Tax Research

Economics Briefing

The Washington Consensus

Introduction

The Washington Consensus was first described by John Williamson[i] in 1989. He recorded ten broad sets of recommendations that represented the paradigm he named as the Washington Consensus. It was he said:

> *"more or less everyone in Washington would agree were needed more or less everywhere in Latin America"*

The Washington Consensus failed

Many involved in development believe the Washington Consensus failed. The table that follows considers what the ten recommendations were, what they turned out to mean, what the consequences were and why they are unacceptable now.

The failed Consensus

What the Washington consensus recommended	What this has meant in practice	The problems that have arisen	Can the recommen-dation be endorsed?
Fiscal policy discipline	• Demands made to cut the size of the state • Demand made that the books be balanced at all costs • The demands of bankers who will otherwise threaten to destabilise the currency are adhered to at all times	• The belief that the state can't deliver – when there is no evidence to support the case • The state treated as if it were a PLC – a public limited company • The state is required to run its finances on the same basis as	No, not on these terms. Of course fiscal discipline is important – but within the Keynesian understandi

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		a company – which is pro-cyclical behavior • The ruinous rise of the power of the ratings agencies	ng of the economic cycle.
Redirection of public spending from subsidies ("especially indiscriminate subsidies") toward broad-based provision of key pro-growth, pro-poor services like primary education, primary health care and infrastructure investment	• The ban on subsidies for local business has been disastrous for developing countries in the face of EU and US competition when those states subsidise most. They have therefore used the Consensus to put their own business at a competitive disadvantage • State action need not be just pro-poor. It can also be wealth enhancing but this has been ignored or derided • If subsidy removal means reduction of the welfare safety net the cost to society is high – and unquantified in the model, except by the spread of fear of unemployment and poverty	• Growth of attacks on the welfare state • Increasing wealth disparity as those with least are denied support • The loss of fledgling enterprises and local business that need support in the face of subsidized international competition emanating from those states that promote the consensus • Steady withdrawal of the social safety net needed to provide security for those who live in any society • Increases in ill health as a result of increased anxiety	No, not on these terms. This concept of subsidy ignores the reality of externalities and as such does not make economic sense.
Tax reform – broadening the tax base and adopting moderate marginal tax rates	• Switches from direct to indirect taxes • Reduced tax rates for the wealthiest • Tax allowances maintained for the	• Increasingly regressive tax systems • Reduced taxes on capital • Reduced share of	No, not on these terms Developing countries need tax

	wealthiest but broadened tax base on those on middle income ("stealth taxes") • Arguments presented that corporations don't pay tax and so seek to switch the tax base from capital to labour • Removal of tariffs	tax paid by the wealthiest • Increase in tax paid by those on middle income • Increased wealth gaps reflecting increased inequality in society • Destruction of tariff revenues of developing countries – often the only effective tax base they have • Reducing proportionate tax yields on profits	systems that suit their own needs. Tax systems need to be progressive. This philosophy ignores these needs.
Interest rates that are market determined and positive (but moderate) in real terms	• With fiscal policy already lost as a mechanism for economic management and interest rate policy passed over to markets the means for governments to manage economies on behalf of their citizens and electorates are foregone • The rise of the power of the rating agency • The fear of the City and Wall Street undermining all policy initiatives bar those that	• The undermining of the power of government • The undermining of democracy • The undermining of the right of people to choose the type of state they wish to live in • Power ceded to a tiny elite, who have successively abused it in their own self interest	No, not on these terms The state has to reclaim the right to manage its own economy The power of the market has to be restrained The market only exists

	are market friendly by governments of any hue		under the protection of the state. The state has therefore to limit the activity of the market so it does not harm the state that underpins it
Competitive exchange rates	• The passing of control of exchange rates to markets • Vulnerability to aggressive attack on a currency by speculators • Loss of control of a key tool in eco9nomic management • Undermining of sovereignty in the face of demands from hedge funds, bankers and speculators that their needs be placed ahead of the needs of whole populations for work, stability and long term prosperity	• The enormous and destructive rise of socially useless and economically unjustifiable trading at the expense of the rest of society at large • The 2008 crash • The 1992 UK crash • The 2009 Euro crisis	No, not on these terms These markets are out of control and destructive Regulation of foreign exchange dealing is essential now
Trade liberalization –	• This has been a wholly	• The rise of offshore	No, not on

liberalization of imports, with particular emphasis on elimination of quantitative restrictions (licensing, etc.); any trade protection to be provided by low and relatively uniform tariffs	one sided process imposed on smaller states by the EU and USA who have maintained their own trade protection policies • The liberalization there has been in the EU and elsewhere has been designed to undermine the rights of labour and wage rates • Trade in intangibles has been used to undermine the tax base of countries whether developed or developing	• Developing countries have lost control of their natural resources for very limited return • The rise of agro-business and genetic modification • Patent abuse e.g. of naturally occurring commodities • Loss of labour rights • The rise of 'offshoring' to undermine labour • Increased transfer mispricing abuse • Resulting loss of tax revenues	these terms This is creation of an unlevel playing field and that is anti-competitive Of course markets need to operate to best effect – but that means the rights of differing cultures, traditions and legal systems are respected There are proper external restraints on markets that must operate in the interests of the broader understanding of human need

Liberalization of inward foreign direct investment;	• Foreign control of critical assets within an economy leaving that economy too vulnerable to outside interests • An indifference to local interests on the part of business • A breakdown of corporate responsibility • The rise of offshore as means to avoid tax, regulation, liability and responsibility within hoist communities • An increase in tax abuse • The rise of international PFI at cost to the taxpayer	• The rise of offshore • Developing countries have lost control of their natural resources for very limited return • Increasing opacity within and between economies through the use of secret and secretive financial structures • An inability to regulate in the public interest when, for example, national infrastructure is under foreign ownership • Increased transfer mispricing abuse • Resulting loss of tax revenues	No, not on these terms This is creation of an unlevel and opaque playing field and that is anti-competitive and which has in vey many cases resulted in the exploitation of assets secured at an undervalue for private gain contrary to the public interest
Privatization of state enterprises	• Loss of control of vital resources and services e.g. water supply, power infrastructure, transport systems and more	• Inability to regulate in the public interest • Serious failure to deliver services in the public interest • Increased cost – private fiancé having a cost of capital up to 5% higher than the state – or reduced investment in necessary	No, not on these terms Natural monopolies need to be under state ownership and control to ensure effective regulation and to

		development • Lack of integration in planning at cost to society as a whole	prevent abuse
Deregulation – abolition of regulations that impede market entry or restrict competition, except for those justified on safety, environmental and consumer protection grounds, and prudent oversight of financial institutions	• Loss of employee protection • The rise of corporate irresponsibility • The undermining of union rights • Increasing wealth disparities as regulatory abuse is exploited for profit • The breakdown of trust • A failure to regulate	• Falling proportion of income being paid to labour • Increased returns to capital • The banking crash of 2008 • Enormous imposition of external costs on society at large to increase the returns to capital in the future • An elite out of and beyond control	No, not on these terms The recession has proven how badly we need to regulate and how badly we have done it as a result of this philosophy
Legal security for property rights	• Protection of capital over the rights of employees • Treatment of the corporation as an entity with human rights • The rise of the rights of offshore entities even though they have no substance • The taxation of form, not substance, at substantial cost to Exchequers all over the world • A rise in the number of corporations	• A reduction in wage returns as capital has stronger rights • A loss of free speech as security of wealth is protected via libel laws • A lack of trust in society as property rights are put ahead of human rights • The rise of individualism leading to break down in law and order	No, not on these terms The right to hold property is vital – but it has to be balanced by a duty to others This philosophy does not reflect that fact

The reasons for failure

What is very obvious is just how badly flawed the recommendations were and just how badly things have turned out.

There is good reason for this. The Washington Consensus was based on the, in itself inadequate micro-economic theory of the firm; a theory that was rather curiously created and promulgated by people who had no experience of working or running such firms. That meant their theory of the firm was wrong.

When applied to the state the micro-economic theory of the firm became a recipe for disaster. As Keynes convincingly showed states do not behave like firms. To presume they do is to court failure, and failure has followed in the wake of these policies in developed and developing countries alike.

The Washington Consensus was the creation of homo economicus. It should be buried along with homo economicus in the wake of the financial crisis of 2008.

[i] http://piie.com/publications/papers/williamson0904-2.pdf