Peterson Institute for International Economics

The London Consensus: Economic Principles for the 21st Century

October 22, 2025

This is an unedited AI-generated transcript that may contain errors. Please confirm quotes in the corresponding event recording. If you find substantive errors, please contact meetings@piie.com.

[00:05:28.20] - Cecilia Malmström

Good morning, everyone. Welcome to the Peterson Institute for International Economics. Welcome also to those of you who are connecting online. I'm Cecilia Malmström, I'm a non-resident senior fellow at this institute, and I have the honor and the pleasure to moderate the discussion this morning. Some of you in the audience might remember the Washington Consensus, an essay published 35 years ago by John Williamson, who was a fellow here at the institute for many years between 1981 and when he retired, until he retired in 2012. He also served in the World Bank, the IMF, the United Nations, and the UK Treasury. So the Washington Consensus that he launched was a name to describe policy reform advocated to emerging market economies elaborated in a publication that came after his first article. The consensus was a kind of rule book on politics for mainly Latin America on what to do and what to do— not to do. In economic policy and development. And it was very much the product of the vicious circle of economic stagnation and debt crisis that we saw in the '80s. The book was very influential, but also criticized, and some thought it was misunderstood.

[00:06:48.19]

But today, 35 years later, the London School of Economics have initiated a very ambitious project with 50 leading scholars from all over the world, two of them from Peterson, uh, trying to identify a new set of ideas and policies that can guide us in today's world with new challenges of climate change, inequalities, etc. And to elaborate on this project, we have a very interesting panel with us here today. First, we have Fred Bergstein, who is the founder of this institute. He's a director emeritus and still a non-resident fellow. He has also worked at the US Treasury, National Security Council, the Advisory Committee on Trade Policy under President Obama and the first Trump administration. And he was here when it was launched, the Washington Consensus. He was in the room where it happened, and he's going to share his experiences from that. We also have two of the editors here today, Tim Besley, who is Professor of Economics and Political Science and Arthur Lewis Professor of Development Economics at the LSE in London. He has extensive policy experience from advising the World Bank, IMF, EBRD, and has served on the Bank of England Monetary Policy Committee.

[00:08:06.27]

We also have Andrés Velasco, who is Dean of the School of Public Policy, LSE, also served as a Minister of Finance in the government of Chile between 2006 and '10. He's an Associate Fellow at Chatham House, the Royal Institute of International Affairs, and a research fellow at the Center for Economic Policy— Economic Policy Research. And he's also one of the co-editors. And we also have the pleasure of having Şebnem Kalemli-Özcan, Schreiber Family Professor of Economics at Brown University and the director of Global Linkages Lab. She's a research assistant at the National Bureau of Economic Research and a research fellow at CEPR. And she's currently also the co-editor of the American economic journal Macroeconomics. So you see a very qualified panel. Fred will be joining us online, I think. So without further ado, I'm looking very much forward to hear about this project and the authors, and then we'll discuss jointly when you've heard the presentation. So Fred, are you with us? Come in, Fred. He's there? Yes? Okay, Fred, please, you have the floor.

[00:09:22.53] - C. Fred Bergsten

I'm here. Thank you, Cecilia.

[00:09:25.32]

Can you hear me?

[00:09:26.17] - Cecilia Malmström

Yes.

[00:09:29.04] - C. Fred Bergsten

Uh, we are meeting at a time when it seems there's no consensus on anything. In our societies. In fact, we're meeting at a time when the U.S. has become a rogue state that seems to be trying to abolish any consensus that existed before on everything running from trade policy and monetary policy through—

[00:10:01.07] - Cecilia Malmström

Your video is off. Okay.

[00:10:09.35] - C. Fred Bergsten

Is it okay now? Okay now? Yeah, you're all set. Okay. Let me just repeat. We're meeting today at a time when it seems there is no consensus on anything in our societies. We're meeting at a time when the US has become a rogue economic power, which seems to be trying to banish consensus on practically everything, ranging from trade policy and monetary policy through the rule of law and even democracy itself. So, anyone trying to forge a new consensus like our friends from LSE and others in this book today, are facing a monumental challenge. But at the same time, it's a challenge that must be addressed. And so we applaud your effort to do this. We hope that it will succeed. We hope that today's meeting will help give it a push in that direction. And we also hope that some memory of how the Washington Consensus succeeded and played a big role in some of the major positive economic developments of the last 30 or 40 years can inform the effort that you undertake today. Those of us who are football fans will remember that the Washington Redskins football team was a very successful outfit back in the 1980s and early 1990s, won 3 Super Bowls.

[00:11:56.13]

And its core strength was this offensive line, which one of its members, a graduate of Columbia University, incidentally, labeled the Hogs. Well, when that name became very famous, he said, if I'd known it would become so popular, I never would have used that term. And that's what John Williamson said about the term the Washington Consensus. He said that if he knew it would catch on so widely, he never would have called it that. And in fact, he tried in our publications in the early 1990s to swap it in for something that he tried to call universal convergence, which at the time was a fair assessment of the widespread acceptance of the Washington Consensus. But it didn't work. Washington Consensus lived on and lives on to this day, and we're discussing it here as a possible backdrop for what you're trying to do with the London Consensus. Now, there were, of course, lots of inputs, both intellectual and policy, to the evolution of the Washington Consensus. But here at the Institute for International Economics, as it was then called, the original impetus may come as a surprise to you. It came from none less than David Rockefeller, who approached us in 1985 out of his abiding interest in Latin America and his desire to look beyond the debt crisis, which was still dominating policy, to try to forge a strategy for how Latin America in particular, but the developing world more broadly, could emerge from that lost decade of the 1980s with its debt crises.

[00:13:52.17]

He asked us at the Institute, where we were already heavily involved in the debt crisis, helping develop the Baker Plan and subsequently the Brady Plan, to look beyond the crisis and see how we could get back to growth in Latin America and the rest of the world as a whole. We began our effort not with John Williamson, who was working on the debt crisis along with Bill Klein and

myself and some others here, but rather with Béla Balassa, who published our initial study on that topic, Toward Renewed Growth in Latin America. It was not just an institute or just a US publication. That book was jointly produced among ourselves, the Colegio de México in Mexico City with Gerardo Bueno, and the Getúlio Vargas Foundation in Rio with Mario Enrique Simonsen. It was a multilateral project right from the start. It came to three basic policy recommendations. One, outward orientation to restore the global approach in the Latin American countries. Second, to increase the level and improve the allocation of national savings, which had become hugely distorted. And third, to more broadly reduce and change dramatically the role of the state. From being a producer of goods and services to being a regulator and a creator of the environment within which economic policy would proceed.

[00:15:33.04]

Those three central themes were later elaborated by John Williamson and others to become his Ten Commandments, which are now still widely referenced, including in your new volume on the London Consensus. But it goes from those three fundamental themes which John came back to in his publications in the 1990s and in the references in the new book today. Now, the new book rightly says that the Washington Consensus was, quote, hugely influential, and that by the early 1990s, it constituted the predominant view of effective policy for development. And we at this institute are delighted that your new London Consensus does not seem to reject any of what was in the Washington Consensus itself. Uh, the new book is also correct that our Washington Consensus had a very precise focus. It was to help the Latin Americans and others escape from and get beyond the debt crisis that had been so dominant in the 1980s. And there were two basic routes to do that. Uh, macroeconomic stability, most importantly fiscal consolidation at that time, and also microeconomic efficiency, which meant trade liberalization, deregulation, and the avoidance of industrial policies, which were also prevalent at that time. I'd quibble a little bit with the assessment in the new book that the Washington Consensus did not promote growth per se.

[00:17:21.04]

I'd quibble maybe a little bit too that it did not address political economy. But on that score, you have to take into account a book that John Williamson put together in 1994 called The Political Economy of Reform, which I think was one of our best volumes. On exactly that topic and should be seen along with the earlier publications in assessing the intellectual impact of the Washington Consensus. But in any event, whatever the failings of the original Washington Consensus, I think it's pretty clear that the results were quite good. Robust economic growth did ensue. Global poverty was reduced dramatically. The Great Moderation pulled inflation down to very tolerable levels. And globalization and outward orientation peaked in the early 1990s and

into the early part of the 21st century. Uh, but the new book is also correct in saying that the Washington Consensus left us with a plethora of unanswered questions. Uh, income distribution, most notably, uh, although the Washington Consensus did address some of the policy variables that go into addressing income distribution, but it's fair to say it did not address it per se. It did not address the adjustment of labor to the disruptions that inevitably derived from outward orientation and globalization.

[00:18:56.00]

And in retrospect, I think that was the most significant omission because the failure to deal with adjustment, particularly of labor forces in the high-income countries, created the backlash to globalization that we are suffering from today, including in populist politics. Uh, and that certainly was an omission from the Washington Consensus. But it did not address technology, innovation policy, uh, competition policy— that nexus of issues very much. And it certainly did not address issues of health, education, gender, and the like, which you talk about in your London Consensus book. That was quite deliberate. My main message today is to say that selection of topics was quite deliberate. We believed we had to focus on the fundamentals that had created the debt crisis and had to be solved if the Latin Americans and others were to recover from that series of disasters. We did not want to overload the circuits with too many recommendations and too many proposals. It was hard enough, I can tell you from having been there, to sell the Washington Consensus and the Ten Commandments as they emerged at the time without adding even further to the list. And so, as I look at the lessons from the Washington Consensus for your London Consensus today, and it's the effort that you all will make to be marketing it widely around the world, my recommendation would simply be, do not overload the circuits.

[00:20:41.31]

I was delighted to see that even though the book addresses a lot of topics, that in Chapter 1 there's a clear recognition, and I quote, "An approach that emphasizes everything ends up prioritizing nothing." So do not lose sight of your priorities. Emphasize them as you go about proceeding with this work. Especially is that true when we go back, and I close with this, to my very first point. We're in a world where there is not much consensus on anything. When the consensus that we may have thought was fairly widespread on a lot of economic policy issues is being shattered, including by the biggest high-income country of all. Now, your study and your London Consensus is of necessity being aimed more at the high-income countries. Whereas the Washington Consensus was aimed at the developing countries. I'm not sure whether that makes it a harder or an easier sell. My guess is it's a harder sell, particularly at this point in time when there is such a shattering of the previous degree of consensus that has existed,

particularly in the high-income countries, including across the Atlantic between the United States and Europe. So we wish you well.

[00:22:07.30]

We wish you good speed and good cheer. We hope that your London Consensus takes off like a rocket. We certainly will support it, and we hope that whatever lessons one can glean from the successes we had with the Washington Consensus will carry over into today. I look forward to hearing your explanation of what you're about and certainly hope to support it. As best we can from the Peterson Institute. Thanks to all for being here today.

[00:22:49.53] - Andrés Velasco

Good morning, everyone. Thanks for being here. On behalf of my fellow co-editor Tim Besley, a couple of the co-authors who are here in the room, Şebnem and Dan, and everybody involved in this project. Thank you very much. We are honored to be doing our Washington launch of this book at the very same institution where, as Fred just described a minute ago, the original Washington Consensus was launched. So thank you, thank you. And Fred, thank you very much for the those generous but also very insightful remarks. So I'm going to tell you a little bit about the genesis and the purpose of the project. And Tim is going to tell you a little bit about the substance. But we're not really here to pontificate. We are here more than anything else to hear comments from the audience and reactions to the project. So the context— and Fred did some of the work for me already— is that it's been 36 years since the original conference, 35 years since the book came out. And the world has changed a lot, sometimes for the better. We don't quibble at all with the notion that macro stability and the opening up of economies to trade was great news for the world.

[00:24:06.47]

We're not pretending to get rid of that. But the world has changed in ways that are not necessarily desirable. And one such change is pretty evident dissatisfaction by citizens and democracies and probably non-democracies alike, with the states of politics, the state of policymaking. And in democracies, you know, a great deal of dissatisfaction with the ability of democracy to deliver. So one question might be, what can economics today offer to the policymakers who are looking for a new playbook? So in one sentence, our hope is to provide some answers, as you will see, conditional answers, to the question is, what can we do now? Of course, economics has also changed a lot in the last 35 years. Among other reasons is that, as Fred pointed out, there were topics that back then didn't really exist, which today are central to our policy concerns, but also to economic research. Technology and innovation is an obvious

one. Environment is an obvious one. Income distribution was an issue back then, but really on the back burner. It is a main issue today. The nature of the labor market and the role of racial and gender inequities in the labor market.

[00:25:25.47]

These are all topics that today people think about a lot and do a lot of research. Back then, that research was really beginning to get going. So there is the book. What we did is simply we asked a number of colleagues. We began with a list of 15 topics, but then the list of contributors mushroomed. So in the end, there were 50 people involved in this project. And the question we posed to everybody was very simple. We said, in these 35 years, what have we learned? So if you do fiscal policy, what have you learned? If you do trade or labor markets or growth and innovation, what have we learned? What do we know today that we didn't quite know back then? And what are the implications for policymaking? This is not meant to be purely an academic book. It is— Ideally, we hope you'll tell us if we are misguided or not. We would like it to be a book that has an impact in the policymaking community. We worked very hard, by the way, to make it readable. There are no equations, just a few pictures, and we hope reasonably clear prose. Now, one question might be, why consensus?

[00:26:39.17]

Another question might be, why London? The London bit takes care of itself. We held the conference there. It's not a bad place to have a conference. Most people have some connection to the LSE, have either teach there now, have taught there in the past, got their PhDs there. But believe me, this is not an attempt to reinvent the British Empire. Most of us, in fact, are not British, beginning with 2 of the 3 co-editors. Why consensus? As Fred pointed out, you look at the world, the word consensus is not the first word that comes to mind. So why the hell call it a consensus? Consensus sometimes, if we play fast and loose with the language, could also be equated to paradigm or approach. And of course, there's a long and distinguished history of economists saying beware of paradigms. You know, Hirschman wrote a classic piece called "The Search for Paradigms as a Hindrance to Understanding." Dani Rodrik, who has a piece in the book, wrote a piece whose title is "Beware of Economists Bearing Paradigms." So why do we want a paradigm? You know, it can become ideological, it become too rigid, it can become the object of attacks, et cetera, et cetera, et cetera.

[00:27:54.44]

We thought nonetheless that talking about a consensus, even if it's not a full consensus, and certainly we do not pretend that all 50 authors subscribe to the intro that Tim and I wrote, but

nonetheless, we thought that trying to bring it together in some more or less coherent whole made some sense for the following reasons. First one, because we economists may not know what works, but we had a reasonably good idea of what does not work. As I listened to Fred, and as I reflected, you know, I'm from Latin America, if I reflected on the state of Latin America back in 1989, You know, we have learned, we should have known all along that, you know, a budget deficit of 9 points of GDP financed by printing pesos is not a good idea, right? That does not work. And therefore, if we can at least help policymakers by narrowing the choice and saying, you know, cut off that tail, cut off that tail, that does not work, that's helpful. Secondly, and Tim will go into this idea in more detail, it is important to distinguish between principles and policies. We would like to think that we can distill from the book a set of principles that come from good economic reasoning, and Tim will present those.

[00:29:13.46]

But a principle can be applied in a very different way and may give rise to different policies depending on what the problem is. You know, what, you know, is the problem too much growth or little growth? Is the economy overheating or is it in a slump? Are you rich or poor? Do you have a competitive labor market or not? Different principles will yield different policies. Thirdly, we think that economists maybe should be a little bit more like doctors. Keynes said that we should be like dentists. We're going to be a tad more ambitious. And by that, I mean that doctors do diagnostics. They look at you, they give you a few tests, then they decide on the basis of those symptoms and those tests They conditionally prescribe a medicine. So a lot of what doctors do is conditional advice. We think that we economists can provide conditional advice. Given the principle, given your circumstances, maybe this is prudent. For a different set of symptoms and a different problem, something else may be prudent. Last but not least, and Tim has done research on this, I have done practical research on it by being a candidate twice in my life, I lost both times, so my record is unblemished.

[00:30:28.28]

You know, what you learn being out there trying to sell policies to voters is in a democracy is that numbers don't carry a lot of weight. What we think as evidence does not carry a lot of weight. Stories, narratives carry a lot of weight. And of course, a paradigm or an approach or a consensus is a story. The London Consensus was so powerful because in part was a story. Here you have a country doing all kinds of things that are wrong. Economies are too closed, the fiscal policies are unsound. There's a narrative of what is wrong and what needs to be done. So if we don't have a narrative, we're not going to be very effective in policymaking. So yes, it is not a full consensus, but we need to have a story. Otherwise, whatever policies or whatever principles we want to peddle will not have much impact. So let me simply round off by saying

that what we try to do is not a very long laundry list or supermarket list of policies, but we would like to put, you know, together not a policy paradigm but an economics paradigm. And economics provides the principle.

[00:31:39.44]

Or if you prefer, a political economy paradigm, because we think that politics and political economy ought to be front and center. And while political economy was not a central target of interest by academic economists 35 years ago, today it is a much bigger one. So as academics, we have more to offer. We have 5 principles, and I'll hand it over to Tim to tell you about those. Thank you very much.

[00:32:11.55] - Tim Besley

So I'm going to be super, super brief, and apologies if I really skate over this, and you can come back to it in the Q&A. So as Andrés has already said, the way we summarize what we thought we'd learned— we read all of the really excellent contributions that have been presented at the conference, and then it was our job to try and pull it together and say, what can we make sense of? And we did it in terms of these, these 5 principles that we then felt came out of the different contributions that we were reading. The first is that— and it's sort of an obvious point, and you could say that economists never didn't believe this, but I do think there's enough evidence out there to suggest that there was a rather more naive view, which is that when we think about success in the world is not just about the money, that people care about lots more besides, and we have quite a lot of evidence on what people care about beyond standard economic considerations. But more importantly, there's a view that goes back— Andrés is a proper scholar, he found a quote, a beautiful quote in J.S. Mill that showed that essentially the role of economists is to make the pie as big as possible, and the role of governments is to make sure that it's distributed in a fair way.

[00:33:31.14]

That's a very kind of naive one-liner. And in terms of the economics profession, the work of Diamond and Merlis was a kind of formalization of that idea. We think that that idea has to be set aside. In what ways is it important to set it aside? Well, we think about the jobs market. Do people just care about a job as a wage and the number of hours worked? There's a lot of evidence that people think of employment as something that gives them dignity, a sense of identity. Things that are not fully captured by just looking at the wages and employment hours. We put a lot of emphasis on growth. We have a starting chapter after the introduction is by Philippe Aghion and John Van Reenen on sort of modern approaches to economic growth

through innovation and creative destruction. Of course, in 1989, none of that work really existed. So this is all subsequent developments. But it gives a very different take on the role of the state as a promoter of economic growth and innovation. And particularly the way the state can create an ecosystem for innovation, adoption, and adaptation. The role of resilience, and of course resilience was in a certain sense central to the Washington Consensus because it came, as Fred reminded us, in the wake of a major debt crisis.

[00:34:54.07]

But we think the remit, the resilience remit now is much wider. And of course, having lived through a pandemic recently, that illustrates different kinds of shocks to which we expect government to respond and to have the fiscal space to respond. So the role, the way we view the role of macro prudential policies and debt policies is now somewhat transformed by the wider range of functions that come under resilience. I was interested, very interested in what Fred said about the political economy side and, you know, subject of a longer conversation. But we think— and this again reflects the research that's been done in the intervening period— the idea that there's no good economics without good politics. And it goes in both directions, that good economics can be derailed by politics, but equally good economics can contribute to good politics. Politics isn't just a constraint. We rely on having a stable credible political environment in which to implement policies. So if we don't pay attention to which policies look credible and therefore can be sustained, we shouldn't be recommending policies that are patently not politically incentive compatible. So we think there's a, there's a much wider approach for the role of good politics in, in relation to the kinds of issues we're talking about.

[00:36:17.49]

And then finally the centrality of a capable state to deliver anything that the government wants it to do. And again, I was curious, something that Fred said which hinted that that had been part of the conversation going back, but I think the work that's now been done on state capacity, we have a chapter on that, and Dan in the audience was one of the authors on that chapter. The idea that we have to— one crucial role of the state is to both create and invest in its own capacity to deliver for its citizens. So there's no way we can meet a green trans— the challenge of a green transition without thinking about what are the capacities of government that we need to deliver that in a fair and just way. Otherwise, it's going to be the politics and the economics simply won't line up. So those are our 5— in a nutshell, those are our 5 key principles. That we think reflect both the contributions in the volume, but also to some— well, to a significant extent, reflect the kinds of developments in the economics profession that have occurred since the Washington Consensus was formulated.

[00:37:27.46]

And I'll leave things there. We have some discussion of possible applications, but I think in the interest of time, I won't go into those. But we feel that all of those principles can dovetail nicely into specific applications on policy and we elaborate that, and maybe that can come out in the discussion. Thank you very much.

[00:38:01.47] - Şebnem Kalemli-Özcan

Okay, thank you very much. It's a pleasure to be here, and thank you for Peterson and of course Andres and Tim to invite me here and also make me part of this amazing book. So I'm going to give a narrower presentation. I was a discussant on the chapter written by Helen Ray in the book, and within that chapter and within that part of the book, I would like to talk about, you know, from Washington to London consensus, but in terms of how macro, international, and finance insights, insights at the intersection of these these three disciplines have changed. And this is something actually very well reflected in the book. And of course, I also want to start by saying, as Andreas, Tim, and Fred said, nothing about the importance of macroeconomic stability and importance of openness is being debated here, right? In fact, the recent Nobel Prize, Amartya Agnon and Howitt, Howitt at Brown, if you look at both Agnons Howitt's interviews that day, and Peter Howitt did an event at Brown in terms of the importance of openness for creative destruction. They both criticized the push for deglobalization, use policies like tariffs, as Fred said, by the largest high-income country.

[00:39:34.38]

Again, this connection is important, the connection between openness openness to talent, openness to trade, openness to finance, and how it also fosters innovation and growth, and how macroeconomic stability has a very important role in that picture. And that goes also back to what happened in Latin America, the debt crisis, and how Washington Consensus emerged. So let me kind of put my talk on this, view. So Washington Compromise, again, opening borders to capital flows was seen an important way to increase economic efficiency. This is still true, but of course we realize what we have learned, a largely unmanaged financial system in which the volatility of capital flows is going to be an issue. That's going to be detrimental. And again, this is something very well understood, of course, through the emerging market experience, not just Latin America debt crisis, Asia, you know, Argentina, Turkey, Mexico, all that, but also actually in light of the European crisis, right? European crisis now understood very much being as a debt crisis combined with a sudden stop from Northern European to Southern European countries. So this is actually a central theme. Emerging markets and developing economies learned the lesson first, but advanced economies also come to that point.

[00:40:53.56]

Now here, of course, monetary policy and macroeconomic stability in general is going to be hugely important because the original thinking in the Washington Consensus is, yes, you know, capital flows are going to be volatile punch, but domestic monetary policy and flexible exchange rate is going to take care of the problem, right? As long as your exchange rate adjusts and domestic monetary policy kind of focuses on macroeconomic stability, we will be good to go. Now, this is one of the lessons learned during these past 36 years is domestic monetary policy is not going to be enough to offset the impact of volatile external finance. Okay, so So how do we view this? Of course, it starts with the lessons in emerging markets. Emerging markets are going to be even more exposed to fluctuations in external financial conditions. Advanced countries also, but of course emerging markets suffer from this more. And you can think this in terms of trade-offs and challenges to domestic monetary policymaking in those countries, right? And again, applies of course to advanced countries too, but very acute in the case of emerging economies. So how do these trade-off challenges work? Trade-off is about, again, when you think about the intersection between volatile capital flows and domestic monetary policy, is it simply, okay, should I be increasing my policy rate or decreasing my policy rate during recessions, right?

[00:42:16.52]

I mean, this is a debate now, as you know, being raged in the United States in a very interesting sense. Why this is a trade-off for emerging market domestic monetary policymakers? Because recessions are also episodes coincide with capital outflows. Outflows, right? If you— and that's going to lead to exchange rate depreciation. So then you are going to have this trade-off. Increasing the rates can help you with that capital outflow and depreciation problem, but that's going to make the recession worse. Decreasing the rates is going to help your recession problem, but I'm going to make the other problem worse. Now, the challenges this creates, of course, for the domestic monetary policymakers is very well put by Helen Ray's famous Jackson Hole paper in 2013, Dilemma versus Trilemma. What I have done in my own 2019 Jackson Hole paper and following work is like, okay, can we put this question in two bits? So what do they do actually? You know, because Washington Consensus tells them flexible exchange rate, you know, don't do anything else, macro stability. But then Washington Consensus also criticized these countries. Well, you know, all the problem is you are doing the monetary policy wrong, that you are doing a procyclical monetary policy exactly your mistake in the fiscal policy, right?

[00:43:34.29]

That's kind of what emerged. So it is kind of your problem, emerging markets, fix your wrong procyclical monetary policies and fiscal policies. Okay, so we would like to have another look at that, right, in the part of what have we learned, as Andres said. And also, is it really the case that external financing is even a bigger challenge for emerging market central bankers?

[00:43:57.26]

Okay, and this is a very, very important academic policy debate.

[00:44:01.51]

Here I have three quotes. Woodward, you know, giant on, of course, when we think about US monetary policies, well, he says he finds it very difficult to construct a scenario under which globalization would interfere in any substantial way with the ability of domestic monetary policy to maintain control over the dynamics of inflation, right? So domestic monetary policy is good to go for inflation and macroeconomic stability. Ray, on the other hand, says, in going back to her dilemma, trilemma, the bet is exactly this. Monetary trilemma is really a dilemma because open economies can exercise no monetary autonomy from the United States policy. She brings the important role of United States monetary policy to full front. And of course, another way of saying that is the global financial cycle that is governed by United States monetary policy unless they impose capital controls. So she proposed capital controls as a tool to deal with this. And Murray, you know, he's sitting here. Murray said an independent monetary policy is feasible for financially open emerging market economies, but limited in what it can achieve. So the research done so far, both our research and other research, lining more with Murray's view.

[00:45:15.39]

Let me give you a little bit details on that. We really need to understand what type of capital flow is flowing. This is from my work on gross capital flows by banks, corporates, and sovereigns. This is now an official dataset of the Bank of International Settlements, so anybody can go and use it from there. So it's a sector-level capital flows. The red is going to be the banks, green is the sovereigns, blue is the corporate, and purple is central bank. So how much of those sectors in any country borrows, and the top is going to be advanced economies, Bottom is emerging markets. So on purpose, I'm stopping this 2015 because after that there was, of course, huge influx of inflows with the help of the QE policies in advanced economies. But this is telling a very, very important story, right? Not everybody is the same and countries are going to differ. So in general, when you think about emerging market and developed economies, 60% of their external borrowing is going to be debt, right? It's not going to be equity, it's going to be debt. And most of this debt is going to go through the banks.

[00:46:14.15]

Not through hedge funds and mutual funds, but like through banks. Banks are going to be very important players there. Only 30% are going to be on the bonds side. And IMF puts this as, you know, the first top is going to be the debt, total debt, and the middle is the other investment debt. That's going to be the bankroll. And the last is the portfolio debt. So all the other portfolio flows is going to be there. And you can see that, you know, banks are going to have a lion's share. In advanced economies and in emerging economies too. Although when you come to the portfolio in emerging economies, the green goes top. Why? Because the sovereign, right? Sovereign, of course, is the largest borrower in emerging markets going back to Latin American crisis. Now, when you look at the total debt, actually corporate sovereigns and the banks kind of borrowing the equal share. So in a sense, actually corporate borrowing is made a bigger increase for emerging markets than the advanced economies. Because advanced economies, corporates and the sovereigns, they don't need to borrow that much external, domestic finance is enough for them. So where the banks are acting as global intermediaries.

[00:47:19.56]

So this is going to have important implications for the monetary policy, what monetary policy can achieve, going back to Maurice Cole. And this is, you know, from joint work with Pierre Delo and Geeta Gopinath. So what you see here is, in emerging economies on the left and advanced economies on the right, what happens to interest rates? The blue is the policy interest rate, things like, you know, everybody's Fed funds rate equivalent, and the red is the market rate. And the market rate here is going to be a very short-term, right? 3-month Treasury rate. In America, we never think these things different because 3-month Treasury rate, even 1-year Treasury rate is taken as equivalent to a monetary policy rate, right? Because monetary policy immediately impacts the short-term rate. And that's what you see on advanced economies on a dynamic path. This is a regression from when GDP growth goes up and down. So this interest rate in blue and interest rate in red, so the policy rate in blue and market rate going up over 8 quarters on that top right, telling you when there is growth, when growth picks up, interest rates go higher, both market and policy in advanced economies.

[00:48:33.26]

Why they— so there is no difference. The bottom gray is like zero line, what we call a short-term disconnect between the monetary policy rate and the market rate. That is just zero. That doesn't exist in advanced economies. Look at emerging economies. So it actually goes the other way, right? The policy rate actually goes up. So emerging market policymakers do the right thing.

Monetary policy is not pro-cyclical. It is a counter-cyclical monetary policy, but they are not fully effective on a very short-term market rate, exactly as in Murray's code. You can see the market rate goes down, right? Good times, growth, market rate goes down, your borrowing rate goes down, even the policy is trying to do the right thing and try to limit that overheating in the economy. This is going to be, of course, an important feature, and that's why there is this short-term disconnect rate, which is countercyclical for emerging economies. So this says, like, you know, monetary policy can only achieve so much. And here, this is going to be even more acute when there are shocks from US, right? This is, I mean, you know, you can do this with US monetary policy shocks and everything, but here I'm going to show you the most exogenous shock ever, taper tantrum.

[00:49:41.05]

You all remember taper tantrum. It goes back to a speech by Ben Bernanke in May 2013. And you see how policy rates and market rates move in the opposite direction. There are outliers, of course, they are Brazil and Indonesia, They came and then they said, we are going to increase our policy rate because our exchange rate depreciation and capital flowing out, but they're outliers. Most of the emerging markets actually cut their rates during that event because the economy slowed down, whereas the market rates went up, right? Because of course the global markets are charging higher rates to these countries. Okay, so what else we know from the big data? We also learned in these last 36 years, we can use microdata to answer these type of macro questions. And a lot of the central banks, both emerging and advanced, have these very large credit registry datasets that you can follow all the transaction, all the household borrowing, all the bank borrowing, all the corporates borrowing domestically and outside and externally. And what we know from that type of work is this supply-side factor. So things coming from the US and other countries to emerging markets are important.

[00:50:50.58]

VIX is going to have a very important impact, a kind of a global barometer of risk on capital flows. And kind of if you want the numbers, an increase in capital flows equivalent to an entire quantile range is going to lead to 1% reduction in the real borrowing cost for these countries. And that's a very important impact actually to affect things like investment, consumption, saving, you know, all the things that are important for the domestic economy. And supply-side-driven capital flows, when I say supply, like, you know, based on, you know, US monetary policy and then the VIX, that can explain actually 43% of the aggregate corporate sector credit growth in these countries. So that's huge, right? I mean, huge number that is outside the control of the domestic monetary authority in these countries. Internationally funded large domestic banks are going to be very important procyclical agents here, right? Because their international borrowing

is going to move on with this risk-on, risk-off episodes. And of course, dollar borrowing is still going to be there. Even the governments, the sovereigns might be borrowing in pesos right now, there's still a lot of dollar borrowing by by households, by the entire countries.

[00:51:57.05]

Why? Because dollar borrowing is cheaper. Simply, there is a, you know, what we call a UIP failure at the very micro level. And as long as dollar borrowing is cheaper, that is never going to be zero. And that's of course going to create additional vulnerabilities. This goes back to very early paper written by Andres Velasco on this actually. And risky firms finance borrowing at lower rates during this risk-on episodes, but then they might still be collateral constrained, so they might never overborrow. So in that sense, we also did achieve through the regulatory policies a lot in these countries. Let me skip this and let me give this implications for macro pru and then conclude. So we still have a long way to go because once we understood this, we said, okay, what other macroprudential policies we can bring here to help that relation between volatile capital flows and domestic macroeconomic stability? If monetary policy is not going to be enough, if flexible exchange is not going to be enough, of course there is a menu— FX interventions, capital flow management policies, capital controls, macroprudential policies, right? It's just that we still, at the very beginning of this research, we still don't know which one to use when and how.

[00:53:07.26]

This goes back to what Andres says, is like, okay, if these are your symptoms, this is the recipe. If these are your symptoms, this is the recipe. So we are literally at the start of this research. Mainly because everything's theoretical. We have very, very little empirical research on this because we lack data. This type of research requires very granular, very detailed data, and we cannot really design the right macroprudential policies without evidence. So you know how the saying goes, without data and evidence, your model is just another story. Even though stories are important, to design the correct policies, we do need evidence. Who is the pro-cyclical agent and the sector in a given economy and what is the exact channel is very, very important to design these policies. Policies. And like this saying, you know, this quote from the European Systemic Risk Board, again, just to make the point that how this is relevant for advanced economies makes it very clear, right? So they decided in that report macroprudential measures, not just for banks, but also for non-banking sectors, very rare. And they focused on communication as a soft tool. Supervision of non-banking sectors is enhanced, but still remains very, very limited.

[00:54:15.00]

So to summarize, the aggregate impact of these volatile capital flows in and out is a big part of the domestic story. So in that sense, it is very important to think different policies in addition to monetary policy. 43% of the actual credit growth can be tied to something like VIX, which is the leading measure we use for global financial cycle. Role of domestic banks is very important. 99% of the impact goes through that because they are the main intermediaries, they are the market policymakers, right, in emerging markets and developing countries, not the portfolio guys who can come and go, but like these really domestic financial intermediaries, large domestic banks who fund themselves cheaply in international markets during episodes of abundant global liquidity is going to pass through lower cost as lower funding cost affects borrowing, is still important. It is 8%age points cheaper on average when times are good. That means when times are about bad, it is going to be vice versa. But this is a cycle. This is a time-varying phenomenon. This is an overlooked channel, right? Because this says it is not enough just ban households from dollar borrowing or ban corporates from dollar borrowing, right?

[00:55:23.16]

It is going to pass through between two currencies, right? So these policies has to be somehow linked to other type of countercyclical policies. Macroprudential policy, regulating domestic banks, capital flow intermediation, is going to be one way of looking at these things. Thank you very much.

[00:55:46.20] - Cecilia Malmström

Thank you.

[00:55:59.30]

Thank you so much for this. This is Fascinating. It's such an ambitious project that you are doing here. I mean, in a way, you're really looking at everything we know on politics, and you're mirroring with the Washington Consensus, and then you try to see, okay, we know what doesn't work, and then you give all these examples. I think this is super fascinating, and I can understand the appeal to do this. But I wanted to push you a little bit of what is the purpose of this? Who is your audience? What do you hope to achieve apart from very interesting reading in a big community like this and in the academic community, of course? Do you intend to sort of boil this down to more concrete recommendations, which could be an interesting thing, but also all of you keep saying, and most chapters say, well, it depends. I mean, every situation is a little bit unique. So who is the audience and how do you intend to take this forward? Would you like to start?

[00:57:06.58] - Andrés Velasco

Sure.

[00:57:08.10]

Is that working? Yes. I'll give you a very basic answer. Like many people in this room, I travel a lot. I have lots of friends in the policymaking community, mostly but not exclusively in emerging markets. So you fly into country X, you have dinner with your friend who's involved in policymaking, and he or she says, You know, we're trying to do the best we can, but people hate us. Mainstream parties are getting decimated, populists are rising, the old recipes don't seem to work, but we're not quite sure what the new recipe should be. Everybody in this room has had that conversation many times in many contexts. This used to be the sort of thing that happened in emerging markets. Today, it's the sort of thing that happens in this country. And a bunch of other countries that are advanced and rich. Now, if that's the starting point, clearly a new playbook is needed. The hard question is, what do we mean by new playbook? And I guess where we're trying to be serious, but also maybe this limits slightly the sort of sex appeal of the project, is that we do not think that it is helpful to boil down what we know about the world to 10 commandments.

[00:58:21.29]

At least not if the scope of issues that we're interested in is broad enough. One reason why John Williamson and people at that conference could boil it all down to 10 Commandments is that their scope was much narrower. It was basically get the macro under control and get some trade flowing, right? But if you're thinking about a broader set of issues, any set of 10 Commandments is going to be useful here but useless there, misguided simplistic. So we're trying to say, look guys, we're not going to provide 10 commandments. We're going to write 5 organizing principles that will help us think and then let us proceed like doctors. Okay, we have the rules, we have the symptoms. Let us let citizens and policymakers in countries come up with a precise and more granular set of policies. Did I get that right, Tim?

[00:59:12.08] - Cecilia Malmström

The former president of the European Commission, Jacques Juncker, he said once that we all know what to do. In economies, but we don't know how to get reelected when we've done it. And that's quite— I mean, that illustrates—

[00:59:23.55] - Andrés Velasco

Absolutely.

[00:59:26.14] - Tim Besley

Yeah, I'm not entirely convinced about that. I mean, there's a timidity among politicians. So politicians are meant to lead, not just follow the voters. And we live in a world now where I think politicians are too frightened to actually come out with a reasoned position on a controversial topic for fear of backlash. So, you know, this is— so if we're going to encourage politicians to become leaders, not followers, they need to have some intellectual substance to fall back on to do that. And the problem is that many of the politicians in the world who are offering simplistic answers are winning out. So That comes to Andreas's point about providing a playbook. But one thing, one interesting experience we had when we presented these ideas early on is we were denounced as preserving the Washington Consensus. It's fine to be sitting in this room and think, oh, what a wonderful thing the Washington Consensus was. But people spit blood. I know people who spit blood when they mention the Washington Consensus. I remember going to a talk at the World Bank, actually John Williamson was there, when Alice Amsden, who wrote her book on South Korea, basically just stood up and said, "The Washington Consensus has derailed development." The real development was building a capable state to deliver in the way South Korea did or in the way Taiwan did.

[01:00:58.19]

And that's not in the Washington Consensus. So, the starting point is actually not, and then the question is, well, can we respond to that? Now, I think that's an unfair criticism, but we think our principles can help us fight back and say, actually, here's things that maybe you didn't worry about inequality as a consequence of stabilization policy. Maybe you didn't think of an activist state as sufficiently important in certain parts of the world, in Singapore, Korea, and Taiwan being three signature examples. We actually think it should help politicians to have a playbook which they can then bring to the table, particularly mainstream politicians, because it's the fringe politicians who seem to be winning the discussion at the moment.

[01:01:42.35] - Şebnem Kalemli-Özcan

No, I mean, I fully agree with the author's book.

[01:01:48.34] - Cecilia Malmström

We are running a little bit short of time, and I want to open up if— there is a mic in the middle if anybody wants to put a question or Yes, Maury, you were referred to many times, so I think you have the right.

[01:01:59.47] - Maurice Obstfeld

I'm not going to talk about those issues, but this is a great report and a great panel. You very rightly in your presentations and in the report emphasize the importance of state capacity and social cohesion, which are closely interrelated. In the US today, we can see the consequences. I think we'll see them even more sharply down the road of degradation of both of those attributes. But I wonder if you see any conflict between those enterprises, which are inherently inwardly focused for any government. It's about the government delivering for the national polity and some aspects of multilateralism, which we desperately need to deal with global challenges. For example, You know, think of climate. If we want to justify a carbon tax, uh, we basically have to argue that other governments are doing the same, otherwise it seems pointless to the electorate. And that raises the credibility of other governments and their state capacities. Uh, again, in climate, we probably need vast transfers from richer countries to, uh, to poorer countries so that they can deal not only with mitigation but with adaptation to climate. Otherwise, it's not going to work. But how do you justify that to the electorate?

[01:03:26.11]

So the question is, do you see any conflict with these? Or if not, how can governments sell these projects? How do they manage the political economy of this, which has proven to be challenging?

[01:03:41.16] - Cecilia Malmström

Every government is thinking about this.

[01:03:45.32] - Tim Besley

Well, I mean, I could, I mean, Laura's quite right that this is one of the issues du jour. We're about to have the COP in Brazil, and every time there's a COP, we're reminded that there's this difficulty of squaring what's going on in those global technocratic institutions and the domestic politics. So, you know, Trump has rejected the Paris Accord twice now. And these global agreements if they can't be made locally incentive compatible. But then I think some of our themes about, well, we can't just ignore what people want for liberal democracy to work. So again, how do we work around that? How do we create a just transition? People are terrified of losing their livelihoods as a consequence of the green transition. So we just have to work with it's a feasible program of work. The one thing I'll say though, and I gave a talk in Stockholm, funny enough, the end of last week about exactly this issue, is if you look at the countries that on average are doing a much better job at dealing with climate, they're all the democracies.

People get hung up on the fact that China has just made a very big pronouncement on the issue of climate and say, well, maybe what we need is more autocracy.

[01:05:03.08]

But actually that's quite contrary to the evidence we see, and that's because in the end, I think democracies are better at trying to sell these projects, but there's no simple answer to what you said.

[01:05:13.29] - Andrés Velasco

Can I add one thought? Maury, as usual, asked a very good question, but a very hard question. My two cents would be to be able to get close to answering your question, we need to ask a previous question. It's how it is that governments gain credibility on even more basic stuff. Let me exemplify. If most voters are not willing to vote for any redistribution at home, it is even less likely they're willing to vote for redistribution to send money abroad. So as I think of the initial impetus for this book is how do we design a broad enough but persuasive enough set of policies or not even policy, an approach to policymaking that creates that sense of shared purpose so that voters and leaders are more or less in the same boat, and then we can begin thinking about more ambitious policies. But today we don't even have the preconditions. Much more basic discussions are completely getting derailed. So what you're asking about, Maurice, is very important, but in my mind, that's sort of stage 2. There's a stage 1 that we need to think about, and we're not doing very well there.

[01:06:22.21] - Cecilia Malmström

Stage 1 are these principles and a sort of broad overview. We know what doesn't work, and these are things that could maybe work depending on the circumstances.

[01:06:30.13] - Şebnem Kalemli-Özcan

Can I just add one point? I fully agree, but I think it's important that governments do need to accept that they can lose the next election. I think it's very important to have a government, okay, I'm going to work at this issue, but I can lose the next election. Still have to put the right training programs so that when people do lose their jobs during these transitioning, they are not going to be left alone. I mean, the best example of this is the China shock. We learned from China shock, right? The Ohio manufacturing guy who lost the job, who defaulted on the loan and who kind of closed shop had nothing but just go and backlash globalization and vote for Trump. The same type of company also lost the job and then the shutdown in Switzerland, but those guys had training programs and like other opportunities for those people because they

were in place. I think learning from that experience for the green transition and for any, big global challenge like that. I think those programs should set in motion, and you have to accept the fact that you can lose the next election.

[01:07:34.56] - Cecilia Malmström

We have time for one more question, please.

[01:07:36.27] - Audience

Right, Barry Wood. I'm an economics journalist, columnist. I want to pay tribute to Fred and to what John Williamson achieved because it seems to me as a journalist that the principles of the Washington Consensus completely upended economic development theory. Some of us grew up in Ronald Prebyshev, Great Leap Forward, Bruno Myrdal. These 10 principles—market-determined exchange rates, market-determined interest rates, promoting foreign direct investment, privatization of state-owned enterprises—extraordinary. So I think historians are going to identify what John did as absolutely fundamental.

[01:08:19.55] - Cecilia Malmström

So there was more of a comment.

[01:08:22.36] - Tim Besley

Okay. Any— Comment. Well, I mean, I agree with what you're saying, but when we were talking about the East Asian miracle, which was in a later period, a lot of people said this is a violation and look at the successful economies of Singapore, Hong Kong, Taiwan, South Korea, they're just not following the basic principle. Now, of course, we can debate whether they were or were not. They didn't have reckless macroeconomic policies for sure. But they have very activist states, which a lot of people said was a core principle that was being rejected. Now, whether it was, I wasn't in the room when all this was being debated, but I think there was a big debate in the '90s about whether, and those have been the, very few countries have made a transition from low to middle income to even high income in the world. And most people would say the only ones we know have done that successfully have done it with very effective activist states. So that would be a very simplistic argument to say, yeah, sure, we may have prevented a lot of other bad stuff happening for the reasons you suggest. But when we've seen development in action in the way we have China and all the rest, it's been because of state activism.

[01:09:35.39]

That would be the counterposition to the state.

[01:09:39.18] - Cecilia Malmström

So before I let you go, what's the next step? How are you going to promote the London Consensus so that it that it acquires the same sort of mythical status as the Washington Consensus. And as Fred said in the beginning, one of the advantages with the Washington Consensus was that it did prioritize. It had a few things. You have covered basically everything, which is good because it shows the complexity of governance and of political, of economic policies. But you also risk, you know, Talking about everything but nothing.

[01:10:13.12] - Andrés Velasco

Yes. One thought on the history, and then I will happily answer your question. We are certainly— I said it at the outset, forgive me if I repeat it— we're certainly not advocating closing the economies and doing crazy things on fiscal and monetary policy. So in that sense, the ideas that Fred and John and this institution put forward 35 years ago remain very sound. But the truth remains that two things did not quite pan out as planned. One is that in countries in which these principles or policy recommendations were applied, growth has not been stellar. I come from a country which is a poster child of reform. I'm Chilean. And Chile grew for about 10, 15 years, and then we stopped growing. And so one question is, what is it that we know, for instance, from the work of Philippe Aghion and other people about how it is that we ignite growth. I think regrettably, the book published in 1990 will probably not give us the clues to that. And the other thing is that even in successful countries, the voters don't seem to be very happy. Poland has grown more than any other country except for China in the last 30 years.

[01:11:27.53]

And then, you know, you look at the recent Polish elections and half of the Polish electorate thinks that and things have gone completely wrong. So there seems to be a pretty clear need to go beyond what is in some senses very useful but limited conventional wisdom. What do we do next? We're going to a lot of places. We were in Delhi last week. We'll be in New York tomorrow. We're going to Brussels next week. But in many senses, and this is not just Politesse, this is a shared enterprise, meaning we have a lot of co-authors and a lot of colleagues who contributed, but also the job of getting from principles to policies is a job where we certainly do not pretend, you know, Şebnem will know much better than Tim and I how exactly this might be useful for Turkey, right? I would not pretend to have the clue, but I'm sure she can probably give us some pointers and the same holds for many other countries. So, you know, it's an open invitation to think together about how it is that we take this to the policymaking arena.

[01:12:31.24] - Tim Besley

And just to add on that, that it was a very interesting conference where there were a group of political scientists pointing out that there's a kind of 30% rule now, that in pretty much every advanced democracy, there's about 30% of people who are voting for really quite disruptive forms of politics. And we, it's not clear that by just resorting back to the recipes of the past that we're gonna do anything about that. We need new ideas, we need new action from the mainstream. And I'm not saying we have the answer to that, but boy do we, I think, need a new conversation. So what would be success for us is to have, we're not rejecting the Washington Consensus, I think that came out very clearly, but what we wanna have and we think we need is a new conversation.. And that new conversation needs principles. And we hope maybe there are better principles than ours. And creative destruction works. People will come out with those, and they'll displace ours. But we think that's what we're trying to foster with this project.

[01:13:33.32] - Cecilia Malmström

I think that's a very noble mission to do that. We could discuss this for a very long time, but we're running out of time, unfortunately, already done. So I want to thank you so much, Professor Tim Besley, Shebnam. Kalemli Özkan and Andrés Velasco. Thank you as well, Fred Bergsten from online. And thank all of you who joined here in person and online to watch this conversation from the Peterson Institute. Have a good day.