SOME FORESEEABLE DISASTERS OF THE GLOBAL ECONOMY: 
THE HIGH COST OF NEGLECTING KEYNES’S APPROACH

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Abstract

The paper revisits some foreseeable disasters of the recent history of the global economy, from the consequences of the failed attempt to construct a disciplinary order based on the Washington Consensus paradigm, to the current global crisis, which dramatically showed the vulnerability of the "Bretton Woods 2" order and contributed to the widespread adoption in Europe of austerity programs. We argue that the historical evolution of the international non-system since the collapse of the Bretton Woods regime can be regarded as the complete repudiation of the essence itself, and general philosophy, of Keynes’s international economics. We aim at demonstrating, conversely, that Keynes’s international macroeconomics is the result of the development of an extremely powerful “complexity approach” to international economic relations, and that it still provides a mostly needed theoretical reference to construct, as Keynes himself would say, a "sounder political economy between all nations".

Keywords: John Maynard Keynes, International Economic Order

JEL Classification: B31, F02
The international “non-system” in historical perspective

“In Washington Lord Halifax / Once whispered to Lord Keynes: / It's true they have the money bags / But we have all the brains” (Gardner 1980: xiii). This rhyme was written by Dennis Robertson during the Anglo-American negotiations of late 1945; as known, American money bags won against British brains. Its general meaning is that, if we are to adopt a power politics approach such as that used by historians like Skidelsky (2000), Keynes’s revolutionary ideas about the post-war order could not compete with the rise of the United States as a political and financial world power, destined to impose the weight of her money bags on the future international architecture. Undoubtedly the economist who did more than anybody else in his life, on both a theoretical and practical level, to reform the global order, Keynes was convinced that “The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else” (The Collected Writings of John Maynard Keynes, hereafter CW; CW 7: 383). He believed that “the power of vested interests is vastly exaggerated compared with the gradual encroachment of ideas” (ibid.). One might therefore easily associate his name to that “defunct economist” today’s “practical men” should be “slave of” (ibid.), as predicted by the Keynes of the General Theory. But it would be wrong: or better, the moral to be drawn from how global economy behaved in recent decades is that today's practical men are not the slaves of Keynes himself.

For many decades, since the collapse of the Bretton Woods system and the anti-Keynesian counter-revolution, Post-Keynesian economists have been invoking a return to Keynes’s plans for the postwar global order, in the attempt to show that an updated version of the Clearing Union proposal could help counteract the shortcomings of the international architecture. Yet the evolution of this latter from the Eighties to the current financial crises in the United States and Europe provides a quite clear demonstration that Keynes had not been defeated on his specific global reform plans only. In truth, the last thirty years have witnessed the complete repudiation of the essence itself, and general philosophy, of Keynes’s international economics. To see the point more clearly, it seems
necessary to revisit the recent history of world economy from a particular perspective, which rests on the use of the concept of the international “non-system”.

On writing, in 1983, on Keynes’s contributions to the Bretton Woods regime, John Williamson defined the non-system which followed the “Nixon shock” of 1971 (ending the Bretton Woods system itself) as the lack of “a set of generally accepted rules and conventions regarding the proper way for countries to conduct those of their economic policies that have significant repercussions outside their own borders” (87). Now, the economic literature abounds in analyzes of peculiar episodes – such as the East Asian crisis, or the historical saga of the Washington Consensus paradigm – of the post-Bretton Woods international order. Yet few economists have heretofore concentrated on such episodes by adopting a systemic view. The lack of legitimated international economic order has somewhat been taken as a general assumption and the “normality” of the non-system has been given for granted, with the result of downplaying the role of the non-system as a particular kind of international economic order, albeit an unnatural and perverted one. On the contrary, the construction of a historical narrative of the current non-system (which evidently exceeds the limits of this article), shifting the focus exactly on the lack of a true, legitimate and rational global economic order, helps to understand the shortcomings of the current international architecture in a fresh way. These latter would firstly appear as the byproduct of deliberate decision taken by policy-makers of the world powers, although for purposes not necessarily connected with the resulting international non-system; a second and more focused glance would reveal their instrumental character, that is their being functional to constructing the international economic order which has developed in the last decades.

**The disciplinary order of the Washington Consensus**

The story of the Washington Consensus provides a perfect illustration in this regard. As any developing region, Latin America had relied on external borrowing to finance its growth strategies in the postwar period. World recession in the Seventies, coupled with the sharp rise of oil prices were responsible for a liquidity crunch which laid the seeds of
the debt crisis in the early Eighties. Yet a decisive step towards the crisis burst was given by interest rate and exchange rate policies of the United States, which then came to the rescue of Latin America by conceding financial assistance through the Brady plan. The term “Washington Consensus” was introduced by John Williamson (1990) in the attempt to show that the neoliberal reforms (“prudent macroeconomic policies, outward orientation, and free market capitalism”, p. 18) endorsed by Latin American countries in the aftermath of the crisis were recognized as “correct” by industrialized countries and justified requests for financial assistance. For a number of reasons – 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: 88), but also the fact that the International Monetary Fund and the World Bank perceived their task to be that of “storming the citadel of statist development strategies” (Kanbur 1999: 2) – the reform package was soon adopted by the international financial institutions as policy prescription for development and “correct” recipe to contrast financial crises of the Nineties. Only apparently a paradox, a relevant point which was not included in the list but had close ideological affinity to the ten policy suggestions of the Consensus, namely capital movements liberalization, came to be seen as a basic precondition for recovery: foreign capital should flow again into crisis-hit countries, in homage to the theory of financial market efficiency and to the benefit of creditors in industrial countries.

The Washington Consensus has been a fairly resoundingly failure, as demonstrated by the economic distress it produced in Latin America, which literally lost a decade – Argentina’s collapse in 2001 being due to the adoption of an extreme version of the paradigm –, but also by the negative performances it offered in the context of the Russian and particularly the East Asian crises. Stiglitz (2002) and Post-Keynesian economists have aptly stressed the ant-Keynesian philosophy of the Consensus program. Capital market liberalization had pushed up the value of Asian currencies and produced unmanageable current account deficits. The IMF austerity solution was intended to restore market confidence, but its only result was to further depress the economies, which simply passed one’s deficit to another; capital flights made the rest to delay the region’s recovery.
Remarkably, in the early Nineties, East Asian countries had been described as luminous examples of the results a country could obtain by following the Consensus. Stiglitz (2002: 213) correctly saw that “Together 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”.

Much more was therefore at stake than declaring the end of the “global apartheid which claimed that developing countries came from a different universe” (Williamson 2002: 2), and the end of development economics with it. As Rodrik (2000) argues, the U.S. Treasury and international financial institutions used the Washington Consensus (in its various editions: the “augmented” version of the late Nineties sought to remedy the early failures of the paradigm by focusing on institutions) as a means to promote an “integrationist agenda” of hyperglobalization and (which amounts to the same thing) a safer world for capitals – liberalization of their flows being thus not a precondition of free-market economy but the veritable ultimate end of the agenda. Worthy of careful attention is the theoretical framework used by Rodrik to illustrate this assertion. What he calls the world economy “trilemma” compels to pick two and only two between a) full integration of world markets, b) democracy and c) national sovereignty, so as to obtain the mutually exclusive options of global federalism (a-b), the “golden straitjacket” of the Consensus (a-c), and a new “Bretton Woods compromise”. This helps to understand that today’s non-system partly derives in truth from this failed attempt to construct an international economic order entirely based on market discipline.
Keynes's complexity approach to international economic relations

The current nostalgia for the “embedded liberalism” (Ruggie 1982) of the Bretton Woods order – felt by Rodrik (2011) himself, Chang (2008) and UNCTAD (2009) economists, among others – and its thin version of globalization seems therefore to rest on solid bases. Though substantially correct, references to the Keynesian character of the past order do not do justice to Keynes’s contributions. For what Keynes teaches us is exactly that if the Consensus order could not work, this is not only because of the inefficacy of the austerity solution or of the damages capital movements liberalization may cause, but, more profoundly and more importantly, because an international economic order cannot rest upon the imposition of an orthodox model of capitalism against its actual and potential varieties, or even radical, fully heterodox alternatives to it (Cedrini 2008). What is at stake is not so much, to put it differently, the anti-Keynesian character of the Consensus orthodoxy – the IMF acted to impose the “global conformity to an economic orthodoxy [that] Keynes had rejected”, writes Newton (2006: 5) – but the fact itself that it has been imposed, and that it has been imposed as such, that is as an orthodoxy.

As a recent strand in the literature is suggesting (Carabelli and Cedrini 2010a, Vines 2003; see also Kirshner 2009), Keynes’s international macroeconomics is the result of the development of an extremely powerful “complexity approach” to international economic relations. This approach provides clear continuity with his general conception of economics as a moral rather than positivist science, to be more properly identified with a way of reasoning about a complex economic material, made up of “motives, expectations, psychological uncertainties” (CW 14: 400). Keynes’s theory of economics is a framework to deal with a social world which is not explicable in terms of the individual behavior of its separate parts; that is, in terms of micro-foundations and rational action theory. Consistently with the analysis of the fallacy of composition between particular and general interests he sketched out in The End of Laissez-Faire, Keynes conceived the international economic order as a complex object showing latent and actual conflicts, and had an “extraordinarily clear understanding of how pieces of the global economy interact, driven
by the policies of autonomous nations, in an only partly coherent manner” (Vines 2003: 339).

His international macroeconomics after the end of the pre-war gold standard led by Britain – which he wanted to reform along lines developed in Indian Currency and Finance (1913) – was the attempt to efficiently cope with the “dilemma of the international system” (CW 6: 272). In A Treatise on Money, having in mind the serious constraints posed on policy space by the renewed gold standard of the interwar period, he identified such dilemmas with the clash between the needs prescribed by international discipline (as regards, in particular, exchange rates in terms of the international standard) and those inherent to the right to national autonomy (as concerns interest rates and foreign lending). Keynes devoted the Twenties and Thirties to the search for a model of national behavior consistent with the general interests of the system (Moggridge 1986). He finally found it, as the discussion of mercantilism from the point of view of the whole system makes evident in the General Theory, in the “twice blessed” (CW 7: 349) policies of regaining control over the interest rate, whereby countries could reach and maintain full employment and help their neighbors, at the same time, to achieve this same result. With the plan for an International Currency Union (ICU) in the Forties, he offered a scheme of global architecture explicitly devised to defend and promote policy space in an overall expansionary environment, through a mix of truly international currency, symmetric adjustment, possibility of capital controls and fully accommodating global monetary policy.

The ICU should provide, in other words, an international “central control” (CW 7: 379) of the kind of those justified by Keynes, in the General Theory, as means to attain full employment while safeguarding the “traditional advantages of individualism”, that is “personal liberty” and the “variety of life” which emerges from such widened “field for exercise of personal choice” (380). Although the ICU plan is usually regarded as the effort to reduce the asymmetry of international adjustment, its final aim was exactly to safeguard each country’s right to policy space and therefore to variety in defining its own version of national capitalism. The somewhat heretic proposal of an American gift, at the end of World War II, to an exhausted Britain – who had financed the Allies’ war against
Germany and incurred in enormous debts with both the United States and the sterling area – provides a clear, both practical and symbolic illustration of the kind of international order desired by Keynes (see Carabelli and Cedrini 2010a). By granting a gift as a retrospective contribution to the financing of the war, he argued, the United States would have offered Britain the freedom to actively contribute to “the kind of [multilateral free-trade] post-war world” (CW 24: 328) on which the Americans had “set their hearts” (280), the same that Britain herself was willing to implement by marching “side by side” (316) with the Americans. A world that the discipline and weight of a business loan, compelling Britain to accept what would have been regarded as the “American conception of the international economic system” (61), would have conversely put at high risk. More in general, what Keynes had in mind was a system wherein creditors take the initiative to reduce global imbalances by granting debtor countries the freedom to choose their own path to development and growth, which in the end would accrue, as the experience of the Marshall plan suggests, to the benefit of creditors themselves.

Rodrik and other nostalgics of the Bretton Woods order are right in opposing “the diversity of national policy” the system could not structurally interfere with, as Keynes himself observed (CW 24: 608) in defending the agreement, to the “outside dictation” (Keynes again, this time on the gold standard; CW 26: 33) of the Washington Consensus. Still, though a complete reversal of the Bretton Woods philosophy, the Consensus has its ultimate roots in the disciplinary mandate Harry Dexter White’s scheme assigned to the regime’s institutions, whereas Keynes’s plans, which assigned technical, not political mandate to the IMF and the World Bank, were explicitly conceived in the awareness that “distinct national circumstances implied that heterogeneity, not homogeneity was appropriate across various states’ macroeconomic policies” (Kirshner 2009: 534). Freedom of capital movements, the main pillar (pace Williamson) of the Consensus, should have surrendered when clashing with each country’s freedom to choose its own macroeconomic policies. Keynes directly, not generically the architects of Bretton Woods, is thence the economist we are not slave of.
The unreasonable system of “Bretton Woods 2” and the problem of global imbalances

Despite its “blocked” structure, the so-called “Bretton Woods 2” system seems more respectful of policy space than the aborted Consensus order. This is not a paradox, since the fictitious spontaneity of BW2 is in truth a direct legacy of the Consensus attempt to impose discipline as the main rule of the international order. According to the original (pre-crisis) BW2 narrative (Dooley et al. 2003), Asian countries implement export-led growth strategies supported by undervalued exchange rates, capital and trade controls, and international reserves accumulation, with the aim of regaining a central position in the world system. Their mercantilism would result in happily sustaining the dollar’s value and assisting the central country and world growth locomotive, the United States, in financing its deficit. The view is highly controversial: a huge debate has developed centering on the true reasons lying behind the most salient aspect of BW2, that is the unprecedented and costly accumulation of foreign exchange reserves by emerging markets. For sure, the strategy was taken “in the context of the decision to adopt or reinforce the neo-liberal strategy of rapid financial liberalisation, unrelated to the development of either deep financial markets or mature and effective regulatory structures” (Cruz and Walters 2008: 666–7). The moral developing nations have drawn from the Consensus saga is that it is safer, in a financially liberalized world, to rely on self-protection through increased liquidity rather than on external borrowing (Feldstein 1999).

The lack of shared views about the connections between global imbalances and the crisis burst (see Borio and Disyatat 2011; Serven and Nguyen 2010; Obstfeld and Rogoff 2009) is not a reason for optimism. In times of sustained world growth, supporters of the “new economy views” (Eichengreen 2006) about global imbalances welcomed the emergence of a seemingly stable and performing international system, one destined to endure in time despite the widening of disequilibria. Dooley et al. were able to defend their own interpretation of the post-1997 international scenario by claiming that “Bretton Woods II still defines the international monetary system” (2009): the 2008-9 crisis was not driven by that dollar plunge (with a sudden stop of capital flows from emerging countries to the United States) which the so-called “gloomy views” about global imbalances
believed to be the most likely outcome of such huge current account disequilibria. Yet, on one side, while it is a quite sure effect of the crisis that global imbalances as such have reduced (Lane and Milesi-Ferretti 2011), uncoordinated responses to the crisis (in the form of financial bailouts and impressive fiscal-stimulus packages) have de facto brought about a sovereign debt impasse in Europe, thereby seriously threatening the general stability of BW2, and global imbalances remain a key issue of world economy (Eichengreen 2011).

A central issue at stake in Dooley et al.’s interpretation and in the whole debate on BW2 is the rationality of the new order. Apparently an indispensable, reasonable strategy of more or less aggressive (that is, mercantilist) self-insurance voluntarily chosen by individual countries in an open financial environment, reserves hoarding as an outcome of the tacit coordination of the BW2 regime appears much less rational from the point of view of the whole international system. The crisis has obviously directed attention to Keynes’s reform plans in the Forties, but in truth, a lesser known part of Keynes’s work would be of great utility in forming reasoned opinions about the sustainability of BW2. In elaborating a “rational” (CW 1: 71) reform of the gold standard regime in Indian Currency and Finance (1913; see Carabelli and Cedrini 2010-2011), Keynes argued that a monetary system should combine “cheapness with stability” (CW 1: 91). His main concern was for the principal effects of what he defined, with regards to India, as the “original sin of mercantilism”, that is the hoarding of gold, also (and mainly) in the form of reserves accumulation. “Wonderfully few … countries have yet learn that gold reserves, although no doubt they serve some purpose when they are held for show only, exist to much better purpose if they are held for use also” (125), he argued: on discussing the 1914 crisis, he added that “although many countries hold large quantities of gold, there are but few which pursue a rational policy in regard to it. At considerable cost they build up large reserves in quiet times presumably with a view to the next crisis; but when the crisis comes mistaken policy renders them as little able to use gold as if it were not there at all (CW 11: 247).

In truth, it appears that today’s emerging countries did use international reserves, and effectively so, in the attempt to protect themselves from “double drain” crisis scenarios with banking problems and capital flights (Obstfeld et al., 2009). Yet there have
also been signs of reluctance to draw down reserves, for “fear of losing international reserves, which may signal a deterioration in the credit worthiness of a country” (Aizenman 2009: 17). Keynes’s 1913 words about the international economic system acquire the utmost importance and freshness once the specific perspective of the current non-system is adopted in making the parallel. Suffice it to reread page 71 of Indian Currency and Finance: we have never developed the ability – which Keynes invoked to justify his “rational” reform – to cope with the spectacular effects of “a change of ideas in Asia” (the passage to “undervaluation-cum-intervention” strategies after the 1997 collapse). Asia has truly by now “turned the tables on the West”, but we have not learned yet how to control “the most intimate adjustments” of our “economic organism”. A direct legacy of Keynes’s complexity approach to international economic relations is that in a structurally uncertain environment, systems and policies must rest on deliberate decisions taken on the basis of probable judgment (neither absolute rationality nor truth). They must be “rational”, that is to say, they must ground themselves on reasonable, neither arbitrary nor irrational judgments, and they must not depend on the fulfillment of expectations, for mere luck does not turn foolish judgments into reasonable judgments. If the BW2 regime, combining expensiveness with instability, is a byproduct of the attempted Consensus order, the unintended evolution that has transformed global imbalances into an engine of global growth (under the tacit assumption of ever-growing American demand for foreign goods) neither make them reasonable, nor justifies inactivity with regard to their persistence.

Here too, as Davidson (2009) among other shows, Keynes's ICU plan might prove of great utility. In commenting the draft report of the “Stiglitz Commission” (2009) of the United Nations for the reform of the international order, Kregel (2009) aptly observes that a new international reserve currency of the kind of the one invoked, with explicit reference to Keynes, by the governor of the People's Bank of China (Zhou 2009) and BRIC countries (2010) would not suffice, and should rather be coupled with a Keynes-inspired proviso of symmetric adjustment. But Keynes could not reasonably predict the abnormal patterns of today's global imbalances, with peripheral developing countries in a surplus position and
the world superpower and growth locomotive, the United States, acting as the system’s deficit of last resort. Not only is a new international adjustment mechanism required, but also a mechanism which is “also sufficiently compatible with global aggregate demand to provide full employment and support the national development strategies of developing countries” (Kregel 2009: 5). The desired mix of full employment and maintenance of the global standard’s purchasing power is not the automatic result of the introduction of the ICU plan, but the product of coordinated symmetric adjustment policies, that is of “coordinated policy action taken mutually by members of the clearing union” (2). As Davidson puts it, in the current “interdependent global economy a substantial degree of economic cooperation among trading nations is essential” (2009: 136).

In truth, on two distant but similar occasions, that is at the end of the two world conflicts, Keynes himself confronted himself with how to obtain coordinated international adjustments of this kind. On lines similar to those employed by Vines in the attempt to illustrate adjustment dynamics in the context of the Asian crisis, we have elsewhere (2010c) shown that the memorandum on post-war Britain written by Keynes in March 1945 for the negotiations of the American loan offers a useful guide to the highly complicated literature on global imbalances. Britain’s economic destiny could follow three mutually exclusive paths, American financial assistance – and its precise nature – playing a fundamental role in orienting London’s decision about her own future. While the lack of U.S. contribution to alleviate Britain’s debt burden would have compelled this latter to the isolationist choice of the “Starvation Corner”, the option of an American loan (“Temptation”) – which Britain finally accepted – would have forced London to surrender to the “American conception of the international economic system” and to adopt “distasteful” second-best policies to redress her financial situation (CW 24: 316). Keynes’s solution (“Justice”) rested on the “psychological atmosphere of the free gift” (340) he wished to obtain from the U.S., allowing Britain to approach the sterling area creditors with proposals of multilateral adjustment (in recognition of the shared responsibility for the war costs) and to participate in the construction of the new order.
Unilateral (Starvation Corner), bilateral (Temptation) and multilateral (Justice) adjustment are obviously also the alternatives for the unwinding of today’s global imbalances. We therefore subdivided the global imbalances literature into three groups: first, “made in” views, such as the twin deficits theory (requiring the U.S. to attack its own deficits) and the “global saving glut” hypothesis (blaming developing countries for the imbalances), both relying on an “austerity solution”; second, the “new economy” views, based on the aforementioned BW2 interpretation, expressly suggesting the possibility of avoiding painful adjustments by the use of market mechanisms (the – pre-crisis! – attractiveness of U.S. financial assets) supplemented by tacit intergovernmental agreement; and finally the “shared responsibilities” views, calling for a multilateral approach to the imbalances. Keynes would have clearly favored this latter approach. He would have likely followed UNCTAD (2004) in stressing, in positive, the fundamental role played by both United States and China in sustaining global demand (the latter is in fact the major engine of growth in Asia and outstandingly contributes to increased trade among developing countries) and, in negative, resounding failures on the part of other important surplus countries to take responsibility for world growth. He too would have argued, like Kregel (2006), that developed countries should grow through internal demand rather than by those policies which developing countries are (and should be) allowed to use in order to fill their gap with the former.

The European debt impasse in the light of Keynes’s *The Economic Consequences of the Peace*

If Germany’s enormous surplus, deriving from sluggish domestic growth, restrictive monetary and fiscal policies, and low-wages strategies, has generally gone unobserved for a decade, it is only because in that same period, Europe – which obviously participated in the global-imbalances game, its firms being engaged in acquiring American assets and technology while keeping the value of their US subsidiaries’ profits stable and protecting investment at home too (Kregel 2006) – has been in equilibrium with the rest of the world. The recent European debt impasse has quite naturally lifted the veil on Germany, and
revealed that the European economic architecture shares many of the flaws which affect the international order, in primis the inability to cope with its imbalances and to restart growth through adequate countermeasures to the downturn. In truth, the European debt crisis has its origins exactly in the global financial collapse, which is responsible (via financial bailouts and fiscal stimulus packages) for the rise in public debts especially in Southern countries (Papadimitriou and Wray 2012). Yet yesterday’s solution has become today’s problem. Consider the letter sent by the President of the European Central Bank Draghi and his predecessor, Trichet, to the Italian government on 29 September, 2011:

Frankfurt/Rome, 5 August 2011.

Dear Prime Minister,

The Governing Council of the European Central Bank discussed on 4 August the situation in Italy’s government bond markets. The Governing Council considers that pressing action by the Italian authorities is essential to restore the confidence of investors.

The Euro area Heads of State or Government summit of 21 July 2011 concluded that «all euro countries solemnly reaffirm their inflexible determination to honour fully their own individual sovereign signature and all their commitments to sustainable fiscal conditions and structural reforms». The Governing Council considers that Italy needs to urgently underpin the standing of its sovereign signature and its commitment to fiscal sustainability and structural reforms.

The Italian Government has decided to pursue a balanced budget in 2014 and, to this purpose, has recently introduced a fiscal package. These are important steps, but not sufficient.

At the current juncture, we consider the following measures as essential:

1. We see a need for significant measures to enhance potential growth. A few recent decisions taken by the Government move in this direction; other measures are under discussion with social partners. However, more needs to be done and it is crucial to go forward decisively. Key challenges are to increase competition, particularly in services to improve the quality of public services and to design regulatory and fiscal systems better suited to support firms’ competitiveness and efficiency of the labour market.

   a) A comprehensive, far-reaching and credible reform strategy, including the full liberalisation of local public services and of professional services is needed. This should apply particularly to the provision of local services through large scale privatisations.

   b) There is also a need to further reform the collective wage bargaining system allowing firm-level agreements to tailor wages and working conditions to firms' specific needs and increasing their relevance with respect to other layers of
negotiations. The June 28 agreement between the main trade unions and the industrial businesses associations moves in this direction.

c) A thorough review of the rules regulating the hiring and dismissal of employees should be adopted in conjunction with the establishment of an unemployment insurance system and a set of active labour market policies capable of easing the reallocation of resources towards the more competitive firms and sectors.

2. The government needs to take immediate and bold measures to ensuring the sustainability of public finances.

a) Additional-corrective fiscal measures is needed. We consider essential for the Italian authorities to front-load the measures adopted in the July 2011 package by at least one year. The aim should be to achieve a better-than-planned fiscal deficit in 2011, a net borrowing of 1.0% in 2012 and a balanced budget in 2013, mainly via expenditure cuts. It is possible to intervene further in the pension system, making more stringent the eligibility criteria for seniority pensions and rapidly aligning the retirement age of women in the private sector to that established for public employees, thereby achieving savings already in 2012. In addition, the government should consider significantly reducing the cost of public employees, by strengthening turnover rules and, if necessary, by reducing wages.

b) An automatic deficit reducing clause should be introduced stating that any slippages from deficit targets will be automatically compensated through horizontal cuts on discretionary expenditures.

c) Borrowing, including commercial debt and expenditures of regional and local governments should be placed under tight control, in line with the principles of the ongoing reform of intergovernmental fiscal relations.

In view of the severity of the current financial market situation, we regard as crucial that all actions listed in section 1 and 2 above be taken as soon as possible with decrees, followed by Parliamentary ratification by end September 2011. A constitutional reform tightening fiscal rules would also be appropriate.

3. We also encourage the government to immediately take measures to ensure a major overhaul of the public administration in order to improve administrative efficiency and business friendliness. In public entities the use of performance indicators should be systematic (especially in the health, education and judiciary systems). There is a need for a strong commitment to abolish or consolidate some intermediary administrative layers (such as the provinces). Actions aimed at exploiting economies of scale in local public services should be strengthened.

We trust that the Government will take all the appropriate actions.

Mario Draghi, Jean-Claude Trichet

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Now read again the parts in bold in the light of both the original list of the Consensus reforms, and Rodrik’s (2002) illustration of its “augmented” version:

<table>
<thead>
<tr>
<th>The Original Washington Consensus</th>
<th>The Augmented Washington Consensus (the original list plus:)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fiscal discipline</td>
<td>Legal/political reform</td>
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<tr>
<td>Reorientation of public expenditures</td>
<td>Regulatory institutions</td>
</tr>
<tr>
<td>Tax reform</td>
<td>Anti-corruption</td>
</tr>
<tr>
<td>Financial liberalization</td>
<td>Labor market flexibility</td>
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<tr>
<td>Unified and competitive exchange rates</td>
<td>WTO agreements</td>
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<tr>
<td>Trade liberalization</td>
<td>Financial codes and standards</td>
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<tr>
<td>Openness to DFI</td>
<td>“Prudent” capital-account opening</td>
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<tr>
<td>Privatization</td>
<td>Non-intermediate exchange rate regimes</td>
</tr>
<tr>
<td>Deregulation</td>
<td>Social safety nets</td>
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<tr>
<td>Secure property rights</td>
<td>Poverty reduction</td>
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</table>

The similarity of approach is evident. The ECB’s “austerity solution” for deficit countries like Italy is in truth a Bruxelles-version of the Washington Consensus recipe for developed countries. The country most severely hit by both the confidence crisis and the austerity solution is Greece, due to the astonishing volume of its public debt and the fact that the government had lied about its deficit when taking the decision to enter the Euro area. This latter circumstance lies evidently at the basis of the “Northern diagnosis”, as De Grauwe (2011) calls the view whereby government profligacy is the true responsible for the crisis, and deterrent sanctions on today’s deviants are required to prevention future economic crimes.

There are now countless commentaries on economic newspapers (e.g. Summers 2011, Krugman 2011) which make references to Keynes’s *The Economic Consequences of the Peace* to highlight the impossibility for Greece to remedy her situation through austerity, and rightly so, but little consideration for the imaginative work of practical economic diplomacy which Keynes made visible in the book. Here is a shining example of his complexity approach to international economic relations (see Carabelli and Cedrini 2010b).
After describing the economic continent as a “body” characterized by “economic solidarity” between its parts, Keynes recognized that Germany’s creditors were caught in an irresoluble “dilemma” (CW 2: 58): due to the burden of Inter-Allied debts, they could not recede from asking Germany for impossible indemnities. By so doing, being so “deeply and inextricably intertwined with their victims by hidden psychic and economic bonds” (2), the Allies were in truth inviting not only Germany’s destruction, but also their own. Keynes argued that Britain should have renounced her share of reparations in cash to the advantage of the Allies, and made an “inevitable” (92) appeal to “the generosity of the United States” (93).

This latter was absolutely crucial: “the financial problems which were about to exercise Europe could not be solved by greed. The possibility of their cure lay in magnanimity. Europe, if she is to survive her troubles, will need so much magnanimity from America, that she must herself practice it. It is useless for the Allies, hot from stripping Germany and one another, to turn for help to the United States to put the States of Europe, including Germany, on to their feet again” (92). Debts forgiveness was therefore conceived as a necessary precondition for Keynes’s “grand scheme for the rehabilitation of Europe” (CW 16: 428), a “shared-responsibilities” plan of an international loan requiring the whole spectrum of countries involved to participate in the reconstruction. Keynes saw American assistance to the continent (including Germany’s creditors) as the required ignition key allowing a spiral movement of magnanimity to spread along the chain of countries disposed to take part in the “grand scheme”. Only a gift, acting as a “strange attractor”, could provide the starting engine for this movement towards a more balanced international economy. Creditors should assume their responsibility.

Greece is now in the same position as Germany in 1919. The Northern diagnosis tells us that if borrowers are guilty of the impasse, they have to repay their debt; they have therefore to consume less and pay more taxes, with unchanged income. But the only possibility to realize savings on both the private and the public front without income reduction is offered by a trade surplus, and this requires cooperative trade partners, which
Germany is not. The developing-country growth strategy adopted by Berlin throughout the decade is responsible for her lending policy to the rest of Europe, and Greece in particular. In Kregel's (2011: 9) fascinatingly clear words: “countries with undervalued currencies have higher rates of income growth than consumption growth, and as a result have higher savings rates ... But for every undervalued currency there must be an overvalued currency, suggesting that the “behavior” of the GIPS (Greece, Italy, Portugal, and Spain) is no more inherent in their culture than the fact that the EU GDP manages to grow at a positive rate, given German policies. And it is Germany’s refusal to cooperate in a collective policy that imposes the opposite behavior on its eurozone trading partners”.

Rodrik (2010) takes the same view: “If others borrowed too much, doesn’t it follow that Germans lent excessively?”. And this is exactly the same argument used by Stiglitz (2003: 83) in treating the Asian crisis and the Washington Consensus: “for every [Asian] borrower there is a lender [from developed countries], and the lender is as much to blame as the borrower”.

**On Keynes's legacy in the times of the crisis**

The illegitimate moralistic aspect of the Northern diagnosis has interesting implications for the historical parallel with Keynes’s times, and for an assessment of Keynes’s legacy in the times of the crisis. Let us first note that the 1945 memorandum on post-war Britain was but an updated version of the model of international adjustment outlined in *The Economic Consequences of the Peace*. Both result from Keynes’s belief that “interdependence required management, and that a 'leader' was a great asset (if not an essential one) in doing this” (Markwell 1995: 209): hence the attempt to “imbue the new hegemonic centre, the United States, with the behavior and ethics which pertain to the world creditor power” (Ferrari Bravo 1990, 407; our translation). This means that Germany has substantially failed as leader of the European continent: “the solution to the Euro crisis is in Germany, not in Greece” (Kregel 2011: 8), but exactly as the Americans as Keynes saw them in 1919, Berlin seems to have a too “strong desire to clear out of European responsibility (without even realising what this will mean to Europe)” (CW 16: 440).
But there is even more. If Keynes assigned so crucial importance, in his attempt to construct a “sounder political economy between all nations” (CW 25: 43), to national “freedom to choose”, it is because in his ethical vision, economics is concerned with providing men the material preconditions for the enjoyment of a happy life and the possibility of individual choice of ends: freedom from economic pressures discloses “the possibilities of personal life” (CW 9: 125). It does not come as a surprise, therefore, that he could consider the “sanctity of contract” (CW 18: 384) as something radically different from “an immutable law of nature”. In his vision, debt contracts cannot be preserved “except by the reasonableness of the creditor”: “debtor are only honourable in countries where creditors are reasonable. If creditors stand on the letter of the law, debtors can usually show them how little the law avails. Internationally, contract has nothing to support it except the self-respect and self-interest of the debtor. A loan, the claims of which are supported by neither, will not be paid for long” (384). He even went so far as to define it a specific “duty of the creditor not to frustrate payment”: debtors cannot be asked to sacrifice their “self-respect and self-interest” in favour of “narrow calculations of financial self-interest” on the part of the creditor (385). If Keynes were alive today, he would probably accuse Germany of being an unreasonable creditor and censure her “anti-social” attitudes, as he did with France and the United States in the inter-war gold standard.

Not even the European Union, with its promises of freedom, has succeeded in ensuring “the proper liberty of each country over its own economic fortunes” (CW 25: 11). We are thus back to the main issue at stake at the beginning of the story of the neo-liberal non-system: like some uncelebrated antecedents such as the inter-war period gold standard, the unrestricted laissez-faire of its main supporters has once again “mistaken private licence for public liberty” (CW 24: 622), and totally disregarded each member’s right to national autonomy. A main lesson one can draw from revisiting the non-system in historical perspective is that we are definitely not slave of Keynes, but also that we are free to take inspiration from him, if our aim is to construct a radically different alternative to the current state of international affairs.
References


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