as a neoliberal manifesto and to engage in a serious discussion about the reforms that the region needs in order to restore growth and equity. Finally, Ffrench Davis (2005) discusses the successes and failures of the reforms and the imminent and pressing need for "reforming the reforms" in Latin America. These books synthesize at least three decades of the financial-structural change that has isolated Latin American from the benefits of development.

Although the macroeconomic view of the financial reforms is important, the close relationship between those changes and their consequences for families is determinant in the consideration of inequalities between them. In his work, *Measuring International and Global Inequality* (2005), Branko Milanovic analyzes income distribution worldwide, relating household activities to traditional indicators of the per capita GDP. He comes to the conclusion that there has been a substantial increase in inequality on the international level, owing mainly to the economic reforms advocated in the Washington Consensus.

When making reference to the Washington Consensus and democracy, it is also necessary to evaluate not only the partisan vote in a society and public participation of men and women in parliaments or congresses, but the levels of satisfaction in regard to basic needs and in regard to increasing the opportunities that the economic system offers. Moreover, the access to human rights—health, education, housing, and employment—to which people have the right to in a society, must also be considered. Inequality, represented by the Human Development Index (HDI), expresses the lack of opportunities for the great majority of worldwide population. The Human Development Report (HDR, 2005) shows that the process of reform throughout the world has led to inequality, in spite of economic growth. Thus, the heterogeneity of international relations has deepened the dramatic inequality in income distribution in many countries. The aforementioned Report points out that 20% of the world's population holds 75% of global income, the poorest 40% has 5% and the poorest 20% only 1.5%.

To this same effect, Milanovic (2005) draws attention to the fact that until the breakdown of the Bretton Woods agreements, there was generally only one supplier of resources per household. On

the other hand, in the last three decades the number of homes in which incomes stem from more than one purveyor has grown in an accentuated way. Not only has the wife become incorporated into the workforce, but within marginal families, even children bring money to the household.

On this point, Ffrench-Davis mentions that

[...] one and a half decade of intensive and profound reforms has left a mix of successes and failures [...] striking mistakes in the design of reforms have been committed, plus a weak capability to recognize failures and correct them at the right moment [...] the proposal is reforming the reforms (Ffrench-Davis, 2005: 14).

Actually, the reforms that were a hope for governments, at least in Latin America, were applied without bearing in mind each country's specific conditions after the "lost decade". Not only did they not favor the strengthening of national business in the face of the foreign competition that invaded the industrial and financial sector, but even public institutions were debilitated. For instance, the importance of the development banking in strategic sectors of development in infrastructure was diminished in countries as Mexico. In contrast to what occurred in Argentina, as it was not possible to sell the public banks before the debacle, they were restructured, now have a high profitability and are helping towards an economic and social national project.

With regard to productive investments and the role of foreign direct investment, Latin America was not favored in the conformation of the new economic order, as were China and India. The characteristics of financing economic development in Latin America have been contrary to the interests of national projects. This confirms that in Latin America financial liberalization did not attain the expected results. Both Asia and Latin America experienced financial crises in the nineties, but development policies, reforms and the liberalization of financial systems were different in these regions (Kaminsky and Reinhart, 1998). The fact is that while in Asia financial systems emerged strengthened from the crisis; in some Latin America countries crises initiated the internationalization of financial services, a phenomenon that has gained strength in many cases.

STABILITY AND INSTABILITY IN MARKETS WITH DEMOCRACY

The great transformation of the IMF and democracy have posed a challenge for countries that make up the South-South-South circle. This challenge results from the fact that the path of development has followed the guidelines of the Washington Consensus in the wake of the rupture of the international monetary system. The

end of regulated markets accompanying the collapse of the Bretton Woods Agreements gave way to the dominance of the free market in the framework of deregulation and liberalization of productive and monetary circuits.

Large international corporations have been the main players in the post-Bretton Woods era and during the last two decades have quickly restructured through mergers and mega mergers, acquiring recently privatized companies, as has been the case in much of Latin America. Important transformations in the financial market have also taken place. Innovations have allowed a common space to further financial profits, thus deepening financial instability. It should not be omitted, however, that the monetary, fiscal and financial policy of United States has aimed to maintain the stability of macroeconomic indicators.

The result has been inequality in income distribution, unemployment and a decrease in consumption. How can one respond to these structural changes from the viewpoint of the South? The Human Development Report does not offer answers. The statistics indicate inequality, while developing countries have an HDI of 0,694; countries with high human development have one of 0,895. The GDP per capita indicator registers \$4,359 for developing countries, and \$25,665 for countries with high human development. The per capita GDP and the HDI indicators therefore represent an asymmetric relation between developing countries and those with high development. Therefore, the results of the Washington Consensus reforms in the countries of the South have not been optimal when taken into consideration the asymmetry in the opportunities of developing and developed countries. These include not only levels of income, education, life expectancy, literacy, sustainable access to water sources, health and nutrition, but also the lack of employment opportunities and a more equitable development financing in place of excessive external debt services or the interests paid to financial markets. In a democratic society, basic issues concerning the globalization processes and the ongoing reforms must be discussed again.

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MEXICO: THE CONTRADICTIONS AND UNCERTAINTIES OF A TRUNCATED DEMOCRATIC PROCESS

JUST A FEW YEARS since the historic election in 2000 in which Vicente Fox Quesada, the candidate of the National Action Party (PAN) was elected as president of the Republic, it has become evident that it has failed the famous democratic transition that supposedly would end with political alternation in the government and with the rule of the transfigured regime of the Mexican Revolution. The votes that piled in then, with the sole aim of putting an end to the domination symbolized by the Institutional Revolutionary Party (PRI), were soon proved useless and a bad bet when an openly corporate government was formed, as this government repeated the same neoliberal policies, impregnated with a religious fundamentalism that has only reinforced the conservative line. The consensus that was built then has crumbled and the disenchantment, anger and even polarization and despair in society is manifest in all sectors (from the businessmen to the ecclesiastical hierarchy, with all types of political parties and civil organizations in between). The economy, which the first president of the post-PRI era had promised to expand, has barely managed to keep afloat, constantly thrashed and battered by the fluctuations in

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