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Economic Orthodoxy and the East Asian Crisis

Working Paper No. 94

November 1999

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ISBN: 0-86905-717-0
ISSN: 1037-4612

INTRODUCTION

It is now clear that the economic crisis that struck East Asia so suddenly and violently at the end of 1997 has irrevocably altered the political and economic landscape of the region. Major Asian companies have gone bankrupt, anxious domestic and foreign investors have relocated vast amounts of capital abroad, interest rates have skyrocketed, and inflation and unemployment have soared. At the same time, the economic crisis has also led to the collapse of several governments within the region. In South Korea, an opposition party led by Kim Dae Jung has come to power for the first time. In Thailand, the governing coalition of Chavalit Yongchaiyudh has fallen and been replaced by a more reformist coalition under Chuan Leekpai. And, most dramatically, Indonesia's President Suharto has been forced to step down amidst massive social unrest, precipitating a shift away from authoritarian rule in that country and towards an incipient form of democracy.

But what is increasingly apparent is that the collapse of the East Asian economies has also led to a serious ideological crisis in the West. Prior to the collapse, there was broad agreement among Western orthodox economists that developing countries should pursue a set of economic policies, often referred to as the 'Washington consensus', that included financial sector liberalisation, privatisation of state-owned enterprises, fiscal discipline, and trade, exchange rate and foreign investment deregulation.i Since the collapse, however, this consensus has broken down. Serious disagreements have now emerged amongst orthodox economists over a range of policy issues, most particularly the appropriateness of liberal exchange rate and financial sector liberalisation. This dissension is best illustrated by that fact that the World Bank's chief economist, Joseph Stiglitz, openly disagreed with the International Monetary Fund's management of the crisis which—like its management of numerous other crises in Latin America and sub-Saharan Africa—was based on the application of the Washington consensus. Whatever the merits of the respective positions, such fundamental disagreement between orthodox economists and the Bretton Woods institutions in particular is unusual and illustrates a breach of the basic tenets of the consensus. In short, East Asia's economic collapse has exposed fractures within the orthodoxy.

The purpose of this paper is to explore the fracturing of this consensus and to outline possible future directions in which orthodox economic theory and practice will move. At the heart of the ideological crisis, we argue, has been the inability of orthodox economists to explain the economic meltdown except in terms that undermine the Washington consensus.

Put simply, the problem for orthodox economists has been to explain why the East Asian economies collapsed without either raising doubts about the presumed benefits of economic (and, in particular, financial) liberalisation for developing countries or contradicting the earlier orthodox assumption that East Asia's economic success was the result of free market policies. As we will see in the first half of the paper, orthodox economists have been unable to resolve this dilemma with the result that their analysis of the crisis has severely undermined the Washington consensus.

In this light, we argue in the second half of the paper that orthodox economists are beginning to give increased attention to what they see as the 'extra-economic' determinants of economic performance. Whilst orthodox economists have been unable to agree on the policy implications of the crisis, they have agreed that the crisis was caused in part, or at least exacerbated, by political and other extra-economic factors. To be sure, they were already beginning to recognise the importance of extra-economic factors for economic development prior to the crisis (World Bank 1991; 1996; 1997; Webb 1996; Fine 1999). However, central to our argument is that the East Asian crisis has shattered the legitimacy of the Washington consensus and triggered a need for a fundamental re-evaluation of the Washington consensus. A manifestation of this emerging 'dissensus' over economic policy is the excessive reliance on non economic factors in the explanation of the crisis. The neo-classical analysis of the East Asian miracle has been a cornerstone of the Washington consensus; in fact, East Asia was the 'crown jewel' of the Washington consensus. For example, the neo-classical reading of the East Asian miracle has been vital in legitimising the Washington consensus in Sub Saharan Africa and Latin America (Baer, Miles and Moran 1999). To survive as the dominant paradigm within development studies, the orthodoxy is being forced to seek a new consensus around a revised and expanded set of ideas.

EAST ASIA AND THE UNDERMINING OF THE WASHINGTON CONSENSUS

Prior to the onset of the East Asian economic crisis, there was a broad consistency between the orthodox economics literature on East Asia's economic development and the Washington consensus. 'Behind the statistics of differential development performance among the countries of East, Southeast and South Asia', it was argued, was 'the importance of appropriate policies' (James, Naya and Meier 1989: 21). In particular, orthodox economists were to explain East Asia's development in terms of the outward-oriented character of the region's industrial strategies. In contrast to the less successful Latin American countries, they pointed

out, most East Asian countries decided at an early stage in their development to pursue more effective export-oriented industrial strategies rather than broaden and deepen their import-substitution industrial activities (Adams and Davis 1994: 8; Balassa 1988: s276-280; 1991: 28; Hughes 1988: xv; Krueger 1991: 34; Chen 1996: 1). No less important, they argued, was that most East Asian countries maintained conservative and stable macroeconomic policies and, in particular, non-inflationary fiscal policies and competitively valued exchange rates (Adams and Davis 1994: 16; Hill 1994: 844-848; Hill 1996: 150). Finally, they also argued that East Asian governments were remarkably successful in performing the classical functions of government—that is, maintaining law and order, providing infrastructure, and enforcing property rights (Hicks 1990: 33; Balassa 1988: s286; Riedel 1988: 29). In other words, the view of orthodox economists was that the East Asian experience provided strong evidence of how the Washington consensus could work in practice and that the consensus was, therefore, technically superior to other policy strategies.

To be sure, many orthodox economists acknowledged that East Asian governments had played an important role in their economies. But generally their view was that: ‘the government played a smaller role in [East Asia] than it did in that of other developing countries. While the government was certainly active in monitoring economic activity, there was less direct parastatal production and less overall size of government than was the case in most developing countries’ (Krueger 1991: 37). Alternatively, some orthodox economists argued that the government played a much more extensive role than this, but that in general it intervened in such a way that its interventions cancelled each other out, effectively creating a ‘simulated free market’ (see, for instance, Berger 1979; Bhagwati 1988; Saxonhouse 1985). As Robert Wade (1990: 23-24; 1993: 431) has suggested, both these views were consistent with the Washington consensus because they linked the economic success of the region to the existence of self-adjusting markets.

A third way in which orthodox economists dealt with the state was to emphasise the strength, coherence, and efficiency of institutional frameworks within the region. In this view, the state was important because it provided strong legal and regulatory frameworks, was manned by competent, honest and realistically paid bureaucracies, and entrusted economic policy-making to highly-skilled technocrats (World Bank 1994). As Ray Kiely (1998: 68-69) has pointed out, this institutionalist argument was entirely consistent with orthodox economists' broader emphasis on the role of orthodox policies. Quoting Schmitz (1995: 690), he points out that the most important thing as far as orthodox economists were concerned was ‘not whether [developing countries] were democracies or autocracies….but whether they had

the governing will and wherewithal to create the 'appropriate policy framework' required to achieve efficient markets and the successful implementation of donor and creditor mandated economic liberalization programs’. In other words, East Asian governments were seen as having played an important role in the development process because their institutional features facilitated the adoption of orthodox policies.

The only work produced by orthodox economists that seriously challenged these interpretations of East Asia's economic success was the World Bank’s *1993 East Asian Miracle* report. In contrast to other orthodox work on the miracle, this report argued that East Asian states had intervened extensively in some areas of their economies (beyond simply cancelling out earlier interventions) and that this intervention ‘may have’ in some cases enhanced the region’s economic performance (World Bank 1993). Yet the report represented less a shift in orthodox economic thinking about development than a forced accommodation with state-centric interpretations of the miracle brought about by Japanese government pressure on the World Bank.ii As Wade (1996) has revealed, the Japanese government, which had dramatically increased its financial support for the Bank’s activities through the 1980s, was keen to see this increased support reflected in the Bank’s policy positions. In this context, it was able to persuade the Bank to produce the *East Asian Miracle* report and to convince its authors to revise their position on the role of the state in East Asia's development. In this sense, although the report was written by orthodox economists from the World Bank, its arguments did not fully reflect orthodox ideas.

In explaining the crisis, by contrast, orthodox economists have effectively undermined the Washington consensus. Some orthodox economists have put forward explanations of the crisis that raise doubts about one of the fundamental tenets of the consensus: namely, the idea that economic liberalisation (and, in particular, financial liberalisation) is good for developing countries. Others have put forward explanations that, although not directly challenging the consensus, nevertheless undermine it because they contradict earlier orthodox accounts about the origins of the East Asian miracle. Below, we review the alternative perspectives that orthodox economists have put forward to explain the crisis and illustrate the way in which they undermine the consensus.

1. *The Government Failure/Crony Capitalism Thesis*

For many orthodox economists, the main cause of the East Asian economic crisis has been excessive government intervention in the economy and, in particular, the use of strategic trade and industry policies. Such intervention, it is argued, has led to the emergence of systems of

‘crony capitalism’ within the region because it has generated rents within the economy and encouraged widespread ‘rent-seeking’ activity. This in turn, it is argued, has created a severe ‘moral hazard’ problem because international and domestic lenders have been led to believe that if they extended credit to government-sponsored projects or lent to well-connected capitalists, they would be bailed out if their loans became bad (Black and Black 1999: 44; Krugman 1998). The ultimate consequence of this has been a serious misallocation of resources and structural imbalances in the economy because investment decisions have effectively been made on the basis of political rather than economic criteria (Black and Black 1999: 44; Wolf 1998; Cathie 1997).

In this vein, Jeffrey Frankel (1998) has sought to explain the East Asian crisis in terms of important differences between Anglo-American financial systems (where firms rely heavily on the capital market to raise investment capital) and Japanese and East Asian financial systems (where banks are the key providers of investment capital and credit allocation is strongly influenced or even determined by the government or ruling political élites. According to Frankel, the East Asian crisis has demonstrated that East Asian financial systems suffer from ‘deep flaws’ that are not present in Anglo-American financial systems stemming from cronyism and corruption.

> Precisely the attribute of the system that previously appeared to be a virtue, the willingness of banks to go on lending to firms in distress (because the banks had longer horizons than impatient American investors), now turns out to have led to serious problems. Borrowers who should have been cut off were not, with the result that further billions were lost (Frankel 1998: 2).

Similarly, Terry Black and Susan Black (1999) have argued that one of the main causes of South Korea’s crisis was that ‘banks frequently made loans on a political rather than commercially prudent basis’.

> Banks operated on the implicit assumption that if they made loans in accordance with the government’s wishes then the government would rescue them if the loans became bad. This expectation led to a self-fulfilling prophecy. The greater the involvement of the government, the bigger the moral hazard problem whereby lending decisions did not reflect commercial risks (Black and Black 1999: 44).

It is these sorts of ideas that have underlain the IMF’s analysis and management of the crisis. According to the First Deputy Managing Director of the IMF, Stanley Fischer, for

instance, the main cause of the crisis was the inadequacies of the East Asian model of economic development:

> It is striking that models run out of string at some point. Communism worked very well for thirty or forty years and then started collapsing. Crony capitalism delivered for a long time in Asia but that interlocking nexus of banks, governments, corporations became quite rotten and it is rotten in the countries in crisis and they have to be reformed (comments made to the Australian Broadcasting Commission's *Four Corners* program, broadcast in Australia on 11 May 1998).

At the same time, the IMF's Managing Director, Michel Camdessus (1997) has also rejected external accounts of the crisis, arguing that 'it would be a mistake to blame hedge funds or other market participants for the turmoil in Asia.' 'Turbulence in the market', he argues 'is only a symptom of more serious underlying problems which are now being addressed seriously in many countries'.

The government failure/crony capitalism thesis may appear at first to be consistent with the Washington consensus in that it blames the crisis on a failure by governments within the region to liberalise their financial systems and deregulate their trade and industrial sectors. The problem for orthodox economists who support this thesis, however, is that their portrayal of East Asia's political economy directly contradicts the earlier orthodox portrayal of East Asian countries as liberal market economies or at least 'simulated free markets'. In this view, East Asian countries no longer provide evidence of how the Washington consensus can work in practice but of how severe economic problems result from a refusal to apply the consensus. In this way, although the analysis of these economists appears at first to comport with the Washington consensus, it effectively undermines it because it implicitly accepts the statist argument that one of the chief features (and therefore arguably one of the main determinants) of the East Asian miracle was a close and collaborative relationship between government and business.

2. *The Macroeconomic Mismanagement Thesis*

A second way in which orthodox economists have explained the crisis is in terms of poor macroeconomic management. In this view, the crisis occurred, not because governments within the region got their trade and industry policies wrong or because systems of crony capitalism characterised by moral hazard emerged, but rather because policy-makers mismanaged their macroeconomic policies. Ross Garnaut (1998: 2-3), for instance, has argued that countries within the region made the mistake of pursuing fixed exchange rate

policies at a time of growing capital mobility and business exuberance brought on by economic boom. 'The greater international capital mobility in recent times', he says, 'has made it more likely that misalignment with a fixed rate will be converted into a crisis by speculative capital flows and has compressed the time within which such a crisis can develop'. Similarly Ross McLeod (1998a: 36) has argued that the crisis in Indonesia needs to be understood in terms of the government's 'failure to accept the empirical reality, supported by theory, that governments cannot simultaneously control more than one of the nominal macroeconomic variables (the price level, the money supply, the nominal exchange rate and the nominal interest rate)—at least not in the long run'.

Like the government failure/crony capitalism argument, this thesis is consistent with the Washington consensus in so far as it stresses the importance of fiscal prudence and liberal interest and exchange rates for sustainable economic development. At the same time, however, (also like the government failure failure/crony capitalism thesis) it effectively undermines the consensus because it inverts the image of East Asia that orthodox economists provided during the period of the miracle. As we have seen, many orthodox economists argued prior to the crisis that one of the key ingredients in the region's industrial success was the use of orthodox policies in the realm of macroeconomic management. This explanation of the crisis suggests that this analysis was mistaken, further conceding ground to critics who argued that the state played a central role in the region's economic development.

3. *The Premature Financial Liberalisation Thesis*

A third and final way in which orthodox economists have explained the crisis is in terms of premature financial liberalisation and financial panic (Montes 1998; Stiglitz 1998; Radelet and Sachs 1998a; 1998b; McLeod 1997; 1998b). In this view, the crisis was not related to errors either in trade and industry or macroeconomic policy but rather to the 'premature' nature of financial liberalisation. As Jeffrey Sachs (1998: 24), for instance, has argued: 'It was financial market 'reform' that allowed Thai and South Korean banks to tap into short-term international loans in the early 1990s, thereby bringing together these banks with excited young investors who were happy to be in Bangkok and Seoul for the first time.' Whilst they argue that the short-term impact of this reform was positive—in so far as financial liberalisation was followed by a massive inflow of foreign funds to East Asia—they say the longer term effects were less positive. Having opened their financial sectors without introducing accompanying institutional and regulatory reforms, East Asian countries were now exposed to the vagaries of international financial markets and, in particular, their tendency for boom-bust behaviour. Indeed, it is argued that it was panic on a massive scale

following the Thai government's decision to float the baht in July 1997 that was to see the crisis spread rapidly and violently to other countries in East Asia.

It is this analysis of the crisis that has led a number of orthodox economists to question the 'suitability and practicality of the basic financial liberalization-globalization model that has been promoted widely in both developed and developing countries over the past 20 years' (Cole and Slade 1999: 108; italics in original). For instance, several leading economists, including the chief economist of the World Bank, have now called for the imposition of capital controls, at least on short-term capital flows, to reduce the potential for a sudden and rapid outflows of capital (Stigliz 1998; Sachs 1998: 24; *South China Morning Post*, 16 June 1999; Cole and Slade 1999: 115). Paul Krugman, who in his more recent writing on the crisis has taken on board many of the arguments of financial panic school, has called for controls on foreign exchange to reduce the need for interest rate hikes and thereby reduce the likelihood of severe economic contraction (Krugman 1998b). And David Cole and Betty Slade (1999: 112-116) have suggested that a range of other measures may also be necessary including (i) providing for direct state intervention into private sector financial markets to deal with financial market manipulation by speculators and (ii) restricting the range of assets and size of liabilities that banks could hold.

In these ways, the 'premature financial liberalisation' thesis poses a direct challenge to the Washington consensus. It suggests that one of the key elements of the consensus—financial liberalisation and, most particularly, capital account liberalisation—may not promote economic growth in developing countries and in fact may even imperil the economic health of these countries. However, the thesis is consistent with earlier orthodox analysis of East Asia. Like this analysis, it maintains that—at least in relation to the region's financial sectors—market forces were the most powerful force at work in the region rather than the interests and objectives of an interventionist state. In this sense, the thesis is consistent with the idea that orthodox policies were responsible for the miracle.

TOWARDS A NEW WASHINGTON CONSENSUS.

Whilst orthodox economists have been unable to agree whether the crisis resulted from too much state intervention or too little, they have been able to agree that political and other extra-economic factors contributed to the crisis. Hal Hill (1999), for instance, has suggested that it is only by considering political and social factors that we can understand why the crisis was so much more severe in Indonesia that in other countries in East Asia. 'The crisis', he says, 'exposed deep flaws in the Soeharto administration which, unlike the economic crisis of the

mid-1980s, proved unable to respond quickly and effectively to the challenge' (Hill 1999: 10). Another problem, he says, was the country's 'delicate ethnic divide which, always simmering beneath the surface, spilled over into violent anti-Chinese protests in May 1998' (p. 10) (see also Sadli 1999). Similarly, Hadi Soesastro (1998: 315) has suggested that the crisis in Indonesia 'is as much political as economic in nature' and, therefore, that 'economic and political reforms will be necessary to overcome this crisis and prevent future ones'. The problem for Indonesia (as well as most other East Asian countries), he suggests, was that the government's inability to provide 'good governance' undermined the credibility of its policies and thereby increased the chances of investor panic.

The World's Bank's recent *Road to Recovery* (World Bank 1999) presents a somewhat similar prognosis when it suggests that 'East Asia's crisis is best seen as a story of rapid growth built on incomplete foundations, which was left exposed to winds of the international capital markets. Now that the financial earthquake has occurred, it will have to rebuild its success on new foundations in its trade competitiveness, in the financial sector, and in the governance of and financing of its corporate sector' (World Bank 1999: 16). In short, for the World Bank, poor governance if not a direct cause of the crisis, nevertheless, contributed to the poor foundations of the East Asian economies, in turn leaving these economies highly vulnerable to the vicissitudes of international capital markets.

What this line of reasoning suggests is that the causes of the crisis are as much institutional and political as the failure of East Asian governments to fully implement the tenets of the Washington consensus. Unlike in the case of similar economic crises in Latin America or sub-Saharan Africa, there has been no consensus on the relative importance of market distortions as an explanation of the Asian economic crisis. Indeed, as we have argued, this is especially difficult, given the fact that the 'success of East Asia since the early 1980s has prompted many observes to tout the region's policies as an example for other to follow' (Baer, Miles and Moran 1999: 1745). Instead, amidst the growing dissensus on the Asian crisis there is an emerging analysis that has underscored the contributory importance of non market factors in the explanation of the economic crisis. Baer et al (1999) underline this position when they point out that 'it was the excessive reliance on the neoclassical paradigm that led many economists to neglect an examination of the true institutional framework within which economic activity in East Asia was carried out' (Baer et al 1999: 1746). In fact, for the World Bank, the Asian economic crisis has demonstrated that market failure has been exacerbated by an institutional inability to provide economic order. The World Bank's *Road to Recovery Report* (World Bank 1999) points to the importance of extra-economic factors in

producing the economic order now seen as so essential to the stable functioning of the market system. This explanation suggests that the new policy thinking in multilateral agencies will endeavour to articulate a set of political underpinnings to support the market reforms championed by the Washington consensus.

In this respect, some of the immediate differences between the World Bank and the IMF in the aftermath of the crisis lay in the more political reading of the crisis by the World Bank as is evident not only in its *Road to Recovery Report* (World Bank 1999), but more importantly, in the official pronouncement of its senior officials. As noted earlier, the World Bank's chief economist Joseph Stiglitz has been at the forefront of those questioning the conventional wisdom of adjustment programs imposed by the IMF in East Asia. With the World Bank and the IMF deeply divided, it is clear that the dominant Washington policy paradigm is badly fractured.

But what is most noteworthy is that a new policy framework had been gathering momentum. The lexicon of this new policy paradigm underlying this new consensus includes civil society, institution building, safety nets, and, especially governance to be added to the conventional Washington terminology of open markets, deregulation, and liberalization and structural adjustment. Of course, the essentials of this post-Washington consensus have been evident for some time in the thinking of organisations like the World Bank and the Asian Development Bank which have been pushing the governance barrow for some time.

This change of emphasis, interestingly, parallels the attempts by Blair and Clinton to carve out a third way between the paths of Thatcherite economic liberalism and old-fashioned bureaucratic interventionism through a greater articulation of the role of the state as a facilitator of economic reform. In many respects, the new policy frameworks pursued by international agencies such as the World Bank, in particular, reflect a desire to seek a 'third way' in international development. This is, of course, not surprising.iii The original Washington consensus itself was strongly influenced by the Reagan and Thatcher revolutions in the US and Britain. Similarly, current changes in multilateral policy should be read in conjunction with the emphasis placed on domestic policy by the Blair and Clinton administrations. Moreover, the core elements of the new Washington consensus reach beyond multilateral institutions to encompass the kinds of economic and social policies being pursued by like Cardoso, and perhaps even Kim Dae Jung.

Three key elements define this new Washington consensus: governance, civil society and social safety nets. First the notion of governance. For the new consensus, developing good governance is the most vital piece of the new policy jigsaw. Governance is a notoriously

undefined term, but broadly it seeks to denote the organization and management of the development process. Crucially, it encompasses the policy frameworks, rules and institutions that regulate the conduct of private and public activity. Examples would include: an adequate legal system, systems of financial and corporate accountability, judicial independence, and transparent regulatory structures. Most of these constituents of governance place great emphasis on the building of institutional capacity (see World Bank 1991). Whereas the previous Washington consensus was about shrinking the state, the policy paradigm of the new consensus places great store on getting the right institutional mix for the functioning of markets. Institutional imperfection if left uncorrected will in the in final analysis distort the allocation of resources within the market

In part, this emphasis on governance comes from the recognition by the World Bank and increasingly the IMF, that structural reform without the concomitant set of institutions to support such reform is likely to fail. One needs only to point to the disappointing experience of Russian economic reforms to bring home the critical point that institutions such as a well resourced, credible legal system strongly influence the success of reform programs.

Another reason for the popularity of the notion of governance is the dominant influence of the so-called 'new institutionalism'. In this context, the pioneering work of the Nobel Laureate Douglass North has been of enduring importance. North (1981) argues that the market system and property rights do not arise spontaneously but are in fact the creations of governments. The clear implication of this was to focus attention on the 'supply' of market institutions by governments.

But there is an important precursor to the new institutionalism, and that is the so-called Ordo-liberal or the Freiburg school that developed in Germany towards the end of the Weimar Republic. It is a system of ideas that was later to play an important role in the German social market institutions in the post-war period. Pivotal to the Ordo-liberal approach is the notion that the construction of economic order cannot be left to the spontaneous actions of the market; it needs to be created through a consistent intervention ('ordnungspolitik') of the state. In short, the production of market order is dependent on the complex interrelationship between market and social, political and juridical institutions (Peacock and Willgerodt 1989). For the Ordo-liberals, the role of the state is not to control the economy; rather, it should provide a system of juridical institutions that would facilitate the orderly regulation of the market. For the Ordo-liberals—as for the new institutionalists—an efficient market system requires the presence of a strong facilitating government. Both approaches place a heavy emphasis on the role of the state in the emergence of market based property

rights. And this is an important point; the emerging policy paradigms tend to see the markets as political creations which need to be sustained and policed by an appropriate institutional framework.

One area where this emphasis on governance is likely to be reflected is in the increasing attention given to the provision of regulatory frameworks in previously deregulated sectors of the economy. Indeed, there has been a clear recognition that in the absence of frameworks, like a strong competition policy, deregulation may result in a transfer of power from the state to powerful private sector oligarchs. The recent experience of countries like Indonesia and Russia bears witness to this trend (for Indonesia, see Robison and Rosser 1998). In these countries, influential networks of bureaucrats and private actors have created cartels in strategic and profitable sectors of the economy, and thereby derailed the effectiveness of the reform program. Ironically, deregulation and privatisation—the cornerstones of the earlier Washington consensus—did not lead to a flowering of liberal markets but simply served the interests of powerful capitalists whose wealth and authority had previously been based on their control of protected industries. The new Washington consensus attempts to respond to these developments by placing an emphasis on the supply of regulatory frameworks (Stiglitz 1998a). Therefore, the important debates in the next decade are likely to be about the future course of this re-regulation.

In terms of this logic, governance programs are premised on the assumption that in order to attend to the economics of reform, one needs to pay equal attention to the role of politics. But of course this is a kind of politics framed in economic terms as the supply and demand of institutions, and neglects the real and messy conflicts of interest that reform entails. Indeed it is kind of politics that is used to create or sustain institutions that are insulated from the politics of interests.

The second element in the new Washington consensus is the notion of civil society: an arena composed of those groups, norms and institutions that lie between the market and the state. This usage departs markedly from civil society as an autonomous sphere of social activity as political theory would have it; instead, it looks upon civil society as a container for social capital. This notion of social capital has been popularised by the work of political scientist Robert Putnam (1993) who essentially makes the point—hardly earth shattering—that 'capital', like networks, culture, family, associations, enables the economy to function by providing trust, credibility and literate consumers and workers. In short, this argument would suggest that high levels of economic performance are due to the interactive effects of both economic and social capital.

Social capital is a highly fluid and tenuous concept which is especially difficult to pin down as it can take on several meanings. Indeed, conservatives such as Fukuyama (1995; 1996) have discovered trust (social capital) in terms of cultural resources, whereas others have tended to define it in terms of associational activity. Whatever definition is used we need to recognise that social capital—like its physical counterpart—is not equally well distributed. Indeed, if it is not asymmetrically distributed there would be no advantage to the possession of social capital. And herein lies the down side of the notion of social capital: it can be used to reinforce inequalities and privileges in society. One man's social capital is another women's social oppression. Putnam and other proponents of social capital seem oblivious to the dark side of social capital.

This lack of understanding of the 'down side' of social capital underlines the fact that the notion of social capital conveys a very different model of society to that normally employed in the social sciences. Society in the social capital view is composed of 'norms' and 'relationships' that can be mobilised for economic development. Indeed as Fine (1999) notes this particular approach to social capital within the new consensus 'allows the new consensus to be selective in where and how it addresses the role of non economic factors in economic performance' (Fine 1999 :13).

Perhaps, more importantly, this focus on norms, networks, relationships, and more broadly a culture, leaves little room in this perspective for the inequalities and conflict that result from the unequal distribution and access to the political economic and cultural resources of society. As Fine (1999) perceptively points out this allows a selective incorporation of aspects of the developmental state literature filtered through the lens of social capital.

One of the key implications of the Asian crisis is to highlight the role of civil society and social capital as a central component in the institutional management of the market . For example the World Bank (1999) analysis of the social implications of the crisis pinpoints the pivotal role played by social capital in enabling individuals to weather the economic crisis. Moreover the provision of social capital is seen to be an important element in shaping the social conduct of individuals which is a vital ingredient in the consolidation of good governance.

In the new Washington consensus of the World Bank and other multilateral agencies the concept of civil society is used in the specific sense of paying due heed to the management and mobilisation of social capital entrenched in civil society. And this social capital is mobilised for the successful management of economic reform. From this perspective,

inevitably, multilateral agencies have placed great stress on the management and incorporation of non government organisations in the development of participatory decision making processes . Again, this managerial civil society of the new consensus marks a significant departure from the technocratic decision making model that characterised the old policy paradigm of the previous Washington consensus. For example, the Asian Development Bank and the World Bank now place considerable emphasis on the role of non-governmental organisation in the development process. In short, within the managerial civil society model great emphasis is placed on participation and partnership in the development process.

Finally, there is in this new policy consensus a greater accent on the construction of safety nets. In the World Bank *Road to Recovery* report there is a considerable effort to explain the impact of the crisis not just in economic terms but also in terms of its social implications as it pertains to issues of equity, poverty, and employment. In fact, its description of the effects of the crisis as one of social corrosion highlights one of the key objectives of the social programs of multilateral agencies: building legitimacy for economic reform through the careful targeting of social expenditure. This is a dominant theme of the World Bank report where it gives high priority to the need for social safety nets as a critical factor in the building of social cohesion or social capital. Furthermore, there is the clear underlying assumption that social cohesion is absolutely essential if sustainable structural economic reforms are to be implemented. The buzz word for this new global social policy is ‘social exclusion’. The objective of economic and social policy is seen as the effective participation of all individuals in the economic process. In this regard, the World Bank’s new language of social policy lays particular emphasis on the very poor and those in the informal sector. iv

No wonder then that the new consensus which places great store on the appropriate targeting and financing of social programs is more restrained about removing subsidies and other entitlements in states undergoing economic reform. This is in sharp contrast to the previous Washington consensus which placed high priority on employment objectives. The new consensus is no doubt a sensible recognition of the difficulties of crafting a politically saleable reform program.

But there is probably another reason for the stress on safety nets. An investment in social policy may simply be good economics. For example, linking labour market to retraining programs, and pension funds to the mobilising of savings enhances both economic efficiency and social welfare. An additional consideration which underlies the new accentuation of social policy in the new paradigm is the little recognised fact that the sooner-than-expected demographic transition to an ageing population in several countries will bring a

whole host of new policy issues. In countries such as China this demographic transition will place retirement and pension policy at the forefront of the political and economic agenda. Therefore, the real debates in the next decade are not going to be about whether there should be safety nets but about the control, management and generosity of retirement funding in East Asia. In this sense, the new consensus is an attempt to seize the policy agenda in response to a new range of demographic and social problems.

CONCLUSION

The central argument of this paper is that the Asian economic crisis has exposed a deep ideological fracture within the dominant multilateral policy paradigm commonly referred to as the Washington consensus. Why has Asia been so critical? Because quite simply the Asian economic miracle was seen to be the outcome of pursuing the kinds of policies advocated by proponents of the Washington consensus. The crisis has badly fractured this consensus because it has raised doubts about the presumed benefits of one of its key elements—financial liberalisation—and undermined earlier orthodox analysis of the origins of the miracle.

In this context one of the major changes in the policy frameworks in the wake of the crisis is the increasing tendency to understand economic failure in extra-economic terms. Much of the emerging new policy consensus can be properly viewed as attempt to articulate a political conception of market order. Economic order in this view requires a set of institutional underpinnings and also a distinctive civil society which will facilitate certain modes of social conduct. From this perspective, a new Washington policy consensus will be formulated through the dominant concepts of governance, civil society, and social safety nets. But, it would be an error to see policy frameworks emerging from the new consensus as a departure from the earlier emphasis on open markets, deregulation and less government. Rather, the new consensus should be understood as a political counterpart to the earlier economic emphasis on structural reform. Indeed, it may be useful to think of these new policy frameworks as attempts to institutionally 'bed down' the structural reforms championed by multilateral policy in the last two decades. It is a recognition that politics matters. While this is very much a sanitised view of politics as institution building—there is scant acknowledgement of conflicts of interests and power—it suggests a refreshing sensitivity to the real difficulties and problems posed by programs of economic reform.

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ENDNOTES

i. John Williamson (1990), who coined the term 'Washington consensus', originally defined it in terms of a consensus within political Washington (i.e. the US Treasury, the World Bank and the IMF) that centred on four broad sets of policies: *first*, fiscal austerity and the need to rein in budget deficits and reorder priorities, *second*, financial liberalisation, and, in particular, the use of market-determined interest rates in order to reduce inflation and ensure a more efficient allocation of economic resources; *third*, the pursuit of trade and exchange rate liberalisation; and finally, the deregulation and privatisation of key sectors of the public economy (see also Williamson 1994). As the structural power of global financial markets grew throughout the late 1980s and early 1990s, however, the parameters of the Washington consensus were expanded to include other elements of the neo-liberal agenda, most particularly liberalisation of the capital account (Stiglitz 1998a). It is this later and broader definition of the Washington consensus that is used in this paper.

ii. Among the best known state-centric works on East Asia's economic development are Wade (1990); Amsden (1985; 1989); Castells (1992); Rodan (1989); Matthews and Ravenhill (1994); Weiss and Hobson (1995).

iii. For a analysis of the third way see Jayasuriya (1999a , 1999b)

iv. See Jayasuriya (1999 a) for a detailed discussion of the ideas of social exclusion in the social policy of the third way.