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THE OTHER CANON AGAINST WASHINGTON CONSENSUS: RE-INDUSTRIALIZATION AS A CONDITION FOR ECONOMIC REVIVAL AND DEVELOPMENT

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***Abstract:** The paper considers the problems of the alternatives to the mainstream in recent economic thought, that resulted in Washington Consensus. The results of the reforms in so called post-communist countries, based on Consensus, showed, with some exceptions, that these countries realized deep and long-term economic fall, followed by similar processes in other spheres. Contrary to ordinary opinions that transition crisis show as result of inconsistency in reforms taking, this is normaly its result. As an analogue is the Morgenthau's plan for West Germany observed, that has promoted Germany to industrial disarmament, and that would lead to its poverty and its transformation into raw material basis for the developed economies, and to impossibility of survival of the existing number of population. Fortunately for the Germany, Morgenthau's plan was abandoned and Marshall's plan was introduced. It lead to industrial renewal of Germany. For the transition countries it is also necessary, considering the practice and basic principles of the Other Canon, which have they origins as far as from the economic policy of Henry VII, to acess re-industrialization in the same way, which is the necessity for renewall of economies, and for overcoming the long-term crisis.*

KEY WORDS: OTHER CANON, WASHINGTON CONSENSUS, TRANSITION CRISIS, INDUSTRIALIZATION, MORGENTHAU'S PLAN, MARSHALL'S PLAN, DEVELOPMENT

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INTRODUCTION

The Fall of the Berlin Wall 1989 and the end of cold war are certainly the most significant events at the end of the XX century. They lead the countries of Eastern and South-Eastern Europe to a fundamental problem: how to make a transition from planned towards market-based economy, but they also created an ambient, in which it would be possible to discuss, without prejudice and ideological burden, among the others the role of the State in economic development. Unfortunately, the mainstream economics' thought hampered this consideration of two fundamentally different economic outlooks: a production-centered and activistic-idealistic (Renaissance) tradition and a barter-centered and passivistic-materialistic tradition of Smith, Ricardo and neo-classical economics [11, p. 270].

Without pre-made recipes for development of market institutions and market economy, or, as it was the case with yugoslav experience since the beginning of 1950s, simply suppressed, creators of the changes in this countries accepted foreign experts and recipes issued by international financial institutions with IMF in front. In their basis were neo-classical postulates, ideas of natural harmony, that recent make the core mainstream in economic thought.

These recipes were at first geografically and historically specific, and were meant to solve problems of Latin America. Former socialist countries similarly have they accept, as well as the countries of Sub-Saharan Africa, and they were became „the general wisdom for growth and development policy“ [9, p. 197]. They are known as Washington Consensus, the term coined by J. Wiliamson in 1989 [18]. Originally, the Consensus policies are next (table 2, left column). Reformers in these countries, and their advisors, emphasized that transition would bring temporary crisis, and then, very soon, the economies would renewal, and their new ownership structure will ensure a quick compensation for the temporary decrease and then a quick growth and catching up with developed countries.

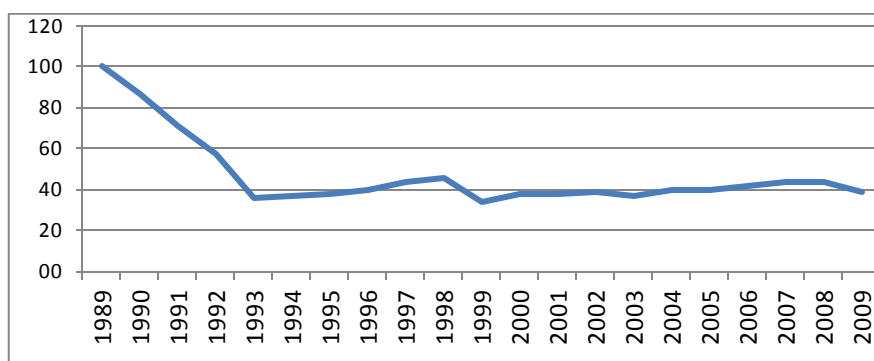
Through the reforms, the institutional ambient in transition countries has been radically changed: for most prices a free price system was introduced, foreign exchange was liberalized, subsidies were cut, currencies were devaluated and made convertible, restrictive credit policy was introduced, borders were open for foreign capital, most of the state-owned enterprises were privatized. In most cases, it is all done by “shock therapy” (all, right now, at the same time). The applied model assumed that the market institutions would spontaneously lead to capitalism, as soon as the ownership was privatized, prices were free, currency was stabilized and free competitive market was established. The economy should, after a short period of crisis, spontaneously lead to the renewal of production and economic growth.

These changes, however, weren't backed with proper and suitable changes in real sector. The results achieved are well known, and there is no point in repeating them here. They undoubtedly show failure.

TRANSITION CRISIS: NATURE AND CAUSES

The results of transition cannot be marked as good. Instead of the promised prosperity, the majority of countries measured a great and a long term fall in GDP, industrial production and living standard. The former yugoslav republics were not an exception. Not even Slovenia, with all its specificities and a refusal to apply some of the IMF policies, with annual GDP growth around 2%, cannot be satisfied. Serbia, fell almost 30% of its value in 1989, is in a similar situation as the Ukraine and Moldavia, whose decrease is between 40% and 50%.

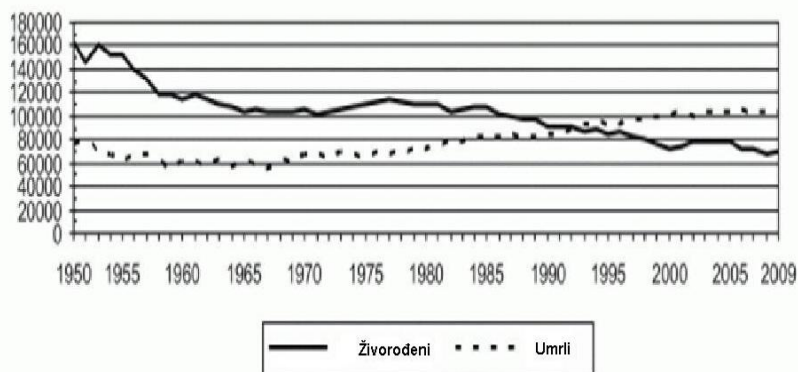
Figure 1. Industrial output in Serbia (1989=100)



Source: Republic Bureau of Statistics

Greatest losses, not only in Serbia, were in industry. The industrial output in Serbia in 2009 is on the level of 39% related to 1989 (figure 1), many branches drastically decreased output, and some seized to exist.¹ As the industry is moving force of technological progress, an engine to economic growth and creator of synergetic effects in all economy², this presentation of its decrease is by itself enough to mark the whole period as “negative”.

Figure 2. Natural population changes in Serbia 1950–2009

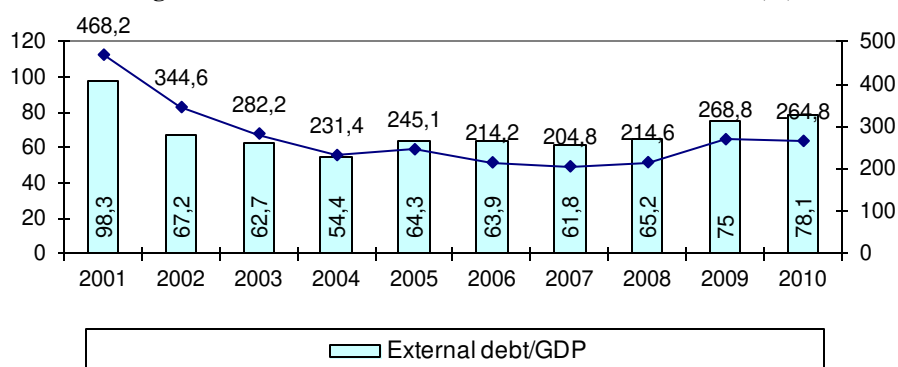


Source: Republic Bureau for Statistics

In most transition countries, the economic crisis was followed by other negative consequences, such as a great demographic crisis – decline in population, spread of the diseases, a drop in fertility, increase in mortality. Stuckler and the co-authors tested the hypothesis that it was the mass privatization that caused the increase in mortality in the post-communist countries [15]. UNICEF has estimated 3.256.000 „excess“ deaths in transition countries, for the decade 1990–1999 (without Bosnia and Herzegovina, Georgia for 1993, Tajikistan for 1996–1999, and FR Yugoslavia for 1999) [17, p. 49]. The depth of demographic crisis is probably best illustrated by the *Russian Cross*, firstly detected in 1992 in Russia: curves of dynamics of live births and deaths were crossed. Same happened in Serbia (figure 2), but the trend of approaching and intersecting of these curves is not clearly seen, as in Russia.

Transition resulted in great social expenses – increased poverty, increased unemployment, increased inequality, aggravation of public services and their polarization, criminal, increase in corruption and citizen unrest.³ Finally, we should point out vast external obligations, which happened inspite of great privatization revenues and great inflow of foreign remittance in case of Serbia. Estimations of all inflows (privatization, foreign direct investments, foreign remittance) are different, from 30 even to 70 billions euro, only for the period since 2000. This huge inflow wasn't directed in production, or to rebuild tragically underdeveloped infrastructure, but in consumption from import.

Figure 3. Indicators of external debt of Serbia 2001–2010 (%)



Note: for 2010 first half

Source: [22]

¹ It is great drop in 1999, a year in which Serbia was bombed by NATO. That factor and others during the 1990s (economic sanctions, wars in the surrounding republics) are not to be underestimated. However, a drastic drop of industrial output is clearly seen.

² This was described in 1613 by italian mercantilist A. Serra [13].

³ Also for first decade of transition [3].

For this enormous consumption growth from import almost always is blamed the relative appreciation of RSD, but not foreign exchange liberalization which was swiftly and uncritically conducted at the beginning of the decade, according to requirements of Consensus. According this argumentation, appreciated exchange rate destimulates export and stimulates import. Both sides of argumentation, however, are questionable: source of inflow from which the foreign currency is bought and the imported goods are payed should be taken into consideration when we talk about import, and more detailed explanations are necessary when we talk about export.

It is wrongly assumed that RSD devaluation (depreciation) would increase competitiveness of our export, even if there is production that could be exported. Devaluation of RSD doesn't change prices of our goods in foreign markets, so they wont be easier to export.⁴ It will only lead to redistribution between domestic manufacturers: more wealth will go to exporters (in RSD, nominally). Moving of export and import is not affected by nominal exchange rate, but its long term trend, expressed as real exchange rate [16]. It is well known that prices in our markets, for a long time, almost automatically adjust to EUR (previously with DM), and react very quickly to changes in exchange rates. So the effects of changes in exchange rate of RSD quickly disappears, and previous constellation is established, on higher nominal value. So what changes?

Table 1. Indebtedness according World Bank criteria

Indicator	Indebtedness		
	High	Medium	Low
External debt/GDP	> 80%	48% – 80%	< 48%
External debt/export	> 220%	132% – 220%	< 132%

Next important moment of transition crisis is high external indebtedness of these countries. This indicator is also unequal between countries, and it is comforting to say that extreme indebtedness is phenomenon that exists in some other countries as well (above all, Greece). As we can see (figure 3), except in 2001, Serbia is, according to External debt/GDP indicator, in a group of medium indebted countries, although moving towards highly indebted countries at the end of period. Other indicator (External debt/Export), excluding 2006–2008, shows significant and belongs to highly indebted countries. (See WB criteria on Table 1.)

Of course, the structure, i.e. share of public and private sector in total debt is important. It is often emphasized as (relatively) favorable circumstance. According official data (figure 4), it really seems so. However, I should be skeptic – who can guarantee that the state (tax payers) won't pay back debts that isn't hers and wasn't guaranteed by the state?

Table 2. Original and augmented Washington Consensus

Original Washington Consensus	"Augmented" Washington Consensus, the previous 10 items, plus:
1. Fiscal discipline	11. Corporate governance
2. Reorientation of public expenditures	12. Anti-corruption
3. Tax reform	13. Flexible labor markets
4. Financial liberalization	14. WTO agreements
5. Unified and competitive exchange rates	15. Financial codes and standards
6. Trade liberalization	16. "Prudent" capital-account opening
7. Openness to FDI	17. Non-intermediate exchange rate regimes
8. Privatization	18. Independent central banks/inflation targeting
9. Deregulation	19. Social safety nets
10. Secure Property Rights	20. Targeted poverty reduction

Source: [18]; [12]

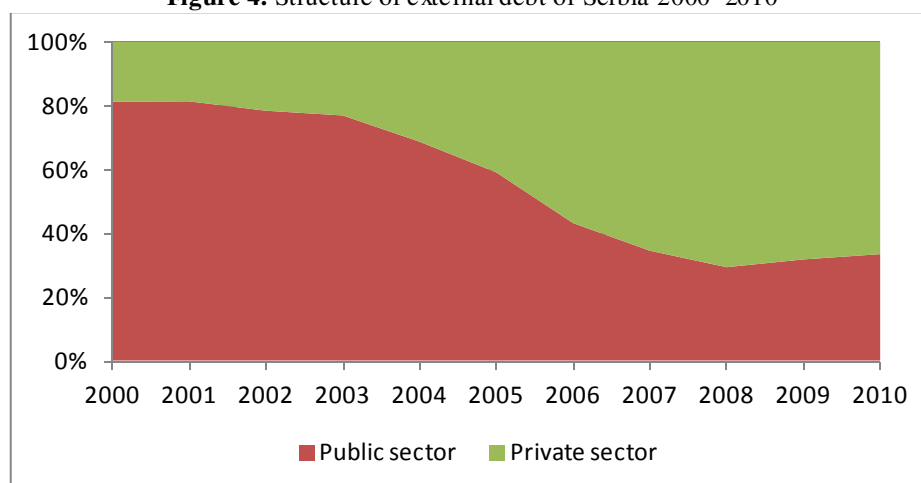
Intensity of negative changes and, especially, longevity of negative results initiate the review of the term transition crisis, or should determinate its new meaning. However, initiators and protagonists of reforms in these countries don't want do, or are not able to see at first the reforms results. Or apply some of the well known evading techniques in facing them.⁵ Basic principles and strategies are not questioned, and the lack of results is explained by

⁴ It is possible to realized export with lower export prices (damping), and exporters would be compensated with greater amounts of RSD. But that kind of export promotion is not allowed, and aside from that, it would meant a spillover of value created in country.

⁵ See more detailed consideration in [20].

inconsistency in handling the reform, and by limitations set by politics, so that it is all brought down to a mere technical problem of reform undertaking. In that case, all debates about causes of crisis and possible means to prevent it, are stopped. Why does this happen?

Figure 4. Structure of external debt of Serbia 2000–2010



Note: for 2010 first half

Source: [22]

But this debate is really necessary. And for it to be successful, it must address the core of the problem. The reconsideration of Consensus must be in focus, as well as its theoretical basis on which it was built and is sustained. Regardless that many countries were drawn to poverty, as a consequence of its recipes. So we must not think that the general approach is good, and that only some of the policies and measures are bad, and not conducted properly.

Although Consensus was meant to solve “local problems”, their policies were soon accepted as a general approach for all developing countries. It is considered that its policies are enough to initiate economic growth and remove stagnation. Great role of the free market within set of policies is the reason it’s often called neoliberal (even „neoliberal manifesto“), although Williamson emphasized that it’s not right, that term neoliberalism was coined to describe doctrines espoused by the Mont Pelerin Society, and that there are a number of distinctively neoliberal doctrines that are conspicuous by their absence policies of Consensus [19, p. 11].

What mean principles of Consensus? Let us see (items on table 2).

- 1) Means that public revenues should cover public expenditures, because budget deficit lead to inflation and to balance of payments deficit.
- 2) This suggested switching expenditure, in a pro-growth and pro-poor way, from things like non-merit subsidies to basic health care, education, and infrastructure.
- 3) The aim is a tax system that would combine a broad tax base with moderate marginal tax rates. This would increase fiscal, and then total public revenues.
- 4) If exist control of interest rates, it must be cancelled.
- 5) Central Bank has to ensure that appreciated domestic currency does not jeopardise the competitiveness of domestic economy in external trade.
- 6) As general approach, without pointing out the swiftness of its application.
- 7) It doesn’t refer to comprehensive capital account, but only to FDI, in the meaning that all foreigners should be able to invest, build or buy something, and should be able to do that without limitations.
- 8) It is assumed that privatization, if conducted properly, is beneficial, whether privatized enterprises do business in competitive market, whether they are regulated.
- 9) It refers, primarily, to removal of barriers to entry given market, which increases competition, as well as the exit barriers for firms, not a removal regulation of safety of production, ecology regulation, or economic regulation in case of natural monopolies.
- 10) It is necessary to ensure to gain property rights at an acceptable cost.

Is this set of policies acceptable? Williamson emphasized uniqueness of 1989 [19, p. 11], and critics of Consensus emphasized that some of the important policies are missing, for example social equality and institutional development. This is unquestionable, and therefore Williamson later supplemented the program, and named it *After the Washington Consensus*. However, it's important to estimate original policies, because they were practically implemented. It's clear that in these evaluations couldn't be (and shouldn't be) a consensus, but still, surprisingly, there are many our economists that fully support these policies. In my opinion, uncritical relation toward policies of the Consensus can't be good – they must be considered individually in the context of specific economy and concrete period of time.

Of course, we must bear in mind that „reforms were uneven and remained incomplete“, as in Report emphasized IMF⁶, which is true, although the conclusion drawn („According to its authors, the problem was not with the approach taken to reform, but that it did not go deep and far enough.“) is questionable. From this point of view, the failures have to be chalked up to too little reform of the kind that Consensus has advocated all along and not to the nature of these reforms itself. Also, the policy implication that follows is simple: do more of the same, and do it well. However, what has become clearer to practitioners of the Consensus over time is that the standard policy reforms did not produce lasting effects if the background institutional conditions were poor: sound policies needed to be embedded in solid institutions. The upshot is that the original Consensus has been augmented by a long list of so-called „second-generation“ reforms that are heavily institutional in nature (table 2, right column) [12, p. 978].

HISTORICAL ANALOGY AND ALTERNATIVE

As the starting point, we can use the experience of the renewal of Germany after the WWII. Feared that Germany could once again cause war, the allies accepted in 1944 a plan that ought to disindustrialize and make it an agrar country. Industrial machines should be removed, mines closed and filled with water and cement. The Germany should be turned into a land of small farmers. Then it would a peaceful nation, and the closer contact to the land and agriculture would bring moral restoration and pacification of its people.⁷ The author of plan was H. Morgenthau.⁸ Plan became active as soon as Germany was defeated, in 1945.⁹ It has become obvious in 1946 and 1947 that the plan created great problems. Former US president H. Hoover lead the team of experts to visit Germany and to report about the nature and the causes of problems. In the last report he emphasized main illusion about the development of Germany: „There is the illusion that the new Germany (...) can be reduced to a ‚Pastoral State‘. It cannot be done unless we exterminate or move 25,000,000 people out of it“ [7, p. 28]. Hoover's reports again discovered the core of old mercantilistic theory of population: „Industrial nation can maintain and nourish many people than it can agriculture state at the same place.“¹⁰ Just as A. Smith emphasized: „the difference is very great between the number of shepherds and that of hunters whom the same extent of equally fertile territory can maintain“ [14, p. 869], with implications on defense power of the country. This means that industrialization increases country sustainability.

Within less than three months Morgenthau plan was quietly stopped. Instead Marshall's plan was introduced, which goal was the reindustrialization of Germany and other parts of Europe. The plan was inaugurated in june of 1947¹¹ with the explanation which has already been known since the beginning of XVII century thanks to the A. Serra, that production of raw materials and industrial production are subject to different laws.¹²

⁶ According to [12, p. 977].

⁷ Similarity of Morgenthau plan and Washington consensus I was at first time emphasized in [1].

⁸ Term Morgenthau's Plan usually has been used either to designate the described agreement or to mean any postwar program designed to effect and preserve German disarmament by significantly reducing its industrial might [5, p. 517]. Second meaning can be enlarged to any plan that leaves out industrialization as a factor to a country development.

⁹ See more detailed description of Morgenthau's Plan in [2].

¹⁰ According to [10, p. 100].

¹¹ Marshall's expose discovers the core of the relationship between industry and agriculture: „Peasant has always produced food to be exchanged for other goods with the people that live in cities. This division of labor is the fundament of our modern civilisation. It now treatens to break. Industries in cities are not producing enough goods to be traded with peasants who produce food (...) Meantime, there are shortages of food and kindling material and in lot of places, people are getting close to starvation. Therefore Governments must use their external reserves to buy necessary goods abroad (...) Modern system of the division of labor on wich commodity exchange is based, is in danger and could fall apart.“ (According to [10, p. 122.]

¹² See [13, ch. 3].

Table 3. Basic characteristic of Marshall's and Morgenthau's plans

Marshall's plans	Morgenthau's plans
Creates "improved"	Exclusively creates "improved"
Schumpeterian activities: (= 'good' export activities)	Malthusian activities: (= 'bad' export activities if no Schumpeterian sector present)
Specialising brings increasing returns / economies of scale	After a certain point, specialisation will cause unit production costs to rise causes diminishing returns
Dynamic imperfect competition	„Perfect competition“
High growth activities	Low growth activities
Price stability	Extreme price fluctuations
Generally skilled labour	Generally unskilled labour
Creates a middle class	Creates 'feudalist' class structure
Irreversible wages (‘Stickiness’ of wages)	Reversible wages
Technical change leads to higher wages to the producer (‘Fordist wage regime’)	Technical change tends to lower price to consumer
Creates large synergies (linkages, clusters)	Creates few synergies

Source: [10, p. 100]

Table 4. Means for national economic development

1.	Acceptance that wealth is created in relations between activities with increasing returns and continuous mechanization. Understanding that the state is in wrong “field of specialization“. Aware of policies it supports, stands for and protects these activities.
2.	Temporal monopoly should be given to these activities in certain geographic area / patents / and customs protections.
3.	Acceptance that economic development is synergetic fenomenon, so that diversity and division of labor in economy are imposed. „Maximizing labor division and number of jobs in country“ (A. Serra) and copying economic structure of Venice and Holland.
4.	Theoretical understanding that industrialization (and advanced service activities) simultaneously solve four great economic problems of poor countries: increase value added, increase employment, increase wages and decrease balance of payment deficit.
5.	Significance of attracting competent labor from abroad (which is more important than foreign capital). This was already very important in England, in the period of Tudor dynasty (throughout the history, many nations deprived themselves of most educated citizens through religious persecution).
6.	Relative oppression of large landowners. From Florence in XIII century through England since 1485, to South Korea after WWII. Physiocracy (the foundation of standard economics) was a revolt of large landowners against that kind of policy.
7.	Tax incentives for economic activities we wish to develop.
8.	Inexpensive loans for same activities.
9.	Export support for same activities.
10.	Helping to increase arable land and incentives to agriculture in general, although we must bear in mind that agriculture itself cannot drive the country out of poverty.
11.	Focus on education and knowledge.
12.	Patents protection for new inventions.
13.	Export duties and export prohibitions so that raw materials would become more expensive for foreign industry (used in England in XVI century, with great efficiency, in order to break Italian textile industry).

Source: [10, pp. 44–46]

These arguments were used after the end of WWII in favor that raw-material production based countries also needed industrial sector. Recent mainstream in economic science, unfortunately, based on neoliberal dogma, forgot this opinions, and through its enforcers, with IMF on the head, even directly forbid the poor countries to develop industry forcing them on „equal“ competition with industrial developed countries. The same countries that used opposite policies for their development, than those enforced on poor countries.

Because Marshall's plan is today wrongly identified with any plan that brings great resources to the poor countries, overlooking its essence – (re)industrialization, it's necessary to specify its main characteristics and differences to Morgenthau's plan (table 3).

It is clearly shown what measures needs to be taken, as well as the current position of transition countries, and Serbia. And to make everything perfectly clear, here is the list of measures used from the time of Henry VII in England (1485) until South Korea (1960s), later banned by World Bank and IMF (table 4).

CONCLUSION

At the end, it should be underlined that, although it seems that the situation is clear, in reality that's not the case. Not because we should question these arguments and ideas – it is necessary to that every time. The point is something else. Current trends in world are more interdependent than ever, and very few countries, especially not Serbia, are able to carry out its own, independent policy. Financial capital has more power today than ever, and is heavily bounded with states policy, especially in USA, and large corporations, creating so called “Oligarchic triad”¹³ (WallStreet + US Treasury + IMF) that holds true political and economic authority in whole world.

So, the most important question today is – could the logic of today's modern capitalism (casino capitalism) i.e. financial capital, be broken? It's not only about offered programs¹⁴, it is essential if there is enough social strength capable for that. Same is to be considered for our country – are there forces that could lead us from ruling (neoliberal) concept that leads to poverty, towards industrial oriented concept which could lead the country towards development? Much has been spoken about new models of development, based, among other, on renewal of industry, but the question whether it's realistic or it's just a political marketing for domestic use, remains. Does the will and capability to pursue autonomous policy exist? It's not clearly shown today, and the economic mainstream doesn't even recognize the necessity for that.

If the consensus about the later could be achieved, then the development strategy should be chosen without prejudice. It shouldn't be based, not on ruling mainstream, but on postulates of almost forgotten “Other Canon”. If that kind of objective review could be done as necessary in USA long before ending of WWII¹⁵, there is no real reason not to be taken today. After all, even renaissance economists told us that the State exists because of the systemic effects in an economy, wick also the early A. Smith glorifies.

¹³ According to [21, p. 8].

¹⁴ One of the important offered programs is made by J. Stiglitz. EuroMemorandum also attracts attention, by promoting transition from finance-led capitalism to capitalism.

¹⁵ „No good will come from discussing the merits of intervention or planning as an abstract principle. Human societies are impossible in the absence of social controls, and our real task is to determine the fields in which such controls should be applied, and to select the machinery best suited for the attainment of our social goals.“ [6, p. 381.]

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DRUGI KANON PROTIV VAŠINGTONSKOG KONSENZUSA: REINDUSTRIJALIZACIJA KAO USLOV EKONOMSKOG OPORAVKA I RAZVOJA

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Sažetak: Rad razmatra probleme alternativa glavnom toku u savremenoj ekonomskoj misli, koji je rezultovao Vašingtonskim konsenzusom. Rezultati reformi u tzv. postkomunističkim zemljama, zasnovanih na Konsenzusu, pokazuju, uz manje izuzetke, dubok i dugotrajan ekonomski pad, uz negativne procese i u drugim sferama. Nasuprot uobičajenim mišljenjima da je tranziciona kriza rezultat nedoslednosti u sprovođenju reformi, ona je upravo suprotno njihov zakonit rezultat. Kao analog ističe se Morgentauov plan za Z. Nemačku, kojim je nakon Drugog svetskog rata bilo predviđeno da ona bude industrijski razoružana, što bi vodilo njenom siromašenju i pretvaranju u sirovinski dodatak razvijenim privredama, i onemogućilo opstanak tadašnjeg broja stanovnika. Na sreću po Nemačku, Morgentauov plan je zamenjen Maršalovim koji joj je obezbedio industrijsku obnovu. I za tranzicione zemlje potrebno je, u skladu s postavkama i praksom Drugog kanona, koji potiče od ekonomske politike Henrija VII, pristupiti reindustrijalizaciji, kao nužnom uslovu oživljavanja privreda i izlaska iz dugotrajne krize.

KLJUČNE REČI: DRUGI KANON, VAŠINGTONSKI KONSENZUS, TRANZICIONA KRIZA, INDUSTRIJALIZACIJA, MORGENTAUOV PLAN, MARŠALOV PLAN, RAZVOJ