The Washington Consensus And the Mexican Economy

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The Washington Consensus, formulated by John Williamson in 1989 and published in 1990, contains the economic policy proposals agreed on by U.S. economists linked to the U.S. political center.[1]

This series of political reforms can be summarized in ten points: 1) fiscal discipline; 2) channeling public spending into health, basic education and infrastructure; 3) fiscal reform; 4) freeing up interest rates and, therefore, the financial sector; 5) maintaining a competitive exchange rate; 6) freeing up foreign trade; 7) liberating the flows of foreign direct investment; 8) privatization; 9) deregulation; and, finally, 10) security for property rights. This article will discuss each of these proposals in terms of its coherence and empirical implementation, both in the United States and in Mexico.

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In the 1980s, the recommendation of fiscal discipline gained political support given the fiscal imbalances in the United States, but above all in Mexico. State expansion was perceived as a threat for individual rights and work incentives. This perception was bolstered by the academic-political triumph of free market ideas and the critiques of the mixed economy headed up by Friedrich von Hayek and Milton Friedman in academia and Margaret Thatcher and Ronald Reagan in the sphere of politics.[2] The decline in the average rate of profit and of the dynamic of the average rate of productivity in the world from the mid-1960s on cannot be ignored either,[3] a manifestation of the exhaustion of what different analyses called capitalism, the mode of regulation, inward development with import substitution, Keynesian economics, etc.[4] In the context of the Washington Consensus, suffice it to point out that Latin American structuralist thinking in the Economic Commission on Latin America (ECLAC) led this body to propose Latin American economic integration as a way around the obstacles to inward development posed since 1949 which was formalized in 1959 and spurred many actions in the 1960s, unfortunately with scant results.[5]

With regard specifically to fiscal equilibrium, we should remember that John Maynard Keynes established the basis for anti-cyclical fiscal disequilibriums. That is why, in the case of what U.S. monetary authorities recently called the irrational exuberance of the financial market, a fiscal surplus is recommended, and that is what happened during William Clinton's second term. On the other hand, if there are recessive trends in the private sector, what is called for is a fiscal deficit and reducing taxes for private investors, which is what has been done during the current Bush administration. Of course, in an open economy, we also have to consider the interaction with external disequilibrium, the exchange rate, and income and its distribution, among other factors.

Today, the U.S. recession has been combatted, resulting in an approximate 7 percent external deficit in U.S. gross domestic product (GDP), accompanied by a fiscal deficit of about 6 percent of GDP and a private deficit of nearly 1 percent of GDP, at the same time that the irrational exuberance appears in the real estate sector to the degree that prestigious analysts foresee the possibility of a crack by mid-2006.[6] Thus, the consensus's first proposal is only valid in conditions of stable growth with equilibrium in private savings-investment accounts in light of economic theory and the U.S. government's fiscal practices.

It should be emphasized that the rapid drop in Mexico's fiscal disequilibriums in 1989-1994 under Finance Minister Pedro Aspe Armella was so admired by the United States and other developed countries that because of this and other achievements, the *Financial Times* called Mexican economic officials the favorites of the World Bank.[7]

We can say that the consensus's second proposal, redirecting public spending toward health, basic education and infrastructure, has not been implemented in Mexico because policy has aimed at reducing public spending and privatizing health and infrastructure. Thus, for example, education makes up about 6 percent of Mexico's GDP, less than the 8 percent recommended by the UNESCO. At the same time, more money was used to bail out the banking system than to build infrastructure and, definitely, the Mexican economy's declining competitiveness in recent years is linked to deficiencies in economic policy. This has been recognized both by Mexican authorities and the World Bank.[8] The United Nations Development Program has added its voice to the criticisms, saying that poverty in human development (per capita income, health and education) and in Mexico's economic and social infrastructure compared to, for example, Vietnam, is due to weak tax collection, the rapid trade opening in conditions of scant domestic integration of exports, a slight poverty reduction but with increased inequality, and the lack of an industrial policy and technological development and adaptation. That is, Mexico has failed to promote economic development on the firm basis of human development and the commitment to productive development with technological advancement and equity.[9]

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The consensus's third recommendation is fiscal reform. Mexico has roundly failed in this fundamental matter. In the last 45 years, only two real attempts at fiscal reform have been made in Mexico: one in 1961 and the other in 1971. Renowned Cambridge economist Nicholas Kaldor was the inspiration for the first attempt, aborted because of opposition from Mexico's Finance Ministry, which argued that it would cause capital flight. For the second attempt, an independent group formed by President Luis Echeverría (made up of Ifigenia Martínez, Francisco Gil-Díaz, Hermenegildo Anguiano Equihua and the author, led by Jesús Puente Leyva, with the enthusiastic support of Horacio Flores de la Peña, Minister of the National Patrimony, and Luis Enrique Bracamontes, the Minister of Public Works) presented a fiscal reform bill that overcame the opposition of the Ministry of Finance and the Central Bank in debates in the presence of President Echeverría and Minister Flores de la Peña. But opposition kept the bill from becoming law. Looking back, it is no exaggeration to say that this changed Mexico's economic history for the worse. It is true that the current Finance Minister, Francisco Gil-Díaz, headed up a fiscal reform proposal that earned him the name Hood Robin because it countered universally accepted fiscal standards by seeking to tax the poor to benefit the rich.

Washington's fourth policy proposal is freeing up interest rates. Recent developments in the field of incomplete and asymmetrical information, as well as regulatory and supervisory domestic practices in the banking, credit and financial sector of all countries show that this liberation can only be relative.

All countries have a central bank charged with issuing currency and running bodies to regulate financial activities precisely because of the peculiarities of the sector, public goods, information and asymmetrical powers, and because they are subject to irrational manias and panics, as demonstrated in numerous financial crises in different parts of the world, including the United States. Today, economists have a consensus about control by monetary authorities in developed countries of the short-term nominal interest rate offered to bank depositors, which influences the rest of interest rates which, therefore, stop being totally free.

The same general perception exists about Mexico. We should add that the interest rate influences capital accumulation and the income of future generations. In addition, stakeholders' freely picking the interest rate is impossible. Lastly the country risk reflects the spread between the interest rates of government securities considered risk free. The significant decline in the country risk in recent years has been an important achievement by Mexico that has pleased foreign investors; but up until now, this has not meant that the Mexican economy's stagnation has been overcome in terms of per capita income or any convergence with income levels of developed countries.[10] In addition we must consider a performative contradiction because the "liberation" of interest rates, just like free market policies as a whole, was not the product either of the free market or of a democratic election, but rather the result of coercion, the training of elite Mexican economists using criteria and objectives of the U.S. economy and opportunist, ignorant imitation.[11]

A competitive exchange rate is the fifth policy recommended by Washington. Today there are doubts about the competitiveness of Mexico's exchange rates. Among other reasons, this is because the country has been incapable of increasing per capita income since the beginning of the free market reforms in 1983. That is, competitiveness should be measured in relation to a level of full employment with equity and other social goals recognized in Mexico's Constitution, such as decent employment, sustainability and national sovereignty.

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The discussion about the Mexican economy's loss of competitiveness under the current administration, corroborated by three different competitiveness indices, has included the participation of Guillermo Ortiz, the governor of the Banco de Mexico Central Bank, and Fernando Canales, the minister of the economy. Ortiz only pointed out the need for certain institutional reforms regarding the central issues of the rule of law and public security in general. Canales represents producers and demands a Central Bank effort to lower interest rates (understood as the lending rate, charged loan recipients, which continues to be much higher than the savings rate paid to depositors) and a more competitive exchange rate, instruments managed by the Central Bank.[12] In addition, we must take into account oil revenues over and above those budgeted; transitory and uncertain, in the last five years these have come to about U.S.$30 billion, which overvalues the exchange rate and the balance of payments.

China joins Vietnam as an example of countries that have surpassed Mexico, confirming the need not only for strategic institutional reforms, but policies different from the market fundamentalism that has prevailed in official Mexican circles since 1983.[13]

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Freeing up foreign trade is Washington's sixth proposal. It is surprising how ignorant the economists in power are of basic economic theory. Already in 1955, Professor James Meade put forward the theory of second best, in which he pointed to the changes that should be made to the hypothesis of the "benevolent invisible hand" of the market given the existence of monopolies, economies of scale, external economies and inequality.

One year later, Professors Richard Lipsey and Kelvin Lancaster generalized the theory by demonstrating that in the absence of one of the conditions for optimal economic equilibrium, it can only be reached by separating oneself from free competition conditions. In other words, if there are imperfections in information, knowledge and competition, partial liberation can affect welfare and efficiency levels in an indeterminate way (it can increase them, lower them or keep them unchanged).[14] In addition, the achievements of neo-institutionalism in the last 20 years seem to be massively ignored by the monoeconomics discourse of the market populists or globalization supporters.[15] According to these propositions, market equilibrium cannot be determined independently of cultural and legal norms or the role of the state for fostering a country's innovative economic performance. This refutes the unilateral hypotheses about freeing up markets using the ideological argument that it is for the benefit of all, an idea maintained in Mexico by the main economic policy decision-makers over the last 22 years, particularly and very decidedly former President Ernesto Zedillo (1994-2000).

The Washington Consensus's seventh recommendation is to liberate foreign direct investment flows. Mexico did this very rapidly, including financial investments, in the context of freeing up interest rates and liberalization in all spheres. Recent advances in monetary theory, in conditions of incomplete and asymmetric information, have generated a consensus among well informed economists about somehow regulating international financial transactions, while U.S. authorities continue to hold fast to the dogma of unregulated capital markets.[16]

The arguments against neo-liberal extremists also apply against privatization, Washington's eighth proposal. Suffice it to add the severe judgement of the father of neo-institutionalism and 1993 Nobel Prizewinner for Economics, Douglas C. North, who wrote, "In fact, the simple-minded notion that 'privatization' is all that is needed to set faltering and failed economies on the path to growth is a travesty of institutional reasoning that reflects the primitive understanding of most economists about economic history and growth. Creating efficient factor and product markets is a complicated process about which we know all too little. But the one thing we know is that formal rules must be complemented by informal constraints and effective enforcement to produce such markets."[17]

Deregulation is the consensus's next-to-the-last suggestion. To the foregoing arguments, we can add that while fostering freedom from interference is desirable, neo-liberal dogmas have caused increased insecurity and the belief that formal or negative freedoms must be accompanied by positive freedoms to be and do what is thought can be achieved as a decent human being.[18]

Lastly, with regard to security for property rights, we can say that the problem with this recommendation is that it does not take into account the defense of property of those who have none, thus perverting the thought of the founding fathers of economics like Adam Smith, Alfred Marshall, Leon Walras and John Keynes, among oth-

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ers, who never excluded justice from their analyses or shared the extravagant tenets of believers in an illusory harmony of markets left to themselves.[19] It would seem that most economists are also unfamiliar with the contributions of welfare economics, particularly those of A. Sen, which corroborate old hypotheses about the need for a social welfare function and its feasibility as the guide for economic policy.[20] VM

NOTES

[1] For almost 25 years, the author worked for bodies such as the Mexican Central Bank, the Ministry of the Presidency, Fomento Industrial Somex, the Mexican Oil Institute and the National Public Works Bank.

[2] My reference for the Washington Consensus is J. Williamson, "What Should the World Bank Think about the Washington Consensus?" *The World Bank Research Observer*, vol. 15, no. 2, August 2000, pp. 251-264. A critical review of contemporary economic thought can be found in E. Tijerina, *Aprendiendo economía con los Nobel. Un examen crítico* (Mexico City: Plaza y Valdés, 1999) and in my article "La teoría económica contemporánea, 1969-1998. Un examen crítico," *Anuario. Departamento de Economía 2000-2001* (Mexico City: UAM-Iztapalapa, 2002), pp. 133-147, available at http://mx.geocities/eliezertijerina. com.mx

[3] About empirical evidence for the average productivity of labor and the average rate of profit in Mexico, see E. Tijerina, "La declinación de largo plazo de la economía mexicana, 1960-1995. Un análisis de las interrelaciones coyunturales y estructurales," G. Vidal, comp., *México y la economía mundial. Análisis y perspectivas* (Mexico City: UAM-Iztapalapa/Miguel Ángel Porrúa, 2001), pp. 143-165, with a comment by Fred B. Moseley, renowned authority on the analysis and gauging of the average rate of profit. This article is also available at http://mx.geocities/eliezertijerina.com.mx

[4] There is a wealth of literature on this topic. For a concise explanation, the reader may consult the sources in note 2.

[5] H. Guillén, *México frente a la mundialización neoliberal* (Mexico City: Ediciones Era, 2005), pp. 63-69.

[6] "After the Fall," *The Economist*, June 18-24, 2005, p. 13. For an up-to-date analysis of the three gaps in the U.S. economy, see D. B. Papadimitriou, "How Fragile Is the U.S. Economy?" in *Strategic Analysis* published by the Bard College Levy Economics Institute, March 2005.

[7] D. Fraser, "Mexico's Growing Intimacy with World Bank," *Financial Times*, March 3, 1992, p. 7, and S. Babb, *Managing Mexico. Economists from Nationalism to Neoliberalism* (Princeton and Oxford: Princeton University Press, second printing, 2004), p. 181.

[8] *La Jornada* (Mexico City), September 1, 2005, p. 28 and September 12, 2005, p. 26.

[9] United Nations Development Program, *Informe sobre Desarrollo Humano 2005* at: http://hdr.undp.org/reports/global/2005/espanol/pdf/HDR05; *El Universal* (Mexico City), September 7, 2005, p. A18.

[10] H. Guillén, op. cit., pp. 219-220 and 334-336; and A. Huerta, *La economía política del estancamiento* (Mexico City: Editorial Diana, 2004).

[11] Babb, op. cit., pp. 185. The author mentions coercive isomorphism and expert isomorphism, to which I add mimetic isomorphism because it seems evident to me that the fear of social ostracism induces imitative behavior in all facets of human existence.

[12] *La Jornada* (Mexico City), September 12, 2005, p. 26.

[13] D.C. North, "The Chinese Menu (for Development)," *The Wall Street Journal* (New York), April 7, 2005. This article points out that there are many ways forward to development and that the key is to create efficient institutions that adapt creatively to swiftly changing conditions without submissively imitating Western institutions.

[14] J.E. Meade, *Trade and Welfare* (London: Oxford University Press, 1955); K. Lancaster and R.G. Lipsey, "The General Theory of Second Best," *Review of Economic Studies*, vol. 24 (1), no. 63, December 1956, pp. 11-32. I would like to thank O. Aktouf from the University of Montreal Business School (HEC) for his suggestion to incorporate Meade, Lancaster and Lipsey's arguments.

[15] D.C. North, *Instituciones, cambio institucional y desempeño económico* (Mexico City: Fondo de Cultura Económica, 1993).

[16] Exchanging opinions with J.E. Stiglitz in *Foreign Policy* no. 141, March-April 2004, R.H. Wade clarifies the contrast between Stiglitz's opinion and that of other cutting-edge economists and that of the U.S. government expressed by Treasury Under Secretary for International Affairs John Taylor, who said that free flowing capital is a "fundamental right." See http://www.ceip.org/

[17] D.C. North, "Institutions, Ideology, and Economic Performance," *Cato Journal*, winter 92, vol. 11, issue 3, pp. 477-489. At http://web5.epnet.com

[18] UNDP, op. cit.

[19] E. Tijerina, "Eficiencia económica y bienestar social: un comentario sobre la Teoría de la Justicia de John Rawls," J.L. Estrada et al., comps., *Ética y economía. Los desafíos del mundo contemporáneo* (Mexico City: UAM-Iztapalapa/Centro Antonio Gramsci/Plaza y Valdés, 1999), pp. 79-95; and Tijerina, *Aprendiendo economía con los Nobel...* op. cit. It is very important to note that the World Bank abandoned its usual apologetic position when it pointed out legal anomalies in Mexico's bank bail-out in its report about world development dedicated to development and equity. See *La Jornada* (Mexico City), September 21, 2005. This welcome change is the answer to criticisms of international bodies and their policies, particularly over the last 10 years.

[20] A summary of A. Sen's contributions can be found in my book about economic Nobel laureates cited in note 2, pp. 187-196.