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Consensus Vs. Freedom or Consensus Upon Freedom? From Washington Disorder to the Rediscovery of Keynes

Mario Cedrini

Dipartimento di Economia "S. Cognetti de Martiis"

Centro di Studi sulla Storia e i Metodi dell'Economia Politica
"Claudio Napoleoni"
(CESMEP)

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CONSENSUS VS. FREEDOM OR CONSENSUS UPON FREEDOM?

FROM WASHINGTON DISORDER TO THE REDISCOVERY OF KEYNES

Mario Cedrini*

ABSTRACT

The paper retraces the history of the debate on the Washington Consensus according to the four-stage partition *Consensus*, *Confusion*, *Contention*, *Conclusion*, with particular attention to the criticisms evoked by the use of it as a tool for the "integrationist agenda" of the Nineties. We argue that the excessive shrinking in policy space available to developing countries is among the key factors explaining why the saga has rapidly come to a *Conclusion*, leaving room to the rediscovery of the "embedded liberalism" of Bretton Woods. It is our aim to show, however, that Keynes's plan for a new international order inspired by a consensus on freedom rather than discipline, is still the most relevant model for a new system of national capitalisms enhancing member countries' freedom to choose.

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Keywords: Washington Consensus, International Economic Order, John Maynard Keynes, Policy Space, Bretton Woods.

* Department of Economic Sciences and Quantitative Methods, SEMeQ, University of Eastern Piedmont, Faculty of Economics, Via Perrone 18, Novara, Italy. E mail: mario.cedrini@eco.unipmn.it. I am grateful to Roberto Marchionatti as well as to the participants of a seminar held at the Department of Economics "Cognetti de Martiis", University of Turin, in 2007, for useful suggestions and criticisms. The usual disclaimer applies.

Consensus Vs. Freedom or Consensus Upon Freedom?

From Washington Disorder to the Rediscovery of Keynes

Introduction

The paper retraces the history of the debate on the Washington Consensus, with particular attention to the criticisms evoked by the use of it as a tool for the "integrationist agenda" of the Nineties. Four stages can be traced. The initial *Consensus* (Par. 1) or universal convergence of Williamson's paradigm is followed by a *Confusion* (Par. 2), due to its evolution into a global brand name for the post-cold war world. The stage of the *Contention* is here represented in particular by Joseph Stiglitz's and Dani Rodrik's complementary critical approaches to the endorsement of the paradigm by the international financial institutions (Par. 3.1) and to its faults as a policy prescription for development (Par. 3.2). We argue that the excessive shrinking in policy space available to developing countries is among the key factors explaining why the saga has rapidly come to a *Conclusion*. Once the implications of the Consensus for the international economic order are fully considered (Par. 4.1), the strength of the paradigm necessarily declines and leaves room to the rediscovery of the "embedded liberalism" of Bretton Woods (Par. 4.2). It is our aim, however, to show that post-Keynesian economists like Paul Davidson are right in calling attention to Keynes's efforts to construct a new international order promoting the diversity of national policies (Par. 4.3): his plans for a new order inspired by a consensus upon freedom rather than discipline, still stand as the

most relevant model for a new international system of national capitalisms enhancing, rather than opposing, member countries' freedom to choose.

1. *CONSENSUS:* THE ORIGINAL PARADIGM

In 1989 the Institute for International Economics fellow John Williamson organized a conference about Latin American countries' reform efforts to overcome the debt crisis which had hit them in the Eighties. While trying to persuade the members of a US Congress Committee about the desirability of the Brady Plan, Williamson wrote a document (1990) to show that the reforms endorsed by Latin American countries were recognized as "correct" by industrialized countries and required their financial assistance. In his paper, Williamson sketched a list of "10 policy instruments about whose proper development Washington can muster a reasonable degree of consensus" (ibid., p. 1). The "unusually wide measure of agreement that a number of rather basic ideas of good economics were not only desirable but were of key importance in the current policy agenda of at least one region, namely Latin America" (1999, p. 8), thus gave life to the "Washington Consensus", based on: 1) fiscal discipline; 2) reordering public expenditures priorities; 3) tax reform; 4) liberalizing interest rates; 5) competitive exchange rate; 6) trade liberalization; 7) liberalization of inward foreign direct investment; 8) privatization; 9) deregulation; 10) property rights. In sum, the Washington Consensus asked for "prudent macroeconomic policies, outward orientation, and free market capitalism" (1990, p. 7). Latin American countries were asked to acknowledge that development economics was not the solution:

> there used to be a sort of global apartheid which claimed that developing countries came from a different universe which enabled them to benefit from (a) inflation (so as to reap the inflation tax and boost investment); (b) a leading role for the state in initiating

> industrialization; and (c) import substitution. The Washington Consensus said that this era of apartheid was over. (2002, p. 2)

The paradigm thus revalued the "monoeconomy" principle, whose rejection was at the roots of development economics (Hirschman, 1981); the principal merit of the new "policy prescription for development" (Williamson, 2004a) was in showing that economic growth depends on a set of "right" policies rather than physical resources (Stiglitz, 2004a). A shift from historicism to ahistorical performance assessment was thus performed (Gore, 2000). The main pillars of development economics were reversed. The Consensus was clearly market-, rather than state-, oriented; external trade became the precondition for development and growth, while competitiveness was transformed into the principal target for economic policy (Polanyi Levitt, 2006b). Openness to international competition and new capital inflows were exchanged for monetary autonomy, while discretion in trade policy was abandoned under the promise of a better access to international goods, finance and technology markets (Unctad, 2004). Faith in "trickle-down economics" substituted for economic justice. With respect to structuralist studies, both the explanatory and normative frameworks for development policy analysis were radically modified: national rather than external factors helped explain developing countries' scarce performances, while solutions should come from the norms of a liberal international economic order (Gore, 2000).

The Nineties thus came to be characterized by a "clear and robust consensus […] about what poor countries should do to become more prosperous" (Naím, 2000, p. 87), at a time when the influence of economists on decision-making reached its height (Rodrik, 2004). However, as Williamson himself soon recognized, there was no real consensus on inflation targeting and stabilization, or on the use of the "ten commandments" to reach high levels of growth once stability assured. More importantly, Washington actually favored the bipolar exchange rate doctrine, and

promoted an aggressive capital liberalization agenda. Three years only after the original paper had been published, Williamson (1993) had placed the "desirability of maintaining capital controls" at the top of the list of issues which were not commanding a consensus in Washington. Nevertheless, the Consensus matched well the international financial institutions' (IFIs) new approaches to development and stability: in Williamson's words, the World Bank came to see the Consensus as "a reasonably accurate and appropriate summary of what the Bank, along with other agencies concerned with the promotion of development, was, and should been, advising countries to do" (1999, p. 4). According to the then Chief economist of the World Bank, Stanley Fischer, "Williamson has captured the growing Washington Consensus on what the developing countries should do" (Williamson, 2004c, p. 4). The IMF historian James M. Boughton (2002) places the Consensus among the ten ideas that have shaped the institution.

2. *CONFUSION*: THE HERMENEUTICS OF THE PARADIGM

Through the active involvement of the IFIs, the Washington Consensus became *the* development paradigm of the Nineties. However, Latin American second "lost decade" proved that the enthusiasm it raised was actually unjustified. For the rest of the developing world, the Washington Consensus decade has meant first of all a period of financial turbulence, marked by the major collapses of East Asia, Russia and Argentina. Joseph E. Stiglitz, among others, popularized the view according to which poor development performances, crisis and even slow recoveries are generally linked to the adoption, under IMF's and World Bank's surveillance, of the Washington Consensus reforms programs. In Stiglitz's interpretation, the Consensus – "between the IMF, the

World Bank and the U.S. Treasury about the 'right' policies for developing countries" (2002, p. 16), i.e. "[f]iscal austerity, privatization, and market liberalization" (ibid., p. 53) – was but a list of Washington *desiderata*, imposed on DCs to herald the global triumph of capitalism. The Asian crisis was there to reveal their ideological character:

> [t]ogether with the IMF, [the U.S. Treasury] had told countries that followed the "right policies" – the Washington Consensus policies – they would be assured of growth. The East Asian crisis cast doubt on this new worldview *unless it could be shown that the problem was not with capitalism, but with the Asian countries and their bad policies*. The IMF and the U.S. Treasury had to argue that the problem was not with the reforms [...] but with the fact that the reforms had not been carried far enough. By focusing on the weaknesses of the crisis countries [...] they attempted to use the experience to push their agenda still further. (ibid., p. 213)

Understandably, Williamson opposes the attempt to identify the Consensus with market fundamentalism or pure neoliberalism: only privatization had survived the fall of Reagan's and Thatcher's governments, he argues (2004c), while denying that a consensus ever existed about capital liberalization and minimal state. Should the "fundamentalist" interpretation be accepted, he wrote (1999), the World Bank would even run the risk of being discredited "simply because the Bank is inevitably implicated in views that command a consensus in Washington and the term 'Washington Consensus' has come to be used to describe an extreme and dogmatic commitment to the belief that markets can handle everything" (ibid., p. 1).

Historical reasons, i.e. the post-cold war world's "urgent and widespread need for an alternative set of ideas on how to organize economic and political life" (Naím, 2000, p. 88), help understand why the Washington Consensus has been changed into a widely criticized ideological agenda. The usual reply to Williamson's doubts – "[n]o country that took the Washington Consensus as I wrote it as a panacea would have been *obliged* to do the sort of things that led countries into crisis [...] But neither were they warned

against such fool acts» (2002, p. 2) – is that the IFIs played a key role by conditioning their financial assistance to the adoption of Consensus-inspired reforms. The reason behind their behavior is thus the puzzle to explain: the IMF insisted in pressing for promoting new capital inflows through austerity policies even when capital flows had previously increased external debts and current account deficits, leading countries into crisis (D'Arista, 2002-3). Recalling the gap between Williamson's "nuanced" version of the Washington Consensus and the IFI's more "aggressive" policies is another way to say that «the Washington Consensus became what it did, not what it said» (Kanbur, 1999, p. 2). In the 1980s and 1990s, Washington institutions perceived their task to be that of "storming the citadel of statist development strategies" (ibid.); suspects about DCs' willingness to welcome free-market capitalism probably led them to adopt a "more extreme stance than ever their own intellectual framework permitted" (ibid.). True "classical theory belief in the beneficence of free markets" (Davidson, 2004-5) is certainly part of the story; other explanations associate the implementation of risky policies like capital liberalization with creditors' interests in industrial countries (Polanyi Levitt, 2006b; D'Arista, 2002-3; Stiglitz, 2002). In general terms, however, it seems reasonable to say that the "hard" Washington Consensus was functional to the "integrationist agenda" of the Nineties, whose main target was to make the world safer for free trade in goods and capital (Rodrik, 2000).

3. *CONTENTION*: THE UNWANTED PARADIGM

3.1 *THE WASHINGTON CONSENSUS DID FAIL*

In 1998, after the outbreak of the Asian crisis, the then vice-president and Chief economist of the World Bank Stiglitz launched a new paradigm, the «Post-Washington

Consensus» (PWC), enriched with «more instruments and broader goals» for development compared to its predecessor. He stressed that though the Consensus "focuses on issues of first-order importance, it sets up an easily reproducible framework […], and it is frank in its limitations to establishing the prerequisites for development" (ibid., pp. 6-7), excessive emphasis is placed on inflation targeting, denying the benefits brought about by a slightly growing inflation. The Consensus "stability" is too narrow (as shown in Ocampo, 2004a); it ignores output and employment stability. It does not pay attention to the preconditions for a free market economy, which are likely absent in DCs, nor for financial regulation: Stiglitz argued that the Asian collapse, far from being the result of bad heterodox policies, necessarily began with removing public authorities from the task of regulating financial activities. More in general, the Consensus considers the state and the market as competitors, rather than complementary elements. Stiglitz's PWC was thus based on dissatisfaction with the paradigm's *omissis*: "[m]aking markets work requires more than just low inflation, it requires sound financial regulation, competition policy, and policies to facilitate the transfer of technology, and transparency, to name some fundamental issues neglected by the Washington Consensus" (1998, p. 1). Finally, the PWC "cannot be based on Washington. If policies are to be sustainable, DCs must claim ownership of them" (Stiglitz 1998, p. 34). Stiglitz's *construens* proposal, however, would later leave room to its *destruens* critique of the IFIs' policies, ideologically supported, he wrote in 2002, by the Consensus itself. Discontent about globalization is raised by "the particular set of doctrines, the Washington Consensus policies that [they] have imposed. And it is not just opposition to the policies themselves, but to the notion that there is a single set of policies that is right" (2002, p. 221).

The Asian crisis is here taken as an example of how countries may feel deprived of making their own choices, to use Stiglitz's words. Capital market liberalization had pushed up the value of Asian currencies, leading to unmanageable current account deficits; subsequent IMF austerity policies, intended to restore market confidence, ultimately depressed the economies and led to capital flights, delaying the region's recovery. Though the 1993 World Bank report on *The East Asian Miracle* praised the virtue of a mixed economy model, with government playing a relevant role (Park, Ahn and Wang, 2004), Asian countries' policies had been often acclaimed for their compliance with the norms of the "Consensus" international order, making it possible to argue for the superiority of economic liberalism (Davidson 2002b; Gore 2000; Rodrik, 1999). Then, the crisis offered a powerful evidence for the unsustainability of Asian "heterodox" policies, though most today's wealthy countries are closer to the East Asian experience than to the Anglo-American model of capitalism (Chang and Grabel, 2004-5). In exchange for financial assistance, whose aim should be that of facilitating the gradual adoption of reforms, the IMF asked for the abrupt passage from "crony capitalism" to free enterprise, capital and trade, and exposed countries to international speculation, though market institutions and adequate social safety nets were simply absent.

> It should be – and it should have been – the task of the international economic institutions to provide the countries the wherewithal to make these *informed* choices on their own, with an understanding of the consequences and risks of each. The essence of freedom is the right to make a choice – and to accept the responsibility that comes with it (Stiglitz 2002, p. 88)

During the crisis, the IMF had imposed capital liberalization to South Korea and Thailand and conditioned its loans to the rest of the region to the adoption of contractionary policies "à la Hoover" (Stiglitz, 2002), which soon revealed their beggar-thy-neighbor and, what is more, «beggar-thyself» character (Stiglitz, 1999). The IMF's

"hidden agenda" left behind Keynes's expansionist philosophy and compelled countries to submit to the fundamental equation of the balance of payments deficits, which must sum to zero in a closed system. The actions of a crisis country to reduce its deficit to zero while its surplus partner refuses to adjust "must be reflected in an increased deficit elsewhere. The contraction of its output reduces another country's exports, worsening its trade balance. In this way, the deficit is like a hot potato, passed on from one country to another" (ibid., p. 12). A third country running a deficit could suffer from pessimistic expectations about its currency; then,

> [t]he international community comes forward with a rescue package, but because of worries about the threat of competitive devaluation, they again insist that the "unsustainable trade deficit" be eliminated. In the process, they force that country into a recession too, until its trade deficit is eliminated, and the hot potato is passed along. The result, it is apparent, is a global economic downturn. (ibid.)

Raising or liberalizing interest rates and restructuring the financial system should have favored foreign capital inflows; rather, Asian enterprises with excessive capital/debt ratios went bankrupt and weakest banks were closed, with further liquidity shortages. Newly granted funds were mostly used to repay foreign creditors, who as a rule were assigned no responsibility for the collapse; subsequent IMF's strategies even granted them crisis management powers, while interest rates raised to unsustainable levels.

The new decade made it possible to weigh up successes and failures of the Consensus-inspired reforms in Latin America. Mainstream theory and the Consensus advocates had argued that the first lost decade was due to import substitution strategies' inefficiency and development policies based on internal demand. Recent studies have shown that growth performances were quite successful until the debt crisis of the Eighties, which was caused by interest rates and terms of trade shocks in the late 1970s. The Consensus was intended to reduce vulnerability to financial crisis, either by

increasing exports through enhanced competitiveness or by rewarding reforms with lower interest rates; paradoxically, it increased debt service and financial turbulence. Favors accorded to the *rentiers* by the mix primary surplus-nominal deficit and the strong redistribution of income which followed the Consensus policies raised the possibilities of a breakdown (Câmara Neto and Vernengo, 2002-3). Latin American countries were offered too narrow conceptions of stability and wrong tools: a mix of anti-inflation policies only valid in a flexible exchange rate regime could not fit "dollarized" currencies. Nor the Consensus had replaced the import substitution model with more effective strategies: productivity gains were simply wasted (Ocampo, 2004a). Capital liberalizing countries were submitted to the risk of capital flights towards the US, which led Williamson to support capital controls similar to those previously adopted by Chili (D'Arista, 2002-3). Unsurprisingly, the outcome of the Washington Consensus in Latin America was a "foreseeable disaster" (Gnos and Rochon, 2004-5, p. 188) for post-Keynesian economists. As to the concrete results of the paradigm in other contexts, consensus-countries's growth during the Nineties has been disappointing if compared with previous decades; most successful performers of that period were heterodox countries like East Asian, India and market-socialism nations. (Rodrik, 2004). What is more, the Consensus can be said to have really failed in directing new capital inflows to DCs, which was its main target (D'Arista, 2002-3).

Fifteen years later his original proposal, Williamson himself raised doubts about the implementation of the paradigm: «I too am uncomfortable if it is interpreted as a comprehensive agenda for economic reform» (2004c, p. 8). Nevertheless, the "new agenda" he launched with Kuczynski in 2003, which was intended to leave "any ideological albatrosses from the past" (Kuczynski and Williamson, 2003, p. 331), does not disavow the Consensus, errors and omissions excepted. The currency board adopted

by Argentina, «often described as a poster-child for the Washington Consensus» (Williamson, 2004a, p. 11) had been excessively rigid, and capital inflows insufficiently managed; “competitive” exchange rates never came to command a consensus. The new agenda prompted for crisis preventing tools and more flexible policies, anticyclical policies to stabilize the real economy “à la Keynes”, together with measures for a more even distribution of income. “First-generation” reforms – i.e. the original Consensus reforms – should have been completed rather than abandoned, while avoiding the «primitive macro policies that accompanied the micro reform» (Williamson, 2004c, p. 11), and supplemented by the institutional in character “second-generation reforms”, like the creation of a national system of innovation and improved property rights and financial regulations, privatization of the banking sector and labor market flexibilization. Many of the “corrections” to the original Consensus, however, still show a neoliberal character (D’Arista, 2002-3). Moreover, as Kuczynski and Williamson (2003) admit, transferring to their suggestions that same critique Williamson (2002) had made to Stiglitz’s PWC, the agenda could appear to be «unrealistically broad» (ibid., p. 18): «[p]erhaps the biggest risk of all is that the region’s leaders will lack the patience that is needed for such an approach to success» (ibid., p. 19).

3.2 *THE WASHINGTON CONSENSUS COULD NOT WORK*

The “new agenda” embodies the “shift in rhetoric” (Birdsall and de la Torre 2001, p. 8), from “getting prices right” to “getting the institutions right” (Rodrik, 2006, p. 10), which inspired the World Bank’s policies in the second half of the Nineties, when non-income development targets were brought to the top of the agenda. The PWC itself was part of the story, as shown by Fine (2002): with the PWC, institutions, social policies and even the government’s active role, briefly all non-economic mechanisms, came to

be regarded as rational responses to market imperfections. Generally, the second-generation reforms hardly escape Chang's (2001) critical remarks about developed countries' "kicking away the ladder" strategies:

> in demanding from developing countries standards that they themselves never had achieved at comparable levels of development, [developed countries] are effectively adopting double standards or even trying (if only unwittingly) to hurt the developing countries by imposing "expensive" and often "unnecessary" institutions on them that they neither need nor can afford". (ibid., p. 28).

With the new "institution fundamentalism" (Rodrik, 2006), the rationality of the intervention was extended to social policies, with the risk of transforming the predominant model of socio-economic organization into the unique reference for international institutions' policy reforms (Ocampo, 2004a).

The Consensus of second generation, or the "Augmented Washington Consensus" (AWC), i.e. the first ten commandments plus: corporate governance, anti-corruption institutions, labor market flexibilization, adhesion to WTO principles and to international financial standards, prudent capital liberalization, non-intermediate exchange rate regimes, central banks independence, social safety nets, poverty reduction targets (Rodrik, 2004), seems to have even stronger challengers than its predecessor. Rather than correcting the original Consensus's faults by recommending policy diversity and experimentation – "[g]eneral principles of good economic policy do not map directly and uniquely into specific agendas" (Rodrik, 2004, p. 4) – the AWC and its endorsement by IFIs add new problems. Its logic is linear. If openness and free market have been disappointing, that must be due to either incomplete or insufficient reforms: the labor market, say, left untouched. Scarce political courage and little ambition are often blamed for the reforms' failures (see Krueger, 2004). However, due to the wide range of sectors concerned, reform efforts are often unsustainable, with

weak impact on growth and insufficient consideration for reform sustainability and second-best theory assumptions. What is more, there is a tautological relationship between the augmented list and economic development:

> [t]he new consensus reflects what a rich country *already* looks like. If a development country can acquire, say, Denmark's institutions, it is already rich and need not worry about development. The list of institutional reforms describe not what countries need to do in order to develop [...] but where they are likely to end up once they developed. (Rodrik, 2004, p. 6)

Both goals and measures to attain them are utopian (Naím, 2000): since the AWC reforms can hardly be implemented at once or completely, it will always be possible to condemn policy-makers and their insufficient ambition. Williamson (2004a) agrees on the need for less consensus and more experimentation. Nevertheless, he argues, Rodrik's "nihilism" would be far excessive: though there exists a variety of ways to implement good policy principles, "successful reformers are less countries that identify the right reforms than those that correctly identify where the constraints are binding and thus implement the right reforms at the right time" (ibid., p. 17). Though Rodrik's contribution to the debate is usually – and often wrongly – defined as a "mainstream" critique of the Consensus, the power of his remarks can hardly be underestimated. Problems with the AWC and the "reform fetishism", i.e. the assumption that development processes are linear and universal in character (Ocampo, 2004b), still need to be faced.

4. *CONCLUSION*: THE INTERNATIONAL DIMENSION AND THE SEARCH FOR A NEW GLOBAL GOVERNANCE

A number of papers by the most important participants to the debate appeared in the Consensus's fifteenth anniversary, agreeing on the paradigm's death. Rodrik's definition of the AWC as a non-starter, "likely to make things worse as to make them better" (2004, p. 7), together with new criticisms to the new agenda, led Williamson to declare that "[s]adder and wiser 15 years later, I no longer expect those particular answers to command a consensus" (2004a, p. 18). Williamson has simply spent too much time in stressing the differences between his nuanced version and the aggressive implementation of the paradigm, while the development policy debate was focusing almost exclusively on «how to cement market reforms in a global economy» (Naím, 2000, p. 94). He repeatedly argued that the paradigm had naïvely failed to emphasize crisis avoidance (Williamson, 2002); that it cannot be blamed for Argentina's errors, quite the contrary, and that capital market liberalization should have come at the end of a development process, rather than during its central phases, as it occurred in the case of East Asia. "The question is not whether the Washington Consensus is dead or alive; it is what will replace it", has recently written Rodrik (2006, p. 2) in a comment to the World Bank's *Learning from Reform* report (2005), whose merit lies in emphasizing "the need for humility, for policy diversity, for selective and modest reforms, and for experimentation" (ibid., p. 3). Most participants to the conference organized in 2004 by the Initiative for Policy Dialogue on a possible "Post Washington Consensus Consensus" stressed that the defensive logic of the Consensus was intrinsically too weak to resist new attacks: any "Consensus plus" version with alternative solutions to newly emerged crisis factors would show to be ineffective when faced by unprecedented problems. Moreover, any enlargement of the original Consensus to, say, social equity issues would impede a future consensus on one-size-fits-all policies, necessarily transforming the Washington Consensus into a Washington "Contentious"

(Birdsall and de la Torre, 2001). The only consensus was thus on the fact that there can be no more consensus. Once all "Consensus plus" versions have been tested, DCs are left with the choice either of surrendering to the impossible task of climbing the ladder, or to lose credibility at once, while applying somewhat "postcolonial" orders (Stiglitz, 2004a). One possible way of solving the dilemma is through the international dimension, as suggested by Stiglitz. A new global governance is required to avoid repeating IFIs' mistakes and stabilize world economy, enhancing equity and promoting DC's freedom to choose. The agenda of globalization, shaped by the Consensus, "ignores the developing countries' legitimate needs to have the policy 'space' ad autonomy within which they can develop their own strategies" (Rodrik, 2002, p. 3): the *Conclusion* stage is thus calling for a reform of the international architecture.

4.1 THE INTEGRATIONIST AGENDA

The Washington Consensus saga can be read as the recent story of the shrinking in policy space available for DCs (see Chang, 2006). In Rodrik's (2000) terms, with the integrationist agenda an unfruitful attempt has been made to deny the existence of different brands of national capitalism, despite the persistent segmentation of world markets along national borders. A self-regulating global market seems an impracticable option, while the alternative of a "global federalism" led by international organizations like the UN is still far from now. Thus, two opposed choices are apparently left. The first lies in adopting Consensus-inspired reforms as a way of forcing integration through "golden straitjackets" (Friedman, 2000). The most striking example is that of Argentina, where currency board regime, dollarization of the economy and integration into the Free Trade Area of Americas were imposed during the Nineties to restore foreing investors' confidence by reducing sovereign risk. The IMF *de facto* came to impose a golden

straitjacket to “saved” Asian crisis countries too, by conditioning its assistance to the adoption of the AWC reforms. The «universal norms of a proper economy» (Vestergaard, 2004, p. 818), i.e. capital market liberalization and the Anglo-Saxon model of financial regulation (fiscal transparency, monetary and financial policy, banking supervision, corporate governance), as well as the reforms of business-government institutions, labor-market institutions and industrial policy, were destined to remodel South Korea and other countries “in the image of a Washington economist’s idea of a free-market economy” (Rodrik, 1999, p. 6). In the latter case, “structural” reforms were imposed to countries whose fundamentals were substantially sound (Cartapanis and Herland, 2002), which is typical of a view in which only debtor countries are blamed for a financial distress, creditors carrying no responsibilities for overborrowing (Vestergaard, 2004). The “Washington Consensus *cum* institutions [...] presumes that globalization, that is, higher mobility of goods, services and capital, is the only alternative, and that developing countries’ states are weak or incapable of countering it. The ill-designed institutions are intended to enhance the mobility of goods, services and capital” (Câmara Neto and Vernengo, 2002-3). Hence international capital mobility privileged in the name of sound policy at the cost of development targets (Rodrik, 1999), and a further limitation of policy space, due to the threat of capital flight in a liberalized context (Chang, 2006). Nevertheless, that played by international investors and the IMF is a “confidence game”, since the confidence argument is recursive (Krugman, 1998), and costly “self-protection through increased liquidity” strategies (Feldstein, 1999) must be implemented by prudent countries to counteract what Kregel (1999) has called a “new Triffin paradox”. The case against capital market liberalization has finally gained timid institutional support, as shown by a recent IMF’s study questioning the relationship between financial integration and

economic growth (Prasad, Rogoff, Wei and Kose, 2003). Stiglitz (2004b) attributes IMF's errors to the assumption of perfect rationality and the neglect of incomplete information and credit rationing problems. Foreign direct investments are not sufficiently distinguished from short-term speculative funds; moreover, financial liberalization can increase consumption volatility. Greater risk premia are then required, discouraging investments and favoring the economy's volatility, rather than growth. Hence the need of capital controls acting like laws impeding to yell fire in a crowded theater, according to Davidson's well-known metaphor. Trade and financial liberalization should be disconnected, and the IMF should help countries stabilize capital flows or ensure that they move counter-cyclically. Attempts to reform the international architecture, however, still follow the AWC model: the adoption of standards "drawn up by and for developed countries" (Sarcinelli, 2004, p. 348) by countries lacking public administration efficiency and safety nets will unlikely reduce financial contagions.

4.2 THE EMBEDDED LIBERALISM OF BRETTON WOODS

The alternative to one-size-fits-all financial architectures and to "proper economy" standards consists in an «international system of national capitalism» (Rodrik, 2000) based on the "embedded liberalism", i.e. multilateralism predicated upon domestic interventionism (Ruggie, 1982), which characterized the Bretton Woods system. Rodrik calls for a new Bretton Woods compromise, aiming at reducing without necessarily eliminating barriers to trade, and permitting countries to reintroduce restrictions should national targets result impossible to reach in their absence. Bretton Woods crystallized an agreement on stabilizing, rather than maximizing, trade and capital flows, as well as on restricting the possibility of exporting economic anxieties

outside external borders. For DCs, capital controls and national industries' defense were the norm rather than the exception; the GATT was mostly concerned with policies at the border. The only requirements were not to impose border restrictions and discriminate among trade partners. In sum, DCs could promote growth strategies having little in common besides the development target (Rodrik, 2000).

This kind of nostalgia for the prosperity of the Bretton Woods period is not uncommon for participants to the debate about the Consensus. Stiglitz blames the IMF and the World Bank for significantly deviating from the original roles which were assigned to them by the architects of the new order, John Maynard Keynes and Harry D. White: helping countries with balance-of-payments problems to restore and maintain equilibrium through expansionist policies potentially beneficial for all their partners. Moreover, the regime is highly appreciated for allowing DCs a large policy space, with a real national autonomy in trade policy matters and few conditions attached to financial assistance by IFIs, and even the "right to be wrong" (Chang, 2006). That is why Bretton Woods stands a model for the advocates of the so-called "Southern Consensus" of Unctad and Eclac, combining Latin American neostructuralism with East Asian developmentalism. That is why Unctad criticizes the World Bank's (2005) new approaches for a certain skepticism with regard to national discretion. Unctad suggests reconsidering the "openness agenda" under the light of its implications for the international economic order. Participation in a liberal global order weakens national autonomy both *de facto*, through trade and capital liberalization, and *de jure*, through adherence to international discipline; however, multilateralism should enhance the influence of national policy instruments on domestic targets. National autonomy, i.e. the inner circle, can thus widen its space only if the two outer envelopes – liberalization and international discipline – permit it; in other words, if global governance is truly

democratic in character (Unctad, 2006). But the current international economic order is far from solving its basic asymmetries (Ocampo, 2004b). Once again, both the gold standard with its “socially-constructed monetary agreement that included a simple set of rules around which core lenders and borrowers could build expectations of a stable future” (Unctad, 2004, p. 92), and Bretton Woods with its institutional framework allowing countries to follow a broad economic agenda while supporting growth and stability through international action, are seen as valuable alternatives to the integrationist agenda. If compared with the “judicious mix” of international rules and cooperation of Bretton Woods, the current ensemble of incomplete global framework and weak national policy effectiveness is a very unsatisfactory solution (Ocampo, 2004b).

Gore considers it likely that “a form of communitarian liberalism, which seeks to reconcile the achievement of national, regional and global objectives, and to marry universal values with a respect for diversity” (2000, p. 801), is destined to win wide acceptance as a model for development. The paradigm of the future will need to solve the contradiction which dampens both the Consensus, whose global normative framework is combined with a national explanatory framework – a liberal global order is seen as the solution for national difficulties – and its challengers, like the PWC and the Southern Consensus, associating a national normative framework with a global explanatory framework – building competitiveness upon national capabilities as the solution to DCs’ problems in integrating into world economy. Future development policy will then assign a global character to both its explanatory and normative frameworks. Unsurprisingly, since the Consensus’ national explanatory framework and its “small country” model lead to assume unlimited foreign markets availability (Gore, 2000), Williamson does not regard global demand conditions as crucial. While opposing

post-Keynesian economists' positions about the need of a global financial reform, he stated that economic growth would be "fundamentally constrained from the supply side, which is why it is desirable to maintain the constraints on the balance-of-payments deficit that are provided by limited reserves" (2004b, p. 607). True, the Consensus was "an unbalanced list, for – especially in the short run – the prospects of these countries will also be heavily influenced by whether the world economy is growing or depressed, whether international liquidity is provided by U.S. Treasury bills or special drawing rights (SDR), and so on" (2004-5, p. 197). But the paradigm, he argued, was not concerned with world economy's conditions, since "*in the long run*, countries' progress is primarily dependent on their own efforts rather than on the international environment" (ibid.).

This is consistent with Williamson's critique of the "nonsystem" which replaced the Bretton Woods order, whose end resulted "in countries adopting policies with significant international repercussions entirely at their national discretion" (1983, p. 87). In his vision, the fixed but adjustable exchange rate system of Bretton Woods and its "broadly symmetrical" constraints, coupled with a "Keynesian" combination of microeconomic liberalism and active macroeconomic management, had prevented antisocial behaviors as well as the divergence between individual and general interests (Williamson, 1985). Prosperity was assured by the fact that the system was able to desynchronize recessions cycles; some "happy accidents" protected this result. Still, Williamson explicitly links this golden era to the intellectual consensus forged by Keynes in the Forties on countries' active management of monetary and investment policy with a view to maintaining internal balance against possible demand deficiencies. Only by recreating such a theoretical convergence it was possible to create a new global order that "significantly constrains countries' policies in the general interest", he argued

in 1983 (p. 109). If a true alternative to the integrationist agenda and the Consensus as its main tool is to come from a reform of the global architecture, however, this suggestion by the "chronic consensus-seeker" Williamson (1993, p. 1334) can be investigated. Provided that the attention is focused not on Keynes's presumed errors under the light of what happened after 1945, but on the deep sense of the intellectual consensus he *wished* to create for the post-war world. In other words, not on the realization of Keynes's main ideas despite the final rejection of his ICU plan, but on the possible legacy, for today's world, of that same rejected proposals, which embodied the need of a consensus based on freedom and policy space, rather than discipline and limited national autonomy.

4.3 Keynes's revival: some reasons why

The advocates of the Southern Consensus quite naturally hold in great consideration the challenge to the Consensus which has recently come from the export-led growth East Asian model. Nevertheless, its generalization would probably fail to live up to its promise, since its simultaneous application by a large number of DCs might itself sensibly lower its potential benefits. Moreover, the model is contributing to current systemic global imbalances. The emergent world has learned the lesson: the Washington Consensus had "created perverse incentives that set nation against nation in a process that perpetuates a world of slow growth (if not stagnation)" (Davidson, 2004-5, p. 217). Together with the Asian crisis, it has taught that "self-protection through increased liquidity" is a much safer strategy for DCs than external finance and tightening the belt under IMF's surveillance in case of balance-of-payments problems: hence "undervaluation-cum-intervention" strategies are being increasingly adopted by DCs (Unctad, 2006). The current pattern of international affairs is not without benefits.

The widening US deficit and overconsumption in a context of strong world expansion is granting the world a "free lunch for all" (Davidson, 2002b) in the form of almost unlimited possibilities to export to the US, i.e. the world growth locomotive. However, even though the emergent world's new strategies have certainly removed some of their most pressing financial anxieties (Eichengreen and Park, 2006), global stability is necessarily threatened both by the possibility of a hard landing of global imbalances, and by the deflationary bias which the current reserve system imposes to the international environment. Moreover, the combination of export surpluses sustaining internal demand with foreign lending through exchange reserves comes at some costs in terms of balanced development and debt reduction (Rodrik, 2005). It is easy to demonstrate that a hard landing mostly threatens DCs. The world is simply too much dependent on US performances, lying in wait for emergent Asia to assist the US locomotive.

Growing interest for Keynes's insights for the international economic order (see Polanyi Levitt, 2006) is connected both with the Washington *Conclusion* and with today's international stability problems. Under Keynes's plans for a new global order, the "catastrophic drains" which since the 1970s had been depriving DCs of much of their export earnings would unlikely have occurred (Singer, 1998). According to Stiglitz (2003a), a change in the global reserve system, with references to Keynes's plan for a new international currency, is required to escape the contradictions of the Washington Consensus world. Stiglitz has suggested creating "global greenbacks", or real money-SDR, i.e. new purchasing power to be granted to DCs and countries with financial difficulties in order to finance global public goods and free (or supplement) DCs' reserves by converting the greenbacks into hard currencies to service debts and finance imports. But Stiglitz's proposal, which included his praise for capital controls and the

suggestion of creating a world bankruptcy organization to deal with indebted countries' problems, was limited in scope (as the title itself, *Dealing with Debt*, suggested). More recently, however, he has developed with Greenwald a new proposal with a more ambitious target, i.e. reforming the international monetary system with a view to avoid both the "deflationary effects of chronic external deficits [and] the distorting consequences of chronic external surpluses" (2006, p. 1). Solutions are found which bear "a striking similarity to those which Keynes cited in connection with the failure of the pre-Bretton Woods system" (ibid.). In the current dollar standard, non-reserve countries desired surpluses (their volume growing in line with international transactions) cause the accumulation of high reserves, which is, "even when the underlying motive is one of competitiveness [...] the price to be paid for not managing the capital account more directly" (Rodrik 2005, p. 4), i.e. for being unable to prosper through internal-led growth policies. Hence the only reserve country must act as the system's deficit-of-last-resort. In sum, the system is caught in a "lock-in" – hence his "Bretton Woods II" (Dooley, Folkerts-Landau and Garber, 2003) characters – further and unnecessarily limiting his members' policy space and freedom to choose. Stiglitz and Greenwald suggest delinking reserves accumulation and deficit positions of any non-reserve countries by issuing SDR as a "non-reserve currency source of international reserves" (2006, p. 12), while disciplining countries with chronic current account surpluses in line with Keynes's ICU plans.

Thus, holding into consideration the gap which separated his previous proposals from Davidson's Clearing Union scheme (Gnos and Rochon, 2004), it is worthwhile noting that Stiglitz has undoubtedly come closer, at least on a practical level, to post-Keynesian economists' reform plans. Davidson's well-known qualified return to Keynes's ICU – a clearing union "to keep the payments 'score' among the various

trading nations plus some mutually agreed-upon rules to create and reflux liquidity while maintaining the purchasing power of the international currency (2002a, p. 231); no supranational bank is required – originates from the desire to create a new agreement "that does not require surrendering monetary policy [...] and national control of domestic banking systems, or surrendering a nation's fiscal policies to an IMF-imposed demand for fiscal discipline" (Davidson, 2004-5, p. 219). Its explicit aim is to create a system with a built-in expansionary bias for a fundamentally "Keynesian" world which rejects the financial market efficiency hypothesis. Davidson's reform plan holds into account those systemic features which are at the basis of Bretton Woods success (fixed but adjustable exchange rates; capital flow restrictions and surplus nations initiating the path towards the reduction of imbalances). However, prosperity was destined to fall should those "happy accidents", as it happened, lack. The system was unable to perpetuate, in particular, the leader's commitment and possibility to act responsibly (Davidson, 1992-93) for the creation of a "sounder political economy between all nations" (Keynes, 1980, p. 43).

Keynes's plans were directed towards the creation of international agreements transforming the desired responsible behavior by the leader, necessarily depending on policies and circumstances, into a system of rules of "general and collective responsibility, applying to all countries alike" (ibid., p. 47). Not by chance Britain's leadership in the pre-war gold standard, helping the new countries' adjustments through foreign lending, is recalled as the most important historical predecessor of the ICU. Though Keynes's requests did not configure an "automatic surrender of surpluses" (see Skidelsky, 2000, p. 213), his plans certainly required the leadership to assume a primary role for the managing of the system. A key suggestion is offered by the "American Loan" episode (see Cedrini, 2007), or the last of Keynes's attempts to trigger the

American intervention in the service of the world (the first coinciding with his plans for the reconstruction of Europe with the American assistance at the end of the First World War). Keynes's request for an "American Gift" to Britain (see Cedrini, 2007) rather than a business-character loan was imbued with the spirit of the ICU plans. In fact, saving Britain through the Gift was saving, indirectly, global multilateralism too: the American Gift was the only possibility, according to Keynes, to induce other countries (the Sterling Area) to take part in the international adjustment. Moreover, only a gift, not a loan, by the only world creditor – would have allowed the main debtor country to freely march side by side with the Americans in the construction of a sounder global political economy. Keynes's new system should happily combine leadership and freedom, i.e. creditors' responsibility for world imbalances with other countries' "freedom to choose" and policy space. The American Gift embodied such a spirit, the US allowing Britain to choose multilateralism instead of compelling her to accept it *à l'Américaine* through market adjustment and austerity. The Gift should act as a sort of tester of the leadership's willingness to comply with the rules of Keynes's desired new system despite its final rejection at Bretton Woods; and the test gave negative results.

Keynes's real defeat as an international policymaker thus lies in the rejection of the "freedom-enhancing" mechanisms which animate both his plans for Bretton Woods and his request for an American Gift to Britain. Though Keynes himself recognized that at the end of the war the world had made a «first great attempt at organizing international order out of the chaos of the war in a way which will not interfere with the diversity of national policy yet which will minimize the causes of friction and ill will between nations» (1979, p. 608), most of his freedom-enhancing proposals – increased international liquidity, exchange rate adjustable in case of structural variations of the economies, neutral rather than political character of the new institutions – were finally

abandoned. Freedom to choose, i.e. promoting national diversity through the elimination of economic anxieties at an international level, was the real target of Keynes's attempt to solve the system's dilemmas. From *Indian Currency and Finance* and his enthusiasm for the gold exchange standard, regulating money on a rational basis and freeing reserves from the obligation not to be used, to his critique of creditors' unwillingness, in the renew gold standard, to easy the adjustment in the Twenties and Thirties; from his plans for a "qualified" return to the gold standard in 1933, the leadership acting against world deflation in a context of desired cooperation, to his ICU scheme: that for freedom was Keynes's most important battle. In his vision, the limitation of policy space which is required by global interdependency must be compensated by countries' participation to a multilateral system reducing the frictions between national freedom and international discipline. Multilateral rules must promote rather than repress freedom to choose and national diversity, managing their co-habitation instead of imposing a one-size-fits-all set of "right" policies. The Washington Consensus as the rule of the "nonsystem" is thus the real symbol for Keynes's defeat. Its emphasis on discipline has been somewhat anticipated in the Seventies by the evolution of the IMF, whose wider discretion was used to realize that «global conformity to the economic orthodoxy [that] Keynes had rejected» (Newton 2006, p. 5). On the contrary, given the failures of both the integrationist agenda and the Washington Consensus as its paradigm, it might be worth while re-examining Keynes's intuitions for the international order, which were intended to assure the Bretton Woods system the possibility to prosper even in the absence of any "happy accident".

5. CONCLUDING NOTES

With its emphasis on discipline as well as on the universality of “right” paths to economic growth, the Washington Consensus has heavily contributed to the further shrinking in policy space available to DCs. After its failures both as a development policy and as the paradigm of the integrationist agenda, many participants to the debate have stressed the need of new international arrangements for dealing with the “nonsystem” and its systemic imbalances. The exit strategy from the 1997 crisis and the Consensus’s faults, i.e. the Asian export-led growth model, denies the world the means to a benign international adjustment. The embedded liberalism of Bretton Woods stands as the most relevant reference for a successful international order promoting global prosperity and respecting national policy space. Most convincing criticisms to the Consensus and the integrationist agenda gives however life to a rediscovery of Keynes’s global reform plans. If Keynes is “fashionable” again, this is above all due to the core message of his activity as an international negotiator: a new successful international system of national capitalisms will be more likely based on consensus upon freedom rather than discipline, i.e. on the will to enhance, rather than oppose, member countries’ freedom to choose and the diversity of national policies.

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