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«Washington Consensus» – Financial Model of Market Reforms in Kazakhstan

Abstract. Main setups and principles of the relief program for developing countries (countries of Southeast Europe, Latin America and CIS) called «Washington consensus» are given. The process of transition engineering in the countries in transition is described. Realization of several plights of Washington consensus in Kazakhstan and countries of Southeast Europe in view of national peculiarities, conditions and specifics of its economy are considered. Constructive criticism of Washington consensus and concrete suggestions on further improvement of economic policy of Kazakhstan are given in the article.

Key words: relief program, liberalization, privatization, monetary restriction, selective social protection, effective owner. feature of any culture.

Introduction

The problem of the interaction of the financial and the real sectors of the economy during the previous to market relations period of plan economy was solved with the help of accumulating (up and running mechanism of sales tax, income tax and others) and distributing financial resources through the state budget according to the center's priorities. With the liquidation of direct planning, its mechanisms should have been substituted by decentralized market institutions of financing in the form of private financial establishments. Unfortunately, such replacement didn't take place.

Reformers of the country, acting within the framework of program of market transformations, which was worked out for Kazakhstan in entrails of international monetary organizations, believed that the main task of the first stage of transformations was the launch of market mechanism with the help of price liberalization and founding institutes of private ownership. Creation of other market institutes had been recognized as an automatic consequence of privatization and liberalization processes. Such reform strategy was effective only at the launch of turnover mechanism.

Methods

Disharmony is evident between the legal segment of the economic system and the actual forms and manners of economic activity. This is indicated by the current state of economy and the business results of economic agents. The origin of the so disharmonized normative and factual economic system is manifold but can be formulated, in its broadest, as a slow and not an overall enough implementation of legal solutions and advocacies for radical change. Through the analysis of the causes of hesitation, delay and even inefficiency in carrying out a thorough reconstruction of the economic system, attention is paid to the inherited, as well as newly-constituted, system of motivation that guides the economic behaviour of individuals and various interest groups in state-owned enterprises awaiting the necessary and fast-approaching privatization.

Main body

Transition engineering in the countries in transition

The essence of the transition process is rather controversial, as well as the perception of transition. The dilemma is whether the process is seen as meeting the

requirements of so-called Washington consensus and a fundamental change of society and spontaneous (i.e. unconstrained) acceptance of modern society norms, based on external receipts. In other words, it would be ideal that the transition follows a comprehensive transformation of society and the relationship that a state has towards its surroundings.

Like any other ideal, this one is also aspired to, but it can never be accomplished completely. Imperfect as it is, the real state of affairs should be as close as possible to the ideal. In this context, the combination of constructivism and spontaneity is fully emphasized. The first component implies the task and responsibility of transition policy makers, while the second is a result of altered formal rules and the willingness of the majority of population to change the perception of life in the community of countries and sharing the same values [1]. This is so-called social genotype, including the willingness of people to change.

The change of institutions and consciousness should simultaneously follow the transition. Is this feasible, and if it is, in what timeframe? The answers to this important question are in the inventiveness of elected representatives in creation the own path in the development of states or to improve ready-made recipes that rely on ideas of Washington consensus.

Having in mind the experience of some countries in the existing processes, the population shows the lack of desire to change, even if the government is ready to meet the goal of a comprehensive society change. Deficit or absence of one of the two factors, which influence the fundamental reconstruction of society, gives only partial solutions. Then, as a rule, the form, not the substance of the transition process, is fulfilled.

After many years of the former socialist countries' transition, one can derive conclusions regarding the content and effects of the process. Volume of the changes varies from country to country. The results of the procedures, which have been undertaken so far, also vary. These differences in the transition engineering and the effects of the changes suggest that the fundamental reconstruction of the economy and society implies deep political and economic transformation. Insight into the current results of transition in many countries shows that significant reform activities have been undertaken, but there is still no fundamental reconstruction of the economy and society.

Clear definition of objectives, means and actors in the process of economic and social change is an important prerequisite for successful transition. In addition, the implementation of changes must be adjusted to market economies and democratic

society. To achieve the objectives, it was necessary to change the institutional framework, and in certain segments, the construction of new institutions and constitution of new code of conduct [2].

The differences in the performance of transition process in some countries is not easy to explain due to the simultaneous effects that economic and non-economic, external and internal factors have on the course and content of the process.

The main sources of normative economic theory applying to the developing countries and countries with the economy in transition were the international economic organizations, and the International Monetary Fund and World Bank at first. And, if World Bank mainly influenced the recipients of its loans not by official conditions, but by pressing persuasion, then the allowance of credit accompanied by macroeconomic, and for extended credits – by structural conditions [3].

The point of view according to the reforming of the economies of developing countries (of Latin America, at first) had formed in 1980s, which was later applied also to countries in transition. Such point of view, following John Williamson's example, was called Washington Consensus (WC), IMF, World Bank, and USA Ministry of Finance, which also took active part in development programs of help to Latin American countries. These are situated in the Capital of the United States of America [4].

If, relatively they multiply and with different amounts of features described in literature of the three main parts of WC, there are no questions: it's a microeconomic liberalization, macroeconomic stabilization and privatization, then the issue about its sources hadn't been taken seriously. The well-known Polish economist and statesman Grzegorz Kolodko had expressed the essence of the Washington Consensus in following: «Liberalize everything, that you can, privatize quickly, as it's possible, follow the strict fiscal and monetary policy.» (Transition. 1998. Vol. 9. N3. June).

Moreover, recommendations of WC contained: liberalization of direct foreign investments, security of property rights, currency rates unification and market mechanism of their adjustment, decrease of state costs and their direction into education, healthcare and infrastructure, tax reforms (tax base extension, reduction of marginal rates and degree of tax progression), selective social policy, and growth of labor market flexibility (decrease of its state regulation) [5].

As for the ratio of components, we should note that in Latin America countries, the most important factor was macro stabilization, liberalization and privatization [6]. For countries of Central and

Eastern Europe, the opposite was true. The main objective was the institutional reconstruction of the economy, covering state and private organizations and formal and informal regulations of the economic activity. Mechanical duplication of the WC accents in principally different conditions had become later the main arguments of the reformers and their western advisors.

To achieve the goal of transition, one must take into account all the parameters relevant to the process. After reviewing the existing conditions, the change of the institutional framework and, in certain segments, new institution building, are initiated. The process should imply initial broad understanding of institutions as a set of formal and informal rules that determine the social relations through which regularities in the interactions of individuals and social groups are exhibited.

The creators of this process are given a most complex assignment to designate its course and content. Building market infrastructure takes time and cannot be but in specific segments established by decree. In addition, building up an integrated market implies creation of a favourable social and economic setting. The accomplishment of necessary changes in the economic, legal, and institutional environment must be a consciously channeled process. This process, similarly to the entire process of transition, is a combination of both spontaneous and planned steering that, depending on the phase of transition, is dominated by one course or the other

On the basis of the experience from the years of transition in some countries, it has become evident that the institutions, from local governments to highest state bodies, have not yet undergone essential internal reform. In such conditions, the institutions very often do not represent the interests of economic agents and customers. It is only a radical change in the mechanisms of authority and governance that can reduce or eliminate the once generated robust, inert, and corruption-inclined system of administration and bureaucracy. The insufficient dispersion of authorization has for decades contributed to the accumulation of power in the hands of a small number of influential centers. In addition, there are external influences also of a small number of financial organizations like the IMF and World Bank, which channel the key internal reforms. Among the countries in transition, such as Poland and Slovenia, there are examples of rejection of external dictations.

In its broadest context of new-institutionalism, attention is drawn to the analysis of free order and constructivism. Free order implies respecting the

rules, regardless of the intentions of individuals or interest groups, which are formed as a result of historical processes of shaping social relations. Formed over a long period of time, such rules become laws, which are verified in everyday interactions of individuals, social groups and institutions [7]. These general rules are based on tradition, customs, religion, culture. Since the informal rules are exhibited independently of the needs and demands of a social process, their effect on the process has parameter character. As objectively given and immune to the influence of individuals or groups' will, informal rules are not subject to «violent» changes. Spontaneously established rules should not be changed by economic or any other interventionism. It can even be argued that interventionism is harmful because it represents a violation of the natural order. At the same time, states must ensure the respect of the rules, necessary for the operation of the spontaneous order, and their evolutionary development.

Constructivism refers to the design of standards created in the inner circles of experts and/or politicians. If one would achieve spontaneous construction of the desired state, the process would require a long period of time. Time, however, is a very limited factor. Therefore, creation and (violent) implementation of solutions that should generate new or modify the existing institutions to accelerate the process of achieving the goals, seems quite rational.

Transition and Washington consensus

According the intention of the Washington consensus, the creators of transition advocate the concept of a rapid, efficient, and thorough reconstruction of the economy and the society. As proof of their determination, the legal framework has been nearly completed with laws and supporting rules and regulations that are meant to induce positive effects on the functioning of the economy.

One of the important tasks is privatization. Transformation in the ownership structure is a required but not necessarily sufficient condition for efficient transition. In addition to defining the ownership right, it is necessary that other institutional changes be carried out simultaneously. Privatization of the state-owned capital has been undertaken as a process that ultimately leads to the final transition end – that of a developed. According the Washington Consensus, a radical shift in the building the market-oriented economy should provide by: 1) massive and rapid privatization, 2) inflow of (foreign) capital for investment; 3) restructuring of the economy and financial market; 4) joining world integrating courses and 5)

creation of an environment favorable for business activities in line of liberalization; 6) establishing a sound ownership regime, 7) fiscal discipline, 8) a redirection of public expenditure priorities toward fields offering both high economic returns and the potential to improve income distribution, such as primary health care, primary education, and infrastructure; 9) tax reform (to lower marginal rates and broaden the tax base); 10) Interest rate liberalization and competitive exchange rate [8].

Those preconditions will be provided for the actualization of the features of modern (western) societies: democracy, competence, competitiveness, innovation, inventiveness and new spirit of entrepreneurship. There is no doubt with respect to supporting these objectives. However, the practice of the 25 years efforts of the creators of transition in a number of states suggests a series of difficulties in their fulfillment. The only question is how the recipes of the IMF contributed to such state of the economy. Many critics of Washington consensus underlying cause of bad performances see precisely imposed priorities imposed by the IMF and World Bank [9].

In the implementation of the above-related decisions, however, numerous problems have arisen [10]. The current state of the affairs in this field in many countries suggests a serious gap between the desired and the actual state of the economy, thus leading to the argument that there is no radical seizure under way but a process that is basically adjustment and change, while at the same time not an energetic enough detachment from the remnants of the past. The reasons for this most commonly lie in the not as yet completed institutional framework according the intention of Washington consensus.

The sources of WC are not just dissimilar, but they are in different levels of abstraction. Firstly, there are fundamental neoclassic theorem of wealthfare, which connects optimal economic condition with free competition and private property as the basis of WC recommendations. Included to the WC recommendations, overall privatization is theoretically based on the Coase theorem, according to which the means of production with strict specification will come to hands of the most effective owner by their selves. This can be named as the ideology or the symbol of confidence of the WC.

Secondly, in the recommendations of the specialists from the international financial organizations, there is always some influence of what is currently popular in the sphere of high theory. Thus, in 1970-1980s the prominent place in the IMF and WB ideology took ideas of

conservative regeneration, including monetarism, economy of supply, Chicago school of «Economy and Law» and the new classical macroeconomics based on the concept of rational expectations and critically assessed probability of systematic state macroeconomic policy. In that period the big attention was paid to «cases of insolvency of the state» (government failures), harmful for the behavioral economics, aimed to getting monopoly rent in the form of state exemptions. That is why in the period of WC formation, the focus on markets development, perfectionism liquidation, state subsidies and state property were in trend. Therefore, there is no need to conclude that the theoretical fashion was dictated by pure ideology and was not supported by empirical researches. The long period of main role of the state in theories and plans of development and encouraging import substitution came before accession of the WC. Failure of the most of these plans led to the change of the accent in the WB and IMF policy to support market oriented reforms. But, as practice shows, sometimes these researches give opposite results. Which of them to choose depends mainly on the intellectual trends and preferences.

In 1980s (World Development report 1987 – most representative document) the following point of view was preferred: export orientation (as a counterweight to the import substitution) and liberalization of foreign trade (as a counterweight to the protectionism) lead to best results in economic development [11]. WC excluded traditional Keynesian recipes of economic growth stimulation at the expense of budget deficit. The openness of the economy (trade, investment, technological and informational) was counted principally important for its progress, though some problems, connected, for example, the excessive freedom of capitals movement from country to country, were not deeply comprehended.

Finally, the third point is according to recommendations of international financial organizations, there had always been very significant pragmatic component. They are mostly active balance of payments, budget with no deficit achievement, which can be interpreted by common sense and more specifically is the concern of the creditor for the money return. Thus short-term macroeconomics of the IMF is resting on three «whales» – balance of the Central bank, country's balance of payments and state budget, and respectively the main parameters to monitor are the currency reserves growth, internal credit and budget deficit. Therefore, the main concern of IMF is the

money of the country's government that would further be spent on debts returns to international (it's not adventitiously that they are oriented for debts policy to satisfy IMF decisions).

Constructive criticism of Washington consensus

There is interest for us in criticism of extended WC application, which is connected principally with the experience of South-Eastern Asia countries, Europe, especially Russia. Critics note, that if South-Eastern Asia countries and China explosively had grown by not following to the recommendations of WC, in particular, had saved active role of the state in foreign trade and restrictions in financial system (herewith the crisis of 1997-1998). In a number of them was explained, according to critics, as insufficient regulation of banking sector), then Russia had suffered from excessive confidence to its recipes. According to their point of view already from 1994 the distinct imbalance between macroeconomic conditions and system-structure parts of the reforms, conducted in the spirit of WC [12]. Shortly recommendations of IMF on the basis of Washington Consensus principles include the most important positions as follows:

1. Suppression of high inflation and its retention in permissible limits
2. State budget deficit reduction at the expense of strict economy of budget resources and limitation of budget expenses.
3. Conducting of the wide range of institutional reforms, forwarded to formation, strengthening and development of market institutions (entrepreneurship system, banking sector, stock market, all infrastructure of internal savings mobilization).
4. Denationalization of the economy by constriction of state regulation sphere and privatization of national entities.
5. Liberalization of external economic sphere, aimed to growth of economy's openness and foreign capital attraction.

Herewith stabilization measures are addressed, as it must be from the above, to liquidation of inflation potential in the form of excessive amount of money (against existing bulk commodities) of the population and enterprises.

That is why withdrawal of the state control of prices and arising immediately after this a sharp break in prices and wages growth rates (because of the actual wages freeze) according to a plan should quite rapidly stop further prices growth, facing the barrier of effective demand. Inflation should slow down, although it stays quite high.

Also liquidation or sharp reduction of state budget deficit and increase of the interest rate over the inflation level contributes to decrease in inflation and market balance, that leads to additional decrease in current demand. Simultaneously, the increase of deposit rates stimulates savings. As a result of these measures the possibility to provide more rational ratio of prices on particular commodities, outrunning real demand. All these should conclude in overcoming of commodities' deficit and achieving equilibrium on the consumer market, when there is a possibility to buy anything easily.

This logic scheme is realized with the help of theoretical model, with the procedure of financial programming in its basis and presupposing the conducting the policy of macroeconomic equilibrium. This policy is based on bilateral accounts, used in external trade and in commercial banks. Wherein the money supply is defined by international reserves, credits to business, as a rule at the expense of commercial banks, and credits to state sector (or government) usually, though not always at the expense National Bank resources.

Money demand is defined from the equation of quantitative money theory:

$$MV=PY, \text{ where}$$

- M – the amount of money in circulation,
- Y – the volume of production,
- P – the prices level (prices index),
- V – the velocity of money circulation.

From the equation of exchange it must be stated that the balance between money demand and supply is provided at the expense of free adjustment of three parameters: the velocity of money circulation, the prices level (prices index), and the volume of production. Under these conditions, in the case of increase of international agreements and (or) increase of government resources borrowed from the National bank, the velocity of money circulation should decrease and (or) the prices level (prices index) should raise, and (or) the volume of production should increase respectively. But the concept of finance programming assumes, that V (predictable) is constant, and Y – is exogenous magnitude. Then changes of M should lead to respective changes of P.

M – depends on the volume of given credits, and also on international reserves. At the given magnitude of net capital inflow (including also the magnitude of net factor incomes, money transfers of

workers, net receipts from the servicing of external debt and other) reserves change in correspondence with changes of Asset or Passives of the trade balance (including, except commodities, non-factor services). Then, in the case of decrease of credits giving pace to government (and, respectively, to private sector) financial programming predicts reduce of inflation and (or) improvement of the trade balance conditions.

Conclusion

This economic policy of financial stabilization in the Republic of Kazakhstan had been conducted from the beginning of 1994 within the framework of signed International Monetary Fund agreement about Stand By loan immediately after quitting from the ruble zone and introduction of national currency – tenge. The main economist of the World Bank Joseph Stiglitz was at the head of the movement for reviewing WC. His point of view reflected not only in his many speeches and articles, but (in a more diminished way) in the official documents of the World Bank [13].

It is needed to say, that such criticism has also originated from the institutional camp. But the facts of it were heard from the second person of the World Bank and former chairman of the USA President Economic consultants' council who gave it special weight age. Major WC criticism from Stiglitz state that the WC distributes the shock method for institutional sphere, where it is easier to destroy existing organizational and social capital,

than to build new one. Thus, Stiglitz thinks that the institutional vacuum should be avoided at any cost.

Particularly, there is hostility about voucher privatization that took place in Russia and Czech Republic, to which Stiglitz prefers the early restructuring leasing. His position is supported by purely institutional argument: in transition economy without institutional structures of the market economy, the long chains of many principals and agents do not work. That is why on the early stages of transformation the individual and leasing enterprises are more preferable to joint-stock companies, especially two-stages, where funds own the stocks of enterprises, and the population owns stocks of these funds [13]. Besides, critics blame WC for incorrect order of conversions: the restructuring of enterprises, public administration and legislation should come before liberalization and privatization.

Furthermore, the role of the state had been truncated, as its functions as an architect of institutional structure and manager of national economy's globalization processes hadn't been taken into account.

Herewith most of WC critics do not deny the necessity of fiscal discipline, liberalization, reduction of inflation lower defined level. But they add to this effective state power, forceful control system of enterprises from owners (corporate governance), stable banking system, some protectionism in external trade and production of public goods. It is also important to take into account political and geographical factors.

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