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Author(s): Kanishka Jayasuriya and Andrew Rosser

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# Economic orthodoxy and the East Asian crisis

KANISHKA JAYASURIYA & ANDREW ROSSER

*ABSTRACT* It is increasingly apparent that the Asian economic crisis has also led to a serious ideological crisis in the West. Before 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', which included financial sector liberalisation, privatisation of state-owned enterprises, fiscal discipline and trade, exchange rate and foreign investment deregulation. Since the collapse, however, this consensus has broken down. This paper examines the emergence of the new so-called post-Washington consensus, with its emphasis on governance and social capital. The lexicon of the new policy paradigm underlying this new consensus includes civil society, safety nets, and, especially, governance, to be added to the conventional Washington terminology of open markets, deregulation, liberalisation and structural adjustment. Our central thesis is that this new post-Washington consensus is an attempt to place more emphasis on the political and institutional foundations for programmes of structural reform. However, it is also a kind of politics of anti-politics that attempts to insulate economic institutions from the process of political bargaining.

It is now clear that the economic crisis that struck East Asia so suddenly and violently during 1997 irrevocably altered the political and economic landscape of the region. Major Asian companies went bankrupt, anxious domestic and foreign investors relocated vast amounts of capital abroad, interest rates skyrocketed, and inflation and unemployment soared. Under pressure from mobile investors, Western governments, and the international development agencies, governments within the region launched extensive programmes of economic liberalisation. At the same time, the economic crisis led to the collapse of several governments within the region. In South Korea an opposition party led by Kim Dae Jung came to power for the first time. In Thailand the governing coalition of Chavalit Yongchaiyudh fell and was replaced by a more reformist coalition under Chuan Leekpai. Most dramatically, Indonesia's President Suharto was forced to step down amid massive social unrest, precipitating a shift away from authoritarian rule in that country and towards an incipient form of democracy. Of course, most countries within the region have begun to recover economically and, with the

*Kanishka Jayasuriya is in the South East Asia Research Centre, City University of Hong Kong. Andrew Rosser is in the Department of Government and Public Administration, University of Sydney, Australia. E-mail: sskanish@cityu.hk*

notable exception of Indonesia, managed to maintain or restore political stability. Yet there is no doubt that the political and economic effects of the crisis have been far-reaching.

But what is increasingly apparent is that the Asian economic crisis has also led to a serious ideological crisis in the West. Before 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.<sup>1</sup> Since the collapse, however, this consensus has broken down. Serious disagreements have now emerged among orthodox economists over a range of policy issues, most particularly the appropriateness of exchange rate and financial sector liberalisation. This dissension is best illustrated by the fact that Joseph Stiglitz, the World Bank's chief economist between February 1997 and February 2000, 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 provide policy-based explanations of 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 part 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 the second part of the paper, we examine the implications of this intellectual impasse for the future development of orthodox economic theory. In particular, we argue, this impasse has reinforced a tendency since the late 1980s for orthodox economists to pay increased attention to what they see as the 'extra-economic' determinants of economic performance. While orthodox economists have been unable to agree on the policy implications of the crisis, we point out, they have agreed that the crisis was partially caused, or at least exacerbated, by political and other extra-economic factors. To survive as the dominant paradigm within development studies, then, we argue, 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

Before 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 *et al*, 1989: 21). In particular, orthodox economists were to explain East Asia's development in terms of the outward-orientated character of the region's industrial strategies (Adams & Davis, 1994: 8; Balassa, 1988: s276–280; 1991: 28; Hughes, 1988: xv; Krueger, 1991: 34; Chen, 1996: 1), the conservative and stable character of its macro-economic policies (Adams & Davis, 1994: 15; Hill, 1994: 844–848; 1996: 150), and the relative success of regional governments in 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. Indeed, it would not be an exaggeration to say that orthodox economic analysis of the East Asian miracle was a cornerstone of the Washington consensus. If East Asia's economic success was the result of free market policies, it was argued, then free market policies must be right for other developing countries. For example, as Baer *et al* (1999) have pointed out, the orthodox economic reading of the East Asian miracle was vital in legitimising the Washington consensus in sub-Saharan Africa and Latin America.

To be sure, many orthodox economists acknowledged that East Asian governments had played a significant role in their economies. But in general 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, confidence and efficiency of institutional frameworks within the region. In this view, the state was important because it provided strong legal and regulatory frameworks, was staffed 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.<sup>2</sup>

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 & 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 & Black, 1999: 44; Wolf, 1998; Cathie, 1997).

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 (1988: 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’. Importantly, orthodox economists who have taken the macroeconomic mismanagement line have not suggested that fiscal profligacy was a cause of the crisis. Indeed, it is almost universally agreed that fiscal policies within the region were highly prudent, or at least much more prudent than those pursued in Latin American counterparts. In general, the focus has been on other areas of macroeconomic policy, including exchange rate policy, interest rate policy and policies to control inflation.

Like the government failure/crony capitalism argument, this thesis is consistent with the Washington consensus in so far as it emphasises the importance of fiscal prudence and liberal interest and exchange rates for sustainable economic development. At the same time, however, and also like the government 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 before 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 earlier analysis was mistaken, in turn conceding further ground to critics who argued that the region’s economies have been characterised by high levels of state intervention rather than free markets.

### *3. The premature financial liberalisation thesis*

A third and final way in which orthodox economists have explained the crisis is in terms of premature fiscal liberalisation and financial panic (Montes, 1998; Stiglitz, 1998b; Radelet & Sachs, 1998a; 1998b; McLeod, 1997; 1998b). In this

view, the crisis was not related to errors either in trade and industry or macro-economic 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.' While 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 to 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 & Slade, 1999: 108; emphasis in the original). For instance, several leading economists, including the former 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 outflow of capital (Stiglitz, 1998; Sachs, 1998: 24; *South China Morning Post*, 16 June 1999; Cole & Slade, 1999: 115). Paul Krugman, who in his more recent writing on the crisis has acknowledged many of the arguments of the 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 can 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**

While 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 than 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' (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 Bank's recent *Road to Recovery* report (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' (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 them highly vulnerable to the vicissitudes of international capital markets.

What this line of reasoning suggests is that the crisis was as much the result of institutional and political 'failure' as of the failure of East Asian governments to fully implement the tenets of the Washington consensus. In contrast to 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 observers to tout the region's policies as an example for others to follow' (Baer *et al*, 1999: 1745). Instead, amid the growing dissension 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' (p 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 (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 but, more importantly, in the official pronouncements of its senior officials. As noted earlier, the World Bank's chief economist Joseph Stiglitz was at the forefront of those questioning the conventional wisdom of adjustment programmes imposed by the IMF in East Asia. While he was later replaced as chief economist, the World Bank's concern with the extra-economic determinants of development appears not to have changed. When the head of the World Bank, James Wolfensohn, announced that Nicholas Stern, then chief economist of the European Bank for Reconstruction and Development, would be taking over as chief economist, he emphasised that Stern would be 'continuing to push forward the development priorities and approach that we have been pursuing over the past five years' (World Bank, 2000). In other words, the Bank's focus on the extra-economic determinants would remain.

Within this context, a new policy framework has been gathering momentum. The lexicon of this new policy paradigm underlying the new consensus adds 'civil society', 'institutional building', 'safety nets' and especially 'governance' to the conventional Washington terminology of open markets, deregulation, liberalisation 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 Tony Blair and Bill 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 reflect a desire to seek a 'third way' in international development. This is, of course, not surprising.<sup>3</sup> The original Washington consensus was itself strongly influenced by the Reagan and Thatcher revolutions in the USA and UK. 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 leaders 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 organisation 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 imperfections if left uncorrected will in the 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 and credible legal system strongly influence the success of reform programmes.

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.

This perspective is strongly reminiscent of Karl Polanyi's *The Great Transformation* (Polanyi, 1944). According to Polanyi, the emergence of liberal markets in England during the 19th century was the direct result of increased intervention by the state.

There was nothing natural about *laissez-faire*; free markets could never have come into being merely by allowing things to take their course. Just as cotton manufactures—the leading free trade industry—were created by the help of protective tariffs, export bounties, and indirect wage subsidies, *laissez-faire* itself was enforced by the state. The thirties and forties saw not only an outburst of legislation repealing restrictive regulations, but also an enormous increase in the administrative functions of the state, which was now being endowed with a central bureaucracy able to fulfill the tasks set by the adherents of liberalism. (1944: 139)

But there is an even earlier intellectual precursor to the new institutionalism, and that is the so-called ordo-liberal or 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 of the postwar 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 the 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 & 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 will 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 of its prominent exponents, Walter Eucken, was closely associated with the extremely conservative Von Papen government in the early 1930s (Peacock & Willgerodt, 1989). According to the *ordo-liberals* of the Freiberg school the ‘various economic, political, legal and other social processes are interrelated. Each act of government intervention must therefore be seen in connection with the total processes and overall economic order so as to ensure the “system conformity of measures”’ (Petersmann, 1991: 63). For the *ordo-liberals*, the market is not a spontaneous creation but a system which needs to be embedded in a set of political relationships and structures; market order is a political creation. Especially important in this conception of economic order is the role played by juridical processes in safeguarding the market order. Therefore implicit in this account is, of course, a conception of a strong states providing economic order.

The *ordo-liberals*, unlike the new institutional economists with whom they otherwise have much in common, are clearer about the political ramifications of notions of economic constitutionalism. Eucken and others were very concerned about the anti-competitive effects of society on the economy. Eucken, for example, echoing the thought of the conservative jurist Carl Schmitt, argued that by the end of the 19th century the state was increasingly captured by private interest groups; this led to the politicisation of the economy, which in turn weakened the state (Jayasuriya, 1999). In other words, the main purpose of economic constitutionalism was to protect the economy from these political pressures. Therefore, this understanding of economic order implied the existence of institutions to protect the politicisation of the economy; and this could not be but politically illiberal. The arguments suggest that the kind of regulatory state advocated by the *ordo-liberals* rested on the development of a form of economic constitutionalism that could only be at the expense of political constitutionalism (Jayasuriya, 1999).

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 & 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 programmes. 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 programmes 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; it neglects the real and messy conflicts of interest that reform entails. Indeed it is a 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, and 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 the result of 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 discussed 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 were not asymmetrically distributed there would be no advantage to the possession of social capital. And herein lies the downside of the notion of social capital: it can be used to reinforce inequalities and privileges in society. One man’s social capital is another woman’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 downside of social capital underlines the fact that the notion of social capital conveys quite a 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’ (1999: 13).

Perhaps more importantly, this focus on norms, networks, relationships and, more broadly, a culture, leaves little room for the inequalities and conflict that result from the unequal distribution of 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 emphasis on the management and incorporation of non-governmental 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 organisations 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 programmes 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, which 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 on those in the informal sector.<sup>4</sup>

No wonder then that the new consensus, which places great store on the appropriate targeting and financing of social programmes, 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 a high priority on employment objectives. The new consensus is no doubt a sensible recognition of the difficulties of crafting a politically saleable reform programme.

But there is probably another reason for the emphasis on safety nets. An investment in social policy may simply be good economics. For example, linking labour markets to retraining programmes, 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 likely 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 trends in orthodox 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 an 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 is being formulated through the dominant concepts of *governance*, *civil society*, and *social safety nets*.

But it would be an error to see the 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 organisations in the past two decades. It is a recognition that *politics* matters. While this is very much a sanitised view of politics as the building of institutions and social capital—there is scant acknowledgement of conflicts of interest and power—the emergence of the new consensus nevertheless suggests a refreshing sensitivity to the real difficulties and problems posed by programmes of economic reform.

At the same time, however, the new consensus provides only a partial account of the way in which politics shapes development. Most importantly, it ignores the way in which political interests shape processes of liberal reform not only in a negative sense—that is, in terms of the way in which coalitions of interest oppose reform—but also in a positive sense—that is, in terms of the way in which coalitions of interest promote reform (Schamis, 1999; Rosser, 1999). The reasons for this are clear. The Bank is effectively required by its Articles of Association

to focus solely on economic matters and avoid getting involved in politics. And both institutions recognise that they are likely to have much greater success in promoting reform in developing countries if their agenda is seen to be apolitical in nature and, in particular, not designed to bring down the dominant coalitions in these countries. They thus find that the sanitised view of politics presented by the new consensus fits neatly with their objectives. It allows the two institutions to pursue what are clearly political objectives while claiming simultaneously that their objectives are purely economic.<sup>5</sup> While the new consensus is clearly more sensitive to the political foundations of development, it does not account fully for the way in which politics shapes development.

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## Notes

- <sup>1</sup> It is necessary to distinguish 'economic orthodoxy' from the Washington consensus. The former refers simply to the dominant set of economic ideas at the global level at any particular time. The latter was originally defined by John Williamson (1990), who coined the term to indicate a consensus within political Washington (ie 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 neoliberal agenda, most particularly liberalisation of the capital account (Stiglitz, 1998). It is this later and broader definition of the Washington consensus that is used in this paper. Importantly, for most of the 1980s and 1990s the Washington consensus constituted the orthodoxy—it was far and away the most widely accepted set of economic policy prescriptions. The purpose of this paper, however, is to illustrate that this consensus has broken down and that a new consensus, centred on the extra-economic determinants of development, is emerging as the new orthodoxy.
- <sup>2</sup> Of course, orthodox economic analysis of the East Asian miracle was not monolithic. There were some dissenting opinions. By far the most important example in this respect 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). Importantly, however, 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. As Wade (1996) has revealed, the Japanese government, which had dramatically increased its financial support for the Bank's activities during 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.
- <sup>3</sup> For an analysis of the third way see Jayasuriya (1999, 2000).
- <sup>4</sup> See Jayasuriya (1999a) for a detailed discussion of the ideas of social exclusion in the social policy of the third way.
- <sup>5</sup> A good example in this respect is the claim by the authors of *Managing Development: The Governance Dimension* (World Bank, 1991) that the Bank's work on governance is 'guided solely by concern for economic development and not by any political agenda' (World Bank, pp 154–155).

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